

Office of Inspector General



Office of Material Loss Reviews
Report No. MLR-10-009

**Material Loss Review of America West Bank,
Layton, Utah**

December 2009



Why We Did The Audit

On May 1, 2009, the Utah Department of Financial Institutions (UDFI) closed America West Bank (AWB) and named the FDIC as receiver. On June 5, 2009, the FDIC notified the Office of Inspector General (OIG) that AWB's total assets at closing were \$310 million and the material loss to the Deposit Insurance Fund (DIF) was \$119 million. As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, the OIG conducted a material loss review of the failure of AWB.

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

Background

AWB was an FDIC-supervised state-chartered limited liability company (LLC) established by the UDFI and insured by the FDIC effective May 18, 2000. The institution was headquartered in Layton, Utah, with three other offices in Utah. AWB was wholly owned by America West Bank Members, LLC, a one-bank holding company organized in June 2005. AWB's Chairman of the Board of Directors (Board) and his family collectively controlled 61 percent of the holding company. Affiliated entities included an entity for the issuance of trust preferred securities, an aviation entity, and other companies under the control of the Chairman. AWB specialized in real estate lending, with concentrations in commercial real estate (CRE) and acquisition, development, and construction (ADC) loans.

Audit Results

Causes of Failure and Material Loss

AWB failed because the bank's Board and management deviated from the bank's business plan and did not effectively manage the risks associated with rapid growth in CRE and ADC lending. AWB lacked adequate loan underwriting, credit administration, and allowance for loan and lease loss practices. AWB also relied heavily on wholesale funding sources, primarily brokered deposits, to fund its CRE and ADC concentrations. Finally, AWB was cited for apparent violations and contraventions of various laws, regulations, and interagency policies in seven of eight examinations. In a declining real estate market, AWB could not withstand significant loan losses, which led to quick and substantial erosion of the bank's capital. AWB's liquidity position became strained as the bank's financial condition deteriorated and access to certain funding sources was restricted. Ultimately, AWB was closed by UDFI due to the bank's capital insolvency in May 2009.

The FDIC's Supervision of AWB

The FDIC and UDFI provided ongoing supervision of AWB and performed eight on-site examinations and four visitations from 2000 to 2009. The FDIC also conducted offsite monitoring activities from December 2003 to March 2008. The examinations and visitations included examiner concerns and recommendations related to issues such as the unsatisfactory performance of AWB's management, the

bank's CRE and ADC concentrations, loan underwriting and credit administration deficiencies, weak risk management practices, heavy reliance on non-core deposits to fund asset growth, unsatisfactory liquidity levels, and inadequate capital position. Examiners also reported apparent violations of law and contraventions of policy associated with the institution's lending practices and insider transactions. In 2002 and 2003, and as the institution's condition deteriorated in 2008, the FDIC and UDFI took enforcement actions to address identified deficiencies. While consistent with DSC policy at the time, stronger action may have been prudent in 2002 and 2003 in light of the bank's de novo status and material deviations from its business plan. Further, additional supervisory action could have been taken to address the bank's high-risk profile at the time of the January 2007 examination, although the financial implications of the bank's inadequate practices were not yet apparent in the loan portfolio.

With respect to PCA, we concluded that the FDIC properly implemented applicable PCA provisions of section 38 based on the supervisory actions taken for AWB. However, the effectiveness of PCA was impacted by capital injections from the bank's holding company and activities by the bank that were inconsistent with the Act's provisions.

Management Response

After we issued our draft report, we met with management officials to further discuss our results. Management provided additional information for our consideration, and we revised our report to reflect this information, as appropriate. On December 4, 2009, the Director, Division of Supervision and Consumer Protection (DSC), provided a written response to the draft report.

DSC reiterated the OIG's conclusions regarding the causes of AWB's failure. With regard to our assessment of the FDIC's supervision of AWB, DSC acknowledged the need for more stringent supervisory attention for de novo institutions, and as a result, the FDIC recently extended the de novo period from the previous 3-year period to 7 years and stated that these institutions will receive a full-scope examination every year for that 7-year period. DSC further stated that de novo business plans are being closely monitored against approved financial projections, and changes taken without prior notice may result in civil money penalties.

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Federal Deposit Insurance Corporation

3501 Fairfax Drive, Arlington, Virginia 22226

Office of Inspector General

DATE: December 4, 2009

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 America West Bank, Layton, Utah*
(Report No. MLR-10-009)

As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, the Office of Inspector General (OIG) conducted a material loss¹ review of the failure of America West Bank, Layton, Utah (AWB). On May 1, 2009, the Utah Department of Financial Institutions (UDFI) closed the institution and named the FDIC as receiver. On June 5, 2009, the FDIC notified the OIG that AWB's total assets at closing were \$310 million and the material loss to the Deposit Insurance Fund (DIF) was \$119 million.

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

The audit objectives were to (1) determine the causes of the financial institution's failure and resulting material loss to the DIF and (2) evaluate the FDIC's supervision² of the institution, including implementation of the PCA provisions of section 38 of the FDI Act. Appendix 1 contains details on our objectives, scope, and methodology. Appendix 2 contains a glossary of terms and Appendix 3 contains a list of acronyms used in the report. Appendix 4 contains the Corporation's comments on this report.

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

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

This report presents the FDIC OIG’s analysis of AWB’s failure and the FDIC’s efforts to ensure AWB’s management operated the bank in a safe and sound manner. We are not making recommendations. Instead, as major causes, trends, and common characteristics of financial institution failures are identified in our reviews, we will communicate those to management for its consideration. As resources allow, we may also conduct more in-depth reviews of specific aspects of DSC’s supervision program and make recommendations, as warranted.

Background

AWB was an FDIC-supervised state-chartered limited liability company (LLC) established by the UDFI and insured by the FDIC effective May 18, 2000.³ At the time AWB was established and received deposit insurance, the bank was designated as a “de novo” institution, indicating a newly established bank that is in its first 3 years of operation.⁴ AWB was headquartered in Layton, Utah, with three other offices in Utah. AWB specialized in real estate lending, with concentrations in commercial real estate (CRE) and acquisition, development, and construction (ADC) loans.

AWB was wholly owned by America West Bank Members, LLC., a one-bank holding company organized in June 2005. AWB’s Chairman of the Board of Directors (Board) and his family collectively controlled 61 percent of the holding company. Affiliated entities included an entity for the issuance of trust preferred securities, an aviation entity, and other companies under the control of the Chairman. Table 1 presents a summary of AWB’s financial condition as of December 2008 and for the 4 preceding calendar years.

Table 1: Financial Condition of AWB

Financial Measure	Dec-08	Dec-07	Dec-06	Dec-05	Dec-04
	(Dollars in Thousands)				
Total Assets	\$299,424	\$270,992	\$185,435	\$104,104	\$64,374
Total Loans	\$230,712	\$249,407	\$164,798	\$82,994	\$44,842
Total Deposits	\$284,065	\$244,949	\$167,232	\$89,045	\$49,964
Net Income (Loss)	(\$11,179)	\$8,081	\$5,222	\$1,915	\$1,148

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

³ AWB, originally organized as a Subchapter-S Corporation, changed its structure to an LLC in June 2005.

⁴ On August 26, 2009, the FDIC extended the de novo period for newly chartered institutions to 7 years.

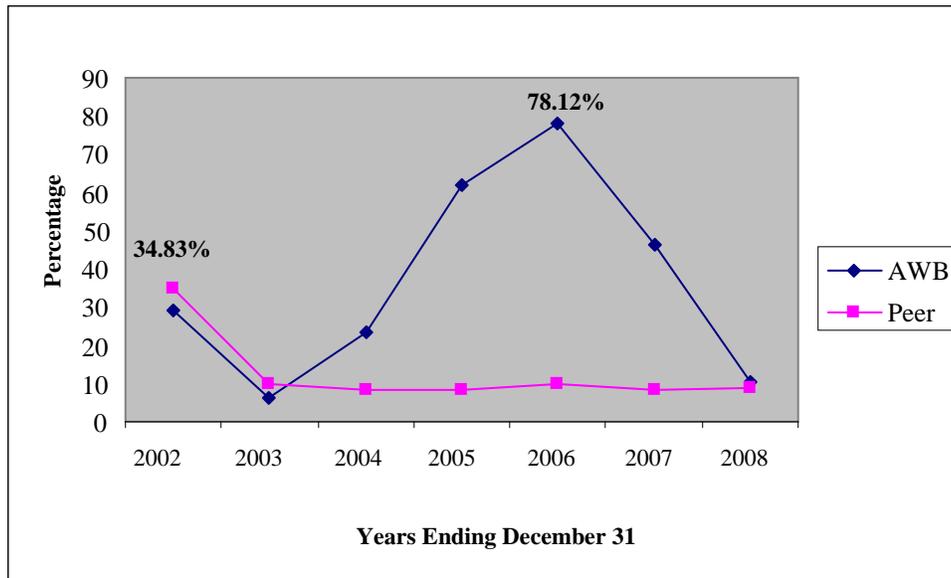
Causes of Failure and Material Loss

AWB failed because the bank's Board and management deviated from the bank's business plan and did not effectively manage the risks associated with rapid growth in CRE and ADC lending. AWB lacked adequate loan underwriting, credit administration, and allowance for loan and lease loss (ALLL) practices. AWB also relied heavily on wholesale funding sources, primarily brokered deposits, to fund its CRE and ADC concentrations. Finally, AWB was cited for apparent violations and contraventions of various laws, regulations, and interagency policies in seven of eight examinations. In a declining real estate market, AWB could not withstand significant loan losses, which led to quick and substantial erosion of the bank's capital. AWB's liquidity position became strained as the bank's financial condition deteriorated and access to certain funding sources was restricted. Ultimately, AWB was closed by UDFI due to the bank's capital insolvency in May 2009.

Rapid Asset Growth

AWB's business plan projected that at the end of its second year, the bank's total assets would have grown at a cumulative rate of 37.03 percent. However, the bank's cumulative total asset growth rate for that timeframe was 156.33 percent, more than four times the projection. As early as the July 2002 examination,⁵ examiners concluded that the Board appeared to overemphasize income or earnings rather than sound asset quality as it pursued growth. As shown in Figure 1, AWB's annual growth rates began to exceed its peer group in 2004 and peaked in December 2006 at over 78 percent, compared to a growth rate of 9.85 percent for the bank's peer group.

Figure 1 : AWB's Annual Growth Rate Compared to Peers



Source: UBPRs for AWB.

⁵ Unless otherwise noted in this report, references to examination dates will refer to the month and year of the examination start dates.

CRE and ADC Loan Concentrations

AWB's business plan indicated that the bank would have a diversified loan mix whereby no general loan type would comprise more than 40 percent of the overall loan portfolio. However, AWB pursued a lending strategy that resulted in CRE and ADC concentrations, both of which exceeded 40 percent of total loans throughout the bank's existence.

Examiners determined that AWB was developing a concentration at the bank's first visitation in November 2000. As early as the May 2001 examination, AWB's CRE and ADC loan concentrations as a percent of total loans were 64 and 51 percent, respectively. Table 2 shows that AWB (1) consistently and significantly exceeded both the 40 percent parameter established in the bank's business plan and the range for CRE and ADC loans for its peer group; and (2) was consistently in a high percentile for those concentrations.

Table 2: AWB's CRE and ADC Concentrations as a Percent of Total Loans Compared to Peers, 2001 — 2009

Type of Concentration	AWB	Peer Group	Percentile for AWB
CRE concentration	64%-96%	37%-50%	73%-98%
ADC concentration	51%-89%	8%-16%	99%*

Source: UBPRs for AWB.

* AWB remained in the 99th percentile for UBPR periods for which data was available.

In October 1998, the FDIC issued Financial Institution Letter (FIL) FIL-110-98, 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. The FIL further indicates that management's ability to identify, measure, monitor, and control portfolio risk through effective underwriting policies, systems, and internal controls is crucial to a sound ADC lending program, and that risk-monitoring techniques for ADC lending should be commensurate with the level of real estate activity and the nature and complexity of the institution's market.

Subsequently, in 2006, the federal banking agencies established guidelines in Financial Institution Letter FIL-104-2006, entitled, *Guidance on Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices*, dated December 12, 2006, which states that concentrations can pose substantial potential risks and can inflict large losses on institutions. The guidance includes the following supervisory criteria for identifying banks that may have potentially significant CRE concentrations and warrant greater supervisory scrutiny:

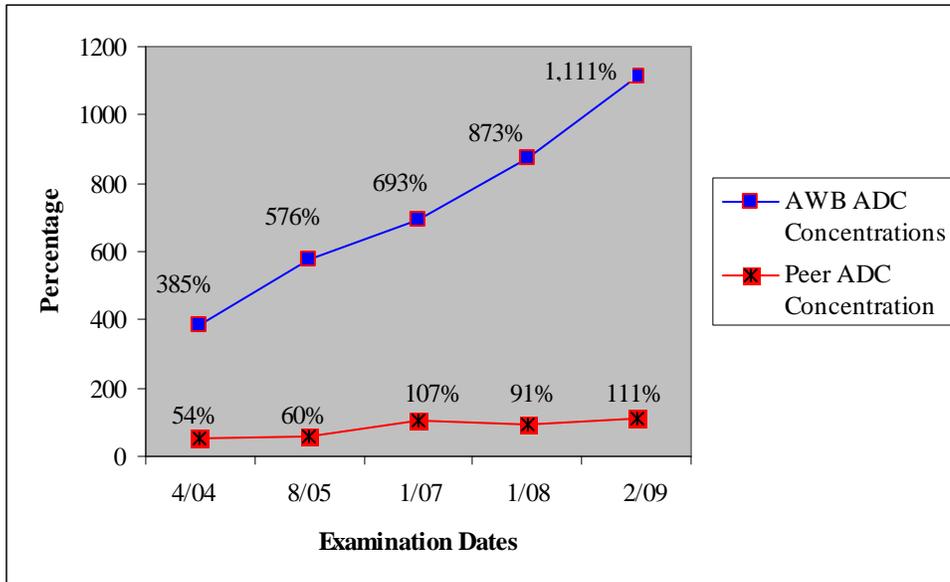
- ADC loans representing 100 percent or more of total capital, or
- Total CRE loans representing 300 percent or more of the institution's total capital, where the outstanding balance of the institution's CRE loan portfolio has increased by 50 percent or more during the prior 36 months.

Examiners noted the significantly high ADC and CRE concentrations in each of the bank's examinations and visitations. The May 2001 examination reported that over half

of the bank’s loan portfolio consisted of ADC loans, which were heavily reliant on a continued strong local real estate market, and concluded that (1) the bank’s credit concentration presented elevated concern and (2) a sudden downturn in the economy in the local real estate economy could expose the bank to potential loss. Examiners recommended that bank management closely monitor the local real estate market and, if necessary, take action to minimize the associated risk, and encouraged bank management to diversify AWB’s loan portfolio.

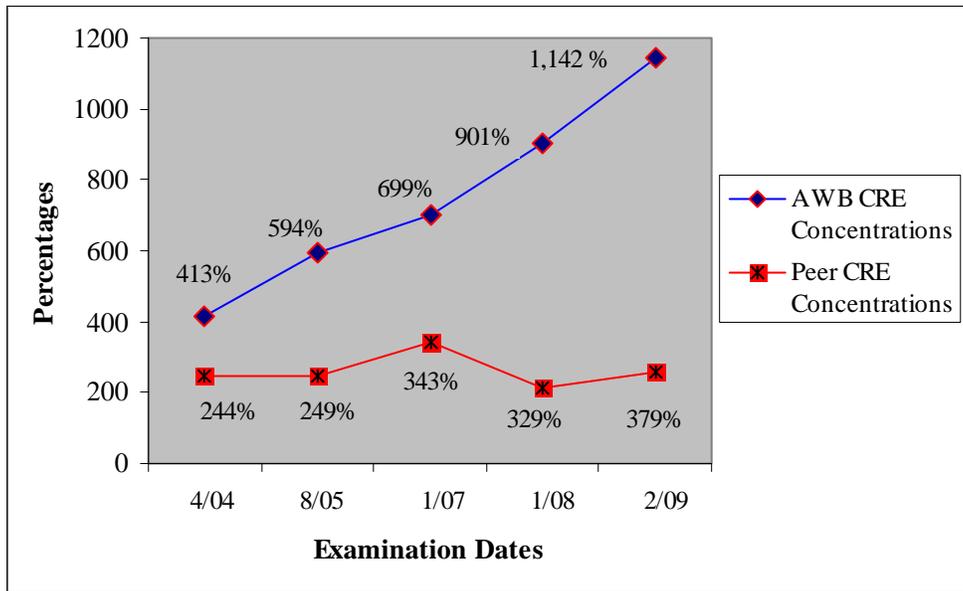
As shown in Figures 2 and 3, despite the examiners’ recommendations, AWB not only continued but intensified its levels of ADC and CRE concentrations. From 2007 until the bank closed, those levels exceeded the parameters for concentrations that warrant greater supervisory concern according to FIL-104-2006.

Figure 2: AWB’s ADC Concentration to Total Capital Compared to Peers



Source: OIG review of UBPRs for AWB.

Figure 3: AWB’s CRE Concentration to Total Capital Compared to Peers



Source: OIG review of UBPRs for AWB.

Note: Owner occupied loans were not included in the 2008 and 2009 CRE concentrations.

AWB’s risky strategy resulted in much higher rates of return than those of the bank’s peer group through 2007. Unlike the bank’s peer group, which experienced a rate of return ranging from 1.06 percent to 1.30 percent before the economic decline started in 2007, AWB’s rate of return on assets (ROA) ranged from 1.88 percent to 3.66 percent for the same period. However, as discussed in FIL-104-2006, rising CRE concentrations can expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in the general CRE market. Accordingly, when the real estate market deteriorated in 2007, AWB’s ROA dropped from 3.66 percent in 2007 to negative 3.47 percent in 2008.

During the October 2008 visitation, examiners concluded that a significant amount of the bank’s \$33.4 million in ADC loans and an additional \$54.5 million in lot loans were delinquent, and would likely lead to significant losses for the bank. Just 4 months later, at the February 2009 examination, examiners concluded that the risks in the bank’s loan portfolio concentration had become more apparent as the real estate market downturn intensified. Assets that were classified as a “loss” totaled more than \$17.6 million, of which \$12.2 million were loans. The majority of these loans were related to ADC.

Loan Underwriting and Credit Administration Practices

As shown in Table 3, examiners consistently expressed confidence in bank management’s ability to decrease or mitigate the risk associated with CRE and ADC lending from the July 2002 through the January 2007 examinations. During that timeframe, examiners included recommendations aimed at improving AWB’s loan underwriting and credit administration practices and, according to DSC officials, the bank took actions to address some of the related deficiencies.

Table 3: Synopsis of Examiner Comments Regarding AWB's Loan Underwriting and Credit Administration

Examination Date	Synopsis of Examiner Comments
July 2002	Management's expertise and internal controls related to real estate construction lending decreased the credit risk associated with this type of credit. Bank personnel were well qualified and experienced in construction real estate lending. Nevertheless, examiners recommended that bank management enhance underwriting guidelines.
April 2003	Management's familiarity with the local real estate market, in addition to the adequate internal controls related to real estate construction lending, decreased the risk associated with this type of credit. Despite management's expertise and internal controls in the real estate construction lending area, management should consider recommendations to enhance policy underwriting guidelines.
April 2004	Examiners generally concluded that risk management practices were adequate except as they related to approval of loans and significant exceptions to board-approved policies concerning speculative construction lending.
August 2005	Examiners made recommendations related to monitoring and reporting CRE and ADC concentrations to better manage the risk of AWB's significant real estate concentrations, such as amending the Loan Policy to include (1) policy limits for concentrations relative to Tier 1 capital; (2) requirements for periodic monitoring of concentrations by the Board; (3) policy limits for various subcategories, i.e., loan types, collateral types, geographic distribution, industry, and borrower; and (4) measurements under the policy limits to consider both funded and unfunded commitments.
January 2007	Examiners generally concluded that credit risk associated with AWB's concentrations was mitigated by bank management's adequate expertise and/or internal controls and effective risk management practices, with recommendations made relative to monitoring and reporting, at least until the July 2007 visitation of AWB.
January 2008	<p>Examiners concluded that management had implemented some of the recommendations made in January 2007 and stated that bank management needed to implement additional procedures and/or reporting to fully comply with the standards for sound risk management practices delineated in the December 2006 Guidance. Those procedures included, but were not limited to the following:</p> <ul style="list-style-type: none"> • develop aggregate limits for each segment (i.e., Pre-Sold Construction), • avoid the use of "catch-all" categories on the concentration report, • ensure that strategic plans address the rationale for concentration levels, • strengthen controls and procedures on loan categorization, and • consider auditing the concentration reporting and monitoring on a periodic basis.

Source: Reports of Examination (ROE) for AWB.

By late 2007, however, examiners began identifying increasing problems with AWB's construction loan portfolio. Most notably, examiners cited loan policy exceptions that included (1) little or no actual paid-in cash equity by borrowers, (2) stated income loans, and (3) collateral-dependent loans. Shortly thereafter, at the January 2008 examination, examiners noted continued loan policy exceptions and the inappropriate use of interest reserves. At the bank's final examination in 2009, examiners noted frequent renewals, modifications, and extensions made to borrowers with credit deficiencies and without obtaining updated appraisals, and concluded that the risks from AWB's excessively high concentrations in higher risk CRE loans had become more apparent as the real estate market downturn had intensified.

Allowance for Loan and Lease Losses

Examiners first recommended improvements in AWB's ALLL practices at the 2005 examination. By the 2007 and 2008 examinations, deterioration in asset quality was evident, adversely classified loans had risen, and increases in the bank's ALLL were required. Concerns regarding these issues continued and intensified subsequent to the January 2007 examination, when adverse classifications totaled 25.63 percent of Tier 1 Capital.

- **October 2008 visitation.** Examiners concluded that adversely classified assets represented approximately 300 percent of the bank's capital and reserves. In addition, AWB's ALLL was grossly underfunded and would require a large provision expense to return the ALLL to a minimally acceptable level. The bank's net loss of \$2 million, as of September 30, 2008, resulted primarily from \$5.6 million in ALLL provisions.
- **February 2009 examination.** The adversely classified items had increased substantially to 623 percent of Tier 1 Capital and reserves, indicating significant deterioration in the bank's loan portfolio, and loans classified as Loss totaled \$12.2 million. Examiners concluded that the ALLL was materially inadequate and recommended an increase of \$15 million to return the ALLL to a minimally acceptable level.

Reliance on Wholesale Funding and Contingency Liquidity Planning

As early as July 2002, examiners noted that AWB's Board and management implemented a strategy focused on the use of wholesale funding sources to accommodate high loan demand and slow core deposit growth. At that examination, examiners also noted that AWB's management needed to develop a contingency liquidity plan (CLP).

Wholesale Funding Sources

Contrary to its business plan, AWB pursued a risky business strategy that included a heavy reliance on wholesale funding sources, including brokered deposits and large time deposits, to fund its CRE and ADC concentrations. Consequently, when the bank's financial condition deteriorated, AWB's access to brokered deposits and interest rates that could be paid on Internet deposits were restricted in compliance with Section 29 of the FDI Act⁶ and in conjunction with enforcement actions issued against AWB.⁷

⁶ According to section 29 of the FDI Act, once an institution is determined to be *Undercapitalized*, as defined in Part 325 of the FDIC Rules and Regulations, the institution is prohibited from receiving brokered deposits. In addition, section 38 of the FDI Act permits the FDIC to restrict the interest rates paid by a *Significantly Undercapitalized* institution. Although AWB filed a brokered deposit waiver with the FDIC, the request was denied due to the bank's deteriorated financial condition.

⁷ The FDIC and UDFI independently issued Cease and Desist (C&D) Orders against AWB in September 2008. Those actions will be discussed in detail in *The FDIC's Supervision of AWB* section of this report.

When properly managed, non-core funding sources can offer important benefits, such as ready access to funding in national markets when core deposit growth in local markets lags planned asset growth. However, according to the *DSC Risk Management Manual of Examination Policies* (Examination Manual), (1) non-core funding sources present potential risks, such as higher costs and increased volatility; and (2) placing heavy reliance on potentially volatile funding sources to support asset growth is risky because access to these funds may become limited during distressed financial or market conditions. A bank's net non-core funding dependence ratio indicates how much a bank is relying on non-core/volatile liabilities to fund assets. Table 4 shows the extent of AWB's reliance on non-core deposits, and how that reliance increased dramatically over time and consistently and significantly exceeded its peer group.

Table 4: AWB's Total Brokered Deposits Compared to Total Deposits and Net Non-Core Funding Dependence Ratios

Date	Non-Core Deposits (Dollars in Thousands)				Net Non-Core Funding Dependence Ratios and Percentile		
	Total Deposits	Brokered Deposits	Percent of Total Deposits	Total Time Deposits (Greater Than \$100,000)	AWB	Peer Group	Percentile
Dec-01	\$27,270	\$5,656	21%	\$9,178	52.85%	13.71%	97
Dec-02	\$34,100	\$6,775	20%	\$14,887	59.59%	11.89%	95
Dec-03	\$38,025	\$9,287	24%	\$18,369	61.96%	11.15%	99
Dec-04	\$49,964	\$20,976	42%	\$28,107	66.28%	13.41%	99
Dec-05	\$89,045	\$62,607	70%	\$59,280	75.54%	12.25%	99
Dec-06	\$167,232	\$122,944	74%	\$134,153	81.17%	21.13%	99
Dec-07	\$244,949	\$217,485	89%	\$8,817	84.71%	23.72%	99
Dec-08	\$284,065	\$222,397	78%	\$23,808	82.30%	30.37%	99
Mar-09	\$286,040	\$210,716	74%	\$26,046	83.46%	23.43%	99

Source: ROEs and UBPRs for AWB.

Contingency Liquidity Planning

When a bank's financial condition deteriorates, access to various sources of funding can become restricted. Examiners for the January 2008 examination concluded that AWB's liquidity position was unsatisfactory given the level of asset growth. Although AWB had a CLP, which was included in the bank's December 2006 Asset Liability Management Policy, examiners expressed concern regarding secondary sources of funding for the bank and reported that the bank's CLP was not viable. AWB's CLP did not include many of

the elements suggested by FDIC guidance,⁸ such as (1) possible liquidity events that an institution might encounter and consideration of the range of probability of events that can arise through institution-specific, systemic market, or operational circumstances; (2) potential for erosion by funding sources under various scenarios; and (3) indicators that would alert bank management to a predetermined level of potential risks. A comprehensive CLP could have assisted in projecting and planning for viable sources for AWB's liquidity needs as the bank's financial condition began to deteriorate and applicable restrictions to sources of funding became imminent.

In spite of the excessive level of brokered deposits used by AWB and the associated risk, bank management did not attempt to change its funding strategy or ensure that appropriate contingency planning had been accomplished before significant financial deterioration had occurred. Rather, as AWB's financial condition deteriorated, as noted in the February 2009 examination report, the bank's access to non-core funding sources became restricted, and AWB's attempts to increase core deposits were not successful. The February 2009 examination concluded that the institution's liquidity position was critically deficient and sources of funding were limited. In addition, AWB replaced the brokered deposits with another wholesale funding source—Internet certificates of deposit (CD)—which violated interest rate restrictions.

Apparent Violations of Laws and Regulations and Contraventions of Policy

According to the Examination Manual, it is important for the bank's Board to ensure that bank management is cognizant of applicable laws and regulations; develops a system to effect and monitor compliance; and, when violations do occur, takes corrective action as quickly as possible. In the case of AWB, examiners reported apparent violations and contraventions in seven of AWB's eight examinations related to transactions with affiliates and insiders, unsafe and unsound practices, appraisals, real estate lending, and ALLL.

The January 2008 examination report stated that some of the violations cited at this and past examinations were due to bank management's unfamiliarity with banking regulations. Examiners also concluded that:

- more experience or proper oversight by bank management would have prevented the apparent violations;

⁸ The FDIC issued FIL-59-2003, entitled, *Use of the Federal Reserve's Primary Credit Program in Effective Liquidity Management*, dated July 23, 2003, which provided interagency guidance on the need for financial institutions to develop CLPs, in addition to other liquidity risk management controls, and informed financial institutions that a CLP should be part of the bank's liquidity management program. The guidance also stated that an adequate CLP is critical to the ongoing maintenance of the safety and soundness of any financial institution. The FDIC also issued FIL-84-2008, entitled, *Liquidity Risk Management*, dated August 26, 2008, which states that institutions that use wholesale funding, securitizations, brokered deposits, and other high-rate funding strategies should ensure that their contingency funding plans address relevant stress events.

- the level and type of apparent violations did not reflect well on management's abilities, indicating a lack of control by management over operations to identify and control risks; and
- the apparent violations and contraventions were a basis to question either management's abilities or willingness to thoroughly comply with regulations, policy, and guidance.

During the February 2009 examination, the FDIC and UDFI considered management critically deficient based on, among other things, the bank's noncompliance with the FDIC's *Final Order for Deposit Insurance*, and continued apparent violations of laws and regulations, in addition to the poor overall financial condition of the bank and inadequately funded ALLL. Moreover, it was determined that AWB acted in apparent violation of section 29 of the FDI Act provisions and the terms of the C&Ds issued in September 2008, by increasing its level of brokered deposits without obtaining prior regulatory approval. AWB also apparently violated section 29 by paying interest rates greater than regulatory limits, thereby exceeding the maximum permissible yield for its capital category.

The FDIC's Supervision of AWB

The FDIC and UDFI provided ongoing supervision of AWB and performed eight on-site examinations and four visitations from 2000 to 2009. The FDIC also conducted offsite monitoring activities from December 2003 to March 2008. The examinations and visitations included examiner concerns and recommendations related to issues such as the unsatisfactory performance of AWB's management, the bank's CRE and ADC concentrations, loan underwriting and credit administration deficiencies, weak risk management practices, heavy reliance on non-core deposits to fund asset growth, unsatisfactory liquidity levels, and inadequate capital position. Examiners also reported apparent violations of law and contraventions of policy associated with the institution's lending practices and insider transactions. In 2002 and 2003, and as the institution's condition deteriorated in 2008, the FDIC and UDFI took enforcement actions to address identified deficiencies. While consistent with DSC policy at the time, stronger action may have been prudent in 2002 and 2003 in light of the bank's de novo status and material deviations from its business plan. Further, additional supervisory action could have been taken to address the bank's high-risk profile at the time of the January 2007 examination, although the financial implications of the bank's inadequate practices were not yet apparent in the loan portfolio.

Supervisory History

The FDIC and UDFI provided continued on-site and offsite monitoring of AWB from the bank's inception in 2000 through its failure. The two regulatory agencies also conducted a targeted review in November 2007 and December 2007, which was part of an overall

risk assessment project that focused on residential ADC lending at eight Utah state-chartered banks.

AWB consistently received composite “2” CAMELS ratings⁹ until the January 2008 examination, which revealed significant financial deterioration in the bank’s overall performance, and as a result its composite rating was downgraded to a “4”. At the February 2009 examination, examiners identified continued deterioration in the bank’s performance that resulted in a further downgrade of the composite rating to a “5”, indicating extremely unsafe and unsound practices or conditions, critically deficient performance, and inadequate risk management practices. Table 5 summarizes key information pertaining to examinations and visitations, including the Bank Board Resolutions (BBR) issued in 2002 and 2003, and the C&Ds issued as a result of the January 2008 examination.

Table 5: AWB’s Examination and Visitation History, November 2000 – February 2009

Examination Start Date	Examination as of Date	Agency	Supervisory Ratings (UFIRS)	Supervisory Action
11/06/2000 (Visitation)	09/30/2000	FDIC/UDFI	222222/2	None
05/14/2001	03/31/2001	FDIC/UDFI	222323/2	None
07/08/2002	03/31/2002	FDIC/UDFI	233222/2	BBR (Effective August 1, 2002)
04/14/2003	12/31/2002	FDIC/UDFI	232322/2	BBR (Effective July 28, 2003)
04/12/2004	12/31/2003	FDIC/UDFI	232322/2	None
08/15/2005	06/30/2005	FDIC/UDFI	222222/2	None
01/08/2007	12/31/2006	FDIC/UDFI	222222/2	None
07/16/2007 (Visitation)	06/30/2007	FDIC/UDFI	Not Applicable	None
11/14/2007 (Visitation)	11/14/2007	FDIC/UDFI	Not Applicable	None
01/22/2008	12/31/2007	FDIC/UDFI	444333/4	C&Ds issued independently by the FDIC and UDFI (Effective September 3, 2008 and September 25, 2008, respectively)
10/08/2008 (Visitation)	09/30/2008	FDIC/UDFI	5 composite rating	C&D
02/09/2009	12/31/2008	FDIC/UDFI	555555/5	C&D

Source: ROEs for AWB.

⁹ Financial institution regulators and examiners use the Uniform Financial Institutions Rating System (UFIRS) to evaluate a bank’s performance in six components represented by the CAMELS acronym: **C**apital adequacy, **A**sset quality, **M**anagement practices, **E**arnings performance, **L**iquidity position, and **S**ensitivity to market risk. Each component, and an overall composite score, is assigned a rating of 1 through 5, with 1 having the least regulatory concern and 5 having the greatest concern.

As shown in Table 5, the FDIC and UDFI conducted four visitations at AWB from 2000 to 2008, in addition to the required risk management examinations. The purposes of those visitations were as follows:

- **November 2000.** In conjunction with the bank's de novo status, the FDIC and UDFI conducted a limited-scope visitation to verify compliance with the orders issued by the FDIC and the UDFI related to the granting of the bank's charter and deposit insurance.
- **July 2007.** This visitation was conducted to review the bank's real estate concentration reporting and monitoring, capital adequacy, and suspicious activity related to a former bank employee.
- **November 2007 through December 2007.** This visitation was conducted to perform a risk assessment to evaluate the level and trend of credit risk in the institution's Residential Construction Loan (RCL), i.e., ADC, portfolio.
- **October 2008.** During this visitation, the regulatory agencies assessed AWB's capital adequacy, asset quality and CRE concentration risk, effectiveness of management, earnings performance, and liquidity, including the brokered deposit reliance and associated risk. Preliminary findings identified a substantial increase in classified assets as well as an underfunded ALLL. Further, examiners found that AWB's management had paid dividends and accepted brokered CDs without obtaining prior approval from the FDIC and/or UDFI, contrary to a September 2008 C&D, as discussed later.

The FDIC took various supervisory actions as a result of the examinations and visitations, including imposing informal and formal actions and making recommendations in the examination reports related to areas of the bank's operations where improvements were needed. A brief description of the supervisory actions follows.

- **August 2002 BBR.** The July 2002 examination identified less than satisfactory asset quality primarily resulting from the bank's commercial loan portfolio, particularly in underwriting practices for Small Business Administration loans. AWB adopted a BBR and agreed to:
 - develop policy governing insider trading and ensure compliance with the Federal Reserve's Regulation O and Sections 23A and 23B on insider transactions;
 - comply with the FDIC's *Final Order for Deposit Insurance*;
 - develop a written strategic plan;
 - manage growth prudently to prevent further asset quality deterioration;
 - ensure capital levels were adequately maintained;
 - ensure that the bank's internal loan grading system was more accurate and that credit risk was properly identified on all loans; and
 - increase the ALLL.

Informal enforcement actions are typically used for banks viewed as having heightened supervisory concern and that are assigned a composite rating of “3”. However, to their credit, although AWB’s composite rating was a “2”, with asset quality and management component ratings of “3”, the FDIC and UDFI requested that AWB adopt a BBR to address the deficiencies identified at the bank.

Examiners at the following April 2003 examination concluded that the bank had not fully complied with the 2002 BBR, noting repeat concerns with (1) the bank’s loan grading system in the assessment of the adequacy of the ALLL and (2) insider transactions that resulted in repeat apparent violations of Section 23A.

- **July 2003 BBR.** This BBR required the Board to develop and implement an information security program and required the bank to provide quarterly progress reports to the regulators. At the April 2004 examination, examiners concluded that the Board and management had satisfied the terms of the 2003 BBR.
- **2004 – 2007 Examination Recommendations.** The FDIC identified risks and made recommendations to address risk management practices pertaining to the institution’s rapid loan growth, CRE and ADC loan concentrations, loan underwriting and credit administration practices, and substantial reliance on non-core funding sources.
- **September 2008 C&Ds.** The FDIC and UDFI issued C&Ds with similar requirements to AWB that included provisions related to:
 - obtaining qualified management;
 - establishing a higher minimum capital standard;
 - reducing classified assets and charge-off assets classified as loss and maintaining an appropriate ALLL;
 - limiting the use of brokered deposits and restricting the payment of dividends;
 - reducing concentration risks and correcting violations;
 - developing a 3-year strategic plan;
 - enhancing policies for liquidity, lending, concentration risk and audit coverage; and
 - submitting quarterly progress reports.

Examiners for the February 2009 examination determined that AWB had substantially complied with provisions related to increasing Board participation in the bank’s operations, reducing concentrations, reducing classified assets, enhancing liquidity policies, and providing progress reports. However, other areas still needing improvement included the need for qualified management, increasing and maintaining an adequate ALLL, increasing capital, and correcting all violations of law.

On May 1, 2009, the UDFI closed AWB due to its severely deteriorated financial condition and the bank's inability to raise additional capital, and named the FDIC as receiver.

Supervisory Response to Risks Identified at AWB

Various factors play a role in the supervisory approach to the risks at an institution. In the case of AWB, DSC officials indicated that examiners were influenced by: the bank's historical success as a construction lender; a relatively low level of adversely classified assets until the 2007 examination; the significant percentage of ADC loans reported as pre-sold, indicating less risk; and a strong mortgage market. Nevertheless, with the benefit of hindsight, the risks that examiners identified at AWB, coupled with supervisory guidance and studies issued during AWB's existence, may have warranted stronger and timelier supervisory action during the bank's de novo phase and as the institution developed a high-risk profile. A brief discussion of those risks and guidance follows.

Risks Identified at AWB

- **Growth and concentrations that exceeded and were inconsistent with the business plan.** AWB quickly and consistently exceeded the growth parameters included in the business plan and implemented a business strategy that resulted in significant CRE and ADC concentrations that were not in agreement with the diversified loan portfolio called for in the plan. As discussed earlier in this report, AWB's concentrations in CRE and ADC loans were identified by examiners 6 months after the bank opened in 2000. Those concentrations and the risk associated with them significantly and consistently increased from 2001 throughout the bank's existence. Although the 2002 BBR addressed AWB's rapid growth and resulted in a decline in the growth rate during 2002 and 2003, AWB significantly expanded its CRE and ADC loan portfolio in 2004.
- **Heavy reliance on brokered deposits.** Soon after it opened, and throughout its existence, AWB ranked between the 95th and 99th percentile of its peer group. In addition, the bank failed to develop a comprehensive CLP to assist the bank in projecting and planning for sources of funding as the bank's financial condition deteriorated.
- **Apparent violations of laws, regulations and contraventions of policy.** Examiners identified and reported apparent violations and contraventions in seven of AWB's eight examinations. AWB's noncompliance with laws and regulations was first evident during the bank's de novo period, when examiners determined that AWB had not complied with the FDIC's *Final Order for Deposit Insurance*.
- **Offsite monitoring results.** Beginning in AWB's de novo period, and throughout the bank's existence, examiners identified significant risks associated with AWB, including the bank's rapid growth, concentrated loan portfolio, deficient ALLL, and use of non-core funding sources. Prior to 2007, the offsite

findings did not result in substantial changes in the supervisory strategy for AWB. However, based on the offsite reviews beginning in March 2007, the FDIC and UDFI performed two visitations in 2007 as discussed earlier in this report, and accelerated the 2008 examination schedule from 18 months to 12 months.

- **Apparent risk at the time of the 2007 examination.** Examiners for the January 2007 examination concluded that, overall, the financial condition of AWB was satisfactory. However, the examination also identified issues that indicated apparent and continued risk to the bank. Specifically:
 - examiners concluded that AWB was a niche lender with significant exposure to CRE and ADC lending;
 - AWB's asset growth rate as of December 31, 2006 was 78.12 percent compared to 9.85 percent for the bank's peer group;
 - adverse classifications had almost doubled from 13.81 percent at the August 2005 examination to 25.83 percent, although according to DSC, this level was normally associated with relatively sound asset quality and did not warrant increased supervisory concern;
 - net loans had increased by 99 percent, while core deposits had increased only 11 percent;
 - AWB's level of non-core deposits significantly exceeded the bank's peer group and had increased to 74 percent of total deposits with (1) the bank being in the 99th percentile for net non-core funding for the fourth consecutive calendar year-end, (2) brokered deposits increasing from \$62.6 million as of December 2005 to \$122.9 million as of December 2006, and (3) time deposits greater than \$100,000 increasing from \$59.2 million to more than \$134.2 million for the same period;
 - capital levels were marginally adequate for the bank's overall risk profile and capital ratios had continued to decline due to rapid asset growth and significant dividend payouts; and
 - earnings were deemed to be lacking to support the bank's rapid asset growth and dividend payouts.

Supervisory Guidance and Studies Issued

- **CRE Review Project.** In 2003, the DSC Atlanta Regional Office (ARO) conducted a project that included institutions exhibiting significant levels of CRE concentration (more than 300 percent of Tier 1 Capital—a level that, according to the FDIC, traditionally represented a relatively high concentration of CRE loans and increased risk to the bank). The bank's April 2004 examination reported that AWB had already developed a concentration that represented 380 percent of

Tier 1 Capital in ADC loans at year-end 2003.

- **2004 De novo Bank Study.** In 2004, the ARO led an interregional study of de novo financial institutions and “young” banks, which were banks in the fourth through ninth years of operation, in fulfillment of a DSC 2004 business line objective. The purpose of the study was to review the timing of, and susceptibility to, problems of de novo and young banks and to determine important factors related to the application process for deposit insurance, compliance with business plans, and high-risk factors for those institutions, including CRE concentrations. AWB exhibited risk factors reported in the 2004 study including, but not limited to (1) weak oversight by the Board; (2) departure from the business plan by exceeding projected asset growth; (3) rapid asset growth, including CRE and ADC lending; and (4) dependence on non-core deposits to fund asset growth.
- **FIL-104-2006.** The FDIC issued supervisory guidance in 2006 that concluded that (1) CRE concentrations can pose substantial potential risks and can inflict large losses on institutions, (2) institutions should hold capital commensurate with the level and nature of their CRE concentration risk, and (3) institutions with high levels of risk would be expected to operate well above minimum regulatory capital requirements. AWB’s concentration levels at the January 2007 examination significantly exceeded the parameters established in the 2006 supervisory criteria.

Supervisory Action

As discussed earlier, AWB’s asset quality component, which was downgraded to a “3” by the FDIC and UDFI during the 2002 examination, remained at that rating during the following 2003 and 2004 examinations. The FDIC and UDFI also issued BBRs in 2002 and 2003, reported apparent violations of law and contraventions of policy, and made recommendations in ROEs to address risks at AWB.

To its credit, the FDIC and UDFI also conducted the RCL visitation in November and December 2007. At that time, AWB reported total commitments representing 659 percent of Total Risk-Based Capital, which was the highest concentration of any institution included in the project. Additionally, the bank’s Tier 1 Capital Ratio of 8.71 percent was among the lowest of the banks included in the risk assessment. Examiners concluded that AWB had high risk associated with increased problem account identification, pending foreclosure actions, high concentration ratios, a modest capital level, and qualitative factors related to local real estate market conditions and trends. Further, according to DSC officials, AWB implemented liberal loan underwriting and administration practices in 2007 to facilitate the bank’s strategy of continuing to grow the bank’s loan portfolio.

On January 10, 2008, the FDIC contacted AWB regarding the results of the risk assessment. Specifically, the FDIC advised AWB that officers and managers interviewed at various institutions expressed concern that their portfolios might not perform as well

during the coming months and that in some cases, management was taking additional steps to mitigate risks presented by CRE and ADC concentrations.

Unfortunately, AWB's Board and management were not always responsive to examiners, and the bank consistently exhibited an appetite for high risk. Therefore, stronger supervisory action, such as a Memorandum of Understanding (MOU), may have been warranted. Such an MOU could have required AWB to implement a plan to address the key risks that examiners identified when the bank first began operations, and later in 2007 when financial indicators began to reflect a high-risk profile. We recognize that the C&Ds issued in September 2008 addressed deficiencies at the bank. However, the viability of the institution was already in serious question by the time the C&Ds were issued.

DSC Initiatives Related to Addressing Risks Like Those Found at AWB

DSC has completed and has in process various initiatives to improve how examiners can identify and address risks like those at AWB. Specifically, DSC has:

- Established reports and tracking systems to enable examiners to determine whether de novo institutions are operating within the parameters of their business plan.
- Provided and communicated guidance to enable regional offices to better address risks—such as reliance on potentially volatile wholesale funding sources—at newly identified “3”, “4”, or “5”-rated banks.
- Established policies and practices aimed at improving communication and tracking of risks and corrective actions for institutions with high-risk profiles.
- Strengthened offsite monitoring activities by providing reports that identify and rank institutions with characteristics that include concentrations and high levels of wholesale funding.

Implementation of PCA

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

The effectiveness of PCA may have been impacted, however, by the fact that AWB:

- received substantial capital injections during 2007 and 2008 from its holding company, which effectively delayed imposition of PCA provisions;
- paid significant dividends to its shareholders at a time when the bank was classified as *Adequately Capitalized* as a result of the September 2008 C&Ds; and
- continued to use brokered CDs without receiving a waiver from the FDIC, with rates on the CDs exceeding the maximum permissible yield for *Adequately Capitalized* banks.

Table 6 provides AWB's capital ratios as of calendar years ending December 2005 through December 2008 and other significant periods for AWB. AWB's capital categories indicated substantial decline from December 2005 to December 2007. Adjustments for the September 2008 Call Report period decreased the bank's capital ratios, which continued to decline until the bank's failure in 2009.

Table 6: AWB's Capital Ratios

Period Ending	Tier 1 Leverage Capital	Tier 1 Risk-Based Capital	Total Risk-Based Capital	Capital Category
PCA Threshold	5% or more	6% or more	10% or more	
AWB Capital Levels				
Dec-05	11.73%	18.05%	19.30%	Well Capitalized
Dec-06	8.41%	10.32%	11.44%	Well Capitalized
Dec-07^a	8.19%	8.44%	9.70%	Adequately Capitalized
Jun-08	8.67%	9.97%	11.20%	Well Capitalized
Sept-08^b	4.70%	5.95%	7.24%	Undercapitalized
Dec-08^c	(2.51)%	(3.53)%	(3.53)%	Critically Undercapitalized
Mar-09	(2.14)%	(3.00)%	(2.99)%	Critically Undercapitalized

Source: UBPR and ROEs for AWB.

^a These ratios were adjusted during the January 2008 examination to account for additional funding needed for the bank's ALLL. Although the bank was determined to be *Adequately Capitalized* after the adjustments, an additional capital injection by the bank's holding company returned the bank to the *Well Capitalized* category before the end of March 31, 2008. Accordingly, the FDIC did not provide an official PCA notification to AWB, and the bank's use of brokered deposits was not restricted.

^b These ratios represent the adjusted capital ratios based on the October 2008 visitation conducted by the FDIC and UDFI.

^c These ratios were adjusted after the February 2009 examination adjustments made by examiners.

On September 3, 2008, and September 25, 2008, the FDIC and UDFI issued C&Ds to AWB, respectively. As a result of the September 3, 2008 C&D, AWB's capital category was reclassified from *Well Capitalized* to *Adequately Capitalized*¹⁰ for PCA purposes. In

¹⁰ Per 12 CFR 325.103(b)(2)(iv) because AWB was subject to an enforcement action, the bank did not meet the definition for a *Well Capitalized* institution. Accordingly, the bank's capital category was re-classified as *Adequately Capitalized* for PCA purposes.

an effort to monitor and preserve the bank's capital, both C&Ds restricted the bank from paying dividends without first obtaining prior written approval from the FDIC and UDFI.

The C&Ds also stated that the bank should not increase its level of brokered deposits. However, on or about September 30, 2008, AWB accepted a brokered CD in the amount of \$4 million without receiving a waiver from the FDIC. Additionally, the bank improperly accepted brokered CDs that exceeded the maximum permissible yield on brokered CDs for *Adequately Capitalized* banks.¹¹

Further, the C&Ds required AWB to increase Tier 1 Capital to 10 percent. During the October 2008 visitation, bank management stated that it would be unlikely that the institution would be able to raise any additional capital in light of the bank's weak financial condition. The bank's need to pay dividends and reliance on brokered deposits justified the need to increase capital well above the required ratios per PCA provisions. With regard to dividends, as a result of the bank's Subchapter S status, AWB was pressured by shareholders to pay dividends to assist the shareholders in paying the associated income tax liabilities on bank earnings. AWB's cash dividends presented an increasing strain on the bank's financial condition. Although the bank increased its capital levels in 2007, dividends totaling \$4.6 million paid to the bank's holding company exceeded the total capital infusions as asset growth outpaced capital.¹²

As required by section 38 of the FDI Act, on December 5, 2008, the FDIC notified AWB that the bank's PCA category had declined to *Undercapitalized* as of September 30, 2008. Accordingly, AWB became subject to the mandatory requirements of section 38, and was (1) no longer eligible to accept, renew or roll over brokered deposits or receive a waiver to do so, (2) required to submit a capital restoration plan, and (3) subject to other restrictions related to asset growth, acquisitions, new activities, new branches, payment of dividends or management fees, or any other capital distributions.

Finally, although AWB created a capital plan to raise \$4 million to \$8 million in new capital, the FDIC determined that the likelihood of the bank being successful in those efforts was low. The bank's efforts to raise capital prior to its failure, including applying for capital under the Troubled Asset Relief Program, were negatively impacted by the bank's severe asset quality deterioration, significant concentration in high-risk CRE loans, and the economic downturn. On May 1, 2009, the UDFI closed the institution and named the FDIC as receiver.

¹¹ Examiners for the October 2008 visitation concluded that in the absence of a waiver, AWB should not have accepted a new brokered CD on or about September 30, 2008. Furthermore, even if the FDIC had granted a waiver for AWB, the brokered CD should not have been accepted at 4.50 percent - which was 35 basis points higher than the permissible rate.

¹² As of year-end 2007, the holding company paid dividends totaling 49.6 percent of its net income to shareholders; and for the first half 2008, the holding company paid dividends to shareholders in excess of capital contributions by \$620,000. Examiners also concluded that estimated annual dividends to service holding company interest and overhead (excluding taxes) exceeded \$1 million.

Corporation Comments

After we issued our draft report, we met with management officials to further discuss our results. Management provided additional information for our consideration, and we revised our report to reflect this information, as appropriate. On December 4, 2009, the Director, DSC, provided a written response to the draft report. That response is provided in its entirety as Appendix 4 of this report.

DSC reiterated the OIG's conclusions regarding the causes of AWB's failure. With regard to our assessment of the FDIC's supervision of AWB, DSC acknowledged the need for more stringent supervisory attention for de novo institutions, and as a result, the FDIC recently extended the de novo period from the previous 3-year period to 7 years and stated that these institutions will receive a full-scope examination every year for that 7-year period. DSC further stated that business plans for de novo banks are being closely monitored against approved financial projections, and changes taken without prior notice may result in civil money penalties.

Objectives, Scope, and Methodology

Objectives

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

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

We conducted this performance audit from June 9, 2009 to November 10, 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Scope and Methodology

The scope of this audit included an analysis of AWB's operations from May 18, 2000 until its failure on May 1, 2009. Our review also entailed an evaluation of the regulatory supervision of the institution over the same period.

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

- Analyzed ROEs prepared by the FDIC and the UDFI examiners from 2000 to 2009.
- Reviewed the following:
 - Documentation for offsite monitoring activities conducted by the FDIC.
 - Available work papers for FDIC examinations.
 - Correspondence maintained at DSC's San Francisco Regional Office and Salt Lake City Field Office.
 - Reports prepared by the Division of Resolutions and Receiverships (DRR) and DSC relating to the bank's closure. We also reviewed available failed

Objectives, Scope, and Methodology

bank records maintained by DRR in Dallas, Texas, for information that would provide insight into the bank's failure.

- Audit Reports prepared by the bank's external auditor, Simpson & Company, CPAs, Salt Lake City, Utah.
- Pertinent DSC policies and procedures.
- Interviewed the following FDIC officials:
 - DSC management in Washington, D.C., and in San Francisco, California.
 - DRR officials at the Dallas Regional Office.
 - FDIC examiners from the DSC Salt Lake City and Tampa Bay Field Offices who participated in AWB examinations and visitations.
- Researched various banking laws and regulations.

We performed the audit field work at the DSC office in San Francisco, California.

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

Consistent with the audit objectives, we did not assess DSC's overall internal control or management control structure. We relied on information in DSC systems, reports, ROEs, and interviews of examiners to understand AWB's management controls pertaining to causes of failure and material loss as discussed in the body of this report.

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

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

Objectives, Scope, and Methodology

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

Glossary of Terms

Term	Definition
Adversely Classified Assets	Assets subject to criticism and/or comment in an examination report. Adversely classified assets are allocated on the basis of risk (lowest to highest) into three categories: Substandard, Doubtful, and Loss.
Allowance for Loan and Lease Losses (ALLL)	Federally insured depository institutions must maintain an ALLL that is adequate to absorb the estimated loan losses associated with the loan and lease portfolio (including all binding commitments to lend). To the extent not provided for in a separate liability account, the ALLL should also be sufficient to absorb estimated loan losses associated with off-balance sheet loan instruments such as standby letters of credit.
Bank Board Resolution (BBR)	A BBR is an informal commitment, adopted by a financial institution's Board, directing the institution's personnel to take corrective action regarding specific noted deficiencies.
Call Report	Consolidated Reports of Condition and Income (also known as the Call Report) are reports that are required to be filed by every national bank, state member bank, and insured nonmember bank pursuant to the FDI Act. These reports are used to calculate deposit insurance assessments and monitor the condition, performance, and risk profile of individual banks and the banking industry.
Cease and Desist Order (C&D)	A C&D is a formal enforcement action issued by a financial institution regulator to a bank or affiliated party to stop an unsafe or unsound practice or a violation of laws and regulations. A C&D may be terminated when the bank's condition has significantly improved and the action is no longer needed or the bank has materially complied with its terms.
Concentration	A concentration is a significantly large volume of economically related assets that an institution has advanced or committed to a certain industry, person, entity, or affiliated group. These assets may, in the aggregate, present a substantial risk to the safety and soundness of the institution.
Memorandum of Understanding (MOU)	An informal corrective administrative action for institutions considered to be of supervisory concern but which have not deteriorated to the point where they warrant formal administrative action. As a general rule, this action is to be considered for all institutions rated a composite "3".

Glossary of Terms

Term	Definition
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 DIF. Part 325 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 1831o, by establishing a framework for taking prompt supervisory actions against insured nonmember banks that are less than adequately capitalized. The following terms are used to describe capital adequacy: (1) Well Capitalized, (2) Adequately Capitalized, (3) Undercapitalized, (4) Significantly Undercapitalized, and (5) Critically Undercapitalized.</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>
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>

Acronyms

ADC	Acquisition, Development, and Construction
ALLL	Allowance for Loan and Lease Losses
ARO	Atlanta Regional Office
AWB	America West Bank
BBR	Bank Board Resolution
C&D	Cease and Desist Order
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
CD	Certificate of Deposit
CLP	Contingency Liquidity Plan
CRE	Commercial Real Estate
DIF	Deposit Insurance Fund
DRR	Division of Resolutions and Receiverships
DSC	Division of Supervision and Consumer Protection
FDI	Federal Deposit Insurance
FDIC	Federal Deposit Insurance Corporation
FIL	Financial Institution Letter
LLC	Limited Liability Company
MOU	Memorandum of Understanding
OIG	Office of Inspector General
PCA	Prompt Corrective Action
RCL	Residential Construction Loan
ROA	Return on Assets
ROE	Report of Examination
UBPR	Uniform Bank Performance Report
UDFI	Utah Department of Financial Institutions
UFIRS	Uniform Financial Institution Rating System

Corporation Comments



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

Division of Supervision and Consumer Protection

December 4, 2009

MEMORANDUM TO: Stephen Beard
Assistant Inspector General for Material Loss Reviews

FROM: Sandra L. Thompson
Director

SUBJECT: Draft Audit Report Entitled, Material Loss Review of America
West Bank, Layton, Utah (Assignment No. 2009-047)

Pursuant to Section 38(k) of the Federal Deposit Insurance Act (FDI Act), the Federal Deposit Insurance Corporation's Office of Inspector General (OIG) conducted a material loss review of America West Bank (AWB) which failed on May 1, 2009. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Report (Report) received on November 16, 2009.

The Report concludes that AWB's failure was due to the Board and management's inability to effectively manage the risks associated with rapid growth in commercial real estate and acquisition, development and construction lending. As management focused increasingly on growth, loan underwriting, credit administration, and allowance for loan and lease loss (ALLL) practices in relation to AWB's risk profile became deficient. AWB also relied heavily on wholesale funding sources, primarily brokered deposits, ultimately leading to liquidity problems as its financial condition deteriorated.

During its de novo period, examiners recommended AWB management closely monitor the local real estate market and, if necessary, take action to minimize the associated risk. Examiners also encouraged AWB management to diversify the loan portfolio. Joint FDIC/State examinations in 2002 and 2003 resulted in informal enforcement actions, including corrective measures for loan underwriting and administration. AWB was deemed to be in substantial compliance during the 2004 examination. Supervisory attention to AWB continued through regular examinations and offsite monitoring from 2004 through 2006, and increased in 2007, with on-site visitations in July and November. The January 2008 Joint FDIC/State examination identified a sharp increase in adversely classified assets, an inadequate ALLL, loan underwriting and administration weaknesses, and other management deficiencies resulting in a formal enforcement action by the FDIC and the State.

In recognition that stringent supervisory attention is necessary for de novo institutions, DSC recently extended its supervisory program so that these institutions receive full scope examinations every year for seven years, as opposed to three years. De novo business plans are being closely monitored against approved financial projections throughout the seven-year period. The Financial Institution Letter issued in August 2009, describes the program changes for de novo institutions and warns that changes undertaken without required prior notice may subject an institution or its insiders to civil money penalties.

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