Office of Inspector General

Office of Material Loss Reviews
Report No. MLR-10-034

Material Loss Review of American United Bank, Lawrenceville, Georgia

May 2010

Office of Inspector General

Executive Summary

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Why We Did The Audit

On October 23, 2009, the Georgia Department of Banking and Finance (DBF) closed American United Bank (AUB), Lawrenceville, Georgia and named the FDIC as receiver. On November 6, 2009, the FDIC notified the Office of Inspector General (OIG) that AUB's total assets at closing were $113.9 million and the estimated material loss to the Deposit Insurance Fund (DIF) was $43.8 million. As of December 31, 2009, the loss had increased to $45.2 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 AUB.

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

Background

AUB opened for business on December 20, 2004 as a state nonmember bank regulated by the FDIC and the DBF. AUB operated a single office in Lawrenceville, Georgia, located about 25 miles north of Atlanta, Georgia. AUB pursued a traditional business plan and engaged principally in commercial real estate (CRE) and acquisition, development, and construction (ADC) lending that consisted of residential and commercial ADC and hotel/motel lending. In addition, AUB purchased and sold CRE and ADC participation loans. The bank's lending programs also included loans originated under the U.S. Small Business Administration guarantee programs.

Although AUB did not have any brokered deposits, the bank used high-priced time deposits and Federal Home Loan Bank borrowings as non-core funding sources. AUB was wholly-owned by American United Bancorp, Inc., a non-complex one-bank holding company. The bank's Board controlled 22 percent of holding company shares.

Audit Results

Causes of Failure and Material Loss

AUB failed primarily because the Board and bank management did not effectively oversee the bank's operations, particularly, by failing to ensure there were adequate risk management controls over CRE and ADC lending activities. The institution grew rapidly after opening and quickly developed CRE and ADC concentrations. As a result of inadequate controls and declining economic and real estate market conditions, the quality of AUB's loan portfolio and the bank's financial condition began to deteriorate in 2007. The bank's condition steadily declined until June 2009, when examiners determined it to be critically deficient. The associated losses and provisions depleted AUB's earnings and capital. Ultimately, AUB's capital position became *Critically Undercapitalized*, resulting in an insolvent institution. AUB was closed due to the overall deterioration in the bank's financial condition, including its loan portfolio, earnings, and capital.

The FDIC's Supervision of AUB

From February 2005 until the bank failed in October 2009, the FDIC, in conjunction with the DBF, provided ongoing supervision of AUB through five onsite risk management examinations and four visitations. During the de novo period, examiners generally concluded that AUB's overall financial condition was sound and management's performance and oversight was satisfactory. However, the DBF's February 2009 visitation identified significant deterioration in AUB's financial condition, which examiners determined had become more pronounced at the time of the joint June 2009 examination. Through their supervisory efforts, the FDIC and the DBF identified and brought key risks to the attention of the bank's Board and management, including the concerns regarding AUB's Board and management oversight, high levels of CRE and ADC concentrations, and associated weak risk management practices.

The FDIC and the DBF initiated enforcement actions in 2009 to address risk management deficiencies and AUB's deteriorating financial condition. Although the FDIC and the DBF closely monitored AUB, and the FDIC downgraded certain component ratings at the October 2007 examination, an additional rating downgrade and supervisory actions may have been warranted. Specifically, given the deficiencies and risks identified at the 2007 examination, it may have been prudent for the FDIC to downgrade AUB's management rating and/or include provisions to address management and asset quality in the supervisory action taken at that time, in light of the bank's level of asset concentrations. In addition, supervisory action may have been prudent when offsite monitoring indicated increasing risk at AUB after the October 2007 examination and before the DBF's February 2009 visitation.

With respect to issues discussed in this report, the FDIC has issued guidance that reemphasizes managing risks associated with CRE and ADC concentrations and de novo institutions, as well as addresses communicating and following up on identified risks and deficiencies. The FDIC also implemented an examiner training initiative that emphasizes the need to assess a bank's risk profile using forward-looking supervision. The training, among other things, addressed the need for examiners to consider management practices as well as the bank's financial performance or trends in assigning ratings as allowable under existing examination guidance.

With respect to PCA, we concluded that the FDIC had properly implemented applicable PCA provisions of section 38 based on the supervisory actions taken for AUB.

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 May 5, 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.

In its response, DSC reiterated the OIG's conclusions regarding the causes of AUB's failure. With respect to our assessment of supervision, DSC noted AUB's significant growth between 2006 and 2008 and stated that examiners identified key risks including inadequate Board and management oversight, the bank's high CRE and ADC concentrations, and associated weak risk management practices. In addition, DSC stated that the AUB Board entered into an Memorandum of Understanding with the FDIC and the

DBF to address weaknesses identified at the February 2009 visitation and that the FDIC and DBF took action through a formal Cease and Desist Order when AUB's management and Board were unable to sufficiently address the cited problems.

Regarding de novo institutions, DSC stated that the supervisory program for these banks has been extended so that these institutions receive a full-scope examination every year for 7 years, as opposed to 3 years. In addition, DSC stated that business plans are receiving careful analysis prior to an institution's opening and are being closely monitored against approved financial projections throughout the 7-year period. Further, DSC stated that a Financial Institution letter issued in August 2009 describes the program changes for de novo institutions and warns that changes to business plans undertaken without required prior notice may subject institutions or their insiders to civil money penalties.

Contents

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

Office of Material Loss Reviews
Office of Inspector General

DATE: May 6, 2010

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

/Signed/

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

SUBJECT: Material Loss Review of American United Bank, Lawrenceville, Georgia (Report No. MLR-10-034)

As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, the Office of Inspector General (OIG) conducted a material loss[1] review of the failure of American United Bank (AUB), Lawrenceville, Georgia. The Georgia Department of Banking and Finance (DBF) closed the institution on October 23, 2009, and named the FDIC as receiver. On November 6, 2009, the FDIC notified the OIG that AUB's total assets at closing were $113.9 million and the estimated material loss to the Deposit Insurance Fund (DIF) was $43.8 million. As of December 31, 2009, the loss had increased to $45.2 million.

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

The objectives were to (1) determine the causes of AUB's failure and the resulting material loss to the DIF and (2) evaluate the FDIC's supervision[2] of AUB, including the FDIC's implementation of the PCA provisions of section 38 of the FDI Act. This report presents our analysis of AUB's failure and the FDIC's efforts to ensure that AUB's Board of Directors (Board) and management operated the institution in a safe and sound

[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.

manner. The report does not contain formal recommendations. Instead, as major causes, trends, and common characteristics of financial institution failures are identified in our material loss 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. Appendix 1 contains details on our objectives, scope, and methodology. Appendix 2 contains a glossary of key terms and Appendix 3 contains a list of acronyms. Appendix 4 contains the Corporation's comments on this report.

Background

AUB opened for business on December 20, 2004 as a state nonmember bank regulated by the FDIC and the DBF. AUB operated a single office in Lawrenceville, Georgia, located about 25 miles north of Atlanta, Georgia. AUB pursued a traditional business plan and engaged principally in commercial real estate (CRE) and acquisition, development, and construction (ADC) lending that consisted of residential and commercial ADC and hotel/motel lending. In addition, AUB purchased and sold CRE and ADC participation loans.[3] The bank's lending programs also included loans originated under the U.S. Small Business Administration guarantee programs.

Although AUB did not have any brokered deposits, the bank used high-priced time deposits and Federal Home Loan Bank borrowings as non-core funding sources. AUB was wholly-owned by American United Bancorp, Inc., a non-complex one-bank holding company. The bank's Board controlled 22 percent of holding company shares.

Table 1 summarizes selected elements of AUB's financial condition for the quarter ending September 2009, and for the 5 preceding calendar years.

Table 1: Selected Financial Information for AUB

Financial Measure	Sept-09	Dec-08	Dec-07	Dec-06	Dec-05	Dec-04
	(Dollars in Thousands)					
Total Assets	110,094	118,737	104,739	65,958	27,124	10,727
Total Loans	82,734	90,374	73,910	41,501	20,549	0
Total Deposits	102,386	103,710	87,571	56,615	18,163	1,089
Net Income (Loss)	(6,908)	(2,183)	239	230	(636)	(84)

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

Causes of Failure and Material Loss

AUB failed primarily because the Board and bank management did not effectively oversee the bank's operations, particularly, by failing to ensure there were adequate risk

[3] Some of AUB's participation loans were purchased from and sold to other failed financial institutions, including Haven Trust Bank, Alpha Bank & Trust, and Security Bank, all of which were located in the Atlanta, Georgia area.

management controls over CRE and ADC lending activities. The institution grew rapidly after opening and quickly developed CRE and ADC concentrations. As a result of inadequate controls and declining economic and real estate market conditions, the quality of AUB's loan portfolio and the bank's financial condition began to deteriorate in 2007. The bank's condition steadily declined until June 2009, when examiners determined it to be critically deficient. The associated losses and provisions depleted AUB's earnings and capital. Ultimately, AUB's capital position became *Critically Undercapitalized*, resulting in an insolvent institution. AUB was closed due to the overall deterioration in the bank's financial condition, including its loan portfolio, earnings, and capital.

Board and Management Oversight

During its short existence, AUB's Board and management failed to effectively supervise bank operations and promote the overall welfare of the institution. According to DSC's *Risk Management Manual of Examination Policies* (Examination Manual), the quality of bank management, including its Board and executive officers, is probably the single most important element in the successful operation of a bank. The Board has the overall responsibility and authority for formulating sound policies and objectives for the institution and for effectively supervising the institution's affairs. Executive management has the primary responsibility of implementing the Board's policies and objectives into the bank's day-to-day operations and affairs. Therefore, an interested, informed, and vigilant Board and the selection of a competent executive management team are both critical to the successful operation of any bank.

Given AUB's de novo status,[4] the knowledge, experience, and involvement of the bank's Board and executive officers were especially critical to ensure the success of AUB's operations. Previously, the FDIC had determined that certain problems at newly-chartered banks during their first 6 years were attributable to various risk factors, including weak oversight by management, inexperience and turnover in key positions, rapid asset growth, and concentrations in CRE and ADC loans. As described below and in other sections of this report, AUB's management was deficient in critical duties and responsibilities and experienced many of these previously identified risk factors.

Inexperience of AUB's Board and Senior Management

Examiners first noted concerns regarding AUB's proposed management during the FDIC's pre-opening investigation. Examiners particularly noted that none of the Board members, with the exception of the Chief Executive Officer (CEO), had any banking

[4] De novo institutions are subject to additional supervisory oversight and regulatory controls, including the development and maintenance of a current business plan and increased examination frequency. When AUB received its deposit insurance in 2004, the de novo period for institutions was 3 years. However, in August 2009, the FDIC issued Financial Institution Letter (FIL) 50-2009, entitled *Enhanced Supervisory Procedures for Newly Insured FDIC-Supervised Depository Institutions*, that extended the de novo period for newly-chartered institutions to 7 years for supervision, examinations, capital, and other requirements and supplemented existing guidance for processing deposit insurance applications for de novo institutions for which the FDIC is the primary federal regulator.

experience. Therefore, the FDIC's *Final Order for Deposit Insurance*[5] required AUB to appoint at least two additional directors that had previous banking and/or bank director experience to the Board. During the November 2005 examination,[6] examiners determined that AUB had complied with this provision of the Final Order.

Examiner concern regarding management's lack of experience was also noted at the bank's first examination conducted in June 2005. Those concerns related to (1) management's inattention to primary responsibilities, (2) the Chief Lending Officer's (CLO) lack of experience in ADC lending, (3) the CEO/President's lack of lending experience, and (4) management's inability to originate loans during the bank's first 6 months of operations.

Inattention to Primary Responsibilities

At the DBF June 2005 examination and concurrent FDIC visitation, examiners noted that executive officers, such as the President and CLO, appeared to be more involved with the day-to-day operations of the bank than their primary areas of responsibility of making loans and other duties. Further, during the DBF's June 2005 examination, examiners observed that four directors had had less than satisfactory attendance at Board meetings. Concerns regarding poor attendance at Board meetings and other committee meetings, such as the Asset/Liability Committee and Audit Committee, were reported at the subsequent November 2005 and October 2006 examinations.

Key Management Turnover

The continuity of individuals hired for critical management positions became a problem early in AUB's existence due to significant turnover in senior level positions. Examiners noted that finding and retaining qualified individuals had been challenging for the institution and by 2007 AUB had employed three CLOs and two Chief Financial Officers (CFO). Adding to the lack of continuity of AUB's management was the removal of four directors from the Board, termination of five senior management members during 2008, and the retirement and resignation of two senior bank officials during 2009.

Failure to Ensure Compliance with Laws, Rules, and Regulations

AUB was cited for apparent violations of state and/or federal laws, rules, and regulations or contraventions to interagency policy in each of the bank's five examinations. Those apparent violations and contraventions related, but were not limited to, inadequate

[5] The *Final Order for Deposit Insurance* imposed 15 conditions on AUB to comply with during its first 3 years of operation. The conditions were related, but not limited to: (1) operating within the parameters of the bank's business plan with notification to the FDIC of major deviations from the plan within 60 days; (2) maintaining Tier 1 Capital at not less than 8 percent and an adequate Allowance for Loan and Lease Losses (ALLL); and (3) obtaining annual audits of the bank's financial statements by an independent auditor for at least the first 3 years of operation.

[6] Unless otherwise noted in this report, references to examination and visitation dates will refer to the month and year of the examination or visitation start dates.

risk management practices for purchased participation loans,[7] inadequate real estate lending standards, the lack of an election for an internal auditor, and an inadequate methodology for the ALLL. In addition, AUB management failed to ensure that the bank complied with Regulation O of the Federal Reserve Act, with apparent violations of Regulation O cited at two of the bank's five examinations.

Deviation from Its Business Plan[8]

Soon after AUB opened, the bank rapidly grew, with annual loan growth rates of 153 percent in 2005 and 143 percent in 2006. Although AUB's business plan included CRE lending, AUB quickly and substantially exceeded financial projections related to its real estate lending activities based on actual year-end financial data, as indicated in Table 2, and significantly increased the risk to the bank.

Table 2: AUB's Projected and Actual Levels for Real Estate-Related Loans

Period Ended	Real Estate Loans		Percentage of Total Loans	
	Projected	Actual	Projected	Actual
	(Dollars in Thousands)		(Percentages)	
December 2005	$7,800	$19,663	51.32	95.69
December 2006	$21,000	$38,066	50.60	91.72
December 2007	$34,650	$71,324	51.22	96.50

Source: OIG analysis of AUB's business plan, examination reports, and UBPRs.

AUB's business plan did not specifically indicate that the bank's lending strategy would result in concentrations in higher-risk CRE and ADC loans. On the contrary, the business plan stated that AUB would (1) not engage in speculative lending and (2) diversify the bank's loan portfolio by including commercial and industrial and other consumer loans in its portfolio. By the October 2007 examination, which was based on financial data as of June 30, 2007, the level of CRE and speculative residential construction loans totaled $62.1 million and represented 642 percent of the bank's Tier 1 Capital. As indicated by Table 2 above, the level of CRE loans as of June 30, 2007 was almost twice the level AUB had projected for December 2007.

AUB's noncompliance with its business plan also involved the failure to adhere to other controls that, in part, were the basis for the FDIC's decision to approve the bank's

[7] Rule 80-1-5.04(1) of the Georgia DBF states that the portion of a loan which is sold by the originating bank to another bank must conform to all laws and regulations applicable to that category of loan to the same extent as if the purchasing bank had originated the loan itself (i.e., collateral documentation, maturity, loan-to-value, maximum loan limits, etc.). During the June 2005 examination, examiners noted that files for some of AUB's purchased participations did not contain adequate loan documentation.
[8] The FDIC's *Final Order for Deposit Insurance* contained a provision that required the bank to operate within the parameters of the business plan and to notify the FDIC 60 days prior to any major deviation or material change.

application for deposit insurance. For example, the business plan stated that AUB would:

- carefully manage its commercial loans in order to limit the risk associated with this type of lending. Instead, AUB concentrated its loan portfolio in high-risk CRE loans, which significantly increased the risk to the bank, and failed to follow adequate risk management controls to mitigate such risk.

- review the bank's business plan on an annual basis and revise it as appropriate. However, AUB's Board did not review or revise the bank's business plan during the de novo period to address changing economic conditions and mitigate the risk to the bank.

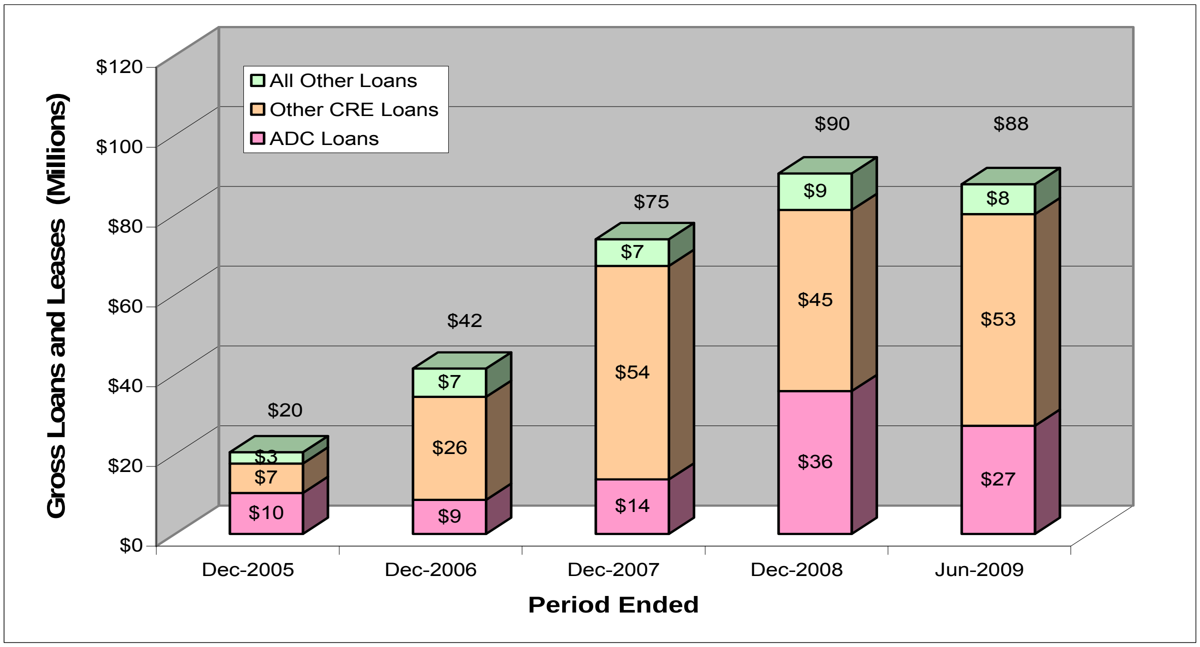
CRE and ADC Lending Strategy, Including Participation Loans

From its inception, AUB pursued a business strategy to concentrate its loan portfolio in CRE and ADC and to include an extensive amount of purchased participations in the portfolio.

CRE and ADC Loan Concentrations

As shown in Figure 3, CRE and ADC accounted for $17 million, or 85 percent of the bank's loan portfolio as of December 31, 2005, and continued to be the focus of AUB's lending strategy in the ensuing years.

Composition and Growth of AUB's Loan Portfolio



Source: UBPRs and *Consolidated Reports of Condition and Income* (Call Report) data for AUB.

Extensive growth in AUB's assets occurred between 2005 and 2008. During that period, other CRE lending increased from $7 million to $45 million (peaking at $54 million during 2007) and ADC lending increased from $10 million to $36 million. In addition, AUB's annual loan growth exceeded the bank's peer group[9] in 2006 and 2007. Although growth in a bank's loan portfolio is expected during the de novo phase, such growth should be accomplished in a prudent manner and accompanied by adequate risk management controls to mitigate the risk.

As AUB's loan portfolio grew, the concentration of CRE and ADC loans to Total Capital increased the risk to the bank and, as the quality of those loans deteriorated, AUB's capital levels and earnings eroded. While AUB's Total Risk-Based Capital ratio was slightly above its peer group in December 2006, this capital ratio progressively fell below the bank's peer group during 2007 and continued to decline until the bank failed. In addition, the bank's earnings significantly declined between December 2007 and December 2008 with deterioration continuing throughout 2009.

The FDIC, the Office of the Comptroller of the Currency, and the Board of Governors of the Federal Reserve System issued joint guidance in December 2006, entitled, *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* (Joint Guidance).[10] Although the Joint Guidance does not establish specific CRE lending limits, it defines criteria to identify institutions potentially exposed to significant CRE concentration risk. According to the 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 criteria may be identified for further supervisory analysis of the level and nature of its CRE concentration risk:

- Total reported loans for construction, land development, and other land (referred to in this report as ADC) representing 100 percent or more of Total Capital; or

- Total CRE loans representing 300 percent or more of 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.

As indicated in Table 3, AUB's CRE and ADC concentrations exceeded the levels outlined in the 2006 Joint Guidance that may be identified for further supervisory analysis from 2007 through June 2009.

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[9] 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. Through 2008, AUB's peer group included institutions established in 2004 with assets less than $750 million. In 2009, AUB's peer group included all commercial banks with assets between $100 million and $300 million in a metropolitan area with two or fewer full-service offices.

[10] On April 1, 2010, DSC issued guidance, entitled, *Clarification of Calculation in Guidance on Commercial Real Estate*, to provide procedures for calculating the total CRE loan ratio specified in the 2006 Joint Guidance and referenced in the March 17, 2008 FIL entitled, *Managing Commercial Real Estate Concentrations in a Challenging Environment* (FIL-22-2008).

In addition, AUB's Loan Policy recognized the need to closely monitor concentrations for adverse financial or economic conditions, stated that concentrations would be limited, and established guidelines for concentrations based on the perceived risk. However, in 2007, AUB's CRE level significantly increased from 359 percent of 557 percent; and in 2008, AUB began to exceed the risk limits of 600 percent and 300 percent of Total Capital established in the bank's Loan Policy for CRE and ADC concentrations, respectively, and continued to exceed those limits in 2009.

Table 3: AUB's CRE and ADC Concentrations as a Percentage of Total Capital

	Dec-05	Dec-06	Dec-07	Dec-08	June-09[b]
CRE[a]	195%	359%	557%	601%	885%
ADC	114%	90%	128%	414%	569%

Source: UBPRs for AUB.
[a] Percentages for 2007 through June 2009 exclude owner-occupied CRE loans.
[b] The increase in risk exposure in June 2009 was due primarily to the decline in AUB's capital level.

The Joint Guidance states that the agencies had observed an increasing trend in the number of institutions with concentrations in CRE loans and noted that rising CRE concentrations could expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in the general CRE market. Indeed, AUB's earnings were significantly and negatively impacted as CRE and ADC risk increased amid the economic downturn. Between December 2006 and December 2008, AUB's net income decreased from $230,000 to negative $2.2 million. AUB's earnings continued to deteriorate through September 2009, decreasing to negative $6.9 million.

Participation Loans

Further increasing AUB's risk profile was the bank's difficulty in originating loans and decision to include a significant number of purchased participation loans in its loan portfolio. Examiners first expressed concern regarding the extent of those loans and the lack of adequate risk management controls at the June 2005 examination and noted that an alarming level of purchased participations represented 75 percent of the bank's loan portfolio. Examiners recommended that AUB increase the bank's originated loans to aid in the long-term profitability of the institution. By the November 2005 examination, purchased participations still represented the majority of the loan portfolio, at 51 percent.

Eventually, many of the participation loans were adversely classified. Adverse loan classifications totaled $4 million during the October 2007 examination. The six loans adversely classified in 2007 were primarily commercial and CRE-related loans and included two participation loans. Adverse loan classifications increased to $33 million during the June 2009 examination. In 2009, all but one of the classifications were CRE loans and $7 million, or about 21 percent, were participation loans. By July 2009, AUB's participation loans accounted for 19 percent of the bank's total gross loans and 19 percent of the bank's CRE loans.

Credit Risk Management Practices

AUB's Board did not ensure that management established effective risk management practices sufficient to limit the bank's exposure to CRE and ADC concentrations and purchased participations, allowing the bank to grow significantly without risk limits and monitoring practices commensurate with the increased risk associated with AUB's loan portfolio.

The FDIC has recognized the need for effective risk management controls for ADC concentrations, in particular, and CRE concentrations, in general, as indicated below.

- FIL-110-98, entitled, *Internal and Regulatory Guidelines for Managing Risks Associated with Acquisition, Development, and Construction Lending*, dated October 8, 1998, states that ADC lending is a highly specialized field with inherent risks that must be managed and controlled to ensure that the activity remains profitable.

- In addition, according to the Joint Guidance, strong risk management practices are important elements of a sound CRE lending program, particularly when an institution has a concentration in CRE loans.

Further, according to the Examination Manual, institutions that purchase loan participations must make a thorough, independent evaluation of the transactions and the risks involved before committing any funds. Institutions should also apply the same standards of prudence, credit assessment, approval criteria, and "in-house" limits that would be employed if the purchasing organization were originating the loan.

Nevertheless, examiners identified deficiencies in AUB's loan underwriting and administration at most of the bank's examinations. Such deficiencies included, but were not limited to:

- loan underwriting and credit administration weaknesses related to purchased participations, including inadequate documentation of appraisals and loans that exceeded the Supervisory Loan-to-Value (LTV);

- a lack of established limits for the bank's speculative construction loans, the need to implement more detailed monitoring procedures for the developing ADC concentration, and the lack of current borrower financial statements and tax returns; and

- an inadequate Loan Policy as it related to establishing appropriate maximum percentages to Total Capital for CRE and ADC lending and addressing other risk management controls outlined in the Joint Guidance.

In addition, at the June 2009 examination, examiners concluded that AUB's risk management controls were less than satisfactory and were responsible for the bank's high level of adversely classified assets. Control weaknesses related to AUB's failure to:

- comply with its internal Loan Policy, considering the concentration in CRE exceeded the bank's 600 percent policy limit;

- include global cash flow reviews, balance sheet analyses, comprehensive financial analyses, projected debt service coverage or debt-to-income ratios, where appropriate, in the bank's underwriting process;[11]

- identify adequate secondary sources of repayment and limit reliance on the use of interest reserves and interest-only loans, which represented $20.3 million of the total $33 million of adversely classified items; and

- adequately underwrite and administer loan participations, which represented $7 million, or 21 percent, of the adversely classified items.

Allowance for Loan and Lease Losses and Adversely Classified Items

The *Interagency Policy Statement on Allowance for Loan and Lease Losses Methodologies* requires an institution to maintain an appropriate ALLL level, discusses items that need to be addressed in written policies and procedures, and describes methodologies that institutions need to use to determine an appropriate level. In addition, the DBF's *Approval of Articles of Incorporation for American United Bank*, dated July 12, 2004, required AUB, during the de novo period, to maintain an ALLL that represented at least 1 percent of the bank's outstanding loans. Although AUB complied with this requirement, the substantial deterioration in the bank's loan portfolio eventually rendered the allowance inadequate.

Prior to 2007, examiners concluded that AUB did not have any adversely classified items and the bank's ALLL methodology and funding level were adequate. However, beginning with the October 2007 examination, examiners began to identify and express concerns regarding AUB's ALLL methodology and/or funding.

- The October 2007 examination noted that AUB needed to expand its ALLL methodology to include Financial Accounting Standards (FAS) 5 and FAS 114 considerations.[12]

- Subsequent examinations and visitations conducted in February 2009 and June 2009 determined that AUB's ALLL methodology still needed improvement. The June 2009 joint examination determined that management had failed to (1) correctly implement FAS 5 and FAS 114, resulting in a contravention to the

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[11] FIL-22-2008, entitled, *Managing Commercial Real Estate Concentrations in a Challenging Environment*, issued March 17, 2008, provides key risk management processes for institutions with CRE concentrations, one of which is to maintain updated financial and analytical information for borrowers, and states that global financial analyses of obligors should be emphasized.

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

Interagency Policy Statement on Allowance for Loan and Lease Losses Methodologies, and (2) adequately fund the ALLL.

Further, examiners reported that significant deterioration in AUB's asset quality, initially noted at the October 2007 examination, had become substantial, as indicated in Table 4.

Table 4: AUB's Adversely Classified Items and ALLL by Examination and Visitation Dates

Category	Jun-05	Nov-05	Oct-06	Oct-07	Feb-09	Jun-09
	(Dollars in Thousands)					
Adversely Classified Items	0	0	0	3,991	11,574	33,209
Adversely Classified Coverage Ratio	0	0	0	39%	117%	339%
ALLL Funding	40	96	328	593	2,453	2,453

Source: Examination reports for AUB and the DBF February 2009 visitation of AUB.

As noted previously, of the loans that were adversely classified, all but one was CRE-related. As the bank's asset quality deteriorated and the level of adversely classified items increased, AUB's earnings and capital were negatively impacted. Specifically, earnings decreased from $230,000 at December 31, 2006, to negative $6.9 million as of September 30, 2009. The decrease in AUB's capital is discussed later in the *Implementation of PCA* section of this report.

The FDIC's Supervision of AUB

From February 2005 until the bank failed in October 2009, the FDIC, in conjunction with the DBF, provided ongoing supervision of AUB through five onsite risk management examinations and four visitations. During the de novo period, examiners generally concluded that AUB's overall financial condition was sound and management's performance and oversight was satisfactory. However, the DBF's February 2009 visitation identified significant deterioration in AUB's financial condition, which examiners determined had become more pronounced at the time of the joint June 2009 examination. Through their supervisory efforts, the FDIC and the DBF identified and brought key risks to the attention of the bank's Board and management, including the concerns regarding AUB's Board and management oversight, high levels of CRE and ADC concentrations, and associated weak risk management practices.

The FDIC and the DBF initiated enforcement actions in 2009 to address risk management deficiencies and AUB's deteriorating financial condition. Although the FDIC and the DBF closely monitored AUB, and the FDIC downgraded certain component ratings at the October 2007 examination, an additional rating downgrade and supervisory actions may have been warranted. Specifically, given the deficiencies and risks identified at the 2007 examination, it may have been prudent for the FDIC to downgrade AUB's management rating and/or include provisions to address management and asset quality in the supervisory action taken at that time, in light of the bank's level of asset concentrations. In addition, supervisory action may have been prudent when offsite monitoring indicated increasing risk at AUB after the October 2007 examination and before the DBF's February 2009 visitation.

With respect to issues discussed in this report, the FDIC has issued guidance that reemphasizes managing risks associated with CRE and ADC concentrations and de novo institutions, as well as addresses communicating and following up on identified risks and deficiencies. The FDIC also implemented an examiner training initiative that emphasizes the need to assess a bank's risk profile using forward-looking supervision. The training, among other things, addressed the need for examiners to consider management practices as well as the bank's financial performance or trends in assigning ratings as allowable under existing examination guidance.

Supervisory History

The FDIC and the DBF provided ongoing supervision of AUB through risk management examinations, onsite visitations, offsite monitoring, and supervisory actions. Table 5 summarizes key information related to AUB's onsite examinations and visitations, including the bank's supervisory ratings.[13]

Table 5: AUB's Supervisory History from 2005 to 2009

Examination or Visitation Start Date	Agency	Supervisory Ratings (UFIRS)	Supervisory or Enforcement Actions
02/18/2005*	DBF	Not applicable	None
06/13/2005	DBF	222312/2	None
06/20/2005*	FDIC	Not applicable	None
11/07/2005	FDIC	112312/2	None
10/09/2006	DBF	112312/2	None
10/29/2007	FDIC	222222/2	Bank Board Resolution (BBR)–Effective 02/26/2008.
07/16/2008*	DBF	Not applicable	None
02/17/2009*	DBF	433422/4 (interim downgrade)	Memorandum of Understanding (MOU)–Effective 05/14/2009.
06/29/2009	Joint	555544/5	PCA Directive–Effective 8/18/2009. Problem Bank Memorandum–8/28/2009. Cease and Desist Order (C&D)–Effective 10/9/2009.

Source: Examination reports and DSC Supervisory History for AUB.
* Denotes visitations.

AUB consistently received composite "2" CAMELS ratings during its de novo period from December 2004 through December 2007. AUB's examination cycle changed to an

[13] Financial institution regulators and examiners use the Uniform Financial Institutions Rating System (UFIRS) to evaluate a bank's financial condition and operations 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. A 1 indicates the highest rating, strongest performance and risk management practices, and least degree of supervisory concern, while a 5 indicates the lowest rating, weakest performance, inadequate risk management practices, and, therefore, the highest degree of supervisory concern.

18-month period once its de novo period ended because the bank met the applicable conditions. Accordingly, AUB's next examination was not performed until June 2009.

The October 2007 examination concluded that the overall condition of AUB was satisfactory and the level of classified assets was moderate. Although examiners noted that AUB needed to improve the monitoring of the bank's significant CRE portfolio and the management of its information systems, they concluded that bank management was working to address the noted deficiencies. Examiner concerns with the bank's management information system resulted in AUB adopting a BBR to address those deficiencies. The BBR did not, however, address risk management deficiencies related to (1) significant growth during the de novo period and a lack of compliance with the business plan, (2) substantial CRE and ADC concentrations, (3) the level of adversely classified assets, or (4) the high risk limits for CRE-related lending established in AUB's Loan Policy.

By February 2009, the risk management deficiencies, in conjunction with the economic downturn, resulted in significant deterioration in the bank's CRE and ADC concentrations that the Board and management would not be able to rectify. The DBF's February 2009 visitation found substantial deterioration in AUB's financial condition and, based on that deterioration, downgraded all of the bank's CAMELS ratings, except liquidity and sensitivity to market risk. Examiners also downgraded the bank's composite rating to a "4", indicating, in part:

- serious financial or managerial deficiencies that resulted in unsatisfactory performance;
- weaknesses and problems that were not being satisfactorily addressed or resolved by the Board and management;
- unacceptable risk management practices relative to the institution's size, complexity, and risk profile; and
- generally unsafe and unsound practices or conditions.

As a result, the DBF and the FDIC issued an MOU, effective May 2009, which required AUB to:

- improve management, including submitting a management plan;
- increase the bank's capital and improve and sustain earnings;
- perform a risk segmentation analysis of the credit concentrations and establish and maintain an appropriate ALLL; and
- review the bank's liquidity position and develop or revise, adopt, and implement a written contingency liquidity plan (CLP).

As AUB's financial condition continued to deteriorate, the FDIC and the DBF took additional supervisory actions during 2009 to address AUB's condition as indicated below.

- Because of the continued deterioration in AUB's financial condition identified during the June 2009 examination, the DBF, in consultation with the FDIC, issued a C&D to AUB in October 2009 that included provisions related to (1) capital, adversely classified items, credit concentrations, and restrictions of credit; (2) management, strategic planning, violations of laws and regulations and the ALLL; and (3) funds management, brokered deposits, and a written CLP.

- The FDIC also issued a PCA Directive in August 2009 that established an immediate and enforceable timeline for the bank's recapitalization, sale, or merger.

- Additionally, the FDIC drafted a Problem Bank Memorandum in August 2009 identifying the significant deterioration in the bank's financial condition and recommended interim rating changes.

Unfortunately, the supervisory actions in 2009 and AUB's efforts to address them were too late to reverse the deterioration in the bank's financial condition.

Supervisory Response to Board and Management Oversight

Examiner concern regarding AUB's Board and management was first expressed in the FDIC's *Report of Investigation,*[14] dated May 7, 2004. Such concern resulted in the FDIC requiring AUB to (1) include at least one outside director with prior banking experience, (2) appoint experienced outside director(s) to the bank's Loan Committee, and (3) employ an acceptable Senior Lending Officer and CFO. Similarly, the FDIC's *Final Order for Deposit Insurance*, dated June 7, 2004, also included conditions related to the need for experienced directors and management and the FDIC's approval.

Prior to the DBF's February 2009 visitation, AUB's management had consistently been rated a "2". Each of the visitations and examinations conducted from June 2005 through June 2009, however, raised a number of concerns and made recommendations related to the inexperience of Board members and senior management, turnover in key management positions, and poor risk practices, and made recommendations to improve those deficiencies. However, examiners did not:

- note specific deficiencies or concerns regarding the bank's noncompliance with the financial projections included in the business plan,

[14] The *Report of Investigation* contains conclusions and recommendations that present an overview of the application, analyzes and summarizes findings, and concludes with the investigating examiner's recommendation of whether the FDIC should grant federal deposit insurance to proposed financial institutions.

- request that AUB update its business plan, or

- take action to ensure the bank's loan portfolio was diversified commensurate with the loan mix included in the bank's business plan.

Supervisory actions to address examiner concerns regarding AUB's Board and management began in 2009 after the bank's financial condition worsened. Specifically, during the DBF's February 2009 visitation, examiners identified concerns regarding AUB's financial deterioration and asset concentration and downgraded AUB's management rating to a "3". A "3" rating indicated that management and Board performance needed improvement and that risk management practices were less than satisfactory given the nature of the bank's activities. In addition, examiners took informal action in the form of an MOU that required AUB to take specific actions in regard to the bank's management and submit a management plan commensurate with the need for increased oversight of the bank's affairs, especially with regard to its lending activities.

During the June 2009 joint examination, examiners further downgraded AUB's management rating to a "5", indicating that AUB's management was critically deficient, and issued a C&D that included provisions to address management deficiencies. Examiners also reminded the Board that the overall condition of the bank was a direct reflection of the Board's management oversight.

In retrospect, earlier and stronger supervisory attention may have been warranted to address the bank's longstanding management weaknesses. Specifically, the FDIC's October 2007 examination noted that although AUB's Board and management performance were acceptable, immediate attention was needed to address the bank's problems in obtaining and retaining qualified management and support staff. However, the BBR agreed to by AUB in 2007 did not address these issues.

Further, it may have been prudent for the FDIC to downgrade the management component rating and/or require the bank to develop a management plan in 2007 considering that AUB's management exhibited many of the known risk factors for de novo banks. Even though AUB's overall financial condition was considered satisfactory at the October 2007 examination, a stronger supervisory response in 2007 may have resulted in more formal Board and management commitment to implement controls to effectively manage the bank's operations before the supervisory actions that were taken in 2009.

Supervisory Response to CRE and ADC Concentrations, Including Participation Loans

Examiners consistently identified AUB's CRE and ADC concentrations and made recommendations related to the associated risk and risk management practices. Risks associated with de novo and young banks were apparent and AUB's risk profile was increasing based on offsite monitoring activities. Nevertheless, a supervisory action was not taken to address those risks, including the rapid growth in CRE and ADC concentrations, until February 2009. That action, an MOU, was effective in May 2009.

November 2005 Examination

Examiners concluded that AUB's asset quality was strong. To review the bank's compliance with its business plan, examiners compared the bank's actual level of real estate-related loans, as of September 2005, to AUB's first-year projection for such loans. The examiners determined that AUB had exceeded the first year projections by more than $4.9 million, a variance of 53 percent. Despite this variance, examiners concluded that AUB was operating within the bank's original business plan.[15]

The examiners recommended that AUB implement additional management and policy controls because the bank was substantially exceeding its projected loan growth, and ADC loans were 80 percent of Tier 1 Capital—approaching the level designated as a concentration. These controls included:

- monitoring procedures for the bank's increasing volume of ADC loans; establishing limits on speculative construction loans; and implementing more detailed procedures to monitor speculative construction loans, including, but not limited to, monitoring (1) total debt obligations, (2) borrowers' liquidity positions, (3) economic conditions, and (4) construction reports; and

- ensuring that real estate loans that exceeded LTV limits were adequately documented and reported to the Board.

October 2007 Examination

AUB's CRE concentration began to exceed the levels described in the December 2006 Joint Guidance and the bank had adversely classified assets for the first time. AUB's CRE concentration continued to increase, representing over 90 percent of the bank's total loans and 642 percent of Tier 1 Capital. Examiners also identified $4 million of adversely classified assets, or 39 percent, of the bank's Tier 1 Capital and ALLL but considered the level to be moderate.

Although the examination report concluded that concentrations were not inherently bad, examiners noted that concentrations add a dimension of risk that management should consider. Examiners further stressed various risk management practices to AUB that are included in the Joint Guidance and noted that the ability to adapt to rapid fluctuations in

[15] At the time these events occurred, the FDIC had not issued guidance to examiners that defined what would constitute a major change or deviation in a business plan. However, in August 2009, the FDIC issued guidance to its examiners, which noted that examiner judgment is critical in determining a major change or material deviation in the business plan. The guidance also specified selected circumstances that would be considered a major change or deviation in a business plan. FIL-50-2009, also issued during August 2009, advised financial institutions of the requirement for prior FDIC approval of any proposed material changes or deviations in business plans.

CRE markets depends heavily on the bank's risk management practices and capital levels.

February 2009 Visitation

In February 2009, the DBF performed a visitation at which examiners identified substantial deterioration in AUB's financial condition, including a significant increase in adversely classified assets—from 39 percent in 2007 to 117 percent of Tier 1 Capital and ALLL. ADC loans represented 414 percent and non-owner occupied CRE loans represented 601 percent of Total Capital, respectively, as of December 31, 2008. Based on the results of the visitation, the DBF downgraded AUB's CAMELS ratings and issued an MOU, effective in May 2009, which contained various provisions, including one that required AUB to perform a risk segmentation analysis of its credit concentrations.[16]

June 2009 Examination

A joint June 2009 examination determined that AUB's loan portfolio had continued to deteriorate, the bank's overall financial condition had become critically deficient, and asset quality represented a serious threat to the institution's viability. Adversely classified assets had risen to $33 million and all but $1.2 million of those impaired assets were CRE loans. Consequently, examiners downgraded the bank's capital, asset quality, management, and earnings each to "5" and liquidity and sensitivity to market risk to a "4".

Further, AUB's risk profile had significantly increased. Specifically, AUB's total CRE concentration, as of June 30, 2009, totaled approximately 1,200 percent of Tier 1 Leverage Capital and significantly exceeded the bank's Loan Policy limit of 600 percent. In addition, the bank's level of non-owner occupied CRE, which represented more than 800 percent of Total Capital, significantly exceeded the level—300 percent—that the Joint Guidance concluded may be identified for further supervisory analysis.

Examiners made several recommendations addressing the bank's CRE and ADC concentrations, including that AUB revise its Loan Policy to comply with the December 2006 Joint Guidance and implement procedures to manage CRE and ADC loans and loan workouts. Examiners also issued a C&D, effective October 2009, which imposed strict deadlines for the bank to review and revise its concentration strategies and policies and to perform a risk segmentation analysis.

Participation Loans

Examiner concern regarding AUB's purchased participation loans was noted at the June 2005 examination when the loans comprised 75 percent of the bank's loan portfolio. At that examination, examiners advised AUB that the majority of loans on the bank's balance sheet should not be participations that had been purchased from other

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[16] AUB performed this analysis according to the June 2009 examination.

institutions. Although AUB's total loan growth had exceeded projections by almost $4 million at the November 2005 examination, and the bank had decreased participation loans to 51 percent of the bank's loan portfolio, a significant portion of the portfolio still consisted of participation loans. As such, examiners encouraged AUB to continue developing local loan relationships. The October 2006 and October 2007 examinations did not specifically discuss AUB's participation loans. During the June 2009 examination, examiners adversely classified a significant number of CRE-related participation loans. Of the loans reviewed at that examination, $16.3 million were participation loans, of which about $7 million were adversely classified, representing 21 percent of the $33 million in total adverse classifications.

Supervisory Response to Offsite Monitoring Findings

Throughout AUB's existence, examiners identified significant risks at AUB through offsite monitoring, including the bank's rapid growth and concentrated loan portfolio. Examiners flagged AUB for offsite review beginning in December 2005 based on the $17 million in asset growth that occurred at the bank between December 2004 and December 2005 and again based on $23 million in asset growth between March 2005 and March 2006. By September 2007 and continuing through the June 2009 Call Report period, AUB was flagged for offsite reviews based on multiple risk indicators. While the FDIC completed the required assessments and continued close monitoring of AUB, offsite review results did not substantially alter the supervisory strategy for AUB prior to January 2009.

Although AUB reported no past due loans as of the second quarter of 2007, by the third quarter of 2007, the FDIC's offsite review noted an increased volume of nonperforming and nonaccrual loans and provision expenses, reflecting increasing risk. By December 2007, offsite monitoring noted some deterioration in asset quality with adversely classified assets increasing and representing 39 percent of Tier 1 Capital and the ALLL. As indicated in Table 6, offsite monitoring conducted for the first through third quarters of 2008 identified increased exposure in the total CRE concentration, and increasing deterioration in the loan portfolio manifested in higher percentages for non-performing and past due loans.

Table 6: AUB's Offsite Monitoring Results for Select 2008 Call Report Periods

Call Report Date	Offsite Review Completion Date	CRE	ADC	Non Performing Loans	Past Due Loans
		Percent of Total Capital		Percent of Tier 1 Capital Plus ALLL	Percent of Total Loans
03/31/2008	06/30/2008	501%	143%	26%	3.72%
06/30/2008	10/08/2008	690%	140%	34%	6.93%
09/30/2008	01/06/2009	737%	136%	55%	7.00%

Source: Offsite monitoring for AUB.

AUB continued to be flagged for offsite monitoring through June 2009 with an increasing level of risk noted at each review.

The FDIC's offsite reviews identified various risks for AUB that included:

- rapid growth in ADC loans,
- high concentrations in CRE loans,
- increases in past due loans,
- increases in adversely classified loans, and
- the need for an increased ALLL.

The FDIC's offsite review program is designed to identify emerging supervisory concerns and potential problems so that supervisory strategies can be adjusted appropriately. However, despite the continuing deterioration in AUB's financial condition identified during offsite monitoring, the findings did not result in a substantial change in AUB's supervisory activities. Rather, as discussed previously, specific action to address the bank's CRE and ADC concentrations was not taken until:

- the February 2009 visitation when the DBF downgraded the bank's CAMELS ratings and issued an MOU, in conjunction with the FDIC, about 3 months later to address the deficiencies and develop a plan to reduce undue concentrations, and

- October 2009, when the C&D issued by the FDIC and the DBF required AUB to review and, if necessary, revise its written plan detailing appropriate strategies for managing ADC and CRE concentration levels, including a contingency plan to reduce or mitigate concentrations given current adverse market conditions.

Supervisory Response to Credit Risk Management Practices

Examiners expressed concern regarding AUB's credit risk management practices during each of the bank's examinations except the October 2006 examination. During the June and November 2005 examinations, examiners noted problems primarily related to loan documentation, loan underwriting, credit administration, loans in excess of LTV limits, and policies and procedures for managing CRE and ADC concentrations.

The October 2007 examination identified further concern regarding the bank's credit risk management policies and practices and noted that improvements were needed in AUB's:

- internal loan grading system,

- planning and monitoring practices for the CRE loan portfolio,

- Loan Policy for diversifying risk, and

- loan review criteria and the maximum percentages allowed for each loan category to Total Capital.

Examiner concerns regarding credit risk management were further heightened during the June 2009 examination when the deficiencies identified were considered to be significant causes for the bank's high level of adversely classified assets and losses. Deficiencies identified by examiners included AUB management's failure to implement sufficient credit risk management policies, procedures, practices, and controls to identify, limit, and manage the CRE loan portfolio concentration.

Despite the repeated concerns, a supervisory action did not occur until the May 2009 MOU, which required AUB to:

- perform a risk segmentation analysis with respect to the credit concentrations;
- identify concentrations by product type, geographic distribution, underlying collateral or other asset groups which are considered economically related and in the aggregate represent a large portion of AUB's capital;
- refer to the interagency guidance on *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices*; and
- develop a plan to reduce any segment of the portfolio which the supervisory authorities deemed to be an undue credit concentration in relation to AUB's capital.

As with other deficiencies identified at AUB, earlier supervisory action may have been warranted to better mitigate risk.

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. Part 325, *Capital Maintenance*, of the FDIC's Rules and Regulations implements PCA requirements by establishing a framework for taking PCA against insured state-charted nonmember banks that are not *Adequately Capitalized*. Based on the supervisory actions taken with respect to AUB, we concluded that the FDIC properly implemented applicable PCA provisions of section 38.

Although AUB's capital ratios substantially exceeded PCA thresholds for *Well Capitalized* banks during its de novo period, each subsequent year resulted in a significant decline in the bank's capital levels. As indicated in Table 7, AUB was still considered to be *Well Capitalized* as of December 2007 and December 2008. However, during this period, the bank's capital ratios were substantially reduced and that decline continued through 2009, resulting in changes in the bank's designated capital category.

Table 7: AUB's Capital Ratios Relative to PCA Thresholds for *Well Capitalized* Banks

		Dec-07	Dec-08	Mar-09	Jun-09	Sept-09[b]
	PCA	**AUB's Capital Ratios**				
Capital Category	**Thresholds**	**Percentages**				
Tier 1 Leverage Capital	5% or mo9.84	6.05	6.29	3.19	0.48	
Tier 1 Risk-Based Capital	6% or more	11.13	7.68	7.54	3.91	0.58
Total Risk-Based Capital	10% or more	12.39	8.93	8.68	5.08	1.16
PCA Category[a]	*W*	*W*	*W*	*A*	*SU*	*CU*[b]

Source: UBPRs for AUB.
[a] W–*Well Capitalized*, U–*Undercapitalized*, SU–*Significantly Undercapitalized*, CU–*Critically Undercapitalized*
[b] The FDIC notified AUB on September 14, 2009, that the bank was considered to be *Critically Undercapitalized* based on the Tangible Equity Capital ratio as of August 31, 2009, and informed AUB of the applicable restrictions based on section 38 of the FDI Act and Section 325 of the FDIC Rules and Regulations.

AUB submitted an application for the Troubled Asset Relief Program (TARP)[17] *Capital Purchase Program* for $2.9 million in capital on November 13, 2008. AUB subsequently withdrew the application on March 12, 2009.

Significant steps taken by the FDIC and the DBF to address the bank's capital during 2009 included the following:

- **May 26, 2009.** The FDIC notified AUB that the bank was *Adequately Capitalized* based on the March 31, 2009 Call Report capital ratios and, as such, access to brokered deposits became restricted based on section 29 of the FDI Act and Part 337.6 of the FDIC Rules and Regulations.

- **August 7, 2009.** The FDIC notified AUB that the bank was *Significantly Undercapitalized* based on the June 30, 2009 Call Report capital ratios.

- **August 18, 2009.** The FDIC issued a PCA Directive requiring AUB to, among other things, (1) submit an acceptable capital restoration plan that met the requirements of section 325 of the FDIC's Rules and Regulations within 14 days; (2) increase its Tier 1 Leverage and Total Risk-Based Capital ratios to 8 percent and 10 percent, respectively, within 30 days or sell or merge the bank with another depository institution; and (3) comply with other restrictions related, but not limited, to compensation, capital distributions, and asset growth.

- **September 14, 2009.** The FDIC notified the bank that AUB was *Critically Undercapitalized* as of August 31, 2009.

[17] TARP was established under the Emergency Economic Stabilization Act of 2008. The Act 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.

- **October 9, 2009.** The C&D issued to AUB by the DBF, in consultation with the FDIC, became effective requiring the bank to, among other things, submit a capital plan and substantially increase the bank's Tier 1 Capital incrementally, so that within 60 days the level would equal or exceed 8 percent of the bank's total assets, and maintain that level for the period during which the C&D was in effect.

Although the FDIC followed PCA guidance, by the time AUB's capital levels fell below the required thresholds necessary to implement PCA, the bank's condition had deteriorated to the point at which the institution could not raise additional capital. The bank was also unable to find a suitable acquirer and, therefore, was closed on October 23, 2009.

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 May 5, 2010, the Director, DSC, provided a written response to the draft report. That response is provided in its entirety as Appendix 4 of this report.

In its response, DSC reiterated the OIG's conclusions regarding the causes of AUB's failure. With respect to our assessment of supervision, DSC noted AUB's significant growth between 2006 and 2008 and stated that examiners identified key risks including inadequate Board and management oversight, the bank's high CRE and ADC concentrations, and associated weak risk management practices. In addition, DSC stated that the AUB Board entered into an MOU with the FDIC and the DBF to address weaknesses identified at the February 2009 visitation and that the FDIC and DBF took action through a formal C&D when AUB's management and Board were unable to sufficiently address the cited problems.

Regarding de novo institutions, DSC stated that the supervisory program for these banks has been extended so that these institutions receive a full-scope examination every year for 7 years, as opposed to 3 years. In addition, DSC stated that business plans are receiving careful analysis prior to an institution's opening and are being closely monitored against approved financial projections throughout the 7-year period. Further, DSC stated that a FIL issued in August 2009 describes the program changes for de novo institutions and warns that changes to business plans undertaken without required prior notice may subject institutions or their insiders to 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 November 2009 to April 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Scope and Methodology

The scope of this audit included an analysis of the application process for AUB and AUB's operations from December 2004 until its failure in October 2009. Our review also entailed an evaluation of the regulatory supervision of AUB over the same period.

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

- Analyzed examination and visitation reports and supporting workpapers prepared by FDIC and DBF examiners from February 2005 through June 2009.

- Reviewed the following:

    - Pertinent DSC policies and procedures and documentation for offsite monitoring activities performed by the FDIC.

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

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

    - Audit reports prepared by AUB's external auditors, Maulden & Jenkins, for the years ended 2004 through 2008.

Objectives, Scope, and Methodology

  - 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 AUB's use of brokered deposits; and (2) section 38 of the FDI Act, including, but not limited to, issuing PCA notification letters and a PCA Directive, and restricting AUB's growth and payment of dividends, when applicable, based on AUB's capital category.

- Interviewed (1) DSC management in Washington, D.C. and the Atlanta Regional Office; and examiners from the DSC Atlanta Field Office, who conducted examinations and visitations of AUB; and (2) officials from the DBF's Atlanta, Georgia office.

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

We obtained data from various FDIC systems but determined that information system controls were not significant to the audit objectives and, therefore, did not evaluate the effectiveness of information system controls. We relied on our analysis of information from various sources, including reports of examination, correspondence files, and 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. 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)	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 BBR 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	The report filed by a bank pursuant to 12 United States Code (U.S.C.) 1817(a)(1), which requires each insured State nonmember bank and each foreign bank having an insured branch which is not a Federal branch to make to the Corporation reports of condition in a form that shall contain such information as the Board of Directors may require. These reports are used to calculate deposit insurance assessments and monitor the condition, performance, and risk profile of individual banks and the banking industry.
Cease and Desist Order (C&D)	A C&D is a formal enforcement action issued by a financial institution regulator to a bank or affiliated party to stop an unsafe or unsound practice or a violation of laws and regulations. A C&D may be terminated when the bank's condition has significantly improved and the action is no longer needed or the bank has materially complied with its terms.
Concentration	A concentration is a significantly large volume of economically related assets that an institution has advanced or committed to a certain industry, person, entity, or affiliated group. These assets may, in the aggregate, present a substantial risk to the safety and soundness of the institution.
Problem Bank Memorandum	A problem bank memorandum documents the FDIC's concerns with an institution and the corrective action in place or to be implemented and is also used to effect interim rating changes on the FDIC's systems.

Glossary of Terms

Term	Definition
Prompt Corrective Action (PCA)	The purpose of PCA is to resolve the problems of insured depository institutions at the least possible long-term cost to the Deposit Insurance Fund. Part 325, subpart B, of the FDIC Rules and Regulations, 12 Code of Federal Regulations, section 325.101, et. seq., implements section 38, *Prompt Corrective Action*, of the FDI Act, 12 United States Code section 1831(o), by establishing a framework for determining capital adequacy and taking supervisory action against depository institutions that are in an unsafe or unsound condition. The following terms are used to describe capital adequacy: (1) *Well Capitalized*, (2) *Adequately Capitalized*, (3) *Undercapitalized*, (4) *Significantly Undercapitalized*, and (5) *Critically Undercapitalized*. A PCA Directive is a formal enforcement action seeking corrective action or compliance with the PCA statute with respect to an institution that falls within any of the three undercapitalized categories.
Troubled Asset Relief Program (TARP)	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.
Uniform Bank Performance Report (UBPR)	The UBPR is an individual analysis of financial institution financial data and ratios that includes extensive comparisons to peer group performance. The report is produced by the Federal Financial Institutions Examination Council for the use of banking supervisors, bankers, and the general public and is produced quarterly from Call Report data submitted by banks.

Acronyms

ADC	Acquisition, Development, and Construction Loans
ALLL	Allowance for Loan and Lease Losses
BBR	Bank Board Resolution
C&D	Cease and Desist Order
CAMELS	**C**apital, **A**sset Quality, **M**anagement, **E**arnings, **L**iquidity and **S**ensitivity to Market Risk
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CLO	Chief Lending Officer
CLP	Contingency Liquidity Plan
CRE	Commercial Real Estate
DBF	Department of Banking and Finance
DIF	Deposit Insurance Fund
DSC	Division of Supervision and Consumer Protection
FAS	Financial Accounting Standard
FDI	Federal Deposit Insurance
FIL	Financial Institution Letter
LTV	Loan-to-Value
MOU	Memorandum of Understanding
OIG	Office of Inspector General
PCA	Prompt Corrective Action
TARP	Troubled Asset Relief Program
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System

Corporation Comments

FDIC

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

May 5, 2010

TO: Stephen Beard
Assistant Inspector General for Material Loss Reviews

/Signed/
FROM: Sandra L. Thompson
Director

SUBJECT: Draft Audit Report Entitled, Material Loss Review of American United Bank, Lawrenceville, Georgia (Assignment No. 2010-011)

Pursuant to Section 38(k) of the Federal Deposit Insurance Act, the Federal Deposit Insurance Corporation's Office of Inspector General (OIG) conducted a material loss review of American United Bank (AUB), Lawrenceville, Georgia, which failed on October 23, 2009. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Report (Report) received on April 21, 2010.

The Report concludes AUB failed because its Board of Directors (Board) and management did not provide effective oversight and risk management practices for its strategy centered in commercial real estate (CRE) and acquisition, development, and construction (ADC) loans. The lack of a diversified loan portfolio, coupled with inadequate risk management controls, made AUB vulnerable to the downturn in the economy and real estate market in the Atlanta metropolitan area.

The FDIC and Georgia Department of Banking and Finance (DBF) jointly and separately conducted five examinations and four visitations from 2005 through 2009. Between 2006 and 2008, AUB experienced significant growth in CRE and ADC loan portfolios. Examiners identified key risks including inadequate Board and management oversight; the high CRE and ADC concentrations; and associated weak risk management practices. The AUB Board entered into a Memorandum of Understanding with the FDIC and the DBF to address weaknesses identified at the February 2009 visitation. FDIC and DBF took action through a formal Order to Cease and Desist when AUB's management and Board were unable to sufficiently address the cited problems.

In recognition that stringent supervisory attention is necessary for de novo institutions, DSC has extended its supervisory program so that these institutions receive a full scope examination every year for seven years, as opposed to three years. De novo business plans are receiving careful analysis prior to an institution's opening and being closely monitored against approved financial projections throughout the seven year period. A Financial Institution Letter issued in August 2009 describes the program changes for de novo institutions and warns that changes in business plans 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.