Office of Inspector General

Office of Material Loss Reviews
Report No. MLR-10-039

Material Loss Review of The Buckhead Community Bank, Atlanta, Georgia

June 2010

Office of Inspector General

Executive Summary

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Why We Did The Audit

On December 4, 2009, the Georgia Department of Banking and Finance (DBF) closed The Buckhead Community Bank (Buckhead), Atlanta, Georgia and named the FDIC as receiver. On December 16, 2009, the FDIC notified the OIG that Buckhead's total assets at closing were $896 million and that the estimated loss to the Deposit Insurance Fund (DIF) was $241 million. As of December 31, 2009, Buckhead's total assets and estimated loss to the DIF had decreased to $890.5 million and $240 million, respectively. As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, the OIG conducted a material loss review of the failure of Buckhead.

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

Background

Buckhead, a full-service commercial bank headquartered in Atlanta, Georgia, opened for business on February 6, 1998 as a nationally-chartered bank regulated by the Office of the Comptroller of the Currency. On July 1, 2005, Buckhead converted to a state-chartered nonmember bank, at which time federal supervision of the bank transferred to the FDIC. Buckhead specialized in commercial real estate (CRE) loans, in particular residential and commercial acquisition, development, and construction (ADC) loans, primarily in and around Atlanta. In addition to its main office, Buckhead maintained six branch offices and one loan production office.

Buckhead was wholly-owned by Buckhead Community Bancorp, Inc. (Bancorp), Atlanta, Georgia, a one-bank holding company. On December 4, 2007, Bancorp acquired Allied Bancshares, Inc. (Allied) and its wholly-owned subsidiary, the First National Bank of Forsyth County, Cumming, Georgia (Forsyth). On the same date, Bancorp merged Forsyth into Buckhead, which significantly increased the dollar amount of the bank's total assets, loans, and deposits. The Board controlled 46 percent of Bancorp's outstanding stock.

Audit Results

Causes of Failure and Material Loss

Buckhead failed because the bank's Board and management did not implement adequate controls to identify, measure, monitor, and control the risks associated with the bank's significant ADC concentration. Further, Buckhead relied on potentially volatile non-core liabilities such as higher-priced certificates of deposit, including brokered deposits, to fund loan growth. Weaknesses in the bank's loan underwriting and credit administration practices, exacerbated by the precipitous economic decline in the Atlanta metropolitan real estate market that began in 2007, led to ADC loan losses that eroded the bank's earnings and capital and an inadequate Allowance for Loan and Lease Losses (ALLL). Buckhead was unable to raise sufficient capital to support its operations or find a suitable acquirer. Ultimately, Buckhead's capital position became *Critically Undercapitalized* for PCA purposes and the DBF determined that the bank was not viable and closed the institution in December 2009.

The FDIC's Supervision of Buckhead

From January 2005 until the bank failed in December 2009, the FDIC, in conjunction with the DBF, provided ongoing supervision of Buckhead through five onsite risk management examinations and offsite monitoring activities. Through its supervisory efforts, the FDIC identified risks in Buckhead's operations and brought these risks to the attention of the bank's Board and management through examination reports and other correspondence. Such risks included Buckhead's significant concentration in CRE loans, including ADC loans; reliance on potentially volatile funding sources; and weaknesses in credit risk management practices related to loan underwriting, credit administration, and the ALLL. Examiners also reported apparent violations of regulations and contraventions of interagency policy and guidance associated with the institution's lending practices. In addition, examiners performed procedures to determine whether the bank had taken appropriate corrective action to address examiner recommendations, and made additional recommendations when the bank's corrective actions were not adequate.

The FDIC downgraded certain supervisory component ratings and the bank's composite rating at the January 2008 examination. The FDIC and the DBF also pursued informal and formal enforcement actions to address problems identified at the January 2008 and December 2008 examinations, respectively. However, additional and earlier supervisory action to address certain key risks may have been warranted in connection with the January 2008 examination, in light of the bank's ADC concentration in a declining real estate market. In addition, the FDIC could have issued certain examination reports and imposed enforcement actions more timely.

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 Buckhead.

Management Response

After we issued our draft report, management provided additional information for our consideration, and we revised our report to reflect this information, as appropriate. On June 9, 2010, the Director, Division of Supervision and Consumer Protection (DSC), provided a written response to the draft report. That response is provided in its entirety as Appendix 4 of this report.

DSC reiterated the OIG's conclusions regarding the causes of Buckhead's failure. With regard to our assessment of the FDIC's supervision of Buckhead, DSC stated that after Buckhead's acquisition of Forsyth in December 2007, the FDIC conducted a full-scope examination in January 2008 and that examiners noted heightened risks due to high concentrations in ADC lending and found that a large portion of the loans adversely classified originated from the Forsyth office. In addition, DSC stated that at the December 2008 examination, Buckhead's loan assets had further deteriorated to a level that raised significant regulatory concern and posed considerable risk, resulting in a formal enforcement action. Buckhead was unable to raise sufficient capital to absorb the loan losses, support its operations, and maintain liquidity. Further, DSC stated that it recognizes that strong supervisory attention is necessary for institutions with high ADC and commercial real estate concentrations and volatile funding sources, such as Buckhead, and has issued updated guidance reminding examiners to take appropriate action when those risks are imprudently managed.

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DATE: June 15, 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 The Buckhead Community Bank, Atlanta, Georgia* (Report No. MLR-10-039)

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 The Buckhead Community Bank (Buckhead), Atlanta, Georgia. The Georgia Department of Banking and Finance (DBF) closed the institution on December 4, 2009 and named the FDIC as receiver. On December 16, 2009, the FDIC notified the OIG that Buckhead's total assets at closing were $896 million and that the estimated loss to the Deposit Insurance Fund (DIF) was $241 million. As of December 31, 2009, Buckhead's total assets and estimated loss to the DIF had decreased to $890.5 million and $240 million, respectively.

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

The objectives of this material loss review were to (1) determine the causes of Buckhead's failure and the resulting material loss to the DIF and (2) evaluate the FDIC's supervision[2] of Buckhead, including the FDIC's implementation of the PCA

[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.

provisions of section 38 of the FDI Act. This report presents our analysis of Buckhead's failure and the FDIC's efforts to ensure that the Board of Directors (Board) and management operated the institution in a safe and sound manner. The report does not contain formal recommendations. Instead, as major causes, trends, and common characteristics of institution failures are identified in our material loss reviews, we will communicate those to FDIC management for its consideration. As resources allow, we may also conduct more in-depth reviews of specific aspects of the FDIC supervision program and make recommendations, as warranted.[3] 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

Buckhead, a full-service commercial bank headquartered in Atlanta, Georgia, opened for business on February 6, 1998 as a nationally-chartered bank regulated by the Office of the Comptroller of the Currency (OCC). On July 1, 2005, Buckhead converted to a state-chartered nonmember bank, at which time federal supervision of the bank transferred to the FDIC. Buckhead specialized in commercial real estate (CRE) loans, in particular residential and commercial acquisition, development, and construction (ADC) loans, primarily in and around Atlanta. In addition to its main office, Buckhead maintained six branch offices and one loan production office.

Buckhead was wholly-owned by Buckhead Community Bancorp, Inc. (Bancorp), Atlanta, Georgia, a one-bank holding company. On December 4, 2007, Bancorp acquired Allied Bancshares, Inc. (Allied) and its wholly-owned subsidiary, the First National Bank of Forsyth County, Cumming, Georgia (Forsyth). On the same date, Bancorp merged Forsyth into Buckhead,[4] which significantly increased the dollar amount of the bank's total assets, loans, and deposits. The Board controlled 46 percent of Bancorp's outstanding stock.

Table 1 provides details on Buckhead's financial condition as of September 30, 2009 and for the 5 preceding calendar years.

[3] For example, in May 2010, the FDIC OIG's Office of Evaluations initiated a review of the role and federal regulators' use of the Prompt Regulatory Action provisions of the FDI Act (section 38, *PCA* and section 39, *Standards for Safety and Soundness*) in the banking crisis.
[4] The acquisition of Allied and merger of Buckhead and Forsyth were approved by the responsible regulatory agencies, as applicable.

Table 1: Selected Financial Information for Buckhead, 2004 to 2009

Financial Measure	Sept-09	Dec-08	Dec-07	Dec-06	Dec-05	Dec-04
	(Dollars in Thousands)					
Total Assets	$856,236	$908,589	$881,955	$529,779	$391,018	$264,572
Total Loans	$648,261	$718,310	$677,351	$381,900	$267,708	$186,249
Total Deposits	$813,668	$766,941	$755,987	$472,153	$348,814	$219,962
Allowance for Loan and Lease Losses	$19,096	$12,114	$9,787	$4,518	$3,293	$2,386
Brokered Deposits	$76,128	$277,683	$183,316	$122,977	$27,768	$14,901
Net Income (Loss)	$(59,787)	$(35,828)	$4,423	$5,633	$3,518	$2,108
Net Loan Growth Rate	(12.23%)	5.79%	76.89%	42.72%	43.81%	49.15%

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

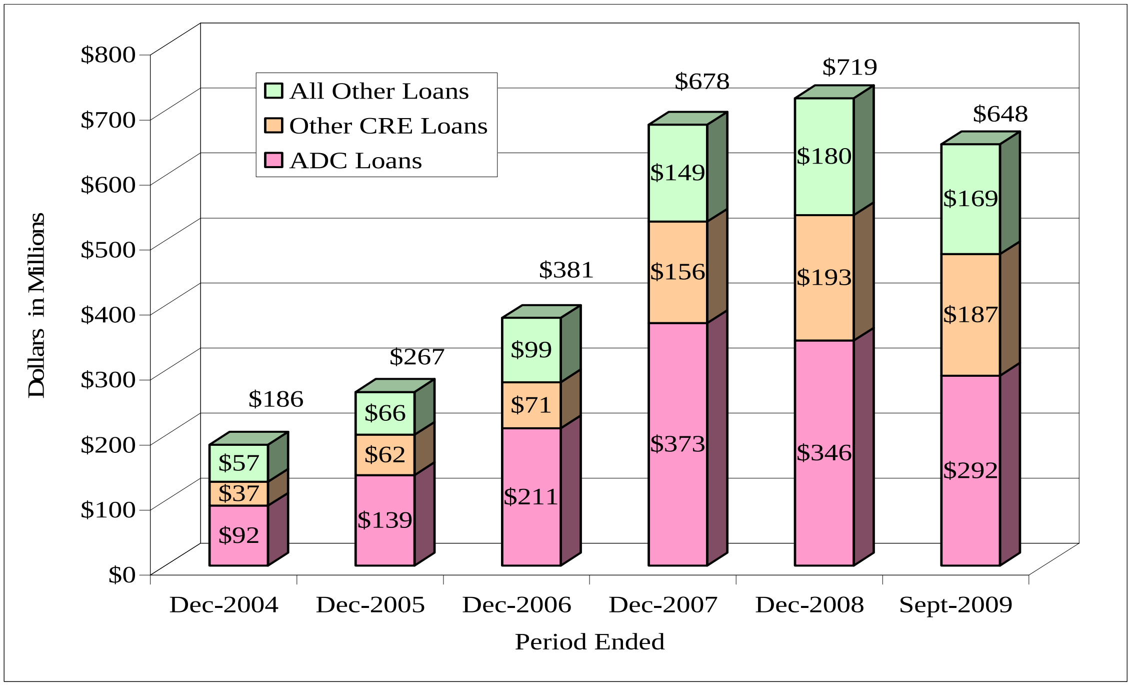
Causes of Failure and Material Loss

Buckhead failed because the bank's Board and management did not implement adequate controls to identify, measure, monitor, and control the risks associated with the bank's significant ADC concentration. Further, Buckhead relied on potentially volatile non-core liabilities such as higher-priced certificates of deposit, including brokered deposits, to fund loan growth. Weaknesses in the bank's loan underwriting and credit administration practices, exacerbated by the precipitous economic decline in the Atlanta metropolitan real estate market that began in 2007, led to ADC loan losses that eroded the bank's earnings and capital and an inadequate Allowance for Loan and Lease Losses (ALLL). Buckhead was unable to raise sufficient capital to support its operations or find a suitable acquirer. Ultimately, Buckhead's capital position became *Critically Undercapitalized* for PCA purposes and the DBF determined that the bank was not viable and closed the institution in December 2009.

ADC Concentration

Much of the bank's loan portfolio focused on CRE loans, comprised primarily of higher-risk ADC loans. However, in spite of earlier signs of a decline in the Atlanta residential real estate market, Buckhead's Board and management did not sufficiently reduce ADC lending activities, or take adequate steps to mitigate the risk associated with these activities, before deterioration in the bank's financial condition became evident. As noted in the figure on the next page, Buckhead rapidly increased its loan portfolio from 2004 to 2007. Annual loan growth rates exceeded 40 percent during this period.

Buckhead's Loan Portfolio Composition and Growth



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

While Buckhead's loan growth through 2007 was more aggressive than its peers,[5] the Board and management generally maintained the bank's capital at levels that were below those of its peers, as discussed in more detail in the *Implementation of PCA* section of this report.

The FDIC, the OCC, and the Board of Governors of the Federal Reserve System issued guidance in December 2006, entitled, *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* (Joint Guidance), to reinforce existing regulations and guidelines for real estate lending and safety and soundness. The Joint Guidance focuses on CRE loans for which cash flow from real estate is the primary source of repayment, including ADC lending. 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. 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

[5] 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. As of December 31, 2004, Buckhead's peer group included all insured commercial banks having assets between $100 million and $300 million, with three or more full-service banking offices and located in a metropolitan statistical area. Beginning in June 30, 2005, Buckhead's peer group became all insured commercial banks having assets between $300 million and $1 billion.

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.

According to the Joint Guidance, CRE loan concentrations can pose substantial potential risks and inflict large losses on institutions. Therefore, risk management practices and capital levels should be commensurate with the level and nature of the CRE loan concentration risk. As shown in Table 2, from December 2004 through September 2009, Buckhead's ADC concentration as a percent of Total Capital consistently and significantly exceeded the 100 percent threshold in the Joint Guidance, as well as the ratios of its peers. The bank's ADC loans as a percent of average gross loans also consistently and significantly exceeded the ratios of its peers.

Table 2: Buckhead's ADC Concentration as a Percent of Total Capital and Average Gross Loans Compared to Peers

	ADC Loans as a Percent of Total Capital		ADC Loans as a Percent of Average Gross Loans	
Period Ending	Buckhead	Peers	Buckhead	Peers
December 31, 2004	353	81	43	10
December 31, 2005	372	104	51	13
December 31, 2006	446	117	52	15
December 31, 2007	475	124	55	16
December 31, 2008	494*	111	52	15
September 30, 2009	1,870*	92	47	13

Source: UBPRs for Buckhead.
* The increase in ADC loans as a percent of Total Capital in 2008 and 2009 was due primarily to the decline in Buckhead's capital.

According to Board minutes for October and November 2007, Board members noted the general decline in economic conditions and the local housing market. However, in December 2007, Buckhead merged with a bank that also had significant CRE and ADC concentrations in the Atlanta metropolitan area, further increasing Buckhead's financial exposure to such lending. As of September 30, 2007, prior to the merger, Forsyth's loan portfolio was less than one-third the size of Buckhead's loan portfolio and its ADC and non-owner occupied CRE concentrations as a percent of Total Capital were 354 percent and 600 percent, respectively. As of December 31, 2007, subsequent to the merger, the ADC and non-owner occupied CRE concentrations as a percent of Total Capital for the combined bank remained high at 475 percent and 590 percent, respectively.

Bancorp paid $53.8 million for the acquisition of Allied and its subsidiary bank Forsyth. The purchase price consisted of approximately $40.4 million in common stock issued and stock options assumed, and $13.4 million in cash that might otherwise have been available to provide capital support to Buckhead. The November 2008 Board minutes indicated that about half of both the dollar amount and the number of the bank's non-performing loans at that time came from the Forsyth acquisition.

According to the Joint Guidance, an institution's Board is responsible for establishing appropriate risk limits, monitoring exposure, and evaluating the effectiveness of the institution's efforts to manage and control risk. The FDIC's January 2008 examination report[6] noted the impact of the downturn in the Atlanta real estate market, the effect of which was amplified by the bank's significant ADC concentration, and recommended Buckhead's management develop additional controls, as outlined in the Joint Guidance. These controls included, among others:

- ongoing risk assessments of the CRE and ADC concentrations,
- a contingency plan for addressing adverse developments in the CRE sector,
- risk tolerance levels included in the bank's strategic plan,
- stratification of the CRE portfolio by various activities and influences,
- market analysis of the property types and geographic markets, and
- stress testing to quantify the impact of changing economic conditions on asset quality.

Although Buckhead took action in 2008 to reduce its ADC concentration exposure and placed a moratorium on new ADC loans, the bank's efforts did not adequately address the recommendations in the January 2008 examination report. Accordingly, the December 2008 examination report identified many of the same CRE concentration-related weaknesses highlighted in the previous examination, including ones related to the controls listed above. The bank's loan policy continued to reflect a high overall CRE concentration limit of 750 percent of Total Capital; therefore, the report included a repeat recommendation for the bank to update its loan policy to address acceptable levels of exposure to CRE and ADC loans, as well as requirements for feasibility studies, sensitivity analysis, and stress testing.

The financial impact of the declining economy and real estate market, coupled with Buckhead's concentrations and associated weaknesses, became apparent during 2008 and worsened during 2009. Specifically, Buckhead's net charge-offs of $33 million, of which 86 percent were ADC loans for the period January 2008 through September 2009, significantly decreased the bank's earnings and capital. In addition, by September 30, 2009, almost 23 percent of the loan portfolio was non-current with the majority (79 percent) of the total delinquencies represented by ADC loans, and in particular, 1-4 family residential construction loans.

Potentially Volatile Funding Sources

Buckhead depended heavily on potentially volatile non-core funding sources, including Internet certificates of deposit and brokered deposits, to help fund its loan growth. The

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

reliance on such funding sources was therefore integral to the bank's ability to obtain and sustain the excessive ADC concentration.

Buckhead's level of brokered deposits ranged from a low of $14.9 million, as of December 2004, to a high of $277.7 million, as of December 2008. In addition, the bank's brokered deposits increased significantly during 2006 and again in 2008, with annual increases of $95 million (343 percent), as of December 2006, and $94 million (51 percent), as of December 2008. Further, Buckhead's reliance on potentially volatile funding sources was reflected in the bank's high net non-core funding dependence ratio, which increased from 26 percent, as of December 2004, to 58 percent, as of December 2008, and consistently and significantly exceeded the average for the bank's peers.

A bank's net non-core funding dependence ratio indicates the degree to which the bank is relying on non-core/volatile liabilities to fund long-term earning assets. Generally, a lower ratio reflects less risk exposure, whereas higher ratios indicate greater risk exposure and a reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions. A heavy reliance on potentially volatile liabilities to fund asset growth is a risky business strategy because the availability and access to these funds may be limited in the event of deteriorating financial or economic conditions, and assets may need to be sold at a loss in order to fund deposit withdrawals and other liquidity needs.

Although the bank developed a contingency funding plan (CFP), the December 2008 examination concluded that the CFP assumed the bank would remain *Well Capitalized* and therefore did not address the contingency of losing access to the brokered deposit market should the bank fall to a lower capital category. Buckhead's access to brokered deposits was restricted in January 2009 once its capital ratios fell to *Adequately Capitalized*,[7] based on the bank's December 31, 2008 financial data.

Credit Risk Management Practices

Buckhead's Board and management failed to develop, implement, and sustain an adequate credit risk management framework commensurate with the inherent risks associated with its ADC concentration. The Joint Guidance states that financial institutions with CRE concentrations should implement risk management practices appropriate to the size of the portfolio, as well as the level and nature of concentrations. In addition, earlier guidance on ADC lending[8] emphasized that management's ability to identify, measure, monitor, and control portfolio risk through effective underwriting policies, systems, and internal controls was crucial to a sound ADC lending program.

[7] Under FDIC Rules and Regulations, Part 337, *Unsafe and Unsound Banking Practices,* an institution that is *Adequately Capitalized,* as defined in Part 325, *Capital Maintenance,* of the FDIC Rules and Regulations, may not accept, renew, or roll over any brokered deposits without a waiver of these restrictions from the FDIC. Part 337 implements section 29, *Brokered Deposits*, among other things.

[8] Financial Institution Letter (FIL) 110-98, entitled, *Internal and Regulatory Guidelines for Managing Risks Associated with Acquisition, Development, and Construction Lending,* dated October 8, 1998.

Loan Underwriting and Credit Administration

According to the DSC's *Risk Management Manual of Examination Policies* (Examination Manual), the degree of risk in a real estate loan depends primarily on the loan amount in relation to collateral value, the interest rate, and most importantly, the borrower's ability to repay in an orderly fashion. Undue reliance should not be placed upon a property's appraised value in lieu of an adequate initial assessment of a debtor's repayment ability.

The January 2005, January 2006, and February 2007 examinations generally found Buckhead's credit risk management practices, including loan underwriting and credit administration, to be adequate, although examiners made some recommendations to improve those controls. In particular, the January 2006 examination report recommended that Buckhead enhance the bank's loan policy to ensure borrower cash flow analyses were expanded in credit memoranda.

In addition, the external loan review of Buckhead conducted in September 2007 identified various loan underwriting weaknesses and made recommendations to improve borrower analyses, strengthen oversight of loan participations purchased, and expand disclosure of credit risk in loan approval memoranda. The review also identified a number of documentation exceptions related to financial statements and tax returns.

By the January 2008 examination, examiners concluded that credit risk management practices were inadequate and specifically noted the following loan underwriting and credit administration weaknesses:

- insufficient analysis of borrower financial condition and global cash flows that incorporated the borrower's entire lending relationship, including obligations to other institutions;

- inappropriate use of interest reserves, and the lack of guidance in the bank's loan policy regarding the use of interest reserves;

- lack of borrower equity in development and construction projects, for which management consistently loaned 100 percent of the cost;

- inadequate (1) appraisals and failure to obtain updated appraisals as needed for loan renewals, (2) monitoring of progress on construction projects, and (3) monitoring and oversight of purchased participations; and

- untimely recognition of problem assets.

FIL-22-2008, entitled, *Managing Commercial Real Estate Concentrations in a Challenging Environment*, dated March 17, 2008, was issued subsequent to the start of the January 2008 examination and recommended key risk management processes to help institutions with significant ADC and CRE concentrations manage through changes in market conditions. Many of the weaknesses in Buckhead's credit risk management practices, identified in the January 2008 examination report, can be associated with one or more of the key risk management processes discussed in this guidance. Nonetheless, the December 2008 examination subsequently determined that Buckhead had failed to adequately address many of the previously reported weaknesses in credit risk management practices. Those weaknesses included, but were not limited to:

- insufficient financial analyses;

- inadequate appraisals, loan monitoring, and borrower equity in construction and development projects;

- the failure to place loans in nonaccrual status and recognize problem loans in a timely manner; and

- the failure to update the bank's loan policy to provide minimum standards for, among other things, initial borrower investment and maintenance of hard equity, borrower net worth and global cash flow, and debt service coverage for collateral property.

Allowance for Loan and Lease Losses

According to the *Interagency Policy Statement on the Allowance for Loan and Lease Losses* (Policy Statement on ALLL), the ALLL represents one of the most significant estimates in an institution's financial statements and regulatory reports. As a result, each institution is responsible for developing, maintaining, and documenting a comprehensive, systematic, and consistently applied process for determining the ALLL.

The examinations conducted from January 2005 to January 2008 generally concluded that Buckhead's ALLL methodology and funding were satisfactory, although the January 2008 examination report identified the need for an additional provision for loan losses. However, the December 2008 examination concluded that the ALLL methodology was inadequate because the bank did not provide sufficient detail to support the accuracy of the Statement of Financial Accounting Standards (FAS) No. 5[9] portion of the ALLL calculation. In particular, management was not:

- segmenting construction loans into specific categories, such as residential and commercial, and providing different levels of reserves based on the risk of each category; or

- performing analyses of current trends, loss histories, economic factors, and significant changes in concentration levels and incorporating the results of the analyses into the ALLL calculation.

Concern regarding the bank's ALLL funding was first reported at the January 2008 examination. By December 2008, examiners determined that, based on trends, loan

[9] FAS No. 5, *Accounting for Contingencies*, is one of the principal sources of guidance on accounting for impairment in a loan portfolio under Generally Accepted Accounting Principles.

concentrations, and the level of adversely classified assets, Buckhead's ALLL was underfunded by more than $8.6 million. In addition, due to the bank's insufficient detail for the FAS 5 calculation, Buckhead was considered to be in apparent contravention of the Policy Statement on ALLL.

Table 3 provides a summary of the growth in Buckhead's adversely classified items and corresponding increase in ALLL funding for the examinations conducted from January 2005 through December 2008.

Table 3: Buckhead's Adversely Classified Items and ALLL

	Examination Start Dates				
	Jan-05	Jan-06	Feb-07	Jan-08	Dec-08
	(Dollars in Thousands)				
Total Adversely Classified Items	$2,555	$4,631	$9,566	$81,559	$173,770
Adversely Classified Items as a Percent of Tier 1 Capital plus ALLL	9.82%	12.63%	20.72%	103.14%	235.79%
ALLL Funding	$2,386	$3,535	$4,749	$9,787	$10,836
Increase in ALLL Computed by Examiners	-0-	-0-	-0-	$1,500	$8,649

Source: Examination reports for Buckhead.

The January 2008 examination report highlighted the high level of classified ADC loans, which comprised approximately 50 percent of total loan classifications. As its loan portfolio deteriorated, the bank's earnings and capital were negatively impacted. Specifically, Buckhead's earnings decreased from $4.4 million, as of December 31, 2007, to negative $35.8 million, as of December 31, 2008, and to negative $59.8 million, as of September 30, 2009.

The FDIC's Supervision of Buckhead

From January 2005[10] until the bank failed in December 2009, the FDIC, in conjunction with the DBF, provided ongoing supervision of Buckhead through five onsite risk management examinations and offsite monitoring activities. Through its supervisory efforts, the FDIC identified risks in Buckhead's operations and brought these risks to the attention of the bank's Board and management through examination reports and other correspondence. Such risks included Buckhead's significant concentration in CRE loans, including ADC loans; reliance on potentially volatile funding sources; and weaknesses in credit risk management practices related to loan underwriting, credit administration, and the ALLL. Examiners also reported apparent violations of regulations and contraventions of interagency policy and guidance associated with the institution's lending practices. In addition, examiners performed procedures to determine whether the bank had taken

[10] The January 2005 examination was conducted by the DBF prior to Buckhead's charter change for the purpose of approving the bank's conversion from a nationally-chartered bank to a state-chartered nonmember bank.

appropriate corrective action to address examiner recommendations, and made additional recommendations when the bank's corrective actions were not adequate.

The FDIC downgraded certain supervisory component ratings[11] and the bank's composite rating at the January 2008 examination. The FDIC and the DBF also pursued informal and formal enforcement actions to address problems identified at the January 2008 and December 2008 examinations, respectively. However, additional and earlier supervisory action to address certain key risks may have been warranted in connection with the January 2008 examination, in light of the bank's ADC concentration in a declining real estate market. In addition, the FDIC could have issued certain examination reports and imposed enforcement actions more timely.

Supervisory History

Between 2005 and 2009, the FDIC and the DBF conducted five onsite examinations of Buckhead as required[12] and monitored Buckhead's condition using various offsite monitoring tools. Table 4 summarizes Buckhead's examination history from 2005 to 2008, including the bank's supervisory ratings and enforcement actions taken.

Table 4: Buckhead's Examination and Enforcement Action History, 2005 to 2009

Examination Start Date	Examination as of Date	Agency	Supervisory Ratings (UFIRS)	Enforcement Action
01/07/2005	12/31/2004	DBF	222222/2	None
01/30/2006	09/30/2005	FDIC	222222/2	None
02/05/2007	09/30/2006	DBF	222222/2	None
01/28/2008	12/31/2007	FDIC	343332/3	Memorandum of Understanding (MOU) – Effective November 2008
12/08/2008	09/30/2008	DBF/FDIC	555554/5	Bank Board Resolution (BBR) – Effective February 2009 Cease and Desist Order (C&D) – Effective August 2009

Source: Examination reports and enforcement actions for Buckhead.

Buckhead consistently received composite "2" CAMELS ratings from its inception through the February 2007 examination, indicating that the bank gave no cause for supervisory concern, and weaknesses identified were considered minor and correctable in the normal course of business. The January 2008 examination found that the overall

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[11] 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.

[12] Section 337.12 of the FDIC Rules and Regulations, which implements section 10(d) of the FDI Act, requires annual full-scope, onsite examinations of every state nonmember bank at least once every 12-month period and allows for 18-month intervals for certain small institutions (total assets of less than $500 million).

condition of the bank had deteriorated to less than satisfactory, resulting in a composite "3" CAMELS rating. Of particular concern was the bank's asset quality, which was rated a "4" as a result of elevated past-due ratios and a substantial increase in adversely classified items, byproducts of inadequate risk management practices and the downturn in the Atlanta real estate market. The "4" rating indicated deficient asset quality or credit administration practices and significant levels of risk and problem assets that were inadequately controlled and subjected the bank to potential losses that, if left uncorrected, might threaten Buckhead's viability.

As a result of concerns identified in the January 2008 examination, during June 2008, the Atlanta Regional Office added Buckhead to its Supervisory Watch List, which identifies financial institutions in the Atlanta Region with composite ratings of "3", "4", or "5". In addition, the FDIC's offsite review, conducted in September 2008, identified continued deterioration at the bank, and indicated a 93-percent probability of a downgrade of Buckhead's composite rating to a "4."

Due to deterioration in Buckhead's condition, the FDIC and the DBF jointly pursued an MOU with the bank. The MOU, effective November 10, 2008, contained 11 provisions that required the bank to, among other things:

- adopt a loan policy that included guidelines for the bank's ADC loan concentration and emphasized reducing that concentration and implementing the risk management practices in the Joint Guidance;
- enhance the quality of the bank's problem assets;
- improve credit risk management practices and the ALLL;
- maintain capital ratios in the *Well Capitalized* range; and
- decrease reliance on volatile liabilities.

As a result of the bank's declining capital level and deteriorating financial condition identified through offsite monitoring, the FDIC and the DBF accelerated the next examination of Buckhead, previously scheduled for the second quarter of 2009, to December 2008. That examination determined that Buckhead had not adequately addressed the weaknesses identified at the previous examination and resulted in a further downgrade in the bank's composite rating to a "5", which indicated extremely unsafe and unsound practices or conditions; critically deficient performance; inadequate risk management practices relative to the institution's size, complexity, and risk profile; and great supervisory concern. Institutions in this group pose a significant risk to the DIF and a high probability of failure.

In February 2009, Buckhead adopted a BBR that incorporated the provisions of the November 2008 MOU as well as additional provisions to address the weaknesses at the bank. Specifically, the BBR included provisions to:

- increase Board oversight, including a third-party assessment of the Board;
- review management and staffing, and maintain qualified senior management;
- develop a 3-year strategic and business plan;
- improve the bank's loan review program and loan grading system;
- perform a risk segmentation analysis of the bank's assets, along with a plan to reduce ADC concentration levels; and
- correct deficiencies in, and reduce the level of, Special Mention loans.

During the period January through June 2009, the bank provided the FDIC and the DBF six periodic progress reports addressing the provisions of the MOU and BBR. Nonetheless, the FDIC and the DBF notified Buckhead on July 9, 2009 that a formal enforcement action was necessary to address unsafe and unsound practices noted at Buckhead's December 2008 and previous examinations. Therefore, the DBF, in consultation with the FDIC, issued a C&D, effective August 6, 2009, which included provisions previously contained in the MOU and/or BBR and an additional requirement that Buckhead fully disclose the C&D requirements to the bank's shareholders.[13]

Despite Buckhead's efforts to address the provisions in the MOU, BBR and C&D, the condition of the bank continued to deteriorate and Buckhead was ultimately closed in December 2009.

Supervisory Response to Key Risks

The January 2006 through December 2008 examination reports for Buckhead indicated that FDIC and DBF examiners identified concerns and made recommendations related to the risks associated with Buckhead's (1) high ADC concentrations, (2) reliance on potentially volatile funding sources, and (3) credit risk management practices, including the ALLL. In addition, as discussed above, the MOU and C&D that the FDIC and the DBF issued contained provisions that addressed those risks. We determined, however, that additional and earlier supervisory action to address these risks may have been warranted in connection with the January 2008 examination. In addition, the FDIC could have issued certain examination reports and imposed enforcement actions more timely.

[13] On July 14, 2009, the FDIC and DBF met with the Buckhead's Board to discuss findings of the December 8, 2008 joint examination and to present the DBF C&D, and on July 28, 2009, the Board signed the C&D. The C&D, issued on August 6, 2009, included the Board's acknowledgment of receipt and agreement to comply with the terms and conditions of the C&D.

ADC Concentration

The Pre-Examination Planning Memorandum for the FDIC's first examination of Buckhead in January 2006 reflected a Real Estate Stress Test (REST)[14] score of "5," due to the bank's rapid asset growth and concentration in ADC lending and indicating the highest level of exposure to potential market deterioration. Both the January 2006 and February 2007 examination reports identified the bank's high ADC concentration level and corresponding significant dependence on potentially volatile non-core funding sources. These reports concluded that Buckhead's asset quality was satisfactory and, in general, found controls related to the bank's loan concentrations to be adequate. The January 2006 examination report contained a recommendation for enhancing concentration-related procedures, while the February 2007 examination report advised the Board and bank management to continue to closely monitor ADC loans.

Subsequent to the February 2007 examination, the bank experienced a significant deterioration in asset quality. The January 2008 and December 2008 examination reports (1) included recommendations to improve oversight and monitoring controls over Buckhead's concentrations, (2) raised concerns over the bank's reliance on non-core funding sources, and (3) cited the bank for an apparent contravention of the Joint Guidance due to inadequate controls to manage concentration risks.

Examiner concern over the bank's ADC concentration during the January 2008 examination resulted in examiners expanding the scope of the loan review. Subsequently, the actual examination hours significantly exceeded the staff budget by 430 hours due to the overall deterioration in the bank's asset quality. The examination concluded that although Buckhead's capital ratios were above the level to be considered *Well Capitalized*, the bank's capital was less than satisfactory and not adequate to mitigate the risks posed by Buckhead's high CRE concentration, primarily comprised of ADC loans, which represented 763 percent of Tier 1 Capital as of December 31, 2007.

Due to the level of concern for the bank's overall financial condition, in general, and the asset quality, in particular, examiners downgraded asset quality from a "2" to a "4" during the January 2008 examination and considered downgrading the bank's composite rating from a "2" to a "4". Examiners stated that a downgrade in the composite rating to a "4" may have resulted in the pursuit of a C&D during 2008 instead of an MOU. However, examiners indicated that the decision to downgrade the bank to a composite rating of "3" rather than a "4" was based, in part, on the Board's and management's verbal promises to provide additional capital as needed to maintain the bank's *Well Capitalized* position. DSC officials stated that this decision was primarily based on the

[14] REST attempts to simulate what would happen to banks today if they encountered a real estate crisis similar to that of New England in the early 1990s. The primary risk factor is the ratio of construction and development loans to total assets. Other risk factors include the percentage of CRE loans, percentage of multifamily loans, percentage of commercial and industrial loans, and high non-core funding and rapid asset growth. A bank with a high concentration in construction and development loans, coupled with rapid asset growth, would appear to be riskier than a bank with similar concentrations but low asset growth. REST uses statistical techniques and Call Report data to forecast an institution's condition over a 3- to 5-year period and provides a single rating from 1 to 5 in descending order of performance quality.

examiners' determination that Board members had access to significant personal financial resources that would have allowed them to follow through on those promises. Formal capital-related commitments were subsequently included in the provisions of the MOU, BBR, and C&D; however, the Board and management ultimately did not obtain the needed capital for the bank. As a result of ADC-related losses, Buckhead's capital ratios fell to *Critically Undercapitalized* based on the bank's August 2009 financial data.

We recognize that rating determinations are a matter of judgment; however, in hindsight, examiners may have been more effective in bringing about necessary risk mitigation for the ADC concentration by not relying so heavily on bank management and Board promises to provide additional capital as needed. Instead, a stronger supervisory response in the January 2008 examination may have resulted, at an earlier stage, in a more formal Board and management commitment to ensure the bank's capital levels remained commensurate with the level and nature of the bank's ADC concentration risk.

Potentially Volatile Funding Sources

The Examination Manual states that when rating liquidity, examiners should consider the capability of management to properly identify, measure, monitor, and control the institution's liquidity position, including the effectiveness of funds management strategies, liquidity policies, management information systems, and CFPs. In addition, funds management practices should ensure that liquidity is not maintained at a high cost, or through undue reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions. Further, the Examination Manual states that bank management should understand the ramifications of having advance funding, such as FHLB advances, curtailed in the event that the institution's financial strength deteriorates, and the bank's CFP should identify alternative sources of funding.

Examination reports indicate that examiners reviewed and assessed the adequacy of Buckhead's liquidity management, in general, and the bank's CFP, in particular. In that regard,

- The January 2008 examination report noted that brokered deposits comprised a significant portion of total funding sources and that the level of these deposits had heightened liquidity concerns. The report concluded that Buckhead's CFP appeared to be adequate based on the bank's overall risk profile. However, our review of the CFP found that it did not address the potential loss of brokered deposits. Bank management told examiners that they planned to replace a significant portion of the brokered deposits at maturity with lower-priced Federal Home Loan Bank borrowings. Instead, as discussed earlier in this report, the bank significantly increased its reliance on brokered deposits during 2008.

- Examiner concern regarding the adequacy of the bank's CFP became more pronounced at the December 2008 examination. Although the examination report concluded that the bank's CFP was generally acceptable, the report also highlighted the need for the CFP to address additional stress events including, but not limited to (1) a change in the bank's credit rating, (2) deterioration in asset quality, (3) changes in the bank's capital position to less than *Well Capitalized*, (4) unplanned asset growth, (5) the recognition of operating losses, and (6) the possibility of losing access to brokered and other high-rate deposits.

As noted previously in this report, Buckhead's access to brokered deposits was restricted in January 2009. Additional supervisory emphasis on contingency planning related to brokered deposits during the January 2008 examination may have further encouraged the bank to reduce reliance on those deposits during 2008 and helped Buckhead better prepare for restrictions on access to those deposits in 2009.

Credit Risk Management Practices

During the January 2006 and February 2007 examinations, examiners found the bank's credit risk management practices to be adequate but made some recommendations for enhancing procedures. During the January 2008 and December 2008 examinations, however, examiners found the bank's credit risk management practices to be inadequate and made a number of recommendations to address the loan underwriting and credit administration weaknesses identified earlier in this report.

Examiner concerns regarding credit risk management practices were also addressed in the November 2008 MOU provision requiring the bank to adopt a loan policy that discussed the use of interest reserves, global cash flow analyses, borrower equity requirements, monitoring of construction projects, and monitoring of loan participations purchased. In addition, both the MOU and the August 2009 C&D identified additional actions that the bank should take to improve credit risk management, including:

- establishing and maintaining an adequate reserve for loan losses, to include a quarterly review of the ALLL;
- improving the management of problem loans, including developing plans for reducing and improving adversely classified loans, and restricting extensions of credit for certain borrowers; and
- correcting apparent violations of regulations and apparent contraventions of policy, and ensuring future compliance.

In each of the examinations conducted since 2005, examiners cited Buckhead for one or more apparent violations of regulatory requirements or apparent contraventions of policy related to credit risk management, specifically:

- FDIC Rules and Regulations, Part 365, *Real Estate Lending Standards*, Appendix A, *Interagency Guidelines for Real Estate Lending Policies*, and Part 323, *Appraisals*.
- Rule 80-1-5.04 of the State of Georgia Rules and Regulations, *Participation Loans, Amended*.

- *Interagency Policy Statement on the Allowance for Loan and Lease Losses.*

Regarding the ALLL, a February 27, 2008 memorandum in the Atlanta Regional Office correspondence files stated that bank management had not provided for an adequate ALLL commensurate with the level of risk in the portfolio. In addition, the memorandum noted that the increase in adverse classifications and the bank's ineffective loan rating system demonstrated management's inability to adequately assess and appropriately maintain the ALLL. The January 2008 examination report, issued September 5, 2008, indicated the need for an additional $1.5 million in provision expense. The report concluded, however, that the ALLL methodology was satisfactory. Subsequently, the December 2008 examination report, issued July 9, 2009, concluded that the bank's ALLL methodology was inadequate and the inadequacy resulted in an ALLL balance that was underfunded by $8.6 million, the aforementioned apparent contravention of interagency policy, and recommendations for specific actions that management should take to improve the ALLL methodology.

Further examiner assessment of Buckhead's ALLL methodology during the January 2008 examination may have been warranted. This additional supervisory attention to the ALLL may have resulted in earlier identification of specific weaknesses in the ALLL methodology and recommendations for improvement, which may have instilled more urgency in the bank's implementation of corrective actions.

Timeliness of Final Examination Reports and Enforcement Actions

As noted earlier in this report, the FDIC and the DBF pursued informal and formal enforcement actions to address deficiencies noted at the January 2008 and December 2008 examinations. However, earlier issuance of the examination reports and related enforcement actions may have been prudent. As indicated in Table 5, substantial time elapsed between the start of the 2008 examinations and the dates that the FDIC imposed certain enforcement actions.

Table 5: Supervisory Action Timeline for Buckhead's January 2008 and December 2008 Examinations

Examination Start Date	Examination as of Date	Examination Complete Date	Examination Report Issuance Date	Enforcement Action and Effective Date
01/28/2008	12/31/2007	04/18/2008	09/05/2008	MOU – Effective November 10, 2008
12/08/2008	09/30/2008	04/09/2009	07/09/2009	BBR – Effective February 2009 C&D – Effective August 6, 2009

Source: FDIC Virtual Supervisory Information on the Net system and Atlanta Regional Office correspondence files.

Although both 2008 examinations identified a significant decline in Buckhead's financial condition, the final examination reports and associated enforcement actions to address the decline were not issued timely.

- The FDIC issued the January 2008 examination report to Buckhead 7 months after the examination began. Although the FDIC included a draft of the related MOU with the report transmittal letter to Buckhead, the final MOU became effective almost 2 months later, well after the FDIC had identified the weaknesses and financial deterioration that this enforcement action was designed to address. Our discussion with DSC officials indicated that resources and examination workload issues were the primary causes for the delayed issuance.

- The DBF and the FDIC issued the December 2008 examination report to Buckhead 7 months after the examination began. Although the C&D was effective within 1 month of the examination report issuance, this date was 8 months after the examination started and 4 months after the examination was completed. In the interim, the bank developed a BBR and provided periodic progress reports on compliance with the BBR to the FDIC and the DBF. While the BBR addressed most of the issues subsequently included in the C&D, the DBF and the FDIC determined that a formal, legally enforceable enforcement action was more appropriate to address the deficiencies and deteriorated financial condition at Buckhead.

Earlier issuance of the January 2008 and December 2008 examination reports and subsequent imposition of related enforcement actions may have instilled more urgency in the Board and management to address weaknesses and improve the bank's financial condition in a timely manner. The FDIC has established a 2010 annual performance goal to promptly implement appropriate corrective programs for "3", "4", and "5"-rated institutions or otherwise ensure that significant examiner concerns are presented to a bank's Board and management's attention after examinations are completed. In addition, the FDIC recently issued examination guidance and provided examiner training that emphasized the importance of timely supervisory action, including consideration of a temporary C&D authorized by section 8(c) of the FDI Act when appropriate.

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 of the FDIC's Rules and Regulations implements PCA requirements by establishing a framework for taking prompt corrective action against insured state-charted nonmember banks that are not adequately capitalized. Based on supervisory actions taken with respect to Buckhead, we concluded that the FDIC had properly implemented applicable PCA provisions of section 38 of the FDI Act. Although the FDIC followed PCA guidance, by the time Buckhead's capital levels fell below the required thresholds necessary to implement PCA, the bank's condition had deteriorated to a point at which the institution was unable to raise additional capital.

As indicated previously in Table 2, Buckhead pursued a business strategy of rapid growth in ADC loans, with the bank's level of ADC concentration well in excess of its peers. The Joint Guidance emphasizes that institutions should maintain capital levels commensurate with the level and nature of their CRE concentration risk. Although

Buckhead remained *Well Capitalized* until December 31, 2008, as shown in Table 6, the bank consistently maintained its Total Risk-Based Capital ratio below that of its peers.

Table 6: Buckhead's Total Risk-Based Capital Ratio Compared to Peers

	Dec-04	Dec-05	Dec-06	Dec-07	Dec-08	Sept-09
	(Percent)					
Buckhead	12.00	11.76	10.77	10.50	8.97	2.23
Peers	13.86	12.95	12.90	12.73	12.60	13.13

Source: UBPRs for Buckhead.

Buckhead's Board pursued several options to increase capital and issued a $10 million subordinated capital note in March 2008, which prevented the bank from falling to *Adequately Capitalized.* In addition, on October 31, 2008, Buckhead submitted an application for Troubled Asset Relief Program funding of $24 million. However, Buckhead subsequently withdrew that application on March 26, 2009.

The FDIC and the DBF discussed the bank's capital position with Buckhead's Board and management through various means of communication and meetings. Further, in addition to including provisions in the MOU and C&D on minimum capital requirements, as discussed earlier in this report, the FDIC followed PCA guidance and appropriately notified the bank of its capital category and corresponding requirements, as follows:

- **January 14, 2009.** The FDIC notified Buckhead that it was *Adequately Capitalized*, based on December 31, 2008 financial information.

- **August 7, 2009.** The FDIC notified Buckhead that it was *Undercapitalized,* based on the initial June 30, 2009 Call Report. The bank was required to prepare a capital restoration plan, which was submitted to the FDIC on September 25, 2009. The FDIC did not provide a formal response to the plan since the bank was targeted for closure.

- **September 14, 2009.** The FDIC notified Buckhead that it was *Critically Undercapitalized*, based on August 31, 2009 financial information.

Although the FDIC followed PCA guidance, by the time Buckhead's capital levels fell below the required thresholds necessary to implement PCA, the bank's condition had deteriorated to a point at which the institution was unable to raise additional capital from external parties or to find a suitable acquirer prior to the failure of the bank on December 4, 2009.

Corporation Comments

After we issued our draft report, management provided additional information for our consideration, and we revised our report to reflect this information, as appropriate. On June 9, 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.

DSC reiterated the OIG's conclusions regarding the causes of Buckhead's failure. With regard to our assessment of the FDIC's supervision of Buckhead, DSC stated that after Buckhead's acquisition of Forsyth in December 2007, the FDIC conducted a full-scope examination in January 2008 and that examiners noted heightened risks due to high concentrations in ADC lending and found that a large portion of the loans adversely classified originated from the Forsyth office. In addition, DSC stated that at the December 2008 examination, Buckhead's loan assets had further deteriorated to a level that raised significant regulatory concern and posed considerable risk, resulting in a formal enforcement action. Buckhead was unable to raise sufficient capital to absorb the loan losses, support its operations, and maintain liquidity. Further, DSC stated that it recognizes that strong supervisory attention is necessary for institutions with high ADC and commercial real estate concentrations and volatile funding sources, such as Buckhead, and has issued updated guidance reminding examiners to take appropriate action when those risks are imprudently managed.

Objectives, Scope, and Methodology

Objectives

We performed this audit in accordance with section 38(k) of the FDI Act, which provides, in general, that if the 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 February to May 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 Buckhead's operations from December 31, 2004 until its failure on December 4, 2009. Our review also entailed an evaluation of the regulatory supervision of the bank from July 1, 2005, the date that the FDIC effectively became the primary regulator of Buckhead, until the bank failed.

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

- Analyzed examination reports issued by the FDIC and the DBF from 2005 to 2009.
- Reviewed the following:
  - Available FDIC examination work papers and correspondence maintained at DSC's Atlanta Regional Office and Atlanta Field Office in Georgia.
  - Documentation related to Buckhead's conversion from a national to a nonmember bank charter, in July 2005.
  - Reports prepared by the Division of Resolutions and Receiverships (DRR) and DSC relating to the bank's closure. We also reviewed selected failed bank records maintained by DRR in Jacksonville, Florida for information that would provide insight into the bank's failure.

  - Audit Reports prepared by the bank's external auditor, Mauldin & Jenkins, LLC.

  - Pertinent DSC policies and procedures and various banking laws and regulations.

  - Actions that DSC implemented to comply with (1) provisions of section 29 of the FDI Act and FDIC Rules and Regulations Part 337, *Unsafe and Unsound Banking Practices*, restricting Buckhead's use of brokered deposits; and (2) section 38 of the FDI Act, including, but not limited to, issuing PCA notification letters restricting Buckhead's growth and payment of dividends, when applicable, based on Buckhead's capital category.

- Interviewed the following FDIC officials:

  - DSC officials in the Atlanta Regional Office.

  - FDIC examiners from the DSC Atlanta Field Office who participated in examinations of Buckhead.

  - DRR officials at the FDIC Jacksonville, Florida office.

- Met with officials from the DBF to discuss the historical perspective of the institution, its examinations, and other activities regarding the state's supervision of the bank.

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

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

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

The Government Performance and Results Act of 1993 (the Results Act) directs Executive Branch agencies to develop a customer-focused strategic plan, align agency programs and activities with concrete missions and goals, and prepare and report on

Objectives, Scope, and Methodology

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 and of the FDIC's Rules and Regulations. 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. Section 8(c) of the FDI Act authorizes the FDIC to issue a temporary C&D, effective immediately, to halt particularly dangerous practices or conditions pending a formal hearing on a permanent C&D. To obtain a temporary C&D, the FDIC has the burden to show that an unsafe or unsound practice on the part of an institution is likely to cause the insolvency or dissipation of assets or earnings, or to weaken the condition, of the institution.
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.

Glossary of Terms

Term	Definition
Contingency Funding Plan (CFP)	A written plan that defines strategies for addressing liquidity shortfalls in emergency situations. Such plans delineate policies to manage a range of stress environments, establish clear lines of responsibility, and articulate clear implementation and escalation procedures. Contingency funding plans should be regularly tested and updated to ensure that they are operationally sound. DSC uses the term contingency funding plan and contingency liquidity plan interchangeably.
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".
Prompt Corrective Action (PCA)	The purpose of PCA is to resolve the problems of insured depository institutions at the least possible long-term cost to the DIF. Part 325, subpart B, of the FDIC Rules and Regulations, 12 Code of Federal Regulations, section 325.101, et. seq., implements section 38, *Prompt Corrective Action*, of the FDI Act, 12 U.S.C. section 1831(o), by establishing a framework for defining capital adequacy and taking prompt supervisory actions against insured 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.
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
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
CFP	Contingency Funding Plan
CRE	Commercial Real Estate
DBF	Department of Banking and Finance
DIF	Deposit Insurance Fund
DRR	Division of Resolutions and Receiverships
DSC	Division of Supervision and Consumer Protection
FAS	Financial Accounting Standards
FDI	Federal Deposit Insurance
FIL	Financial Institution Letter
MOU	Memorandum of Understanding
OCC	Office of the Comptroller of the Currency
OIG	Office of Inspector General
PCA	Prompt Corrective Action
REST	Real Estate Stress Test
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

June 9, 2010

TO: Stephen Beard
Assistant Inspector General for Material Loss Reviews

/Signed/

FROM: Sandra L. Thompson
Director

SUBJECT: FDIC Response to the Draft Audit Report Entitled, Material Loss Review of The Buckhead Community Bank, Atlanta, Georgia (Assignment No. 2010-021)

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 The Buckhead Community Bank, Atlanta, Georgia (Buckhead) which failed on December 4, 2009. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Report (Report) received on May 19, 2010.

The Report concludes that the decision of Buckhead's Board of Directors' (Board) and management to concentrate the loan portfolio in acquisition, development, and construction (ADC) loans and its reliance on brokered and large deposits were the principal factors leading to its rapid deteriorating financial condition and failure. Buckhead's overall weak loan administration contributed to the increased delinquencies and non-performing assets. Additionally at the time of the economic downturn, Buckhead's Board made an ill-timed decision to expand with the acquisition of another institution with significant ADC concentrations.

From 2005 through December 2009, the FDIC and the Georgia Department of Banking and Finance (GDBF) jointly and separately conducted five full-scope examinations. After Buckhead's acquisition of The First National Bank of Forsyth County (Forsyth) in December 2007, the FDIC immediately began a full scope examination in January 2008. Examiners noted heightened risks due to high concentrations in ADC lending and found that a large portion of the loans adversely classified originated from the Forsyth office. At the December 2008 GDBF and FDIC joint examination, Buckhead's loan assets had further deteriorated to a level that raised significant regulatory concern and posed considerable risk, resulting in GDBF and FDIC implementing a formal enforcement action. Buckhead was unable to raise sufficient capital to absorb the loan losses, support its operations, and maintain liquidity.

DSC recognizes that strong supervisory attention is necessary for institutions with high ADC and commercial real estate concentrations and volatile funding sources, such as Buckhead, and has issued updated guidance reminding examiners to take appropriate action when those risks are imprudently managed.

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