

# Office of Inspector General



Office of Evaluations  
Report No. EVAL-11-001

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**Recapitalization and Resolution  
Efforts Associated with ShoreBank,  
Chicago, Illinois**

March 2011



## Why We Did The Audit

On August 20, 2010, the Illinois Department of Financial and Professional Regulation (IDFPR) closed ShoreBank, Chicago, Illinois and appointed the FDIC as receiver. On August 5, 2010, prior to ShoreBank's failure, two members of the Congress requested that we review private-sector efforts to recapitalize ShoreBank and the FDIC's consideration of ShoreBank's application for funds under the United States Department of the Treasury's (Treasury) Community Development Capital Initiative (CDCI) program. The Members requested that we determine whether the Administration or Members of the Congress exerted political influence over the FDIC associated with efforts to recapitalize ShoreBank.

The objectives of this audit were to determine the following:

- 1) the timeline of events pertaining to the FDIC's supervision and CDCI consideration for ShoreBank;
- 2) the extent and nature of FDIC involvement in the ShoreBank investor recapitalization effort;
- 3) whether the FDIC followed its standard process in reviewing ShoreBank's CDCI application and whether ShoreBank met CDCI eligibility requirements;
- 4) whether the resolution followed selected FDIC policies and regulations related to marketing the bank, assessing purchaser eligibility, and making a least cost decision; and
- 5) whether there was any indication of political or inappropriate influence imposed on the FDIC in connection with the supervision, investor recapitalization effort, CDCI consideration, or resolution of ShoreBank.

Because ShoreBank's failure resulted in a material loss to the Deposit Insurance Fund (DIF), we also conducted a material loss review of ShoreBank, as required by section 38(k) of the Federal Deposit Insurance (FDI) Act. Our material loss review of ShoreBank can be found at <http://www.fdicig.gov>.

We note that, in conjunction with other organizational changes made to enhance the FDIC's ability to carry out its new and enhanced responsibilities under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Division of Supervision and Consumer Protection (DSC) became the Division of Risk Management Supervision (RMS) effective February 13, 2011. As a result of the timing of our fieldwork, we refer to DSC throughout the executive summary and the body of this report.

## Background

ShoreBank was a \$2.2 billion, state-chartered, nonmember bank headquartered in Chicago, Illinois. The institution was established in 1939 as a national bank. In 1973, the Illinois Neighborhood Development Corporation (which later became known as the ShoreBank Corporation (SBC)), acquired control of the bank with the goal of profitably investing in community development activities. A key focus for the new owners was rebuilding their local community that had for a decade been increasingly torn by crime and poverty. The bank converted to a state charter in 1978, and subsequently expanded its operations into Michigan and Ohio.

ShoreBank was wholly owned by SBC, its bank holding company located in Chicago, Illinois. Shareholders of SBC consisted of financial institutions, foundations, insurance companies, faith-based institutions, trusts, and individuals.

ShoreBank's lending strategy focused on providing financing for affordable housing and economic development activities in underserved and economically disadvantaged areas. The institution's customers included small businesses, not-for-profit organizations, churches, and individuals in low- to moderate-income areas, including Chicago's South Side. ShoreBank's asset concentrations and weak risk management practices made the institution vulnerable to a sustained economic downturn in the Chicago real estate market. Ultimately, the losses, provisions, and delinquencies associated with the bank's loan portfolio depleted the institution's earnings and capital, and impaired its liquidity position. The IDFPF closed ShoreBank on August 20, 2010 because the institution did not have sufficient capital to continue normal operations.

## Audit Results

The FDIC and IDFPF conducted regular examinations of ShoreBank, as required, and took formal supervisory action to address the bank's deteriorated financial condition in 2009. During 2009 and 2010, the FDIC sought to avoid a difficult and costly failure and took a number of steps to save ShoreBank. Senior Corporation officials closely monitored ShoreBank's recapitalization effort and provided the Chairman with regular updates. As the recapitalization effort faltered, senior Corporation officials, including the Chairman, contacted banks to discuss their interest in investing in ShoreBank. In addition, based on the bank's ability to raise private capital, the FDIC recommended ShoreBank for CDCI funding. At the time, the bank was poorly rated and met four of the Treasury's six required performance ratios. All of these actions, and others taken with regard to supervising and resolving ShoreBank, were consistent with the FDIC's broad statutory mission of minimizing costs to the DIF and in compliance with applicable policies and procedures. Further, nothing came to our attention to suggest that there was any indication of political or inappropriate influence imposed on the FDIC in connection with any ShoreBank-related matters.

A more detailed discussion of our results follows.

**The FDIC's Supervision of ShoreBank:** The FDIC and IDFPF conducted regular examinations of ShoreBank as required, made recommendations to address identified weaknesses, and issued a formal enforcement action (consent order) in response to the bank's deteriorated financial condition in 2009. FDIC and IDFPF officials told us that their supervisory efforts were not impacted by political or inappropriate influence. At ShoreBank's request, the FDIC's Chairman and senior FDIC headquarters officials met with ShoreBank officials to discuss the bank's condition, planned corrective actions, and a FDIC draft consent order. The Chairman stated that she was otherwise not involved in the supervisory aspects of the bank. Three former outside FDIC Board Members were also directors or officers of ShoreBank and/or SBC; however, Chicago regional officials told us the former outside Board Members' involvement in ShoreBank did not cause the FDIC to supervise the bank any differently.

**Recapitalization Effort:** In 2009 and 2010, ShoreBank solicited a number of potential investors and raised \$146.3 million to strengthen its capital base. We verified that ShoreBank originated the recapitalization effort and determined which investors to contact. We found that FDIC officials closely monitored ShoreBank's recapitalization effort and provided the Chairman with regular updates. As the recapitalization effort faltered, senior Corporation officials, including the Chairman, called institutions to discuss their interest in investing in ShoreBank and subsequently, Urban Partnership, a newly chartered institution created to purchase ShoreBank. Representatives from large banks that we interviewed stated

that they invested in ShoreBank and Urban Partnership primarily because they believed in ShoreBank's mission and they did not feel pressure to invest as a result of the FDIC Chairman's calls.

**Community Development Capital Initiative:** The recapitalization effort was contingent on ShoreBank being approved for approximately \$72 million from Treasury's CDCI program, a Troubled Asset Relief Program initiative intended for Community Development Financial Institutions like ShoreBank. ShoreBank applied for CDCI funds on March 1, 2010. We found that the FDIC followed its standard process and applied the Treasury's viability criteria in reviewing ShoreBank's CDCI application and recommending ShoreBank for funding. ShoreBank was the only composite "5-rated" institution (defined as exhibiting extremely unsafe and unsound practices or conditions) recommended for CDCI funding by the FDIC. The primary consideration for the FDIC's positive recommendation was ShoreBank's ability to raise approximately \$150 million in private capital. With this capital, ShoreBank met four of the six required performance ratios specified by the Treasury. Ultimately, a CDCI Interagency Council disagreed with the FDIC's view and concluded that ShoreBank needed additional capital to be viable and recommended against, and ShoreBank did not receive, CDCI funding.

**Marketing of ShoreBank:** The FDIC marketed ShoreBank in preparation for resolution on two occasions—in March and July 2010. The FDIC suspended marketing efforts in May 2010 at the IDFPR's request to allow for consideration of ShoreBank's CDCI application. We found that the FDIC marketed ShoreBank broadly and offered bidders several standard purchase options. Ultimately, six institutions expressed an interest in ShoreBank and only one institution submitted a bid to buy the bank. We concluded that the FDIC followed applicable procedures related to the marketing of ShoreBank.

**Establishment of Urban Partnership:** In August 2010, a group of ShoreBank officers and investor representatives formed a new bank, Urban Partnership, to acquire ShoreBank out of receivership. The organizers of Urban Partnership included several former ShoreBank officers that were installed at ShoreBank during 2010 to replace managers responsible for ShoreBank's troubled condition. We found that the FDIC followed applicable procedures related to granting deposit insurance, assessing Urban Partnership's eligibility to purchase ShoreBank, and approving its proposed senior officers and Directors. The FDIC expressed confidence in Urban Partnership's management team and draft business plan and concluded that Urban Partnership's purchase of ShoreBank would not create an undue risk to the DIF. The FDIC plans to closely monitor Urban Partnership as it would any *de novo* bank.

**Resolution of ShoreBank:** The IDFPR closed ShoreBank on August 20, 2010, and appointed the FDIC as receiver. On August 27, 2010, the FDIC notified the OIG that the failure cost the DIF an estimated \$329.0 million. The FDIC revised the estimated loss amount to \$452 million as of January 31, 2011, based on updated asset recovery assumptions and liquidation information. Urban Partnership purchased the majority of ShoreBank's assets and liabilities. The FDIC provided a loss share agreement covering ShoreBank's assets that were purchased by Urban Partnership and provided Urban Partnership with financing to facilitate the transaction. We found that the FDIC applied its least cost test to determine the least-costly resolution of ShoreBank, and performed the test and related analysis in conformance with the applicable guidance. By accepting Urban Partnership's bid to purchase ShoreBank, instead of liquidating the bank, the FDIC determined that it avoided an additional DIF loss of \$250.4 million. As part of its resolution costs, the FDIC paid early termination fees to two large banks totaling \$74.5 million associated with the unwinding of ShoreBank's repurchase agreements, as required by the FDI Act. These two banks also committed funds to ShoreBank's recapitalization effort and invested in Urban Partnership.

**Extent of Political or Inappropriate Influence:** As discussed previously, we performed steps to determine whether there was any evidence of political or inappropriate influence associated with the FDIC's handling of ShoreBank-related matters. These steps included (1) interviewing officials from the FDIC, IDFPR, and other federal banking agencies; (2) interviewing representatives from ShoreBank and selected large bank investors; and (3) reviewing selected FDIC officials' e-mail, telephone records, and calendar entries related to ShoreBank, Administration, or Congressional officials. Nothing came to our attention to suggest that the supervision of ShoreBank, private-sector recapitalization effort, CDCI process, ShoreBank marketing process, Urban Partnership qualification process, or resolution of ShoreBank were subject to any political or inappropriate influence.

## Management Response

After we issued our draft report, RMS and the Division of Resolutions and Receiverships (DRR) provided additional information for our consideration, and we revised our report to reflect this information, as appropriate. Because the report contained no recommendations, a written management response was not required. The Director, RMS, elected to provide a written response on March 7, 2011. In the response, the Director reiterated that the FDIC's actions taken with regard to supervising and resolving ShoreBank were within the FDIC's statutory mission of minimizing costs to the DIF and in compliance with applicable policies and procedures. With regard to the CDCI program, the Director noted that the FDIC followed its standard process and applied the Treasury's viability criteria in reviewing ShoreBank's CDCI application and that DSC conducted a comprehensive analysis to determine a capital level that would be necessary to support lending under worse-than-expected economic scenarios.

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**DATE:** March 8, 2011

**MEMORANDUM TO:** Sandra L. Thompson, Director  
Division of Risk Management Supervision

Bret D. Edwards, Acting Director  
Division of Resolutions and Receiverships

**FROM:** */Signed/*  
E. Marshall Gentry  
Acting Assistant Inspector General for Evaluations

**SUBJECT:** *Recapitalization and Resolution Efforts  
Associated with ShoreBank, Chicago, Illinois  
(Report No. EVAL-11-01)*

On August 20, 2010, the Illinois Department of Financial and Professional Regulation (IDFPR) closed ShoreBank, Chicago, Illinois and appointed the FDIC as receiver. On August 5, 2010, prior to ShoreBank's failure, the Ranking Member of the House Financial Services Committee and the Ranking Member of the Subcommittee on Oversight and Investigations requested that we review private-sector efforts to recapitalize ShoreBank and the FDIC's consideration of ShoreBank's application for funds under the United States Department of the Treasury's (Treasury) Community Development Capital Initiative (CDCI) program. The Ranking Members requested that we determine whether the Administration or Members of the Congress exerted political influence over the FDIC's associated efforts to recapitalize ShoreBank.

Further, as required by section 38(k) of the Federal Deposit Insurance (FDI) Act and amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Financial Reform Act), the OIG conducted and publicly released a material loss review (MLR) of the failure of ShoreBank.<sup>1</sup> When the Deposit Insurance Fund (DIF) incurs a material loss with respect to an insured depository institution, the Inspector General of the appropriate federal banking agency shall prepare a report to that agency outlining the bank's causes of failure and the agency's supervision of the institution.

The objectives of this audit were to determine (1) the timeline of events pertaining to the FDIC's supervision and CDCI consideration for ShoreBank; (2) the extent and nature of FDIC involvement in the ShoreBank investor recapitalization effort; (3) whether the FDIC followed its standard process in reviewing ShoreBank's CDCI application and

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<sup>1</sup> The MLR report is entitled, *Material Loss Review of ShoreBank, Chicago, Illinois* (Report No. MLR-11-012), and can be found at <http://www.fdicig.gov>.

whether ShoreBank met CDCI eligibility requirements; (4) whether the resolution followed selected FDIC policies and regulations related to marketing the bank, assessing purchaser eligibility, and making a least cost decision; and (5) whether there was any indication of political or inappropriate influence imposed on the FDIC in connection with the supervision, investor recapitalization effort, CDCI consideration, or resolution of ShoreBank. In addition, to address the requirements of the FDI Act, we (6) determined the causes of ShoreBank's failure and the resulting material loss to the DIF and (7) evaluated the FDIC's supervision of ShoreBank, including the FDIC's implementation of the Prompt Corrective Action (PCA) provisions of section 38 of the FDI Act.

This report addresses the first five objectives, in response to the Ranking Members' concerns and the MLR report addresses objectives six and seven. Appendix 1 of this report contains details on our objectives, scope, and methodology. Appendix 2 contains a list of acronyms.

We note that, in conjunction with other organizational changes made to enhance the FDIC's ability to carry out its new and enhanced responsibilities under the Financial Reform Act, the Division of Supervision and Consumer Protection (DSC) became the Division of Risk Management Supervision (RMS), effective February 13, 2011. As a result of the timing of our fieldwork, we refer to DSC throughout the executive summary and the body of this report.

## **BACKGROUND**

ShoreBank was a \$2.2 billion, state-chartered, nonmember bank headquartered in Chicago, Illinois. The institution was established in 1939 as a national bank. In 1973, the Illinois Neighborhood Development Corporation (which later became known as the ShoreBank Corporation (SBC)), acquired control of the bank with the goal of profitably investing in community development activities. A key focus for the new owners was rebuilding their local community that had for a decade been increasingly torn by crime and poverty. The bank converted to a state charter in 1978, and subsequently expanded operations into Michigan and Ohio.

ShoreBank was wholly owned by SBC, a bank holding company located in Chicago, Illinois. Shareholders of SBC consisted of financial institutions, foundations, insurance companies, faith-based institutions, trusts, and individuals. ShoreBank and SBC's Boards of Directors or officers were comprised of community organizers and former federal bank regulators, three of whom were former outside members of the FDIC's Board of Directors.<sup>2</sup>

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<sup>2</sup> The FDIC's Board of Directors was comprised of the FDIC Chairman, two Directors internal to the FDIC, and two outside board members—the Comptroller of the Currency and the Director of the Office of Thrift Supervision (OTS). The Financial Reform Act made changes to the composition of the Board so that the Director of the OTS will be replaced by the Director of the Consumer Financial Protection Bureau.

ShoreBank's lending strategy focused on providing financing for affordable housing and economic development activities in underserved and economically disadvantaged areas. The institution's customers included small businesses, not-for-profit organizations, churches, and individuals in low- to moderate-income areas, including Chicago's South Side. ShoreBank was certified by the Treasury's Community Development Financial Institution (CDFI) Fund and was the largest CDFI in the United States at the time of its failure.<sup>3</sup>

ShoreBank failed due to insolvency because its Board and management did not implement adequate risk management practices. In particular, ShoreBank's management (1) did not effectively manage the risks associated with its concentrations in Commercial Real Estate and Acquisition, Development, and Construction loans; (2) employed poor underwriting and credit administration practices; and (3) supported loan growth and ongoing operations with non-core funding sources.

ShoreBank's asset concentrations and weak risk management practices made the institution vulnerable to a sustained economic downturn in the Chicago real estate market. Deterioration in the bank's loan portfolio began in 2007 and accelerated throughout 2008 and 2009. Ultimately, the losses, provisions, and delinquencies associated with the bank's loan portfolio depleted the institution's earnings and capital, and impaired its liquidity position. The IDFP closed ShoreBank on August 20, 2010 because the institution did not have sufficient capital to continue normal operations. Urban Partnership Bank (Urban Partnership) acquired ShoreBank out of receivership and was created by investors on August 19, 2010 for the sole purpose of acquiring the assets and assuming the liabilities of ShoreBank.

### **Community Development Capital Initiative Program**

In October 2009, President Obama announced a new Troubled Asset Relief Program (TARP) initiative, known as the CDCI Program, and on February 3, 2010, the Treasury announced the program's final viability criteria. Through this program, CDFI banks, thrifts, and credit unions—that were certified by the Treasury as targeting more than 60 percent of their small business lending and other economic development activities to underserved communities—were eligible to receive capital investments from the Treasury. For CDFIs that might not otherwise be recommended for participation by their regulator, the Treasury offered matching capital investments, up to 5 percent of an institution's risk-weighted assets, against private investments on a dollar-for-dollar basis, provided that the combined amount would return the institution to a viable position. Through the CDCI Program, institutions submitted applications to the FDIC or other appropriate federal banking agency,<sup>4</sup> which then made recommendations to the Treasury about whether to approve or deny funding requests. In certain instances, applications

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<sup>3</sup> Congress established the CDFI Fund in 1994 to expand the capacity of financial institutions to provide credit, capital, and financial services to underserved populations and communities in the United States. A certified CDFI is a specialized financial institution that works in market niches that are underserved by traditional financial institutions.

<sup>4</sup> The banking agencies are the FDIC, the Board of Governors of the Federal Reserve System (FRB), the Office of the Comptroller of the Currency (OCC), and the OTS.

were also reviewed by a CDCI Interagency Council, which was comprised of representatives from the FDIC, FRB, OCC, and OTS. The Council made recommendations to the Treasury regarding a bank's eligibility for CDCI funds. The Treasury determined the final eligibility and allocations for interested parties.

## **AUDIT RESULTS**

The FDIC and IDFPF conducted regular examinations of ShoreBank, as required, and took formal supervisory action to address the bank's deteriorated financial condition in 2009. During 2009 and 2010, the FDIC sought to avoid a difficult and costly failure and took a number of steps to save ShoreBank. Senior Corporation officials closely monitored ShoreBank's recapitalization effort and provided the Chairman with regular updates. As the recapitalization effort faltered, senior Corporation officials, including the Chairman, contacted banks to discuss their interest in investing in ShoreBank. In addition, based on the bank's ability to raise private capital, the FDIC recommended ShoreBank for CDCI funding. At the time, the bank was poorly rated and met four of the Treasury's six required performance ratios. All of these actions, and others taken with regard to supervising and resolving ShoreBank, were consistent with the FDIC's broad statutory mission of minimizing costs to the DIF and in compliance with applicable policies and procedures. Further, nothing came to our attention to suggest that there was any indication of political or inappropriate influence imposed on the FDIC in connection with any ShoreBank-related matters.

### **The FDIC's Supervision of ShoreBank**

The FDIC and IDFPF conducted regular examinations of ShoreBank, as required.<sup>5</sup> FDIC and IDFPF officials told us that their supervisory efforts were not impacted by political or inappropriate influence. At ShoreBank's request, the FDIC's Chairman and senior FDIC headquarters officials met with ShoreBank officials to discuss the bank's condition, planned corrective actions, and an FDIC draft enforcement action (consent order). The Chairman stated that she was otherwise not involved in the supervisory aspects of the bank. Three former outside FDIC Board Members were also directors or officers for ShoreBank and/or SBC; however, Chicago regional officials told us the former outside Board Members' involvement in ShoreBank did not cause the FDIC to supervise the

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<sup>5</sup> Financial institution regulators and examiners use the Uniform Financial Institutions Rating System to evaluate a bank's performance in six components represented by the CAMELS acronym: Capital adequacy, Asset quality, Management practices, Earnings performance, Liquidity position, and Sensitivity to market risk. Each component, and an overall composite score, is assigned a rating of "1" through "5", with "1" having the least regulatory concern and "5" having the greatest concern. CAMELS composite ratings are generally defined as "1", Sound in Every Respect; "2", Fundamentally Sound; "3", Exhibits Some Degree of Supervisory Concern in One or More Component Areas; "4", Exhibits Unsafe and Unsound Practices or Conditions; and "5", Exhibits Extremely Unsafe and Unsound Practices or Conditions. Banks rated a composite "4" or "5" are considered Problem Banks.

bank any differently. We did not identify evidence of political or inappropriate influence in connection with the FDIC’s supervision of ShoreBank.

Table 1 presents a timeline of key events regarding the FDIC’s supervision of ShoreBank between 2008 and 2010 and illustrates the deterioration of the bank.

**Table 1: Timeline of Events Regarding ShoreBank’s Supervision**

Date	Event
1/23/08	October 2007 Joint Examination Report issued. ShoreBank rated 232222/2.
4/17/09	November 2008 Joint Examination Report issued. ShoreBank rated 444444/4.
4/20/09	Joint visitation of ShoreBank.
5/08/09	ShoreBank requested and held a meeting with the Chairman and other FDIC officials.
7/14/09	The FDIC and IDFPR issued a formal consent order against ShoreBank.
11/25/09	The FDIC notified ShoreBank that it was <i>Adequately Capitalized</i> .
2/23/10	The FDIC notified ShoreBank that it was <i>Critically Undercapitalized</i> .
2/24/10	The FDIC made an interim rating change to downgrade ShoreBank to 555555/5.
3/01/10	ShoreBank applied for CDCI funds.
3/22/10	The FDIC amended the consent order to include capital maintenance provisions.
5/18/10	The FDIC extended the period required to place the bank in receivership by 90 days, to August 22, 2010.
6/17/10	The FDIC notified ShoreBank that it should not expect CDCI funds.
6/25/10	January 2010 Joint Examination Report issued. ShoreBank rated 555555/5.
8/20/10	IDFPR closed ShoreBank and appointed the FDIC as receiver.

Source: OIG analysis of supervisory documentation.

The FDIC, in conjunction with the IDFPR, provided ongoing supervisory oversight of ShoreBank through risk management examinations, a visitation, and offsite monitoring efforts. Examinations were conducted in compliance with the required statutory examination schedule, and the FDIC and IDFPR made recommendations for improvement and issued a formal consent order in July 2009, in response to the bank’s deteriorated financial condition. FDIC and IDFPR examiners stated that their supervisory efforts were not impacted by political or inappropriate influence from FDIC officials or officials outside of the FDIC. Further, Chicago regional officials stated that their supervisory efforts were not impacted by former outside FDIC Board members who were associated with ShoreBank and we noted no evidence of such.

The FDIC’s Chairman and senior FDIC headquarters officials participated in a May 8, 2009 meeting requested by ShoreBank. The purpose of the meeting was to discuss ShoreBank’s plans to address deficiencies identified in the November 2008 joint examination and a proposed consent order. ShoreBank representatives discussed the harshness of the proposed consent order and requested that the FDIC instead consider imposing a non-public informal enforcement action. The FDIC did not acquiesce and continued to pursue and ultimately issued a formal enforcement action. As discussed in greater detail in our MLR report, the FDIC and the IDFPR decided not to include a

capital maintenance provision in the original consent order.<sup>6</sup> A senior DSC official stated that ShoreBank representatives did not request that the capital provision be removed from the consent order at the May 8, 2009 meeting.<sup>7</sup> In addition, the Chairman stated that she was not involved in deciding whether to include a capital maintenance provision in the consent order.

The Chairman also stated that she was not involved in any other supervisory matters pertaining to ShoreBank, other than her participation in the May 8, 2009 meeting. For example, she stated that she was not involved in a DSC decision to extend ShoreBank's closure date by 90 days when the bank was *Critically Undercapitalized* or in DSC's decision to recommend ShoreBank for CDCI funds, as discussed later in this report. Our review of FDIC officials' e-mail, phone logs, and e-calendar events, and performance of other audit procedures did not identify any indication that the Chairman was involved in these decisions. Officials in DSC and the Division of Resolutions and Receiverships (DRR) told us that they kept the Chairman apprised of ShoreBank's supervision and resolution activities as they would for any troubled institution.

The FDIC's Vice Chairman received occasional briefings from FDIC staff about ShoreBank-related supervision and resolution activities. The Vice Chairman stated that he was otherwise not involved in any supervisory or resolution efforts regarding ShoreBank.

Finally, as noted previously, three former outside FDIC Board Members served as either board members or officials of ShoreBank and/or SBC.<sup>8</sup> Officials from the Chicago Regional Office told us that the former outside Board Members' involvement in ShoreBank and SBC did not affect the FDIC's supervision of ShoreBank, and nothing came to our attention during our review to suggest otherwise.

## **ShoreBank's Recapitalization Effort**

In 2009 and 2010, ShoreBank solicited a number of potential investors and raised \$146.3 million to strengthen its capital base. We verified that ShoreBank originated the recapitalization effort and determined which investors to contact. We found that FDIC officials closely monitored ShoreBank's recapitalization effort and provided the Chairman with regular updates. As the recapitalization effort faltered, senior Corporation officials, including the Chairman, called institutions to discuss their interest in investing in ShoreBank and subsequently, Urban Partnership, a newly chartered institution created to purchase ShoreBank. Representatives from large investors that we interviewed stated that they invested in ShoreBank and Urban Partnership primarily because they believed in ShoreBank's mission and they did not feel pressure to invest as a result of the FDIC

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<sup>6</sup> The FDIC and the IDFPF amended the order in March 2010 to include a capital maintenance provision when the FDIC became increasingly concerned about the bank's capital position.

<sup>7</sup> A former ShoreBank official informed us that ShoreBank asked the Chicago Regional Office if the consent order could avoid the inclusion of capital maintenance provisions.

<sup>8</sup> One former regulator was a ShoreBank and SBC Director. A second former regulator was an SBC Director. A third former regulator was an SBC officer.

Chairman's calls. A state agency, the Illinois Finance Authority (IFA), also met with the FDIC and the IDFPR to discuss a separate recapitalization effort that never materialized. We did not identify evidence of political or inappropriate influence in connection with the FDIC's activities surrounding ShoreBank's recapitalization effort.

### **ShoreBank's Efforts to Raise Capital**

In the first quarter of 2009, ShoreBank initiated an effort to raise capital by issuing shares of common stock to private investors. ShoreBank initially estimated its capital needs to be around \$20 million. As ShoreBank's asset quality and financial situation continued to deteriorate in 2009 and 2010, ShoreBank officials determined that the bank's capital needs were greater. During July 2009, ShoreBank estimated that it needed approximately \$50 to \$60 million and by the end of 2009, its estimate increased to \$80 to 100 million. In the first quarter of 2010, ShoreBank believed it needed even more capital and later concluded that it would attempt to raise \$125 million in order to qualify for CDCI funds.

During the third quarter of 2009, ShoreBank created a committee to develop a capital campaign and identify prospective investors. ShoreBank asked its officers and directors to invest in ShoreBank and contacted several large banks and foundations about investing in the bank. Several of these investors conducted due diligence at ShoreBank in September and October 2009. In the first quarter of 2010, ShoreBank engaged a consulting firm that assisted the bank in raising capital and identified and contacted a number of large investors.<sup>9</sup> The consultant contacted the FDIC's Chairman to request her assistance with the effort. The Chairman declined the consultant's request. The consultant and another SBC officer—both former outside FDIC Board members—also met with the FDIC's Vice Chairman in March 2010 to provide a status briefing on ShoreBank's capital raising efforts.

By March 2010, ShoreBank had firm funding commitments or expressions of interest from a number of large banks and foundations and by May 2010 had raised \$146.3 million from 53 investors, including financial institutions, foundations, and individuals. The funds were held in escrow and contingent upon ShoreBank's receipt of approximately \$72 million in CDCI funds, as discussed later in this report. We confirmed with a senior ShoreBank officer and FDIC officials that ShoreBank initiated the recapitalization effort and decided which investors to contact.

Although ShoreBank obtained significant capital commitments from investors, ShoreBank ultimately did not receive CDCI funds, as some members of the CDCI Council believed the bank needed significantly more capital to be viable. As a result, the investors that pledged funds to ShoreBank were entitled to reclaim their capital commitments. As discussed later in this report, the vast majority of funds that were committed to ShoreBank were subsequently invested in Urban Partnership.

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<sup>9</sup> The consultant involved with raising capital was a former outside FDIC Board Member and a former SBC Director.

## **FDIC Involvement in ShoreBank's Efforts to Raise Capital**

FDIC regional and headquarters officials closely monitored ShoreBank's recapitalization effort and received status updates from ShoreBank officials. In May 2010, FDIC officials determined that ShoreBank's recapitalization effort was not progressing sufficiently and there were no potential purchasers for the bank. A senior DRR official requested that the Chairman become involved by contacting potential investors that the bank had identified.

The Chairman indicated that she avoided becoming involved in the recapitalization effort until requested to do so by staff. The Chairman was concerned that ShoreBank would be a costly failure and difficult to liquidate. These concerns prompted the Chairman to call the Chief Executive Officers (CEO) of several of the large institutions that ShoreBank had identified as potential investors to explain ShoreBank's recapitalization effort and financial situation, and to request that they consider making an investment. The Chairman also informed some of the large institutions that their share of losses to the DIF resulting from a ShoreBank failure would likely exceed their portion of a capital investment to save ShoreBank. The Chairman stated that she was very direct in these phone calls and wanted to make sure the institutions understood ShoreBank's situation. However, she also stated that it was each institution's decision as to whether it wanted to invest in the bank. The Chairman also contacted some institutions a second time to discuss whether they would transfer their capital commitments from ShoreBank to Urban Partnership. The Chairman estimated that, in the past, she made similar calls to banks to discuss their interest in investing in six to seven other financially distressed institutions, including calls on behalf of a small savings and loan association that had a mission similar to ShoreBank's.

The Chairman stated that she became involved in ShoreBank's recapitalization effort at DRR's request and that her objective in contacting potential investors was to protect the DIF from losses. The Chairman stated that her involvement was not politically motivated and she did not receive requests from Members of Congress or the Administration to assist ShoreBank. The Chairman and the FDIC are responsible for meeting statutory provisions designed to protect the DIF and required to resolve failed financial institutions in a manner that results in the least possible cost to the FDIC. Several statutory provisions in title 12 of the United States Code (U.S.C.) provide the FDIC's Chairman with broad authority to protect the DIF. These provisions are not mandatory but provide the Chairman with the discretion regarding when and what types of action to take to prevent a bank's default and to limit losses.

A senior DSC official also called potential investors to discuss how much capital ShoreBank needed, regulatory matters associated with the bank, and to answer questions about the recapitalization process. This official stated that he did not suggest to any potential investors how much money to invest in ShoreBank. This official also said that it is not unprecedented for the Chairman or other FDIC officials to call institutions about investing in a bank that is financially distressed, especially when the bank's circumstances are elevated to FDIC senior officials, as was the case with ShoreBank.

## **Rationale for Large Banks Investing in ShoreBank**

We contacted six large banks that made capital commitments to ShoreBank and subsequently invested in Urban Partnership. The banks told us that they made these capital commitments for several reasons:

- Five banks indicated that they believed in ShoreBank and Urban Partnership's mission and investing in ShoreBank was socially responsible.
- One bank indicated it would receive Community Reinvestment Act (CRA) credit by investing in ShoreBank.
- Three banks' commitments were made for reputational reasons and upon learning that other large-bank competitors had agreed to invest in ShoreBank.
- One bank had a large presence in Chicago, Illinois and believed in promoting business in that area.

A representative from one bank said that the bank had initially decided against investing in both ShoreBank and Urban Partnership because it wanted to focus its resources on a pending merger and integration with another large bank, but reconsidered and decided to invest after the bank's CEO received phone calls from and discussed the ShoreBank and Urban Partnership investments with the FDIC's Chairman. Senior staff from all of the banks that we contacted stated that they did not feel pressure to invest in ShoreBank as a result of the FDIC's contact, nor did they have any reason to believe that the FDIC's involvement in ShoreBank or Urban Partnership's recapitalization efforts were motivated by political or inappropriate influence. Senior staff from the banks also stated that FDIC officials, including the Chairman, had called the banks in the past about investing in other distressed institutions.

## **Illinois Finance Authority Effort to Recapitalize ShoreBank**

On January 5, 2010, FDIC and IDFPF officials participated in a meeting with ShoreBank and State of Illinois officials. A representative for the IFA<sup>10</sup> provided participants with a strategy designed to save the bank, which was reportedly backed by the Governor of Illinois and a United States Senator from Illinois. The strategy involved issuing up to \$75 million in bonds and using the proceeds to bolster ShoreBank's capital base. According to DSC's meeting notes, the Chicago Regional Office stated that the FDIC would continue to follow its normal regulatory protocols in supervising ShoreBank, regardless of the actions of the IFA. A Chicago regional official told us that the IFA recapitalization effort never materialized.

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<sup>10</sup> The IFA is a self-financed, state authority principally engaged in issuing taxable and tax-exempt bonds, making loans, and investing capital for businesses, non-profit corporations, and local government units in the state of Illinois. The IFA does not receive general revenue funds from the State of Illinois, and the state does not bear any direct or indirect liability for the debt the IFA issues or incurs except for specific, statutorily authorized programs.

## Community Development Capital Initiative Program

The recapitalization effort was contingent on ShoreBank being approved for approximately \$72 million from the Treasury’s CDCI program. ShoreBank applied for CDCI funds on March 1, 2010. We found that the FDIC followed its standard process and applied the Treasury’s viability criteria in reviewing ShoreBank’s CDCI application and recommending ShoreBank for funding. ShoreBank was the only composite “5-rated” institution (defined as exhibiting extremely unsafe and unsound practices or conditions) that FDIC recommended for CDCI funding. The primary consideration for the FDIC’s positive recommendation was ShoreBank’s ability to raise approximately \$150 million in private capital. With this capital, ShoreBank met four of the six required performance ratios specified by the Treasury. Ultimately, the CDCI Interagency Council disagreed with the FDIC’s view and concluded that ShoreBank needed additional capital to be viable and recommended against, and ShoreBank did not receive, CDCI funding. We did not identify evidence of political or inappropriate influence in connection with the FDIC’s review of ShoreBank’s CDCI application. Table 2 shows the timeline of events regarding ShoreBank’s CDCI application.

**Table 2: Timeline of Events Regarding ShoreBank’s CDCI Application**

Date	Event
3/01/10	ShoreBank applied for CDCI funds.
4/02/10	Treasury’s program deadline to apply for CDCI funds.
5/19/10	The FDIC’s Chicago Regional Office (1) finalized its <i>Case Decision Memo</i> , recommending that ShoreBank receive CDCI funds contingent upon certain criteria and (2) forwarded ShoreBank’s application to DSC headquarters for further consideration.
5/26/10	The CDCI Interagency Council considered ShoreBank’s CDCI application and deferred on a vote because the Council members needed more information about ShoreBank’s asset losses and ability to raise additional capital.
6/02/10	The CDCI Interagency Council considered ShoreBank’s CDCI application for a second time and deferred on a vote because of continued questions about ShoreBank’s asset losses and ability to raise additional capital.
6/15/10	The CDCI Interagency Council considered ShoreBank’s CDCI application for a third time. The FDIC recommended that ShoreBank receive CDCI funds and the OCC, FRB, and OTS recommended against funding. As a result, ShoreBank’s application was not forwarded to the Treasury for funding consideration.
6/17/10	The FDIC notified ShoreBank that it should not expect CDCI funds.
9/30/10	CDCI program funding deadline.

Source: FDIC CDCI documentation.

### The CDCI Program and Treasury’s Viability Criteria

The CDCI program was designed to support the continued viability, growth and expansion of CDFI-certified depository institutions. As discussed earlier, ShoreBank was the largest CDFI. The Treasury established CDCI viability criteria which included an institution’s composite examination ratings, CRA rating, and six selected performance ratios. The ratios related to the institution’s classified assets, non-performing loans, and construction and development loan concentrations, and included three standard capital

ratios—Tier 1 Risk-Based Capital, Tier 1 Leverage Capital, and Total Risk-Based Capital Ratios. The Treasury specified acceptable levels for three of the performance ratios and DSC informed us that the capital ratios needed to meet the *Well Capitalized* criteria for Prompt Corrective Action purposes. The FDIC used a *Case Decision Memo* to record its findings related to: ShoreBank’s CAMELS and CRA ratings, the six performance ratios, ShoreBank’s viability, the FDIC’s supervisory strategy, and relevant enforcement actions. The FDIC also included narrative comments in the document to support its recommendation.

The Treasury required the recommendation of each institution’s primary federal regulator in determining the institution’s eligibility for CDCI funds. The eligibility recommendation was based on an assessment of the overall strength and viability of the institution, considering the criteria previously described. In some cases, the primary federal regulator recommended CDCI funds for institutions without considering potential funds received under the CDCI program; these institutions were deemed to be viable on a stand-alone basis. In other cases, the primary federal regulator recommended that the applicant raise additional capital from third parties prior to receiving funds under the CDCI program. In these cases, the primary federal regulator performed a pro-forma capital analysis, which considered third-party and the Treasury’s matching capital investments. Institutions that relied upon private capital and CDCI funds to be viable were reviewed by the CDCI Interagency Council.

### **The FDIC’s Review of ShoreBank’s CDCI Application**

ShoreBank applied for CDCI funds on March 1, 2010 and requested the maximum allowable funding amount.<sup>11</sup> The application was filed with the Chicago Regional Office pursuant to the FDIC’s established process for reviewing CDCI applications. Chicago regional staff evaluated ShoreBank on the basis of the capital it had raised and assuming the receipt of CDCI funds. ShoreBank raised \$146.3 million in capital from investors, which was in escrow and contingent upon the bank’s receipt of CDCI funds. The Chicago Regional Office reviewed ShoreBank’s application and relied upon the Treasury’s guidance to determine whether ShoreBank qualified for CDCI funds. The Chicago Regional Office finalized the *Case Decision Memo* for ShoreBank on May 19, 2010 and determined that ShoreBank met four of the Treasury’s six performance ratios based upon the private capital that ShoreBank had raised and the requested CDCI funds.<sup>12</sup>

Chicago regional staff also performed an analysis to estimate how much capital ShoreBank needed to be considered *Well Capitalized*. According to this analysis, ShoreBank needed between \$175 and \$202 million to be *Well Capitalized*, based on its March 31, 2010 financial data. This analysis considered loan losses that ShoreBank

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<sup>11</sup> At the time of its CDCI application, ShoreBank requested and was eligible for \$74.7 million in CDCI funds (5 percent of its Risk-Weighted Assets). According to its most recent financial statements at the time of the FDIC’s review of ShoreBank’s CDCI application, the bank’s Risk-Weighted Assets had decreased and the bank was eligible to receive \$71.6 million in CDCI funds.

<sup>12</sup> ShoreBank did not meet any of the performance ratios on a pre-subscription basis, which did not consider the private capital or requested CDCI funds.

already recognized as well as future estimated loan losses and other performance factors over a 2-year period. DSC staff told us that the assumptions used to estimate future losses and other performance factors were consistent with those used by the banking agencies in completing the 2009 Supervisory Capital Assessment Program.<sup>13</sup>

On May 19, 2010, the Chicago Regional Office forwarded ShoreBank's application to DSC headquarters for additional consideration and recommended the bank for funding contingent upon:

- ShoreBank's ability to raise a minimum of \$151 million of new private equity in conjunction with \$71.6 million from the Treasury; and
- ShoreBank establishing a technical advisory committee to monitor and mitigate enterprise-wide risks. The committee was to be comprised of individuals that were not involved in the daily operations of ShoreBank or SBC.

DSC headquarters officials reviewed the Chicago Regional Office's recommendation for the purpose of determining whether to forward the application to the CDCI Interagency Council for consideration. DSC officials told us that their primary reason for recommending ShoreBank for CDCI funding was the bank's assessed viability subject to its ability to raise private capital in combination with the receipt of CDCI funds, an improved management team, and a refocused business plan. These officials believed that ShoreBank would have been viable had it received CDCI funding and capital from third-party investors; therefore, the FDIC forwarded ShoreBank's application to the CDCI Interagency Council for consideration, as called for by the Treasury's guidelines.

### **The CDCI Interagency Council's Review of ShoreBank's CDCI Application**

The CDCI Interagency Council considered ShoreBank's CDCI application at three meetings between May and June 2010 (see Table 2). The FDIC presented a detailed analysis of ShoreBank's capital levels and asset quality and answered questions raised by the Council members. Council members' discussions focused on ShoreBank's capital needs and viability. While the FDIC provided an assessment showing that ShoreBank needed between \$175 and \$202 million to be viable, based on the capital analysis described above, the FRB and OCC decided that the bank needed at least \$100 million more in capital than what the FDIC estimated in order to recommend ShoreBank for CDCI funding. The FRB, OCC, and OTS did not perform detailed analyses to estimate ShoreBank's capital needs. Ultimately, the FDIC's Council member voted in favor of, and the FRB, OTS, and OCC Council members voted against ShoreBank's receipt of CDCI funds.

The FDIC's Council member voted in favor of CDCI funds because ShoreBank would have received \$146.3 million from committed investors and \$71.6 million from the Treasury (\$217.9 million in total) had ShoreBank been approved for CDCI funds. This

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<sup>13</sup> In the wake of the recent financial crisis, this interagency program assessed whether the largest domestic financial organizations had sufficient levels of capital to withstand a recession and financial market turmoil.

amount exceeded the FDIC's capital needs estimate, and the FDIC's Council member believed that ShoreBank would have been viable had it received those funds. Further, the FDIC's Council member believed that the investors that committed capital to ShoreBank would have provided the bank with additional capital, if needed. This Council member believed ShoreBank was unique because the bank successfully raised a significant amount of capital to be eligible for CDCI funds and made significant changes to its management team and board. The FDIC's Council member believed that ShoreBank's new management team and board would have successfully managed the bank.

Due to continued questions about ShoreBank's viability and capital needs, the FRB, OCC, and OTS Council members voted against CDCI funding. We contacted four Council members who represented the FRB, OCC, and OTS and they provided the following reasons for not recommending ShoreBank for CDCI funds:

- The FRB, OCC, and OTS Council members believed that ShoreBank needed significantly more capital to be viable than what the FDIC had estimated;
- One Council member was not comfortable recommending ShoreBank for CDCI funds because the FDIC and FRB (the primary regulator for ShoreBank's holding company) did not agree on the amount of ShoreBank's capital needs;
- One Council member believed that ShoreBank's level of problem assets was severely understated in the FDIC's *Case Decision Memo* and ShoreBank's Allowance for Loan and Lease Losses was inadequate;
- Three Council members had concerns about ShoreBank's management team; and
- One Council member would have been more comfortable had the FDIC and FRB performed more detailed capital needs analyses for ShoreBank.

Based on the CDCI Interagency Council vote, ShoreBank's CDCI application was not forwarded to the Treasury for funding consideration and ShoreBank did not receive CDCI funds.

### **The FDIC's Review of All CDCI Applications**

We also evaluated the FDIC's review of other CDCI applications to provide perspective on how ShoreBank's application was handled. During 2010, the FDIC's regional offices reviewed 64 CDCI applications and made recommendations for or against providing funding to each applicant. If the regional office recommended CDCI funding, the FDIC's DSC headquarters office reviewed the application and made the final funding recommendation to the Treasury or the CDCI Interagency Council, as appropriate. If the regional office did not recommend CDCI funding, the related application did not receive any further FDIC review and was not forwarded to the Treasury or the CDCI Interagency Council for consideration.

The FDIC’s regional offices forwarded 14 of the 64 CDCI applications to DSC headquarters for further consideration. The 14 applicants had the following composite ratings at the time they submitted their applications:

- ShoreBank had a CAMELS composite rating of “5”.
- None of the banks had a CAMELS composite rating of “4”.
- 13 of the banks had a CAMELS composite rating of “2” or “3”.

ShoreBank was the only bank that was considered for CDCI funds based on a combination of privately raised capital and the requested CDCI funds. The other 13 banks were evaluated on a stand-alone basis. As a result, we compared the number of performance ratios that ShoreBank met after considering the receipt of private capital and CDCI funds to the number of performance ratios that the other 13 banks met on a stand-alone basis. Information about the number of performance ratios met for the 14 applications considered by DSC headquarters follows:

- ShoreBank met four of the Treasury’s six performance ratios when both private capital and CDCI funds were considered.
- Ten banks met all of the Treasury’s performance ratios on a stand-alone basis.
- Three banks met five out of six of the Treasury’s performance ratios on a stand-alone basis.

The FDIC recommended that Treasury provide CDCI funding for 12 institutions, with 11 of the recommendations requiring review by the CDCI Interagency Council. The CDCI Interagency Council recommended CDCI funding for all of the banks except for ShoreBank. Ultimately, Treasury approved 10 of the 12 FDIC-recommended institutions to receive CDCI funds.

The FDIC’s regional offices did not recommend CDCI funding for the remaining 50 applicants. These applications were not forwarded to DSC headquarters or the Treasury for consideration. Table 3 provides an overview of the CAMELS composite ratings of the banks for which the regional offices did not recommend funding. DSC officials told us that these institutions did not meet the viability criteria on a stand-alone basis and had not demonstrated the ability to raise private capital in order to be evaluated for viability post-receipt of CDCI funding.

**Table 3: Ratings for Banks That Did Not Receive CDCI Funding Recommendations from FDIC Regional Offices**

<b>Most Recent Rating at the Time of the CDCI Application</b>	<b>Number of Banks</b>
Sound in Every Respect (1-rated)	0
Fundamentally Sound or Exhibits Some Degree of Supervisory Concern (2- and 3-rated)	14
Exhibits Unsafe or Extremely Unsafe and Unsound Practices (4- and 5-rated)	36
Total	50

Source: FDIC CDCI data.

## **Political or Inappropriate Influence Related to ShoreBank's CDCI Application**

We contacted four CDCI Interagency Council members who represented the FRB, OCC, and OTS to inquire whether ShoreBank's CDCI application received preferential treatment or if politics played a role in any decisions regarding ShoreBank's application for CDCI funds. The Council members indicated that ShoreBank's CDCI application process was similar to that followed for other CDCI applicants but believed that ShoreBank was an "outlier," as it was the only composite "5-rated" institution to receive consideration by the CDCI Interagency Council. All four Council members said that they did not make any decisions regarding ShoreBank's CDCI application based on any type of political influence nor were they aware of anyone else inside or outside of the FDIC who did so.

Two Council members expressed surprise over the FDIC's strong support of ShoreBank's CDCI application, given the bank's weak financial condition and prospects for viability even after considering proposed capital infusions. In this regard, one Council member stated that the Council was subject to "abnormally high pressure" from the FDIC to approve ShoreBank for CDCI funding. The Council member commented on the FDIC's strong support of ShoreBank's CDCI application and noted that the FDIC presented the application to the CDCI Interagency Council at three Council meetings and "continued to argue for its approval even after it had been rejected multiple times by other Council members." The Council member stated that while the pressure to approve CDCI funding for ShoreBank was unusual, there was no indication that the FDIC's actions were politically motivated.

According to a Treasury official responsible for administering the CDCI program, at least one other CDCI application was considered at three or even four CDCI Interagency Council meetings, and the Council considered ShoreBank's CDCI application in a similar fashion to the way it considered other CDCI applications. This official also stated that ShoreBank was unique because it raised funds from private investors.

In addition, we interviewed relevant FDIC officials and reviewed their e-mail, phone logs, and e-calendar events to determine whether FDIC officials were subject to political or inappropriate influence to take any actions regarding ShoreBank's CDCI application. We did not identify any evidence of such influence in connection with ShoreBank's CDCI application.

## **Marketing of ShoreBank as a Failed Bank Resolution Transaction**

The FDIC marketed ShoreBank in preparation for resolution on two occasions—in March and July 2010. We found that the FDIC marketed ShoreBank broadly and offered bidders several standard purchase options. Only six institutions expressed an interest in ShoreBank, and Urban Partnership was the only institution that submitted a bid to purchase the bank. We concluded that the FDIC followed applicable procedures related

to marketing ShoreBank and did not identify evidence of political or inappropriate influence in connection with the FDIC's marketing efforts.

The overall goal of marketing an institution is to develop and analyze a variety of marketing options to arrive at a strategy that encourages competition among potential acquirers and results in the least-costly resolution of the failing institution. DRR's *Resolutions Policy Manual* outlines the procedures that the FDIC should follow when marketing a failing institution.<sup>14</sup>

Prior to ShoreBank's two marketing efforts, the FDIC used a standard process to identify potential bidders that met certain eligibility criteria. These criteria were approved by FDIC senior management and consisted of institutions with the following characteristics:

- *Well Capitalized;*
- At least \$2 billion in total assets and \$1.1 billion in total deposits;<sup>15</sup>
- Satisfactory or better CAMELS, CRA, Compliance,<sup>16</sup> and FRB bank holding company composite ratings; and
- Satisfactory anti-money laundering records.

Table 4 provides an overview of the timeline of events related to the FDIC's marketing of ShoreBank.

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<sup>14</sup> DRR Resolutions Policy Manual – Chapter IV, *Marketing the Failing Institution*.

<sup>15</sup> The FDIC changed its bid criteria for the second marketing effort. Eligible institutions were required to have at least \$1.5 billion in total assets and \$1.2 billion in deposits.

<sup>16</sup> The FDIC conducts compliance examinations to determine whether a financial institution is meeting its responsibility to comply with federal consumer protection laws and regulations.

**Table 4: Timeline of Events Regarding the Marketing of ShoreBank**

Date	Event
02/17/10	The FDIC identified 212 institutions that met the eligibility criteria to purchase ShoreBank.
03/19/10	The FDIC requested pre-closing deposit data from ShoreBank to determine the value of its insured and uninsured deposits.
03/27/10	DRR arrived on site to prepare for ShoreBank's failure.
03/30/10	First marketing campaign initiated. ShoreBank was marketed to 72 of the 212 institutions identified on February 17, 2010.
03/30/10	DRR opened IntraLinks to potential bidders.*
05/03/10	The FDIC informed potential bidders for another failing bank in the Chicago area of the opportunity to also purchase ShoreBank.
05/07/10 and 05/14/10	The FDIC notified two other banks of the opportunity to purchase ShoreBank.
05/17/10	First marketing effort halted.
06/17/10	The FDIC identified 259 institutions that met the eligibility criteria to purchase ShoreBank.
07/14/10	Second marketing campaign initiated. ShoreBank was marketed to the 259 institutions identified on June 17, 2010.
07/28/10	Urban Partnership gained access to the IntraLinks Web site.
08/18/10	Urban Partnership submitted its bid to purchase ShoreBank.
08/19/10	The FDIC approved Urban Partnership's bid.
08/20/10	ShoreBank was closed.

Source: FDIC DRR data.

\* IntraLinks is a secure Web site that the FDIC uses to post documents and exchange comments with a specific group of internal and external users. The site contained key financial information about ShoreBank, details of the proposed transaction, and other pertinent information for potential bidders.

### The FDIC's Marketing Efforts

As part of the first marketing effort, on February 17, 2010, the FDIC identified 212 institutions that met the eligibility criteria to purchase ShoreBank. Seventy-two of these institutions were located in the Chicago metropolitan area, Illinois, and contiguous states to Illinois; the remaining 140 institutions were located in non-contiguous states, according to DRR. In an effort to prevent media leaks regarding ShoreBank's resolution, DRR informed us that the FDIC only marketed ShoreBank to the 72 institutions that were geographically closer to the bank. The FDIC notified the 72 eligible bidders via e-mail on March 30, 2010, of an opportunity to purchase a bank in the State of Illinois with \$2.2 billion in assets, and that interested parties needed to respond via e-mail to gain access to the FDIC's IntraLinks site in order to view additional information about the bank. The FDIC offered ShoreBank under five different options, all of which constituted standard FDIC offerings as shown in Table 5.

**Table 5: Purchase and Assumption Offerings for ShoreBank**

Purchase and Assumption Option	Description
1. Whole Bank Purchase and Assumption Agreement with Loss Share Provisions	<ul style="list-style-type: none"> <li>• The assuming institution bids on insured deposits only or all deposits, with the exception of certain brokered deposits.</li> <li>• The assuming institution acquires substantially all of the assets.</li> <li>• Certain assets and liabilities are excluded from the transaction.</li> <li>• Bank premises and the bank’s furniture, fixtures, and equipment (FF&amp;E) can be acquired by the assuming institution under a 90-day post-closing option.</li> <li>• The FDIC reimburses the purchaser for up to 80 percent of the failed institution’s loan losses for up to 10 years.</li> </ul>
2. Whole Bank Purchase and Assumption Agreement with <b>no</b> Loss Share Provisions	<ul style="list-style-type: none"> <li>• Same as number 1 except the FDIC does not reimburse the assuming institution for loan losses.</li> </ul>
3. Modified Whole Bank Purchase and Assumption Agreement with Loss Share Provisions	<ul style="list-style-type: none"> <li>• Same as number 1 except additional assets are excluded from the transaction.</li> </ul>
4. Purchase and Assumption Agreement with Optional Loan Pools	<ul style="list-style-type: none"> <li>• The assuming institution has the option to acquire all of the deposits or only the insured deposits, with the exception of certain brokered deposits.</li> <li>• Certain assets and liabilities are excluded from the transaction.</li> <li>• The assuming institution has the option to purchase any, all, or none of the optional loan pools. Optional loan pools typically consist of performing and non-performing pools of the various loan types.</li> <li>• Loan pools can be bid and purchased separately or linked to the deposit franchise bid. The FDIC does not reimburse the assuming institution for losses.</li> <li>• The assuming institution has a 90-day post-closing option to acquire the bank’s premises and FF&amp;E.</li> <li>• The assuming institution has a 30-day post-closing option to acquire loans (if the loans were not acquired as part of the bid option pools).</li> </ul>
5. Clean Purchase and Assumption Agreement*	<ul style="list-style-type: none"> <li>• The assuming institution has the option to acquire all deposits or only the insured deposits, with the exception of certain brokered deposits.</li> <li>• The assuming institution has a 90-day post-closing option to acquire the bank’s premises and FF&amp;E.</li> <li>• The assuming institution has a 30-day post-closing option to acquire loans (if the loans were not acquired as part of the bid option pools).</li> <li>• The FDIC does not reimburse the assuming institution for losses.</li> </ul>

Source: FDIC DRR officials.

\* The FDIC no longer offers transaction number 5 on its own; this transaction is now offered as a part of transaction number 4 - *Purchase and Assumption Agreement with Optional Loan Pools*.

On May 3, 2010, the FDIC notified all of the bidders that were eligible to purchase another failing institution in the Chicago area, of the opportunity to also purchase ShoreBank, resulting in an increase in the number of potential bidders that could

purchase ShoreBank.<sup>17</sup> Later in May 2010, the FDIC notified two additional banks about the ShoreBank acquisition opportunity because the FDIC believed these banks may have been interested in ShoreBank.

During the first marketing effort, four banks expressed an interest in ShoreBank, two banks conducted due diligence, but none submitted a bid because of ShoreBank's risk profile and geographic location. ShoreBank's recapitalization effort was underway during the first marketing effort, and due to its success, the IDFPR asked the FDIC to halt the ShoreBank marketing effort, which the FDIC did on May 17, 2010.<sup>18</sup>

The FDIC initiated the second marketing effort in July 2010, after ShoreBank did not receive CDCI funds and it became apparent that ShoreBank would be closed. On June 17, 2010, the FDIC identified 259 institutions that met the eligibility criteria and notified all of these institutions of the acquisition opportunity, via e-mail on July 14, 2010. ShoreBank was offered as a Whole Bank Purchase and Assumption Agreement with or without loss share provisions.

During the second marketing effort, one bank expressed an interest in submitting a nonconforming bid for ShoreBank's Treasury Management Business, which oversaw the bank's relationship-based deposits. FDIC staff spoke to the bank about this potential bid but the bank's Board of Directors did not allow the bank to submit a bid. Ultimately, Urban Partnership submitted the only bid to purchase ShoreBank.

FDIC management stated that ShoreBank had a very specialized market and was the largest CDFI at the time, making it difficult to interest potential bidders. Further, the other CDFIs in existence at the time did not meet the bid list criteria to purchase ShoreBank, as they were not sufficiently large or healthy. Finally, ShoreBank was offered at the same time as eight other banks in the Chicago region, all of which were financially sounder than ShoreBank.

## **Establishment of Urban Partnership**

Urban Partnership was formed in August 2010 to acquire ShoreBank out of receivership. The organizers of Urban Partnership included several former ShoreBank officers that were installed at ShoreBank during 2010 to replace managers responsible for ShoreBank's troubled condition. We found that the FDIC followed applicable procedures related to granting deposit insurance to Urban Partnership, assessing its eligibility to purchase ShoreBank, and approving its proposed senior officers and Directors. The FDIC expressed confidence in Urban Partnership's management team and

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<sup>17</sup> The FDIC also notified all of the potential bidders for ShoreBank of the opportunity to purchase this other institution in the Chicago area. FDIC staff informed us that when more than one bank is offered for sale in the same geographic area and when the banks have certain characteristics in common, the FDIC may share the names of the potential bidders of each bank with each other. This results in a larger number of potential bidders for each bank.

<sup>18</sup> As of May 26, 2010, ShoreBank received capital commitments from investors totaling \$146.3 million.

proposed business plan<sup>19</sup> and concluded that Urban Partnership’s purchase of ShoreBank would not create an undue risk to the DIF. The FDIC plans to closely monitor Urban Partnership as it would any *de novo* bank. We did not identify evidence of political or inappropriate influence in connection with the FDIC’s approval of Urban Partnership’s deposit insurance application or the assessment of its qualification to purchase ShoreBank.

### Organization of Urban Partnership

Once it became apparent that ShoreBank would not receive CDCI funds and the bank would be closed, recently installed ShoreBank officers formed a new bank, Urban Partnership, to acquire ShoreBank. This initiative required Urban Partnership to quickly obtain a state nonmember bank charter from the IDFPR, deposit insurance from the FDIC, and agreement from several of the large ShoreBank investors to allow their capital commitments to transfer to Urban Partnership. Table 6 shows key events regarding the formation of Urban Partnership.

**Table 6: Timeline of Events Regarding Urban Partnership**

Date	Event
7/22/10	The FDIC began looking into matters regarding Urban Partnership’s deposit insurance application.
7/28/10	Urban Partnership gained access to the IntraLinks Web site.
8/10/10	Urban Partnership formally applied for deposit insurance.
8/16/10	The FDIC issued its <i>Risk-to-the-Fund</i> memorandum, which provided an overview of Urban Partnership, its purchase of ShoreBank, and concluded that the purchase would not present an undue risk to the DIF.
8/16/10	The State of Illinois granted Urban Partnership a permit to organize.
8/17/10	Bids were due for the purchase of ShoreBank.
8/18/10	Urban Partnership submitted its bid to purchase ShoreBank.*
8/19/10	DSC approved Urban Partnership’s application for deposit insurance.
8/19/10	The State of Illinois granted a bank charter to Urban Partnership, establishing the bank.
8/19/10	DSC approved Urban Partnership’s bid for ShoreBank.
8/20/10	ShoreBank was closed by the State of Illinois. The Purchase and Assumption Agreement between Urban Partnership and the FDIC took effect.

Source: FDIC correspondence and other data.

\* Urban Partnership submitted its bid to purchase ShoreBank on August 18, 2010, 1 day after the due date for bid applications. DRR extended the due date at Urban Partnership’s request, which allowed the bank to resolve an administrative issue related to one of its investors. An FDIC official estimated that DRR extends the due date 25-30 percent of the time, often to accommodate the receipt of a bid that may be delayed for administrative or logistical reasons.

Urban Partnership is an FDIC-insured, state nonmember, community-development bank. Similar to ShoreBank, Urban Partnership’s mission includes promoting economic and environmental sustainability and serving the needs of low- and moderate-income groups in urban Chicago, Illinois; Cleveland, Ohio; and Detroit, Michigan. No Federal or state

<sup>19</sup> The Chicago Regional Office received Urban Partnership’s proposed business plan in February 2011 and as of February 22, 2011, was in the process of evaluating the plan for approval. Prior to February 2011, the Regional office received other draft versions of the business plan.

regulators opposed the creation of Urban Partnership. Urban Partnership applied through the Treasury for its CDFI designation in November 2010.

Urban Partnership is wholly owned by financial institutions (including banks, bank holding companies, thrift holding companies, and their affiliates), foundations, other companies, and individuals that sought to continue ShoreBank's mission. Urban Partnership was organized so that no one investor would own a controlling interest in the bank. Each investor's ownership is limited to 4.9 percent of the voting shares of the bank and 14.9 percent of the bank's total equity.<sup>20</sup>

Twenty-two of the 53 investors that pledged funds to ShoreBank transferred their investments to Urban Partnership. Of the \$146 million raised by ShoreBank, \$139 million was invested in Urban Partnership. Certain investors withdrew the funds that they had placed in escrow for the recapitalization effort because they were officers or employees of ShoreBank but did not transition to Urban Partnership, to avoid a conflict of interest, or because of uncertainty regarding whether Urban Partnership would continue certain lending programs.

### **The FDIC's Review of Urban Partnership's Deposit Insurance Application**

The FDIC is charged by statute with the responsibility of acting on applications for federal deposit insurance by all depository institutions. In considering applications for deposit insurance, the FDIC must evaluate each application in relation to seven statutory factors prescribed in section 6 of the FDI Act (12 U.S.C. § 1816).

DSC evaluated Urban Partnership's deposit insurance application in relation to the following seven statutory factors: (1) the depository institution's financial history and condition; (2) the adequacy of the capital structure; (3) future earnings prospects; (4) the general character and fitness of management; (5) the risk presented to the DIF; (6) the convenience and needs of the community to be served; and (7) whether the institution's corporate powers are consistent with the purposes of the FDI Act. DSC determined that Urban Partnership met the seven statutory factors and was therefore eligible to receive deposit insurance.

We reviewed relevant documentation and interviewed FDIC officials who processed Urban Partnership's deposit insurance application. As shown in Table 6, Urban Partnership applied for deposit insurance on August 10, 2010, and DSC approved the bank for deposit insurance 9 days later, on August 19, 2010. DSC staff told us that they followed their normal process for reviewing and processing Urban Partnership's deposit insurance application, except the process was expedited and the FDIC assigned more people to this task in order to complete the review timely.

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<sup>20</sup> According to FDIC staff, the investors wanted to avoid any appearance of controlling Urban Partnership's operations. Further, as a result of the limited ownership interests, the investors' liability is limited in the event that Urban Partnership fails, and the investors are not subject to the Bank Holding Company Act.

Given that Urban Partnership was a proposed depository institution formed for the sole purpose of acquiring the assets and assuming the liabilities of ShoreBank, an insured institution in default, the FDIC employed procedures consistent with those outlined in the FDIC's November 26, 2008 Press Release *FDIC Expands Bidder List for Troubled Institutions*. The Press Release alerted the industry that:

“...in light of the time constraints involved with these types of transactions and consistent with the FDIC's Statement of Policy on Applications for Deposit Insurance, the FDIC may apply modified deposit insurance application processes. The FDIC will consider abbreviated information submissions and applications, and may issue conditional approval for Deposit Insurance, in order to qualify interested parties for the FDIC's failing institution bidders list.”

Consistent with the above guidance, the FDIC followed approved procedures to resolve the statutory factors contained in section 6 of the FDI Act in reaching its decision to grant Urban Partnership deposit insurance. The FDIC approved Urban Partnership's deposit insurance application in time for Urban Partnership to submit a bid to purchase ShoreBank. A senior DSC official stated that most of the capital for Urban Partnership came from banks or bank holding companies well-known to the FDIC, and the FDIC had vetted Urban Partnership's key management officials.

Commensurate with FDIC guidance on *de novo* institutions,<sup>21</sup> the FDIC plans to (1) conduct a visitation of Urban Partnership within 6 months of its inception and annual examinations every year for its first 7 years of operations; (2) monitor changes in Urban Partnership's management; (3) review applicable financial data; and (4) approve Urban Partnership's proposed business plan and ensure the bank is in compliance with the plan.

### **Urban Partnership's Management Structure**

Urban Partnership was established by ShoreBank senior officers or Directors who were hired by ShoreBank, after it became a troubled institution, to address problems identified by regulators. These individuals transitioned to Urban Partnership and were not responsible for ShoreBank's decline, according to FDIC and IDFPR officials.<sup>22</sup> Table 7 provides an overview of senior ShoreBank officials who transitioned to Urban Partnership.

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<sup>21</sup> DSC Memorandum 6200, entitled: *Deposit Insurance Application Processing and De Novo Institution Supervision and Examination Guidance*, dated August 26, 2009.

<sup>22</sup> Following its downgrade to a composite "4" rating in 2008, ShoreBank replaced several executive officers, most notably its President and the Chief Credit Officer. According to DSC officials, these changes were made too late to stem ShoreBank's decline.

**Table 7: ShoreBank Officials Who Transitioned to Urban Partnership**

Official	Role and Tenure at ShoreBank	Role at Urban Partnership
Official 1	Appointed to ShoreBank’s Board in June 2010. Prior to this appointment, this individual was not affiliated with ShoreBank or SBC.	Executive Chair and Director.
Official 2	Became the Chief Operating Officer of ShoreBank in June 2010. Prior to assuming this position, this individual was not affiliated with ShoreBank or SBC.	President, CEO, and Director.
Official 3	Became a consultant to ShoreBank in February 2010 and a full-time employee in May 2010.	Chief Financial Officer (CFO), Cashier, and Director.
Official 4	Became ShoreBank’s Director, President, and CEO in January 2010.  Affiliated with SBC since 1976 and became a CFO in 1996, Director in December 2009, and CEO and President in April 2010.	This individual served temporarily in a transitional role, as an advisor to retain ShoreBank’s core mission and key community linkages. This individual left Urban Partnership on January 31, 2011. FDIC examination reports of ShoreBank did not contain any negative information about this individual.

Source: FDIC and ShoreBank documentation.

DSC had previously approved three of the managers depicted in Table 7 when those managers were initially hired by ShoreBank. 12 CFR Part 303, Subpart F, sets forth the circumstances under which an insured state nonmember bank must notify the FDIC of a change in any member of its board of directors or any senior executive officer and the procedures for filing such notice. Subpart F implements section 32 of the FDI Act. This law requires insured state nonmember banks to give the FDIC written notice at least 30 days prior to the effective date of any addition or replacement of a member of the board of directors or the employment or change in responsibilities of any individual to a position as a senior executive officer if:

- The bank is not in compliance with all minimum capital requirements applicable to the bank as determined on the basis of the bank’s most recent report of condition or report of examination;
- The bank is in troubled condition; or
- The FDIC determines, in connection with its review of a capital restoration plan required under section 38(e)(2) of the FDI Act or otherwise, that such notice is appropriate.

We found that ShoreBank submitted the applicable documents and the FDIC reviewed and approved ShoreBank’s management changes for Officials 1, 2, and 4 from Table 7. ShoreBank did not submit a complete application for Official 3, and, as a result, this person did not assume a CFO role at ShoreBank. The FDIC later approved Official 3 to

become the CFO and Director of Urban Partnership as part of its approval of Urban Partnership's application for deposit insurance.

Further, the FDIC considered the background, integrity, and competence of all of Urban Partnership's senior officers and Directors as part of its review of Urban Partnership's deposit insurance application. The FDIC required proposed Directors and officers to submit biographies and financial information. The FDIC's review of this information did not identify any negative results, and the FDIC concluded that Urban Partnership's senior officers and Directors were seasoned, well-regarded professionals in banking, finance, and accounting, and capable of serving as a satisfactory core management team.

### **Differences Between ShoreBank and Urban Partnership**

As part of the deposit insurance approval process, the FDIC reviewed a draft version of Urban Partnership's business plan to ensure that the bank appeared viable and that Urban Partnership's operations would be sufficiently different from ShoreBank's. Benefitting from "lessons learned" regarding ShoreBank, Urban Partnership's proposed business plan showed that it intended to refine its business model by:

- Assembling a management team of banking professionals who had extensive experience in successful bank operations;
- Singularly focusing on banking services to urban marketplaces, which consisted of unbanked and under-banked individuals, businesses, organizations, and entrepreneurs;
- Balancing its risk portfolio and ensuring its customer base fit the bank's mission, operating risk, profit, and business operating goals;
- Focusing on centralized technologies and processes that provided clarity, a lack of duplication, and clear lines of accountability;
- Establishing policies, procedures, and oversight bodies to effectively manage the bank's portfolio and underwriting risk;
- Using technology to better access information and ensure transactions were executed at a lower cost;
- Developing transparent and integrated processes to better enable risk management and bank operations; and
- Establishing a Board of Directors consisting of local, diverse, independent individuals with banking, legal, financial, real estate development, and community development experience and expertise. Board members would serve only 1-year terms to ensure that the governance needs of the bank could be rapidly adjusted as needs arose.

## **The FDIC's Assessment of Urban Partnership's Eligibility to Purchase ShoreBank**

The FDIC has rules and regulations in effect to ensure that a potential purchaser meets certain eligibility criteria to purchase a failed institution. *Restrictions on Sale of Assets by the Federal Deposit Insurance Corporation*, codified at 12 C.F.R., part 340, prohibits individuals or entities that profited or engaged in wrongdoing at the expense of an insured institution, or seriously mismanaged an insured institution, from buying assets of failed financial institutions from the FDIC. FDIC Circular 7220.4, *Purchaser Eligibility Certification* (PEC), provides guidance on implementing 12 C.F.R. part 340 and states that a potential bidder is required to provide the FDIC with an unmodified PEC prior to the FDIC's acceptance of any offer to purchase assets. The purpose of a PEC is to identify prospective purchasers that are not eligible to purchase assets of failed financial institutions from the FDIC.

The FDIC and IDFPF represented that the individuals responsible for ShoreBank's closure did not transition to Urban Partnership. The 2008 and 2010 joint examination reports noted that ShoreBank made significant changes to its overall management structure and that certain Board members or managers resigned or were terminated. In particular, ShoreBank replaced its President and Chief Credit Officer. We also verified that Urban Partnership is wholly owned by 22 entities, including financial institutions, foundations, and individuals, none of which were employees of ShoreBank or responsible for the bank's closure.

Urban Partnership submitted a PEC that indicated it was eligible to purchase ShoreBank, that neither Urban Partnership nor any of its affiliated entities had a delinquent obligation to the FDIC or any other failed institution, and that neither Urban Partnership nor any of its associated persons caused a substantial loss to ShoreBank. The FDIC accepted the assertions in ShoreBank's PEC, as the PEC is a self-certification document and the FDIC does not typically verify its assertions.

## **Resolution of ShoreBank**

The IDFPF closed ShoreBank on August 20, 2010, and appointed the FDIC as receiver. On August 27, 2010, the FDIC notified the OIG that the failure cost the DIF an estimated \$329.0 million. The FDIC revised the estimated loss amount to \$452 million as of January 31, 2011, based on updated asset recovery assumptions and liquidation information. Urban Partnership purchased the majority of ShoreBank's assets and liabilities. The FDIC provided a loss share agreement covering ShoreBank's assets that were purchased by Urban Partnership and provided Urban Partnership with financing assistance to facilitate the transaction.

We found that the FDIC applied its least cost test to determine the least-costly resolution of ShoreBank, and performed the test and related analysis in conformance with the applicable guidance. By accepting Urban Partnership's bid to purchase ShoreBank, instead of liquidating the bank, the FDIC determined that it avoided an additional DIF loss of \$250.4 million. As part of its resolution costs, the FDIC paid early termination fees to two large banks totaling \$74.5 million associated with the unwinding of ShoreBank's repurchase agreements, as required by the FDI Act. These two banks also committed funds to ShoreBank's recapitalization effort and invested in Urban Partnership. We did not identify evidence of political or inappropriate influence in connection with the resolution of ShoreBank.

The FDIC entered into a purchase and assumption agreement with Urban Partnership to purchase ShoreBank. As of June 30, 2010, ShoreBank had approximately \$2.2 billion in total assets and \$1.5 billion in total deposits. Urban Partnership acquired an estimated \$1.5 billion and \$1.3 billion of ShoreBank's assets and liabilities, respectively. Urban Partnership paid a discount of \$146.3 million (11 percent) for ShoreBank's assets and a premium of 0.5 percent to assume ShoreBank's deposits. Urban Partnership purchased all of ShoreBank's loans. The FDIC retained approximately \$655 million and \$910 million of ShoreBank's assets and liabilities, respectively. According to FDIC officials, the assets and liabilities that the FDIC retained are not typically transferred to acquiring institutions.<sup>23</sup>

The FDIC provided a loss share agreement covering \$1.4 billion of ShoreBank's assets that were purchased by Urban Partnership. The loss share agreement specified that the FDIC would reimburse Urban Partnership for up to 80 percent of its losses incurred over a 10-year period on single-family residential loans and up to 80 percent of its losses incurred over a 5-year period on other assets. Loss sharing is a feature that the FDIC introduced into selected purchase and assumption transactions in 1991 and has been commonly included in recent bank resolutions.

To minimize the cost to the DIF, the FDIC retained ShoreBank's brokered deposits and paid out those deposits directly from the receivership. The FDIC typically retains brokered deposits in the receivership, as the FDIC is able to unwind these deposits more efficiently and at a lower cost than an assuming institution. This approach resulted in the assets included in the sale exceeding the liabilities and a resolution transaction payment due from Urban Partnership of approximately \$75 million. The FDIC, in its receivership capacity, offered to accept a 5-year promissory note for \$75 million which provided Urban Partnership with liquidity that would have otherwise been provided by the excluded brokered deposits. This form of financing was offered to all prospective bidders for the bank and was expected to increase the number of potential bidders by providing a source of liquidity and permitting bids that were closer to the intrinsic value of ShoreBank's assets. FDIC officials stated that substituting note financing for high-

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<sup>23</sup> The assets retained by the FDIC included securities, tax assets, bank-owned life insurance, FF&E; and Federal Home Loan Bank stock. The liabilities retained by the FDIC included secured borrowings, certain brokered deposits, and payments due to general creditors.

cost brokered deposits can maximize recoveries, and DRR informed us of three recent closed bank transactions that had similar liability structures (i.e., where assets exceeded liabilities) and where such financing was provided.

The FDIC also provided Urban Partnership a line of credit allowing it to draw up to \$100 million because the FDIC was concerned that entities would remove funds they deposited with ShoreBank upon its acquisition by Urban Partnership. As of March 7, 2011, Urban Partnership had not borrowed against this line of credit. FDIC officials were not aware of other instances where a similar line of credit was offered to a purchasing institution. FDIC staff told us that offering financing assistance and a line of credit are both rare and only offered when an institution is difficult to sell.

### **Least Cost Decision**

We reviewed the FDIC's least cost analysis and interviewed FDIC staff who prepared the least cost calculations to obtain an overview of the FDIC's process for estimating DIF losses under various resolution methods. We also reviewed applicable portions of DRR's *Least Cost Test Manual*, which provides a detailed description of how to determine the least-costly resolution of a failing institution. We found that ShoreBank's least cost analysis was prepared in conformance with the applicable portions of this manual. The FDIC determined that the least-costly resolution was to accept Urban Partnership's bid to purchase ShoreBank, instead of liquidating the bank, which avoided an additional DIF loss of \$250.4 million.

Since 1991, the FDIC has been subject to a statutory mandate that requires it to address a stressed financial institution by using the resolution type that is the least-costly to the DIF of all possible options.<sup>24</sup> The FDIC calculates the least cost by using standard formulas that are contained in a series of Excel spreadsheets to determine the DIF costs associated with applicable resolution methods. The formulas take into account a bank's balance sheet items, valuations of the bank's assets, estimated losses and expenses, and bids received. If there are multiple bidders and types of bids to purchase a failing bank, the FDIC is required to compare each bid to determine which one results in the least cost to the DIF. There are three basic resolution methods for failing institutions, as follows:

- **Purchase and assumption transaction:** A closed institution transaction in which a healthy institution purchases some or all of the assets of a failed financial institution and assumes some or all of the liabilities, including all insured deposits.
- **Deposit payoff:** This option applies when there are no bidders for a failing financial institution. As soon as the appropriate chartering authority closes the bank

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<sup>24</sup> The FDIC Improvement Act of 1991 amended the FDI Act to require the invocation of the least-costly resolution in resolving a distressed institution. The only exception to the "least cost resolution" requirement is when it is determined that a systemic risk to the financial system exists. A least cost resolution can be foregone only if the Board of Directors of the FDIC, the Board of Governors of the Federal Reserve System, and the Secretary of the Treasury, in consultation with the President of the United States, determine the least-costly approach would have serious adverse effects on economic conditions or financial stability.

or thrift, the FDIC is appointed receiver. The FDIC pays all of the failed institution's depositors for the full amount of their insured deposits, up to \$250,000.

- **Open bank assistance transaction:** The FDIC as insurer provides financial assistance to an operating insured bank or thrift determined to be in danger of failing. In this capacity, the FDIC may make loans to, purchase the assets of, or place deposits in, a troubled institution. Where possible, an assisted institution is expected to repay its assistance loan. Due to restrictions imposed by legislation, open bank assistance is no longer a commonly used resolution method.

ShoreBank was resolved through the purchase and assumption resolution method. The FDIC's least cost analysis for resolving ShoreBank was straightforward because the FDIC was only required to compare Urban Partnership's bid to the estimated cost of liquidation, as there were no other bidders and open bank assistance did not apply to ShoreBank. Using standard formulas and computations to estimate the cost to the DIF, the FDIC estimated that liquidating ShoreBank would have cost the FDIC \$618.1 million while selling ShoreBank to Urban Partnership cost the FDIC \$367.7 million.<sup>25</sup> As a result, the FDIC determined that accepting Urban Partnership's bid to purchase ShoreBank avoided an additional loss of \$250.4 million, resulting in the least-costly resolution of ShoreBank.

As discussed earlier, between August 27, 2010, and January 31, 2011, the FDIC increased its DIF loss estimate for the ShoreBank failure by \$123 million (from \$329 million to \$452 million), based on updated asset recovery assumptions and liquidation information. According to DRR officials, the assumptions used by the Division of Finance in estimating the asset recovery amounts had changed. Our understanding is that the FDIC applied these revised assumptions to all receiverships, and some loss estimates increased, while others decreased. We confirmed that the assumptions would apply equally to a deposit payoff or a purchase and assumption transaction, thus the change in assumptions would not have impacted ShoreBank's least cost test.

### **Long-Term Repurchase Agreements**

At the time of its failure, ShoreBank had approximately \$400 million in outstanding repurchase agreements that it relied upon for funding and liquidity needs. Under such agreements, an institution sells a security to a counterparty and agrees to repurchase the security at a mutually agreed upon date and price. The agreement provides the institution with an immediate source of liquidity. The majority of ShoreBank's repurchase agreements had 5 to 7 years remaining before maturity, were considered non-core funding sources, and contained early termination penalties, which were triggered when ShoreBank failed. While the FDIC can repudiate many contracts at the time of a bank's failure, repurchase agreements are statutorily protected by the FDI Act and fall into the category of Qualified Financial Contracts that the FDIC must honor. As a result, the

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<sup>25</sup> These amounts include failure costs to the DIF (\$329 million) and costs to the Transaction Account Guarantee Program (\$38.7 million).

FDIC incurred approximately \$77 million in early termination fees payable to its counterparties. Two of the counterparties also committed funds to ShoreBank's recapitalization effort and subsequently invested in Urban Partnership. The FDIC paid the majority of the termination fees (\$74.5 million) to these two counterparties, as required by the agreements.

DRR officials informed us that the repurchase agreements terms used by ShoreBank were similar to those used by other banks that enter into repurchase agreements and are under the FDIC's supervision. DRR officials also informed us that ShoreBank's level of repurchase agreements and related termination fees were significantly higher than those associated with most other bank failures. According to DSC, this was because ShoreBank historically relied upon high levels of non-core funding sources, including repurchase agreements, due to limited funding from deposits in the areas the bank serviced.

### **Extent to Which There Was Political or Inappropriate Influence Regarding ShoreBank Matters**

As discussed previously, we performed steps to identify evidence of political or inappropriate influence associated with the FDIC's handling of ShoreBank-related matters. These steps included (1) interviewing officials from the FDIC, IDFP, and other federal banking agencies; (2) interviewing representatives from ShoreBank and selected large bank investors; and (3) reviewing selected FDIC officials' e-mail, telephone records, and calendar entries related to ShoreBank, Administration, or Congressional officials. None of the officials we interviewed indicated that they were subject to political or inappropriate influence. Further, nothing came to our attention to suggest that the supervision of ShoreBank, private-sector recapitalization effort, CDCI process, ShoreBank marketing process, Urban Partnership qualification process, or resolution of ShoreBank were subject to any political or inappropriate influence.

### **CORPORATION COMMENTS**

After we issued our draft report, RMS and DRR provided additional information for our consideration, and we revised our report to reflect this information, as appropriate. Because the report contained no recommendations, a written management response was not required. The Director, RMS, elected to provide a written response on March 7, 2011. In the response, the Director reiterated that the FDIC's actions taken with regard to supervising and resolving ShoreBank were within the FDIC's statutory mission of minimizing costs to the DIF and in compliance with applicable policies and procedures. With regard to the CDCI program, the Director noted that the FDIC followed its standard process and applied the Treasury's viability criteria in reviewing ShoreBank's CDCI application and that DSC conducted a comprehensive analysis to determine a capital level that would be necessary to support lending under worse-than-expected economic scenarios. The response is included in its entirety in Appendix 3.

## Objectives, Scope, and Methodology

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### Objectives

On August 5, 2010, prior to ShoreBank's failure, the Ranking Member of the House Financial Services Committee and the Ranking Member of the Subcommittee on Oversight and Investigations requested that we review private-sector efforts to recapitalize ShoreBank and the FDIC's consideration of ShoreBank's application for funds under the Treasury's CDCI program. The Ranking Members requested that we determine whether the Administration or Members of the Congress exerted political influence over the FDIC associated with efforts to recapitalize ShoreBank.

Further, as required by section 38(k) of the FDI Act, and amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Financial Reform Act), the OIG conducted an a MLR of the failure of ShoreBank. When the DIF incurs a material loss with respect to an insured depository institution, the Inspector General of the appropriate federal banking agency shall prepare a report to that agency outlining the bank's causes of failure and the agency's supervision of the institution.

The objectives of this audit were to determine (1) the timeline of events pertaining to the FDIC's supervision and CDCI consideration for ShoreBank; (2) the extent and nature of FDIC involvement in the ShoreBank investor recapitalization effort; (3) whether the FDIC followed its standard process in reviewing ShoreBank's CDCI application and whether ShoreBank met CDCI eligibility requirements; (4) whether the resolution followed selected FDIC policies and regulations related to marketing the bank, assessing purchaser eligibility, and making a least cost decision; and (5) whether there was any indication of political or inappropriate influence imposed on the FDIC in connection with the supervision, investor recapitalization effort, CDCI consideration, or resolution of ShoreBank. In addition, to address the requirements of the FDI Act, we (6) determined the causes of ShoreBank's failure and the resulting material loss to the DIF and (7) evaluated the FDIC's supervision of ShoreBank, including the FDIC's implementation of the PCA provisions of section 38 of the FDI Act.

This report addresses the first five objectives, in response to the Ranking Members' concerns. We issued a separate report addressing objectives six and seven, which can be found at <http://www.fdicig.gov>.

We conducted this performance audit from August 2010 to February 2011 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.

## Objectives, Scope, and Methodology

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### Scope and Methodology

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

- Reviewed the following:
  - Pertinent regulations, policies, procedures, guidance, and other documents related to the CDCI program and the FDIC's marketing of failing institutions, assessment of purchaser eligibility, and least cost decision.
  - Marketing materials related to ShoreBank and documents that described how the FDIC identified eligible ShoreBank purchasers and how ShoreBank was offered to potential purchasers.
  - ShoreBank's CDCI application and *Case Decision Memo*.
  - Information about the 64 institutions that the FDIC considered for CDCI funds and their CAMELS ratings at the time of their CDCI applications.
  - E-mail, e-calendar events, and phone logs from selected FDIC officials to determine their level of involvement with ShoreBank, its recapitalization effort, and its CDCI application; if they had contact with Administration or Congressional officials regarding ShoreBank or Urban Partnership; and whether any individuals acted inappropriately or were subject to political or inappropriate pressure regarding any actions they undertook regarding ShoreBank or Urban Partnership. We also reviewed e-mail from two ShoreBank and SBC officials. We received a large volume of e-mail and due to limited staff resources, narrowed our in-depth review of e-mail to those that pertained to FDIC officials who we interviewed and a limited number of e-mail from ShoreBank-related officials.
- Interviewed the following officials:
  - The FDIC's Chairman, Vice Chairman, and Deputy to the Chairman for External Affairs.
  - DSC's Director and Senior Deputy Director.
  - DRR's Deputy and Associate Directors and former Director.
  - The FDIC's Ethics Program Manager and Legal Division officials.
  - Other FDIC officials in headquarters, the Chicago Regional Office, and the Dallas Regional Office regarding the supervision of ShoreBank, ShoreBank's recapitalization effort, the marketing and resolution of

## Objectives, Scope, and Methodology

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ShoreBank, the creation of Urban Partnership, and the FDIC's least cost decision.

- Officials from the FRB, OCC, OTS, Treasury, Urban Partnership, and six banks that pledged capital to ShoreBank and Urban Partnership.

We asked interviewees from both inside and outside of the FDIC if they or anyone they knew of were subject to political or inappropriate influence regarding any activities associated with ShoreBank and Urban Partnership.

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

Consistent with the audit objectives, we did not substantively assess the FDIC's overall internal controls or management control structures related to the areas that we reviewed. 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 information from various sources, including examination reports, correspondence files, and testimonial evidence, and in some instances used this information 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. Our objectives did not require us to evaluate the FDIC's efforts to meet the Results Act.

Regarding compliance with laws, regulations, policies and procedures, we performed tests to determine whether the FDIC complied with applicable requirements related to its review of ShoreBank's CDCI application; supervision, marketing, and resolution of ShoreBank, including the least cost analysis and decision; and assessment of Urban Partnership's deposit insurance application and eligibility to purchase ShoreBank. Additionally, we assessed the risk of fraud and abuse related to our objectives in the course of evaluating audit evidence.

## Acronyms

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CAMELS	<u>C</u> apital, <u>A</u> sset Quality, <u>M</u> anagement, <u>E</u> arnings, <u>L</u> iquidity and <u>S</u> ensitivity to Market Risk
CDCI	Community Development Capital Initiative
CDFI	Community Development Financial Institution
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CRA	Community Reinvestment Act
DIF	Deposit Insurance Fund
DRR	Division of Resolutions and Receiverships
DSC	Division of Supervision and Consumer Protection
FDI	Federal Deposit Insurance
FF&E	Furniture, Fixtures, and Equipment
FRB	Board of Governors of the Federal Reserve System
IDFPR	Illinois Department of Financial and Professional Regulation
IFA	Illinois Finance Authority
MLR	Material Loss Review
OCC	Office of the Comptroller of the Currency
OIG	Office of Inspector General
OTS	Office of Thrift Supervision
PCA	Prompt Corrective Action
PEC	Purchaser Eligibility Certificate
RMS	Risk Management Supervision
SBC	ShoreBank Corporation
TARP	Troubled Asset Relief Program
Treasury	United States Department of the Treasury
U.S.C.	United States Code

## Corporation Comments

**Federal Deposit Insurance Corporation**

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

Division of Supervision and Consumer Protection

March 7, 2011

**TO:** Jon T. Rymer  
Inspector General

**FROM:** /Signed/  
Sandra L. Thompson  
Director

**SUBJECT:** FDIC's Division of Supervision and Consumer Protection's Response to the Draft Report Entitled *Recapitalization and Resolution Efforts Associated with ShoreBank, Chicago, Illinois* (Assignment No. 2010-085)

The Division of Supervision and Consumer Protection (DSC) has received and reviewed your report entitled *Recapitalization and Resolution Efforts Associated with ShoreBank, Chicago, Illinois*. Your review confirms that the supervision and application processes were not subject to any potential or inappropriate influence, and DSC followed applicable policies and procedures.

The FDIC and the Illinois Department of Financial and Professional Regulation conducted regular examinations of ShoreBank, made recommendations to address identified weaknesses, and took formal supervisory actions to address the Bank's deteriorating financial condition. The Bank failed primarily because the Board and management did not effectively manage the risks associated with concentrations in commercial real estate and acquisition, development, and construction loans.

Before ShoreBank failed, the institution engaged in significant capital-raising efforts in the private and public sectors. Late in 2009, the U.S. Department of the Treasury (Treasury) developed the Community Development Capital Initiative (CDCI) program which was designed to support the viability and expansion of financial institutions that promoted access to capital and economic growth in low-income communities across the nation. Shore Bank, the largest certified Community Development Financial Institution in the country, submitted an application for the CDCI program one month after the program standards were finalized.

The FDIC followed its standard process and applied the Treasury's viability criteria in reviewing ShoreBank's CDCI application. DSC conducted a comprehensive analysis to determine a capital level that would be necessary to support lending under worse-than-expected economic scenarios. DSC then recommended ShoreBank for CDCI funding; this recommendation was based primarily on the institution's success in raising a significant amount of private capital as well as substantive changes made to the management team and the Board. The CDCI funding request was denied, and it became apparent the Bank would be closed. The FDIC's Division of Resolutions and Receiverships followed established procedures for marketing a failing institution, and a new bank was chartered to assume the deposits of ShoreBank. In the formation of Urban Partnership Bank, the FDIC followed applicable policies and procedures for evaluating deposit insurance applications.

Your review confirms that the actions taken with regard to supervising and resolving ShoreBank were within the FDIC's statutory mission of minimizing costs to the Deposit Insurance Fund and in compliance with applicable policies and procedures. Thank you again for the opportunity to review and comment on your Report.