Office of Inspector General

Office of Material Loss Reviews
Report No. MLR-11-005

Material Loss Review of CF Bancorp, Port Huron, Michigan

December 2010

Office of Inspector General

Executive Summary

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Why We Did The Audit

On April 30, 2010, the Michigan Office of Financial and Insurance Regulation (OFIR) closed CF Bancorp, Port Huron, Michigan, on the grounds that the institution was in an unsafe and unsound condition, and named the FDIC as receiver. On June 2, 2010, the FDIC notified the Office of Inspector General (OIG) that CF Bancorp's total assets at closing were $1.8 billion and the estimated loss to the Deposit Insurance Fund (DIF) was $582.2 million. As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, and as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the OIG conducted a material loss review (MLR) of the failure of CF Bancorp. As of October 31, 2010, the estimated loss to the DIF had decreased to $535.7 million.

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

Background

CF Bancorp was established as a mutual federal savings and loan in 1937. The institution became a state-chartered mutual savings bank in 1997, and completed a mutual-to-stock conversion in 2001. CF Bancorp historically focused on 1-4 family real estate mortgages. In 2003, management shifted its lending strategies by placing increased emphasis on commercial real estate (CRE) loans, including acquisition, development, and construction (ADC) projects.

CF Bancorp was wholly-owned by Citizens First Bancorp (Citizens First), a one-bank holding company. Citizens First's other wholly-owned subsidiaries included Coastal Equity Partners, LLC, an entity established to own and operate real estate, and Horizon Capital Management, an investment advisor. The holding company also owned CF1 Investment Fund, LLC, that was formed for real estate and business investments. In January 2004, Citizens First acquired Metrobank, which, in October 2005, was merged into CF Bancorp.

The bank, itself, also maintained several subsidiaries, including Citizens First Mobile Services, LLC; Citizens First Mortgage, LLC, a mortgage company that primarily originated conforming residential loans; Citizens Financial Services, Inc., which owned CFS Insurance Agency, LLC; and a 50-percent ownership of CFS Title Insurance Agency, LLC, a title insurance company.

Audit Results

Causes of Failure and Material Loss

CF Bancorp's failure was due to poor risk selection, which included concentrations in CRE and ADC loans with collateral located in Michigan and Florida, and investments in private-label collateralized mortgage obligations (CMO). CF Bancorp historically focused on 1-4 family real estate mortgages; however, in 2003, bank management shifted lending strategies and increased CRE and ADC lending. These portfolios increased significantly in 2005 and 2006, with the growth funded by brokered deposits and Federal Home Loan Bank borrowings. In 2008, the bank began experiencing significant losses in its

CRE and ADC portfolios. In addition, in 2007, management shifted its business focus by investing in CMOs backed by nontraditional residential mortgages. These higher-risk securities were also funded with non-core funding sources and exposed the bank to substantial risk in declining market conditions. Due diligence for these investments was poor, and the market value of these assets deteriorated rapidly. As a result of the decline in market value, the CMO portfolio suffered significant adverse classifications and losses. In fact, at the July 2009 examination, examiners determined that the CMO portfolio represented 57 percent of adversely classified assets.

In addition, ineffective Board of Directors (Board) and management oversight contributed to weak risk management practices. According to the July 2009 examination report, the bank's risk management program did not rise to the level of sophistication required to monitor and manage the risks associated with the bank's CRE loan and CMO investment portfolios.

As of year-end 2008, CF Bancorp reported a net loss of almost $53 million, due, in part, to the high cost of maintaining and selling Other Real Estate Owned acquired via foreclosure, a trend that was expected to continue, and recognition of losses on the bank's large CMO portfolio. The significant loan and CMO portfolio losses resulted in deep net operating losses, deterioration of capital ratios, a strain on bank liquidity, and a high sensitivity to market risk. Ultimately, the bank did not have enough capital to adequately support its risk profile and could not absorb the losses.

The FDIC's Supervision of CF Bancorp

The FDIC, in conjunction with the OFIR, provided ongoing supervision of CF Bancorp through regular onsite risk management examinations and a visitation. Specifically, during the period June 2005 through April 2010, the FDIC and the OFIR jointly conducted five onsite examinations, and the FDIC performed one visitation. Through their supervisory efforts, the FDIC and OFIR identified key risks in CF Bancorp's operations and brought these risks to the attention of the institution's Board and management in examination reports and through informal and formal enforcement actions.

CF Bancorp was flagged by the Statistical CAMELS Offsite Rating (SCOR) system every quarter from December 2006 through June 30, 2008. Generally, written offsite reviews were prepared; however, the results of the reviews noted that the FDIC would continue to monitor the bank on an offsite basis or that either in-process or upcoming examinations eliminated the need for further offsite action. Accordingly, although SCOR detected emerging risks, the early warnings did not result in a substantial shift in the FDIC's supervisory strategy. The FDIC and OFIR, however, did start the 2008 joint examination about 2 months earlier than was required.

The FDIC and the OFIR issued or proposed five enforcement actions over the period July 2005 through February 2010. Specifically,

- A July 2005 Memorandum of Understanding (MOU) addressed weak management practices related to the bank's Bank Secrecy Act and Anti-Money Laundering programs.
- In December 2008, the FDIC and OFIR issued an MOU that addressed asset quality, capital, earnings, liquidity, and management issues.

- During the July 2009 joint examination, examiners determined that a CF Bancorp officer deliberately had relevant bank documents hidden from regulators, purged appraisal information from loan files, and had relevant information excluded from reports requested by the examiners. As a result, the FDIC proposed a removal action and an action for civil money penalties under the FDI Act against the officer, which is still being pursued. The officer was placed on administrative leave and resigned on October 2, 2009.

- Based on the findings of the July 2009 examination and the continued deterioration in the overall condition of the bank, regulators pursued a Cease and Desist Order (C&D) against the bank. The C&D became effective February 24, 2010 and required the bank to address supervisory concerns related to management, capital, asset quality, earnings, liquidity, and sensitivity to market risk.

At the time of the 2007 examination, CF Bancorp's financial condition was considered satisfactory, but there were several risks and declining trends associated with asset quality. Many asset quality factors fell within the parameters of the satisfactory rating that was assigned, and examiners took certain steps to address the risks and declining trends. In retrospect, however, given existing and forecasted local economic conditions, additional emphasis on the potential impact of the risks and trends may have been prudent as examiners were assessing the bank's operations and determining a supervisory response.

As for PCA, based on the supervisory actions taken with respect to CF Bancorp, we determined that the FDIC properly implemented applicable PCA provisions of section 38.

Management Response

On November 24, 2010, the Director, Division of Supervision and Consumer Protection (DSC), provided a written response to a draft of this report. That response is provided in its entirety as Appendix 4 of this report. DSC reiterated the OIG's conclusions regarding the causes of CF Bancorp's failure. With regard to our assessment of the FDIC's supervision of CF Bancorp, DSC's response referenced the number of examinations conducted between 2005 and 2010, as described in our report. Further, DSC's response noted that the 2008 and 2009 examinations revealed an increase in the bank's risk profile as a result of the new, higher-risk business strategy, and weak internal controls and reporting that delayed loan workout strategies and collections. As mentioned in our report, examiners downgraded CF Bancorp's ratings and pursued supervisory actions based on those examination results.

DSC also indicated that it has issued guidance to enhance its supervision of institutions, such as CF Bancorp, with concentrated CRE and/or ADC lending and reliance on volatile non-core funding. Specifically, DSC mentioned a 2008 Financial Institution Letter (FIL) on *Managing Commercial Real Estate Concentrations in a Challenging Environment* that re-emphasizes the importance of robust credit risk management practices and sets forth broad supervisory expectations, and a 2009 FIL on *Risk Management of Investments in Structured Credit Products*, which provided clarification to existing guidance and strongly recommended vigilant due diligence and appropriate internal controls related to such credit products.

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

Office of Material Loss Reviews
Office of Inspector General

DATE:	December 2, 2010
MEMORANDUM TO:	Sandra L. Thompson, Director Division of Supervision and Consumer Protection
FROM:	**/Signed/** Stephen M. Beard Assistant Inspector General for Material Loss Reviews
SUBJECT:	*Material Loss Review of CF Bancorp, Port Huron, Michigan* (Report No. MLR-11-005)

As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, and as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Financial Reform Act), the Office of Inspector General (OIG) conducted a material loss review (MLR) of the failure of CF Bancorp, Port Huron, Michigan. The Michigan Office of Financial and Insurance Regulation (OFIR) closed CF Bancorp on April 30, 2010, on the grounds that the institution was in an unsafe and unsound condition, and named the FDIC as receiver. On June 2, 2010, the FDIC notified the OIG that CF Bancorp's total assets at closing were $1.8 billion and the estimated loss to the Deposit Insurance Fund (DIF) was $582.2 million. The estimated loss exceeds the $200 million MLR threshold for losses occurring between January 1, 2010 and December 31, 2011, as established by the Financial Reform Act. As of October 31, 2010, the estimated loss to the DIF had decreased to $535.7 million.

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

The objectives of this material loss review were to (1) determine the causes of CF Bancorp's failure and the resulting material loss to the DIF and (2) evaluate the FDIC's supervision of CF Bancorp, including the FDIC's implementation of the PCA provisions of section 38 of the FDI Act. This report presents our analysis of CF Bancorp's failure and the FDIC's efforts to ensure that the Board of Directors (Board) and management operated the institution in a safe and sound manner. The report does not contain formal recommendations. Instead, as major causes, trends, and common characteristics of institution failures are identified in our MLRs, we will communicate those to FDIC management for its consideration. As resources allow, we may also conduct more comprehensive reviews of specific aspects of the FDIC's supervision program and make recommendations as warranted.[1]

Appendix 1 contains details on our objectives, scope, and methodology. We also include several other appendices to this report. Appendix 2 contains a glossary of key terms, including material loss, the FDIC's supervision program, and the Uniform Financial Institutions Rating System, otherwise known as the CAMELS ratings. Appendix 3 contains a list of acronyms and Appendix 4 contains the Corporation's comments on this report.

Background

CF Bancorp, which was headquartered in Port Huron, Michigan, was established as a mutual federal savings and loan in 1937. The institution became a state-chartered mutual savings bank in 1997 and completed a mutual-to-stock conversion in 2001. CF Bancorp historically focused on 1-4 family real estate mortgages. In 2003, management shifted its lending strategies by placing increased emphasis on commercial real estate (CRE) loans, including acquisition, development, and construction (ADC) projects.

CF Bancorp was wholly-owned by Citizens First Bancorp (Citizens First), a one-bank holding company. Citizens First's other wholly-owned subsidiaries included Coastal Equity Partners, LLC, an entity established to own and operate real estate, and Horizon Capital Management, an investment advisor. The holding company also owned CF1 Investment Fund, LLC, that was formed for real estate and business investments. In January 2004, Citizens First acquired Metrobank, which, in October 2005, was merged into CF Bancorp.

The bank, itself, also maintained several subsidiaries, including Citizens First Mobile Services, LLC; Citizens First Mortgage, LLC, a mortgage company that primarily originated conforming residential loans; Citizens Financial Services, Inc., which owned CFS Insurance Agency, LLC; and a 50-percent ownership of CFS Title Insurance Agency, LLC, a title insurance company.

Table 1 summarizes selected financial information pertaining to CF Bancorp for the year ending December 31, 2009 and for the preceding 4 calendar years.

Table 1: Selected Financial Information for CF Bancorp, 2005 to 2009

Financial Data ($000s)	Dec 2009	Dec 2008	Dec 2007	Dec 2006	Dec 2005
Total Assets	1,712,782	1,954,783	1,795,681	1,767,669	1,664,910
Total Loans	1,266,626	1,434,726	1,543,916	1,598,813	1,440,698
Total Deposits	1,436,836	1,298,761	1,198,538	1,195,744	1,103,840
Net Income (Loss)	(118,177)	(52,864)	3,521	9,430	9,252

Source: Uniform Bank Performance Reports (UBPR) for CF Bancorp.

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

Causes of Failure and Material Loss

CF Bancorp's failure was due to poor risk selection, which included concentrations in CRE and ADC loans with collateral located in Michigan and Florida, and investments in private-label collateralized mortgage obligations (CMO). CF Bancorp historically focused on 1-4 family real estate mortgages; however, in 2003, bank management shifted lending strategies and increased CRE and ADC lending. These portfolios increased significantly in 2005 and 2006, with the growth funded by brokered deposits and Federal Home Loan Bank (FHLB) borrowings. In 2008, the bank began experiencing significant losses in its CRE and ADC portfolios.

In 2007, management shifted its business focus by investing in CMOs[2] backed by "Alt-A" mortgage loans.[3] These higher-risk securities were also funded with non-core funding sources and exposed the bank to substantial risk in declining market conditions. Due diligence for these investments was poor, and the market value of these assets deteriorated rapidly. As a result of the decline in market value, the CMO portfolio suffered significant adverse classifications and losses. In fact, at the July 2009 examination, examiners determined that the CMO portfolio represented 57 percent of adversely classified assets.

Also playing a role in the failure was ineffective Board and management oversight that contributed to weak risk management practices. According to the July 2009 examination report, the bank's risk management program did not rise to the level of sophistication required to monitor and manage the risks associated with the bank's CRE and ADC loan and CMO investment portfolios.

As of year-end 2008, CF Bancorp reported a net loss of almost $53 million, due, in part, to the high cost of maintaining and selling Other Real Estate Owned (OREO) acquired via foreclosure, a trend that was expected to continue, and recognition of Other-Than-Temporary-Impairment (OTTI)[4] on the bank's large CMO portfolio. The significant loan and CMO portfolio losses resulted in deep net operating losses, deterioration of capital ratios, a strain on bank liquidity, and a high sensitivity to market risk. Ultimately, the bank did not have enough capital to adequately support its risk profile or absorb the mounting losses and was closed by the OFIR.

Concentrations in CRE and ADC Lending

In 2005 and 2006, CF Bancorp management increased it loan portfolio by $356 million (33 percent) and $158 million (11 percent), respectively. The increases were largely

[2] CF Bancorp's CMO investments began in May 2007, with the purchase of approximately $70 million of the CMOs. An additional $300 million was purchased in the first quarter of 2008. By May 2008, the CMO portfolio was experiencing credit rating downgrades and increasing depreciation.
[3] Alt-A mortgage loans are generally considered loans made under expanded underwriting guidelines to borrowers with marginal to very good credit. Alt-A loans are riskier than prime loans because of the underwriting standards of the loans, not necessarily the credit quality of the borrowers.
[4] OTTI is an impairment of a debt instrument that occurs when the fair value of the security is less than its amortized cost basis and, based on various factors, the impairment is considered other than temporary.

concentrated in CRE and ADC loans and were primarily funded by the use of brokered deposits and FHLB borrowings. The concentrations in these lending products exposed the bank to excessive credit risk as real estate values declined. Starting in 2008, the financial condition of the bank began deteriorating, with CRE and ADC charge-offs totaling $17 million. In 2009, CRE and ADC charge-offs increased to $24 million. Such charge-offs had a significant and adverse impact on the bank's condition.

Federal banking regulatory agencies issued guidance in December 2006, entitled, *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* (Joint Guidance), recognizing that there are substantial risks posed by CRE and ADC concentrations.[5] The Joint Guidance specifically notes that concentrations in CRE lending coupled with weak loan underwriting and depressed CRE markets have contributed to significant credit losses in the past and that such concentrations may make institutions more vulnerable to cyclical CRE markets.

The Joint Guidance defines institutions with significant CRE concentrations as those reporting loans for construction, land and development, and other land (i.e., ADC) representing 100 percent or more of total capital; or institutions reporting total CRE loans representing 300 percent or more of total capital, where the outstanding balance of CRE has increased by 50 percent or more during the prior 36 months. According to the Joint Guidance, an institution that has experienced rapid growth in CRE lending, has notable exposure to a specific type of CRE, or is approaching or exceeds the previous criteria may be identified for further supervisory analysis of the level and nature of its CRE concentration risk.

As shown in Table 2, CF Bancorp's concentrations in ADC loans from 2006 to 2009 exceeded the criteria for concentrations used to identify institutions that may warrant further supervisory analysis. In addition, ADC loans as a percent of the bank's total capital and total loans were above its peer group[6] averages during the same period.

Table 2: CF Bancorp's ADC and CRE Loans Compared to Peer Group

Period Ended	ADC Loans As a Percentage of Total Capital			Non-owner Occupied CRE Loans * As a Percentage of Total Capital		
	CF Bancorp	Peer	Percentile	CF Bancorp	Peer	Percentile
Dec 2005	92.31	43.91	83	N/A	N/A	N/A
Dec 2006	121.62	50.61	83	N/A	N/A	N/A
Dec 2007	104.23	57.93	77	413.44	196.38	89
Dec 2008	116.52	46.97	87	376.21	180.39	91
Dec 2009**	1,550.42	41.82	98	4,511.98	186.83	98

Source: UBPR data for CF Bancorp.
* The level of non-owner occupied CRE credits was understated due to the bank's miscoding of hotels and motels as owner-occupied CRE.
** The elevated concentration level in 2009 can be attributed to decreasing capital and not increases in the bank's origination of loans.

[5] The guidance was issued jointly by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the FDIC (referred to as the agencies in the guidance).
[6] CF Bancorp's peer group included insured savings banks with assets greater than $1 billion.

The 2008 examination report noted that adverse classifications had risen to 69 percent of capital and reserves as compared to 28 percent at the 2007 examination. Adverse classifications totaled 5.28 percent of total assets, more than double the 2.56 percent at the 2007 examination. During 2006 and 2007, about 94 percent of the classified assets were in the loan portfolio. By the 2008 examination, 86 percent of the classified assets were in the loan portfolio, with the majority of the loan classifications being concentrated in CRE and ADC loans.

During the July 2009 examination, examiners identified a significant deterioration in the financial condition of the bank. Adversely classified assets totaled nearly $500 million, representing over 26 percent of total assets. This increase resulted in a high provision expense to restore reserves to a satisfactory level. Table 3 shows the bank's adversely classified assets for each asset type, by examination date. As shown in the table, classifications increased significantly in 2008 and the first half of 2009. The table also shows the dramatic increase in classification in the securities portfolio, which is discussed in more detail in the following section.

Table 3: CF Bancorp's Adversely Classified Assets by Asset Type

Asset Type ($000s)	Examination Date				
	June 2005	June 2006	June 2007	May 2008	July 2009
Loans and Leases	5,442	20,260	43,152	93,966	195,737
Securities	0	0	0	3,975	282,363
Other Owned Real Estate	438	959	2,101	11,098	14,280
Other Assets/Contingent Liabilities	143	330	546	2,290	6,342
Totals	**6,023**	**21,549**	**45,799**	**111,329**	**498,722**

Source: Examination reports for CF Bancorp.

As of March 31, 2008, the bank's allowance for loan and lease losses (ALLL) was considered insufficient due to additional loan classifications identified by examiners at the May 2008 examination and the elevated risk of the portfolio. As a result, examiners recommended a minimum provision of $5.5 million to adequately fund the ALLL. During the 2009 examination, the ALLL was again found to be significantly underfunded—this time by approximately $48 million. Examiners attributed the underfunding to the bank's inaccurate "Watch List"[7] and management's failure to properly write down impaired and collateral-dependent loans to the fair value of the underlying collateral.

<u>Risk Monitoring of the CRE and ADC Portfolios</u>

Bank management could have better monitored risk in its CRE and ADC loan portfolios. Notably, nearly half of the 2009 examination classifications were not on management's Watch List or measured for impairment. Further, in 2007 and 2008, examiners

[7] The term "Watch List" refers to a list of loans or credit exposures compiled by a bank for internal monitoring.

recommended that the bank move lot loans and builder direct (residential construction program) loans out of the residential loan department and into the commercial loan department where they could be appropriately monitored as commercial loans. However, examiners found that six builder relationships had not been transferred and that many additional commercial-purpose loans appeared to have been included in the consumer portfolio. As a result, there may have been a lack of heightened collection efforts and recognition of potential loss and/or impairment in these loans, which could have contributed to the inordinate volume of adversely classified loans at the 2009 examination that had not been previously identified by management.

Investments in CMOs

As bank management began to recognize increased risk in its CRE and ADC loan portfolios, it began an investment strategy that included the purchase of private-label CMOs. Specifically, between the 2007 and 2008 examinations, the credit risk in the bank's investment portfolio increased substantially due to the purchase of nearly $370 million in private-label CMOs, which were largely collateralized by nontraditional residential mortgages originated between 2005 and 2007. Approximately $70 million in CMOs were purchased in May 2007, with an additional $300 million purchased in the first quarter of 2008, in an effort to improve the bank's net interest margins. The bank funded the CMO purchases using brokered deposits and FHLB borrowings. However, this strategy exposed the bank to substantial risk in a declining market condition. At the time of the purchases, national economic indicators were showing severe signs of stress, particularly in the mortgage industry. Further, the CMO portfolio was largely collateralized by nontraditional mortgages with substantial exposure in certain geographic locations such as California and Florida, which were areas exhibiting weak market conditions and high foreclosure rates.

Financial Institution Letter (FIL) 20-2009, entitled, *Risk Management of Investments in Structured Credit Products*, dated April 2009, re-emphasized existing supervisory guidance[8] to banks on the purchase and holding of complex structured credit products, such as CMOs. The FDIC found that, in some instances, institutions had invested in structured products in volumes representing concentrations of capital. Further, in some cases, significant purchases were initiated after the credit market turmoil began and funding came from brokered deposits or other volatile funding sources. Specifically, FIL 20-2009 states:

> Risk management of investments in structured credit products should include adequate due diligence, reasonable exposure limits, accurate risk measurement, an understanding of the tranched structure, knowledge of the collateral performance, and a determination of investment suitability. . . Institutions should strive to limit concentrations in any one investment category, especially complex, illiquid, and high-risk investments such as structured credit products. . . Institutions must

[8] The existing supervisory guidance was primarily contained in FIL-45-98, *Supervisory Policy Statement on Investment Securities and End-User Derivatives Activities*, and FIL-70-2004, *Uniform Agreement on the Classification of Assets and Appraisal of Securities*.

> understand not only an investment's structural characteristics, but also the composition and credit characteristics of the underlying collateral. . . Institutions should consider credit ratings as a factor in the risk management process; however, credit ratings should not be the sole factor considered when evaluating the risk present in structured credit products.

In addition, FIL-20-2009 states that amid the credit turmoil, some institutions that were attracted to higher yields purchased illiquid and, in some instances, distressed structured securities at a discount. This strategy assumed the discount would provide a margin of safety against principal losses even given continued market stress, including ongoing deteriorating collateral performance and credit rating downgrades. However, in many cases, the discounts signaled the market's well-founded concerns and risk perception. Further, the FDIC has found that, generally, the discounts were not sufficient to cover the losses that followed.

CMO Concentrations

CF Bancorp's investment portfolio totaled $412.8 million as of March 31, 2008 and represented 20 percent of total assets. Between March 31, 2007 and March 31, 2008, the bank's investment portfolio increased over six times in dollar value primarily due to private-label CMO purchases. As of March 31, 2008, CMOs represented approximately 89 percent of the bank's total investment portfolio and totaled $367.4 million. This amount represented 259 percent of Tier 1 Capital and 229 percent of Total Risk-Based Capital. During the July 2009 examination, examiners determined that the bank's investment in private-label CMOs represented approximately 882 percent of Tier 1 Capital and 558 percent of Total Risk-Based Capital. According to the May 2008 examination report, the bank's Investment Policy did not have established limits for private-label CMOs as a percentage of the investment portfolio or as a percentage of Tier 1 or Total Risk-Based Capital.

CMO Losses

By the end of the May 2008 joint examination, the CMOs were experiencing credit rating downgrades and increasing depreciation. Net depreciation in the entire private-label CMO portfolio increased from $1.5 million to $15.7 million between month-end March 2008 and month-end April 2008. At the time, private-label CMOs were under scrutiny by the rating agencies and had been subject to frequent downgrades by them. At June 30, 2009, the bank had CMOs with an amortized cost of $303.2 million and market value depreciation of $68.9 million. With greater than 26 percent of the bank's total assets being adversely classified at the examination, examiners noted that the bank's viability was threatened. Over 57 percent of the classified assets were attributed to the CMO portfolio, which, by then, was subinvestment quality and represented approximately 96 percent of the total securities portfolio. The entire portfolio continued to deteriorate in tandem with the quality of the underlying mortgages. Management had already charged off more than $40 million of this portfolio and an additional $4 million of loss was identified as of the July 2009 examination date. The remainder of the portfolio, totaling $278 million, was classified Substandard.

In 2009, the bank adopted Financial Accounting Standards Board Staff Position 115-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, which provided disclosure guidance regarding fair value measurements and impairments of securities. This guidance was expected to give financial institutions more latitude in determining the extent of losses attributable to their troubled assets—including mortgage-backed securities and collateralized debt obligations. The accounting treatment requires the amortized cost of the securities to be reduced by management's expectation of future credit losses, discounted at the effective interest rate. These expectations are driven by future expectations on liquidations, the severity of future losses, and prepayment speeds on a security-specific basis. According to the FDIC and OFIR, in December 2009, CF Bancorp's management determined that an additional material charge of approximately $8 million to the CMO portfolio was required for OTTI. The impairment related to the quarter ended September 30, 2009, and resulted in a *Critically Undercapitalized* capital category for PCA purposes.

Management Oversight of the CMO Portfolio

Examiners expressed concern with the bank's decision to invest in such a high volume of CMO products and with the timing of the purchases. The investments, in and of themselves, would have provided little liquidity to the bank because the CMOs were 100-percent pledged to FHLB advances, showed significant depreciation, and had few potential buyers. In addition, examiners expressed concerns about management's due diligence before involving itself with this particular investment strategy.

The objectives of the bank's investment strategy were to increase (1) the number of different asset types as well as the geographic diversification of its assets; (2) earnings; and (3) sources of stable, long-term funding. Although the CMOs offered a higher yield due to the unconventional characteristics of the underlying loans, examiners identified the following risk characteristics:

- Exposure to geographic areas experiencing weak real estate market conditions and high foreclosure rates similar to Michigan, such as California and Florida.
- No- or low-documentation loans and fixed-rate loans with interest-only payment features.
- Hybrid-option adjustable rate mortgages.
- Suspect loan-to-value ratios due to the use of appraised values from the height of the real estate boom.

In addition, the average credit score for the borrowers in most of the CMOs in the bank's portfolio was near 700, which meant that the credit score distribution likely included some borrowers with subprime credit scores. The increasing delinquency trends of the underlying, risk-layered mortgages demonstrated the heightened level of credit risk within the CMOs.

Further, examiners found that the bank's Board and management had not performed adequate review and oversight of the CMO purchase. Specifically, examiners determined that:

- The decision-making process followed by the Board and bank management was poorly documented and not supported in the bank's official records.

- There was no formalized, documented Board review of the objectives, risks, and rewards prior to implementation.

- There was no documented Board approval to implement the investment strategy.

- There was no documented Board-approved dollar limitation on the investment strategy.

Finally, the bank's Board and management did not perform adequate due diligence in making the decision to invest in the CMOs. Bank management officials had relied heavily on a total return analysis model provided by their broker, which showed that the strategy was beneficial to the bank in either an upward or downward interest rate environment. The broker was involved in various aspects of the strategy, including presenting the strategy and total return concept to the bank's Vice President and the Asset/Liability Committee, preparing the pre-purchase analysis and modeling reports, facilitating the CMO purchases, and providing on-going modeling and monitoring reports. However, examiners could not determine what due diligence had been performed by management when choosing the broker and what independent research had been completed by the bank regarding the CMOs' underlying assets.

Oversight and Risk Management Practices

Although the depressed Michigan economy and the declining real estate market contributed to the deterioration in asset quality, the bank's risk management practices resulted in increased exposure to these economic risks. Specifically, as discussed in the previous sections, CF Bancorp's Board and management demonstrated poor risk selection by investing in CMOs and concentrating in CRE and ADC lending. In addition, the bank's overall credit administration practices were weak, and bank management was cited with repeat violations of laws and contraventions of statements of policy related to preparing Consolidated Reports of Condition and Income (Call Report), transactions with affiliates, appraisals, statutory bad debt, and interagency standards for safety and soundness.

Credit Administration

During the May 2008 examination, file reviews conducted by examiners identified technical exceptions in 27 percent, by dollar amount, of loans reviewed. The primary technical exception noted was stale financial information. Examiners cautioned that, given the persistent decline in economic trends, it was even more critical for management to obtain current financial information in order to ascertain cash flow and debt service capacity. In addition, the following credit administration weaknesses were identified:

- Reporting of restructured troubled debt was not accurately reported in the Call Report.

- The collateral value of deteriorating credits was not reassessed and documented in a timely manner and liquidation values for properties in which foreclosure was likely were not being requested.

- The accounting treatment for transactions involving the disposition of OREO that was financed by the bank was not accurate.

- The fair value of collateral for OREO properties was not being reviewed at least quarterly and adjusted, if necessary, to ensure accurate reporting on the Call Report.

- In instances where tax assessment values were used for real estate collateral evaluations, additional supporting information was not used or documented to support the collateral value. Additionally, the bank's Retail Lending Policies and Guidelines and the Appraisal Policy did not address minimum guidelines for collateral evaluations.

Apparent Violations and Contraventions of Statements of Policy

Apparent violations of law and contraventions of statements of policy were further indications of weaknesses in Board and management oversight. In four instances, the bank was cited for repeat violations:

- **Call Reports.** During the 2008 examination, examiners identified apparent violations of FDIC Rules and Regulations section 304.3(a), which requires every insured state nonmember bank to file Call Reports in accordance with the instructions for these reports. Examiners' review of the March 31, 2008 Call Report found errors in 12 Call Report schedules with errors aggregating to a total of $1.4 billion. As a result, the bank was required to re-file its March 2008 Call Report. Violations were also identified at the 2009 examination when Call Report errors were found on six schedules. The aggregate dollar value of the errors totaled approximately $74 million. As a result of the errors, the bank was required to amend and re-file the December 31, 2008 and March 31, 2009 Call Reports. The March 31, 2009 changes resulted in the bank dropping from *Adequately Capitalized* to *Undercapitalized* under PCA. According to examiners, the FDIC considered civil money penalties related to the bank's continued Call Report violations; however, they determined that the errors did not warrant such action.

- **Affiliate Transactions.** At the 2005, 2007, 2008, and 2009 examinations, examiners identified apparent violations of sections 23A and/or 23B of the Federal Reserve Act. These sections restrict transactions with affiliates and provide, in part, that transactions with affiliates be made with the same terms and conditions that would be offered to non-affiliate institutions. Specifically, the bank was in apparent violation of sections governing the sale of assets to affiliates and payments of money or the furnishing of services to an affiliate.

- **Appraisals.** Apparent violations of section 323.3(a) of the FDIC Rules and Regulations were identified during the 2008 and 2009 examinations. Section 323.3(a), in general, requires an appraisal for all real estate-related financial transactions. One exception to this requirement are transactions involving existing extensions of credit, provided that there has been no obvious and material change in market conditions or physical aspects of the property that would threaten the adequacy of the institution's real estate collateral protection. Examiners found two transactions that were in apparent violation during the May 2008 examination and 12 apparent violations during the July 2009 examination.

- **Statutory Bad Debt.** Apparent violations of section 512(3) of the State of Michigan Savings Bank Act were identified at the 2008 and 2009 examinations. Section 512(3) states that unless a debt constitutes a claim against a solvent estate in probate, if the interest on debt held by a bank is past due and unpaid for a period of 6 months (changed to 12 months in 2009), the bank shall charge off, to its ALLL, the portion of the debt that is not well secured. Examiners found 54 instances where the bank failed to charge off debt when interest was past due in apparent violation of the Act during the May 2008 examination and 43 more apparent violations during the July 2009 examination.

Bank management was also cited for contraventions of Appendix A to Part 364 of the FDIC Rules and Regulations, *Interagency Guidelines Establishing Standards for Safety and Soundness*, Section II - Operational Standards and Managerial Standards. Appendix A states, in part, that an institution should have internal controls that are appropriate to the size of the institution and the nature, scope, and risk of its activities. According to the 2009 examination report, the bank was in apparent contravention of this Appendix because it had not established internal controls that were sufficient for the size and complexity of the bank. Specifically:

- Management's oversight of personnel having elevated authority was inadequate. Strong procedures were not in place to test for abuse of authority levels and to review and ensure management reports were sufficient to provide a clear picture of the health of the loan portfolio.

- Loan documentation was inadequate for the modified loans. The bank did not obtain credit reports, analyze capacity to repay, or establish revised loan-to-value ratios.

- The bank had not established an adequate and on-going credit review system that provided appropriate communication to the Board. The Watch List was incomplete due to the volume of loans carried in the mortgage department that should have been treated as commercial loans and monitored and reported accordingly.

- The bank was found to be in apparent contravention of the *Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Associations*. The policy statement sets forth standards for analyzing and maintaining appropriate levels in the ALLL. According to examiners, the bank's flawed methodology for analyzing the adequacy of the ALLL resulted in an inordinately high provision expense during the examination.

The FDIC's Supervision of CF Bancorp

During the period June 2005 through April 2010, the FDIC and the OFIR, through their supervisory efforts, identified key risks in CF Bancorp's operations and brought these risks to the attention of the institution's Board and management in examination reports and in informal and formal enforcement actions. At the time of the 2007 examination, CF Bancorp's financial condition was considered satisfactory, but there were several risks and declining trends associated with asset quality. Many asset quality factors fell within the parameters of the satisfactory rating that was assigned, and examiners took certain steps to address the risks and declining trends. In retrospect, however, given existing and forecasted local economic conditions, additional emphasis on the potential impact of the risks and trends may have been prudent as examiners were assessing the bank's operations and determining a supervisory response.

Supervisory History

The FDIC, in conjunction with the OFIR, provided ongoing supervision of CF Bancorp through regular onsite risk management examinations and a visitation. CF Bancorp was also identified for offsite review seven times from December 2006 through June 2008. Table 4 provides the supervisory history for CF Bancorp, and shows the results from the most recent five risk management examinations and one visitation conducted by the FDIC and/or the OFIR.

Table 4: CF Bancorp's Examination History from June 2005 to January 2010

Examination/ Visitation Start Date	Transmittal Letter Date	Agency	Supervisory Ratings (UFIRS)	Supervisory Action
Jan 25, 2010	Jan 29, 2010	FDIC	N/A - Visitation	None
July 13, 2009	Jan 7, 2010	Joint	555554/5	Cease and Desist Order (C&D), dated February 24, 2010
May 19, 2008	Nov 3, 2008	Joint	333433/3	Memorandum of Understanding (MOU), dated December 10, 2008
June 11, 2007	Aug 31, 2007	Joint	222222/2	None
June 19, 2006	Sept 4, 2006	Joint	222222/2	None
June 6, 2005	July 19, 2005	Joint	112222/2	MOU, dated July 20, 2005

Source: The FDIC's Virtual Supervisory Information on the Net and examination reports for CF Bancorp.

Offsite Reviews

CF Bancorp was flagged by the Statistical CAMELS Offsite Rating (SCOR) system every quarter from December 2006 through June 30, 2008. Detailed written offsite reviews were prepared in all but two instances. No written offsite review was prepared for March 2008 because the May 19, 2008, examination was in process and no written offsite review was prepared for June 2008 because the 2008 MOU, in place at the time, required quarterly monitoring reports that would be used to monitor the bank. The SCOR reviews generally noted potential deterioration in asset quality as evidenced by increases in the past due ratios (non-performing and non-accruals), OREO, credit losses, and classified assets. However, the reviews noted that the FDIC would continue to monitor the bank on an offsite basis or that in-process or upcoming examinations eliminated the need for further offsite action. Accordingly, although SCOR detected emerging risks, the early warnings did not result in a substantial shift in the FDIC's supervisory strategy. The FDIC and OFIR, however, did start the 2008 joint examination about 2 months earlier than was required.

Enforcement Actions

The FDIC and the OFIR executed or proposed five enforcement actions over the period July 2005 through February 2010.

2005 MOU. During the 2005 joint examination, regulators noted weak management practices relating to the Bank Secrecy Act (BSA) and Anti-Money Laundering (AML) programs. As a result of the BSA/AML concerns, the FDIC and OFIR executed an MOU with CF Bancorp on July 20, 2005. On August 22, 2005, the FDIC performed a visitation to review the bank's progress toward meeting the requirements of the MOU and addressing other weaknesses. During the visitation, examiners found that the bank had addressed the elements of the MOU and corrected the other weaknesses noted in the 2005 examination. As a result, on September 6, 2005, the MOU was terminated.

2008 MOU. During the May 2008 joint examination, regulators found the bank's condition to be less than satisfactory. As a result, the FDIC and the OFIR executed an MOU with CF Bancorp, effective December 10, 2008. The MOU addressed asset quality, capital, earnings, liquidity, and management issues. Specifically, the MOU required the bank to, among other things:

- Submit and adopt a plan to reduce assets classified as Substandard and Doubtful.
- Formulate a plan to reduce concentrations.
- Strengthen credit administration.
- Develop a capital and ALLL allocation analysis for the subprime loan portfolio.
- Strengthen risk management practices relating to the CMO portfolio.
- Develop a written capital plan.
- Maintain Tier 1 Capital at 8 percent and Total Risk Based Capital at a level equal to or exceeding 10 percent.
- Re-file the March 31, 2008 Call Report to correct all errors identified in the 2008 examination report.
- Formulate and adopt a plan to improve liquidity, to include strategies on how to reduce the dependence on volatile funds.
- Submit quarterly progress reports.

Regulator reviews of quarterly progress reports submitted by CF Bancorp for the period covering December 31, 2008 through June 30, 2009 determined that the bank had not maintained the required capital levels, the ALLL was grossly inadequate, the bank continued to have to re-file Call Reports due to continuing errors, and the bank's system of internal controls continued to be deficient. In addition, the bank had a receivable from the holding company, due to the settlement of outstanding tax obligations of the bank and holding company, which resulted in a violation of section 23B of the Federal Reserve Act.

2009 Section 8(e)(1) Removal Action and Section 8(i)(2) Civil Money Penalty Action. During the July 2009 joint examination, it was determined that a CF Bancorp officer deliberately had relevant bank documents hidden from regulators, purged appraisal information from loan files, and had relevant information excluded from reports requested by the examiners. As a result, the FDIC proposed a removal action and an action for civil money penalties under the FDI Act against the officer, which is still being pursued. The officer was placed on administrative leave and resigned on October 2, 2009.

2010 Joint C&D. Based on the findings of the July 2009 examination and the continued deterioration in the overall condition of the bank, regulators pursued a C&D against the bank. The C&D became effective February 24, 2010 and required the bank to address supervisory concerns related to management, capital, asset quality, earnings, liquidity, and sensitivity to market risk. The C&D included, but was not limited to, the following provisions:

- Maintain Tier 1 Capital at 9 percent and Total Risk-Based Capital at 12 percent.

- Implement a plan to sell or merge itself into a federally-insured financial institution.
- Implement a plan to reduce assets in excess of $1 million, which were more than 90 days delinquent or classified as Substandard or Doubtful in the July 2009 examination report.
- Submit weekly liquidity analysis reports to both regulators.
- Increase ALLL with an additional provision of $48.3 million.
- Implement a written profit plan and a realistic and comprehensive budget.
- Implement a written plan to manage and limit concentrations of credit.
- Eliminate and/or correct all violations of laws, rules, and regulations listed in the July 2009 examination report.
- Develop procedures for managing the bank's sensitivity to interest rate risk.
- Submit quarterly progress reports to the FDIC.

The first quarterly progress report detailing actions taken in compliance with the C&D was submitted by the bank on March 24, 2010. However, the FDIC did not process the report because the bank was closed on April 30, 2010.

Supervisory Response to Key Risks

The FDIC and the OFIR consistently identified key risks in CF Bancorp's operations and brought the risks to the attention of the bank's Board and management. The following provides a brief synopsis of examination efforts to address and mitigate those risks from 2005 to 2009.

June 2005 Joint Examination

The examination report indicated that the overall financial condition of the bank was satisfactory and the bank was rated a composite "2". According to examiners, despite an increase in adversely classified assets and past due loans, asset quality was regarded as strong. Examiners noted that management had developed an ambitious strategic plan, which detailed specific growth projections. For 2005, management targeted asset growth of 32 percent and commercial loan growth at 26 percent. Policies and procedures were determined to be satisfactory; however, of regulatory concern were the weak management practices relating to BSA and AML programs. As previously mentioned, as a result of the BSA/AML concerns, an MOU was implemented.

June 2006 Joint Examination

According to the examination report, the overall financial condition of the bank was satisfactory and the bank was rated a composite "2". Examiners noted that although asset classifications and past due ratios were elevated, asset quality was acceptable. Examiners attributed the increase in adversely classified assets to the problem loan portfolio acquired in October 2005, when CF Bancorp merged with Metrobank. In addition, examiners attributed the risk trends to the local depressed economy and rising unemployment levels. Examiners acknowledged that, despite increases in loan delinquencies, management continued to pursue an aggressive growth strategy. However, according to examiners, that credit risk was partially mitigated by a well-diversified loan portfolio, lending concentrations that were well-identified and closely monitored, and capital levels that were adequate and could support operations and growth plans. The examination report also stated that management was satisfactory. However, additional apparent violations were contained in the examination report relating to BSA. The report contained recommendations related to the bank's BSA/AML program and ALLL policy and methodology.

June 2007 Joint Examination

The June 2007 examination report stated that the bank's condition was satisfactory and the bank was rated a composite "2". However, the report also stated that the deterioration in credit quality—primarily in the mortgage and consumer loan portfolios—and an underfunded ALLL was a regulatory concern. According to the examination report, asset quality had declined considerably, primarily due to local economic conditions. The report also noted that plant closings related to Michigan's automobile industry had significantly impacted delinquencies and foreclosures. Significantly, examiners noted that the bank's past due ratio had increased to 8.12 percent, up from 3.51 percent at the 2006 examination. Similarly, adversely classified assets had increased to $45.8 million from $21.5 million at the previous examination. According to the FDIC, such an increase meant that the coverage ratio[9] had gone from 14 percent to 28 percent, which was consistent with the composite "2" rating that was assigned. The ALLL was deemed insufficient due to the examination classifications and additional risk identified in the residential construction loan portfolio, with examiners recommending an additional provision of $1 million.

In addition, examiners considered bank management to be satisfactory, but they noted that several operating functions required improvement. Specifically, examiners reported that residential development loans were not being rated and evaluated for appropriate risk factors and that the bank had made numerous material errors in the March 2007 Call Report. They also cited the bank for an apparent violation of section 23B of the Federal Reserve Act for transactions between the bank and a company wholly owned by the holding company.

Although CF Bancorp's financial condition was considered satisfactory, the following risks were present and impacting the bank at that time: (1) deteriorating credit quality, primarily in the bank's consumer and mortgage portfolios; (2) a prolonged decline in the Michigan economy, including the decline in the automobile industry and plant closures in the bank's market area that had a significant effect on delinquencies and foreclosures; (3) adverse classifications that had increased from $22 million at the 2006 examination to $46 million at the 2007 examination; (4) a significant increase in loans 30-90 days past

[9] The coverage ratio is a measure of the level of asset risk and the ability of capital to protect against that risk and reflects the aggregate level of all items classified as substandard, doubtful, and loss in relation to Tier 1 Capital and the ALLL.

due from $36.2 million as of March 31, 2006 to $98.7 million 1 year later; and (5) the bank's ALLL was underfunded and the methodology needed to be improved.
In recognition of these risks, examiners did, as noted above, highlight in the examination transmittal letter to CF Bancorp's Board that deteriorating credit quality and an underfunded ALLL was of regulatory concern. In addition, the examination report indicated that examiners had made recommendations in these areas and management had either taken or planned action to address them. Further, we noted that the examination report included a Risk Assessment Matrix that indicated credit had a high composite risk and that risk would increase over the next 12 months. Finally, the report indicated that examiners had expanded the examination scope of the mortgage loan review due to significant deterioration and increasing classifications and performed a targeted review of CRE and ADC loans over $3 million.

Examiners concluded, however, that the identified risks and weaknesses were not significant in light of the bank's overall financial condition and capital levels. Specifically, FDIC and OFIR regulators indicated that the condition of the bank was not out of line with its peers because most banks in Michigan were showing deteriorating asset quality ratios due to the downturn in the economy, and capital and liquidity levels were deemed adequate and supportive of operations. As a result, CF Bancorp received a "2" rating for Asset Quality—the same rating it had received at the 2006 examination—indicating that asset quality and credit administration practices were satisfactory and the level and severity of classifications and other weaknesses warranted a limited level of supervisory attention.

According to the FDIC's *Risk Management Manual of Examination Policies*, Asset Quality should be reviewed within the context of any local or regional conditions that might impact bank performance and should be evaluated not only according to current conditions but also consider potential risk and any ongoing trends. Recognizing that many of the factors involved in assigning the rating fell within what are generally considered the parameters of a "2" rating, additional emphasis on the declining economy and deteriorating performance trends may have been prudent in assessing this aspect of the bank's operations and determining a supervisory response.

May 2008 Joint Examination

Examiners found that the bank's condition had deteriorated since the 2007 examination, and the bank was downgraded to a composite "3". There was a significant increase in adversely classified assets, delinquencies, and OREO, and the ALLL was underfunded. According to examiners, the depressed Michigan economy and the declining real estate market contributed to the deterioration in asset quality. Further, examiners reported a significant concern related to management's decision to implement an investment strategy in the first quarter of 2008 involving the purchase of CMOs funded by brokered deposits and FHLB borrowings.[10] According to the examination report, bank management's decision to invest in these higher-risk securities in such a significant volume was of supervisory concern. At the time of the examination, the CMOs

[10] As previously stated, this investment strategy actually began—although to a lesser extent—in May 2007.

represented approximately 18 percent of the bank's total assets and were exhibiting credit rating downgrades and increasing depreciation. The depreciation on the portfolio increased from $1.5 million to $15.7 million between March and April 2008.

Examiners deemed risk management practices at the bank to be less than satisfactory and credit administration practices were seen as needing improvement. The examination report discussed concerns regarding significant inaccuracies with the Call Reports, repeat regulatory recommendations that had not been addressed, and undocumented deviations from internal policies and procedures. Examiners noted that capital was insufficient, considering that the bank's risk profile and earnings were insufficient to support operations and maintain an appropriate level of capital and ALLL. Liquidity sources were limited and reliance on wholesale funding sources had increased significantly. In response to these supervisory concerns, as previously mentioned, the FDIC and OFIR executed an MOU with CF Bancorp addressing asset quality, capital, earnings and management issues.

July 2009 Joint Examination

Examiners reported that the financial condition of the bank had deteriorated significantly since the prior examination and the bank's long-term viability was in doubt. As a result, the bank was downgraded to a "5". According to the 2009 examination report, the bank's asset quality had dramatically declined since the last examination and asset quality was critically deficient and presented an imminent threat to the bank's viability. Notably, over 26 percent of the bank's assets were adversely classified. Adverse classifications at the examination were not isolated to the loan portfolio. Over 57 percent of classified assets represented the subinvestment quality CMO portfolio, which represented approximately 96 percent of the total securities portfolio. In addition, examiners noted that Board and management oversight was critically deficient and did not provide sufficient oversight of the bank's operations. Poor risk management practices and unacceptable oversight had caused significant losses and threatened the continued viability of the bank.

The overall weak internal controls, inadequate financial reporting, and lack of monitoring and reporting of lending policy exceptions permitted questionable activities to go undetected by bank management, resulting in additional losses at the time of that examination and the potential for further losses. Also, management had not fully adhered to all of the provisions of the December 2008 MOU. Specifically, provisions for consolidating all troubled credits on the Watch List, eliminating technical exceptions, and reducing the level of classifications required strict attention and correction. Significant loan losses and CMO portfolio losses resulted in deep net operating losses, a deterioration of capital ratios, a strain on bank liquidity, and an overly exposed sensitivity to market risk. Earnings were critically deficient and did not support the heightened risk and severe asset quality problems. The capital position was critically deficient due to the elevated risk profile of the bank. Losses at this examination exceeded $60 million. As a result of the examination findings and adjustments to capital made during the examination, the bank's PCA category fell to *Critically Undercapitalized*.

Implementation of PCA

The purpose of PCA is to resolve problems of insured depository institutions at the least possible long-term cost to the DIF. Part 325 of the FDIC Rules and Regulations implements PCA requirements by establishing a framework for taking prompt corrective action against insured state-chartered nonmember banks that are not adequately capitalized. The FDIC is required to closely monitor the institution's compliance with its capital restoration plan, mandatory restrictions defined under section 38(e) of the FDI Act, and discretionary safeguards imposed by the FDIC (if any) to determine if the purposes of PCA are being achieved.

Based on the supervisory actions taken with respect to CF Bancorp, we determined that the FDIC properly implemented applicable PCA provisions of section 38.

- On February 24, 2009, the FDIC notified CF Bancorp that it was *Adequately Capitalized* and subject to certain mandatory actions, including a restriction on obtaining new, or rolling over existing, brokered deposits. At the time, there was an MOU in place (effective December 10, 2008) that required CF Bancorp to, among other things: (1) develop a written capital plan and (2) maintain Tier 1 Capital equal to or exceeding 8 percent of the bank's total assets and total Risk Based Capital equal to or exceeding 10 percent, as described in Part 325 of the FDIC Rules and Regulations.

- On August 5, 2009, the FDIC notified CF Bancorp that it was *Undercapitalized* for PCA purposes. The FDIC required the bank to submit a capital restoration plan by September 7, 2009. The bank submitted a capital restoration plan that was received by the FDIC on September 9, 2009. According to section 325.104(c) of the FDIC's Rules and Regulations, the FDIC shall provide written notice to the bank on whether the capital restoration plan has been approved, within 60 days of receipt of that plan. The FDIC may extend the period for providing the notice.[11] However, the FDIC did not respond to the bank's capital restoration plan within the 60-day period, which ended on November 8, 2009. According to the FDIC Case Manager, she was reviewing the bank's plan while the 2009 examination was underway. During the examination, it became clear to the FDIC that it would be sending the bank another notification letter requiring a new capital restoration plan, which it did, as described below.

- On December 1, 2009, the FDIC notified the bank that it was considered *Significantly Undercapitalized* and was required to file a written capital restoration plan by January 15, 2010. However, on January 7, 2010, the FDIC sent a letter to CF Bancorp notifying the bank that it was considered *Critically Undercapitalized*, as of September 30, 2009. Based on this notification, the bank

[11] Under section 38(e) of the FDI Act, the agency shall establish by regulation a deadline for taking action on the capital restoration plan expeditiously and generally not later than 60 days after submission of the plan. The *Case Manager Procedures Manual* indicates that extensions should be rare and should be documented.

was required to file a written capital restoration plan with the FDIC by February 18, 2010. CF Bancorp submitted a capital restoration plan that was received by the FDIC on February 19, 2010. According to the FDIC, the bank was not provided an official written response because the bank was scheduled to be closed within a few weeks and the plan was not likely to be effective.

Section 38(h) of the FDI Act generally requires that a bank be placed into receivership within 90 days from when it becomes *Critically Undercapitalized*, which, for CF Bancorp, should have been April 5, 2010. However, on March 24, 2010, consistent with an exception to section 38(h), the FDIC's Chicago Regional Office requested, and was granted, approval by the Director, Division of Supervision and Consumer Protection (DSC), to extend appointment of receivership for an additional 45 days to provide sufficient time for interested bidders to receive regulatory clearances, conduct due diligence, and submit bids. CF Bancorp was placed into receivership within this extended period.

In October 2008, Citizens First Bancorp, Inc., the holding company for CF Bancorp, submitted an application under the Troubled Asset Relief Program for $48 million. However, in November 2008, the holding company withdrew its application. On April 30, 2010, the OFIR closed the bank and appointed the FDIC as receiver.

Corporation Comments

On November 24, 2010, the Director, DSC, provided a written response to a draft of this report. That response is provided in its entirety as Appendix 4 of this report. DSC reiterated the OIG's conclusions regarding the causes of CF Bancorp's failure. With regard to our assessment of the FDIC's supervision of CF Bancorp, DSC's response referenced the number of examinations conducted between 2005 and 2010, as described in our report. Further, DSC's response noted that the 2008 and 2009 examinations revealed an increase in the bank's risk profile as a result of the new, higher-risk business strategy, and weak internal controls and reporting that delayed loan workout strategies and collections. As mentioned in our report, examiners downgraded CF Bancorp's ratings and pursued supervisory actions based on those examination results.

DSC also indicated that it has issued guidance to enhance its supervision of institutions, such as CF Bancorp, with concentrated CRE and/or ADC lending and reliance on volatile non-core funding. Specifically, DSC mentioned a 2008 FIL on *Managing Commercial Real Estate Concentrations in a Challenging Environment* that re-emphasizes the importance of robust credit risk management practices and sets forth broad supervisory expectations, and a 2009 FIL on *Risk Management of Investments in Structured Credit Products*, which provided clarification to existing guidance and strongly recommended vigilant due diligence and appropriate internal controls related to such credit products.

Objectives, Scope, and Methodology

Objectives

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

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

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

Scope and Methodology

The scope of this audit included an analysis of CF Bancorp's operations from 2005 until its failure on April 30, 2010. Our review also entailed an evaluation of the regulatory supervision of the institution over the same period.

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

- Analyzed examination and visitation reports prepared by the FDIC and the OFIR examiners from 2005 to 2009.

- Reviewed the following:

    - Bank data and correspondence maintained on various FDIC systems.

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

    - Audit reports prepared by the bank's external auditor.

Objectives, Scope, and Methodology

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

- Interviewed the following FDIC officials:

  - DSC management and two DSC subject matters experts in the Chicago Regional Office, and Detroit, Michigan Field Office.

  - DRR officials at the Dallas Regional Office and Irvine, California office.

  - FDIC examiners from the DSC Detroit, Michigan, Field Office who participated in examinations and visitations of CF Bancorp.

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

We performed the audit work at the OIG office in Arlington, Virginia.

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

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

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

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

Objectives, Scope, and Methodology

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

Related Coverage of Financial Institution Failures

On May 1, 2009, the OIG issued an internal memorandum that outlined major causes, trends, and common characteristics of FDIC-supervised financial institution failures that had resulted in a material loss to the DIF. The memorandum also indicated that the OIG planned to provide more in-depth coverage of those issues and make related recommendations, when appropriate. Since May 1, 2009, the OIG has issued additional MLR reports related to failures of FDIC-supervised institutions and these reports can be found at www.fdicig.gov. In June 2010, the OIG initiated an audit, the objectives of which are to (1) determine the actions that the FDIC has taken to enhance its supervision program since May 2009, including those specifically in response to the May 2009 memorandum, and (2) identify trends and issues that have emerged from subsequent MLRs.

In addition, with respect to more comprehensive coverage of specific issues, in May 2010, the OIG initiated an evaluation of the role and federal regulators' use of the Prompt Regulatory Action provisions of the FDI Act (section 38, *PCA* and section 39, *Standards for Safety and Soundness*) in the banking crisis.

Glossary of Terms

Term	Definition
Acquisition, Development, and Construction (ADC) Loans	ADC loans are a component of Commercial Real Estate that provide funding for acquiring and developing land for future construction, and that provide interim financing for residential or commercial structures.
Adversely Classified Assets	Assets subject to criticism and/or comment in an examination report. Adversely classified assets are allocated on the basis of risk (lowest to highest) into three categories: Substandard, Doubtful, and Loss.
Affiliate	Under section 23A of the Federal Reserve Act (12 U.S.C. section 371c), an affiliate generally includes, among other things, a bank subsidiary, or a company that (1) controls the bank and any other company that is controlled by the company that controls the bank, (2) is sponsored and advised on a contractual basis by the bank, or (3) is controlled by or for the benefit of shareholders who control the bank or in which a majority of directors hold similar positions in the bank.
Allowance for Loan and Lease Losses (ALLL)	The ALLL is an estimate of uncollectible amounts that is used to reduce the book value of loans and leases to the amount that is expected to be collected. It is established in recognition that some loans in the institution's overall loan and lease portfolio will not be repaid. Boards of Directors are responsible for ensuring that their institutions have controls in place to consistently determine the allowance in accordance with the institutions' stated policies and procedures, generally accepted accounting principles, and supervisory guidance.
Bank Secrecy Act (BSA)	Congress enacted BSA of 1970 to prevent banks and other financial service providers from being used as intermediaries for, or to hide the transfer or deposit of money derived from, criminal activity. The BSA requires financial institutions to maintain appropriate records and to file certain reports, including cash transactions over $10,000 via the Currency Transactions Reports (CTR). These reports are used in criminal, tax, or regulatory investigations or proceedings.
Call Report	Reports of Condition and Income, often referred to as Call Reports, include basic financial data for insured commercial banks in the form of a balance sheet, an income statement, and supporting schedules. According to the Federal Financial Institutions Examination Council's (FFIEC) instructions for preparing Call Reports, national banks, state member banks, and insured nonmember banks are required to submit a Call Report to the FFIEC's Central Data Repository (an Internet-based system used for data collection) as of the close of business on the last day of each calendar quarter.

Glossary of Terms

Cease and Desist Order (C&D)	A C&D is a formal enforcement action issued by a financial institution regulator pursuant to 12 U.S.C. section 1818 to a bank or affiliated party to stop an unsafe or unsound practice or a violation of laws and regulations. A C&D may be terminated when the bank's condition has significantly improved and the action is no longer needed or the bank has materially complied with its terms.
Collateralized Mortgage Obligation (CMO)	A type of mortgage-backed security, CMOs are bonds that represent claims to specific cash flows from large pools of home mortgages. The streams of principal and interest payments on the mortgages are distributed to the different classes of CMO interests, known as tranches, according to a complicated deal structure. Each tranche may have different principal balances, coupon rates, prepayment risks, and maturity dates (ranging from a few months to 20 years).
Commercial Real Estate (CRE) Loans	CRE loans are land development and construction loans (including 1-to-4 family residential and commercial construction loans) and other land loans. CRE loans also include loans secured by multifamily property and nonfarm nonresidential property, where the primary source of repayment is derived from rental income associated with the property or the proceeds of the sale, refinancing, or permanent financing of the property.
Credit Rating	An indicator of the credit risk of one or more securities assigned by a nationally recognized statistical rating organization, such as Moody's Investors Service, Standard & Poor's Corporation, or Fitch Investors Service. In general, a credit rating of AA indicates that the underlying obligator has a very strong capacity to meet its financial commitments, but not as strong as the highest rating of AAA.
FDIC's Supervision Program	The FDIC's supervision program promotes the safety and soundness of FDIC-supervised institutions, protects consumers' rights, and promotes community investment initiatives by FDIC-supervised institutions. The FDIC's Division of Supervision and Consumer Protection (DSC) (1) performs examinations of FDIC-supervised institutions to assess their overall financial condition, management policies and practices (including internal control systems), and compliance with applicable laws and regulations and (2) issues related guidance to institutions and examiners.
Federal Home Loan Bank (FHLB)	FHLBs provide long- and short-term advances (loans) to their members. Advances are primarily collateralized by residential mortgage loans, and government and agency securities. Community financial institutions may pledge small business, small farm, and small agri-business loans as collateral for advances. Advances are priced at a small spread over comparable U.S. Department of the Treasury obligations.

Glossary of Terms

Financial Holding Company	A financial entity engaged in a broad range of banking-related activities, created by the Gramm-Leach-Bliley Act of 1999. These activities include: insurance underwriting, securities dealing and underwriting, financial and investment advisory services, merchant banking, issuing or selling securitized interests in bank-eligible assets, and generally engaging in any non-banking activity authorized by the Bank Holding Company Act. The Federal Reserve Board is responsible for supervising the financial condition and activities of financial holding companies.
Investment Grade	Investment grade generally means a security that is rated in one of the four highest rating categories by (1) two or more nationally recognized statistical rating organizations (NRSRO) or (2) one NRSRO if the security has been rated by only one NRSRO. In many instances, a security must be “investment grade” to be a permissible investment for a national bank. Bonds that are below investment-grade are sometimes called high-yield bonds or junk bonds.
Loan-to-Value	A ratio for a single loan and property calculated by dividing the total loan amount at origination by the market value of the property securing the credit plus any readily marketable collateral or other acceptable collateral.
Material Loss	As defined by section 38(k)(2)(B) of the FDI Act, and as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, for the period beginning January 1, 2010 and ending December 31, 2011, a material loss is defined as any estimated loss in excess of $200 million.
Memorandum of Understanding (MOU)	A Memorandum of Understanding is an informal agreement between the institution and the FDIC, which is signed by both parties. The State Authority may also be party to the agreement. MOUs are designed to address and correct identified weaknesses in an institution’s condition.
Mortgage-backed Securities (MBS)	Securities representing an undivided interest in a pool of mortgages with similar characteristics. Payments on the underlying mortgages are used to make payments to the security holders.
Nonaccrual Status	The status of an asset, often a loan, which is not earning the contractual rate of interest in the loan agreement, due to financial difficulties of the borrower. Typically, interest accruals have been suspended because full collection of principal is in doubt, or interest payments have not been made for a sustained period of time. Loans with principal and interest unpaid for at least 90 days are generally considered to be in a nonaccrual status.

Glossary of Terms

Offsite Review Program	The FDIC's Offsite Review Program is designed to identify emerging supervisory concerns and potential problems so that supervisory strategies can be adjusted appropriately. Offsite reviews are performed quarterly for each bank that appears on the Offsite Review List. Regional management is responsible for implementing procedures to ensure that Offsite Review findings are factored into examination schedules and other supervisory activities.
Other Than Temporary Impairment (OTTI)	An impairment of a debt instrument occurs when the fair value of the security is less than its amortized cost basis. According to accounting standards, when the impairment is judged to be other than temporary, the cost basis of the individual security must be written down to fair value, thereby establishing a new cost basis for the security, and the amount of the write-down must be included in earnings as a realized loss.
Peer Group	Institutions are assigned to 1 of 15 peer groups based on asset size, number of branches, and whether the institution is located in a metropolitan or non-metropolitan area.
Prompt Corrective Action (PCA)	The purpose of PCA is to resolve the problems of insured depository institutions at the least possible long-term cost to the Deposit Insurance Fund. Part 325, subpart B, of the FDIC Rules and Regulations, 12 Code of Federal Regulations, section 325.101, et. seq., implements section 38, *Prompt Corrective Action*, of the FDI Act, 12 United States Code section 1831(o), by establishing a framework for determining capital adequacy and taking supervisory actions against depository institutions that are in an unsafe or unsound condition. The following terms are used to describe capital adequacy: (1) Well Capitalized, (2) Adequately Capitalized, (3) Undercapitalized, (4) Significantly Undercapitalized, and (5) Critically Undercapitalized. A PCA Directive is a formal enforcement action seeking corrective action or compliance with the PCA statute with respect to an institution that falls within any of the three categories of undercapitalized institutions.
Risk-Based Capital	A "supplemental" capital standard under Part 325 of the FDIC Rules and Regulations. Under the risk-based framework, a bank's qualifying total capital base consists of two types of capital elements, "core capital" (Tier 1) and "supplementary capital" (Tier 2).

Glossary of Terms

Section 23A of the Federal Reserve Act	Section 23A (1) establishes limits on the amount of "covered transactions" between a member bank and its affiliates (any one affiliate and in the aggregate as to all affiliates); (2) requires that all covered transactions between a member bank and its affiliates be on terms and conditions that are consistent with safe and sound banking practices; (3) prohibits the purchase of low quality assets from an affiliate; and (4) requires that extensions of credit by a member bank to an affiliate, and guarantees on behalf of affiliates, be secured by statutorily defined amounts of collateral.
Special Mention Assets	A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.
Statistical CAMELS Offsite Rating (SCOR) System	SCOR is a financial model that uses statistical techniques, offsite data, and historical examination results to measure the likelihood that an institution will receive a CAMELS downgrade at the next examination.
Substandard	One of three types of classifications used by examiners to describe adversely classified assets. The term is generally used to describe an asset that is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Substandard assets are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.
Tier 1 (Core) Capital	Defined in Part 325 of the FDIC Rules and Regulations, 12 C.F.R. section 325.2(v), as **The sum of**: • Common stockholder's equity (common stock and related surplus, undivided profits, disclosed capital reserves, foreign currency translation adjustments, less net unrealized losses on available-for-sale securities with readily determinable market values); • Non-cumulative perpetual preferred stock; and • Minority interest in consolidated subsidiaries; **Minus:** • Certain intangible assets; • Identified losses; • Investments in securities subsidiaries subject to section 337.4; and • Deferred tax assets in excess of the limit set forth in section 325.5(g).

Glossary of Terms

Tranches	Multiple classes of equity and debt that are set in a senior or subordinate position to one another based upon seniority in bankruptcy and timing of repayment. The tranches are divided into three general categories: (1) Senior tranche; (2) Mezzanine tranche; and (3) Equity tranche.
Troubled Asset Relief Program (TARP)	TARP was established under the Emergency Economic Stabilization Act of 2008, which established the Office of Financial Stability within the Department of the Treasury. Under TARP, Treasury will purchase up to $250 billion of preferred shares from qualifying institutions as part of the Capital Purchase Program.
Uniform Bank Performance Report (UBPR)	The UBPR is an individual analysis of financial institution financial data and ratios that includes extensive comparisons to peer group performance. The report is produced by the Federal Financial Institutions Examination Council for the use of banking supervisors, bankers, and the general public and is produced quarterly from Call Report data submitted by banks.
Uniform Financial Institutions Rating System (UFIRS)	Financial institution regulators and examiners use the Uniform Financial Institutions Rating System (UFIRS) to evaluate a bank's performance in six components represented by the CAMELS acronym: **C**apital adequacy, **A**sset quality, **M**anagement practices, **E**arnings performance, **L**iquidity position, and **S**ensitivity to market risk. Each component, and an overall composite score, is assigned a rating of 1 through 5, with 1 having the least regulatory concern and 5 having the greatest concern.
Wholesale Funding	Wholesale funding sources include, but are not limited to, Federal funds, public funds, Federal Home Loan Bank advances, the Federal Reserve's primary credit program, foreign deposits, brokered deposits, and deposits obtained through the Internet or CD listing services. Financial institutions may use wholesale funding sources as an alternative to core deposits to satisfy funding and liability management needs.

Acronyms

ADC	Acquisition, Development, and Construction
ALLL	Allowance for Loan and Lease Losses
AML	Anti-Money Laundering
BSA	Bank Secrecy Act
C&D	Cease and Desist Order
CAMELS	**C**apital, **A**sset Quality, **M**anagement, **E**arnings, **L**iquidity and **S**ensitivity to Market Risk
CFO	Chief Financial Officer
CMO	Collateralized Mortgage Obligation
CRE	Commercial Real Estate
DIF	Deposit Insurance Fund
DRR	Division of Resolutions and Receiverships
DSC	Division of Supervision and Consumer Protection
FDI	Federal Deposit Insurance
FHLB	Federal Home Loan Bank
FIL	Financial Institution Letter
LTV	Loan-to-Value
MOU	Memorandum of Understanding
OFIR	Michigan Office of Financial and Insurance Regulation
OIG	Office of Inspector General
OREO	Other Real Estate Owned
OTTI	Other-Than-Temporary-Impairment
PCA	Prompt Corrective Action

Acronyms

SCOR	Statistical CAMELS Offsite Rating
TARP	Troubled Asset Relief Program
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System

Corporation Comments

FDIC

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

November 24, 2010

TO: Stephen Beard
Assistant Inspector General for Material Loss Reviews

/Signed/
FROM: Sandra L. Thompson [signed by Sandra L. Thompson]
Director

SUBJECT: FDIC Response to the Draft Audit Report Entitled, Material Loss Review of CF Bancorp, Port Huron, Michigan (Assignment No. 2010-070)

Pursuant to Section 38(k) of the Federal Deposit Insurance Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Federal Deposit Insurance Corporation's Office of Inspector General (OIG) conducted a material loss review of the failure of CF Bancorp, Port Huron, Michigan, which failed on April 30, 2010. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Report received on October 28, 2010.

CF Bancorp's failure was due to poor risk selection, which included concentrations in commercial real estate (CRE) and acquisition, development, and construction (ADC) loans located in Michigan and Florida, along with investments in private label collateralized mortgage obligations (CMO). CF Bancorp relied heavily on brokered deposits and Federal Home Loan Bank (FHLB) borrowings to fund lending and CMO purchases. In addition, ineffective Board of Directors and management oversight resulted in weak risk management practices. Significant losses in the loan and CMO portfolios ultimately depleted earnings and eroded capital.

From 2005 through April 2010, the FDIC and the Office of Financial and Insurance Regulation (OFIR) conducted five joint onsite examinations. When FDIC offsite monitoring identified declining trends in 2008, CF Bancorp's examination was accelerated. The 2008 examination revealed an increase in the bank's risk profile due to management's decision to implement a leverage strategy to purchase a significant volume of higher-risk private label CMOs with volatile funding sources. Based on the findings of the 2008 examination, CF Bancorp was downgraded to a composite "3" rating and a Memorandum of Understanding was issued. The 2009 examination found substantial deterioration in the CMOs. Additionally, weak internal controls and inadequate financial reporting delayed collection and workout strategies in CF Bancorp's loan portfolio. Based on the results of the 2009 examination, CF Bancorp was downgraded to a composite "5" rating and a Cease and Desist Order was issued.

DSC has issued guidance to enhance our supervision of institutions, such as CF Bancorp, with concentrated CRE/ADC lending and reliance on volatile non-core funding. A Financial Institution Letter (FIL) on *Managing Commercial Real Estate Concentrations in a Challenging Environment* was issued in 2008 that re-emphasizes the importance of robust credit risk-management practices and sets forth broad supervisory expectations. Additionally, DSC issued a FIL in 2009 on *Risk Management of Investments in Structured Credit Products,* providing clarification to existing guidance and strongly recommending vigilant due diligence and appropriate internal controls related to these securities.

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