

# Office of Inspector General



Office of Audits and Evaluations  
Report No. EVAL-13-001

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**Acquisition, Development, and  
Construction Loan Concentration Study**

October 2012



## Why We Did The Evaluation

This report presents the results of our study of FDIC-supervised institutions with significant acquisition, development, and construction (ADC) loan concentrations that did not fail during the recent economic downturn. ADC loans are considered the riskiest type of commercial real estate (CRE) lending. During the recent financial crisis, FDIC analysis shows that failed institutions had concentrations of ADC loans to total assets that were roughly three times the average of concentrations of non-failed institutions.

Our objective was to study the characteristics and supervisory approaches for FDIC-supervised institutions that had significant ADC loan concentrations in December 2007 and were not considered to be problem banks as of April 2011. In initiating this study, we were interested in identifying factors that may have helped banks mitigate the risks historically associated with ADC concentrations during periods of economic stress.

To evaluate the characteristics of the banks included in our study, we reviewed key financial ratios for the FDIC-supervised institutions meeting the criteria of our study – generally in satisfactory condition and having concentrations that regulators considered to be significant – and the 214 FDIC-supervised institutions that failed between January 2007 and April 2011. Doing so allowed us to compare and contrast the two groups. We also contacted bank officials for a sample of the institutions and discussed their strategies for managing ADC concentrations and factors, which in their view, allowed their institutions to remain fundamentally sound or to successfully overcome the risk and losses associated with the concentrations. To evaluate the FDIC’s supervisory approach, we reviewed the supervisory documents, including any enforcement actions taken, for a sample of banks that we refer to as “turn-around” banks. That is, banks with significant ADC concentrations in December 2007, some level of supervisory concern between 2007 and 2010, and improved supervisory ratings as of April 2011.

## Background

History has demonstrated that CRE markets can experience fairly rapid changes. Specifically, according to the FDIC’s *History of the Eighties—Lessons for the Future*, investment in CRE has traditionally been quite risky. Real estate markets as a whole are traditionally cyclical, so that even the most well-conceived and soundly underwritten CRE project can become troubled during the periodic overbuilding cycles that characterize these markets. ADC lending is generally considered to be the riskiest class of CRE due to long development times and because ADC lending can include properties that are built before having firm commitments from buyers or lessees. In addition, by the time the construction phase is completed, market demand may have fallen – placing downward pressure on sales prices or rents – making this type of loan more volatile.

Between 2001 and 2008, ADC lending grew rapidly at FDIC-insured banks. To address the growth in CRE concentrations, the banking regulatory agencies issued joint guidance in December 2006, which was intended to reinforce existing regulations and guidelines for real estate lending and safety and soundness. However, by the summer of 2007, a series of complex and interrelated shocks began to unfold, sparking sharp declines in real estate values in many regions of the country and setting off a wave of bank failures beginning in 2008.

**Evaluation Results**

We identified 436 institutions that met our criteria of having an ADC concentration of 100 percent or greater as of December 2007 and were in satisfactory condition as of April 2011. We focused attention on a sample of 18 of those institutions that had ADC concentrations of 300 percent or more. We took this approach because, in our view, the experience of these 18 institutions was unique and allowed us to readily compare their practices to those institutions with ADC concentrations that failed. Notably, we did not identify a significant number of banks with high concentrations in 2007 that were in satisfactory condition in 2011. We believe this is reflective of how difficult it is for institutions with exceedingly high ADC concentrations to mitigate the concentration risk during an economic downturn. Perhaps not surprisingly, bankers we interviewed characterized the Board's and management's risk appetite to be conservative or moderate. These same bankers implemented many of the key elements of the risk management framework that regulators have said are needed to manage ADC concentrations. Additionally, bankers we spoke to indicated that they limited speculative lending, loan participations, and out-of-area lending. Finally, a number of bankers were quick to point out that their market areas were less impacted by the economic decline. As a result of these factors, banks in our study did not experience significant losses from their ADC portfolio and managed to maintain stable capital positions even with a steep and prolonged economic decline.

We found that the supervisory approach and level of supervisory attention for the 23 turn-around banks we sampled were generally consistent with the FDIC's supervisory practices and policies and similar to the approach for banks that ultimately failed. That is, as economic conditions declined and banks' financial condition began to weaken, the FDIC's supervisory attention increased and supervisory actions were pursued. However, we observed that the approach yielded a better outcome – stable or improved examination ratings – because turn-around banks were responsive to supervisory actions and guidance and maintained or secured capital needed to absorb losses in response to regulatory demands.

**Observations and Matters for Consideration**

Prior to the recent financial crisis, competition among financial institutions for growth, profitability, and community influence often resulted in the compromise of sound credit principles and acquisition of unsound loans. Ultimately, that type of compromise resulted in a spate of bank failures not seen since the 1980s—a period that, in broad terms, was not that long ago. Much was written following the banking crisis of the 1980s and early 1990s, and there were ample discussions of lessons learned. In addition, far-reaching legislative and regulatory actions were taken and extensive guidance was issued by regulators on key risks, including repeated warnings and references to best practices related to ADC lending because it is a highly specialized field with inherent risks that must be managed and controlled. Nevertheless, unlike the circumstances at the banks we studied, Boards and management at too many other institutions pursued profits through growth and higher-earning, risky assets, in an era of easy credit, while lacking robust risk management practices—a story that appears very similar to the one told just over 20 years ago.

We found that some institutions with ADC concentrations were able to weather the recent financial crisis without experiencing a corresponding decline in their overall financial condition. The factors that contributed to their survival validate the point that regulators have emphasized and reiterated for years – a well-informed and active Board, strong management, sound credit administration and underwriting practices, and adequate capital are important in managing ADC concentrations in a safe and sound

manner. In addition, the banks in our study did not rely on brokered deposits to fund growth, and geographic location factored into the degree of ADC loan losses. Ultimately, the strategic decisions and disciplined, values-based practices and actions taken by the Boards and management helped to mitigate and control the institutions' overall ADC loan risk exposure and allowed them to react to a changing economic environment. Unlike many failed banks that saw their capital evaporate rapidly because of the losses associated with their ADC portfolios, the banks in our study experienced comparatively fewer losses and were able to maintain stable capital positions.

Further, we determined that the FDIC's supervisory approach and level of supervisory attention for the turn-around banks were generally consistent with the FDIC's supervisory practices and policies and similar to the approach for failed banks. In that regard, the following areas in which the FDIC has implemented revised supervisory policies and procedures are worth highlighting.

- While the supervisory approach we observed for turn-around banks proved effective, similar to observations made in our material loss reviews (MLRs), we believe that earlier emphasis on risk management practices would have been beneficial. To that end, the Corporation completed a training initiative in 2010 for its entire supervisory workforce that focused on placing greater emphasis on risk management practices for institutions with elevated risk profiles. The training addressed the importance of considering management practices as well as current financial performance or trends when assigning ratings, consistent with existing examination guidance. This approach encourages bank management to continuously implement effective risk management practices and examiners to promptly address control weaknesses, regardless of how well a bank is performing financially.
- Management's responsiveness to supervisory concerns was a key differentiating factor between banks that failed and the turn-around banks we reviewed. Generally, our MLRs have shown that examiners identified significant risks but did not take timely and effective action to address those risks until the bank had started to experience significant financial deterioration in the loan or investment portfolios. In response to those findings, the FDIC has conducted training and issued guidance aimed at timely communication of risks to financial institutions, prompt supervisory and enforcement actions, and examiner follow-up. The Corporation should remain vigilant in ensuring that its processes and examiners sufficiently promote prompt and effective responses to examination findings and supervisory actions, including timely and progressive enforcement of situations involving banks that are not responsive to examination findings, repeat criticisms, or violations.

Finally, the FDIC has to date, and must continue to make certain, that lessons learned associated with ADC concentrations become ingrained in day-to-day supervisory activities and that placing greater emphasis on risk management practices for institutions with elevated risk profiles is sustained regardless of the health of the economy or banking industry or the political appetite for financial regulation. We trust that the analysis and conclusions of our study will benefit the Corporation and assist in management's continuous efforts to have an efficient and effective supervisory program that protects depositors and the Deposit Insurance Fund.

## **Corporation Comments**

We provided a draft of this report to FDIC management on August 9, 2012. The FDIC was not required to provide a written response because the report contained no recommendations, and management opted to only provide informal comments regarding the technical accuracy of certain report content. We made changes to the report, where appropriate, to address those comments. FDIC management did express general agreement with the evaluation results at the exit conference for this assignment.

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**DATE:** October 31, 2012

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

**FROM:** */Signed/*  
Stephen M. Beard  
Deputy Inspector General for Audits and Evaluations

**SUBJECT:** *Acquisition, Development, and Construction Loan  
Concentration Study (Report No. EVAL-13-001)*

This report presents the results of our study of FDIC-supervised institutions<sup>1</sup> with significant acquisition, development, and construction<sup>2</sup> loan (ADC) concentrations that did not fail during the recent economic downturn. ADC loans are considered the riskiest type of commercial real estate (CRE) lending. During the recent financial crisis, FDIC analysis shows that failed institutions had concentrations of ADC loans to total assets that were roughly three times the average of concentrations of non-failed institutions.

In presenting these results, we are mindful that FDIC-supervised institutions and the FDIC itself have already learned key lessons associated with ADC loan concentrations. Banks are modifying borrowers' loan terms so that they can continue to make payments; increasing bank capital and reserves as protection against future losses; and, in some cases, reducing lending. The FDIC and the other federal banking regulators have responded by issuing interagency statements and guidance on managing the risks of ADC concentrations, encouraging banks to continue lending to creditworthy borrowers, clarifying to banks how examiners will review loans secured by real estate, and explaining how banks can work with troubled borrowers. While there has been some improvement in the market, problems in this type of lending are expected to continue and could present further challenges to the market in coming years.

With that in mind, it was our intention in this report to shift the focus away from banks that failed to those that managed to see their way through the economic downturn and maintain safe and sound operations. Likewise, the intent of the study was to focus on the FDIC's supervisory approach to ADC concentrations in banks that remained open rather than evaluate what examiners did to minimize loss to the Deposit Insurance Fund (DIF) as a result of an institution that had failed. To provide a context for our results, the report first presents background information addressing the extent to which FDIC-insured banks grew their ADC loan portfolios during the financial crisis and how that growth contributed to failures and then summarizes key supervisory guidance and tenets of sound risk management associated with ADC concentrations. The next two sections of our report discuss (1) the common characteristics of the banks we studied and how they

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<sup>1</sup> Throughout this report, we use the terms "FDIC-supervised institution" and "bank" interchangeably unless noted otherwise.

<sup>2</sup> Underlined terms are defined in the Glossary, Appendix 2.



contrast with those that failed and (2) how the supervisory approach and level of supervisory attention for the banks we sampled compared to those banks that ultimately failed. Finally, we provide our concluding observations and matters for management's consideration.

## EVALUATION OBJECTIVE AND APPROACH

Our objective was to study the characteristics and supervisory approaches for FDIC-supervised institutions that had significant ADC loan concentrations in December 2007 and were not considered to be problem banks as of April 2011. In initiating this study, we were interested in identifying factors that may have helped banks mitigate the risks historically associated with ADC concentrations during periods of economic stress.

We identified 436 institutions meeting our criteria – that is, institutions with ADC concentrations 100 percent or greater as of December 2007 and considered to be in a satisfactory condition as of April 2011.<sup>3</sup> We used 100 percent as a benchmark because it is the threshold that regulators use to identify institutions that are potentially exposed to significant CRE concentration risk, which is described in guidance entitled, *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* (Joint Guidance).<sup>4</sup>

To study the characteristics of these banks, we performed level and trend analysis of key financial ratios for the 436 FDIC-supervised institutions we identified and the 214 FDIC-supervised institutions that failed between January 2007 and April 2011.<sup>5</sup> Doing so allowed us to compare and contrast the two groups. Of the 436 institutions, we focused attention on a sample of 18 institutions that had concentrations of 300 percent or greater and were in satisfactory condition to determine whether these institutions had any unique characteristics that we could learn from. We also reviewed an FDIC-generated loan underwriting survey to understand the risk profile of sound banks with ADC concentrations, which we compared with the FDIC-supervised banks that failed.

To study the FDIC's supervisory approach, we looked at banks with ADC concentrations between 100 and 300 percent as of December 2007 that were in a less-than-satisfactory condition between 2007 and 2010 and subsequently received a higher composite rating as of April 2011. We identified 71 institutions meeting these criteria and selected a non-statistical sample of 23 banks, which we refer to as "turn-around" banks in this report.<sup>6</sup> For each of the 23 turn-around banks, we

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<sup>3</sup> For purposes of this report, banks with 1 or 2 CAMELS composite ratings were considered to be in satisfactory condition and banks with 3, 4, or 5 ratings were considered to be in less than satisfactory condition. 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 – Capital adequacy, Asset quality, Management practices, Earnings performance, Liquidity position, and Sensitivity to market risk – and determine an overall composite rating.

<sup>4</sup> 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 in December 2006.

<sup>5</sup> Level analysis is the process of reviewing financial statement ratios and volumes as of a specific date. Level analysis allows for a comparison of performance. Trend analysis is the process of assessing the general direction or prevailing tendency (i.e., increasing, decreasing, or stable) of operating ratios or volumes over several periods (i.e., generally over a 5-year period) using the level of each period.

<sup>6</sup> A non-statistical sample is judgmental and cannot be projected to the intended population by standard statistical methods. See Appendix 1 for a detailed description of the sampling methodology used during the audit.

obtained and reviewed key supervisory documents for our scope period, January 2007 through June 2011.

Lastly, we contacted bank officials in 38 institutions to discuss their strategies for managing ADC concentrations and factors, which in the officials' view, allowed their institutions to remain fundamentally sound or to successfully overcome the risk and losses associated with the concentrations. We also solicited their views on the FDIC's supervision with respect to ADC concentrations. Among the banks we contacted were officials from (1) all 18 banks in our sample of institutions that had concentrations of 300 percent or greater and were in satisfactory condition and (2) about half of our sample of turn-around banks. Thirty-six bank officials agreed to talk with us. The results of our discussions are reflected throughout the report. However, to avoid overstating the precision of the results, we use the terms "few," "some," and "most."<sup>7</sup> We did not interview officials in banks with high ADC concentrations that were considered to be in a less-than-satisfactory condition as of April 2011 because those banks were not a focus of this study. Therefore, the experiences and views of those officials may differ from those of the officials we interviewed and are not reflected in this report except where we reference results from a Government Accountability Office (GAO) study on CRE.

Our basic understanding of the risks associated with ADC concentrations is based on our review of regulatory guidance and ADC-related reports, including reports from GAO and the FDIC. We also considered material loss review (MLR) reports<sup>8</sup> issued by our office and other studies written about bank failures during the recent financial crisis to identify issues associated with ADC concentrations discussed in those reports.

We performed our evaluation work from July 2011 through February 2012 in accordance with the Council of the Inspectors General on Integrity and Efficiency's *Quality Standards for Inspection and Evaluation*. Appendix 1 includes additional details related to our objective, scope, and methodology. Appendix 2 provides a glossary of certain terms used in this report, and Appendix 3 provides a list of acronyms also used in this report.

## BACKGROUND

According to the FDIC's *History of the Eighties—Lessons for the Future*, investment in CRE has traditionally been quite risky. Real estate markets as a whole are traditionally cyclical, so that even the most well-conceived and soundly underwritten CRE project can become troubled during the periodic overbuilding cycles that characterize these markets. ADC lending is generally considered to be the riskiest class of CRE due to long development times and because ADC lending can include properties that are built before having firm commitments from buyers or lessees. In addition, by the time the construction phase is completed, market demand may have fallen –

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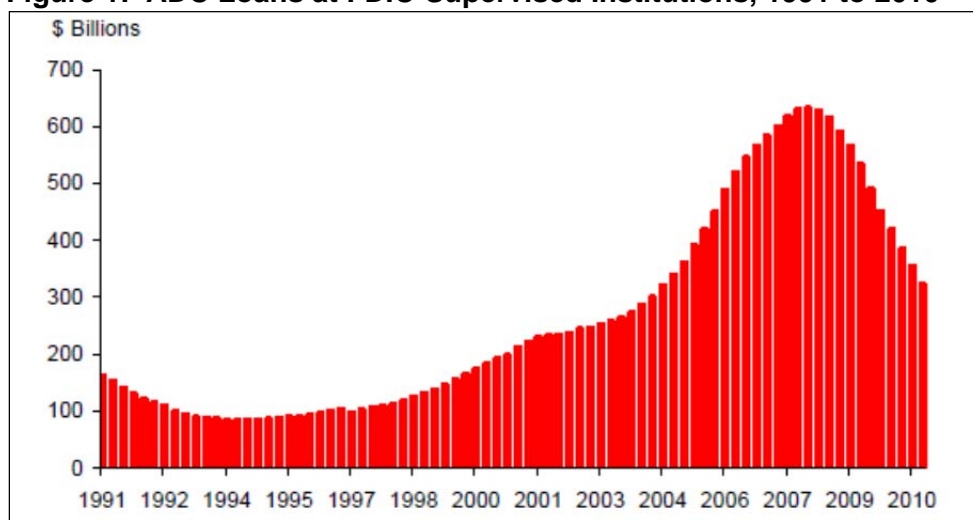
<sup>7</sup> Appendix 1 provides information about how we use these terms.

<sup>8</sup> As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), when the DIF incurs a material loss, the IG of the appropriate federal banking agency is required to make a written report to that agency. The report is to consist of a review of the agency's supervision of the institution and a determination as to why the institution's problems resulted in a material loss to the DIF and recommendations to prevent future losses.

placing downward pressure on sales prices or rents – making this type of loan more volatile. In the years after the banking and thrift crisis of the 1980s and early 1990s, banking and economic conditions were favorable and relatively few banks failed. During this period, banks had record earnings but were also building up significant credit risk exposures.

Notably, between 2001 and 2008, ADC lending grew rapidly at FDIC-insured banks and, as later illustrated, shrank just as quickly as the housing bubble burst. A 2007 FDIC article on managing CRE concentrations (including ADC loans) noted that demand for CRE lending – a traditional core business for many community banks – had been strong, and a number of banks had CRE concentrations that were high by historical standards and were rising.<sup>9</sup> Growth in ADC lending was especially pronounced as depicted in Figure 1.

**Figure 1: ADC Loans at FDIC-Supervised Institutions, 1991 to 2010**



Source: FDIC's Division of Insurance and Research (DIR).

According to FDIC data, ADC lending grew 75 percent from the first quarter of 2005 to the first quarter of 2008, and ADC loan volume for all FDIC-insured banks peaked in March 2008. The FDIC's analysis of the data noted that ADC loan growth was more prevalent in (1) *de novo* banks; (2) small community banks; (3) certain regions of the country, such as the Southeast, Northwest, and Mountain states; and (4) states affected by the housing boom, such as Georgia, Washington, Arizona, and North Carolina.

To address the growth in CRE concentrations, the agencies issued the Joint Guidance in December 2006, which was intended to reinforce existing regulations and guidelines for real estate lending and safety and soundness. The Joint Guidance identifies institutions that are potentially exposed to significant CRE concentration risk as those that have experienced rapid growth in CRE lending, have notable exposures to a specific type of CRE, or are approaching or exceed the following supervisory criteria:

- Total loans reported for construction, land development, and other land represent 100 percent or more of the institution's total capital; or

<sup>9</sup> FDIC Supervisory Insights, *Managing Commercial Real Estate Concentrations*, Winter 2007.

- Total CRE loans that represent 300 percent or more of the institution’s total capital, and the outstanding balance of the institution’s CRE loan portfolio has increased by 50 percent or more during the prior 36 months.

The Joint Guidance states that these criteria are not limits and are viewed neither negatively nor as a “safe harbor.” According to the Joint Guidance, the ability of institutions with significant concentrations to withstand difficult market conditions will depend heavily on the adequacy of their risk management practices and capital levels. The guidance recognizes that the sophistication of an institution’s risk management process will depend on the size of the CRE portfolio and the level and nature of its CRE concentration risk. Figure 2 summarizes the key elements needed for managing concentration risk as outlined in the Joint Guidance.

**Figure 2: Key Elements Needed in a Risk Management Framework for Concentrations**

**Board and Management Oversight.** If an institution has significant CRE concentration risk, its strategic plan should address the rationale for its CRE levels in relation to its overall growth objectives, financial targets, and capital. The Board of Directors (Board) should establish policy guidelines and approve an overall CRE lending strategy regarding the level and nature of CRE exposures acceptable to the institution.

**Portfolio Management.** Management should regularly evaluate the degree of correlation between related real estate sectors and establish internal lending guidelines and concentration limits that control the institution’s overall risk exposure. Management should develop a contingency plan to reduce or mitigate concentrations in the event of adverse CRE market conditions.

**Management Information Systems.** A management information system should be provided to management with sufficient information to identify, measure, monitor, and manage CRE concentration risk.

**Market Analysis.** Market analysis should provide the institution’s management and Board with information to assess whether its CRE lending strategy and policies continue to be appropriate in light of changes in CRE market conditions. An institution should perform periodic market analysis for the various property types and geographic markets represented in its portfolio.

**Credit Underwriting Standards.** When an institution has a CRE concentration, the establishment of sound lending policies becomes even more critical. Credit analysis should reflect both the borrower’s overall creditworthiness and project-specific considerations, as appropriate.

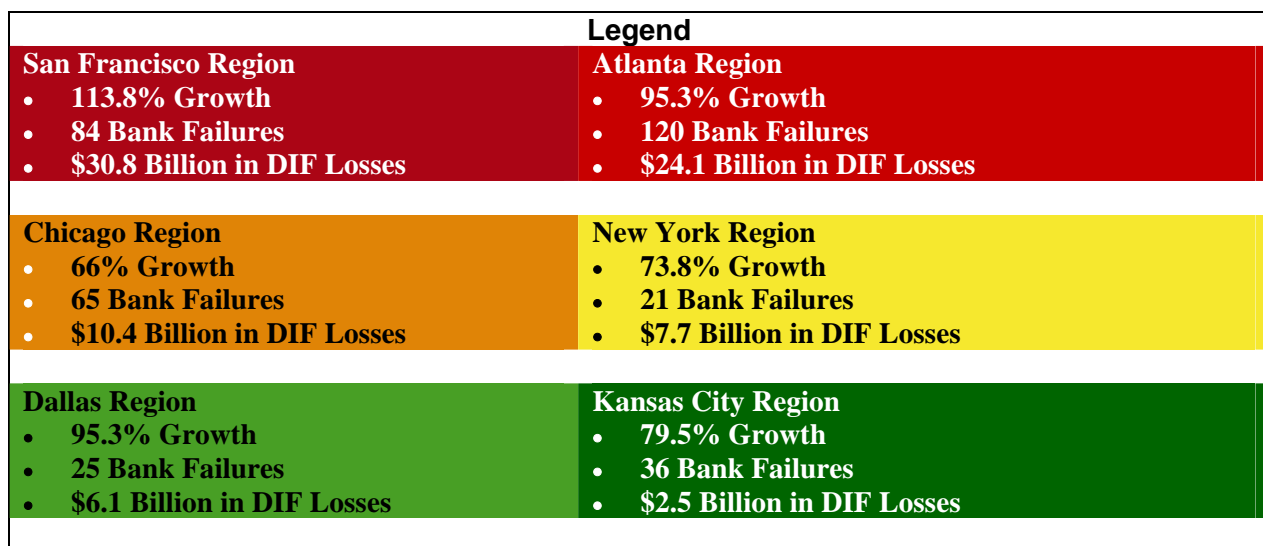
**Portfolio Stress Testing and Sensitivity Analysis.** An institution with CRE concentrations should perform portfolio-level stress tests or sensitivity analysis to quantify the impact of changing economic conditions on asset quality, earnings, and capital.

**Credit Risk Review Function.** A strong credit risk review function is critical for an institution’s self-assessment of emerging risks. An effective, accurate, and timely risk-rating system provides a foundation for the institution’s credit risk review function to assess credit quality and, ultimately, to identify problem loans.

Source: Joint Guidance.

History has demonstrated that CRE markets can experience fairly rapid changes and, by the summer of 2007, a series of complex and interrelated shocks, rooted in poor underwriting and poor administration of residential subprime mortgages and flaws in securitization practices and capital markets, began to unfold, triggering a liquidity crisis and recession. The financial crisis sparked sharp declines in real estate values in many regions of the country and set off a wave of bank

### Figure 3: ADC Loan Growth, Bank Failures, and DIF Losses by Region



Note: Bank failure and loss data are from January 2007 to March 2011.

In response to the challenging economic conditions that began to materialize in 2007, the FDIC issued guidance in 2008 to re-emphasize the importance of strong capital and allowance for loan and lease loss (ALLL) levels and robust credit risk management practices for institutions with concentrated CRE exposures consistent with the Joint Guidance.

## **COMMON CHARACTERISTICS OF BANKS IN THIS STUDY**

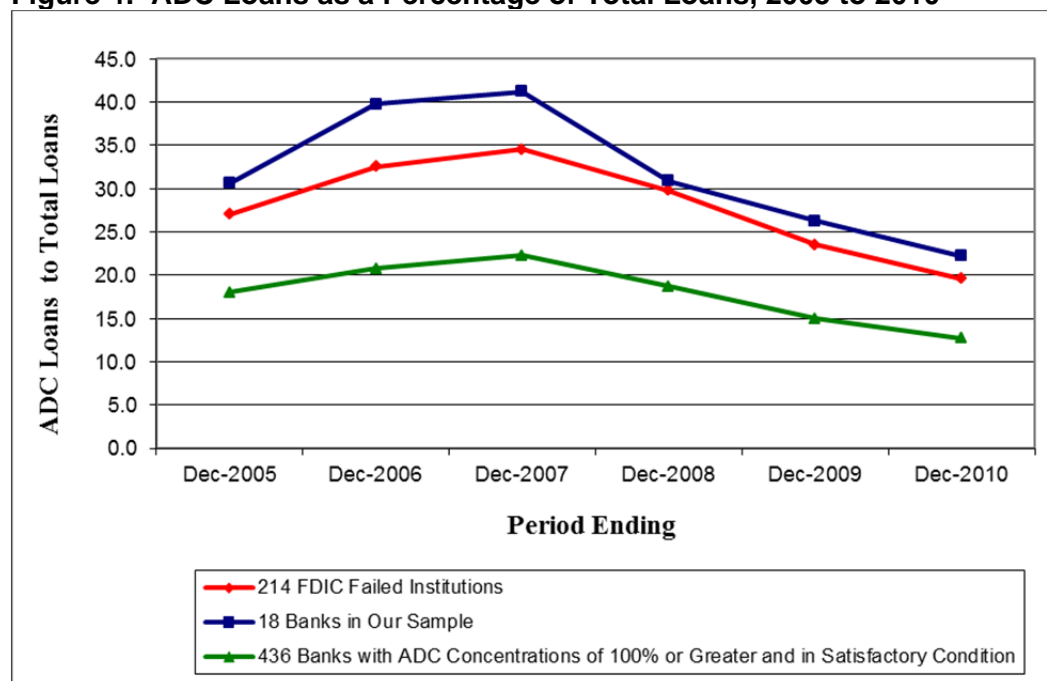
This section of the report discusses what we learned about the characteristics of the banks with ADC concentrations that did not fail. As noted earlier, we focused attention on a sample of 18 banks that had ADC concentrations of 300 percent or greater and were in satisfactory condition. We selected this sample, because, in our view, the experience of these 18 institutions was unique and allowed us to readily compare their practices to those institutions with ADC concentrations that failed. Notably, we did not identify a significant number of banks with high concentrations in 2007 that were in satisfactory condition in 2011. We believe this is reflective of how difficult it is for institutions with exceedingly high ADC concentrations to mitigate the concentration risk during an economic downturn. Perhaps not surprisingly, bankers we interviewed characterized the Board's and management's risk appetite to be conservative or moderate. These same bankers implemented many of the key elements of the risk management framework that regulators have said are needed to manage ADC concentrations. Additionally, a number of bankers we interviewed were quick to point out that their market areas were less impacted by the economic decline. As a result of these factors, banks in our study did not experience significant losses from their ADC portfolio and managed to maintain stable capital positions even though the economy, as a whole, experienced a steep and prolonged economic decline.

### **IMPLEMENTED MORE CONSERVATIVE GROWTH STRATEGIES**

According to the Joint Guidance, an institution's Board has ultimate responsibility for the level of risk assumed by the institution. In general, the banks that failed pursued aggressive growth strategies centered in ADC lending, which left those institutions more vulnerable to the economic downturn. While the 436 banks in our study experienced some increasing ADC concentration levels from 2005 through 2007, most of the bankers we spoke with characterized their institution's risk appetite to be conservative or moderate, and most pursued a conservative or moderate growth strategy. Bank officials from one bank explained that the bank was aggressive early but "got scared" early. The officials explained that competitive market factors influenced their decision to pursue an aggressive growth strategy in 2005 and 2006, but, overall, they tried to maintain a conservative culture and emphasize sound underwriting standards.

Figure 4 presents trend information reflecting the percentage of ADC loans to total loans for failed banks and the banks in our sample. The analysis reveals that, for the 436 banks in our study, ADC loans represented a smaller percentage of the total loan portfolio than failed banks, which reflects the Boards' lower risk appetite and ensuing strategic decisions.

**Figure 4: ADC Loans as a Percentage of Total Loans, 2005 to 2010**



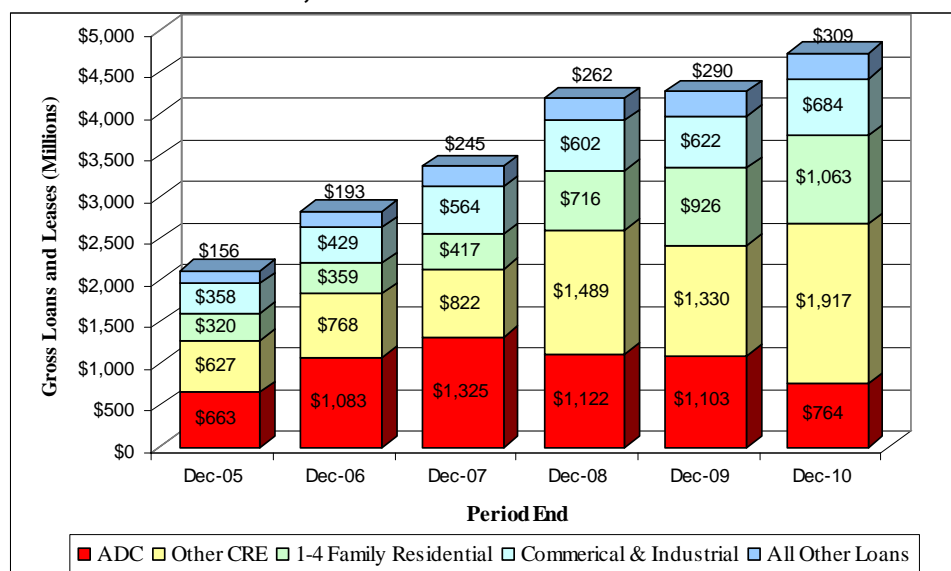
Source: OIG analysis of selected Uniform Bank Performance Report (UBPR) data.

Note: Data points presented are averages for the failed and sampled banks.

Further, the 18 banks in our sample were able to significantly diversify their loan portfolio in comparison to the other banks in our study. The declining trend line for the failed banks was due to the recognition of ADC loan losses within the loan portfolio – not as a result of the banks’ efforts to diversify into other loan products. Bankers we interviewed stated that once the economy declined, they mitigated the risk associated with their ADC loan concentrations by intentionally reducing their ADC loan portfolio, further diversifying their loan portfolio, and implementing pre-existing (well-developed) loan workout policies to meet the bank’s increased operational demands. Most of the bank officials we spoke with from the 18 banks stated that they made conscious decisions to diversify their loan portfolio by shifting their loan mix away from ADC loans and to shrink the volume of ADC loans in response to the economic decline, which our level and trend analysis supports. A few officials acknowledged that they did not make a conscious decision to diversify or shrink their ADC loan portfolios; rather, the shift away from ADC lending happened because there was less demand for ADC loans.

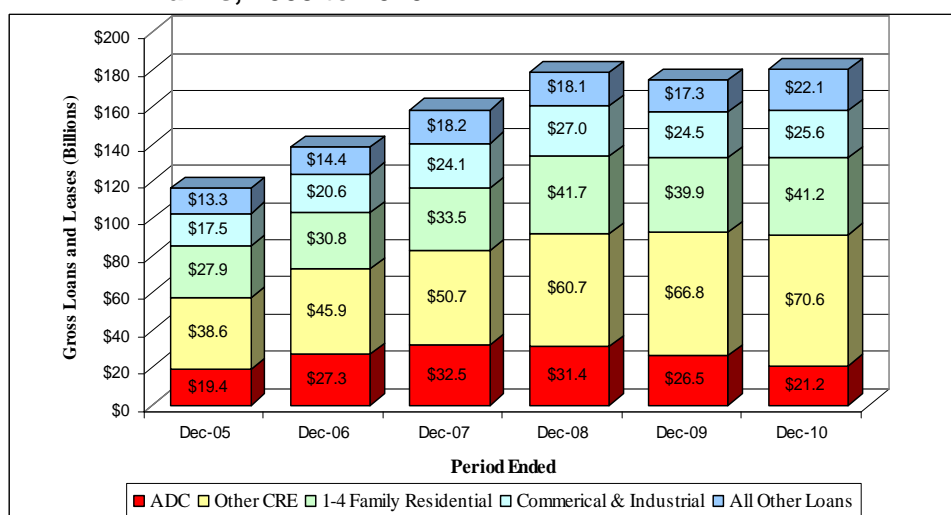
Most officials we interviewed from the 18 banks also stated that the banks’ Boards took an active role in monitoring the ADC portfolio and were familiar with the local real estate market. More than half of the bank officials from those banks stated that they relied on formal market analysis processes, including obtaining housing data and trends from third-party subscription services. The other officials we interviewed relied on less-formal processes but said they kept abreast of market conditions by maintaining strong relationships with local realtors and borrowers and being knowledgeable about their respective communities. Additionally, most of the officials from the 18 banks we interviewed stated that they proactively “ramped up” loan work-out staffing to address problem loans and did so early in the cycle. Figures 5 and 6 present loan composition and growth information for the 18 and 436 banks, respectively.

**Figure 5: Loan Portfolio Composition and Growth for the Sample of 18 Banks, 2005 to 2010**



Source: OIG analysis of selected Call Report data.

**Figure 6: Loan Portfolio Composition and Growth for 436 Banks, 2005 to 2010**



Source: OIG analysis of selected Call Report data.

## RELIED ON CORE DEPOSITS AND LIMITED NET NON-CORE FUNDING DEPENDENCE

In response to our question about funding sources, most bankers we interviewed stated they primarily relied on core deposits to fund operations and growth. Core deposits have historically been categorized as stable, less-costly deposits obtained from local customers that maintain a relationship with the institution, while brokered deposits<sup>10</sup> are considered potentially volatile, interest-rate-sensitive deposits from customers in search of yield. The FDIC's research indicates that core deposits may reduce a bank's probability of failure because they typically provide a bank

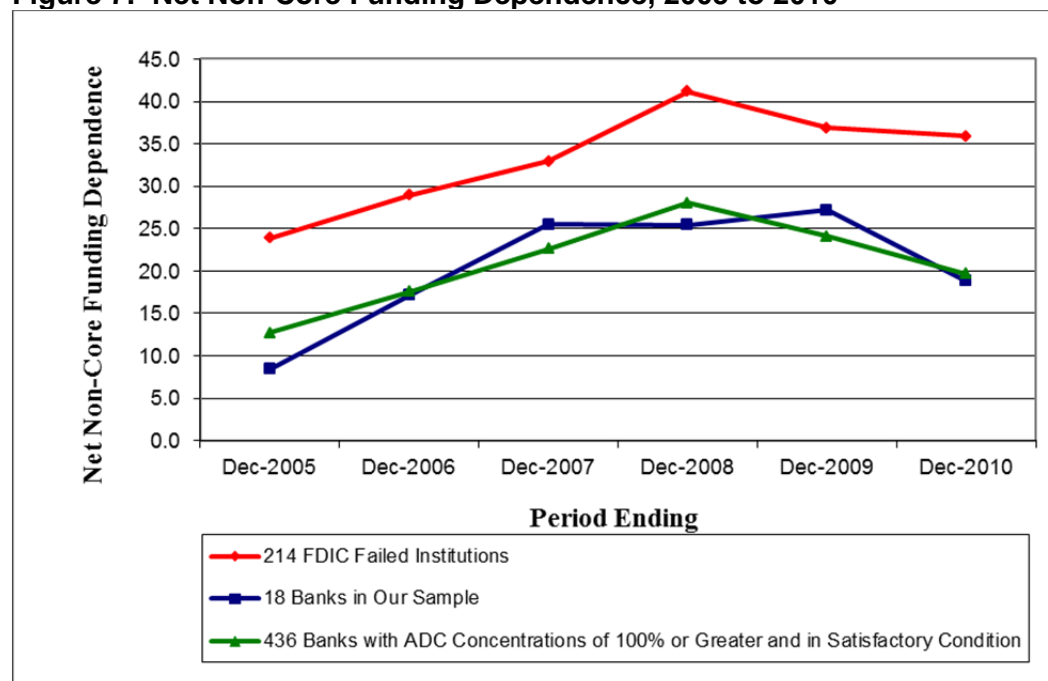
<sup>10</sup> Brokered deposits are a type of wholesale funding.



with a stable and relatively cost-effective source of funds and are a direct indication of a bank's valuable customer relationships and franchise value. An FDIC study of core and brokered deposits noted that while examiners do not necessarily view the presence of any certain source of funding as inherently bad, the FDIC had observed that a number of bank failures occurred where concentrations in CRE and ADC lending were funded by large amounts of brokered deposits.<sup>11</sup> We also made this observation in our MLRs.

Figure 7 compares the net non-core dependence ratio for banks in our study and FDIC-supervised banks that failed. As illustrated, failed banks, in general, were more reliant on non-core funding sources to support their ongoing operations than were the banks in our study. The net non-core funding dependence ratio measures the extent to which a bank is using non-core funds to invest in long-term assets, which can create a liquidity concern because non-core funds can be volatile and long-term assets may not be readily converted to cash. A high positive ratio may indicate a bank's possible vulnerability to adverse events in the non-core funding environment (i.e., when the cost of these funds becomes prohibitive).

**Figure 7: Net Non-Core Funding Dependence, 2005 to 2010**



Source: OIG analysis of UBPR data.

Note: The net non-core funding dependence ratio is a bank's non-core liabilities, less short-term investments, divided by long-term assets. Data points presented are averages for failed and sampled banks.

Further, because the failed banks entered the crisis with high levels of non-core funding, those banks had limited funding options once they became troubled or undercapitalized.<sup>12</sup> Conversely,

<sup>11</sup> Pursuant to section 1506 of the Dodd-Frank Act, the FDIC completed the *Study on Core Deposits and Brokered Deposits* (July 8, 2011).

<sup>12</sup> Section 29 of the FDI Act and Part 337.6 of the FDIC Rules and Regulations address restrictions placed on financial institutions that are deemed to be less than *Well Capitalized* for Prompt Corrective Action purposes, including the use of brokered deposits and interest-rate restrictions.

banks in our study were able to utilize additional non-core funding sources to facilitate a shift or growth away from ADC lending and into other more profitable operations.

### **IMPLEMENTED PRUDENT RISK MANAGEMENT PRACTICES AND LIMITED SPECULATIVE LENDING, LOAN PARTICIPATIONS, AND OUT-OF-AREA LENDING**

In a 2010 follow-up audit report, we stated that concentrations in CRE and ADC loans, coupled with inadequate risk management practices have played a role in practically every failure that was the subject of an MLR.<sup>13</sup> In addition, the inappropriate use of interest reserves by bank management was noted in many of the MLRs we conducted. In contrast to our MLR findings, most officials we interviewed for this study characterized their bank's underwriting practices to be conservative or moderate. Further, our review of FDIC-generated underwriting survey results generally support the notion that the banks included in our study had stronger loan underwriting practices than failed banks and, consequently, a lower risk profile in general.

Long-standing supervisory guidance states that management's ability to identify, measure, monitor, and control portfolio risk through effective underwriting policies, systems, and internal controls is crucial to a sound ADC lending program.<sup>14</sup> The Joint Guidance reiterated that concentrations in CRE lending, coupled with weak loan underwriting and depressed CRE markets, contributed to significant credit losses in the past. According to the Joint Guidance:

- strong risk management practices are an important element of a sound CRE lending program, particularly when an institution has a concentration in CRE loans;
- financial institutions with CRE concentrations should ensure that risk management practices appropriate to the size of the portfolio, as well as the level and nature of concentrations, and the associated risk to the institution are implemented; and
- financial institutions should establish a risk management framework that effectively identifies, monitors, and controls CRE concentration risk.

In addition, FIL-22-2008, *Managing Commercial Real Estate Concentrations in a Challenging Environment*, issued March 17, 2008, provides key risk management processes for institutions with CRE concentrations, including maintaining prudent, time-tested lending policies with a strong credit review and risk rating system to identify deteriorating credit trends early and maintaining updated financial and analytical information for borrowers. For example, institutions should emphasize global cash flow analysis of obligors, which involves analyzing borrowers' complete financial resources and obligations. The guidance further states that inappropriately adding extra interest reserves on loans where the underlying real estate project is not performing as expected can erode collateral protection and mask loans that would otherwise be reported as delinquent.

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<sup>13</sup> FDIC OIG report entitled, *Follow-up Audit of FDIC Supervision Program Enhancements*, dated December 23, 2010, (Report No. MLR 11-010).

<sup>14</sup> *Internal and Regulatory Guidelines for Managing Risks Associated with Acquisition, Development, and Construction Lending*, Financial Institution Letter (FIL)-110-98, dated October 8, 1998.

The following paragraphs highlight the lending and underwriting and credit administration practices of banks in our study, as described by the bank officials we interviewed:

**Limited or No Speculative ADC Lending.** Speculative lending involves providing financing to developers for constructing homes that are not pre-sold, adding an additional dimension of risk. Monitoring a speculative single-family housing development can be especially challenging. Institutions must have a clear understanding of the demand for housing within geographic areas, submarkets, or specific projects, as well as price points within markets or projects. Most of the bankers we interviewed characterized their practices as conservative. Generally, bank officials said that speculative loans were originated only on a limited basis before the economic crisis, if at all. Further, in cases where banks did fund speculative ADC loans, bank officials indicated that loans were made to existing borrowers and were tied to strong customer relationships.

**Limited or No ADC Loan Participations.** Loan participations are a means by which banks diversify their assets and generate lending income. According to the FDIC's *Risk Management Manual of Examination Policies* (Examination Manual), a bank purchasing a participation loan is expected to perform the same degree of independent credit analysis on the loan as if the bank were the originator of the loans. To determine if a participation loan meets its credit standards, a participating bank must obtain all relevant credit information and details on collateral values, lien status, loan agreements, and participation agreements before a commitment is made to purchase. Some of our MLRs found that institutions that purchased out-of-area participations relied on the underwriting of the institution that originated the loans rather than making independent assessments of the loans prior to purchase, which was among the factors contributing to some failures. Most officials we interviewed said that their banks did not purchase loan participations or had bought participations only on a limited basis.

**Limited or No Out-of-Area Lending.** Out-of-area lending can diversify an institution's portfolio and reduce geographic concentration risk. However, before engaging in out-of-area lending, institutions should ensure the infrastructure is in place (i.e., staff, systems, and processes) to monitor and administer these loans. A 2010 FDIC analysis of loan underwriting data indicated that some banks increased their overall risk profiles because of this type of lending.<sup>15</sup> According to the FDIC's analysis, the majority (89 percent) of out-of-area lending activity was reported in commercial/CRE (including ADC) portfolios. Further, the FDIC found that institutions that exhibited frequent or common out-of-area lending activity tended to have higher levels of credit risk and more loose overall underwriting standards, particularly in ADC portfolios.

Most of the bankers we interviewed described their practices as conservative – either not originating out-of-area loans or originating these loans on a limited basis. For example, a few bank officials stated that they made an out-of-area loan to existing customers or in familiar areas. A few officials stated that they had reduced any out-of-area loan origination volume during the financial crisis.

**Routine Global Cash Flow Analysis.** Global cash flow analysis involves analyzing borrowers' complete financial resources and obligations. Most bankers we interviewed described their practices as conservative, stating global cash flow analysis was performed. A few officials

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<sup>15</sup> *Insights From the FDIC's Credit and Consumer Products/Services Survey*, FDIC Supervisory Insights, Winter 2010.

acknowledged that they had not performed or emphasized global cash flow analysis until the economic crisis began to unfold.

**Limited Use of Interest Reserve Accounts.** Interest reserve accounts essentially capitalize contractual interest payments into a construction loan's principal balance, similar to the funding of other development costs that are supported by construction loan advances. The use of interest reserves in conjunction with the funding of initial development and construction costs is an acceptable lending practice subject to prudent underwriting standards, appropriate repayment terms, and the timely completion of the project in accordance with the original loan agreement. However, the use of, or over-reliance on, interest reserves beyond the timely completion of construction may be inappropriate. For example, if a project experiences delays or has diminished feasibility resulting from a weak local real estate market, interest reserves can inappropriately disguise a problem credit relationship. Most bankers we interviewed described their practices as conservative, stating that they did not originate loans with an interest reserve funding component – allowing loan proceeds to fund the borrower's interest payments.

**Analysis of Loan Underwriting Survey Results.** In addition to the differences highlighted above, our analysis of the FDIC's loan underwriting survey results showed that the failed banks generally took on a greater level of risk from 2004 to 2006. FDIC-supervised banks that failed also increased their risk profile more severely, as the economic cycle peaked and then began to decline in 2007, and then again in 2009. In particular, from 2004 to 2009, examiner survey results indicate that the failed banks initially had higher levels of potential risk and/or significantly increased their risk profiles above that of sound institutions, in the following areas:

- Loan growth,
- Current underwriting practices,
- Loan portfolio credit risk,
- Loan participations purchased,
- Contributions to concentrations of credit,
- Out-of-area lending,
- Loan administration risk,
- Failure to require material principal reduction before renewal,
- Lending policies differing from actual practices,
- Funding speculative residential ADC projects,
- Funding speculative commercial real estate development projects,
- Funding ADC loans without consideration of other sources of repayment (other than the project being funded),
- Funding ADC loans without consideration of the quality of other sources of repayment (when alternative sources of repayment are required),
- Failure to use realistic appraised values,
- Funding, or deferring, interest payments on ADC loans, and
- Funding 100 percent of the cost of ADC loans (land and construction) with no borrower/developer cash equity.

Survey results also indicated that in 2004, both sound and failed banks typically adjusted their loan pricing based on perceived differences in loan quality and/or risk; and to a certain extent, both

populations required a material principal reduction before renewing term loans. However, as the economy began to deteriorate in 2007, and through 2009, the failed banks moved away from accurately pricing their loans based on risk and increasingly failed to require a material principal reduction before renewal.

Based on the results of the FDIC's revised examiner survey, we also noted that from October 2009 to December 2010, the failed banks continued to exhibit higher risk traits over those of sound institutions. However, the potential risk in certain areas, such as ADC loan growth and out-of-area lending, appeared to decline and/or stabilize, as banks slowed or halted originating new ADC loans. The revised examiner survey data also indicated that failed banks had higher-risk profiles than sound institutions in the following areas:

- Granting credit before obtaining a documented review or a qualified appraisal of the property;
- Liberal use of interest reserves or deferred interest payments, potentially masking rising delinquency levels;
- Weak to poor loan workout infrastructure; and
- Weak to poor credit review and grading system.

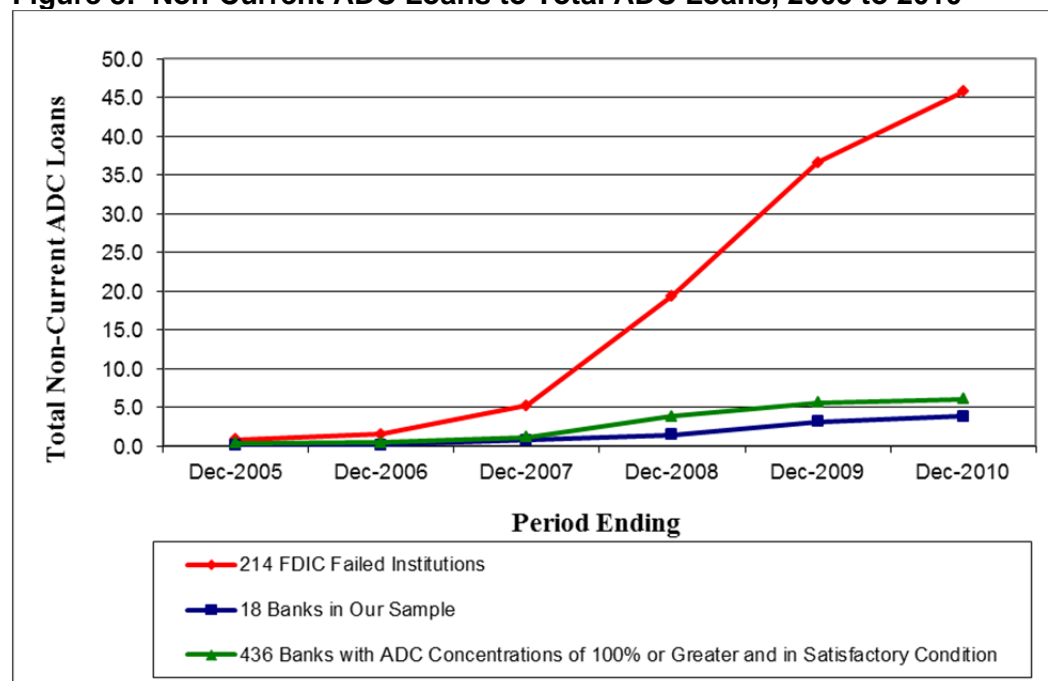
Also of note, the survey data indicated that the failed banks were typically subject to the following conditions:

- Elevated levels of concentrations in CRE loans – particularly in ADC loans,
- Weak to poor management of the CRE loan portfolio consistent with the 2006 CRE Guidance,
- Weak to poor management of CRE concentration risk,
- Very weak to distressed CRE markets,
- Declining to critically declining real estate market values, and
- An excess to a saturated supply of unsold property in the bank's real estate markets.

#### **GENERALLY EXPERIENCED A LOWER LEVEL OF NON-CURRENT LOANS AND LOSSES ASSOCIATED WITH ADC LOANS**

In our 2010 follow-up audit report, we noted that aggressive growth centered in ADC concentrations coupled with weak risk management practices was a leading cause of losses, which led to the rapid erosion of capital during the economic downturn. The banks in our study generally experienced a lower level of non-performing loans and losses. For example, noncurrent ADC loans – loans that were 90 days or more past due or in a nonaccrual status – were significantly higher for banks that failed than the banks in our study as shown in Figure 8.

**Figure 8: Non-Current ADC Loans to Total ADC Loans, 2005 to 2010**



Source: OIG analysis of selected UBPR data.

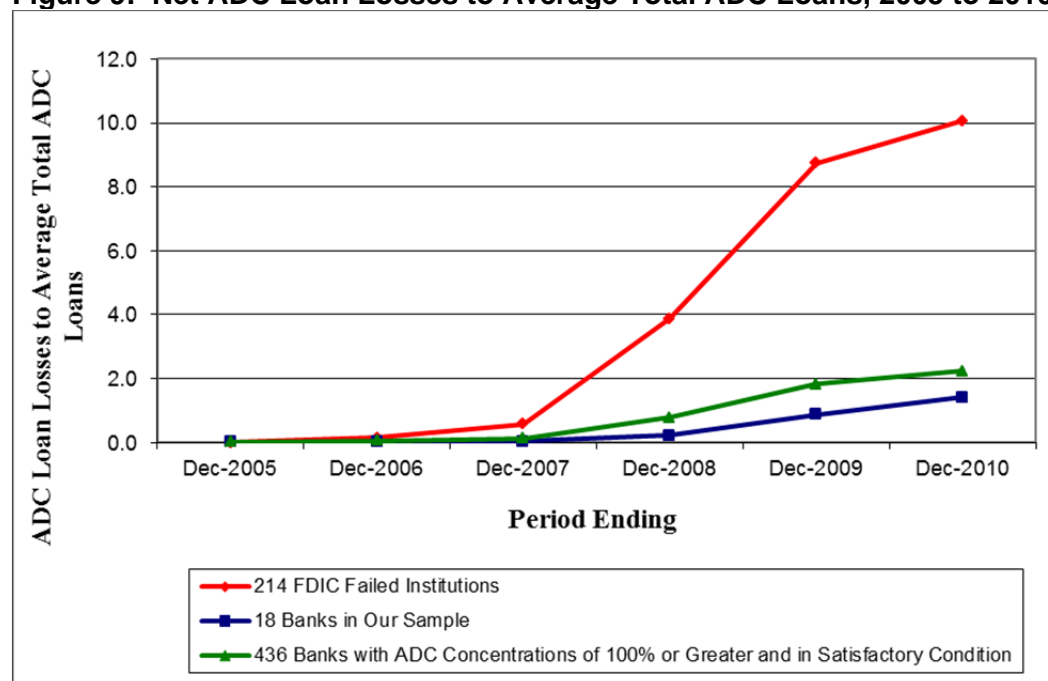
Note: Data points presented are averages for failed and sampled banks.

An ADC lending analysis performed by the FDIC concluded that the exposure to potentially volatile real estate development markets contributed to asset quality deterioration at many institutions and, ultimately, to their failure. FDIC-generated data showed the following:

- For institutions that failed, non-performing ADC loans represented 8 percent of all non-performing assets in the first quarter of 2000 and rose to a high of 54 percent in the third quarter of 2008.
- For survivor institutions, non-performing ADC loans also rose but not as much – from almost 4 percent in the first quarter of 2000 to a decade high of 23 percent in the third quarter of 2009.
- The average non-current ratio for all loans reached a decade high of 17.61 percent at failed institutions at year-end 2010, compared with 3.02 percent among survivor institutions. The FDIC attributed the trend, in part, to the sharp rise in non-performing ADC loans.

We also looked at the ratio of net ADC loan losses to average total ADC loans, which shows the level of losses experienced within the ADC portfolio. In general, lower ratios are better because they indicate that losses for a particular loan type are a small proportion of average loans in that type. According to FDIC guidance, a high level of losses within a particular loan type may indicate underwriting, collections, or asset quality problems for that type of lending. Further, increasing trends in any type of lending indicate developing problems. Figure 9 shows that banks in our study had lower and steadier trends than banks that failed with regard to losses associated with ADC portfolios.

**Figure 9: Net ADC Loan Losses to Average Total ADC Loans, 2005 to 2010**



Source: OIG analysis of selected UBPR data.

Note: Data points presented are averages for failed and sampled banks.

In our view, the differences in the level of losses and non-performing ADC loans between the groups can be attributed to the factors we have discussed in this report.

## **MAINTAINED STABLE CAPITAL LEVELS AND HAD ACCESS TO ADDITIONAL CAPITAL IF NEEDED**

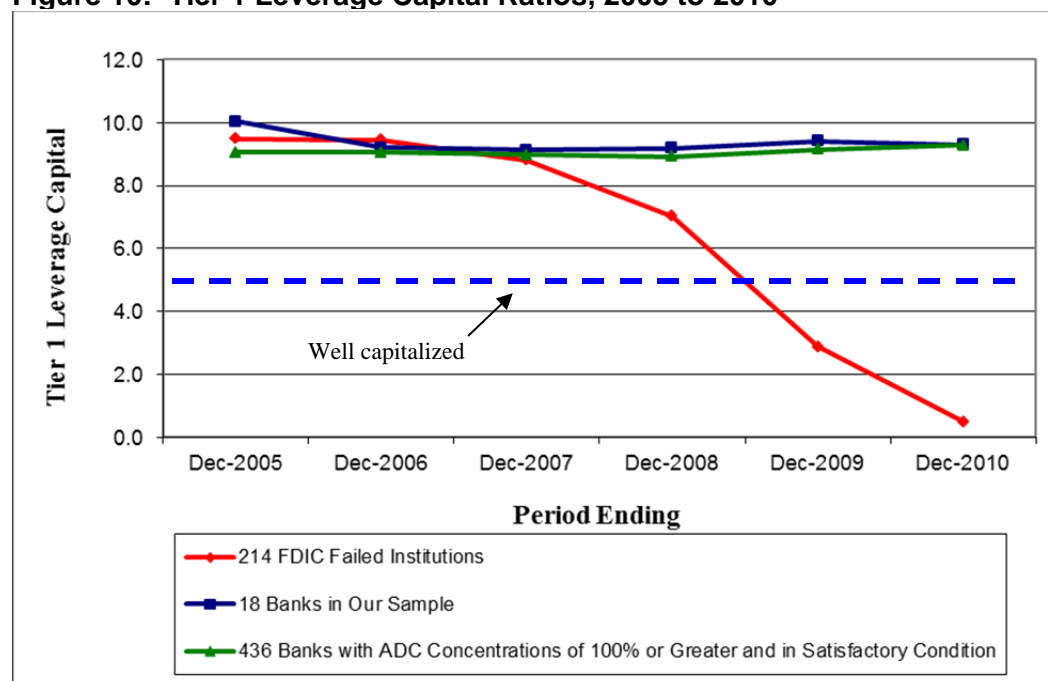
Capital serves as a buffer between operating losses and insolvency. The more capital a bank has the more losses it can withstand. In other words, a bank's capital determines the amount of time it has to correct internal weaknesses or outlast negative external influences. Generally, a bank is expected to maintain capital commensurate with the nature and extent of risks to the institution and the ability of management to identify, monitor, and control risks.

Part 325 of the FDIC's Rules and Regulations establishes the criteria and standards the FDIC uses in calculating the minimum leverage capital (Tier 1 (Core) Capital) requirement and determining capital adequacy. Risk-based capital is another capital measure that is more explicitly and systematically sensitive to the risk profile of individual banks. A bank's risk-based capital ratio is calculated by dividing its qualifying total capital base by its risk-weighted assets. Under the risk-based framework, a bank's qualifying total capital basis consists of Tier 1 Capital and supplementary capital elements, known as Tier 2 Capital.

As illustrated above in Figure 9, losses associated with ADC loans were not as significant for the 436 banks in our study as the banks that failed. In the failed banks, the losses quickly eroded capital. In contrast, we found that capital positions of the 436 banks, including the 18 banks in our sample, were generally stable between 2005 and 2010 as illustrated in Figure 10. Further, most bankers commented that their bank's access to capital was not restricted—if needed, their

shareholders or outside investors were willing to invest additional capital. A few bank officials explained that their bank's strong core deposit base helped to attract capital.

**Figure 10: Tier 1 Leverage Capital Ratios, 2005 to 2010**



Source: OIG analysis of selected UBPR data.

Note: Data points are median ratios for failed and sampled banks. Section 38 of the FDI Act, known as Prompt Corrective Action (PCA), establishes a framework for taking prompt supervisory action against banks not adequately capitalized. Generally, a bank is considered *Well Capitalized* for PCA purposes if it maintains a Tier 1 Leverage Capital ratio of at least 5 percent.

## GEOGRAPHIC LOCATION PLAYED A SIGNIFICANT ROLE IN FINANCIAL PERFORMANCE

Most officials we interviewed emphasized that the bank's geographic location played a significant role in the bank's financial performance during the financial crisis. That is, the economic decline was not as steep in their marketplace as it was in some other areas of the country. Table 1 summarizes where these banks were located by FDIC region. As illustrated in Figure 3 earlier in the report, most failures occurred in the Atlanta and San Francisco regions, and only 7 of the 36 banks in our interview pool were located in those areas.

As discussed earlier in this report, although every region of the country was impacted by the financial crisis, the economic fallout was not uniform across the country. Bank failures were more concentrated in areas that experienced greater economic distress – including Georgia, Florida, Illinois, and California (as illustrated in Figure 3). Figure 11 presents the geographic location of the 18 banks in our sample.

**Table 1: Location of Bankers Interviewed for Our Study**

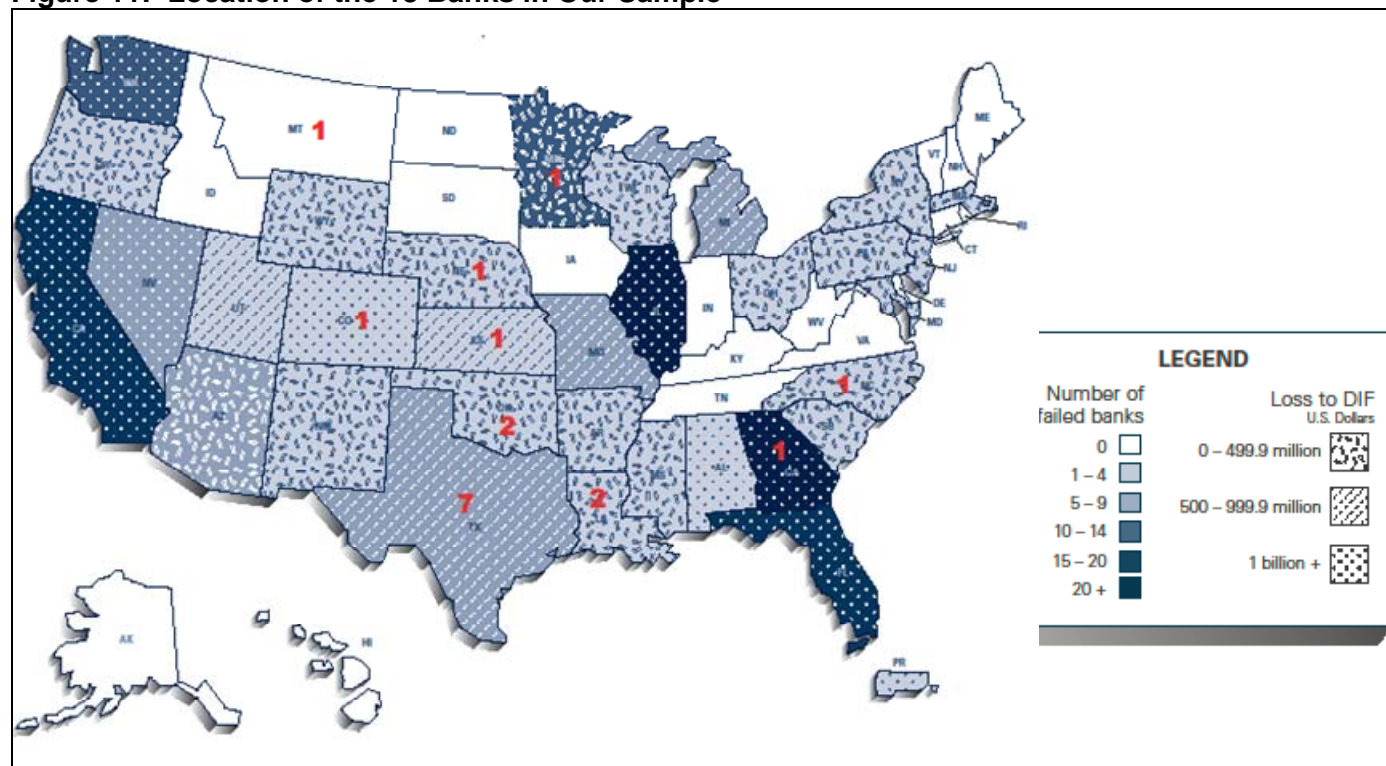
Region	Number of Banks
Atlanta	4
Chicago	2
Dallas	20
Kansas City	5
New York	2
San Francisco	3
<b>Total</b>	<b>36</b>

Source: OIG analysis.



We found only one bank that was located in one of the states with the greatest number of failures – Georgia. Most of the 18 banks were in markets where few bank failures occurred.

**Figure 11: Location of the 18 Banks in Our Sample**



Source: OIG analysis of the FDIC's *Loss History Report*.

Note: Bank failures and losses were from January 2007 through March 2011.

## SUPERVISORY APPROACH FOR TURN-AROUND BANKS

This section of the report discusses the supervisory approach for the sampled turn-around banks. We also highlight broader supervisory actions taken in response to MLR trends and other issues stemming from the recent financial crisis. We found that the supervisory approach and level of supervisory attention for the 23 turn-around banks we sampled were generally consistent with the FDIC's supervisory practices and policies and similar to the approach for banks that ultimately failed. That is, as economic conditions declined and banks' financial condition began to weaken, the FDIC's supervisory attention increased and supervisory actions were pursued. We observed that the supervisory approach yielded a better outcome – stable or improved examination ratings – because of managements' responsiveness in addressing supervisory concerns.

### EXAMINATION FINDINGS WERE SIMILAR TO THOSE FOR FAILED BANKS

The FDIC's supervision program primarily relies on annual onsite examinations and its offsite review program to monitor the condition of its banks. The onsite examinations provide information necessary to understand the nature, relative seriousness, and ultimate cause of a bank's problems, and thus assist in providing a factual foundation on which to base corrective measures,

recommendations, and instructions.<sup>16</sup> The FDIC's offsite review program is designed to identify emerging supervisory concerns and potential problems so that supervisory strategies can be adjusted appropriately. For instance, offsite reviews may trigger targeted visitations.

To understand the supervisory history of each of the 23 turn-around banks, we reviewed examination reports for these banks from 2007 through 2011.<sup>17</sup> Although examiners identified some weaknesses, they generally considered the turn-around banks' risk management practices to be adequate before the financial crisis. ADC concentrations were generally noted to be a risk in the 2008 and 2009 examinations, as losses within the portfolio materialized. In addition, we noted that examiners generally determined that the methodology and funding for the ALLL was inadequate during the same period. As discussed in the next section of this report, examiners downgraded composite and component ratings and pursued enforcement actions against the banks to address supervisory concerns. Further, targeted visitations were performed as warranted.

As discussed in our 2010 follow-up audit report related to supervisory program enhancements, the CAMELS rating for failed financial institutions placed greater emphasis on a bank's financial condition at the time of the examination and levels of capital and earnings, rather than the bank's ability to successfully mitigate identified risks. As such, with the benefit of hindsight, we often concluded in our MLR reports that greater supervisory concern and more timely supervisory action may have been prudent. Further, in some cases, MLR reports noted that doing so would generally have served to establish supervisory expectations and prompted Boards and management to implement corrective actions to address supervisory concerns. Although the supervisory approach proved effective, we believe that earlier emphasis on risk management practices at the turn-around banks would have been equally beneficial.

#### **ENFORCEMENT ACTIONS ADDRESSING ASSET QUALITY, CAPITAL, AND MANAGEMENT WERE IMPOSED AS BANKS' FINANCIAL CONDITION DETERIORATED – GENERALLY CONSISTENT WITH THE APPROACH FOR FAILED BANKS**

In general, supervisory attention is heightened when banks are in a less-than-satisfactory condition. Accordingly, the FDIC uses formal and informal enforcement actions to address practices, conditions, or violations that could result in risk of loss or damage to a financial institution. Specifically, to assure greater uniformity of action and help assure that supervisory efforts are directed to banks most in need, the FDIC's examination policy presumes either a formal or informal administrative action will be taken on banks with 3, 4, or 5 composite CAMELS ratings unless specific circumstances argue strongly to the contrary. A composite 3 rating implies that a bank has weaknesses that, if not corrected, could worsen. Informal actions are generally appropriate for institutions that receive a composite 3 rating. The FDIC may recommend that the bank's Directors adopt a Bank Board Resolution (BBR), which establishes the bank's commitment to address specific deficiencies. Alternatively, the FDIC may enter into a Memorandum of Understanding (MOU) with the institutions.

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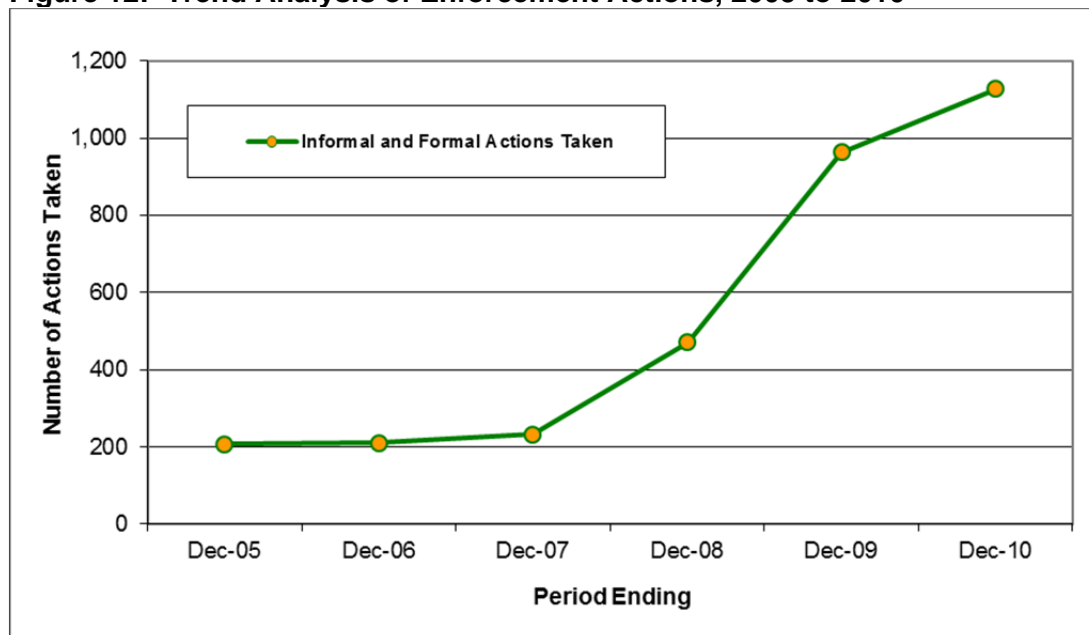
<sup>16</sup> Section 337.12 of the FDIC's Rules and Regulations, which implements section 10(d) of the FDI Act, requires annual full-scope, on-site examinations of every state nonmember bank at least once every 12-month period and allows for 18-month intervals for certain small institutions (with total assets of less than \$500 million) if certain conditions are satisfied.

<sup>17</sup> If there was no examination report in 2007, we used a 2006 report.

Banks with composite ratings of 4 or 5 will, by definition, have problems of sufficient severity to warrant formal action. In these cases, the FDIC will typically take formal action pursuant to section 8 of the FDI Act against all insured state nonmember banks rated 4 or 5, where evidence of unsafe or unsound practices is present. Exceptions to the policy may be considered when the condition of the bank clearly reflects significant improvement resulting from an effective corrective program or where individual circumstances strongly mitigate the appropriateness or feasibility of this supervisory tool. For example, acceptable action by the state authority might preempt the need for FDIC action, or qualified new management might allow the use of an MOU instead of a formal consent order.

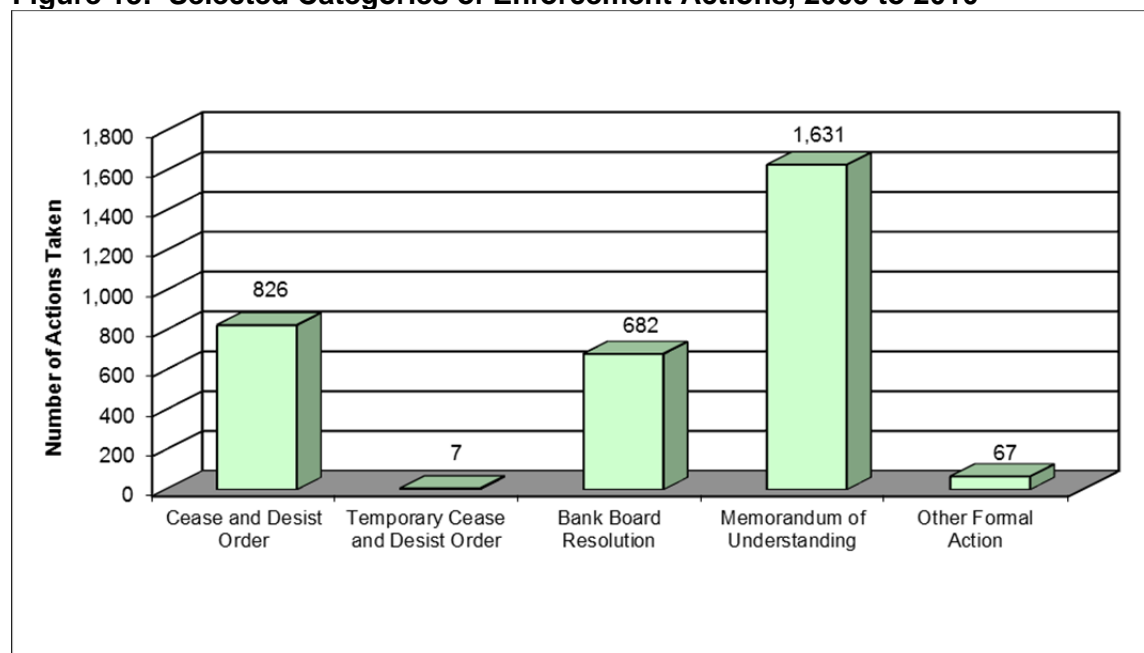
We found that each of the 23 turn-around banks was subject to some type of formal and/or informal action between 2007 and 2010 and, as such, heightened supervisory attention consistent with the FDIC's policies. In total, the turn-around banks were subject to a total of 42 FDIC stipulated (i.e., agreed to) actions. We determined the timeliness of actions was consistent with broader trends for enforcement actions issued during the period. Specifically, we found as the economy deteriorated, the number of actions issued per year for all FDIC-supervised banks dramatically increased, rising to 1,127 actions during 2010. From 2005 through 2010, the FDIC and/or state regulatory authorities issued (or assumed responsibility for) approximately 3,213 enforcement actions. Figure 12 shows the trend with respect to enforcement actions during this period, while Figure 13 shows selected categories of actions taken.

**Figure 12: Trend Analysis of Enforcement Actions, 2005 to 2010**



Source: Division of Risk Management Supervision (RMS) Formal and Informal Action Tracking (FIAT) System.

**Figure 13: Selected Categories of Enforcement Actions, 2005 to 2010**



Source: RMS FIAT System.

Note: The figure does not include civil money penalties, orders for removal or investigation, or certain other actions. The *Other Formal Action* category primarily includes state-issued actions that the FDIC did not sign.

For the turn-around banks, the 42 FDIC-stipulated enforcement actions included a total of 558 provisions. In general, the actions routinely included provisions that addressed capital, asset quality, management, earnings, and reserves. For example, a capital provision was included in 90 percent (38 of 42) of the enforcement actions. The capital-related provisions required the bank to increase and/or maintain capital at a specific targeted ratio. Eighty-eight percent of the actions also included an asset quality-related provision. These provisions typically required an institution to charge off non-performing loans, develop a plan for reducing classified assets, and improve loan underwriting and loan administration. In addition, 98 percent (41 of 42) of enforcement actions included provisions requiring the banks to assess and improve or obtain qualified management. Each of the enforcement actions also included a provision requiring the turn-around banks to submit quarterly progress reports, which are a common tool the FDIC uses to monitor institutions operating under an enforcement action. The FDIC usually conducted on-site visitations between full-scope examinations to monitor these institutions' progress in addressing critical weaknesses.

As reflected in the improved composite ratings, most of the turn-around banks took steps to substantially comply with supervisory actions and address problem areas, including raising or securing additional capital, as needed. In most cases, examiners noted management's substantial compliance with provisions in the subsequent examination. We noted that in some cases, the injection of capital was accompanied by a change of management control. These two factors were likely contributors to improvements noted by examiners, and the additional capital allowed the existing or new management team the time necessary to implement corrective actions. Although the condition of banks had improved, most banks remained subject to an enforcement action and heightened supervisory attention as of April 2011. In some cases, formal orders were removed and replaced by informal actions.

## THE FDIC HAS TAKEN STEPS TO ADDRESS SPECIFIC MLR TRENDS AND ISSUES

In response to MLR findings and other issues, the FDIC has issued specific examiner and financial institution guidance, as discussed in our 2010 report. Briefly, actions taken included:

- Establishing the importance of implementing a forward-looking approach to examinations and reflecting financial institution risks in the assigned CAMELS rating as part of its *Forward-Looking Training Initiative*;
- Recognizing factors that are indicative of elevated risk associated with management, which included high-risk appetite and degree of responsiveness to examiner recommendations;
- Issuing additional guidance regarding the inappropriate use of interest reserves;
- Emphasizing to examiners the risks that the use of non-core funding can present to a financial institution;
- Issuing guidance regarding the consideration of brokered deposits in the deposit insurance risk assessment process, use of such funding sources for institutions that are in a weakened condition, processing requests for brokered deposit waivers, and interest rate restrictions for banks that are less than *Well Capitalized*;
- Issuing guidance to emphasize the importance of monitoring institutions subject to enforcement actions, including the need to clarify expectations for quarterly progress reports, meet with an institution's Board at the beginning of a corrective program, and conduct onsite supervisory activities between examinations; and
- Enhancing off-site monitoring activities for various high-risk issues.

As discussed earlier in this report, the Joint Guidance addresses sound risk management practices for concentrations in CRE lending (and ADC lending) and reinforces existing regulations for real estate lending and safety and soundness. As the financial crisis was unfolding, the FDIC issued additional CRE- and ADC-related guidance during 2008 and 2009 and has implemented a number of other initiatives to ensure examiners have the tools necessary to assess an institution's vulnerability with regard to concentrations.

## BANKING OFFICIALS HAD POSITIVE VIEWS OF THE EXAMINATION PROCESS, BUT CONCERNS EXIST REGARDING EXAMINER REVIEW OF CRE LENDING AND REGULATORY BURDEN

Most bankers characterized the examination process as “good” or “okay” and viewed the examination process as beneficial. Also, most bankers viewed the Joint Guidance positively, explaining that the guidance helped to raise their own awareness or reinforced the need for good credit administration and underwriting practices even if their practices were in line with the guidance. A few bankers offered a different perspective, commenting that the guidance was issued too late to be fully effective. Further, a few bankers stated that the guidance has prompted

examiners to be overly critical of concentrations. For example, a few bankers stated that examiners were treating supervisory thresholds as limits, which is inconsistent with the guidance.

In a related vein, GAO completed a study of examiners' practices related to CRE lending in May 2011.<sup>18</sup> The scope of GAO's report included institutions with CRE concentrations of 300 percent or greater and CAMELS ratings of 3, 4, and 5, which provided for a broader range of views than our study. Based on interviews with officials from the 43 banks in its sample, GAO reported that banking officials' overarching concern was that examiners were applying CRE guidance more stringently than before the financial crisis. Banking officials also informed GAO that:

- Examiners were classifying loans that were technically performing based on a global cash flow analysis of the borrower's ability to repay the loan. Such an analysis would show that even though a borrower is currently paying a CRE loan, the borrower's income and other debt obligations, when reviewed as a whole, raised questions about whether the borrower could continue paying the CRE loan in the future.
- Examiners were being more critical of recent appraisals. For example, according to some of the officials GAO interviewed, examiners have been requiring appraisals on CRE collateral more often, criticizing the banks' appraisal review process, and criticizing the appraisals themselves.
- Examiners were misapplying the 2006 Joint Guidance and viewing the 300 percent CRE concentration threshold as a lending limit, even though the Joint Guidance states that the CRE and ADC concentration levels are thresholds that may warrant greater supervisory scrutiny.
- Examiners were critically assessing the management component rating and basing the rating on asset quality and other component ratings as well as portfolio deterioration due to the broader economic downturn, which was out of the bankers' control.

GAO noted that a few bankers they interviewed considered that the additional scrutiny was appropriate given the current CRE market situation and the severity of the economic downturn. GAO recommended that the federal banking regulators enhance or supplement the Joint Guidance to ensure the guidance was consistently applied.

In January 2012, the Congress passed, and the President signed, legislation requiring our office to study, among other things, examiner implementation of appraisal and CRE loan workout guidance. We will be providing a written report to the Congress no later than January 2013 that will address the views of the bankers discussed above.

Finally, while not related to supervision of ADC concentrations, most bankers that we interviewed expressed concerns about the level of regulatory burden associated with the Dodd-Frank Act, particularly newly established compliance-related regulations for smaller banks. Because this issue was raised by most of the bankers we interviewed, we followed up and noted that many of the issues have been discussed as part of the FDIC Advisory Committee on Community Banking,

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<sup>18</sup> *Banking Regulation: Enhanced Guidance on Commercial Real Estate Risks Needed*, GAO-11-489, May 2011.

which provides the FDIC with advice and guidance on a broad range of important policy issues impacting small community banks throughout the country. Advisory committee minutes noted that FDIC officials have acknowledged the burdens that new regulations impose on community banks and have observed that every new regulation imposes an incremental cost to community banks that is higher than the cost to large banks. The minutes also reflect that FDIC officials were sensitive to the fact that the new regulations address issues that arose with large banks and that the FDIC needs to avoid unintended trickle-down effects on community banks. Further, FDIC officials recognized that even though many of the new rules do not impact community banks, significant effort is often required to sort through the many publications in order for banks to make that determination.

## **OBSERVATIONS AND MATTERS FOR CONSIDERATION**

Prior to the recent financial crisis, competition among financial institutions for growth, profitability, and community influence often resulted in the compromise of sound credit principles and acquisition of unsound loans. Ultimately, that type of compromise resulted in a spate of bank failures not seen since the 1980s—a period that, in broad terms, was not that long ago. Much was written following the banking crisis of the 1980s and early 1990s, and there were ample discussions of lessons learned. In addition, far-reaching legislative and regulatory actions were taken and extensive guidance was issued by regulators on key risks, including repeated warnings and references to best practices related to ADC lending because it is a highly specialized field with inherent risks that must be managed and controlled. Nevertheless, unlike the circumstances at the banks we studied, Boards and management at too many other institutions pursued profits through growth and higher earning, risky assets, in an era of easy credit, while lacking robust risk management practices—a story that appears very similar to the one told just over 20 years ago.

We found some institutions with ADC concentrations were able to weather the recent financial crisis without experiencing a corresponding decline in their overall financial condition. The factors that contributed to their survival validate the point that regulators have emphasized and reiterated for years – a well-informed and active Board, strong management, sound credit administration and underwriting practices, and adequate capital are important to managing ADC concentrations in a safe and sound manner. In addition, the banks in our study did not rely on brokered deposits to fund growth, and geographic location factored into the degree of ADC loan losses. Ultimately, the strategic decisions and disciplined, values-based practices and actions taken by the Boards and management helped to mitigate and control the institutions’ overall ADC loan risk exposure and allowed them to react to a changing economic environment. Unlike many failed banks that saw their capital evaporate rapidly because of the losses associated with their ADC portfolios, the banks in our study experienced comparatively fewer losses and were able to maintain stable capital positions.

Further, we determined that the FDIC’s supervisory approach and level of supervisory attention for the turn-around banks were generally consistent with the FDIC’s supervisory practices and policies and similar to that of failed banks. In that regard, the following areas in which the FDIC has implemented revised supervisory policies and procedures are worth highlighting.

- While the supervisory approach we observed for turn-around banks proved effective, similar to observations made in our MLRs, we believe that earlier emphasis on risk management practices would have been beneficial. To that end, the Corporation completed a training initiative in 2010 for its entire supervisory workforce that focused on placing greater emphasis on risk management practices for institutions with elevated risk profiles. The training addressed the importance of considering management practices as well as current financial performance or trends when assigning ratings, consistent with existing examination guidance. This approach encourages bank management to continuously implement effective risk management practices and examiners to promptly address control weaknesses, regardless of how well a bank is performing financially.
- Management's responsiveness to supervisory concerns was a key differentiating factor between banks that failed and turn-around banks that we reviewed. Generally, our MLRs have shown that examiners identified significant risks but did not take timely and effective action to address those risks until the bank had started to experience significant financial deterioration in the loan or investment portfolios. In response to those findings, the FDIC has conducted training and issued guidance aimed at timely communication of risks to financial institutions, prompt supervisory and enforcement actions, and examiner follow-up. The Corporation should remain vigilant in ensuring that its processes and examiners sufficiently promote prompt and effective responses to examination findings and supervisory actions, including timely and progressive enforcement of situations involving banks that are not responsive to examination findings, repeat criticisms, or violations.

Finally, the FDIC has to date, and must continue to make certain, that lessons learned associated with ADC concentrations become ingrained in day-to-day supervisory activities and greater emphasis on risk management practices for institutions with elevated risk profiles is sustained regardless of the health of the economy or banking industry or the political appetite for financial regulation. We trust that the analysis and conclusions of our study will benefit the Corporation and assist in management's continual efforts to have an efficient and effective supervisory program that protects depositors and the DIF.

## **CORPORATION RESPONSE**

We provided a draft of this report to RMS on August 9, 2012. The FDIC was not required to provide a written response because the report contained no recommendations, and management opted to only provide informal comments regarding the technical accuracy of certain report content. We made changes to the report, where appropriate, to address those comments. RMS did express general agreement with the evaluation results at the exit conference for this assignment.



## Objective, Scope, and Methodology

### Objective and Scope

The objective of this evaluation was to study the characteristics and supervisory approaches for FDIC-supervised institutions that had significant ADC loan concentrations in December 2007 and were not considered to be problem banks as of April 2011.

We performed our evaluation work from July 2011 through February 2012 in accordance with the Council of the Inspectors General on Integrity and Efficiency's *Quality Standards for Inspection and Evaluation*.

### Methodology

To identify the population of banks relevant to our study, we stratified data associated with the 4,535 FDIC-supervised banks, using the ratio of ADC loans to total capital as of December 2007 and the composite CAMELS rating as of April 8, 2011. The ratio of ADC and CRE loans to capital provides the basis of supervisory thresholds that were established in the Joint Guidance. Table 2 provides a stratification of FDIC-supervised banks by ADC loan concentration levels and condition, as defined earlier in the report by their CAMELS rating.

**Table 2: Stratification of FDIC-Supervised Banks by ADC Loan Concentration**

ADC Loans to Total Capital	No Rating*	Satisfactory Condition	Less-Than-Satisfactory Condition	Total
100% percent or greater		436	738	1,174
Less than 100%	5	2,627	729	3,361
<b>Total</b>	<b>5</b>	<b>3,063</b>	<b>1,467</b>	<b>4,535</b>

Source: OIG analysis based on data available through RMS's Virtual Supervisory Information on the Net (ViSION).

\*A rating was not assigned to these institutions at the analysis based on data available through RMS's ViSION.

We focused our analysis on the following:

- Institutions with 100 percent or greater ADC concentrations and in satisfactory condition. We identified 436 institutions meeting our criteria. We focused particular attention on a sample of 18 institutions in this group that had ADC concentrations of 300 percent or greater.
- Institutions meeting our turn-around criteria. That is, institutions with concentrations between 100 percent and 300 percent that were in less-than-satisfactory condition during our scope period and received a higher composite rating as of April 2011. We identified 71 institutions meeting our criteria and selected a non-statistical sample of 23 banks to study the FDIC's supervisory approach.

None of the sampling techniques that we used can be used to project to the intended population by standard statistical methods.

## Objective, Scope, and Methodology

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We took a three-pronged approach to perform this study:

**Discussions with bank officials.** We contacted bank officials from 38 institutions, comprised of (1) 28 of the 436 institutions, including officials from the 18 banks in our sample and (2) 10 randomly selected banks from our pool of turn-around banks. Thirty-six officials agreed to talk with us.

Using structured interviewed questions, we asked the bankers to:

- Describe their respective lending and growth strategies and how they were able to mitigate the risk associated with the ADC loan concentrations;
- The extent to which local market conditions or geographic location impacted the bank's financial performance during the financial crisis;
- Characterize their loan underwriting and credit administration practices as liberal, moderate, or conservative;
- Describe their ability to raise capital; and
- Identify any lessons learned.

We also solicited their views on the FDIC's supervision as related to CRE and ADC concentrations.

Throughout the report, when we summarize statements about the 36 banks for which we interviewed associated officials, we use the term “few” to refer to 1-9 of 36 bankers making the statement, “some” to refer to 10-24 of 36 bankers making the statement; and “most” to refer to 25-36 bankers making the statement. We do not provide specific numbers in the body of the report to avoid overstating the precision of the results.

**Analysis and comparison of financial and other data.** Using data from UBPRs, we performed level and trend analysis that compared and contrasted the key financial performance ratios for banks in our population with the 214 FDIC-supervised institutions that failed between January 2007 and April 2011. The UBPR is produced quarterly from Call Report data submitted by banks.

We also obtained loan survey results from DIR and RMS in order to compare and contrast the loan survey results using the FDIC's survey results from January 2007 to December 2010. We used data from the *Underwriting Survey Questionnaire* and the *Credit and Consumer Products/Services Survey*. The *Credit and Consumer Products/Services Survey* replaced the *Underwriting Survey Questionnaire* in 2009 to strengthen the identification and tracking of risks facing insured institutions. These surveys are completed by examiners at FDIC-supervised banks.

**Evaluation of the FDIC's supervisory strategy.** To study the FDIC's supervisory approach we reviewed supervisory information available for our sample of 23 turn-around banks. For each

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## Objective, Scope, and Methodology

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bank, we obtained and reviewed key supervisory documents from 2007 through 2011, including completed reports of examination, problem bank memoranda, and information from the FDIC's ViSION system, including summary-related information and information about enforcement actions taken.

Our basic understanding of risks associated with CRE/ADC concentrations is based on our review of FDIC policies, regulatory guidance, and various CRE/ADC-related reports from the GAO and the FDIC as noted throughout the report.

We also reviewed MLR reports issued by our office from January 2007 through March 2011 and other studies written on the causes of the bank failures during the recent financial crisis to provide a general context for the role CRE/ADC concentrations played in the failures.

## Glossary

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<b>Acquisition, Development, and Construction (ADC) Loans</b>	ADC loans are a component of CRE that provide funding for acquiring and developing land for future construction and that provide interim financing for residential or commercial structures.
<b>Allowance for Loan and Lease Losses (ALLL)</b>	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.
<b>Bank Board Resolution (BBR)</b>	A BBR is an informal commitment adopted by a financial institution's Board of Directors (often at the request of the FDIC) directing the institution's personnel to take corrective action regarding specific noted deficiencies. A BBR may also be used as a tool to strengthen and monitor the institution's progress with regard to a particular component rating or activity.
<b>Call Report</b>	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.
<b>Commercial Real Estate (CRE) Loans</b>	CRE loans are land development and construction loans (including 1-4 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.
<b>Concentration</b>	A concentration is a significantly large volume of economically related assets that an institution has advanced or committed to a certain industry, person, entity, or affiliated group. These assets may, in the aggregate, present a substantial risk to the safety and soundness of the institution.
<b>Consent Order</b>	A formal enforcement action issued by a financial institution regulator to a bank or affiliated party to stop an unsafe or unsound practice or a violation of laws and regulations. A consent order 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.

## Glossary

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<b>De novo bank</b>	A de novo bank is a newly established bank that is in its first 7 years of operation. De novo banks are subject to additional supervisory oversight and regulatory controls, including the development and maintenance of a current business plan and increased examination frequency.
<b>FDIC's Supervision Program</b>	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 RMS (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.
<b>Global Cash Flow Analysis</b>	A global cash flow analysis is a comprehensive evaluation of borrower capacity to perform on a loan. During underwriting, proper global cash flow must thoroughly analyze projected cash flow and guarantor support. Beyond the individual loan, global cash flow must consider all other relevant factors, including: guarantor's related debt at other financial institutions, future economic conditions, as well as obtaining current and complete operating statements of all related entities. In addition, global cash flow analysis should be routinely conducted as a part of credit administration. The extent and frequency of global cash flow analysis should be commensurate to the amount of risk associated with the particular loan.
<b>Interest Reserve Account</b>	An interest reserve account allows a lender to periodically advance loan funds to pay interest charges on the outstanding balance of the loan. The interest is capitalized and added to the loan balance. Frequently, ADC loan budgets will include an interest reserve to carry the project from origination to completion and may cover the project's anticipated sellout or lease-up period.
<b>Loan Participation</b>	The transfer of an undivided interest in all or part of the principal amount of a loan from a seller, known as the "lead," to a buyer, known as the "participant," without recourse to the lead, pursuant to an agreement between the lead and the participant. "Without recourse" means that the loan participation is not subject to any agreement that requires the lead to repurchase the participant's interest or to otherwise compensate the participant upon the borrower's default on the underlying loan.

## Glossary

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<b>Material Loss</b>	As defined by section 38(k)(2)(B) of the FDI Act, a loss is material if it exceeds the greater of \$25 million or 2 percent of an institution's total assets at the time the FDIC was appointed as the receiver. The Dodd-Frank Wall Street Reform and Consumer Protection Act amended section 38(k) of the FDI Act in part 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, and to \$150 million for failures occurring during 2012 and 2013.
<b>Memorandum of Understanding (MOU)</b>	An MOU 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.
<b>Offsite Review Program</b>	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.
<b>Problem Bank Memorandum</b>	A problem bank memorandum documents the FDIC's concerns with an institution and the corrective action in place or to be implemented and is used to effect interim rating changes on the FDIC's systems.
<b>Prompt Corrective Action (PCA)</b>	The purpose of PCA is to resolve the problems of insured depository institutions at the least possible long-term cost to the DIF. Part 325, subpart B, of the FDIC Rules and Regulations, 12 Code of Federal Regulations, section 325.101, et, seq., implements section 38, <i>Prompt Corrective Action</i> , 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) <i>Well Capitalized</i> , (2) <i>Adequately Capitalized</i> , (3) <i>Undercapitalized</i> , (4) <i>Significantly Undercapitalized</i> , and (5) <i>Critically Undercapitalized</i> .
<b>Provision</b>	Specific corrective measures an institution or individual respondent is required to take under a corrective action.
<b>Risk-Based Capital</b>	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

<b>Tier 1 (Core) Capital</b>	<p>Defined in Part 325 of the FDIC Rules and Regulations, 12 Code of Federal Regulations, section 325.2(v), as:</p> <p><b>The sum of:</b></p> <ul style="list-style-type: none"> <li>• 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);</li> <li>• Non-cumulative perpetual preferred stock; and</li> <li>• Minority interest in consolidated subsidiaries;</li> </ul> <p><b>Minus:</b></p> <ul style="list-style-type: none"> <li>• Certain intangible assets;</li> <li>• Identified losses;</li> <li>• Investments in securities subsidiaries subject to section 337.4; and</li> <li>• Deferred tax assets in excess of the limit set forth in section 325.5(g).</li> </ul>
<b>Tier 2 (Supplemental) Capital</b>	<p>Tier 2 capital is defined in Appendix A to Part 325 of the FDIC Rules and Regulations and is generally the sum of:</p> <ul style="list-style-type: none"> <li>• Allowances for loan and lease losses, up to a maximum of 1.25 percent of risk-weighted assets;</li> <li>• Cumulative perpetual preferred stock, long-term preferred stock, and related surplus;</li> <li>• Perpetual preferred stock (dividend is reset periodically);</li> <li>• Hybrid capital instruments; and</li> <li>• Term subordinated debt and intermediate-term preferred stock.</li> </ul>
<b>Uniform Bank Performance Report (UBPR)</b>	<p>The UBPR is an individual analysis of financial institution financial data and ratios that includes extensive comparisons to peer group performance. The report is produced by the FFIEC for the use of banking supervisors, bankers, and the general public and is produced quarterly from Call Report data submitted by banks.</p>
<b>Uniform Financial Institutions Rating System (UFIRS)</b>	<p>Financial institution regulators and examiners use the UFIRS to evaluate a bank's performance in six components represented by the CAMELS acronym: <b>C</b>apital adequacy, <b>A</b>sset quality, <b>M</b>anagement practices, <b>E</b>arnings performance, <b>L</b>iquidity position, and <b>S</b>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.</p>
<b>Wholesale Funding</b>	<p>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 certificate of deposit listing services. Financial institutions may use wholesale funding sources as an alternative to core deposits to satisfy funding and liability management needs.</p>

## Acronyms

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ADC	Acquisition, Development, and Construction
ALLL	Allowance for Loan and Lease Losses
BBR	Bank Board Resolution
CAMELS	<b>C</b> apital Adequacy, <b>A</b> sset Quality, <b>M</b> anagement Practices, <b>E</b> arnings Performance, <b>L</b> iquidity Position, and <b>S</b> ensitivity to Market Risk
CRE	Commercial Real Estate
DIF	Deposit Insurance Fund
DIR	Division of Insurance and Research
FDI	Federal Deposit Insurance
FFIEC	Federal Financial Institutions Examination Council
FIAT	Formal and Informal Action Tracking
FIL	Financial Institution Letter
GAO	Government Accountability Office
MLR	Material Loss Review
MOU	Memorandum of Understanding
OIG	Office of Inspector General
PCA	Prompt Corrective Action
RMS	Division of Risk Management Supervision
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System
ViSION	Virtual Supervisory Information on the Net