Office of Inspector General

Office of Audits and Evaluations
Report No. AUD-15-006

Material Loss Review of Capitol City Bank & Trust Company, Atlanta, Georgia

September 2015

Office of Inspector General

Executive Summary

Material Loss Review of Capitol City Bank & Trust Company, Atlanta, Georgia

Report No. AUD-15-006
September 2015

Why We Did The Audit

Section 38(k) of the Federal Deposit Insurance Act (FDI Act) (12 United States Code § 1831o(k)), as amended, provides, in general, that if the Deposit Insurance Fund (DIF) incurs a material loss with respect to an insured depository institution, the Inspector General of the appropriate federal banking agency shall prepare a report to that agency that includes a review of the agency's supervision of the institution. The report is required to be completed within 6 months of it becoming apparent that a material loss has been incurred. Section 38(k) establishes a material loss review (MLR) threshold of $50 million for losses that occur on or after January 1, 2014.

On February 13, 2015, the Georgia Department of Banking and Finance (DBF) closed Capitol City Bank & Trust Company, Atlanta, Georgia (CCB), and the FDIC was appointed receiver. The FDIC's Division of Finance notified the FDIC's Office of Inspector General (OIG) on March 6, 2015, that the estimated loss to the DIF for the failure was $88.9 million. Based on this loss amount, the FDIC OIG determined that the DIF had incurred a material loss for purposes of section 38(k) of the FDI Act, and the FDIC OIG engaged KPMG to conduct an MLR of CCB. The objectives of the audit were to (1) determine the causes of CCB's failure and the resulting material loss to the DIF and (2) evaluate the FDIC's supervision of CCB, including the FDIC's implementation of the Prompt Corrective Action (PCA) provisions of section 38 of the FDI Act.

Background

CCB was a state nonmember minority depository institution (MDI) that was chartered and became insured in 1994. Its Board of Directors (Board) and management historically pursued a traditional community banking model focused on serving the African American community in the Atlanta, Georgia, metropolitan area. CCB was wholly owned by Capitol City Bancshares, Inc., a one-bank holding company. In the years leading up to the bank's failure, the holding company had a minimal amount of liquidity and was highly leveraged and, as a result, could no longer provide financial support to CCB.

MDIs often promote the economic viability of minority and under-served communities. The FDIC has long recognized the importance of MDIs and has historically taken steps to preserve and encourage minority ownership of insured financial institutions. The FDIC also recognizes that MDIs face many challenges, including the need to compete with larger financial institutions for both business and a talented work force. Additionally, it may be difficult for MDIs to diversify their geographical and credit risk exposure due to their commitment to serve local communities and ethnic populations.

FDIC guidance issued in 2007 regarding MDIs notes that high profitability may not be essential to the organizers and shareholders of an MDI. Instead, community development, improving consumer services, and promoting banking services to the unbanked or under-banked segment of its community may drive many of the organization's decisions. Further, according to an FDIC study conducted in 2014, entitled *Minority Depository Institutions: Structure, Performance, and Social Impact*, MDIs serve some of the most challenging markets in the country, and their financial data indicate reliance on core deposits to fund loans that are mostly related to residential and Commercial Real Estate (CRE). The study indicated that MDIs originated a larger share of their mortgages to borrowers who live in a low- or moderate-income (LMI) census tract and to minority borrowers than did non-MDI community banks.

CCB played a unique role in promoting the economic viability of minority and under-served communities, particularly the African American communities in the metropolitan Atlanta area and in Albany, Georgia; Augusta, Georgia; and Savannah, Georgia. All of CCB's offices, which consisted of seven branches and a main office, were also located in or near an LMI census tract. CCB's assets were centered in its loan portfolio, which had large concentrations of CRE loans, including loans to Church and Religious Organizations (CRO).

Audit Results

Causes of Failure and Material Loss

CCB failed primarily because its Board and management did not properly manage the risks associated with the bank's growth strategy that was centered on higher-risk CRE loans, which included Acquisition, Development, and Construction, CRO, and Gas and Convenience Store loans. Specifically, CCB's Board and management did not establish appropriate risk management practices, such as applying prudent credit underwriting and administration practices, ensuring adequate internal controls were in place, and maintaining key personnel and proper staffing levels as the bank grew. The President and Chief Executive Officer (CEO) served as a dominant official, exerting significant authority over the lending function as well as the Board. Under the leadership of the CEO, the bank significantly increased its CRE portfolio and did not adequately respond to examiners' repeat recommendations to improve the bank's overall condition, particularly in the lending area.

Deficient loan underwriting and credit administration practices, such as over-reliance on collateral, lack of borrower financial information, and continued loan renewals negatively impacted the CRE loan portfolio. Additionally, the bank's appraisal practices were less than ideal since the bank did not often obtain updated appraisals, and the bank's appraisal reviews did not identify concerns noted by examiners. Such practices resulted in inaccurate calculations of the Allowance for Loan and Lease Losses and had the effect of delaying the timely recognition of loan exposure and losses as well as overstating earnings and capital. As a result, when economic and real estate market conditions deteriorated during the financial crisis, beginning in late 2007, CCB's loan portfolio was heavily impacted.

The FDIC's Supervision of Capitol City Bank & Trust Company

The FDIC, in coordination with the DBF, provided ongoing supervisory oversight of CCB through regular on-site examinations, visitations, and various offsite monitoring. In addition, the FDIC provided technical assistance to the bank in certain areas, consistent with the requirements of the FDIC's MDI Program. Through its supervisory efforts, the FDIC identified risks in the bank's operations as early as 2005 and brought these risks to the attention of the institution's Board and management through examination reports and visitation documentation, correspondence, and informal and formal enforcement actions. Such risks included the presence of a high-risk loan portfolio in an operating environment that lacked key controls and risk management practices, particularly in the lending area.

The FDIC and DBF generally provided supervision in accordance with examination policies and guidelines. In retrospect, however, an elevated level of supervisory scrutiny and/or stronger enforcement action may have been warranted to emphasize the inherent risk and exposure that resulted from the bank's growth strategy and, in later years, management's inability to fully address weaknesses and recommendations or comply with supervisory enforcement actions.

With respect to PCA, the FDIC properly implemented the applicable provisions of section 38.

Management Response

Subsequent to the issuance of KPMG's draft report, RMS officials provided additional information for our consideration, and KPMG revised its report to reflect this information, as appropriate. In addition, on September 2, 2015, the Director, RMS, provided a written response, dated August 28, 2015, to a draft of this report. In the response, the Director reiterated the causes of CCB's failure and the supervisory activities described in the report.

As it relates to the supervisory lessons learned KPMG described in its report, the Director referenced guidance that was issued to FDIC-supervised institutions in 2008, which re-emphasized the importance of robust credit risk management practices for institutions with concentrated CRE exposures and set forth broad supervisory expectations. The Director also mentioned that RMS conducted examiner training initiatives in 2010, 2011, 2014, and 2015 emphasizing how the evaluation of bank management's risk management practices should be considered in the forward-looking supervision model.

In addition, we noted that the FDIC issued internal policy to its examiners in 2011 addressing the risk and supervisory expectations associated with dominant bank officials. Among other things, the internal policy reiterated to examiners that the presence of a dominant official coupled with other risk factors, such as ineffective internal controls, lack of Board independence or inadequate oversight, and engaging in questionable or risky business strategies irrespective of financial performance, are of concern and require enhanced supervision.

FDIC
Federal Deposit Insurance Corporation
3501 Fairfax Drive, Arlington, VA 22226

Office of Audits and Evaluations
Office of Inspector General

DATE: September 3, 2015

MEMORANDUM TO: Doreen R. Eberley, Director
Division of Risk Management Supervision

/Signed/

FROM: Mark F. Mulholland
Assistant Inspector General for Audits

SUBJECT: *Material Loss Review of Capitol City Bank & Trust Company, Atlanta, Georgia* (Report No. AUD-15-006)

The subject final report is provided for your information and use. The report does not contain recommendations, thus a response was not required. However, on September 2, 2015, the Division of Risk Management Supervision provided a written response, dated August 28, 2015, to a draft of the report. We incorporated the response into Part II of the final report.

If you have questions concerning the report, please contact me at (703) 562-6316 or Ann R. Lewis, Audit Manager, at (703) 562-6379. We appreciate the courtesies extended to the Office of Inspector General and contractor staff.

Attachment

Table of Contents

Part I

Report by KPMG LLP

Material Loss Review of
Capitol City Bank & Trust Company
Atlanta, Georgia

Prepared for the
Federal Deposit Insurance Corporation
Office of Inspector General

KPMG LLP
1676 International Drive
McLean, VA 22102

Table of Contents

KPMG LLP
1676 International Drive
McLean, VA 22102

September 3, 2015

Mark F. Mulholland
Assistant Inspector General for Audits
Federal Deposit Insurance Corporation, Office of Inspector General
3501 Fairfax Drive
Arlington, VA 22226

Material Loss Review of Capitol City Bank & Trust Company, Atlanta, Georgia

Dear Mr. Mulholland:

The Federal Deposit Insurance Corporation (FDIC) Office of Inspector General (OIG) contracted with KPMG LLP (KPMG) to conduct a material loss review (MLR) of Capitol City Bank & Trust Company, Atlanta, Georgia (CCB or the bank). The objectives of the MLR were to (1) determine the causes of CCB's failure and the resulting material loss to the Deposit Insurance Fund (DIF) and (2) evaluate the FDIC's supervision of CCB, including the FDIC's implementation of the Prompt Corrective Action (PCA) provisions of section 38 of the Federal Deposit Insurance Act (FDI Act). The enclosed report details the results of our review.

We identified several supervisory lessons learned in the report, consistent with the FDIC OIG's general approach of considering the circumstances and identifying lessons learned from individual bank failures in the broader context of other bank failures. As major causes, trends, and common characteristics of institution failures are identified in MLRs, the FDIC OIG periodically communicates those matters to FDIC management and makes recommendations, as warranted.

We conducted our work as a performance audit in accordance with Generally Accepted Government Auditing Standards. These standards require that we plan and conduct the performance audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The information included in this report was obtained during our fieldwork, which occurred during the period April 2015 through June 2015.

Very truly yours,

KPMG LLP

Why a Material Loss Review Was Performed

Section 38(k) of the FDI Act,[1] as amended, provides, in general, that if the DIF incurs a material loss[2] with respect to an insured depository institution, the Inspector General of the appropriate federal banking agency shall prepare a report to that agency that includes a review of the agency's supervision of the institution, including the implementation of the PCA provisions of section 38(k). The report is required to be completed within 6 months of it becoming apparent that a material loss has been incurred. Section 38(k) establishes a material loss threshold of $50 million for losses that occur on or after January 1, 2014.

On February 13, 2015, the Georgia Department of Banking and Finance (DBF or the State) closed CCB, and the FDIC was appointed receiver. The FDIC's Division of Finance notified the OIG on March 6, 2015, that the estimated loss to the DIF for the failure was $88.9 million. Based on this loss amount, it was determined by the FDIC OIG that the DIF had incurred a material loss for purposes of section 38(k) of the FDI Act, and the FDIC OIG engaged KPMG to conduct an MLR of CCB. The objectives of the audit were to (1) determine the causes of CCB's failure and the resulting material loss to the DIF and (2) evaluate the FDIC's supervision of CCB, including the FDIC's implementation of the PCA provisions of section 38 of the FDI Act.[3] Appendix 1 contains additional information about our objectives, scope, and methodology; Appendix 2 contains a glossary of key terms; and Appendix 3 contains a list of acronyms and abbreviations.

Background

CCB was a state nonmember minority depository institution (MDI) that was chartered and became insured in 1994. Its Board of Directors (Board) and management historically pursued a traditional community banking model focused on serving the African American community in the Atlanta, Georgia, metropolitan area. CCB was wholly owned by Capitol City Bancshares, Inc., a one-bank holding company. The directors owned approximately 15 percent of the outstanding holding company shares, and the largest shareholder owned 6.65 percent of the holding company shares. In the years leading up to the bank's failure, the holding company had a minimal amount of liquidity and was highly leveraged and, as a result, could no longer provide financial support to CCB.

[1] 12 United States Code (USC) § 1831o(k).
[2] Terms that are underlined when first used in this report are defined in Appendix 2, *Glossary of Key Terms.*
[3] In conducting this performance audit and preparing the report, KPMG relied primarily on CCB's records and on information provided by the FDIC OIG, the Division of Risk Management Supervision (RMS), and the Division of Resolutions and Receiverships (DRR). Within the FDIC, RMS performs examinations of FDIC-supervised institutions to assess their overall financial condition, management of policies and practices, and compliance with applicable laws and regulations, as well as issues guidance to institutions and examiners. DRR has primary responsibility for resolving failing financial institutions and managing the resulting receiverships.

MDIs often promote the economic viability of minority and under-served communities. The FDIC has long recognized the importance of MDIs and has historically taken steps to preserve and encourage minority ownership of insured financial institutions. The FDIC also recognizes that MDIs face many challenges, including the need to compete with larger financial institutions for both business and a talented work force. Additionally, it may be difficult for MDIs to diversify their geographical and credit risk exposure due to their commitment to serve local communities and ethnic populations.

FDIC guidance issued in 2007 regarding MDIs notes that high profitability may not be essential to the organizers and shareholders of an MDI. Instead, community development, improving consumer services, and promoting banking services to the unbanked or under-banked segment of its community may drive many of the organization's decisions. Further, according to an FDIC study conducted in 2014, entitled *Minority Depository Institutions: Structure, Performance, and Social Impact*, MDIs serve some of the most challenging markets in the country and their financial data indicate reliance on core deposits to fund loans that are mostly related to residential and Commercial Real Estate (CRE). According to the study, MDIs originated a larger share of their mortgages to borrowers who live in a low- or moderate-income (LMI) census tract and to minority borrowers than did non-MDI community banks.

CCB played a unique role in promoting the economic viability of minority and under-served communities, particularly the African American communities in the metro Atlanta area and in Albany, Georgia; Augusta, Georgia; and Savannah, Georgia. All of its offices, which were comprised of seven branches and the main office, were also located in or near an LMI census tract. CCB's assets were centered in its loan portfolio, which had large concentrations of CRE loans, including loans to Church and Religious Organizations (CRO). Table 1 provides selected information pertaining to CCB's financial condition and operating results from 2005 to 2014.

Table 1: CCB's Annual Financial Condition, Years-End 2005 to 2014

Financial Data ($000s)	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005
Total Assets	$272,311	$286,761	$300,442	$295,648	$295,074	$317,158	$300,190	$272,278	$249,774	$240,434
Total Loans	$189,889	$209,470	$217,650	$220,173	$235,546	$240,781	$233,400	$199,488	$181,316	$172,504
Brokered Deposits/Total Liabilities	0.04%	1.62%	2.14%	4.89%	6.94%	12.38%	11.37%	10.68%	10.98%	15.11%
Net Non-core Funding Dependence Ratio	62.28%	58.97%	51.48%	50.85%	47.58%	38.13%	29.78%	28.78%	27.84%	28.67%
Federal Home Loan Bank Borrowings	$5,500	$5,500	$5,500	$5,500	$5,500	$10,700	$2,000	$0	$0	$0
CRE Loans/Total Capital	2,283%	1,752%	1,170%	1,242%	1,212%	1,238%	770%	565%	528%	603%
Net Interest Margin	3.26%	3.17%	3.43%	3.30%	2.92%	2.19%	2.94%	4.46%	4.96%	4.79%
Return on Average Assets	-1.20%	-1.78%	-0.49%	-0.46%	0.08%	-3.22%	-0.18%	0.97%	1.01%	1.12%

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

Causes of Failure and Material Loss

CCB failed primarily because its Board and management did not properly manage the risks associated with the bank's growth strategy that was centered on higher-risk CRE loans, which included Acquisition, Development, and Construction (ADC), CRO, and Gas and Convenience Store (C-Store) loans. Specifically, CCB's Board and management did not establish appropriate risk management practices, such as applying prudent credit underwriting and administration practices, ensuring adequate internal controls were in place, and maintaining key personnel and proper staffing levels as the bank grew. The President and Chief Executive Officer (CEO) served as a dominant official,[4] exerting significant authority over the lending function as well as the Board. Under the leadership of the CEO, the bank significantly increased its CRE portfolio and did not adequately respond to examiners' repeat recommendations to improve the bank's overall condition, particularly in the lending area.

Deficient loan underwriting and credit administration practices such as over-reliance on collateral, lack of borrower financial information, and continued loan renewals negatively impacted the CRE loan portfolio. Additionally, the bank's appraisal practices were less than ideal since the bank did not often obtain updated appraisals, and the bank's appraisal reviews did not identify concerns noted by examiners. Such practices resulted in inaccurate calculations of the Allowance for Loan and Lease Losses (ALLL) and had the effect of delaying the timely recognition of loan exposure and losses, as well as overstating earnings and capital. As a result, when economic and real estate market conditions deteriorated during the financial crisis, beginning in late 2007, CCB's loan portfolio was heavily impacted.

Board Oversight and Management Supervision

The FDIC's *Risk Management Manual of Examination Policies* (Examination Manual) states that the Board has overall responsibility and authority for formulating sound policies and objectives for the institution and for effectively supervising the institution's affairs. Executive officers, such as the CEO, have primary responsibility for managing the day-to-day operations and affairs of the bank. Further, ensuring appropriate corrective actions are taken in response to regulatory concerns is a key responsibility of the Board. In the case of CCB, the bank's Board and management did not provide effective oversight or supervision of the bank's critical business functions, particularly in the lending function, and did not ensure that internal controls and risk management practices were commensurate with the bank's increasing risk profile. Additionally, the

---

[4] FDIC guidance issued in 2011 defines a dominant official or policymaker as an individual, family, or group of persons with close business dealings, or otherwise acting in concert, that appears to exert an influential level of control or policymaking authority, regardless of whether the individual or any other members of the family or group have an executive officer title or receive any compensation from the institution. As stated in the Examination Manual, a dominant official is often found in a "One Man Bank" wherein the institution's principal officer and shareholder dominates virtually all phases of the bank's policies and operations.

Board and management failed to adequately address repeat regulatory recommendations and implement corrective actions.

Despite the challenges the bank may have had as an MDI in recruiting and retaining qualified staffing personnel, CCB's Board and management pursued a growth initiative without adequate staffing and absent the appropriate credit risk management and monitoring oversight needed to appropriately manage the additional risk. Further, despite clear market indicators signaling that a change in strategy was necessary, management failed to proactively react and adjust its strategy and continued on its course of significant growth in higher risk CRE lending. It became evident to examiners in 2008 that the bank's size and complexity had outgrown the current organizational structure, and certain banking individuals had too many responsibilities assigned to them. Furthermore, examiners noted that many of the strategic credit decisions were made by management and the Board with an undue focus on earnings, and insufficient consideration was given to sound underwriting fundamentals, concentration limitations, and existing portfolio performance.

Notably, the December 2008 FDIC examination, the September 2009 FDIC visitation, and the January 2010 joint examination reports identified the need for a management study and management structure, and a lack of capable individuals in key roles such as Chief Credit Officer (CCO), Chief Operations Officer (COO), and Collections Officer (also referred to as a Loan Workout Officer). In one case, management responded by promoting a senior loan officer who was responsible for a large portion of the bank's loan portfolio to oversee the lending function. Not only did examiners note that the individual's lending responsibilities as an originating officer could impede his ability to effectively oversee the lending function, but also cited that a large percentage of the nonperforming assets, identified loan losses, and underwriting weaknesses were attributed to credits originated and administered by that individual. Examiners also found it alarming at the January 2010 joint examination that a formalized credit analysis or risk management department did not exist within the loan operations area, given the high risk and administrative-intensive nature of the bank's loan portfolio.

Examiners cited numerous apparent violations and contraventions of policy throughout the scope period of our review, as well as noted several repeat recommendations to improve the bank's overall condition that bank management did not fully address. The level of repeat violations and recommendations was a poor reflection on the Board and management's ability to operate the bank in a safe and sound manner, and examiners noted that the pervasiveness of management's noncompliance had cast doubt on the bank's ability and willingness to adhere to governing regulations. As discussed in more detail later in this report, examiners cited numerous repeat issues and apparent violations regarding appraisal weaknesses at 11 examinations and visitations from 2005 to 2014, including an apparent violation involving 18 appraisals at the January 2010 joint examination alone. Further, repeat apparent violations of the Federal Reserve Act's Section 23A and 23B and Regulation O regarding insider and affiliate transactions reflected poorly on the bank's Board.

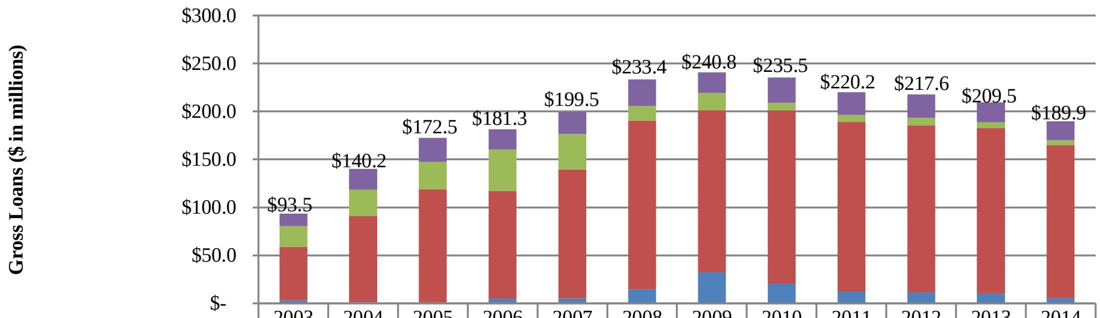
CCB's CEO was the controlling official at the bank who, per examiners, made most, if not all, of the operational and executive decisions at CCB. Examiners noted at the December 2008 examination that the CEO's level of involvement in the bank's daily operation could hinder the overall performance of a growing bank, given the changing and growing demands of an institution that results in multiple priorities that are difficult for an individual to effectively address. The CEO's dominant influence was also evident at the Board level, as examiners cited that the CEO used his relationships with certain shareholders to ensure any directors that challenged his authority were not re-elected to the Board. Notably, the Board's composition was reduced by nearly 50 percent, from 15 to 8 directors, between the January 2010 and March 2012 joint examinations, and examiners noted that a key vacancy in the role of a permanent Chairman of the Board during that timeframe had been detrimental to the bank and reflected poorly on the entire Board. The CEO's dominance and influence over the bank resulted in a weak Board that failed to provide a credible challenge to the CEO's decisions and hold management accountable for addressing the numerous risk management and operational weaknesses identified throughout the bank, and effectively delegated nearly all material decision making authority to the CEO.

While examiners noted that the CEO had effectively run the bank for many years, he had been unable to stem the continuing decline in CCB's performance and failed to adequately address identified weaknesses and fully comply with supervisory enforcement actions as the bank's condition began to deteriorate. Consequently, the CEO resigned as President, CEO, and Board director in September 2013, but continued to serve in a non-executive position focused on raising capital until the time of the bank's failure.

Loan Growth and Concentrations

CCB pursued a loan growth strategy between 2003 and 2009 that was centered in higher-risk CRE loans, which included CRO and C-Store loans, and to a lesser extent ADC loans in later years. As illustrated in the figure on the next page, the bank's loan portfolio grew from $93.5 million in 2003 to $240.8 million in 2009, representing an increase of 158 percent and a compound annual growth rate of 17 percent over the 6-year period. The bank funded the growth primarily with Internet and brokered deposits and high-rate certificates of deposit funded locally. Together with deficient credit underwriting and administration practices (as described later), CCB's significant exposure to CRE loans made the bank vulnerable to economic fluctuations and a downturn in the real estate market. The size of CCB's loan portfolio declined between 2010 and its failure, as the volume of new lending decreased, delinquent loans migrated to other real estate, and the bank recognized losses on existing problem credits.

Figure: CCB's Loan Composition, Years-End 2003 to 2014



	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
All Other Loans	$13.0	$21.6	$24.9	$20.7	$22.9	$27.5	$21.5	$26.4	$23.9	$24.2	$20.8	$19.7
Commercial and Industrial	$21.5	$27.5	$28.9	$43.4	$37.0	$15.4	$17.7	$8.0	$7.1	$8.0	$5.8	$5.3
Other CRE	$55.8	$89.7	$117.7	$112.1	$134.2	$175.8	$168.9	$180.6	$176.8	$174.3	$172.7	$159.2
ADC	$3.2	$1.4	$1.1	$5.1	$5.4	$14.8	$32.7	$20.5	$12.4	$11.1	$10.2	$5.7

Source: Reports of Condition and Income (Call Reports) for CCB.
Note: Totals may not match sum of loan categories due to rounding. Total CRE is the sum of ADC and Other CRE.

In December 2006, the FDIC, the Office of the Comptroller of the Currency, and the Board of Governors of the Federal Reserve System issued joint guidance, entitled *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* (Joint Guidance). The Joint Guidance defines criteria that the agencies use to identify institutions potentially exposed to significant CRE concentration risk. Specifically, an institution that has experienced rapid growth in CRE lending, has notable exposure to a specific type of CRE, or is approaching or exceeds the following supervisory criteria may be identified for further supervisory analysis of the level and nature of its CRE concentration risk:

- total CRE loans representing 300 percent or more of total capital where the outstanding balance of the institution's CRE loan portfolio has increased by 50 percent or more during the prior 36 months; or

- total loans for construction, land development, and other land (referred to in this report as ADC) representing 100 percent or more of total capital.

The figure above reflects that CCB's CRE and ADC loan portfolios grew from $59 million at year-end 2003 to $201.6 million at year-end 2009, representing a compound annual growth rate of 23 percent. As shown in Table 2 on the next page, CCB had a CRE loan concentration as a percentage of total capital that significantly exceeded the levels defined in the Joint Guidance as warranting additional supervisory analysis. Further, the bank's CRE loan concentration substantially exceeded the bank's peer group[5] averages. However, despite this high concentration, the bank did not implement various controls

[5] For years-end 2005 to 2008 and from October 2011 until the bank's failure, CCB's peer group consisted of insured commercial banks having assets between $100 million and $300 million, with 3 or more full service banking offices and located in a metropolitan statistical area. From 2009 to September 2011, the bank's peer group consisted of insured commercial banks having assets between $300 million and $1 billion.

discussed in the Joint Guidance, such as preparing a contingency plan to reduce or mitigate concentrations in the event of adverse CRE market conditions, timely tailoring the CRE loan exposure to emerging indicators, and strengthening loan underwriting and administration practices (as described later). While the bank's ADC concentration levels exceeded the Joint Guidance only in 2009 and 2010, the bank's exposure to ADC loans increased dramatically from $1 million in 2005 to $32.7 million in 2009, as reflected in the above figure. Consequently, ADC loans represented the majority of the losses recognized by the bank in 2009, as the bank's exposure in this sector was highly vulnerable to a sustained downturn in the real estate market.

Table 2: CRE and ADC Concentrations Compared to Peer Groups

Year-End	CRE Loans as a Percentage of Total Capital			ADC Loans as a Percentage of Total Capital		
	CCB	Peer Group	Percentile	CCB	Peer Group	Percentile
2005	603%	332%	94	5%	91%	5
2006	528%	335%	87	23%	101%	16
2007	565%	338%	90	22%	106%	13
2008	770%	344%	98	60%	97%	37
2009	1,238%	356%	98	201%	85%	89
2010	1,212%	321%	98	124%	61%	86
2011	1,242%	296%	98	82%	48%	81
2012	1,170%	284%	99	70%	43%	79
2013*	1,752%	274%	99	98%	43%	92
2014*	2,283%	269%	99	79%	43%	82

Source: UBPRs for CCB.
Note: Peer group comparison is presented for illustrative purposes relative to CRE and ADC concentrations only. FDIC guidance notes that in evaluating MDIs, undue emphasis must not be placed on UBPR's peer analysis due to the unique characteristics of an MDI.
* The significant increase in CCB's loan to capital ratios in 2013 and 2014 was largely attributable to a decrease in capital rather than new CRE and ADC lending.

Compounding the risk in the CRE portfolio was the bank's exposure to CRO and C-Store loan concentrations.[6] The bank's lending strategy had historically included a focus on CRO loans, and between 2005 and 2009, the bank's CRO concentration increased annually from approximately 200 to 268 percent of Tier 1 Capital, and represented 25 percent of total loans as of September 30, 2009. Examiners considered the bank's CRO lending as a collateral concentration, as nearly all the loans were secured by churches and/or church-related real estate. According to the Examination Manual, a loan secured by collateral with inferior marketability characteristics, such as single-purpose real estate that has not been compensated for by other reliable repayment sources, may indicate a problem loan. In the case of CCB, examiners found some of the CRO loans to have poor repayment performance and inadequate cash flows, and examiners cautioned management to be aware of the associated risks when extending loans secured by single-purpose properties in the January 2010 joint examination report.

CCB's CRE portfolio also included a large number of loans to C-Store borrowers. The C-Store concentration was at 276 percent of Tier 1 Capital during the September 2009 FDIC visitation and represented 26 percent of total loans as of September 30, 2009.

[6] The Examination Manual defines an industry concentration or concentration by type of collateral as 100 percent or more of Tier 1 Capital.

Some of these loans were identified by examiners as adversely classified assets, and one loan had a loss classification in the amount of $1.2 million in 2014.

Within the CRE portfolio, CCB also had numerous large individual borrower concentrations[7] that added to the level of risk in the loan portfolio. For example, examiners at the May 2013 joint examination identified 16 individual borrower concentrations within the CRE portfolio, of which 5 relationships totaling $18.3 million were adversely classified.

Lending, Credit Administration, and Appraisal Practices

Poor loan underwriting, administration, and monitoring were significant factors in the asset quality problems that developed at CCB. The Joint Guidance reminded institutions, among other things, to establish risk management practices that are commensurate with the level and nature of the institution's CRE concentration risk, including establishing concentration limits and standards for all extensions of credit, stress testing the CRE portfolio, and reporting all concentrations to management and the Board. Underwriting standards should include, among other things, collateral valuation, borrower's net worth, and property cash flow.

Despite the increasing risks in CCB's CRE loan portfolio and the changing economic environment, the Board and management did not establish or enhance credit practices consistent with the CRE guidelines. As discussed below, examinations and visitations from 2005 through the bank's failure in 2015 identified various aspects of CCB's credit underwriting, administration, and monitoring practices that needed improvement, many of which were repeat weaknesses and recommendations. However, CCB's Board and management did not fully address those concerns.

Loan Underwriting. FDIC and/or DBF examiners noted the following:

- Management was over-reliant on collateral as a mitigating credit factor, leaving the bank vulnerable to collateral value fluctuations. Further, management originated and renewed loans with questionable collateral valuations (e.g., use of waived appraisal value or outdated appraisals, and no income approach value or support for assumptions in appraisals).

- The bank failed to consistently obtain and analyze current borrower financial information necessary to document and evidence repayment ability.

- Management's historical use of liberal credit terms, such as payment extensions, multiple renewals without reasonable amortization, and capitalization of interest and taxes, had masked problems and distorted the condition of the loan portfolio.

[7] According to the Examination Manual, concentrations by individual borrowers represent 25 percent or more of Tier 1 Capital.

- Lack of adequate global cash flow analysis of borrowers and guarantors impeded management's ability to identify increasing risk within the loan portfolio.

Credit Administration. FDIC and/or DBF examiners noted the following:

- There were repeat weaknesses and inadequacies in the bank's ALLL methodology and levels as the loan portfolio continued to deteriorate over time. As a result, examiners required $14.6 million in additional provisions to the bank's ALLL in the five joint examinations from January 2010 to July 2014.

- There were areas in the bank's lending function that needed to be added or revised in the bank's loan policy. Additionally, contraventions to the loan policy were cited by the examiners, including failure to adhere to the bank's risk limits for CRE lending concentrations.

- The volume of past due and nonaccrual loans -- which increased from 7 percent to 21 percent of the loan portfolio from the 2005 to the 2013 examination, respectively -- revealed the magnitude of the bank's poor collection practices. Further, examiners noted that the past-due ratio was understated by management's practice of originating, extending, or renewing loans, primarily CRE credits, on annual interest only repayment terms. This particular loan structure was inappropriate for CRE loans and can serve to mask the deterioration within the credits. Since these loans did not appear as past due, management did not actively pursue collection.

- The frequency of external loan review was inconsistent and the reviews lacked depth. For example, examiners noted that the reviews focused on documentation, credit policy exceptions and financial statement exceptions, rather than the credit quality of each relationship. Given the level and severity of the asset quality concerns, comprehensive external loan reviews were needed to ensure the larger and problematic credit relationships were reviewed on a more frequent basis.

- Management was not able to identify loan problems in a timely fashion and failed to identify nonaccrual loans in a timely manner and appropriately risk rate loans.

- Stress testing of the bank's CRE portfolio was limited. In instances where the bank did conduct stress testing, the procedures were inadequate and did not address potential impacts on earnings and capital.

Appraisal Practices

CCB's appraisal practices were deficient, and examiners consistently noted weaknesses and concerns regarding the bank's appraisal practices and the quality of appraisals obtained through the scope of our review. Examiners cited apparent violations of the

FDIC's Rules and Regulations[8] section 323 regarding appraisal issues at 11 of the 15 examinations and visitations conducted from 2005 to 2014, including 18 individual citations at the January 2010 joint examination. The nature of deficiencies and weaknesses ranged from missing or stale appraisals, appraisals that failed to adequately support the collateral values, an inadequate appraisal review function, failing to obtain appraisals prior to extending credits, and appraisals ordered by the borrower instead of the bank. Bank management's failure to adequately address the ongoing appraisal issues at the bank contributed to the bank's practice of delaying the recognition of problem assets and potential exposure in the loan portfolio.

Decline in the Loan Portfolio

CCB's high concentrations coupled with weak loan underwriting, administration, and monitoring practices resulted in significantly impaired asset quality, operating losses, and capital erosion. CCB's total adversely classified assets increased from 55 percent of total capital and reserves at the March 2005 FDIC examination to 85 percent at the December 2008 FDIC examination. The adversely classified assets increased significantly to 231 percent at the January 2010 joint examination, and increased at each subsequent examination to peak at 665 percent at the July 2014 joint examination. The January 2014 FDIC visitation noted that CRO and C-Store loans posed a significant risk to the bank's viability as these credits accounted for a significant portion of the watch list and adversely classified credits.

Table 3 reflects the sustained increase in adversely classified assets from the March 2005 FDIC examination through the July 2014 joint examination. Notably, CCB did not recognize large loss amounts in the final years leading up to its failure as compared to the amount of assets adversely classified Substandard. As discussed earlier in this report, this appears to be the result of the bank's weak loan monitoring practices that had the effect of delaying the recognition of exposure and potential loss in the loan portfolio. Based upon the bank's Call Report filings, CCB recognized $23.7 million in charge-off losses from 2005 to 2014. Our independent analysis of documentation pertaining to CCB's failure indicates that a majority of the loans that resulted in losses were originated or renewed from 2006 to 2009, when the bank was emphasizing CRE and ADC lending and examiners were critical of the bank's risk management practices associated with that area.

Table 3: CCB's Adversely Classified Assets, 2005-2014 Examinations

Asset Classification ($000s)	3/2005	12/2005	7/2006	2/2007	12/2008	1/2010	2/2011	3/2012	5/2013	7/2014
Substandard	$9,444	$9,822	$14,679	$13,397	$20,704	$45,562	$59,408	$75,123	$78,118	$81,460
Doubtful	$25	$93	$9	$99	$0	$4,710	$449	$5,903	$0	$0
Loss	$185	$121	$71	$0	$832	$6,717	$1,679	$1,118	$2,988	$3,388
Total	$9,654	$10,036	$14,759	$13,496	$21,536	$56,989	$61,536	$82,144	$81,106	$84,848

Source: Examination Reports for CCB. Asset classifications are based upon the dates of the examination.

[8] The FDIC's Rules and Regulations are codified to title 12 of the Code of Federal Regulations.

The FDIC's Supervision of Capitol City Bank & Trust Company

The FDIC, in coordination with the DBF, provided ongoing supervisory oversight of CCB through regular on-site examinations, visitations, and various offsite monitoring. In addition, the FDIC provided technical assistance to the bank in certain areas, consistent with the requirements of the FDIC's MDI Program. Through its supervisory efforts, the FDIC identified risks in the bank's operations as early as 2005 and brought these risks to the attention of the institution's Board and management through examination reports and visitation documentation, correspondence, and informal and formal enforcement actions. Such risks included the presence of a high-risk loan portfolio in an operating environment that lacked key controls and risk management practices, particularly in the lending area.

The FDIC and DBF generally provided supervision in accordance with examination policies and guidelines. In retrospect, however, an elevated level of supervisory scrutiny and/or stronger enforcement action may have been warranted to emphasize the inherent risk and exposure that resulted from the bank's growth strategy and, in later years, management's inability to fully address weaknesses and recommendations or comply with supervisory enforcement actions. With respect to PCA, we determined that the FDIC properly implemented relevant provisions of section 38.

The following sections detail CCB's supervisory history, which includes the FDIC's pursuit of enforcement actions; the supervisory response to key risks; the FDIC's compliance with PCA; and supervisory lessons learned from CCB's failure.

Supervisory History

The FDIC and DBF conducted 10 on-site examinations and 6 visitations of CCB from March 2005 through the bank's failure in February 2015. The frequency of these on-site examination activities was consistent with relevant statutory and regulatory requirements,[9] with the exception of the December 2008 examination, which commenced approximately 2 months after the maximum 18-month period from the prior examination. Table 4 on the next page summarizes key supervisory information pertaining to CCB's examinations and visitations, followed by a summary of enforcement actions taken by the FDIC and DBF that reflects increasingly stronger supervisory action over time, as well as a summary of the FDIC's MDI program activities.

[9] Section 337.12 of the FDIC Rules and Regulations, which implements section 10(d) of the FDI Act (12 USC § 1820(d)), generally requires annual full-scope, on-site examinations of every state non-member bank at least once during every 12-month period. The length of time between the end of one examination and the start of the next (whether one or both of the examinations are conducted by a state supervisory agency or the FDIC) should not exceed 12 months. For purposes of monitoring compliance with examination frequency schedules, the end of the examination is defined as the earlier of the date the Examiner-In-Charge submits the report for review or 60 calendar days from the Examination Start Date. The regulation allows the annual examination interval to be extended to 18 months for certain small institutions (i.e., total assets of less than $500 million, effective April 10, 2007; prior to then, $250 million) if certain conditions are satisfied.

Table 4: CCB's Examination History, 2005 to 2015

Examination Start Date	Examination or Visitation	Regulator(s)	Supervisory Ratings *	Informal or Formal Action Taken **
3/21/2005	Examination	FDIC	233222/3	Bank Board Resolution (BBR) effective 6/14/2005
12/1/2005	Examination	DBF	233222/3	2005 BBR still in effect
7/10/2006	Examination	FDIC	233222/3	BBR revised effective 9/12/2006
2/7/2007	Examination	DBF	232222/2	2006 BBR still in effect
12/1/2008	Examination	FDIC	333333/3	Existing 2006 BBR replaced with a Memorandum of Understanding (MOU) effective 5/19/2009
9/15/2009	Visitation	FDIC	444433/4	MOU terminated 1/20/2010 and replaced with Cease and Desist Order (C&D) effective 1/20/2010
1/8/2010	Examination	Joint	555554/5	Consent Order in effect
9/13/2010	Visitation	FDIC	555554/5	Consent Order still in effect
2/7/2011	Examination	Joint	555454/5	Consent Order still in effect
8/29/2011	Visitation	FDIC	555554/5	Consent Order still in effect
3/26/2012	Examination	Joint	555555/5	Consent Order still in effect
10/1/2012	Visitation	FDIC	555555/5	Consent Order still in effect
5/20/2013	Examination	Joint	555545/5	Consent Order still in effect
1/13/2014	Visitation	FDIC	555545/5	Consent Order still in effect
7/14/2014	Examination	Joint	555555/5	Consent Order still in effect
1/12/2015	Visitation	Joint	n/a	Consent Order still in effect

Source: Examination Reports, Visitation Reports, Correspondence, Supervisory History Document, and Virtual Supervisory Information on the Net (ViSION) for CCB.
* The FDIC uses the Uniform Financial Institutions Rating System (UFIRS) during bank examinations and/or visitations.
** Informal actions often take the form of a BBR or MOU. Formal enforcement actions often take the form of a C&D, which becomes a Consent Order when stipulated by the bank, or PCA Directive.

Examinations and Enforcement Actions

Based on the results of the March 2005 FDIC examination, CCB's Board adopted a BBR on June 14, 2005 (2005 BBR) that included provisions to address weaknesses in asset quality, loan administration, and violations of laws and regulations. Examiners at the July 2006 FDIC examination noted that, while the bank had complied with most of the provisions of the 2005 BBR, a substantial volume of loans not previously identified had deteriorated and became adversely classified, and lending decisions continued to be made without the support of complete borrower financial information and analysis. Further, internal control deficiencies, some of which were deemed significant, were identified at the July 2006 FDIC examination. Given the continued deficiencies, the bank's Board accepted the FDIC's request to revise the 2005 BBR to address these new matters, which became effective on September 12, 2006 (2006 BBR). The 2006 BBR contained a new provision to address concerns related to negatively amortizing loans and removed certain provisions from the 2005 BBR that examiners deemed to have been adequately corrected.

Examiners noted that the bank was in substantial compliance with the 2005 BBR at the February 2007 DBF examination, and the FDIC's review of the progress reports revealed compliance with the 2006 BBR; however, continued effort was needed in reducing the level of classified assets and technical exceptions, as well as improving the bank's asset quality and credit administration practices. Examiners identified additional loan administration weaknesses and apparent violations at the December 2008 FDIC examination and noted deterioration in the bank's financial condition. Based on the results of the examination, the FDIC entered into an MOU with CCB's Board that became effective on May 19, 2009, and replaced the 2006 BBR. Among other things, the MOU included provisions wherein CCB's Board agreed to:

- Develop specific plans to reduce and improve loan relationships that were subject to adverse classification;

- Eliminate all assets or portions of assets classified Loss in the examination report and establish appropriate reserve for loan losses;

- Eliminate technical exceptions listed in the examination report, improve risk management practices related to CRO concentrations, and improve credit underwriting and administration practices;

- Restrict total asset growth to no more than 5 percent during any consecutive 3-month period without prior regulatory notification; and

- Maintain a minimum Tier 1 Leverage Capital Ratio of 8 percent and a minimum Total Risk-Based Capital Ratio of 10 percent.

The FDIC conducted a visitation in September 2009 that focused on the deterioration in the bank's asset quality, ALLL, and compliance with certain aspects of the MOU. The findings of the visitation indicated that the bank's condition had deteriorated significantly and remained unsatisfactory. As a result, the FDIC pursued formal enforcement action in the form of a C&D to address the deterioration in the bank's performance, which the Board stipulated to and became the Consent Order effective on January 20, 2010. In addition to provisions similar to those in the MOU, the Consent Order required the bank's Board to increase its participation in the affairs of the bank and to retain management with qualifications and experience commensurate with assigned duties and responsibilities. CCB was not successful in addressing the bank's weaknesses and complying with the provisions of the Consent Order in the five examinations and five visitations that followed the September 2009 FDIC visitation. Consequently, the Consent Order remained in place through the bank's failure in February 2015.

FDIC's Technical Assistance under the Minority Depository Institution Program

As noted earlier in this report, MDIs often play a unique role in promoting the economic viability of under-served communities, and the FDIC has historically taken steps to preserve and encourage minority ownership of insured financial institutions. The FDIC has established an MDI Program that is aimed to promote increased communication with MDIs, coordinate with trade associations that represent MDIs, and provide opportunities for MDIs to request technical assistance from the FDIC or participate in conferences and trainings. Designated Regional Coordinators provide oversight of the MDI Program in their specific region, serve as contact persons for MDI matters, and provide quarterly reports to corporate headquarters.

Consistent with the requirements of the MDI Program, the FDIC regularly offered CCB on-site technical assistance from 2005 to 2014 to review areas of concern or topics of interest to the bank in order to assist management in understanding and implementing examination recommendations. The FDIC also offered advice on matters such as compliance and risk management procedures, accounting practices, and recruiting techniques. Based on our review of documentation provided by the Atlanta Regional Office, CCB accepted the FDIC's technical assistance in numerous instances from 2006 until 2014. As reflected in Table 5, the technical assistance topics included issues in lending, capital raising efforts, ALLL methodology, global cash flow analysis, stress testing the CRE portfolio, emerging industry topics and related Financial Institution Letters (FIL), and examination findings, which included appraisals and concentrations.

The FDIC also offered targeted training to CCB's management, and in 2005 provided the bank training related to compliance and Community Reinvestment Act (CRA) issues. The FDIC also offered CCB opportunities to meet with the FDIC's regional management or participate in regional and national conferences to provide MDIs the opportunity to focus on issues unique to their institutions.

Table 5: Technical Assistance Provided to CCB

Date	Technical Assistance Topic(s)
4th Quarter 2006	Lending Issue
7/20/2010	Capital, Troubled Asset Relief Program (TARP) and Consent Order
9/2/2010	Capital, TARP and Consent Order
9/20/2010	Capital, TARP and Consent Order
9/7/2012	ALLL, Global Cash Flow Analysis, and Stress Testing
2/25/2013	MDI Program, Emerging Industry Topics, Recent FILs, Supervision of Technology Providers and Outsourcing Technology Services, Payment Processor Relationships, Findings from the latest examination which included Appraisals, CRE and C-Store Concentrations, Due Diligence, Latest Banking Statistics, and Community Banking issues
10/15/2013 and 10/16/2013	Information Technology weaknesses
10/17/2013	Compliance Management System, Fair Lending, and CRA
7/14/2014	ALLL

Source: Technical Assistance Documentation and Quarterly Reports by the Regional Coordinator.

Supervisory Response to Key Risks

The FDIC and DBF continuously provided comments and recommendations and pursued enforcement actions to address the risks identified at each examination and visitation. Examiners assigned composite and component ratings that were generally consistent with the UFIRS ratings definitions and the condition of the bank at a specific examination or visitation.

Board and Management Oversight

According to the Examination Manual, an institution's Board is responsible for establishing appropriate risk limits, monitoring exposure, and evaluating the effectiveness of the institution's efforts to manage and control risk. The Examination Manual further notes that the quality of management is often the single most important element in the successful operation of an insured institution and is usually the factor that is most indicative of how well risk is identified, measured, monitored, and controlled. Further, ensuring appropriate corrective actions to regulatory concerns is a key responsibility of the Board.

FDIC and DBF examiners considered CCB's Board and management performance to be unsatisfactory[10] and in need of improvement at each examination from 2005 through the bank's failure, with the exception of the February 2007 DBF examination where management was reported as satisfactory, as described below. As early as the March 2005 FDIC examination, examiners noted that bank management needed to strengthen loan underwriting and credit administration, improve internal control weaknesses, and correct apparent violations that were cited during examinations. Certain aspects of the 2005 BBR and 2006 BBR included actions to improve the bank's management performance, including provisions to revise and update the bank's strategic plan, correct all violations of laws, rules and regulations and contraventions of policy, and correct all internal routine and control deficiencies identified in the examination report.

Examiners at the February 2007 DBF examination found management's performance to be satisfactory, based primarily on the bank's responsiveness to regulatory recommendations, personnel changes to strengthen areas of concern, and substantial compliance with the 2005 BBR. However, examiners cited the need for management's continued effort to improve the bank's asset quality and credit administration practices. At the next on-site FDIC examination in December 2008, examiners noted that management's strategy of allowing relatively rapid growth during a period of economic uncertainty had contributed to the overall deterioration in the bank's condition and that CCB's size and complexity had outgrown the bank's organizational structure. Examiners suggested that the bank develop a management infrastructure that was consistent with the needs of the bank in an effort to correct many of the weaknesses cited at the examination. Consequently, examiners downgraded the bank's Management component to "3."

At the time of the September 2009 FDIC visitation, examiners considered management performance and Board oversight to be unacceptable and downgraded the Management component to "4," noting that the Board and management had been ineffective in responding to risks that impaired the viability of the bank. Among other things, examiners cited a repeat violation of Regulation O regarding overdrafts of a director's account, and reminded management that violations of law and regulations may be subject to civil money penalties (CMP) and that repeat violations are viewed unfavorably. As noted earlier in this report, the Consent Order that became effective in January 2010 also included provisions requiring specific action and improvement in the quality of the bank's Board and management oversight.

Examiners continued to cite weaknesses and criticisms in CCB's Board and management oversight at examinations and visitations between January 2010 and the bank's failure, as evidenced by the Management component rating "5" during that timeframe. In general,

[10] Unsatisfactory in this context describes 3, 4, and 5-rated Management.

examiners emphasized management's failure to act in a proactive manner to prevent deterioration in the bank's condition, correct past criticisms in a timely fashion, and ensure that effective risk management procedures were in place at the bank. Among other things, examiners noted that the Board had not demonstrated the ability to properly plan and coordinate business strategies in response to internal and external risks, and the level of repeat recommendations and violations cited by examiners at numerous examinations reflected poorly on the Board and management. Further, examiners noted that management's failure to identify nonaccrual loans, recognize problem assets, and appropriately risk rate loans magnified the asset quality problems at the bank.

The extent of ongoing operational and risk management weaknesses raised serious doubt as to whether executive management possessed the skills and willingness to effectively address the myriad of problems facing the bank and comply with the requirements of the Consent Order. As a result, examiners at the May 2013 joint examination recommended that the Board immediately assess whether the executive management team was capable of returning the bank's performance to a satisfactory level and to make any necessary management changes. Consequently, as noted earlier, the CEO resigned as President, CEO, and Director in September 2013, and subsequently the COO was appointed to the position of President and CEO.

Loan Growth and Concentrations

Examiners identified the risks and provided recommendations and required actions on behalf of bank management regarding the bank's loan growth and asset concentrations throughout the period of our review. The March 2005 FDIC examination report noted that the asset concentration regarding CRO was not being monitored on at least a quarterly basis by the Board or senior management, which was cited as a repeat criticism from prior FDIC and DBF examinations. Examiners reminded the Board and management of the potential for increased risk posed by the CRO concentration and the importance that concentration reports be reviewed by the loan committee and the Board in accordance with internal policy. Examiners considered the bank's concentration monitoring practices to be satisfactory at examinations from December 2005 to February 2007.

Examiners noted in the December 2008 examination report that given the economic situation, the bank's risk management practices relating to concentrations were no longer adequate, stating that concentration risk within the loan portfolio continued to be significant. In response, a provision was included in the May 2009 MOU wherein bank management agreed to formulate a plan to improve risk management practices relating to the bank's CRO concentration and to limit the increase in total assets to no more than 5 percent during any consecutive 3-month period without notifying the FDIC and DBF.

At the September 2009 FDIC visitation, examiners determined that the deterioration in the bank's loan portfolio was magnified by the bank's CRE loan concentrations, which included CRO loans and loans to convenience stores. Examiners noted that the concentration levels were excessive and overall monitoring of concentrations needed improvement. Examiners recommended improving credit underwriting standards and implementing portfolio stress testing to mitigate concentration risk, as CCB had failed to implement mitigation strategies to reduce its exposure. In addition, the Consent Order, which replaced the MOU in 2010, included concentration provisions that required the bank to perform risk segmentation analysis with respect to the concentrations of credit and to notify the FDIC and DBF 60 days prior to undertaking 10 percent or more of asset growth. As discussed later, the Consent Order also contained provisions intended to improve credit underwriting and administration practices.

The January 2010 joint examination identified findings similar to those in the September 2009 FDIC visitation. In addition to CRO loan concentrations, examiners noted that ADC concentrations had exacerbated overall deterioration in the loan portfolio caused primarily by lax underwriting standards and the downturn in general economic conditions. Examiners noted that the bank had not developed a contingency plan to reduce or mitigate concentrations in the event of adverse CRE market conditions, and recommended that the bank perform stress testing or sensitivity analysis of the CRE portfolio concentrations. Examiners also noted that CCB management and the Board must take the necessary action to improve concentration identification, measurement, and monitoring and implement the prudent risk management practices outlined in the Joint Guidance.

During the February 2011 joint examination, examiners found the bank's risk management practices for concentration in CRE lending, which now also included multiple large borrowing individual relationships, to be inadequate, as the concentration exceeded acceptable levels in the bank's internal guidelines as well as the Joint Guidance. Management was asked to reevaluate what constitutes an acceptable level of risk for the bank and to continue its efforts to prudently reduce exposure to concentration risks. In the subsequent March 2012 and May 2013 joint examinations, examiners noted that CCB had still not implemented the loan portfolio stress testing that was recommended in 2009. When the bank did implement stress testing, per the July 2014 examination, the stress testing report did not address potential impacts on earnings and capital.

<u>Lending, Credit Administration, and Appraisal Practices</u>

Examiners continuously criticized and provided recommendations regarding the bank's credit underwriting and administration practices at examinations and visitations from 2005 until 2014. Repeat recommendations included reminders to obtain updated borrower financial information and other applicable documents, particularly appropriate collateral appraisals; conduct an analysis of the borrower's capacity to repay the loan; maintain an adequate loan review function; perform loan monitoring and portfolio stress testing; adjust the ALLL levels and methodology; and update the bank's Loan Policy. Examiners also brought to the Board and management's attention that weak underwriting practices, such as the origination and renewal of loans with questionable collateral positions and the inadequate assessment of repayment ability, significantly increased the risk level in the CRE loan portfolio.

Board and management were also informed how management's historical use of liberal credit terms such as payment extensions, multiple renewals without reasonable amortization, and capitalization of interest and taxes had masked problems and distorted the condition of the loan portfolio. As it relates to CCB's over-reliance on collateral, examiners informed management to work towards minimizing credit administration practices that assume rising collateral values. While it was recognized that relying on collateral as a mitigating credit factor may be appropriate in certain circumstances, CCB's over-reliance on collateral left the bank vulnerable to collateral value fluctuations that ultimately contributed to asset deterioration and losses.

In addition to examiner recommendations, the informal and formal enforcement actions pursued by the FDIC and adopted by the bank from 2005 through its failure included provisions intended to improve the bank's credit underwriting and administration practices. Table 6 provides a summary of provisions and requirements of the 2005 and 2006 BBRs, 2009 MOU, and 2010 Consent Order specific to the bank's lending practices.

Table 6: Enforcement Action Provisions to Improve Lending Practices

Enforcement Action	Lending Practices Provision
2005 and 2006 BBRs	• Submit specific plans to effect reduction in and/or improvement of assets adversely classified, • Prohibit extension of additional credit to or for the benefit of any borrower who is obligated on any credit that had been charged off or classified Loss or Doubtful, so long as that credit remained uncollected. Also, no additional advances shall be made to any borrower whose loan had been adversely classified as Substandard without the prior approval of a majority of the Board, • Charge off all assets classified as Loss and half of any assets classified as Doubtful in the examination report, • Develop and implement a system of loan documentation that will require all necessary documentation be obtained before credit is extended (2005 BBR only), and • Identify all negatively amortizing variable-rate loans and develop plans to address collection and amortization of debt (added in the 2006 BBR).
2009 MOU	• Submit specific plans to reduce and improve loan relationships subject to adverse classification in the amount of $500,000 or more. Additionally, the balance of the assets classified Substandard and Doubtful in the December 2008 FDIC examination report shall be reduced by 25 percent within 180 days, 45 percent within 360 days, and 60 percent within 540 days, • Eliminate from its books all assets classified as Loss in the examination report, • Establish and maintain an appropriate reserve for loan losses, and • Require complete loan documentation and current financial information adequate to support the outstanding indebtedness of each borrower. It should include, at a minimum, detailed balance sheets, profit and loss statements, or copies of tax returns and cash flow projections.
2010 Consent Order	• Review the adequacy of the ALLL and establish a comprehensive policy for determining the adequacy of the ALLL, • Eliminate from its books all assets or portions of assets classified Loss and 50 percent of those assets classified Doubtful in the September 2009 FDIC visitation report, • Submit a written plan to reduce the bank's risk position in each asset in excess of $500,000, which was classified Substandard or Doubtful in the visitation report. Further, the balance of the assets classified Substandard and Doubtful in the visitation report shall be reduced by 25 percent within 180 days, 45 percent within 360 days, and 60 percent within 540 days from the effective date of the Order, and • Revise and ensure full implementation of its written lending and collection policy.

Source: Examination Reports and Enforcement Actions for CCB.

Implementation of PCA

Section 38 of the FDI Act, *Prompt Corrective Action*, establishes a framework of mandatory and discretionary supervisory actions pertaining to all insured depository institutions. The section requires regulators to take progressively more severe actions, known as "prompt corrective actions" as an institution's capital level declines. The purpose of section 38 is to resolve the problems of insured depository institutions at the least possible cost to the DIF. Part 325, *Capital Maintenance*, of the FDIC Rules and Regulations[11] defines the capital measures used in determining the supervisory actions to be taken pursuant to section 38 for FDIC-supervised institutions. Part 325 also establishes procedures for the submission and review of capital restoration plans (CRP) and for the issuance of directives and orders pursuant to section 38. The FDIC is required to closely monitor institution compliance with CRPs, mandatory restrictions defined under section 38(e), and discretionary safeguards imposed by the FDIC (if any) to determine if the purposes of PCA are being achieved.

Based on the supervisory actions taken with respect to CCB, the FDIC properly implemented the applicable PCA provisions of section 38. Table 7 provides a summary of CCB's capital ratios relative to the PCA thresholds for *Well Capitalized*[12] institutions during examinations and at other key points in time. A chronological description of the changes in the bank's capital categories and the FDIC's implementation of PCA follow the table.

Table 7: CCB's Capital Ratios

Event Date	Total Risk-Based	Tier 1 Risk-Based	Leverage	PCA Capital Category
Well Capitalized Threshold	**≥10%**	**≥6%**	**≥5%**	
3/21/2005 Examination	10.11	8.90	8.63	*Well Capitalized*
12/1/2005 Examination	10.69	9.51	7.76	*Well Capitalized*
7/10/2006 Examination	10.29	9.04	7.35	*Well Capitalized*
2/7/2007 Examination	10.78	9.53	7.87	*Well Capitalized*
12/1/2008 Examination	9.95	8.75	7.45	*Adequately Capitalized*
1/8/2010 Examination	5.67	4.40	3.80	*Significantly Undercapitalized*
2/7/2011 Examination	6.39	5.12	4.31	*Undercapitalized*
8/29/2011 Visitation	5.56	4.60	3.88	*Significantly Undercapitalized*
3/26/2012 Examination	4.59	3.32	2.86	*Significantly Undercapitalized*
5/20/2013 Examination	4.81	3.54	3.01	*Significantly Undercapitalized*
3/3/2014 PCA Notification	4.67	3.41	2.92	*Significantly Undercapitalized*
7/14/2014 Examination	3.00	1.74	1.48	*Critically Undercapitalized*

Source: Examination Reports and activities relevant to PCA for CCB. Capital thresholds and categories were obtained from the Examination Manual.

---

[11] On January 1, 2015, a phase-in period began for community banks whereby Part 325 will be superseded by Part 324, *Capital Adequacy of FDIC-Supervised Institutions*. Because CCB failed on February 13, 2015, substantially all supervisory action with respect to CCB would have implemented Part 325. Accordingly, our audit focused on the FDIC's compliance with Part 325.

[12] Section 325.103(b)(1)(iv) of the FDIC Rules and Regulations states that for an institution to be considered *Well Capitalized*, it must not be subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the FDIC pursuant to Section 8 of the FDI Act, the International Lending Supervision Act of 1983, section 38 of the FDI Act, or any regulation thereunder, to meet and maintain a specific capital level for any capital measure. See also section 324.403 of the FDIC Rules and Regulations.

CCB was considered *Well Capitalized* for PCA purposes from 2005 until 2007. The bank fell to the *Adequately Capitalized* category during the December 2008 FDIC examination and remained *Adequately Capitalized* until the January 2010 joint examination, when the FDIC determined that CCB's capital position had declined to *Significantly Undercapitalized* based on the results of the examination. During the September 2010 FDIC visitation and the February 2011 joint examination, CCB's capital position improved to *Undercapitalized* as a result of capital injections from non-institutional investors and the holding company and retained earnings in 2010. However, CCB fell back to *Significantly Undercapitalized* as a result of the findings from the August 2011 FDIC visitation, and the bank remained in that category until the July 2014 joint examination, at which point the bank was deemed to be *Critically Undercapitalized.*

In each instance that the bank's capital fell to the next category, the FDIC notified the bank of its PCA capital category and communicated the corresponding required actions and restrictions, either through a notification letter or through examination reports and visitation documentation. In addition to the capital level provisions contained in the 2010 Consent Order, the FDIC required a CRP from CCB once the bank fell below the *Adequately Capitalized* category. Between May 2010 and April 2014, CCB submitted seven CRPs to the FDIC, five of which were submitted prior to the CEO's departure. However, in each case, the FDIC either deemed the CRP to be unacceptable or requested revised CRPs once the bank was unable to secure adequate capital in the timeframes outlined in the prior CRP. As of October 2014, there were no more prospects for sale, merger, or recapitalization for CCB.

On November 7, 2014, the FDIC notified the bank of its *Critically Undercapitalized* PCA capital category based on the results of the July 2014 joint examination. PCA guidelines[13] require that a bank be placed into receivership within 90 days of the date it becomes *Critically Undercapitalized*. On January 30, 2015, the bank was expected to be closed and placed into receivership. However, on January 29, 2015, the FDIC approved a 90-day extension of the statutorily mandated resolution date based on capital commitments to allow for regulatory review of a potential recapitalization of the bank. The Atlanta Regional Office recommended that the FDIC extend the bank's PCA resolution period to May 6, 2015. While regulatory approval was not assured, the extension would provide the parties involved time to file the necessary applications and allow the regulators time to evaluate the feasibility of the recapitalization proposal. However, in consultation with DBF, the FDIC subsequently determined that there was no reasonable possibility that the bank's serious financial condition could be rehabilitated without Federal assistance, and DBF closed CCB on February 13, 2015.

---

[13] Section 38(h)(3)(A) of the FDI Act requires either that a receiver be appointed after 90 days or that the agency take alternative action that better achieves the purpose of the law.

Supervisory Lessons Learned

Stronger supervisory posture towards the bank's risk management practices and operational infrastructure was warranted as early as 2005

Based on discussions conducted during the course of our review, examiners indicated that they had viewed the bank's operations and organization to be disorderly and had doubts regarding the level of expertise in the bank's lending function during the period in which the bank was executing the growth strategy. As early as the March 2005 FDIC examination, examiners identified the inherent risks associated with CCB's growth strategy and weaknesses in the bank's loan underwriting and credit administration practices. In response, the FDIC was proactive in pursuing corrective measures in the form of BBRs in 2005 and 2006 to address such concerns. While CCB was able to demonstrate progress in addressing the certain weaknesses and issues cited in the BBRs, examiners continued to cite new and additional weaknesses, apparent violations, and deterioration in the bank's loan portfolio in the examinations following the Board's adoption of the BBRs, while at the same time the bank continued to execute its growth strategy. Ongoing supervisory concerns were focused on management oversight and asset quality weaknesses, as evidenced by the Management and Asset Quality rating "3" and composite rating "3" assigned at the three consecutive examinations between March 2005 and July 2006.

Despite the supervisory actions taken in 2005 and 2006, it does not appear that the provisions contained in the actions fully reflected and incorporated the extent of the examiner concerns and the elevated risk associated with growing the bank without the proper management and risk management practices in place. Given the benefit of hindsight and recognizing the challenges the bank may have faced as an MDI in terms of hiring and retaining qualified staff, a stronger supervisory posture may have been warranted to ensure such risks were adequately addressed. For example, the FDIC may have considered pursuing an MOU sooner with specific terms wherein the bank would agree to restrict growth until the Board and management could establish an acceptable risk management and internal control infrastructure, adequately address loan underwriting and credit administration deficiencies, and establish appropriate staffing levels to support the bank's growth and increasing risk profile.

Participation of the FDIC during the February 2007 examination

Examiners at the July 2006 examination noted that CCB's management performance and asset quality remained less than satisfactory, and that internal controls, including loan underwriting and administration, had remained deficient. Further, examiners noted that a substantial volume of loans not previously identified as adversely classified had deteriorated and became adversely classified, and that lending decisions continued to be made without the support of complete financial information and analysis. As a result, the FDIC assigned CCB a composite rating "3" – including Management and Asset Quality component ratings of "3" – and recommended that the bank's Board adopt a revised BBR given the continued deficiencies noted at the examination.

The FDIC did not participate in the subsequent examination conducted by DBF in February 2007. As a result of the bank's composite rating upgrade to a "2" at the February 2007 DBF examination, CCB's on-site examination schedule was subsequently expanded to an 18-month period, and the next examination commenced in December 2008. The time period between the July 2006 and December 2008 FDIC examinations represented approximately 2½ years in which the FDIC did not perform any on-site supervisory activities while CCB continued to execute its growth strategy and the loan portfolio had grown 32 percent to $228.1 million.

The Examination Manual states that alternate examinations between the FDIC and the state supervisory authority for composite 3-rated institutions, as was the case leading up to the February 2007 DBF examination at CCB, should only be accepted for stable and improving institutions if the composite rating is confirmed by offsite reviews and no adverse trends are noted from other available information. In the case of CCB, there were no offsite reviews triggered between the July 2006 and February 2007 examinations, and the FDIC's offsite monitoring program did not indicate the probability of a downgrade to a composite "3" rating during that timeframe.

However, in our view, it does not appear that the bank was in a stable or improving condition in advance of the February 2007 DBF examination based upon the sustained asset quality weaknesses, concerns regarding management oversight, and the less than satisfactory Management and composite ratings cited at the July 2006 FDIC examination coupled with the outstanding enforcement action. In retrospect, it may have been beneficial for the FDIC to have participated in the on-site examination in February 2007 to assess the bank's progress in addressing the outstanding BBR, weaknesses, and repeat recommendations from prior examinations.

Stronger or alternative supervisory action between 2010 and the bank's failure

As the bank's financial condition continued to deteriorate over time, the CEO's influential level of control over the bank appeared to become even stronger. As noted earlier in the report, the CEO's influence was evident in his involvement in nearly all aspects of bank operations as well as his impact on Board composition. Further, the bank's credit function remained deficient as management continued to originate and renew loans with questionable loan structures to borrowers that did not exhibit the capacity to repay the debt, failed to obtain collateral valuations that supported the underlying loan amounts, and did not adequately monitor the loan portfolio to recognize exposure and impairment in a timely manner. The FDIC issued guidance in June 2011 noting that the presence of a dominant official coupled with other risk factors such as ineffective internal controls, lack of Board independence or adequate oversight, and engaging in questionable or risky business strategies irrespective of financial performance are of concern and require enhanced supervision.

While the Consent Order that became effective in January 2010 contained provisions intended to help the bank address concerns regarding asset quality, credit administration, and Board and management oversight, CCB failed to fully comply with the requirements of the enforcement action for the 5 years that it was in place before the bank's ultimate failure. Notwithstanding the extent of ongoing weaknesses, apparent violations, and noncompliance with the provisions of the Consent Order, the FDIC left the Consent Order in place, unmodified, until the bank's failure. RMS Regional Office officials informed us that the enforcement action was not modified as it was their view that the 2010 Consent Order had contained provisions addressing the critical issues at the bank.

In retrospect, a stronger supervisory tenor may have been prudent to emphasize the increasing severity and supervisory risk in the bank's lending activities and operations that were not adequately addressed by CCB's Board and management. Such an approach could have included pursuing a revised Consent Order to require the addition of new and independent Board members to mitigate the risk associated with the CEO's dominant influence of the bank, and specific provisions and requirements to address the ongoing and repeated appraisal weaknesses and violations. Alternative enforcement action may have included requirements to replace or strengthen the executive management team sooner, albeit accomplishing such a requirement may have been difficult for an MDI in troubled condition, or the pursuit of a CMP in light of the ongoing noncompliance with the Consent Order, as well as the volume and severity of repeated apparent violations and contraventions of policy.[14] Further, in regards to the ongoing appraisal weaknesses and violations, performing targeted scope visitations or requiring detailed progress reports focusing on appraisal matters may have provided a greater level of assurance that the bank was adequately addressing appraisal weaknesses and recommendations.

[14] According to the Examination Manual, CMPs may be assessed for, among other things, the violation of any law or regulation and any final order or temporary order issues. CMPs are assessed not only to punish the violator according to the degree of culpability and severity of the violation, but also to deter future violations.

Objectives, Scope, and Methodology

Objectives

The performance audit objectives were to (1) determine the causes of CCB's failure and the resulting material loss to the DIF and (2) evaluate the FDIC's supervision of the bank, including the FDIC's implementation of the PCA provisions of section 38 of the FDI Act. We conducted our work from April 2015 through June 2015 in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives.

Scope and Methodology

The scope of the performance audit covered the period from the time of the January 2005 examination until the bank's failure on February 13, 2015. We also evaluated the regulatory supervision of the bank during the same time period.

To determine the causes of CCB's failure and the resulting material loss to the DIF, we reviewed relevant reports, correspondence, and other analyses prepared by RMS, DRR, and the State. For example, we reviewed examination reports and visitation reports or memos, UBPRs, and a supervisory history prepared by RMS. We also reviewed certain reports and analyses prepared by CCB and certain professional service firms. In addition, we interviewed current RMS officials and personnel from the Atlanta Regional Office, as well as State officials, to obtain their perspectives on the principal causes of CCB's failure. Further, we interviewed DRR officials and reviewed selected bank records maintained by DRR.

To evaluate the FDIC's supervision of CCB, including the implementation of PCA, we assessed whether the supervisory approach and actions taken with respect to the bank were commensurate with its risk profile and relevant regulations, policies, and guidelines. Specifically, we:

- researched various banking laws and regulations to understand the requirements that were relevant to CCB in the context of the issues that contributed to the bank's failure;

- identified and reviewed RMS policies and procedures, including the *Risk Management Manual of Examination Policies*, the *Formal and Informal Actions Procedures Manual*, and certain *Examination Modules* that were relevant to CCB and the supervisory actions taken with respect to the bank;

- analyzed examination reports and visitation documentation, as well as selected examination working papers, correspondence, and data maintained in ViSION and other information systems, to identify the timing and nature of supervisory actions taken to address risks at the bank;

- reviewed bank data, such as Call Reports and UBPRs for CCB;

- interviewed previous and current FDIC MDI regional coordinators and reviewed MDI policies and procedures, guidelines, and reports, to understand supervisory activities from the perspective of the MDI program of which CCB was a part;

- interviewed FDIC officials who had supervisory responsibility for CCB, most notably officials from the RMS Atlanta Regional Office, to obtain clarification and context regarding key supervisory activities and determinations; and

- contacted the Georgia Department of Banking and Finance officials to obtain their perspectives on the supervision of CCB.

We obtained data from various FDIC systems, but determined that information system controls were not significant to the audit objectives and, therefore, we did not evaluate the effectiveness of information system controls. We relied primarily upon hard-copy and electronic information provided by the FDIC OIG, RMS, and DRR as well as testimonial evidence provided during interviews. We did not perform specific audit procedures to assess the reliability of this information. In addition, we are aware that FDIC Circular 12000.1, *Cooperation with the Office of Inspector General*, dated October 1, 2013, requires that all FDIC employees, contractors, and subcontractors cooperate with the OIG in order for the OIG to carry out its statutory mandate. To that end, all employees, contractors, and subcontractors must provide authorized representatives of the OIG complete, prompt, and unrestricted access to all files, documents, premises, and employees, except as limited by law, including access to all Corporation, Receivership, contractor, and subcontractor personnel, facilities, equipment, hard copy and electronic records, information systems, and other sources of information available to any part of the FDIC when requested during the course of the OIG's official duties.

Regarding compliance with laws and regulations, we performed certain tests to determine whether the FDIC had complied with relevant PCA provisions in section 38 of the FDI Act. We also assessed compliance with aspects of the FDIC Rules and Regulations, including the examination frequency requirements defined in section 337.12. The results of our compliance tests are discussed in this report, where appropriate. Additionally, we assessed the risk of fraud and abuse in the context of our audit objectives in the course of evaluating audit evidence.

Related Coverage of Financial Institution Failures

On May 1, 2009, the OIG issued a memorandum that outlined major causes, trends, and common characteristics of FDIC-supervised financial institution failures that resulted in a material loss to the DIF. The memorandum indicated that the OIG planned to provide more comprehensive coverage of those issues and make related recommendations, when appropriate. Since the issuance of the memorandum, the OIG has issued additional MLR reports and these reports can be found at www.fdicig.gov. In addition, the OIG issued an audit report, entitled *Follow-up Audit of FDIC Supervision Program Enhancements* (Report No. MLR-11-010), in December 2010. The objectives of the audit were to (1) determine the actions that the FDIC has taken to enhance its supervision program since May 2009, including those in response to the May 2009 memorandum, and (2) identify trends and issues that have emerged from subsequent MLRs.

Further, the OIGs of the FDIC, the Department of the Treasury, and the Board of Governors of the Federal Reserve System issued an evaluation report in September 2011, entitled, *Evaluation of Prompt Regulatory Action Implementation* (Report No. EVAL-11-006), which assessed the role and Federal regulators' use of the Prompt Regulatory Action provisions of the FDI Act (section 38, *Prompt Corrective Action*, and section 39, *Standards for Safety and Soundness*) in the banking crisis. In addition, in October 2012, the FDIC OIG conducted a study entitled, *Acquisition, Development, and Construction Loan Concentration Study* (Report No. EVAL-13-001), that evaluated how certain banks with ADC loan concentrations survived the recent crisis and the supervisory actions taken for these institutions by the FDIC. The study identified factors that may help banks mitigate risks historically associated with ADC loan concentrations during periods of economic stress. The FDIC OIG also issued an evaluation report to the Congress, entitled *Comprehensive Study on the Impact of Failure of Insured Depository Institutions* (Report No. EVAL-13-002), in January 2013. This report addressed a number of topics relevant to institution failures, such as the evaluation and use of appraisals, the implementation of the FDIC's policy statement on CRE loan workouts, risk management enforcement actions, and examiner assessments of capital. Lastly, the FDIC issued on February 26, 2015 a study entitled *Minority Depository Institutions' Performance Throughout the Crisis*, which covered MDIs that failed between 2007 and 2015.

We considered each of the reports and the studies described above in planning and conducting our MLR of CCB.

Glossary of Key Terms

Term	Definition
Acquisition, Development, and Construction (ADC) Loans	ADC loans are a component of Commercial Real Estate that provide funding for acquiring and developing land for future construction and that provide interim financing for residential or commercial structures.
Adversely Classified Assets	Assets subject to criticism and/or comment in an examination report. Adversely classified assets are allocated on the basis of risk (lowest to highest) into three categories: Substandard, Doubtful, and Loss.
Allowance for Loan and Lease Losses (ALLL)	The ALLL is an estimate of uncollectible amounts that is used to reduce the book value of loans and leases to the amount that is expected to be collected. It is established in recognition that some loans in the institution's overall loan and lease portfolio will not be repaid. Boards of directors are responsible for ensuring that their institutions have controls in place to consistently determine the allowance in accordance with the institutions' stated policies and procedures, generally accepted accounting principles, and supervisory guidance.
Bank Board Resolution (BBR)	A BBR is an informal commitment adopted by a financial institution's Board (often at the request of the FDIC) that directs the institution's personnel to take corrective action regarding specific noted deficiencies. BBRs may also be used as a tool to strengthen and monitor the institution's progress with regard to a particular component rating or activity. The FDIC is not a party to these resolutions.
Brokered Deposits	Brokered deposit means any deposit that is obtained from or through the mediation or assistance of a deposit broker, which may include listing services. Brokered deposits usually exhibit highly volatile characteristics and often carry higher interest rates than alternative sources of funds.
Capitalization of Interest and Taxes	Unpaid accrued interest and taxes that are added to the outstanding principal loan balance.
Capital Restoration Plan (CRP)	Section 325.104(a)(1) of the FDIC Rules and Regulations requires a bank to file a written CRP with the appropriate FDIC Regional Director within 45 days of the date that the bank receives notice or is deemed to have notice that the bank is *Undercapitalized*, *Significantly Undercapitalized*, or *Critically Undercapitalized*, unless the FDIC notifies the bank in writing that the plan is to be filed within a different period. See also section 324.404 of the FDIC Rules and Regulations.

Term	Definition
Cease and Desist (C&D) or Consent Order	A formal enforcement action issued by financial institution regulators to a bank or affiliated party to stop an unsafe or unsound practice or violation. A C&D Order may be terminated by the regulators when they have determined that the bank's condition has significantly improved and the action is no longer needed or the bank has materially complied with its terms. A Consent Order is a C&D Order that has been stipulated to by the bank's Board. See section 8 of the FDI Act (12 USC § 1818).
Certificates of Deposit	Certificates of Deposit are a component of large deposits that are usually issued by a money center or large regional banks in denominations of $1 million or more and may be issued at face value with a stated rate of interest or at a discount similar to the U.S. Treasury bills.
Civil Money Penalty (CMP)	CMP is a fine or the payment of money to the U.S. Treasury by a respondent as punishment for his or her wrongdoing. It serves to create a disincentive for such conduct by others who hold positions of trust at insured depository institutions.
Commercial Real Estate (CRE) Loans	CRE loans are land development and construction loans (including 1-to-4 family residential and commercial construction loans) and other land loans. CRE loans also include loans secured by multifamily property and nonfarm nonresidential property, where the primary source of repayment is derived from rental income associated with the property or the proceeds of the sale, refinancing, or permanent financing of the property.
Community Reinvestment Act (CRA)	CRA requires the FDIC to assess an institution's record of helping to meet the credit needs of the local communities in which the institution is chartered.
Concentration	A concentration is a significantly large volume of economically related assets that an institution has advanced or committed to a certain industry, person, entity, geographic region, or affiliated group. Collectively, these assets may, in the aggregate, present a substantial risk to the safety and soundness of the institution. The FDIC Examination Manual defines concentrations as (1) an exposure to any industry, product line, or type of collateral representing more than 100 percent of Tier 1 Capital and (2) an exposure to an individual borrower or small interrelated group of individuals aggregating more than 25 percent of Tier 1 Capital.
Core Deposits	Core deposits are the sum of demand deposits, all Negotiable Order of Withdrawal and Automatic Transfer Service accounts, Money Market Deposit Account savings, other savings deposits, and time deposits under $100,000. Core deposits are generally stable, lower cost funding sources that typically lag behind other funding sources in the need for repricing during a period of rising interest rates. These deposits are typically funds of local

Term	Definition
	customers that also have a borrowing or other relationship with the institution.
Federal Home Loan Bank (FHLB) Borrowings	The FHLB System provides liquidity to member institutions that hold mortgages in their portfolios and facilitates the financing of mortgages by making low-cost loans, called advances or borrowings, to its members. Advances are available to members with a wide variety of terms to maturity, from overnight to long term, and are collateralized. Advances are designed to prevent any possible loss to FHLBs, which also have a super lien (a lien senior or superior to all current and future liens on a property or asset) when institutions fail. To protect their position, FHLBs have a claim on any of the additional eligible collateral in the failed bank.
Federal Reserve Act Section 23A and Section 23B	Section 23A and Section 23B of the Federal Reserve Act (12 USC §§ 371c and 371c-1) identify the restrictions on transactions with affiliates, which include the prohibition for a bank and its subsidiaries to purchase low-quality assets from an affiliate.
Federal Reserve Board Regulation O	Regulation O, as promulgated by the Federal Reserve Board under 12 Code of Federal Regulation part 215, covers Insider Transactions and states, among other things, that no member bank may extend credit to any insider of the bank or insider of its affiliates in an amount that, when aggregated with the amount of all other extensions of credit by the member bank to that person and to all related interests of that person, exceeds the lending limit of the member bank as specified in the regulation.
Global Cash Flow Analysis	A global cash flow analysis is a comprehensive evaluation of borrower capacity to repay a loan. During underwriting, proper global cash flow analysis 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, current and complete operating statements of all related entities, and future economic conditions. 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.
Internet Deposits	Internet deposits are deposits obtained through Internet listing services and are generally considered part of a bank's wholesale funding sources.
Leverage	Leverage refers to an institution's capital that is comprised of debt. Also referred to as borrowed capital.
Low- or Moderate-Income (LMI) Census Tract	LMI census tracts are areas with a median family income below 80 percent of the median family income for the metropolitan area in which it is located. "In or near an LMI census tract" means that

Term	Definition
	the branch is physically located in an LMI census tract or it is within one mile of an LMI census tract.
Material Loss	As defined by section 38(k)(2)(B) of the FDI Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, a material loss is any estimated loss (as further defined in section 38(k)(2)(A)) to the DIF in excess of $50 million for losses that occur on or after January 1, 2014.
Memorandum of Understanding (MOU)	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.
Minority Depository Institution (MDI)	MDI is defined as any Federally insured depository institution where 51 percent or more of the voting stock is owned by minority individuals. This includes institutions collectively owned by a group of minority individuals, such as a Native American Tribe. Ownership must be by U.S. citizens or permanent legal U.S. residents to be counted in determining minority ownership. In addition to the institutions that meet the ownership test, institutions will be considered MDIs if a majority of the Board of Directors is minority and the community that the institution serves is predominantly minority. MDIs often promote the economic viability of minority and under-served communities.
Net Non-Core Funding Ratio	Net Non-Core Funding Ratio is calculated as non-core liabilities less short term investments divided by long-term assets. This ratio is based on the premise that non-core liabilities are better suited to fund short-term investments rather than long-term assets.
Nonaccrual	The status of an asset, often a loan, which is not earning the contractual rate of interest in the loan agreement due to financial difficulties of the borrower. Typically, interest accruals have been suspended because full collection of principal is in doubt, or interest payments have not been made for a sustained period of time. Loans with principal and interest unpaid for at least 90 days are generally considered to be in a nonaccrual status.
Other Real Estate	Other real estate consists of real property held for reasons other than to conduct bank business. Banks usually acquire Other Real Estate through foreclosure after a borrower defaults on a loan secured by real estate.
Peer Group	Institutions are assigned to 1 of 15 peer groups based on asset size, number of branches, and whether the institution is located in a metropolitan or nonmetropolitan area.

Term	Definition
Prompt Corrective Action (PCA)	The purpose of PCA is to resolve the problems of insured depository institutions at the least possible long-term cost to the Deposit Insurance Fund. Part 325, subpart B, of the FDIC Rules and Regulations, 12 Code of Federal Regulations, section 325.101, et. seq., implements section 38, *Prompt Corrective Action*, of the FDI Act, 12 USC §1831o, by establishing a framework for determining capital adequacy and taking supervisory actions against depository institutions that are in an unsafe or unsound condition. The following terms are used to describe capital adequacy: (1) *Well Capitalized*, (2) *Adequately Capitalized*, (3) *Undercapitalized*, (4) *Significantly Undercapitalized*, and (5) *Critically Undercapitalized*. See also Part 324 of the FDIC Rules and Regulations. A PCA Directive is a formal enforcement action seeking corrective action or compliance with the PCA statute with respect to an institution that falls within any of the three categories of undercapitalized institutions.
Reports of Condition and Income (Call Report)	Consolidated Reports of Condition and Income, also known as Call Reports, are reports that are required to be filed by each insured depository institution pursuant to the FDI Act. These reports are used to calculate deposit insurance assessments and monitor the condition, performance, and risk profile of individual banks and the banking industry.
Stress Testing	Stress testing of loans is an analysis that attempts to simulate the reaction of the bank's loan portfolio to different financial situations. It is used to gauge how certain stress factors will affect the loans and the overall institution.
Tier 1 Capital	Defined in Part 325 of the FDIC Rules and Regulations, 12 Code of Federal Regulations, section 325.2(v), as **The sum of**: • Common stockholder's equity (common stock and related surplus, undivided profits, disclosed capital reserves, foreign currency translation adjustments, less net unrealized losses on available-for-sale securities with readily determinable market values); • Non-cumulative perpetual preferred stock; and • Minority interest in consolidated subsidiaries; **Minus:** • Certain intangible assets; • Identified losses; • Investments in securities subsidiaries subject to section 337.4; and • Deferred tax assets in excess of the limit set forth in section 325.5(g). See also Part 324 of the FDIC Rules and Regulations.

Term	Definition
Tier 1 Leverage Capital Ratio	This ratio is calculated as Tier 1 Leverage Capital divided by Average Total Assets to show the relationship between a bank's core capital and total assets.
Total Risk-Based Capital Ratio	Risk-Based Capital is a "supplemental" capital standard under Part 325 of the FDIC Rules and Regulations. Under the risk-based capital framework, a bank's qualifying total capital base consists of two types of capital elements, "core capital" (Tier 1) and "supplementary capital" (Tier 2). Part 325 Appendix A—*Statement of Policy on Risk-Based Capital*—defines the FDIC's risk-based capital rules. Appendix A states that an institution's balance sheet assets and credit equivalent amounts of off-balance sheet items are assigned to broad risk categories according to the obligor, or, if relevant, the guarantor or the nature of the collateral. The aggregate dollar amount in each category is then multiplied by the risk weight assigned to that category. The resulting weighted values from each of the four risk categories are added together, and this sum is the risk-weighted assets total that, as adjusted, comprises the denominator of the risk-based capital ratio. The institution's qualifying total capital base is the numerator of the ratio. See also Part 324 of the FDIC Rules and Regulations.
Troubled Asset Relief Program (TARP)	The Emergency Economic Stabilization Act of 2008 authorized the creation of the TARP to enable the Department of the Treasury to promote stability in financial markets through the purchase and guarantee of "troubled assets."
Uniform Bank Performance Report (UBPR)	The UBPR is an analysis of financial institution financial data and ratios that includes extensive comparisons to peer group performance. The report is produced by the Federal Financial Institutions Examination Council for the use of banking supervisors, bankers, and the general public and is produced quarterly from Call Report data submitted by banks.
Uniform Financial Institutions Rating System (UFIRS)	Financial institution regulators and examiners use the UFIRS to evaluate a bank's performance in six components represented by the CAMELS acronym: <u>C</u>apital adequacy, <u>A</u>sset quality, <u>M</u>anagement practices, <u>E</u>arnings performance, <u>L</u>iquidity position, and <u>S</u>ensitivity to market risk. Each component, and an overall composite, is assigned a rating of "1" through "5," with "1" having the least regulatory concern and "5" having the greatest concern.
Virtual Supervisory Information on the Net (ViSION)	ViSION is an FDIC information system that provides access to a broad range of information related to insured financial institutions in support of the Corporation's insurance and supervision programs. RMS personnel use the system to perform supervisory-related functions, such as tracking applications, accessing examination information, and monitoring enforcement actions. Analysts in the Division of Insurance and Research also rely on information in ViSION to perform insurance-related functions,

Term	Definition
	such as analyzing trends in the banking industry and calculating deposit insurance assessment rates for financial institutions.
Watch List	An asset on a bank's watch list has potential weaknesses that are not sufficient enough to warrant an adverse classification but deserve management's close attention. If left uncorrected, the potential weaknesses may result in the deterioration of the loan quality. Such assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. An asset on a watch list may also be referred to as special mention.

Acronyms and Abbreviations

ADC	Acquisition, Development and Construction
ALLL	Allowance for Loan and Lease Losses
BBR	Bank Board Resolution
C&D	Cease and Desist Order
CAMELS	Capital, Asset Quality, Management, Earnings, Liquidity, Sensitivity to Market Risk
CCB	Capitol City Bank & Trust Company, Atlanta, Georgia
CCO	Chief Credit Officer
CEO	Chief Executive Officer
CMP	Civil Money Penalty
COO	Chief Operations Officer
CRA	Community Reinvestment Act
CRE	Commercial Real Estate
CRO	Church and Religious Organization
CRP	Capital Restoration Plan
DBF	Georgia Department of Banking and Finance
DIF	Deposit Insurance Fund
DRR	Division of Resolutions and Receiverships
FDI	Federal Deposit Insurance
FDIC	Federal Deposit Insurance Corporation
FHLB	Federal Home Loan Bank
FIL	Financial Institution Letter
LMI	Low- or Moderate-Income
MDI	Minority Depository Institution
MLR	Material Loss Review
MOU	Memorandum of Understanding
OIG	Office of Inspector General
PCA	Prompt Corrective Action
RMS	Division of Risk Management Supervision
TARP	Troubled Asset Relief Program
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System
USC	United States Code
ViSION	Virtual Supervisory Information on the Net

Part II

Corporation Comments and OIG Evaluation

Corporation Comments and OIG Evaluation

Subsequent to the issuance of KPMG's draft report, RMS officials provided additional information for KPMG's consideration, and KPMG revised its report to reflect this information, as appropriate. In addition, on September 2, 2015, the Director, RMS, provided a written response, dated August 28, 2015, to a draft of KPMG's report. The response is provided in its entirety on page II-2.

In the response, the Director reiterated the causes of CCB's failure and the supervisory activities described in the report. As it relates to the supervisory lessons learned KPMG described in its report, the Director referenced guidance that was issued to FDIC-supervised institutions in 2008, which re-emphasized the importance of robust credit risk management practices for institutions with concentrated CRE exposures and set forth broad supervisory expectations. The Director also mentioned that RMS conducted examiner training initiatives in 2010, 2011, 2014, and 2015 emphasizing how the evaluation of bank management's risk management practices should be considered in the forward-looking supervision model.

In addition, we noted that the FDIC issued internal policy to its examiners in 2011 addressing the risk and supervisory expectations associated with dominant bank officials. Among other things, the internal policy reiterated to examiners that the presence of a dominant official coupled with other risk factors, such as ineffective internal controls, lack of Board independence or inadequate oversight, and engaging in questionable or risky business strategies irrespective of financial performance, are of concern and require enhanced supervision.

Corporation Comments

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

August 28, 2015

TO: Stephen M. Beard
Deputy Inspector General for Audits and Evaluations

FROM: Doreen R. Eberley /**Signed**/
Director

SUBJECT: Response to the Draft Audit Report Entitled, Material Loss Review of Capitol City Bank & Trust Company, Atlanta, GA (Assignment No. 2015-024)

Pursuant to Section 38(k) of the Federal Deposit Insurance Act, as amended by the Dodd Frank Wall Street Reform and Consumer Protection Act, the Federal Deposit Insurance Corporation's (FDIC) Office of Inspector General (OIG) conducted a Material Loss Review of Capitol City Bank & Trust Company, Atlanta, Georgia (CCB), which failed on February 13, 2015. This memorandum is the response of the Division of Risk Management Supervision (RMS) to the OIG's Draft Report (Report) received on July 30, 2015.

CCB failed primarily because the Board and management did not properly manage the risks associated with the bank's strategy of concentrated growth in high-risk commercial real estate (CRE) loans. Specifically, CCB's Board and management pursued a growth initiative without adequate staffing or the appropriate credit risk management and monitoring oversight needed to manage the additional risk, particularly in the lending function. The CRE concentration was not properly underwritten and monitored by management. As a result, at the end of 2007, when economic and real estate market conditions started to deteriorate, CCB's loan portfolio was negatively impacted.

The FDIC and Georgia Department of Banking and Finance conducted 10 on-site examinations and 6 visitations of CCB from March 2005 through the bank's failure in February 2015. In addition, the FDIC provided technical assistance to the bank in certain areas consistent with the requirement of the FDIC's Minority Depository Institution Program. The FDIC, through its supervisory efforts, identified risks in the bank's operations starting in 2005 and communicated these risks to the Board and management through examination and visitation reports, correspondence, and informal and formal enforcement actions.

RMS has recognized the threat that institutions with high risk profiles, such as CCB, pose to the Deposit Insurance Fund and has heightened its focus on forward-looking supervision to ensure that risks are mitigated before they lead to financial deterioration. In 2008, RMS issued to FDIC-supervised institutions a Financial Institution Letter (FIL) entitled, Managing Commercial Real Estate Concentrations in Challenging Environment. This FIL re-emphasizes the importance of robust credit risk management practices for institutions with concentrated CRE exposures and sets forth broad supervisory expectations. Additionally, RMS has conducted examiner training initiatives in 2010, 2011, 2014, and 2015, emphasizing how the evaluation of bank management's risk management practices should be considered in the forward-looking supervision model.

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