Failed Bank Review

Almena State Bank | Almena, Kansas

March 2021 **FBR-21-003**

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Federal Deposit Insurance Corporation
Office of Inspector General
Office of Program Audits and Evaluations

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Memorandum To: Doreen R. Eberley
Director, Division of Risk Management Supervision

/Signed/
From: Terry L. Gibson
Assistant Inspector General for Program Audits and Evaluations

Subject: **Failed Bank Review Memorandum** | Almena State Bank | Almena, Kansas | FBR-21-003 |

Background

On October 23, 2020, the Kansas Office of the State Bank Commissioner (OSBC) closed Almena State Bank (ASB) and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver. To protect depositors, the FDIC entered into a purchase and assumption agreement with Equity Bank of Andover, Kansas, to assume all of ASB's deposits. ASB was a state-chartered, nonmember bank that the FDIC insured in 1936. The bank operated two offices in Almena and Norton, Kansas. ASB was wholly owned by Almena Investments, LLC, a one-bank holding company. Former Chairman of the Board of Directors (Board), Shad Chandler, and his wife, Director Amy Chandler, jointly controlled 59 percent of the outstanding shares of the bank.

According to the FDIC's Division of Finance, the estimated loss to the Deposit Insurance Fund (DIF) was $18 million or 27 percent of the bank's $69 million in total assets. The OSBC took possession and closed ASB, because it was considered to be "critically undercapitalized,"[1] lacked a plan to restore capital, and operated in an unsafe and unsound manner.[2]

This Memorandum examines whether the subject bank failure warrants an In-Depth Review.[3]

[1] A bank is "critically undercapitalized" when the ratio of its capital to total assets is equal to or less than 2.0 percent. Kan. Stat. Ann. § 9-1902a (2015).
[2] According to the Kansas State Banking Code, the Commissioner may take charge of a critically undercapitalized bank and all its property and assets. The Commissioner may appoint a receiver if the bank cannot sufficiently recapitalize, resume business or liquidate the bank's indebtedness to the satisfaction of the depositors and creditors of the bank. Kan. Stat. Ann. § 9-1903 (2015).
[3] When the DIF incurs a loss under $50 million, Section 38(k)(5) of the Federal Deposit Insurance Act requires the Inspector General of the appropriate federal banking agency to determine the grounds identified by the state or federal banking agency for appointing the FDIC as receiver and whether any unusual circumstances exist that might warrant an In-Depth Review of the loss. Federal Deposit Insurance Act (FDI Act), 12 U.S.C. § 1831*o*(k)(5).

In conducting this Failed Bank Review, we assessed key documents related to the bank's failure, including the Division of Risk Management Supervision's (RMS) Supervisory History, the Division of Resolutions and Receiverships' (DRR) Failing Bank Case, and examination and visitation reports dated 2016, 2017, 2018, 2019 and 2020.[4]

Causes of Failure

Based on our review of FDIC documents, ASB's failure occurred because of a Board that did not provide adequate corporate governance or management oversight. The Board's performance and management were considered to be critically deficient.[5] Chairman Chandler was considered by examiners to be a "dominant official"[6] and substantially influenced the bank's policies and practices. According to FDIC examiners, in 2014 and thereafter, Chairman Chandler led an aggressive growth strategy that focused on originating large government guaranteed loans, largely funded through liquid assets and higher cost, wholesale funds. Examiners also found the Board and bank management, however, lacked the requisite skills and experience to ensure appropriate loan underwriting and credit administration, and sufficient levels of liquidity and capital. As a result, beginning in 2018, ASB experienced significant asset quality problems, eroding the bank's capital and threatening its continued viability.

FDIC Supervision

Beginning in 2014, bank management implemented a strategy to expand its loan portfolio by originating large-dollar guaranteed loans issued by the Small Business Administration (SBA) and Farm Service Agency of the U.S. Department of Agriculture. Thereafter, ASB sold the guaranteed portions after closing on the loans. In 2016 and 2017, the FDIC examiners alerted ASB management to the increased risk associated with originating Federal government-guaranteed loans and the need to meet all requirements to ensure government guaranty.[7] The examination report in 2016 included Matters Requiring Board Attention[8] (MRBA) recommending that the Board expand the bank's loan policy to include specific guidelines for its government-guaranteed lending program.

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[4] This review does not constitute an audit conducted in accordance with Generally Accepted Government Auditing Standards.
[5] Under the Uniform Financial Institutions Rating System, a bank is assigned a rating on six essential components, including "Management". In 2018 and 2019, the FDIC rated ASB's "Management" component a "5" indicating a critically deficient Board and management that had not demonstrated the ability to correct problems and implement appropriate risk management practices. This rating required the bank to replace or strengthen management or the Board.
[6] According to RMS Examination Manual Section 4.1 *Management* (April 2018), "[a] dominant official or policymaker is defined as an individual, or group of persons with close business dealings or otherwise acting together, that exerts an influential level of control or policymaking authority. The definition applies regardless of whether the individual or individuals involved have an executive officer title or receive compensation from the bank. The term is commonly used to describe situations where the institution's principal officer or shareholder dominates virtually all phases of the bank's policies and operations."
[7] A government guaranty is contingent upon bank officials fulfilling all program requirements. For example, bank officials must complete the guaranteed loan documents accurately. Bank officials must also disburse, close, and service the loans in compliance with the requirements, or the government agency could reduce a portion or all of its guaranty reimbursement in the event of a claim.
[8] MRBA is defined as an issue or risk of significant importance that requires the Board's attention.

Over the next four examination and visitation cycles, examiners identified significant deterioration in ASB's assets, liquidity, and earnings and downgraded the bank to a composite "4" rating in 2018 and a composite "5" rating in 2019.[9] In 2018 and 2019, the FDIC issued additional MRBAs related to management, liquidity, asset quality, loan underwriting and administration, capital, and earnings. Examiners noted that the bank's rapid growth, coupled with numerous objectionable and hazardous lending practices directly contributed to its deficient position.

Because of the examination findings, the FDIC and OSBC issued a Consent Order on April 5, 2019. ASB failed to comply with many provisions of the Consent Order, including the development and implementation of capital and liquidity restoration plans. Further, the bank became *Undercapitalized*[10] in May 2019 and *Critically Undercapitalized* in July 2020. The Board was unable to remediate the bank's deficient capital condition.

OIG Analysis

When conducting Failed Bank Reviews, the OIG considers a series of factors to determine whether unusual circumstances warrant further review. These factors include: (1) the magnitude and significance of the loss to the DIF in relation to the total assets of the failed institution; (2) the extent to which the FDIC's supervision identified and effectively addressed the issues that led to the bank's failure or the loss to the DIF; (3) indicators of fraudulent activity that significantly contributed to the loss to the DIF; and (4) other relevant conditions or circumstances that significantly contributed to the bank's failure or the loss to the DIF. If, during the course of our review, we learn about fraudulent activity at the failed bank, it is our practice to refer the matter to investigators for consideration and potential action. In addition, where we identify significant programmatic weaknesses in the FDIC's supervision, we will determine if there is a need for follow-up work and the appropriate course of action.

With respect to the first factor, the loss to the DIF in relation to ASB's total assets was 27 percent, which is similar to the average losses to the DIF of other recent failures. We did not find this loss to be of sufficient magnitude or significance to warrant an In-Depth Review. With respect to the second factor, we found that the FDIC's supervision identified and effectively addressed the issues that led to the bank's failure and the loss to the DIF. With respect to the third factor, we did not identify indicators of fraudulent activity that significantly contributed to the loss amount. With respect to the fourth factor, we did not identify other relevant conditions or circumstances that significantly contributed to the bank's failure or the loss to the DIF.

[9] Financial institution regulators evaluate a bank's performance in six components represented by the CAMELS acronym: **C**apital adequacy, **A**sset quality, **M**anagement capabilities, **E**arnings sufficiency, **L**iquidity position, and **S**ensitivity to market risk. Examiners assign each CAMELS component and an overall, composite score, a rating of "1" (strong) through "5" (critically deficient), with "1" having the least supervisory concern and "5" having the greatest concern.

[10] The FDIC's rules and regulations specify five capital categories for banks ranging from Well Capitalized to Critically Undercapitalized. 12 C.F.R. §324.403.

Conclusion

ASB experienced longstanding capital and asset quality issues resulting from the aggressive growth strategy that management implemented in 2014. It launched this growth strategy without sufficient experience, and coupled with hazardous lending practices and inadequate Board oversight, this strategy resulted in the bank's deterioration. ASB's Board and management failed to comply with the Consent Order and were unable to improve the bank's safety and soundness. Furthermore, ASB was unable to remediate its deficient capital condition resulting in its failure.

Based on our review, we did not find unusual circumstances that would warrant an In-Depth Review of the loss.