Office of Inspector General

Office of Material Loss Reviews
Report No. IDR-10-002

In-Depth Review of the Failure of Columbia River Bank, The Dalles, Oregon

September 2010

Office of Inspector General

Executive Summary

In-Depth Review of the Failure of Columbia River Bank, The Dalles, Oregon

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Why We Did The Audit

The FDIC Office of Inspector General (OIG) contracted with KMPG LLP (KPMG) to conduct a material loss review (MLR) of Columbia River Bank (CRB), The Dalles, Oregon.

On January 22, 2010, the Oregon Division of Finance and Corporate Securities (DFCS) closed CRB and named the FDIC as receiver. On March 1, 2010, the FDIC notified the OIG that CRB's total assets at closing were $947.3 million and the estimated loss to the Deposit Insurance Fund (DIF) was $161.1 million. As of August 6, 2010, the estimated loss to the DIF had decreased to $144.9 million.

On July 21, 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (Financial Reform Act). The Financial Reform Act amends section 38(k) of the Federal Deposit Insurance Act (FDI Act) by increasing the MLR threshold from $25 million to $200 million for losses that occur for the period January 1, 2010 through December 31, 2011. Further, the Financial Reform Act calls for the OIG to perform in-depth reviews of failures when the associated losses are not material but they involve unusual circumstances. At the time the Financial Reform Act was enacted, KPMG's fieldwork and a draft of this report were substantially complete. As a result, although the estimated loss for CRB no longer met the threshold requiring an MLR, the OIG decided to have KPMG complete the audit as an in-depth review and issue this report.

Consistent with both Acts, the objectives of this review were to (1) determine the causes of CRB's failure and the resulting loss to the DIF and (2) evaluate the FDIC's supervision of CRB, including the FDIC's implementation of the PCA provisions of section 38 of the FDI Act.

Background

CRB was a state nonmember bank that became insured on June 6, 1977. The bank was one of the largest community banks in the Northwest region with 22 branches serving 18 markets. CRB was a wholly-owned subsidiary of Columbia Bancorp, a publicly-traded corporation headquartered in The Dalles, Oregon. Since its inception, CRB pursued a traditional community bank business plan. However, between 2004 and 2008, CRB management shifted its focus to commercial real estate (CRE), in particular acquisition, development, and construction (ADC) residential projects in the Bend and Portland, Oregon regions and Vancouver, Washington area. The bank historically relied on core deposits but to fund asset growth became more dependent on brokered deposits.

Audit Results

Causes of Failure and Loss

CRB's failure can be attributed to the Board's and management's growth strategy, which included expansion into new geographic areas that led to high CRE and, in particular, ADC loan concentrations, coupled with management's and the Board's failure to establish appropriate practices to mitigate the corresponding concentration risk. Poor loan underwriting and weak credit administration practices contributed to the precipitous deterioration in asset quality when the economy began to decline. Management and the Board were slow to recognize the need to adjust the bank's strategy in response to the real estate downturn. Ultimately, the DFCS closed CRB after determining the bank was not viable due to deteriorating asset quality, poor earnings, and inadequate capital.

The FDIC's Supervision of CRB

The FDIC's and the DFCS' examinations and a visitation of CRB identified key risks, including credit administration weaknesses, inadequate loan underwriting, and high CRE and ADC loan concentrations, all of which eventually contributed to the bank's failure. The examinations were conducted according to the statutory schedule, and the FDIC and the DFCS pursued a formal supervisory action in 2009 as the bank's financial condition deteriorated. Additionally, the FDIC's offsite review system flagged CRB for review, but the timing was such that it did not materially impact the supervisory strategy.

Due to adverse changes in the real estate markets in 2007, and the combination of CRB's risk management weaknesses and a high ADC loan concentration, the financial condition of the bank had significantly deteriorated by the August 2008 examination. In retrospect, the regulators may have benefited from a more forward-looking approach to addressing the 2007 examination findings and overall risk profile of CRB at that time. Doing so may have involved greater emphasis on management practices in assigning the Management and Asset Quality ratings and closer monitoring of CRB following the examination.

The DFCS did not disagree with our overall findings and conclusions but provided additional perspective about information they considered when assigning CRB's Asset Quality rating at the 2007 examination. According to the DFCS, examiner analysis of key financial ratios and CRE and ADC concentrations based on March 2007 data showed that CRB compared favorably to its peers, particularly at the regional level. Further, DFCS officials noted that while the economy was showing signs of a slight decline during the 2007 examination, the steep decline that ensued was not projected at that time.

With respect to PCA, based on the supervisory actions taken, the FDIC properly implemented applicable PCA provisions of section 38 in a timely manner. CRB was unsuccessful in raising needed capital and the bank was subsequently closed on January 22, 2010.

Management Response

On August 18, 2010, the Director, Division of Supervision and Consumer Protection (DSC), provided a written response to the draft report. That response is provided in its entirety on page II-2 of this report.

DSC reiterated the OIG's conclusions regarding the causes of CRB's failure and the FDIC's supervision of the bank. With regard to the FDIC's supervision of CRB, DSC summarized the supervisory history described in the report. Further, DSC stated that strong supervisory attention is necessary for institutions with high CRE and ADC concentrations, such as CRB, and has issued updated guidance reminding examiners to take appropriate action when those risks are imprudently managed.

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

Office of Material Loss Reviews
Office of Inspector General

DATE: September 1, 2010

MEMORANDUM TO: Sandra L. Thompson, Director
Division of Supervision and Consumer Protection

/Signed/

FROM: Stephen M. Beard
Assistant Inspector General for Material Loss Reviews

SUBJECT: *In-Depth Review of the Failure of Columbia River Bank, The Dalles, Oregon* (Report No. IDR-10-002)

The subject final report is provided for your information and use. Please refer to the Executive Summary, included in the report, for the overall audit results. The report did not contain recommendations, thus a response was not required. However, the Division of Supervision and Consumer Protection provided a written response on August 18, 2010. We incorporated the response into the final report.

If you have questions concerning the report, please contact me at (703) 562-6352 or Mary Carmichael, Audit Manager, at (703) 562-6360. We appreciate the courtesies extended to the Office of Inspector General staff.

Attachment

cc: Stan Ivie, Regional Director, DSC
Elaine D. Drapeau, Acting Chief, Office of Internal Control and Review, DSC
James H. Angel, Jr., Director, OERM

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Part I

Report by KPMG LLP

In-Depth Review of the Failure of Columbia River Bank The Dalles, Oregon

Prepared for the
Federal Deposit Insurance Corporation
Office of Inspector General

August 31, 2010

KPMG LLP
2001 M Street, NW
Washington, DC

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2001 M Street, NW
Washington, DC 20036-3389

August 31, 2010

Executive Summary

Stephen M. Beard
Assistant Inspector General for Material Loss Reviews
Federal Deposit Insurance Corporation
3501 North Fairfax Drive
Arlington, VA 22226

In-Depth Review Report of the Failure of Columbia River Bank, The Dalles, Oregon

Dear Mr. Beard:

This is our performance audit report on the results of the In-Depth Review of the Failure of Columbia River Bank (CRB), The Dalles, Oregon. This assignment was initiated as a Material Loss Review (MLR). However, on July 21, 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (Financial Reform Act), which amends section 38(k) of the Federal Deposit Insurance Act (FDI Act). The Financial Reform Act increases the MLR threshold from $25 million to $200 million for losses that occur for the period January 1, 2010 through December 31, 2011. Further, the Financial Reform Act calls for the Office of Inspector General (OIG) to perform in-depth reviews of failures when the associated losses are not material but they involve unusual circumstances. In-depth reviews are required to be performed and reported in a manner consistent with that of an MLR.

At the time the Financial Reform Act was enacted, fieldwork and the draft report were substantially complete. As a result, although the estimated loss for CRB is less than the new MLR threshold, the OIG determined that we should complete the audit as an in-depth review and issue this report.

Consistent with both Acts, the objectives of this performance audit were to (1) determine the causes of CRB's failure and the resulting loss to the Deposit Insurance Fund (DIF) and (2) evaluate the FDIC's supervision of CRB, including the FDIC's implementation of the Prompt Corrective Action (PCA) provisions of section 38 of the FDI Act.

Causes of Failure

CRB's failure can be attributed to the Board's and management's growth strategy, including expansion into new geographic areas that led to high Commercial Real Estate (CRE) and, in particular, Acquisition, Development, and Construction (ADC) loan concentrations. Further, management and the Board failed to establish appropriate practices to mitigate the corresponding risk. Poor loan underwriting and weak credit administration practices contributed to the precipitous deterioration in asset quality when the economy began to decline. In addition, management and the Board were slow to recognize the need to adjust the bank's strategy in response to the real estate downturn.

Evaluation of Supervision

Through its supervisory efforts, the FDIC identified key risks in CRB's management practices and operations and brought these risks to the attention of the institution's Board and management team through regular discussions and correspondence, examination reports, a visitation, and formal supervisory actions. Regulators conducted four onsite examinations since May 2006 and one visitation in May 2009.

Due to adverse changes in the real estate markets in 2007, and the combination of CRB's risk management weaknesses and a high ADC loan concentration, the financial condition of the bank had significantly deteriorated by the August 2008 examination. In retrospect, the regulators may have benefited from a more forward-looking approach to addressing the 2007 examination findings and overall risk profile of CRB at that time. Doing so may have involved greater emphasis on management practices in assigning the Management and Asset Quality ratings and closer monitoring of CRB following the examination.

Section 38 of the FDI Act, *Prompt Corrective Action,* establishes a framework of mandatory and discretionary supervisory actions pertaining to all insured depository institutions. Based on the supervisory actions taken with respect to CRB, the FDIC properly implemented applicable PCA provisions of section 38.

We conducted our performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS). These standards require that we plan and perform 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 from April through June 2010.

Very truly yours,

KPMG LLP

Background

On January 22, 2010, the Oregon Division of Finance and Corporate Securities (DFCS) closed Columbia River Bank (CRB) and named the FDIC as receiver. On March 1, 2010, the FDIC notified the Office of Inspector General (OIG) that CRB's total assets at closing were $947.3 million and the estimated loss to the Deposit Insurance Fund (DIF) was $161.1 million. As of August 6, 2010, the estimated loss to the DIF had decreased to $144.9 million.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Financial Reform Act) amends section 38(k) of the Federal Deposit Insurance Act (FDI Act) by increasing the Material Loss Review (MLR) threshold from $25 million to $200 million for losses that occur for the period January 1, 2010 through December 31, 2011. In addition, the Financial Reform Act calls for the OIG to perform in-depth reviews of failures when the associated losses are not material but they involve unusual circumstances. In-depth reviews are required to be performed and reported in a manner consistent with that of an MLR. The OIG had initially retained KPMG LLP (KPMG) to perform an MLR of CRB. At the time the Financial Reform Act was enacted, our fieldwork and draft report were substantially completed. As a result, although the estimated loss for CRB no longer met the threshold requiring an MLR, the OIG determined that KPMG should complete the audit as an in-depth review and issue this report.[1]

CRB was a state nonmember bank that became insured on June 6, 1977. The bank was one of the largest community banks in the northwest region with 22 branches serving 18 markets. CRB was a wholly-owned subsidiary of Columbia Bancorp, a publicly-traded corporation headquartered in The Dalles, Oregon.

Since its inception, CRB had pursued a traditional community bank business plan. However, between 2004 and 2008, CRB management shifted its focus to Commercial Real Estate (CRE) loan growth, particularly in Acquisition, Development and Construction (ADC) residential projects in the Bend and Portland, Oregon and Vancouver, Washington regions. To fund its operations, the bank historically relied on core deposits. However, from 2006 to 2008, asset growth became more dependent on brokered deposits.

Table 1 provides details on CRB's financial condition as of December 31, 2009, and for the 3 preceding calendar years.

[1] In conducting this performance audit and preparing this report, KPMG relied primarily on information provided by the FDIC OIG and the Division of Supervision and Consumer Protection (DSC). Appendix I, Objectives, Scope, and Methodology, describes in greater detail the procedures used by KPMG.

Table 1: Financial Condition of CRB

Financial Data	12/31/2009	12/31/2008	12/31/2007	12/31/2006
Total Assets ($000s)	$955,112	$1,121,497	$1,042,412	$1,033,239
Total Loans ($000s)	$678,326	$863,442	$869,866	$804,477
Total CRE loans ($000s)	$396,411	$466,951	$527,045	$538,946
Loan Growth	-21.21%	-3.22%	8.10%	18.56%
Total Deposits ($000s)	$908,132	$1,004,548	$928,067	$862,465
Brokered Deposits/Total Liabilities	6%	22%	16%	10%
Tier 1 Leverage Capital Ratio	2.34%	6.29%	9.26%	8.95%
Total Risk-Based Capital Ratio	4.46%	8.75%	11.23%	10.89%
Asset Growth	-14.84%	7.59%	0.89%	22.88%
PD+NA[1] Loans/Gross Loans	14.66%	10.69%	1.17%	0.61%
Return on Average Assets	-4.69%	-2.34%	1.57%	1.96%
Real Estate Loans/Total Assets	52.91%	57.38%	63.04%	54.96%
ADC Loans/Total Capital	479.63%	303.84%	279.06%	225.17%
Total CRE Loans/Total Capital	1,181.57%	604.34%	508.02%	496.39%

[1] Past Due & Nonaccrual
Source: Uniform Bank Performance Report (UBPR) for CRB, December 31, 2009 and DSC's Supervisory History.

Causes of Failure and Loss

CRB's failure can be attributed to the Board's and management's growth strategy, including expansion into new geographic areas that led to high CRE and, in particular, ADC loan concentrations, coupled with management's and the Board's failure to establish appropriate practices to mitigate the corresponding risk. Poor loan underwriting and weak credit administration practices contributed to the precipitous deterioration in asset quality when the economy began to decline. Management and the Board were slow to recognize the need to adjust the bank's strategy in response to the real estate downturn.[2] Ultimately, the DFCS closed CRB after determining the bank was not viable due to deteriorating asset quality, poor earnings, and inadequate capital.

Growth Strategy

Management's risk appetite relating to growth in ADC lending contributed to the deterioration of the bank's financial condition. Management positioned the institution for aggressive growth without appropriate standards and risk management practices for real estate concentrations and funding strategies. Specifically, CRB pursued an aggressive growth strategy starting in the 2004-2006 timeframe, which included expanding the bank's presence into the Vancouver, Washington area. In addition, at the same time, the bank was continuing its expansion into the ADC residential lending business.

[2] Office of Federal Housing Enterprise Oversight Home Price Index for the metropolitan statistical area of Bend, Oregon fell by approximately 36.6 percent from the fourth quarter of 2006 through the fourth quarter of 2009.

In June 2006, management submitted a transition plan to relocate Columbia Bancorp's headquarters to Vancouver, Washington for the Board's approval. The plan stated that if CRB was to continue as an independent community bank, it was a good time to consider relocating Columbia Bancorp to Vancouver, Washington, as the company's financial performance was strong and markets in that area were growing. According to the plan, the timeline included signing a lease for a building on June 30, 2006, recruiting and hiring employees in July 2006, and having Executive Vice Presidents relocate to Vancouver and report to work in August 2006.

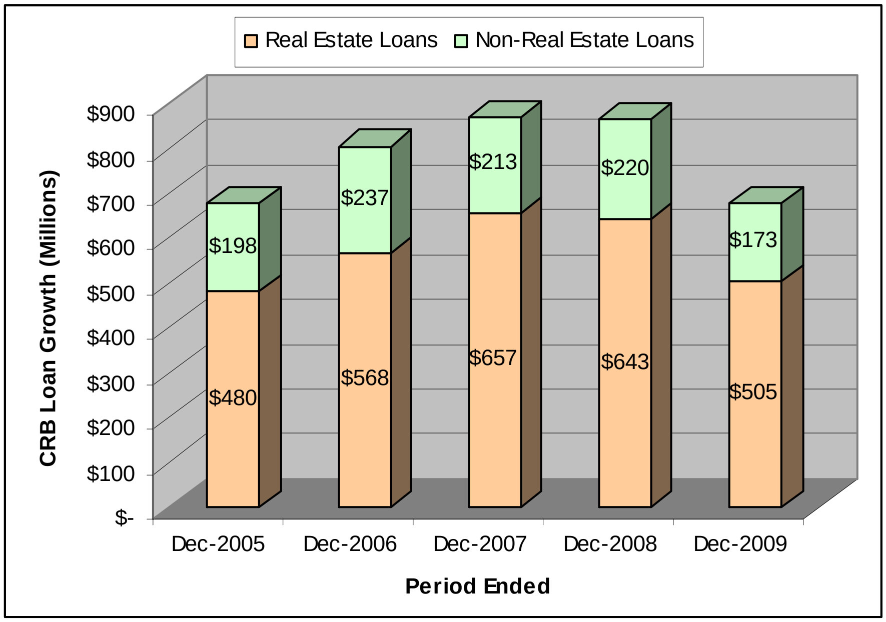
Examiners noted during the 2007 examination that overhead expenses were high due to added personnel, occupancy, and other costs associated with operating an extensive branch system. For the first half of 2008, the non-interest expense ratio was 3.84 percent versus the peer group[3] average of 2.74 percent. Although the Board approved the transition plan and incurred expenses associated with implementing the plan, Columbia Bancorp's move to Vancouver was not completed by the time the bank closed in January 2010.

The August 2008 Report of Examination (ROE) noted that to meet ADC loan demand, a sales culture was promoted and lending specialists with significant industry contacts were hired to meet loan growth expectations. Growth goals were met and the resulting loan portfolio became concentrated in CRE loans targeted towards ADC. These goals, as well as the sales culture, did not properly address risk and long-term performance. Management's risk appetite relating to growth in ADC lending and wholesale funding had resulted in a high-risk institution that the management team had failed to supervise in an adequate manner.

Figure 1 provides details on CRB's loan growth as of December 2009, and for the 4 preceding calendar years.

[3] The peer group for CRB consisted of all insured commercial banks having assets between $1 billion and $3 billion.

Figure 1: Loan Growth at CRB



Source: UBPR for CRB as of December 31, 2009.

Examiners noted during the August 2008 examination that management had positioned the institution for aggressive growth without appropriate consideration of the risks associated with real estate concentrations and funding strategies. Examiners indicated that over the previous 5 years the institution had approximately doubled in size and the most recent strategic plan suggested an ongoing 10 percent annual growth rate.

<u>Loan Concentrations</u>

CRB's concentrations in CRE and ADC lending were excessive compared to its peers and to the thresholds established by regulatory guidelines. This lending made the bank particularly vulnerable to a downturn in the real estate market, and was a major factor contributing to the bank's failure in 2010.

Interagency guidance titled *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* (Joint Guidance), issued on December 12, 2006, established levels of concentrations that may warrant further supervisory analysis. The Joint Guidance states as follows:

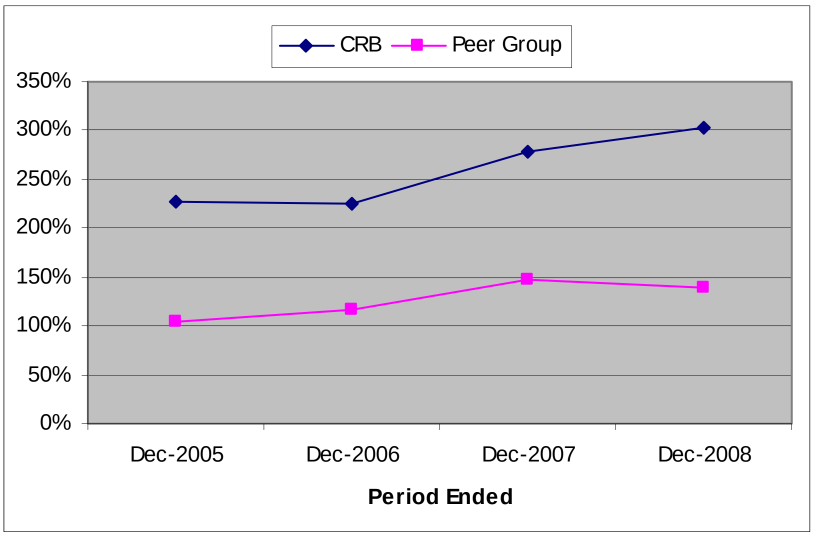
> "An institution that has experienced rapid growth in CRE lending, has notable exposure to a specific type of CRE, or is approaching or exceeds the following supervisory criteria may be identified for further supervisory analysis of the level and nature of its CRE concentration risk:
>
> - Total reported loans for construction, land development, and other land represent 100 percent or more of the institution's total capital; or

- Total commercial real estate loans as defined in this guidance represent 300 percent or more of the institution's total capital, and the outstanding balance of the institution's commercial real estate portfolio has increased by 50 percent or more during the prior 36 months."

At the March 2006 examination, the bank's concentration in ADC lending was $256 million, or 212 percent of Total Capital. According to the October 2009 examination, CRB's ADC concentration had exceeded 275 percent of Total Capital since March 31, 2007.

Figure 2 represents ADC concentration levels from 2005 to 2008 for CRB compared to its peer group.

Figure 2: ADC Loans as a Percentage of Total Capital Compared to Peer Group



Source: UBPR for CRB.
The ADC concentration level for 2009 was excluded as the percentage was inflated due to diminishing capital.

The August 2008 examination revealed that the rapid deterioration in the bank's asset quality was due to the level of residential ADC exposure that the bank had booked over the last several years. ADC loans represented 276 percent and 399 percent of Total Capital as of June 2008 and June 2009, respectively. In addition, CRE loans represented 523 percent and 843 percent of Total Capital as of June 2008 and June 2009, respectively, which exceeded the thresholds regulators established in the December 2006 Joint Guidance to identify institutions that may warrant further supervisory attention.

The October 2009 examination noted that the bank had a high concentration in ADC lending and speculative residential construction loans, particularly in the Central Oregon and metropolitan Portland, Oregon markets (including Vancouver, Washington). This high level of concentration exposed the bank to significant risk as the real estate market conditions continued to deteriorate. The risk exposure continued despite a large number of charge-offs and the transferring of assets to Other Real Estate Owned (OREO). In that regard, the bank's aggregate CRE concentration only dropped from 640 percent to 605 percent of Total Capital after the charge-offs and asset transfers.

Wholesale Funding. Although CRB's increased dependence on brokered deposits was not a primary contributor to the failure of the bank, it served to enable the aggressive loan growth pursued by management. Specifically, between 2006 and 2008, the growth in lower-cost retail deposits lagged the loan growth rate. As a result, management had to increasingly rely on brokered deposits, certificates of deposit (CD), and advances from the Federal Home Loan Bank (FHLB) to make up the funding shortfall. Most significantly, brokered deposits represented 23.42 percent of total deposits as of December 31, 2008, compared to 10.54 percent 2 years earlier.

Management and Board Oversight

Inadequate oversight by CRB's Board and management was also a significant factor in the bank's failure. CRB's management and Board failed to properly identify, measure, monitor, control, and mitigate growing risks associated with the highly concentrated CRE and ADC loan portfolio. In addition, management turnover occurred during a critical period, affecting management's response to the real estate downturn in 2007.

Identify, Measure, Monitor, Control, and Mitigate Credit Risks

CRB's management was considered satisfactory during the May 2006 examination. However, examiners encouraged management to continue its efforts to develop a uniform program of cash flow analysis and an effective loan file review process. In response to the examination findings, senior officials at the bank stated in a letter dated August 18, 2006 that they would continue to work with their staff and the Audit Department to enhance their internal process of monitoring and controlling CRE concentrations. In addition, the letter stated that the Board would continue to establish risk thresholds on concentrations for control purposes.

Examiners considered procedures for monitoring loan concentrations to be satisfactory during the July 2007 examination. Loans were monitored by type, branch, and geographic regions and it was noted that management reports provided sufficient information for the monitoring of concentrations within the various segments of the loan portfolio. However, examiners determined that management had not yet developed an effective process for monitoring the bank's exposure to ADC projects, particularly speculative construction loans.[4]

During the August 2008 examination, examiners noted that despite the deterioration in relevant markets, which should have been evident since at least early 2007, there was little transactional evidence that management began to take meaningful steps to curtail the ADC exposure until March 2008. In fact, concentration risk limits for residential ADC lending were increased in April 2007. Examiners noted that management's inability

[4] Speculative construction loans are loans that are not accompanied by meaningful pre-sale, pre-lease, or take-out commitments.

to respond in a timely and effective manner to deteriorating economic conditions was one of the causes for the bank's critical state at the time.

In an attempt to curtail the effects of the real estate downturn, management issued a moratorium on ADC lending in a series of communications to the bank's loan officers beginning in July 2008. Additionally, the Board lowered the internal policy limits for various CRE segments in May 2009 in an effort to lower the loan portfolio risk level. However, these positive measures proved to be too late to diminish the effects of the real estate downturn.

Management Turnover

The August 2008 ROE noted that a key factor affecting the delay in responding to the real estate downturn was the lack of executive management focus, as key senior official positions were in states of transition because of the plan to move Columbia Bancorp's headquarters to Vancouver. For example, during this period, the Chief Accounting Officer served as de facto Chief Financial Officer, in addition to facilitating and overseeing the transition to Vancouver. Examiners noted a lack of executive attention to compel the Board to shift the bank's focus from a production mode to protecting the bank's assets as the real estate markets started to deteriorate in 2007.

The August 2008 ROE also noted that the Chief Credit Officer (CCO) resigned in September 2007 to seek employment elsewhere. The Board hired a replacement in March of 2008. Despite the relatively short period during which the position was not filled, the impact of the vacancy was significant because the real estate markets were experiencing unprecedented property value declines and CRB did not have a CCO in place to manage the growing risks.

Loan Underwriting

Weak loan underwriting was a frequent concern noted by examiners. CRB's failure to correct weaknesses in loan underwriting, coupled with a high credit risk loan portfolio, were significant factors in the bank's failure. At the July 2007 examination, examiners noted that the volume of technical exceptions had increased from prior examinations, demonstrating the need to strengthen loan underwriting practices. Matters that needed attention included ensuring that a consistent cash flow analysis was used to evaluate a borrower's ability to service debt.

During the August 2008 FDIC examination, examiners noted that multiple aspects of transactional underwriting were weak and contributed to the heightened risk profile of the loan portfolio. Key underwriting deficiencies on more complex transactions typically included CRB's failure to:

- ascertain the extent of borrower and guarantor contingent liability obligations;
- assess cash flow on a global rather than project-specific basis; and

- consider the observations, conclusions, and concerns conveyed in many real estate appraisal reviews.

According to the August 2008 examination, although CRB had adequate loan policies, these policies were not implemented at a transactional level. Specifically, approval practices did not accurately reflect risk and underwriting standards were set, but not enforced.

Compliance with Laws and Regulations

The August 2008 ROE stated that transactional underwriting and portfolio-level management of the ADC portfolio were in contravention of various aspects of Subsection C, *Loan Documents,* and Subsection D, *Credit Underwriting,* of Appendix A, *Interagency Guidelines Establishing Standards for Safety and Soundness*, to Part 364 of the FDIC's Rules and Regulations.[5] According to the ROE, those deficiencies, especially those of a portfolio nature, magnified the negative financial ramifications stemming from continued residential real estate market deterioration. Management systematically failed to recognize changing market conditions impacting the institution's ADC concentration in a timely manner. As a result, management did not bolster transactional underwriting criteria or reduce aggregate ADC risk tolerances.

Credit Administration Practices

Credit administration weaknesses were a significant factor in the bank's failure. Insufficient loan reviews, an inappropriate Allowance for Loan and Lease Losses (ALLL) methodology that did not adequately reflect the risk of the portfolio, and inadequate real estate appraisal practices all contributed to the failure of the bank.

Loan Reviews

During the May 2006 examination, management was encouraged by examiners to continue its efforts to develop a uniform program of cash flow analysis and an effective loan file review process. In September 2007, bank personnel conducted an independent loan review, pursuant to a scope selected by the bank's external accountant, which included a loan penetration of less than 9 percent of the portfolio. This scope was deemed insufficient by examiners. Furthermore, examiners also indicated that the timeframe between this independent loan review and the prior one (in 2005) was unacceptably long.

The August 2008 examination noted that, in early 2008, management initiated an unscheduled, in-depth, ADC-focused credit review. However, the review was conducted too late in the credit cycle for the results to provide any value beyond simply identifying heightened transactional credit risk, which should have already been evident. Examiners

[5] Section 39 of the FDI Act requires the FDIC to establish safety and soundness standards. Section 364.101(a) of the FDIC Rules and Regulations implements that provision by establishing interagency guidelines for safety and soundness, as set forth in Appendix A to Part 364.

also noted that management must do a better job of timely and accurate risk identification as they noted numerous situations where internal credit grades were too lenient given the risk profile of the loan relationship. Accurate and timely risk recognition would have required both increasing loan officer accountability and establishing stronger loan review processes.

In August 2008, the FDIC prepared a memorandum detailing the loan review process at CRB, which stated that the frequency and scope of the loan review process were considered inadequate given the nature and complexity of the bank's lending activities.

The October 2009 ROE noted that credit grading practices were not effective, as evidenced by the large number of loans that were downgraded from the bank's internal grade or where additional impairment was identified during the examination. The credit review process had not been effective in identifying deterioration in the loan portfolio. A third party was commissioned to complete loan reviews at six branches in 2009; however, in all cases, the review focused only on "Pass" credits.[6] A comprehensive review of the loan portfolio and the accuracy of grading practices had not been completed since the prior examination.

ALLL Methodology

Examiners noted during the May 2006 examination that the ALLL, at 1.30 percent of total loans as of March 31, 2006, was adequate based upon the credit risk in the portfolio at the time. However, examiners noted that management should enhance the methodology used to determine the adequacy of the ALLL by: increasing the current stratification of "Pass" loan categories (e.g., "commercial" and "real estate") to better reflect individual sector risks; analyzing the "Pass" category composition by credit grade (i.e., assigning higher weights for lower quality loans); and improving the reasoning for qualitative reserve adjustments.

During the July 2007 State examination, examiners noted that the ALLL amounted to 1.20 percent of total loans as of March 31, 2007, and considered the ALLL to be appropriate. Examiners noted that the methodology used to determine the adequacy of the ALLL was generally satisfactory; however, the impairment analysis of loans should be expanded to include all large credits internally graded "Substandard" or worse.[7]

Examiners noted during the August 2008 examination that management's reserve methodology was generally reasonable and that the $25 million provision required during the quarter was largely prompted by newly received reappraisals on problem ADC loans. However, examiners did note that the reserve methodology should be revised and management's implementation of associated accounting pronouncements should be

[6] Credits not covered by Special Mention, Substandard, Doubtful, or Loss are "Pass" Credits.
[7] Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as Substandard must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.

modified. Specific recommendations included re-evaluating Financial Accounting Standard (FAS) 5 loss percentage assumptions given 2008 results;[8] increasing the granularity of FAS 5 risk categories, especially for real estate-secured loans; expanding the transparency of the FAS 114 calculation; and promptly charging off identified impairment on collateral-dependent loans that were evaluated under FAS 114.

The October 2009 ROE noted that management had not implemented the recommendation provided at the previous examination for increasing the granularity of the FAS 5 analysis applicable to real estate-secured loans. Specifically, all real estate loan groups were still internally analyzed as one homogeneous group with no recognition given to the different risk characteristics applicable to various loan types. Most significantly, the FAS 5 analysis did not take into consideration the significant charge-off rate experienced in 2009.

Real Estate Appraisals

The July 2007 State examination noted several apparent violations of Part 323, *Appraisals*, of the FDIC Rules and Regulations. Part 323 requires that appraisals meet certain minimum requirements. Violations included a lack of recent appraisals to support current market values and loan files that lacked appraisals to support the values cited in the applications for loan approval.

During the August 2008 examination, examiners noted that CRB had renewed, modified, and extended loans to borrowers with maturing credits without obtaining updated appraisals. Had updated appraisals been ordered on all renewals, management would have seen the insufficiency of collateral being held by the bank and could have acted more prudently in extending additional credit.

The FDIC's Supervision of CRB

The FDIC's and the DFCS's examinations and visitation of CRB identified key risks including credit administration weaknesses, inadequate loan underwriting, and a high CRE and ADC loan concentration, all of which eventually contributed to the bank's failure. The examinations were conducted according to the statutory schedule and the FDIC and the DFCS pursued a formal supervisory action in 2009 as the bank's financial condition deteriorated. Additionally, the FDIC's offsite review monitoring system flagged CRB for review but the timing was such that it did not impact the supervisory strategy.

Due to adverse changes in the real estate markets in 2007, and the combination of CRB's risk management weaknesses and a high ADC loan concentration, the financial condition of the bank had significantly deteriorated by the August 2008 examination. In retrospect,

[8] Accounting Standard Codification (ASC) Subtopics 450-20 (formerly FAS 5) and ASC 310-10-35 (formerly FAS 114) provide accounting guidance for loss contingencies on a pool basis and the impairment of loans on an individual basis, respectively.

the regulators may have benefited from a more forward-looking approach to addressing the 2007 examination findings and overall risk profile of CRB at that time. Doing so may have involved greater emphasis on management practices in assigning the Management and Asset Quality ratings and closer monitoring of CRB following the examination.

Supervisory History

Since 2006, the FDIC and the DFCS conducted one visitation and four safety and soundness examinations. As a result of the deteriorated financial condition at the time of the August 2008 examination, CRB stipulated to a Cease and Desist Order (C&D), which became effective on February 9, 2009. The C&D required, among other things, that the Board take a more active role in the affairs of the bank, the bank have and retain qualified management, and the bank increase and maintain a Tier 1 Capital level equal to or above 10 percent within 90 days of the issuance of the C&D. Table 2 summarizes CRB's examination history and supervisory actions from 2006 through 2009.[9]

Table 2: CRB's Examination History from 2006 to 2009

Examination Start Date	Examination as of Date	On-Site Supervisory Effort	Supervisory Ratings (UFIRS)*	Informal or Formal Action** taken
05/30/06	03/31/06	FDIC Examination	222122/2	None
07/09/07	03/31/07	State Examination	222122/2	None
08/18/08	06/30/08	FDIC Examination	444444/4	C&D
05/04/09	03/31/09	Joint Visitation	454***544***/5	PCA Notification
10/05/09	09/30/09	Joint Examination	555544/5	PCA Notification

Source: Supervisory History, Reports of Examination, and Report of Visitation.
*Financial institution regulators and examiners use the Uniform Financial Institutions Rating System (UFIRS) to evaluate a bank's performance.
**Informal supervisory actions often take the form of Bank Board Resolutions or MOUs. Formal enforcement actions often take the form of PCA directives or C&Ds, but under severe circumstances can also take the form of insurance termination proceedings.
***The visitation scope was not sufficient to assign a rating. Therefore, the ratings assigned at the August 2008 examination for Management and Sensitivity to Market Risk remained the same.

In addition to the examinations and visitations, the FDIC met with CRB management in June 2007 to discuss the CRE concentrations at the bank. There were no changes made to FDIC's supervisory plan as a result of this discussion; however, the FDIC noted the supervisory plan should be reassessed based upon the findings of the July 2007 State examination.

Offsite Review

The FDIC's offsite review program did not identify emerging supervisory concerns or potential problems for CRB until September 2008, at which time the FDIC was conducting a safety and soundness examination. At the conclusion of the examination, the bank was downgraded to a composite "4" rating. By not identifying potential problems prior to September 2008, the effectiveness of the offsite review program was

[9] On February 3, 2009, a Memorandum of Understanding (MOU) was agreed to between the Federal Reserve Bank of San Francisco, DFCS, and Columbia Bancorp.

limited in identifying risks that would result in a change to the FDIC's supervisory strategy.

The offsite review program is designed to identify emerging supervisory concerns and potential problems so that supervisory strategies can be adjusted appropriately. Offsite reviews are performed quarterly for each bank that appears on the Offsite Review List (ORL). Regional management is responsible for implementing procedures to ensure that offsite review findings are factored into examination schedules and other supervisory activities. Offsite reviews must be completed and approved 3½ months after each Report of Condition and Income (Call Report) date. This generally provides 45 days to complete the offsite reviews once Call Report data is finalized.

The system-generated ORL includes only institutions rated "1" and "2" that are either:

- Identified by the Statistical CAMELS Offsite Rating (SCOR)[10] system as having a 35 percent or higher probability of downgrade to "3" or worse, or
- Identified in the Growth Monitoring System (GMS)[11] as having a growth percentile of 98 or 99.

CRB did not appear on the system-generated ORL because it did not meet the criteria prior to 2008. An offsite review was completed September 22, 2008 using data as of June 30, 2008, as a result of the Real Estate Stress Test (REST)[12], SCOR, and SCORLag risk flags being triggered. At this time, a full-scope FDIC examination had already begun and found the bank's condition to be unsatisfactory.

The September 2008 offsite review analysis memorandum noted the overall risk profile of the institution had increased significantly due to deterioration in the ADC loan portfolio. Asset quality was deficient due to the high level of problem assets, the velocity of deterioration in the loan portfolio, and the potential for further deterioration. Management's performance was noted as unsatisfactory due to its (1) aggressive risk appetite relating to ADC lending, (2) slow reaction to the economic downturn, (3) failure to implement several prior examination recommendations, (4) failure to provide an accurate loan review process, and (5) lack of formal liquidity contingency planning.

An additional offsite review was triggered in September 2009 by a REST risk flag. This review was manually added to the ORL as the bank had already been downgraded to a composite "4" rating. Per the offsite review, the bank's financial condition had deteriorated primarily due to an excessive concentration in real estate-related loans in a severely declining market. As of June 30, 2009, the bank's Tier 1 Capital ratio declined to 4.16 percent and on August 26, 2009, the bank was notified of its PCA category of *Undercapitalized.* The bank was projected to fail in the first quarter of 2010.

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[10] SCOR is a financial model that uses statistical techniques, offsite data, and historical examination results to measure the likelihood that an institution will receive a CAMELS downgrade at the next examination.
[11] GMS is an offsite rating tool that identifies institutions experiencing rapid growth and/or having a funding structure highly dependent on non-core funding sources.
[12] REST attempts to simulate what would happen to banks today if they encountered a real estate crisis similar to that of New England in the 1990s. Scores are considered high when 3.5 or higher.

Supervisory Responses to Risks Identified at CRB

Through its supervisory efforts, the FDIC and the DFCS identified and documented key risks at the bank and provided recommendations to management as described in the *Causes of Failure and Loss* section of this report. However, by the time the FDIC and the DFCS instituted the C&D in February 2009, the viability of the institution was seriously in question as a consequence of the high level of classified loans and eroding capital protection.

May 2006 FDIC Examination

At the 2006 examination, Capital was rated satisfactory and assigned a "2" component rating. Examiners also found Asset Quality to be satisfactory with a manageable level of adversely classified assets, totaling 23.23 percent of Tier 1 Capital plus the ALLL, and a modest level of past due and nonaccrual credits. Additionally, the examination noted that the CRE concentration level had increased moderately from 542 percent of Total Capital as of March 31, 2005 to 574 percent as of March 31, 2006. Although examiners noted that the CRE exposure level remained elevated, improved risk management practices were implemented as recommended at the previous joint examination in June 2005. At that time, CRB's CRE and ADC concentrations were higher in relation to its peers.

Asset Quality was considered adequate as evidenced by the manageable level of classified loans. Examiners commented that earnings continued to improve and were strong in relation to the risk profile of the bank. Additionally, it was noted that the Net Interest Margin (NIM) had increased from 6.08 percent as of December 31, 2005 to 6.41 percent as of March 31, 2006.

Examiners encouraged management to continue its efforts to develop a uniform program for cash flow analysis and an effective loan review process. They also suggested that management enhance the methodology used to determine the adequacy of the ALLL by increasing the current stratification of "Pass" loan categories. Examiners also stated that management should reassess the appropriateness of all assumptions used in its risk analytics model. Independent validation of the model should also be completed to ensure, at minimum, the reasonableness of bank-specific assumptions.

Overall, CRB was found to be operating in a satisfactory manner and its financial condition was sound. Examiners assigned the institution a CAMELS composite rating of "2". As a result, examination of the bank continued on a regular schedule.

July 2007 State Examination

During the July 2007 State examination, Capital was considered satisfactory. However, the Tier 1 Leverage Capital ratio was at 8.99 percent, down from 9.13 percent at the previous examination, and CRB's risk-based capital ratios were in the lowest 25 percent among its peer group.

Examiners considered the institution's procedures for monitoring loan concentrations to be generally satisfactory. Loans were monitored by type, branch, and geographic regions and it was noted that management reports provided sufficient information for the monitoring of concentrations within the various segments of the loan portfolio. However, examiners determined that management had not yet developed an effective process for monitoring the bank's exposure to ADC projects, particularly speculative construction loans. DFCS officials stated that the Joint Guidance was considered by examiners in making this comment, but the ROE did not make specific reference to the guidance.

Examiners also determined Asset Quality to be satisfactory. Adversely classified assets had increased from $19.2 million at the prior examination to $25.2 million and the Adversely Classified Items Coverage Ratio[13] had increased from 23.23 percent to 26.03 percent during the same period. Further, as of June 30, 2007, ADC loans totaled $361 million, or 365 percent of Total Capital. This level of ADC concentration was well above the thresholds used to identify institutions that may warrant greater supervisory analysis by the Joint Guidance.

Examiners noted that there were weaknesses in CRB's credit administration. The methodology used to determine the adequacy of the ALLL was generally satisfactory; however, the impairment analysis of loans needed to be expanded to include all large credits internally graded "Substandard" or worse. The loan policy and procedures were satisfactory, but the implementation of the policy was viewed as inconsistent. Examiners also noted deficiencies in file documentation and ongoing monitoring practices that were evidenced by the high volume of technical exceptions, as well as the number of loans cited for apparent violation of laws and regulations. Examiners found four loans in apparent violation of Section 323.4.[14] The examination report stated that the appraisals for these four loans were either outdated or were not present prior to funding. Examiners recommended that management ensure that required documentation is obtained in a timely manner and that they improve the policy and procedures for monitoring construction loans and documenting construction draws.

Examiners commented that earnings continued to be strong, although CRB had a decrease in its Return on Average Assets (ROAA) for the first quarter of 2007 compared to year end 2006, from 1.96 percent to 1.59 percent, respectively. The decrease was related to a narrowing NIM and an increased provision expense due to a partial charge-off during the first quarter of 2007. Examiners also noted that CRB's expenses remained high due to increased personnel, occupancy, and other costs associated with increasing its branch system.

Examiners noted CRB's liquidity risk profile had tightened since the previous examination. Loan growth had outpaced deposit growth causing the bank to rely on brokered deposits, CDs, and advances from FHLB. Brokered deposits represented

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[13] The "Adversely Classified Items Coverage Ratio" is the ratio of total adversely classified items to Tier 1 Capital plus the ALLL (before adjustments for Loss classifications).
[14] Section 323.4 requires that appraisals meet certain minimum requirements.

14.2 percent of total deposits as of March 31, 2007, compared to 5.0 percent as of March 31, 2006.

Although CRB's financial condition was starting to show some symptoms of stress as evidenced by the growth in classified assets, lower ROAA, and tightened liquidity, the examination resulted in the same CAMELS ratings as the previous FDIC examination. As a consequence, examination of the bank continued on a regular schedule and the next onsite supervisory activity occurred in August 2008.

In retrospect, considering: (1) CRB's ADC concentration levels; (2) identification of weak credit administration practices; (3) signs of financial deterioration; and (4) the start of deterioration in the local real estate markets,[15] the FDIC and the DFCS should have placed greater emphasis on management practices in assigning the Asset Quality rating. According to the *Risk Management Manual of Examination Policies* (Examination Manual), a "2" Asset Quality component rating indicates that the level and severity of issues warrant a limited level of supervisory attention. A "3" rating generally indicates that an elevated level of supervisory attention is required. Although the level of classified loans (26.03 percent) at the time appeared manageable, heightened supervisory attention appears to have been warranted.

DFCS did not disagree with our overall findings and conclusions, but provided additional perspective about information its examiners considered when assigning CRB's Asset Quality rating at the 2007 examination. According to the DFCS, examiner analysis of key financial ratios based on March 2007 data showed that CRB compared favorably to peers, particularly at a regional level. In addition, while CRB's CRE and ADC concentrations were higher than peers at a national level, the concentration levels were generally in line with other banks in the region. Further, DFCS officials noted that while the economy was showing signs of a slight decline during the examination, the steep decline that ensued was not projected at that time.

August 2008 FDIC Examination

By August 2008, the financial condition of the bank had significantly deteriorated as the level of adversely classified loans had grown to 135 percent of Tier 1 Capital plus the ALLL. Examiners noted that CRE loans represented 423 percent of Total Capital and the ADC concentration was at 326 percent of Total Capital. Additionally, examiners noted that 81 percent of the classified assets were within the ADC loan portfolio. Capital was deemed unsatisfactory given the bank's elevated risk profile.

Examiners noted that an additional provision expense of at least $25 million was necessary during the third quarter of 2008 in order to maintain the ALLL at an appropriate level. Subsequent to the charge-off of loans adversely classified, the ALLL

[15] An FDIC Relationship Management memorandum dated June 2007 indicated that risk was increasing as the residential real estate markets in Deschutes County (Bend/Redmond) had slowed considerably in 2007. A senior executive at the bank considered the market in Bend to be both overpriced and overbuilt and stated that a number of builders in the bank's portfolio were already experiencing problems.

was projected to represent approximately 2.5 percent of total loans at the end of the third quarter. It was noted that the $25 million provision expense was related to the reappraisals on problem ADC loans.

Examiners also noted that approval processes on loans did not adequately reflect risk, underwriting standards were set but not enforced, renewal and extension practices elevated risk without adequate mitigating factors, the loan review process did not result in adequate risk identification, and the credit grading system was not effective.

The ROE noted that management's decision to allow CRB to assume a high ADC concentration level contributed to the asset quality deterioration at the bank. The negative implication of this strategic decision was compounded by management's failure to respond in a timely and effective manner to the deteriorating market conditions. The ROE noted that management should reduce CRB's residential ADC exposure to improve asset quality.

Supervisory Actions. As a result of this examination, CRB's CAMELS composite rating was downgraded from a "2" to a "4". The bank stipulated to a C&D on February 3, 2009 to address examiners' concerns, including the need for additional capital. Although this action was appropriate, by the time the C&D became effective on February 9, 2009, the viability of the bank was in question absent an injection of capital from external sources.

May 2009 Joint Visitation

In May 2009, the FDIC and the DFCS conducted a limited onsite visitation for the purpose of evaluating the financial condition of the bank and assessing management's efforts to comply with the C&D. Examiners found that the condition of the bank had continued to deteriorate. Capital was rated deficient and assigned a "4" component rating. The visitation report noted that the Tier 1 Leverage and Total Risk-Based Capital Ratios were expected to drop to 5.78 percent and 7.88 percent, respectively, as of June 30, 2009. The visitation report also noted that the bank would be *Undercapitalized* for PCA purposes.

Examiners indicated that asset quality had deteriorated to the point of being critically deficient and represented an imminent threat to the bank's viability. Adversely classified items had grown from $25.2 million at the July 2007 examination to $150.4 million at the August 2008 examination, and totaled $177.7 million as of May 2009, based largely upon internal risk ratings. Adversely classified assets represented an excessive 17 percent of total assets and approximately 200 percent of Tier 1 Capital plus the ALLL. Examiners noted that further asset quality deterioration was likely based upon the volume of loans that were 30 to 89 days past due, the volume of loans internally rated "Watch" and "Special Mention", and the extremely unfavorable economic climate in a majority of the bank's geographic footprint. Furthermore, the risk of additional deterioration in assets already classified "Substandard" was extremely high as many were collateralized by failed or severely distressed residential ADC projects in Central Oregon or overbuilt submarkets in Portland and Vancouver.

Examiners determined that credit oversight and problem asset management responsibilities had been more effectively segregated, internal risk identification practices had improved based upon the limited transactional testing completed at the visitation, and special asset management staffing levels had been bolstered by the addition of experienced personnel since the prior examination. However, examiners noted that overall portfolio performance was subject to external market influences outside of management's control and management's actions had not yet stemmed the tide of asset quality deterioration. With regard to the bank's compliance with the C&D provisions, examiners indicated that management was attempting to stabilize the bank and to satisfy the requirements of the Order. However, those efforts had not translated into an overall reduction in risk.

October 2009 Joint Examination

At the 2009 joint examination, Capital was rated critically deficient and assigned a "5" component rating. Additionally, it was noted that CRB's ability to remain viable was severely threatened. Capital levels had dropped by 80 percent from $86 million as of September 30, 2008, to $17 million as of September 30, 2009. Projections showed that capital growth through retained earnings was not an option due to the large level of non-performing assets. Adversely classified items totaled $175.2 million and represented 414.2 percent of Tier 1 Capital plus the ALLL. As of September 30, 2009, CRB reported an operating loss of $46 million, while the ROAA for 2009 was negative 5.80 percent.

Examiners determined that the bank's asset quality problems were the result of weak risk management practices, which included a high concentration in ADC loans, poor underwriting decisions, an inadequate loan review process, and a credit grading system that failed to accurately identify adverse trends in individual credits. All of these factors were exacerbated by the economic downturn and the sharp decline in real estate values.

As of October 2009, the bank's Board and senior management had been able to comply with the majority of the 14 provisions included in the C&D. However, efforts to raise new capital had been unsuccessful, leaving the viability of the bank questionable for the future months. As the bank was not able to raise the additional capital necessary, the DFCS closed CRB on January 22, 2010.

Implementation of PCA

The purpose of PCA is to resolve problems of insured depository institutions at the least possible long-term cost to the DIF. Part 325 of the FDIC's Rules and Regulations implements PCA requirements by establishing a framework for taking prompt corrective action against insured state-charted nonmember banks that are not adequately capitalized. The FDIC is required to closely monitor the institution's condition and compliance with its capital restoration plan, 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, the FDIC properly implemented applicable PCA provisions of section 38.

Table 3 illustrates CRB's capital level categories for each examination date. The bank was considered *Well Capitalized* for PCA purposes until the August 2008 examination.

Table 3: Summary of Capital Level Categories for CRB

Key Capital Ratios (%)	Well Capitalized Thresholds*	Oct-09	Aug-08	Jul-07	May-06
Total Risk-Based Capital Ratio	10%	3.40%	7.93%	10.60%	11.12%
Tier 1 Risk-Based Capital Ratio	6%	2.13%	6.66%	9.51%	9.93%
Tier 1 Leverage Ratio	5%	1.59%	6.45%	8.99%	9.13%
Capital Category		Critically Under-capitalized**	Under-capitalized	Well Capitalized	Well Capitalized

Source: ROEs for Columbia River Bank.
* Minimum capital requirements to be considered *Well Capitalized* for PCA purposes.
** Due to an additional loan loss provision of $16 million identified during the October 2009 examination, CRB's capital levels dropped from *Significantly Capitalized* to *Critically Undercapitalized*.

The August 2008 examination determined that the ALLL required an additional provision of $25 million, resulting in the Total Risk-Based Capital ratio dropping from 10.50 percent as of June 2008 to 7.93 percent as of August 2008. As a result, the bank was *Undercapitalized* for PCA purposes. Management was notified that due to the PCA downgrade, the bank could no longer renew or obtain new brokered funds. Anticipated capital levels did not support the overall risk profile and external capital was needed to recapitalize the bank.

The C&D required that within 90 days from the February 9, 2009 effective date, the bank should maintain the Tier 1 Capital ratio at a minimum level of 10 percent as well as develop and adopt a plan to meet and thereafter maintain the minimum risk-based capital requirements for a *Well Capitalized* bank, in addition to other actions prescribed in the C&D. Management developed a capital plan; however, the Tier 1 Capital ratio remained below 10 percent as of the October 2009 examination and there were no firm prospects for new capital.

During 2009, PCA notifications and directives included:

- **August 26, 2009.** The FDIC notified CRB that it was *Undercapitalized,* based on June 30, 2009 financial information. The bank was required to prepare a capital restoration plan by October 12, 2009. The FDIC received a capital restoration plan from the bank on October 16, 2009. Preliminary review of the submitted plan indicated that it was unacceptable and needed to be updated in order to more accurately reflect CRB's financial condition. CRB management was unsuccessful in submitting an amended plan due to the rapid deterioration of the bank.

- **December 16, 2009.** The FDIC notified CRB that it was *Significantly Undercapitalized*, based on the September 30, 2009 Call Report. The bank was required to prepare an updated capital restoration plan by January 15, 2010.
- **December 21, 2009.** Examiners provided CRB with the results of the October 2009 examination. As indicated in Table 3, the bank's capital level fell to *Critically Undercapitalized* based on results of the October 2009 examination.
- **December 23, 2009.** The FDIC issued a PCA Directive to CRB, based on the fact that the capital restoration plan submitted to the FDIC on October 16, 2009 was unacceptable and did not adequately address the bank's plan for the needed capital infusion.

In January 2010, the FDIC performed a credit visitation with the purpose of testing the bank's Tier 1 Capital Ratio. During the visitation, it was noted that the Tier 1 Capital Ratio had dropped below 2 percent of assets. As a consequence, on January 22, 2010, the DFCS closed CRB due to its low level of capital, and named the FDIC as receiver.

Objectives, Scope, and Methodology

Objectives

We performed this performance audit to satisfy the requirements of section 38(k) of the FDI Act as amended by the Financial Reform Act that was signed into law on July 21, 2010. The Financial Reform Act amends section 38(k) of the FDI Act by increasing the MLR threshold from $25 million to $200 million for losses that occur for the period January 1, 2010 through December 31, 2011. Further, the Financial Reform Act calls for the OIG to perform in-depth reviews of failures when the associated losses are not material but they involve unusual circumstances. In-depth reviews are required to be performed and reported in a manner consistent with that of an MLR.

At the time the Financial Reform Act was enacted, we had completed our fieldwork and were in the process of preparing a draft MLR report. Although the estimated loss for CRB no longer met the threshold requiring an MLR, the OIG decided to have us complete the audit and issue this report as an in-depth review.

Consistent with the Financial Reform and FDI Act provisions described above, the objectives of this review were to (1) determine the causes of CRB's failure and the resulting loss to the DIF and (2) evaluate the FDIC's supervision of CRB, including the FDIC's implementation of the PCA provisions of section 38 of the FDI Act.

Scope and Methodology

The scope of this audit included an analysis of CRB from May 2006 until its failure on January 22, 2010. Our review also entailed an evaluation of the regulatory supervision of the institution over the same period.

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

- Analyzed examination and visitation reports prepared by the FDIC and the DFCS examiners from May 2006 to January 2010.

- Reviewed the following documentation:

    - Financial institution data and correspondence maintained at DSC's San Francisco Regional Office and Portland Field Office, as provided to KPMG by DSC.

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

    - Pertinent DSC policies and procedures.

- Interviewed the relevant FDIC officials who had supervisory responsibilities pertaining to CRB, which included DSC examination staff in Oregon.

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

- Researched various banking laws and regulations, including Oregon state laws.

KPMG relied primarily upon the materials provided by the FDIC OIG and DSC, including information and other data collected during interviews. KPMG did not perform specific audit procedures to ensure the information and data were complete and accurate. KPMG is, however, aware that Circular 12000.1, *Cooperation with the Office of Inspector General*, dated September 28, 2007, 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:

(1) Provide authorized representatives of the OIG immediate and unrestricted access to all Corporation, receivership, contractor, and subcontractor personnel, facilities, equipment, hard copy and electronic records, files, information systems, and other sources of information when requested during the course of their official duties.

(2) Provide authorized representatives of the OIG immediate and unrestricted access to any records or material available to any part of the FDIC.

Interviews were conducted to gain a better understanding of decisions made regarding the supervisory approach to the institution and to clarify information and conclusions contained in ROEs and other relevant supervisory correspondence between the FDIC and the bank. KPMG relied on the information provided in the interviews without conducting additional specific audit procedures to test such information.

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

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

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

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

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

Related Coverage of Financial Institution Failures

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

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

Glossary of Terms

Term	Definition
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)	Federally insured depository institutions must maintain an ALLL that is adequate to absorb the estimated loan losses associated with the loan and lease portfolio (including all binding commitments to lend). To the extent not provided for in a separate liability account, the ALLL should also be sufficient to absorb estimated loan losses associated with off-balance sheet loan instruments such as standby letters of credit.
Call Report	Consolidated Reports of Condition and Income (also known as the Call Reports) are reports that are required to be filed by every national bank, state member bank, and insured nonmember bank pursuant to the Federal Deposit Insurance 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.
Cease and Desist Order (C&D)	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 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.
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, or affiliated group. These assets may, in the aggregate, present a substantial risk to the safety and soundness of the institution.
FDIC's Supervision Program	The FDIC's supervision program promotes the safety and soundness of FDIC-supervised institutions, protects consumers' rights, and promotes community investment initiatives by FDIC-supervised institutions. The FDIC's Division of Supervision and Consumer Protection (1) performs examinations of FDIC-supervised institutions to assess their overall financial condition, management policies and practices (including internal control systems), and compliance with applicable laws and regulations and (2) issues related guidance to institutions and examiners.

Term	Definition
Global Cash Flow Analysis	A global cash flow analysis is a comprehensive evaluation of borrower capacity to perform on a loan. During underwriting, proper global cash flow must thoroughly analyze projected cash flow and guarantor support. Beyond the individual loan, global cash flow must consider all other relevant factors, including: guarantor's related debt at other financial institutions, future economic conditions, as well as obtaining current and complete operating statements of all related entities. In addition, global cash flow analysis should be routinely conducted as a part of credit administration. The extent and frequency of global cash flow analysis should be commensurate to the amount of risk associated with the particular loan.
Material Loss	As defined by section 38(k)(2)(B) of the FDI Act, and as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, for the period beginning January 1, 2010 and ending December 31, 2011, a material loss is defined as any estimated loss in excess of $200 million.
Prompt Corrective Action (PCA)	The purpose of PCA is to resolve the problems of insured depository institutions at the least possible long-term cost to the Deposit Insurance Fund. Part 325, subpart B, of the FDIC Rules and Regulations, 12 Code of Federal Regulations, section 325.101, et. seq., implements section 38, *Prompt Corrective Action*, of the FDI Act, 12 United States Code Section 1831(o), by establishing a framework for determining capital adequacy and taking supervisory actions against depository institutions that are in an unsafe or unsound condition. The following terms are used to describe capital adequacy: (1) Well Capitalized, (2) Adequately Capitalized, (3) Undercapitalized, (4) Significantly Undercapitalized, and (5) Critically Undercapitalized. A PCA Directive is a formal enforcement action seeking corrective action or compliance with the PCA statute with respect to an institution that falls within any of the three categories of undercapitalized institutions.
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.

Term	Definition
Uniform Financial Institutions Rating System (UFIRS)	Financial institution regulators and examiners use the Uniform Financial Institutions Rating System to evaluate a bank's performance in six components represented by the CAMELS acronym: Capital adequacy, Asset quality, Management practices, Earnings performance, Liquidity position, and Sensitivity to market risk. Each component, and an overall composite score, is assigned a rating of 1 through 5, with 1 having the least regulatory concern and 5 having the greatest concern.

Appendix 3

Acronyms

ADC	Acquisition, Development, and Construction
ALLL	Allowance for Loan and Lease Losses
ASC	Accounting Standard Codification
C&D	Cease and Desist Order
CAMELS	Capital, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk
CCO	Chief Credit Officer
CD	Certificate of Deposit
CRB	Columbia River Bank
CRE	Commercial Real Estate
DFCS	Division of Finance and Corporate Securities
DIF	Deposit Insurance Fund
DSC	Division of Supervision and Consumer Protection
FAS	Financial Accounting Standard
FDI	Federal Deposit Insurance
FHLB	Federal Home Loan Bank
GAGAS	General Government Auditing Standards
GMS	Growth Monitoring System
MLR	Material Loss Review
MOU	Memorandum of Understanding
NIM	Net Interest Margin
OIG	Office of Inspector General
OREO	Other Real Estate Owned
ORL	Offsite Review List
PCA	Prompt Corrective Action
REST	Real Estate Stress Test
ROAA	Return on Average Assets
ROE	Report of Examination
SCOR	Statistical CAMELS Offsite Rating
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System

Part II

OIG Evaluation of Management Response

OIG Evaluation of Management Response

On August 18, 2010, the Director, Division of Supervision and Consumer Protection (DSC), provided a written response to the draft report. That response is provided in its entirety on page II-2 of this report.

DSC reiterated the OIG's conclusions regarding the causes of CRB's failure and the FDIC's supervision of the bank. With regard to the FDIC's supervision of CRB, DSC summarized the supervisory history described in the report. Further DSC stated that strong supervisory attention is necessary for institutions with high CRE and ADC concentrations, such as CRB, and has issued updated guidance reminding examiners to take appropriate action when those risks are imprudently managed.

FDIC

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

August 18, 2010

TO: Stephen Beard
Assistant Inspector General for Material Loss Reviews

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

SUBJECT: FDIC Response to the Draft Audit Report Entitled, Material Loss Review of The Columbia River Bank, The Dalles, Oregon (Assignment No. 2010-035)

Pursuant to Section 38(k) of the Federal Deposit Insurance Act, the Federal Deposit Insurance Corporation's Office of Inspector General (OIG) conducted a material loss review of The Columbia River Bank, The Dalles, Oregon (CRB), which failed on January 22, 2010. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Report (Report) received on July 29, 2010.

The decision of CRB's Board and management to pursue a loan growth strategy concentrating in commercial real estate (CRE) and acquisition, development, and construction (ADC) loans was the principal factor which led to its rapid deteriorating financial condition and failure. CRB's overall weak loan administration contributed to the increased delinquencies and non-performing assets. Additionally, at the time of the economic downturn, CRB's Board made an ill-timed decision to aggressively expand into a new geographic market area, Vancouver, Washington, which also experienced a downturn in its real estate market.

From 2005 through December 2009, the FDIC and the Oregon Division of Finance and Corporate Securities (DFCS) jointly and separately conducted four full-scope examinations and one joint visitation. At the August 2008 FDIC examination, CRB's loan assets had deteriorated to a level that raised significant regulatory concern and posed considerable risk, resulting in the FDIC implementing a formal enforcement action. At the October 2009 joint examination, capital was rated critically deficient, and CRB was assigned a composite "5" rating. CRB was unable to raise additional capital, and was ultimately closed by the DFCS due to deteriorating asset quality, poor earnings, and inadequate capital.

DSC recognizes that strong supervisory attention is necessary for institutions with high CRE/ADC concentrations, such as CRB, and has issued updated guidance reminding examiners to take appropriate action when those risks are imprudently managed.

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