

# Office of Inspector General



Office of Material Loss Reviews  
Report No. MLR-10-007

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**Material Loss Review of Strategic Capital  
Bank, Champaign, Illinois**

December 2009



## Why We Did The Audit

On May 22, 2009, the Illinois Department of Financial Professional Regulation (IDFPR), Division of Banking, closed Strategic Capital Bank (Strategic Capital), Champaign, Illinois, and named the FDIC as receiver. On June 5, 2009, the FDIC notified the Office of Inspector General (OIG) that Strategic Capital's total assets at closing were \$537.1 million and the estimated material loss to the Deposit Insurance Fund (DIF) was \$172.3 million. As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, the OIG conducted a material loss review of the failure of Strategic Capital.

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

## Background

Strategic Capital was a state-chartered nonmember bank that operated from a single office in Champaign, Illinois. Strategic Capital was wholly owned by Strategic Capital Bancorp, Inc. (SCBI), a single-bank holding company. The bank opened in November 1999, and in January 2004, SCBI stockholders approved the sale of 80 percent of SCBI stock to two individuals who assumed key leadership positions in Strategic Capital and SCBI. This change in control was completed in June 2004.

Strategic Capital had a number of affiliates, including an association with Citizens Central Bancorp, Inc. (the holding company of Citizens National Bank, Macomb, IL (CNB)) through common ownerships of the two individuals that acquired SCBI in 2004. CNB was also closed on May 22, 2009 and also resulted in a material loss to the DIF. CNB was a national bank supervised by the Office of the Comptroller of the Currency, and the Department of the Treasury OIG is responsible for conducting a material loss review of CNB. Treasury OIG's report on its material loss review of CNB is expected to be issued by January 1, 2010. In mid-2007, Strategic Capital also opened a loan production office (LPO) in Oakbrook, Illinois, (a suburb of Chicago, Illinois) that originated commercial real estate (CRE) loans.

## Audit Results

### Causes of Failure and Material Loss

Strategic Capital's failure can be attributed to the Board of Directors (Board) and management's speculative and ill-timed growth strategy involving high-risk assets and volatile funding that began subsequent to the completion of IDFPR's 2007 on-site examination. Strategic Capital's selection of risk in the fourth quarter of 2007 and the first quarter of 2008 proved to be poor. Further, Strategic Capital's rapid growth strategy was in contravention to long-standing supervisory guidance related to CRE concentrations and securities. In a short span of time, market conditions rapidly deteriorated, and Strategic Capital faced credit downgrades associated with its investment portfolio and encountered escalating loan problems that it had not anticipated. Ultimately, Strategic Capital did not have enough capital to adequately support its new risk profile and could not absorb the losses.

**The FDIC's Supervision of Strategic Capital**

Between 2005 and 2007, the FDIC and IDFPF conducted timely and regular examinations of Strategic Capital. Moreover, through their respective offsite monitoring activities, both the FDIC and IDFPF promptly identified the rapid growth that occurred in the span of a few months subsequent to the 2007 examination. Further, the FDIC and IDFPF recognized the fact that the rapid growth was funded primarily with brokered deposits and these activities had significantly altered Strategic Capital's risk profile and warranted increased supervisory attention. Accordingly, the FDIC, in coordination with IDFPF, initiated a series of supervisory actions that led to the issuance of a formal enforcement action against Strategic Capital in August 2008 in an effort to stop unsafe and unsound practices and deficiencies related to its aggressive growth strategy. The FDIC and IDFPF closely monitored Strategic Capital's condition after the cease and desist order was issued until the institution was closed.

With respect to PCA, enforcement actions addressing Strategic Capital's capital deficiencies were taken in accordance with PCA capital-related provisions. Based on the supervisory actions taken, the FDIC properly implemented applicable PCA provisions of section 38 in a timely manner. The bank was unsuccessful in raising needed capital and was subsequently closed on May 22, 2009.

**Management Response**

On December 4, 2009, the Director, Division of Supervision and Consumer Protection (DSC), provided a written response to the draft report. DSC's response reiterated the OIG's conclusions regarding the cause of failure and our assessment of supervision.

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**Federal Deposit Insurance Corporation**

3501 Fairfax Drive, Arlington, Virginia 22226

Office of Inspector General

**DATE:** December 4, 2009

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

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

**SUBJECT:** *Material Loss Review of Strategic Capital Bank,  
Champaign, Illinois (Report No. MLR-10-007)*

As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, the Office of Inspector General (OIG) conducted a material loss<sup>1</sup> review of the failure of Strategic Capital Bank (Strategic Capital), Champaign, Illinois. On May 22, 2009, the Illinois Department of Financial Professional Regulation (IDFPR), Division of Banking, closed the institution and named the FDIC as receiver. On June 5, 2009, the FDIC notified the OIG that Strategic Capital's total assets at closing were \$537.1 million and the estimated material loss to the Deposit Insurance Fund (DIF) was \$172.3 million.

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

The audit objectives were to (1) determine the causes of the financial institution's failure and resulting material loss to the DIF and (2) evaluate the FDIC's supervision<sup>2</sup> of the institution, including implementation of the PCA provisions of section 38 of the FDI Act. Appendix 1 contains details on our objectives, scope, and methodology. Appendix 2

<sup>1</sup> As defined by Section 38(k)(2)(B) of the FDI Act, a loss is material if it exceeds the greater of \$25 million or 2 percent of an institution's total assets at the time the FDIC was appointed receiver.

<sup>2</sup> 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 insured depository institutions. The FDIC's Division of Supervision and Consumer Protection (DSC) (1) performs examinations of FDIC-supervised institutions to assess their overall financial condition, management policies and practices (including internal control systems), and compliance with applicable laws and regulations and (2) issues related guidance to institutions and examiners.

contains a glossary of key terms and Appendix 3 contains a list of acronyms. Appendix 4 contains the Corporation's comments on this report.

## **Background**

Strategic Capital was a state-chartered nonmember bank that operated from a single office in Champaign, Illinois. Strategic Capital was wholly owned by Strategic Capital Bancorp, Inc. (SCBI), a single-bank holding company. The bank opened in November 1999 and in January 2004, SCBI stockholders approved the sale of 80 percent of SCBI stock to two individuals who assumed key leadership positions in Strategic Capital and SCBI. This change in control was completed in June 2004.

Strategic Capital had a number of affiliates, including an association with Citizens Central Bancorp, Inc. (the holding company of Citizens National Bank, Macomb, IL (CNB))<sup>3</sup> through common ownerships of the two individuals who acquired SCBI in 2004. In mid-2007, Strategic Capital also opened a loan production office (LPO) in Oakbrook, Illinois (a suburb of Chicago, Illinois) that originated commercial real estate (CRE) loans. The bank operations included several unique features:

- The bank functioned like a private bank, providing a full range of banking and financial services to individual and corporate customers in central Illinois.
- A significant portion of deposits was comprised of accounts in excess of \$100,000, which was a function of brokered deposits and core account holders that carried higher account balances.
- The bank actively managed its investment portfolio to promote earnings. Until 2007, Strategic Capital's investment portfolio consisted of a large volume of municipal securities.

The bank experienced moderate growth following the change in ownership control until late 2007 when total assets began to sharply increase. To fund that growth, Strategic Capital significantly increased its reliance on brokered deposits. Table 1 provides selected details on Strategic Capital's financial condition from 2006 to 2009.

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<sup>3</sup> On May 22, 2009, the Office of the Comptroller of the Currency closed CNB and named the FDIC as receiver. CNB was a national bank supervised by the Office of the Comptroller of the Currency and also resulted in a material loss to the DIF. The Department of the Treasury OIG is responsible for conducting a material loss review of CNB. Treasury's report on its material loss review of CNB is expected to be issued by January 1, 2010.

**Table 1: Financial Condition of Strategic Capital from 2006 to 2009**

<b>Financial Measure</b>	<b>Mar-2009</b>	<b>Dec-2008</b>	<b>Dec-2007</b>	<b>Dec-2006</b>
Total Assets (\$000s)	546,576	586,740	379,130	255,944
Total Investments (\$000s)	311,276	326,141	198,286	139,478
Total Loans (\$000s)	205,416	229,856	162,410	99,574
Total Deposits (\$000s)	479,384	512,250	300,999	209,277
Total Brokered Deposits (\$000s)	421,772	452,009	178,758	81,506
Brokered Deposits/Total Deposits	88%	88%	59%	39%
Net Income (Loss) (\$000s)	1,607	(22,622)	3,527	3,447

Source: Uniform Bank Performance Reports (UBPR) for Strategic Capital.

Also impacting the financial condition of the Strategic Capital was a number of capital injections in 2008, as follows:

- March 4, 2008 - \$2 million in proceeds from an advance on an SCBI bank note.
- March 17, 2008 - \$4.8 million in proceeds from the sale of a loan to bank shareholders. This was shown as a loan charge-off on the bank's records.
- March 31, 2008 - \$5 million in partial proceeds from the sale of additional SCBI stock.
- May 27, 2008 - \$2 million in proceeds from another advance on an SCBI bank note.
- August 8, 2008 - \$5.1 million in proceeds from the sale of additional SCBI stock.

## **Causes of Failure and Material Loss**

Strategic Capital's failure can be attributed to the Board of Directors (Board) and management's speculative and ill-timed growth strategy involving high-risk assets and volatile funding that began subsequent to the completion of IDFP's 2007 on-site examination. Strategic Capital's selection of risk in the fourth quarter of 2007 and the first quarter of 2008 proved to be poor. Further, Strategic Capital's rapid growth strategy was in contravention to long-standing supervisory guidance related to CRE concentrations and securities. In a short span of time, market conditions rapidly deteriorated, and Strategic Capital faced credit downgrades associated with its investment portfolio and encountered escalating loan problems that it had not anticipated. Ultimately, Strategic Capital did not have enough capital to adequately support its new risk profile and could not absorb the losses.

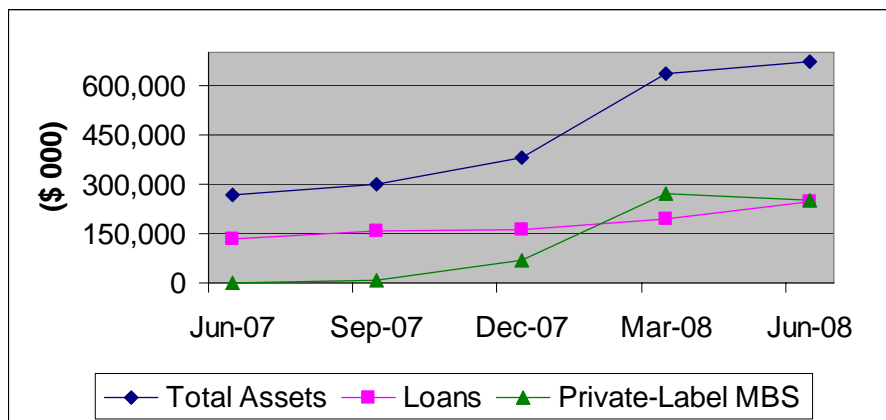
### **Speculative Growth Strategy Involving High-Risk Assets**

Between September 30, 2007 and June 30, 2008, Strategic Capital embarked on a speculative growth strategy by increasing its reliance on brokered deposits to fund significant concentrations of two risky assets:

- Mortgage-backed securities (MBS), more specifically, private-label mortgage-backed securities.<sup>4</sup> These securities were backed by nontraditional mortgages with less than full documentation.
- CRE loans, comprised of (1) out-of-area CRE loan participations and (2) out-of-area CRE loans originated through its LPO. Concentrations of CRE lending can leave an institution vulnerable to economic cycles. Out-of-area loans are by nature more difficult to monitor and administer.

Figure 1 illustrates Strategic Capital’s growth in total assets, private-label MBS, and loans by quarter from June 2007 through June 2008. Strategic Capital’s increased reliance on brokered deposits is discussed later in this report.

**Figure 1: Strategic Capital’s Growth from June 2007 through June 2008**



Source: 2008 Report of Examination (ROE) for Strategic Capital.

### Investments in High-Risk Securities

In 2007, Strategic Capital’s Board and management concluded that it was an opportunistic time to invest in private-label MBS because these securities were being offered at a significant discount. The private-label MBS that the bank purchased were largely backed by nontraditional mortgages and many of the securities featured concentrations in California and Florida. The decision to purchase such a concentration of securities, that as of May 31, 2008, represented 782 percent of Tier 1 Capital, proved to be disastrous for Strategic Capital even though the bank acquired the securities at a discount. Table 2 summarizes Strategic Capital’s investment in private-label MBS and municipal securities between June 2007 and June 2008. As illustrated in the table, the most significant growth in investments occurred in the first quarter of 2008. By June 2008, the bank’s total investment portfolio totaled approximately 59 percent of total assets.

<sup>4</sup> MBS (also referred to as collateralized mortgage obligations (CMO)) are created when individual mortgage loans are packaged or pooled by issuers and offered to sale to investors. There are two types of issuers – agency and private label. Agency-issued mortgage-backed securities meet specific underwriting criteria whereas private label issues generally comprise nonconforming loans.



**Table 2: Strategic Capital's Investment Portfolio (\$000s)**

	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08
Private-Label MBS	\$0	\$8,360	\$67,304	\$270,520	\$251,179
Municipal Securities	\$116,046	\$119,323	\$129,277	\$148,133	\$149,406

Source: UBPRs for Strategic Capital.

Initially, the private-label MBS carried investment grade credit ratings. Accordingly, these were weighted for risk-based capital purposes at 20 percent.<sup>5</sup> However, during the second quarter of 2008, two private-label MBS with a book value of \$20.6 million were downgraded below investment grade due to high delinquencies and other poor performance metrics of the underlying mortgages. The requisite risk-based weighting for below investment grade securities was substantially higher. For instance, the weighting can equate to as much as one dollar of capital for each dollar invested. As a result of the downgrades and need for increased capital to offset higher risk, Strategic Capital's capital levels were insufficient and the bank fell to *Undercapitalized* under PCA rules during the 2008 examination. As discussed later, this capital classification restricted Strategic Capital's ability to accept and renew brokered deposits, which were its primary funding source. Future credit downgrades continued to place considerable pressure on the bank's risk-based capital ratio.

According to the *Supervisory Policy Statement on Investment Securities and End-User Derivative Activities* (1998 Statement),<sup>6</sup> institutions should strive to limit concentrations in any one investment category, especially complex, illiquid, and high-risk investments such as structured credit products.<sup>7</sup> The 1998 Statement also makes it clear that Board and senior management should (1) understand the nature and level of various risks involved in the institution's investments, (2) understand how such risks fit within the institution's overall business strategies, and (3) establish policies for conducting investment activities and the policy should include risk limits. Further, purchasing distressed structured credit products that represent large concentrations of capital is considered an imprudent banking practice.

The 2008 ROE reported that Strategic Capital's actions were in apparent contravention of the 1998 Statement. First, Strategic Capital's pre-purchase analysis and ongoing monitoring failed to take into consideration the exposure of risk-based capital measures to significant downgrades of securities and their implications for increased capital. Consequently, when the bonds fell below investment grade, Strategic Capital had no capital contingency plan in place. Second, Strategic Capital's investment and asset-

<sup>5</sup> Appendix A (*FDIC's Statement of Policy and Risk-Based Capital*) to Part 325, *Capital Maintenance*, of the FDIC Rules and Regulations establishes a system for calculating risk-weighted assets by assigning assets and off-balance sheet items to broad risk categories. The general risk-based capital standards allow institutions to assign risk weights to MBS based on external credit ratings. Under this methodology, risk weights range from 20 percent for the highest investment grade to 200 percent for below investment grade. Alternately, institutions can assign risk weights based on the obligor or underlying collateral.

<sup>6</sup> This policy was adopted by the FDIC and other members of the Federal Financial Institutions Examination Council in 1998.

<sup>7</sup> The term structured credit products includes, but is not limited to, MBS or CMOs.

liability policies did not include risk limits to control investment activity. The lack of risk limits in its investment policy was also a weakness cited in the 2007 examination.

A Financial Institution Letter (FIL-20-2009), *Risk Management of Investments in Structured Credit Products*, issued by the FDIC on April 30, 2009 to clarify existing supervisory guidance on complex structured credit products, provides some insight into Strategic Capital's failed strategy. FIL-20-2009 states that amid the credit turmoil, some institutions that were attracted to higher yields purchased illiquid and, in some instances, distressed structured securities at a discount. This strategy assumed the discount would provide a margin of safety against principal losses even given continued market stress, including ongoing deteriorating collateral performance and credit rating downgrades. However, in many cases, the discounts signaled the market's well-founded concerns and risk perception. Further, the FDIC has found that generally the discounts were not sufficient to cover the losses that followed.

FIL-20-2009 also reiterates that despite their initial credit ratings, these securities retained predominately speculative or high-risk characteristics. As a result, the purchase of higher-risk structured financial securities at a discount did not preclude the securities from adverse classification or analysis required by accounting rules to determine whether a decline in fair value is temporary or an other than temporary impairment (OTTI).<sup>8</sup>

#### Out-of-Area CRE Loan Concentrations

Between June 30, 2007 and June 30, 2008, Strategic Capital also increased total loans from \$133 million to \$248 million (or 87 percent). More specifically, CRE loans grew from approximately \$52 million at the time of the 2006 examination to approximately \$158 million by the July 2008 examination. Although Strategic Capital officials recognized that other institutions were exiting this arena in 2007, senior officials believed they could "cherry pick" the better CRE loans or projects and be profitable. Examiners also learned that Strategic Capital's Chairman wanted to replicate the aggressive growth strategy of another bank, ANB Financial, National Association (ANB) of Bentonville, Arkansas, because he perceived ANB's strategy to be highly successful at the time. Unfortunately, ANB's aggressive growth strategy proved unsuccessful in the long-term and was a leading cause of ANB's failure in May 2008.<sup>9</sup> Likewise, the strategy created significant risks for Strategic Capital and strains on its capital that it could not overcome.

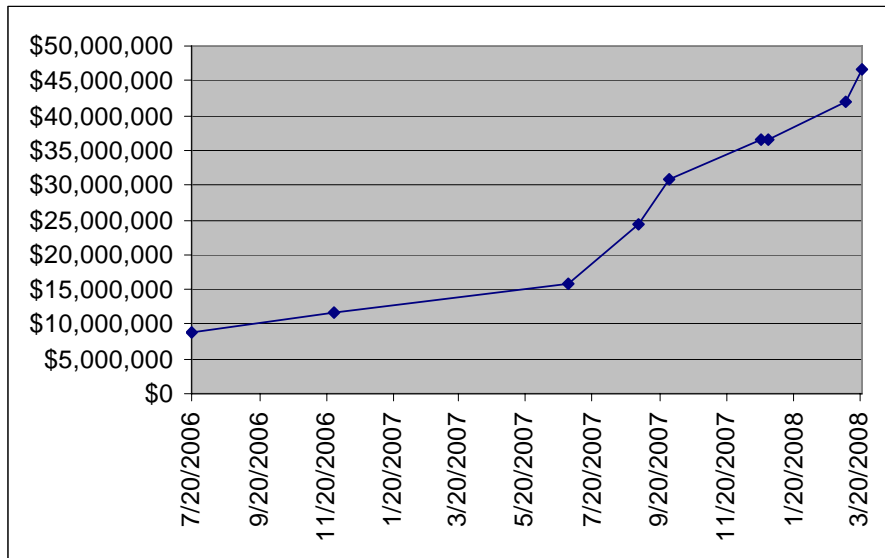
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<sup>8</sup> Under Statement of Financial Accounting Standards No.115, *Accounting for Certain Investments in Debt and Equity Securities*, if an impairment is other than temporary, the security must be written down to fair value, with the corresponding loss taken through earnings (i.e., the income statement) establishing a new cost basis for the security. The Statement was issued by the Financial Accounting Standards Board (FASB).

<sup>9</sup> The Department of the Treasury completed a material loss review of ANB and identified aggressive growth through CRE loans, including loans originated through an LPO, as one of the causes of ANB's failure (Treasury OIG report, entitled *Safety and Soundness: Material Loss Review of ANB Financial, National Association*, dated November 25, 2008 (Report No. OIG-09-013)).

Strategic Capital first purchased two participations from ANB in 2006. During its aggressive growth period, Strategic Capital purchased additional participations from ANB. The ANB loans were primarily extended for residential and commercial land development where repayment was dependent upon the sale of property. The loans purchased from ANB were secured by real estate located well beyond Strategic Capital's lending market - 72 percent were in Utah and the remaining 28 percent were secured by real estate in Arkansas, Arizona, and Wyoming. In most cases, soon after the loans were made, the projects were delayed or never completed, resulting in the borrower's delinquency. Figure 2 illustrates the current value of ANB loans that Strategic Capital purchased between 2006 and 2008 at the time of the FDIC and IDFPR 2009 visitation.

**Figure 2: Strategic Capital's ANB Loan Participations**



Source: DSC files for Strategic Capital.

Also, during its growth period, Strategic Capital's LPO generated approximately \$86 million in loans. Notably, ANB's business model had also included the use of an LPO. The LPO-generated loans represented approximately 40 percent of Strategic Capital's total loan portfolio with the vast majority centered in CRE lending. Although prior examination reports had noted that Strategic Capital's loan underwriting and credit administration practices were generally satisfactory, the 2009 visitation report stated that loan underwriting practices appeared to have been compromised in the bank's efforts to grow the bank.

According to FIL-104-2006, entitled, *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices*, dated December 12, 2006, concentrations in CRE loans can make institutions more vulnerable to cyclical CRE markets, and risk management practices and capital levels should be commensurate with the level and nature of the CRE concentration risk. Although the guidance does not specifically limit a bank's CRE lending, the guidance provides supervisory criteria for identifying financial institutions that may have significant concentrations in CRE loans. Specifically, FIL-104-2006 states that greater supervisory scrutiny may be appropriate for financial

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

The 2006 examination identified some concerns related to concentrations in commercial real estate. Further, the June 2007 examination cited a few concerns with the volume of out-of-area loans and recommended that the Board take steps to review and monitor all loans outside of the bank's trade area and give consideration to the principles of risk diversification when making loans. Both the 2008 examination and 2009 visitation reports emphasized the fact that the poor condition of the bank was a reflection of management's poor judgment as evidenced by the fact that many of the loans extended after the 2007 examination quickly went bad. For example, during the 2008 examination, a significant portion of the ANB loans were adversely classified. By the time of the FDIC and IDFPR visitation in February 2009, the bank had experienced additional asset quality deterioration, and 100 percent of the remaining ANB loans were classified. A significant portion of the LPO-generated loans also became problematic because of the poor real estate market and the borrower's inability to carry the projects.

The July 2008 examination also found that the bank was in apparent violation of Part 365, *Real Estate Lending Standards*, of the FDIC Rules and Regulations, in that the bank's loan policy did not include guidance on loan diversification and concentrations, and did not set any specific limits on types of loans. Strategic Capital's 2008 loan policy also omitted more detailed guidelines that had been in its previous 2005 policy regarding loan-to-value (LTV) limits. Further, the bank was in apparent contravention of Appendix A (*Interagency Guidelines for Real Estate Lending Policies*) of Part 365, with two loans that exceeded the loan-to-value limits that had not been included in the bank's LTV list.

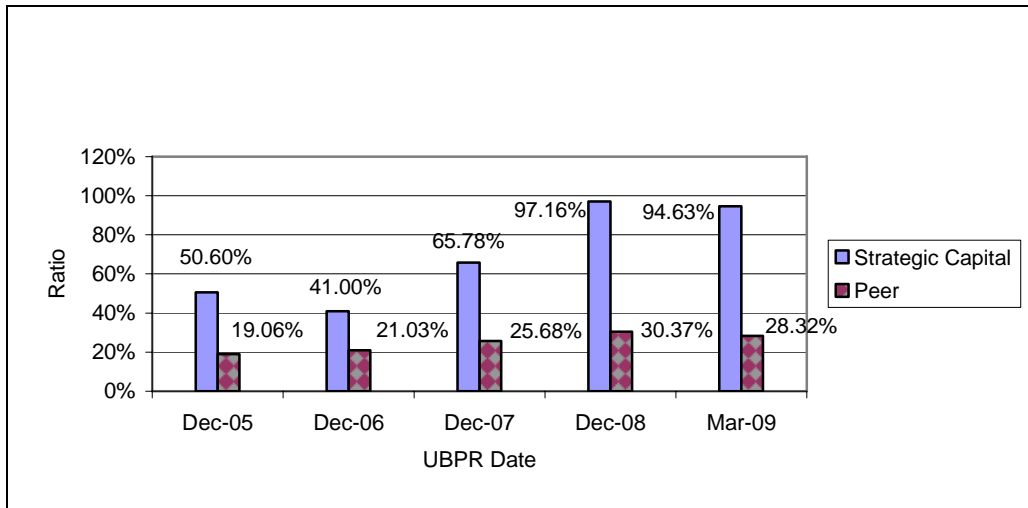
### **Reliance on Brokered Deposits**

Historically, Strategic Capital funded its lending and investment activities by acquiring brokered deposits. Longer-maturity brokered deposits were written with a call option to provide management with the flexibility of redeeming the deposit should interest rates drop significantly and spreads start to narrow. In addition, the only early withdrawal option held by the depositor was typically a "death put" (withdrawal permitted upon the death of the depositor). Although brokered deposits are usually viewed as volatile funding, Strategic Capital's management regarded brokered deposits as very stable because of the "death put" restriction. The 2006 and 2007 examination reports noted that Strategic Capital's liquidity structure was atypical and lent itself to a higher degree of risk. Nonetheless, the 2007 examination report found that Strategic Capital adequately managed non-core liabilities with proper attention to the maturity mix.

To fund its speculative growth strategy, management sharply increased its reliance on brokered deposits beginning in the fourth quarter of 2007. Between September 30, 2007 and June 30, 2008, brokered deposits increased from approximately \$102 million to \$467 million, or 359 percent. The bank also increased its reliance on Federal Home Loan Bank (FHLB) advances during this period. A key metric of the risks related to a bank's liquidity management is the net non-core funding dependence ratio. This ratio is an

indication of the degree to which the bank relies on non-core volatile liabilities, such as brokered deposits, FHLB borrowings to fund long-term earning assets, and certificates of deposit over \$100,000. Generally, the lower the ratio, the less risk exposure there is for the bank, whereas higher ratios reflect a reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions. During the 2007 examination, this ratio was reported to be 42.75 percent. As illustrated in Figure 3, Strategic Capital’s ratio was higher than 97 percent by December 2008, and its reliance on non-core funding was consistently and significantly higher than its peer group.

**Figure 3: Strategic Capital’s Net Non-Core Funding Dependence**



Source: UBPRs for Strategic Capital.

## The FDIC’s Supervision of Strategic Capital

Between 2005 and 2007, the FDIC and IDFPR conducted timely and regular examinations of Strategic Capital. Moreover, through their respective offsite monitoring activities, both the FDIC and IDFPR promptly identified the rapid growth that occurred in the span of a few months subsequent to the 2007 examination. Further, the FDIC and IDFPR recognized the fact that the rapid growth was funded primarily with brokered deposits and these activities had significantly altered Strategic Capital’s risk profile and warranted increased supervisory attention. Accordingly, the FDIC, in coordination with IDFPR, initiated a series of supervisory actions that led to the issuance of a formal enforcement action against Strategic Capital in August 2008 in an effort to stop unsafe and unsound practices and deficiencies related to its aggressive growth strategy. The FDIC and IDFPR closely monitored Strategic Capital’s condition after the cease and desist order (C&D) was issued until the institution was closed in May 2009.

### Supervisory History

Historically, Strategic Capital was a well-rated institution. From June 2006 through February 2009, the FDIC and IDFPR collectively conducted three full-scope examinations and three visitations of Strategic Capital. The bank had received a

composite “2” CAMELS rating in 2006 and a composite “1” in 2007.<sup>10</sup> These types of ratings generally indicate that a bank gives no cause for supervisory concern and weaknesses identified are considered minor and correctable in normal course of business. For example, consistent with its rating, the 2006 examination stated that all the exceptions noted were well within management’s ability to implement, and adequate commitments to implement recommendations were obtained during the various meetings with management or from the Board members at the examination exit meeting. Accordingly, given Strategic Capital’s 2007 composite rating and its size, the FDIC, which alternated examinations with IDPFR, would have planned the next on-site examination for December 2008.<sup>11</sup>

The level of supervisory concern changed considerably, however, in the fourth quarter of 2007, when the FDIC and IDPFR became aware through their respective offsite monitoring activities that Strategic Capital was sharply increasing assets and its reliance on brokered deposits. The actions taken by the FDIC in coordination with IDPFR, including a formal enforcement action, are discussed below. Table 3 summarizes examination and visitation activity from 2006 to 2009.

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<sup>10</sup> Financial institution regulators and examiners use the Uniform Financial Institutions Rating System (UFIRS) to evaluate a bank’s performance in six components represented by the CAMELS acronym: **C**apital adequacy, **A**sset quality, **M**anagement practices, **E**arnings performance, **L**iquidity position, and **S**ensitivity to market risk. Each component, and an overall composite score, is assigned a rating of 1 through 5, with 1 having the least regulatory concern and 5 having the greatest concern.

<sup>11</sup> Section 337.12 of the FDIC Rules and Regulations, which implements section 10(d) of the FDI Act, requires annual full-scope, on-site examinations of every state nonmember bank at least once during each 12-month period and allows for 18-month intervals for certain small institutions (total assets of less than \$500 million) if certain conditions are satisfied. Strategic Capital met these conditions by being well capitalized and being assigned a “1” or “2” management component rating and a “1” or “2” composite rating.

**Table 3: Examinations and Visitations of Strategic Capital from 2006 to 2009**

Start Date	As of Date	Agency	Supervisory Ratings (UFIRS)	Supervisory Action
1/17/2006	12/31/2005	FDIC	222122/2	N/A
6/04/2007	3/31/2007	State	121121/1	N/A
6/25/2007 Visitation*	3/31/2007	FDIC	N/A	FDIC participation in state examination.
4/22/2008 Visitation	3/31/2008	FDIC	N/A	Accelerated examination schedule by 5 months and identified the need to bring in two capital market specialists.
7/14/2008	6/30/2008	FDIC	445444/4	Issued C&D during the examination and an amended C&D when the examination was completed.
2/16/2009 Visitation	N/A	FDIC/State	555554/5	Continued monitoring compliance with C&D.

Source: Strategic Capital's Reports of Examination and DSC supervisory documents.

\*This activity is characterized in FDIC's tracking system as a visitation. An FDIC examiner participated in the state's examination to evaluate Strategic Capital's security portfolio. This activity did not result in a separate report; rather the results were reflected in the 2007 ROE.

### Supervisory Concern Related to Rapid Growth

The FDIC, in coordination with IDFPR, took prompt supervisory action to address the increased use of brokered deposits to fund rapid growth. Table 4 summarizes growth that was of concern to both the FDIC and IDFPR between September 2007 and March 2008.

**Table 4: Strategic Capital's Growth Between September 2007 and March 2008**

	Sep-2007 (\$000s)	Dec-2007 (\$000s)	Percent Change	Dec-2007 (\$000s)	Mar-2008 (\$000s)	Percent Change
Total Assets	300,973	379,130	26	379,130	635,890	68
Investments	128,603	198,286	54	198,286	419,052	111
Brokered Deposits	101,878	178,758	75	178,758	399,540	124

Source: UBPRs for Strategic Capital.

### April 22, 2008 Visitation

The FDIC's and IDFPR's respective offsite analyses of 2007 third quarter Call Report data in December 2007 prompted discussions between the FDIC and IDFPR about the level of growth that had occurred since June 2007, and resulted in an agreement on the need to closely evaluate Strategic Capital's 2007 fourth quarter Call Report data. The FDIC also called Strategic Capital officials to discuss the growth. In response to the FDIC's request during that discussion, Strategic Capital provided a list of ANB participations to the FDIC. The FDIC compared this list to a list of classified loans contained in an October 2007 Office of Comptroller of the Currency examination of

ANB. None of the ANB loans that Strategic Capital purchased were adversely classified at that time. Based on its analysis of the fourth quarter data, the FDIC planned two visits:

- A targeted review of the ANB loan purchases made since the 2007 examination. (By this time, FDIC officials were aware of ANB's deteriorating condition, and the FDIC wanted to assess the impact of ANB participations.)
- A targeted review of Strategic Capital's investment portfolio by the FDIC's capital market specialists.

The FDIC was able to begin the targeted review of loans purchased from ANB on April 22, 2008. The visitation report, issued on May 2, 2008, found that four of the ANB relationships were internally rated substandard and an additional two relationships posed an increasing risk to the loan portfolio. At the time of the visitation, three of the substandard relationships were delinquent, two of which were delinquent more than 90 days. The allowance for loan and lease losses (ALLL) was not at an appropriate level.

Based on the findings of the April 2008 visitation and the exceptional growth in assets, MBS, and brokered deposits reflected in the March 31, 2008 Call Report data, the FDIC decided to accelerate the start of its full-scope examination from the fourth quarter to the third quarter of 2008. Consequently, the FDIC decided to defer the second visit planned for June 2008 until July 2008 to coincide with the start of the examination.

#### July 2008 Examination

The 2008 examination team found that the overall condition of the bank had deteriorated from satisfactory to unsatisfactory because of the downturn in the MBS and CRE loan markets. The examination report characterized management's strategy of using insured brokered deposits to fund private-label MBS and CRE loans as speculative and wholly unacceptable. Two capital market specialists participated on the examination team in order to value the investment portfolio. The 2008 examination report stated that the downward trend of credit ratings was indicative of an increased default probability, and these downgrades had implications for Strategic Capital's risk-based capital ratio and regulatory capital thresholds. Examiners pointed out in the 2008 report that management did not acquire the requisite expertise related to the risk-based capital calculation and, consequently, did not understand the implications of the downgrades.

The FDIC's capital market specialists found that pricing the portfolio proved to be very volatile because of the credit rating downgrades that were occurring within the portfolio. The accounting rules for valuing these types of securities were also evolving at that time.<sup>12</sup> The capital market specialists consulted with DSC's Washington Office to determine the proper valuation and treatment for Call Report purposes. During

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<sup>12</sup> FASB Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, defines and establishes a framework for measuring fair value. In October 2008, additional guidance was issued to clarify application of this standard in a market that is not active.



the examination, the FDIC issued a C&D to compel the bank to discontinue its high-risk investment strategy. The order required the bank to:

- maintain or shrink total assets;
- prohibit the acceptance of any new brokered deposits;
- submit a written plan to reduce the volume of brokered deposits;
- develop a written contingency funding plan;
- submit a written plan to reduce the concentration of risk in securities backed by nontraditional mortgages, and mortgages with less than full documentation of underlying loans;
- maintain Tier 1 capital and risk-based capital at or above 8 percent and 12 percent, respectively;
- prohibit the declaration or payment of any cash dividends;
- establish policies and procedures to establish independent pricing on its investment portfolio;
- adopt written guidelines to quarterly assess the securities portfolio for impairment, in compliance with generally accepted accounting principles;
- establish policies and procedures for risk-based capital treatment of securities;
- develop a program to provide for monitoring of the bank's compliance with the order; and
- provide progress reports to the FDIC's Regional Director.

The bank stipulated to the C&D on August 14, 2008. On August 29, 2008, the bank forwarded to the FDIC its *Corrective Action and Preliminary Capital Restoration Plan* that was approved by Strategic Capital's Board on August 27, 2008. Additionally, in September 2008, the bank began submitting daily Liquidity Reports to the FDIC. Upon completion of the examination, an amended C&D was issued to address the remaining examination concerns. The bank stipulated to the amended C&D on December 8, 2008.

#### February 2009 Joint Visitation

The February 2009 joint visitation found that the bank's overall condition had continued to decline significantly since the July 2008 examination. The following highlights the visitation results:

- The CRE concentration had increased to represent 545 percent of Tier 1 Capital (due to the decline in capital).
- Classified loans increased to \$77 million. ANB loan classifications represented 46 percent of total loan classifications and loans generated from the LPO represented 47 percent of total loans classifications. As a result of the poor condition of the loan portfolio, examiners determined that a provision of almost \$10 million was required to reflect an acceptable ALLL balance.
- The valuation of the investment portfolio proved to be critical and difficult because of continued turmoil in the credit market. The FDIC capital market specialists took exception to the valuation model the bank used to calculate the fair value of the private-label MBS.

- The December 31, 2008 Call Report had to be amended to reflect several findings of this visit. First, the provision expense of nearly \$10 million was necessary to replenish the ALLL to an acceptable level. Second, additional unrealized losses related to the securities portfolio also needed to be reflected. Third, total risk weighted assets needed to be increased significantly.

The visitation report also noted that management had not fully complied with the amended C&D, and failure of the institution appeared imminent.

### **Supervisory Concern Related to Brokered Deposits**

FDIC's Rules and Regulations Part 337, *Unsafe and Unsound Banking Practices*, states that any *Well Capitalized* insured depository institution may solicit and accept, renew, or roll over any brokered deposits without restriction. Under FDIC's Rules and Regulations, restrictions on brokered deposits are imposed when an institution falls below *Well Capitalized*.<sup>13</sup> Thus, prior to August 2008, when Strategic Capital's capital level fell below *Well Capitalized*, it was allowed to acquire brokered deposits. Accordingly, even though Strategic Capital was aware of its deteriorating condition, it was able to acquire an additional \$83 million of insured brokered deposits at the end of July 2008.

Bank officials indicated to examiners that the purchase had been planned prior to the examination. The funds were used to pay off maturing brokered deposits, and no additional brokered deposits were added after July 2008. This increase, while allowable, could have potentially increased the cost to the DIF if all the deposits were not assumed by the acquiring institution. In February 2009, the bank submitted a request to roll over brokered deposits; however, the FDIC had notified the bank on March 12, 2009 that it was *Significantly Undercapitalized*. Under Part 337, the FDIC does not have the authority to waive brokered deposit restrictions for institutions that are less than *Adequately Capitalized*. Consequently, the FDIC denied the request.

In March 2009, the FDIC issued additional guidance, entitled, *The Use of Volatile or Special Funding Sources by Financial Institutions That are in a Weakened Condition*, (FIL 13-2009) that informs institutions that the FDIC will heighten its supervisory concern for institutions that rely on non-core liabilities to fund risky assets, and that such activity could result in higher deposit insurance premiums. Although this guidance was not in effect at the time, increased reliance on brokered deposits was one of the triggers for increased supervisory attention by the FDIC and IDFP in the fourth quarter of 2007.

### **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. PCA establishes a system of restrictions and mandatory and discretionary supervisory actions that are to be triggered depending on an

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<sup>13</sup> Under Part 337, *Undercapitalized* and *Adequately Capitalized* institutions are prohibited from obtaining or rolling over brokered deposits; however, *Adequately Capitalized* institutions may request a waiver of the prohibition.

institution's capital levels. Part 325 of the FDIC's Rules and Regulations implements PCA requirements by establishing a framework for taking prompt corrective action against insured nonmember banks that are not adequately capitalized. Enforcement actions addressing Strategic Capital's capital deficiencies were taken in accordance with PCA capital-related provisions. Based on the supervisory actions taken, the FDIC properly implemented applicable PCA provisions of FDI Act section 38 in a timely manner, as follows:

- On August 12, 2008, the FDIC notified the bank it was considered *Undercapitalized* and that it could not accept, renew, or roll over any brokered deposits as a result of the July 2008 examination.
- On September 24, 2008, the FDIC notified the bank that after a \$5.1 million capital injection in August 2008, the bank's capital category was raised to *Adequately Capitalized*, which still restricted the acquisition of brokered deposits without a waiver from the FDIC.
- On March 12, 2009, the FDIC notified Strategic Capital that its capital ratios for PCA purposes had declined to *Significantly Undercapitalized* as a result of the February 2009 joint visitation.

Strategic Capital submitted an application for Troubled Asset Relief Program (TARP)<sup>14</sup> funding on November 14, 2008. Strategic Capital subsequently withdrew its application on April 20, 2009. The bank was unsuccessful in raising needed capital and was subsequently closed on May 22, 2009.

## Corporation Comments

After we issued our draft report, we met with management officials to further discuss our results. Management provided additional information for our consideration, and we revised our report to reflect this information, as appropriate. On December 4, 2009, the Director, DSC, provided a written response to the draft report. DSC's response reiterated the OIG's conclusions regarding the cause of failure and our assessment of supervision, and the response is provided in its entirety as Appendix 4 of this report.

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<sup>14</sup>TARP was established under the Emergency Economic Stabilization Act of 2008. The Act established the Office of Financial Stability within the Department of the Treasury. Under the TARP, Treasury will purchase up to \$250 billion of preferred shares from qualifying institutions as part of the Capital Purchase Program.

## Objectives, Scope, and Methodology

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### Objectives

We performed this audit in accordance with section 38(k) of the FDI Act, which provides, in general, that if a deposit insurance fund incurs a material loss with respect to an insured depository institution, the Inspector General of the appropriate federal banking agency shall prepare a report to that agency reviewing the agency's supervision of the institution. The FDI Act requires that the report be completed within 6 months after it becomes apparent that a material loss has been incurred.

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

We conducted this performance audit from September 2009 to November 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

### Scope and Methodology

The scope of this audit focused on Strategic Capital's operations from 2006 until its failure on May 22, 2009. Our review also entailed an evaluation of the regulatory supervision of the institution over the same period.

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

- Analyzed ROEs and visitation reports prepared by the FDIC and the IDFPF examiners from 2006 to 2009.
- Reviewed the following:
  - Bank data and correspondence maintained at DSC's Chicago Regional Office and Field Office.
  - Reports prepared by the Division of Resolutions and Receiverships (DRR) and DSC relating to the bank's closure.
  - Pertinent DSC policies and procedures.
- Interviewed the following officials:
  - DSC management in Washington, D.C., and the Chicago Regional Office.

## Objectives, Scope, and Methodology

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- FDIC examiners from the Champaign and Springfield, Illinois, Field Offices, and the Eau Claire, Wisconsin, Field Office, as well as capital market specialists from the Chicago Regional Office and Princeton, Illinois, Field Office who participated in examinations and visitations of Strategic Capital.
- DRR officials at the Dallas Regional Office.
- Officials from IDFPR to discuss the historical perspective of the institution, its examinations, and other activities regarding the state's supervision of the bank.

### **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 Strategic Capital's management controls pertaining to causes of failure and material loss as discussed in the body of this report.

We obtained data from various FDIC systems but determined that information system controls were not significant to the audit objectives and, therefore, did not evaluate the effectiveness of information system controls. We relied on our analysis of information from various sources, including 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 material loss review, we did not assess the strengths and weaknesses of DSC's annual performance plan in meeting the requirements of the Results Act because such an assessment is not part of the audit objectives. DSC's compliance with the Results Act is reviewed in program audits of DSC operations.

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

## Glossary of Terms

<b>Term</b>	<b>Definition</b>
<b>Adversely Classified Assets</b>	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.
<b>Allowance for Loan and Lease Losses (ALLL)</b>	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.
<b>Call Report</b>	Consolidated Reports of Condition and Income (also known as the Call Report) 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.
<b>Cease and Desist Order (C&amp;D)</b>	A C&D is a formal enforcement action issued by a financial institution regulator to a bank or affiliated party to stop an unsafe or unsound practice or a violation of laws and regulations. A C&D may be terminated when the bank's condition has significantly improved and the action is no longer needed or the bank has materially complied with its terms.
<b>Concentration</b>	A concentration is a significantly large volume of economically related assets that an institution has advanced or committed to a certain industry, person, entity, or affiliated group. These assets may, in the aggregate, present a substantial risk to the safety and soundness of the institution.
<b>Loan Production Office (LPO)</b>	LPOs are banking offices that take loan applications and arrange financing for corporations and small businesses, but they do not accept deposits. Loan applications are subject to approval by the lending institution.
<b>Mortgage Backed Security (MBS)</b>	Securities representing an undivided interest in a pool of mortgages with similar characteristics. Payments on the underlying mortgages are used to make payments to the security holders.
<b>Other Than Temporary Impairment (OTTI)</b>	An impairment of a debt instrument occurs when the fair value of the security is less than its amortized cost basis. According to accounting standards, when the impairment is judged to be other than temporary, the cost basis of the individual security must be written down to fair value, thereby establishing a new cost basis for the security and the amount of the write-down must be included in earnings as a realized loss.
<b>Private Label Mortgage-Backed Securities</b>	Mortgage-backed securities issued by private entities that are generally comprised of nonconforming loans or mortgages that do not meet the size, delinquency, or underwriting standards to be included in agency-issued securities.

## Glossary of Terms

<p><b>Prompt Corrective Action (PCA)</b></p>	<p>The purpose of PCA is to resolve the problems of insured depository institutions at the least possible long-term cost to the DIF. Part 325, subpart B, of the FDIC Rules and Regulations, 12 Code of Federal Regulations (C.F.R), section 325.101, et. seq., implements section 38, <i>Prompt Corrective Action</i>, of the FDI Act, 12 United States Code section 1831(o), by establishing a framework for taking prompt supervisory actions against insured nonmember banks that are less than adequately capitalized. The following terms are used to describe capital adequacy: (1) Well Capitalized, (2) Adequately Capitalized, (3) Undercapitalized, (4) Significantly Undercapitalized, and (5) Critically Undercapitalized.</p> <p>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.</p>
<p><b>Risk-Based Capital</b></p>	<p>A “supplemental” capital standard under Part 325 of the FDIC Rules and Regulations. Under the risk-based framework, a bank’s qualifying total capital base consists of two types of capital elements, “core capital” (Tier 1) and “supplementary capital” (Tier 2).</p>
<p><b>Risk-Weighted Assets</b></p>	<p>A system of calculating the risk-weighting of assets by assigning assets and off-balance sheet items to broad risk categories.</p>
<p><b>Tier 1 (Core) Capital</b></p>	<p>Defined in Part 325 of the FDIC Rules and Regulations, 12 C.F.R. section 325.2(v), as</p> <p><b>The sum of:</b></p> <ul style="list-style-type: none"> <li>• Common stockholder’s equity (common stock and related surplus, undivided profits, disclosed capital reserves, foreign currency translation adjustments, less net unrealized losses on available-for-sale securities with readily determinable market values);</li> <li>• Non-cumulative perpetual preferred stock; and</li> <li>• Minority interest in consolidated subsidiaries;</li> </ul> <p><b>Minus:</b></p> <ul style="list-style-type: none"> <li>• Certain intangible assets;</li> <li>• Identified losses;</li> <li>• Investments in securities subsidiaries subject to section 337.4; and</li> <li>• Deferred tax assets in excess of the limit set forth in section 325.5(g).</li> </ul>

## Glossary of Terms

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<b>Tier 2 (Supplemental) Capital</b>	<p>Tier 2 capital is defined in Appendix A to Part 325 of the FDIC Rules and Regulations, and is generally the sum of:</p> <ul style="list-style-type: none"> <li>• Allowances for loan and lease losses, up to a maximum of 1.25 percent of risk-weighted assets;</li> <li>• Cumulative perpetual preferred stock, long-term preferred stock and related surplus;</li> <li>• Perpetual preferred stock (dividend is reset periodically);</li> <li>• Hybrid capital instruments; and</li> <li>• Term subordinated debt and intermediate-term preferred stock.</li> </ul>
<b>Uniform Bank Performance Report (UBPR)</b>	<p>The UBPR is an individual analysis of financial institution financial data and ratios that includes extensive comparisons to peer group performance. The report is produced by the 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.</p>



## Acronyms

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ALLL	Allowance for Loan and Lease Losses
ANB	ANB Financial, National Association
C&D	Cease and Desist Order
CAMELS	<u>C</u> apital, <u>A</u> sset Quality, <u>M</u> anagement, <u>E</u> arnings, <u>L</u> iquidity, and <u>S</u> ensitivity to Market Risk
CMO	Collateralized Mortgage Obligation
CNB	Citizens National Bank
CRE	Commercial Real Estate
DIF	Deposit Insurance Fund
DRR	Division of Resolutions and Receiverships
DSC	Division of Supervision and Consumer Protection
FASB	Financial Accounting Standards Board
FDI	Federal Deposit Insurance
FDIC	Federal Deposit Insurance Corporation
FHLB	Federal Home Loan Bank
FIL	Financial Institution Letter
IDFPR	Illinois Department of Financial Professional Regulation
LPO	Loan Production Office
LTV	Loan-to-Value
MBS	Mortgage-Backed Securities
OIG	Office of Inspector General

## Acronyms

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OTTI	Other Than Temporary Impairment
PCA	Prompt Corrective Action
ROE	Report of Examination
SCBI	Strategic Capital Bancorp, Incorporated
TARP	Troubled Asset Relief Program
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System

## Corporation Comments

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**Federal Deposit Insurance Corporation**  
550 17th Street NW, Washington, D.C. 20429-9950

Division of Supervision and Consumer Protection

December 4, 2009

MEMORANDUM TO: Stephen Beard  
Assistant Inspector General for Material Loss Reviews

FROM: Sandra L. Thompson  
Director

SUBJECT: Draft Audit Report Entitled, Material Loss Review of Strategic  
Capital Bank, Champaign, Illinois  
(Assignment No. 2009-054)

Pursuant to Section 38(k) of the Federal Deposit Insurance Act (FDI Act), the Federal Deposit Insurance Corporation's Office of Inspector General (OIG) conducted a material loss review of Strategic Capital Bank (SCB) which failed on May 22, 2009. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Report (Report) received on November 13, 2009.

The Report concludes SCB failed due to the Board's and management's speculative and ill-timed growth strategy involving higher-risk assets and non-core funding that began subsequent to the June 2007 examination. The Report further states SCB significantly altered its risk profile in the fourth quarter of 2007 and first quarter of 2008. Additionally, SCB's rapid growth strategy was in contravention of long-standing supervisory guidance related to commercial real estate concentrations and securities. The rapid deterioration in market conditions led to credit downgrades in SCB's securities portfolio and increasing loan problems. Ultimately, SCB did not have the capital to absorb the losses and adequately support its new risk profile.

As part of the supervisory program, the FDIC and the Illinois Department of Financial Professional Regulation (IDFPR) conducted on-site risk management examinations in January 2006, June 2007, and July 2008; and on-site risk management visitations in June 2007, April 2008, and February 2009; of which the July 2008 examination included recommendations regarding concentrations and non-core funding. As recognized in the Report, offsite monitoring by both the FDIC and the IDFPR in December 2007, promptly identified the rapid growth subsequent to the June 2007 examination, and FDIC performed additional offsite monitoring in January 2008, March 2008, and June 2008. Further, in August 2008, DSC issued a formal enforcement action in an effort to stop unsafe and unsound banking practices and address deficiencies related to SCB's aggressive growth strategy. FDIC and the IDFPR appropriately monitored SCB until the time that it was closed.

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