Office of Inspector General

Office of Material Loss Reviews
Report No. IDR-11-004

In-Depth Review of the Failure of The Park Avenue Bank, New York, New York

December 2010

Office of Inspector General

Executive Summary

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Why We Did The Audit

On March 12, 2010, the New York State Banking Department (NYSBD) closed The Park Avenue Bank (Park Avenue), New York, New York, and named the FDIC as receiver. On April 1, 2010, the FDIC notified the Office of Inspector General (OIG) that Park Avenue's total assets at closing were $509 million and the estimated loss to the Deposit Insurance Fund (DIF) was $48.9 million As of September 3, 2010, the estimated loss to the DIF had increased to $57.1 million.

On July 21, 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Financial Reform Act). The 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. Although the estimated loss for Park Avenue does not meet the amended threshold requiring an MLR, the OIG determined that the circumstances pertaining to the failure of Park Avenue warranted an in-depth review as authorized by the Financial Reform Act.

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

Background

Park Avenue was established in November 1987 as a federally-chartered bank under the supervision of the Office of the Comptroller of the Currency. Until its conversion to a state charter on March 30, 2004, Park Avenue operated as a wholesale institution focusing on international trade finance and working capital loans to foreign companies and financial institutions. Following the charter conversion, a new investor purchased a majority of the bank's common stock, new directors were elected to the Board of Directors (Board), and the bank's executive officers were replaced. Park Avenue also reduced its foreign country exposure and changed its business strategy to that of a community-based retail bank. Between 2004 and 2007, Park Avenue's lending activities focused on commercial real estate, including acquisition, development, and construction projects. During 2007, the bank began emphasizing commercial and industrial loans to businesses in a wide range of industries. Park Avenue's main office was located in Manhattan. The bank also operated three branches in Brooklyn and one branch in Manhattan.

Audit Results

Causes of Failure and Loss

Park Avenue failed primarily because of lax oversight by its Board and management and a lack of sound corporate governance. Following its charter conversion in 2004, Park Avenue embarked on a rapid loan growth strategy without adequate loan underwriting, credit administration, or related monitoring practices. High overhead expenses and a high cost of funds added to Park Avenue's financial problems, as the bank did not achieve an annual pre-tax profit on its operations after its charter conversion. Park Avenue's loan growth, together with recurring pre-tax losses from operations, caused the bank to fall below *Well Capitalized* for PCA purposes by March 2008. Notably, Park Avenue continued to grow its average total assets during 2009, even though the bank had fallen below *Adequately Capitalized*, in apparent violation of the growth restrictions imposed by PCA. Some of the loans made during this period were poorly underwritten and experienced problems soon after they were originated. In general, Park Avenue's Board and management failed to promptly or fully respond to negative trends and developments in the institution's financial and operational condition or to effectively address regulatory concerns.

Park Avenue's weakened capital position strained its liquidity and limited the bank's ability to absorb losses when the credit quality of its assets deteriorated. In an attempt to improve the bank's capital position, management purported to raise $6.6 million in new capital during the fourth quarter of 2008. However, it was later determined that $6.5 million of this amount consisted of borrowings from the bank itself. Because the FDIC Rules and Regulations do not permit such funds to be treated as regulatory capital, the bank's true capital position was worse than reported by management. Further, losses associated with the bank's investment securities, together with an $8.7 million write-down of a deferred tax asset, effectively offset the purported capital infusion and resulted in the bank reporting an *Undercapitalized* position at year-end 2008. During 2009, the quality of Park Avenue's loan portfolio deteriorated significantly, resulting in losses totaling almost $20 million. By January 2010, the bank had become *Critically Undercapitalized*, and efforts to raise new capital had not been successful. The NYSBD closed Park Avenue on March 12, 2010 because it could not raise sufficient capital to continue safe and sound operations.

On October 8, 2010, the United States Attorney for the Southern District of New York issued a press release stating that the President and CEO of Park Avenue had pled guilty to criminal charges of fraud against the U.S. Treasury's Troubled Asset Relief Program, securities fraud, self-dealing, bank bribery, and embezzlement of bank funds. With respect to the fraud charges, the press release stated that the President and CEO admitted to misleading the FDIC and NYSBD by representing that $6.5 million of the $6.6 million in purported capital infused into the bank during the fourth quarter of 2008 consisted of personal funds, when in fact, the source of the funds consisted of borrowings from the bank. The business transactions pertaining to these criminal charges, including the purported capital infusion, contributed to the financial problems that developed at the bank. At the time of our review, the FDIC was continuing to review the causes of Park Avenue's failure, including the Board and management's implementation of strategies and risk management practices, and the extent to which the causes might result in additional regulatory action.

The FDIC's Supervision of Park Avenue

The FDIC, in coordination with the NYSBD, provided ongoing supervisory oversight of Park Avenue through regular on-site risk management examinations, visitations, and offsite monitoring activities. Through its supervisory efforts, the FDIC identified key risks in Park Avenue's operations and brought these risks to the attention of the institution's Board and management. Such risks included lax Board and management oversight, unsatisfactory earnings, weak risk management practices (including with respect to the lending function), and repeat apparent violations of laws and regulations and contraventions of statements of policy. Further, Park Avenue never received a satisfactory composite or management component rating following the bank's charter conversion in 2004. Such supervisory ratings were forward-looking and properly reflected the bank's risky management practices.

In October 2005, Park Avenue adopted a Bank Board Resolution (BBR) that focused on addressing BSA program deficiencies identified during the April 2005 examination. Included within the BBR were provisions to strengthen the bank's earnings performance and strategic planning. However, management's efforts to improve its earnings and strategic planning were not successful. Examiners identified new, and in some cases, repeat internal control and risk management weaknesses during the May 2006 and June 2007 examinations. The FDIC seriously considered implementing Memorandums of Understanding (MOU) with Park Avenue to address the weaknesses identified during these examinations. However, due to various reasons described in the report, the MOUs were not implemented. Instead, examiners made recommendations in the reports of examination and senior New York Regional Office officials and examiners made recommendations during meetings and telephone discussions with bank management to address the weaknesses.

In retrospect, obtaining a commitment from Park Avenue for more affirmative action to address the weaknesses identified during the May 2006 and June 2007 examinations, such as through an MOU, may have been beneficial. Such an approach could have furthered the FDIC's ongoing efforts to set an appropriate supervisory tenor of expectations. However, given management's lack of compliance with supervisory enforcement actions implemented in subsequent years, it is uncertain whether the MOUs would have influenced Park Avenue's Board and management to take more effective and timely actions to address examiner concerns.

Based on the weaknesses identified during the July 2008 examination, the FDIC and NYSBD issued parallel Cease and Desist Orders (C&D) against Park Avenue, which became effective in February 2009. In April 2009, the FDIC and NYSBD conducted a visitation to determine the sufficiency of management's responses to the C&Ds and advised management of its lack of compliance. In July 2009, the FDIC and NYSBD notified the bank's Board that its actions to comply with the C&Ds were deficient and reminded the Board of the potential consequences of material noncompliance with the orders, such as civil money penalties. Park Avenue's Board and management were ultimately unsuccessful in returning the bank to a safe and sound condition and, as a result, the NYSBD closed Park Avenue on March 12, 2010. At the time of our review, the FDIC was reviewing the circumstances pertaining to the bank's lack of compliance with the C&Ds and apparent violation of PCA's growth restrictions to determine whether additional regulatory actions would be appropriate.

With respect to PCA, the FDIC implemented supervisory actions that were consistent with relevant provisions of section 38. Among other things, the FDIC notified Park Avenue of changes in its PCA capital category; requested and evaluated capital restoration plans; monitored the institution's financial condition and activities; and expressed concern to the bank's Board and management regarding issues of apparent noncompliance. While the FDIC monitored and advised management of its concerns regarding Park Avenue's apparent violation of the growth restrictions defined in PCA, more aggressive action may have been warranted. Doing so would have been consistent with the FDIC's guidance in this area and would have provided another avenue for instilling urgency in the bank's Board and management to implement corrective measures.

Management Response

After we issued our draft report, management provided additional information for our consideration, and we revised our report to reflect this information, as appropriate. On December 22, 2010, the DSC Director provided a written response to the draft report. That response is provided in its entirety as Appendix 4 of this report. In the response, the DSC Director reiterated the causes of Park Avenue's failure described in our report. With regard to our assessment of the FDIC's supervision of the bank, the Director summarized the supervisory activities described in our report and noted that the actions taken by the Board and management were generally not timely or adequate to correct the risk management weaknesses that existed at the bank. The response added that DSC has issued guidance to enhance its supervision of institutions with CRE concentrations.

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Office of Material Loss Reviews
Office of Inspector General

DATE: December 23, 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 The Park Avenue Bank, New York, New York*
(Report No. IDR-11-004)

The New York State Banking Department (NYSBD) closed The Park Avenue Bank (Park Avenue) on March 12, 2010, and named the FDIC as receiver. On April 1, 2010, the FDIC notified the Office of Inspector General (OIG) that Park Avenue's total assets at closing were $509 million and that the estimated loss to the Deposit Insurance Fund (DIF) was $48.9 million. As of September 3, 2010, the estimated loss to the DIF had increased to $57.1 million (or 11 percent of Park Avenue's total assets at closing).

On July 21, 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Financial Reform Act). The Financial Reform Act amends section 38(k) of the Federal Deposit Insurance Act (FDI Act) by increasing the threshold for a material loss review from $25 million to $200 million for losses that occur for the period January 1, 2010 through December 31, 2011. The Financial Reform Act also establishes a new requirement to review all failures to (a) identify all losses that the Inspector General estimates have been incurred by the DIF, (b) identify the grounds identified by the state or federal banking agency for appointing the FDIC as receiver, and (c) determine whether any unusual circumstances exist that may warrant an in-depth review (IDR) of the loss. Although the estimated loss for Park Avenue does not meet the amended threshold requiring an MLR, the OIG determined that the circumstances pertaining to the failure of Park Avenue warranted an IDR as authorized by the Financial Reform Act.

Consistent with the Financial Reform Act and FDI Act provisions described above, the objectives of this review were to (1) determine the causes of Park Avenue's failure and the causes of the resulting loss to the DIF and (2) evaluate the FDIC's supervision of Park Avenue, including the FDIC's implementation of the Prompt Corrective Act (PCA) provisions of section 38 of the FDI Act. This report presents our analysis of Park Avenue's failure and the FDIC's efforts to promote safe and sound banking operations at the institution. The report does not contain formal recommendations. Instead, as major causes, trends, and common characteristics of institution failures are identified in our material loss and in-depth reviews, we will communicate those to FDIC management for its consideration. As resources allow, we may also conduct more comprehensive reviews of specific aspects of the FDIC's supervision program and make recommendations as warranted.[1]

Appendix 1 contains detailed information pertaining to our objectives, scope, and methodology. We also include several other appendices to this report. Appendix 2 contains a glossary of terms, including material loss, the FDIC's supervision program, and the Uniform Financial Institutions Rating System (otherwise known as CAMELS ratings). Appendix 3 contains a list of acronyms. Appendix 4 presents the Corporation's comments on our report.

Background

Park Avenue was established in November 1987 as a federally-chartered bank under the supervision of the Office of the Comptroller of the Currency (OCC). Until its conversion to a state charter on March 30, 2004, Park Avenue operated as a wholesale institution focusing on international trade finance and working capital loans to foreign companies and financial institutions located in the Republic of Turkey (Turkey), Latin America, and Europe. Park Avenue had a troubled regulatory history while under the OCC's supervision. In January 2003, the institution entered into a Consent Order to Cease and Desist (C&D) with the OCC requiring, among other things, that the bank develop and implement an acceptable capital program and strategic plan, or if this was not accomplished, to sell, merge, or liquidate the bank.

In January 2004, Park Avenue applied to the NYSBD for a state charter. To obtain favorable consideration of its application, Park Avenue and certain individuals[2] entered into a formal agreement with the NYSBD. Key provisions of the agreement included requirements for Park Avenue to reduce its foreign country exposure, maintain minimum capital levels, and replace its management team. In March 2004, the NYSBD approved Park Avenue's application for a state charter. The FDIC and NYSBD subsequently approved a change in the bank's control whereby a new investor purchased a majority of the institution's common stock and infused $10 million in capital. As part of the change in control, new directors were elected to the Board of Directors (Board) and the bank's executive officers were replaced. Park Avenue also took steps to reduce its foreign country exposure and changed its overall business strategy to that of a community-based retail bank.

Between 2004 and 2007, Park Avenue's lending activities focused on commercial real estate (CRE), including acquisition, development, and construction (ADC) projects. During 2007, the bank began emphasizing commercial and industrial (C&I) loans to businesses in a wide range of industries. Park Avenue also maintained an investment securities portfolio consisting primarily of U.S. Government and agency securities and

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[1]A further discussion of OIG-related coverage of financial institution failures can be found in the *Objectives, Scope, and Methodology* section of the report.

[2] These individuals included the Board directors, a proposed Board director, and a proposed majority shareholder.

various debt and equity instruments, such as residential mortgage-backed securities, collateralized debt obligations, and preferred shares in the Federal National Mortgage Association (Fannie Mae).

As of August 31, 2009, approximately 95 percent of Park Avenue's common stock was held by the Park Avenue Bancorp, Inc. (Bancorp), a privately-held, one-bank holding company located in New York City. The remainder of the bank's common stock was held by the Savings Deposit Insurance Fund of Turkey. Park Avenue's President and Chief Executive Officer (CEO) owned about 52 percent of Bancorp's common stock.[3] An additional 34 percent of the holding company's common stock was owned by another individual, with the remainder of the stock owned by various investors. Park Avenue's main office was located in Manhattan. The bank also operated three branches in Brooklyn and one branch in Manhattan. Table 1 summarizes selected financial information for Park Avenue for the 5 years ended December 31, 2009.

Table 1: Selected Financial Information for Park Avenue

Financial Measure ($000)	Dec-05	Dec-06	Dec-07	Dec-08	Dec-09
Total Assets	292,162	389,079	394,010	494,305	520,146
Total Deposits	216,983	288,409	272,870	421,584	494,505
Gross Loans and Leases	177,775	218,367	250,148	360,948	379,488
Pretax Net Operating Income (Loss)	(168)	(611)	(3,483)	(5,689)	(19,887)
Net Income (Loss)	1,456	976	(9 ,271)	(6,547)	(19,887)

Source: Uniform Bank Performance Reports (UBPR) for Park Avenue.

Causes of Failure and Loss

Park Avenue failed primarily because of lax oversight by its Board and management and a lack of sound corporate governance. Following its charter conversion in 2004, Park Avenue embarked on a rapid loan growth strategy without adequate loan underwriting, credit administration, or related monitoring practices. High overhead expenses and a high cost of funds added to Park Avenue's financial problems, as the bank did not achieve an annual pre-tax profit on its operations following the charter conversion. Park Avenue's loan growth, together with recurring pre-tax losses from operations, caused the bank to fall below *Well Capitalized* for PCA purposes by March 2008. Notably, Park Avenue continued to grow its average total assets during 2009, even though the bank had fallen below *Adequately Capitalized*, in apparent violation of the growth restrictions imposed by PCA. Some of the loans made during this period were poorly underwritten and experienced problems soon after they were originated. In general, Park Avenue's Board and management failed to promptly or effectively respond to negative trends and

[3] The majority of the President and CEO's stock was acquired during the fourth quarter of 2008 and was controlled by a third-party trustee while the NYSBD considered a change in control application. In addition, the President and CEO owned one-third of Park Avenue Associates, Inc., which held about 4 percent of Bancorp's outstanding stock.

developments in the institution's financial and operational condition or to fully address regulatory concerns.

Park Avenue's weakened capital position strained its liquidity and limited the bank's ability to absorb losses when the credit quality of its assets deteriorated. In an attempt to improve the bank's capital position, management purported to raise $6.6 million in new capital during the fourth quarter of 2008. However, it was later determined that $6.5 million of this amount consisted of borrowings from the bank itself. Because the FDIC Rules and Regulations do not permit such funds to be accorded treatment as regulatory capital, the bank's true capital position was worse than reported by management. Further, losses associated with the bank's investment securities, together with an $8.7 million write-down of a deferred tax asset (DTA),[4] effectively offset the purported capital infusion and resulted in the bank reporting an *Undercapitalized* position at year-end 2008. During 2009, the quality of Park Avenue's loan portfolio deteriorated significantly, resulting in losses totaling almost $20 million. By January 2010, the bank had become *Critically Undercapitalized*, and longstanding efforts to raise new capital had not been successful. The NYSBD closed Park Avenue on March 12, 2010 because it could not raise sufficient capital to continue safe and sound operations.

On October 8, 2010, the United States Attorney for the Southern District of New York issued a press release stating that the President and CEO of Park Avenue had pled guilty to criminal charges of fraud against the U.S. Treasury's Troubled Asset Relief Program (TARP), securities fraud, self-dealing, bank bribery, and embezzlement of bank funds. With respect to the fraud charges, the press release stated that the President and CEO admitted to misleading the FDIC and NYSBD by representing that $6.5 million of the $6.6 million in purported capital infused into the bank during the fourth quarter of 2008 consisted of personal funds, when in fact, the source of the funds consisted of borrowings from the bank. The business transactions pertaining to these criminal charges, including the purported capital infusion, contributed to the financial problems that developed at the bank. At the time of our review, the FDIC was continuing to review the causes of Park Avenue's failure, including the Board and management's implementation of strategies and risk management practices, and the extent to which the causes might result in additional regulatory action.

Board Oversight and Governance

The *DSC Risk Management Manual of Examination Policies* (Examination Manual) states that the quality of an institution's management, including its Board and executive officers, is perhaps the single most important element in the successful operation of an institution. According to the Examination Manual, the Board has overall responsibility and authority for formulating sound policies and objectives for the institution and for effectively supervising the institution's affairs. Executive officers, such as the President and CEO, Chief Lending Officer (CLO), and Chief Financial Officer (CFO), have

[4] A DTA is the potential tax benefit associated with operating losses. In the case of Park Avenue, it represented the expected value of future income tax savings that would be available to offset expected future taxable income with the carry-forward of net operating losses. See the Glossary of Terms for more information.

primary responsibility for managing the day-to-day operations and affairs of the bank. Further, ensuring appropriate corrective actions to regulatory concerns is a key responsibility of the Board.

The knowledge, experience, and involvement of the Board and executive officers are especially critical for new institutions. This point was underscored in a 2004 study conducted by the FDIC, which found that problems occurring during the first 6 years of an institution's operation were predominantly attributable to weak oversight by the Board and management inexperience and turnover. While Park Avenue was not a new institution, it had many characteristics of a new banking organization in 2004. For example, the bank had a new charter, a new Board, a new team of executive officers, and a substantially different business model. As discussed below and in subsequent sections of this report, weak Board and management oversight of Park Avenue was the primary cause for the decline in the bank's financial and operational condition.

A *Management and Staff Assessment Report* prepared by an outside consultant on behalf of Park Avenue in June 2009 illustrated significant weaknesses in the Board's oversight, management's performance, and the bank's governance. The report, which was required by parallel C&Ds issued by the FDIC and NYSBD in February 2009, concluded that:

- The Board did not effectively oversee the bank's performance or hold senior management accountable for poor performance. Instead, the Board ceded too much responsibility to the President and CEO, and the CFO and did not pressure the President and CEO to make tough decisions sooner, such as removing the lending staff that originated many of the bank's non-performing loans earlier than was done.

- A restructuring of the Board was needed to ensure (a) vigorous and candid dialogue with the President and CEO and other executive officers regarding the bank's strategies and (b) necessary talent was in place at the senior management level to execute key initiatives. Among other things, the report recommended that the Board's Chairman be replaced to break the culture of not holding management accountable for unsatisfactory financial performance and that new directors (including a financial expert) be added.

- The President and CEO lacked the necessary management skills to run the bank and had outside or conflicting business interests. The report recommended that the bank seek a new President and CEO to execute the strategic plan and return the bank to a safe and sound condition.

- Loan underwriting and credit administration procedures were either absent or not followed. In addition, loan documentation was poor and turnover of key staff plagued the lending function. The report recommended that the bank seek a new CLO.

In responding to the *Management and Staff Assessment Report*, Park Avenue's Board Chairman acknowledged the need for a new President and CEO, but indicated that a change in this position would not likely occur until the bank's recapitalization efforts were complete. However, the Chairman generally disagreed with the remaining criticisms referenced above. In the years preceding the issuance of the *Management and Staff Assessment Report*, examiners expressed concern about Park Avenue's weak internal controls and risky management practices and made numerous recommendations for improvement. Among other things, examiners expressed concern about the lack of Board oversight, unsatisfactory earnings, weak internal controls (such as a lack of segregation of duties and formal policies in the accounting department), and risky lending practices. However, the limited actions taken by Park Avenue's Board and management to address these concerns and recommendations were generally not timely or adequate.

Recurring Pre-tax Losses from Operations

Contributing to Park Avenue's financial deterioration was the bank's inability to achieve a pre-tax profit on operations following its charter conversion in 2004. The Board and management undertook a number of initiatives between 2004 and 2009 to achieve profitability on a pre-tax basis. Such initiatives included the adoption of various earnings plans, strategic plans, and budget and profit plans that defined financial benchmarks and goals. However, management was not successful in achieving many of the benchmarks and goals contained in these plans, or in achieving profitability on a pre-tax basis.

High overhead expenses associated with the institution's retail branch expansion, Park Avenue headquarters location, and payroll contributed significantly to the bank's recurring pre-tax operational losses. Park Avenue's high overhead expenses were reflected in the bank's Efficiency Ratio,[5] which ranged between 88 percent and 117 percent during the period 2005 through 2009. These ratios were substantially higher than the goal established in Park Avenue's Board-approved 2007-2009 Strategic Plan of less than 60 percent and ranked the bank in the 89th to 99th percentile of its peer group. Also contributing to the bank's recurring pre-tax losses was a high cost of funds associated with above-market-rate time deposits. Park Avenue's high cost of funds was reflected in its ratio of total interest expenses to average earning assets,[6] which ranked the bank in the 95th to 97th percentile of its peer group between 2005 and 2009.

Although Park Avenue reported pre-tax losses on its operations between 2004 and 2006, it was able to report positive net income in its regulatory filings during this same period due to the potential tax benefit associated with a DTA. However, Park Avenue could only realize the benefits of the DTA if it could generate sufficient future taxable income. By 2008, Park Avenue's external financial statement auditors were becoming increasingly concerned about the value of the bank's DTA. After years of experiencing pre-tax operating losses, it appeared uncertain when the bank would reach profitability on a pre-tax basis and begin to realize the tax savings associated with the DTA.

As losses continued during 2008, Park Avenue's management was unable to persuade its auditors that the DTA should continue to be recognized as an asset on the bank's balance

[5] The Efficiency Ratio represents the ratio of overhead expenses to total revenues.
[6] This ratio measures the average yield that must be earned on every dollar of average assets to cover a bank's interest expenses.

sheet. As a result, management established a valuation allowance totaling $8.7 million against the entire carrying value of the DTA in November 2008. This allowance had a negative effect on Park Avenue's regulatory capital[7] and was a significant factor in Park Avenue reporting a net loss of $9.3 million for 2007. The continued effect of high overhead expenses and a high cost of funds, together with losses on the bank's investment securities, resulted in an additional loss of $6.5 million during 2008.

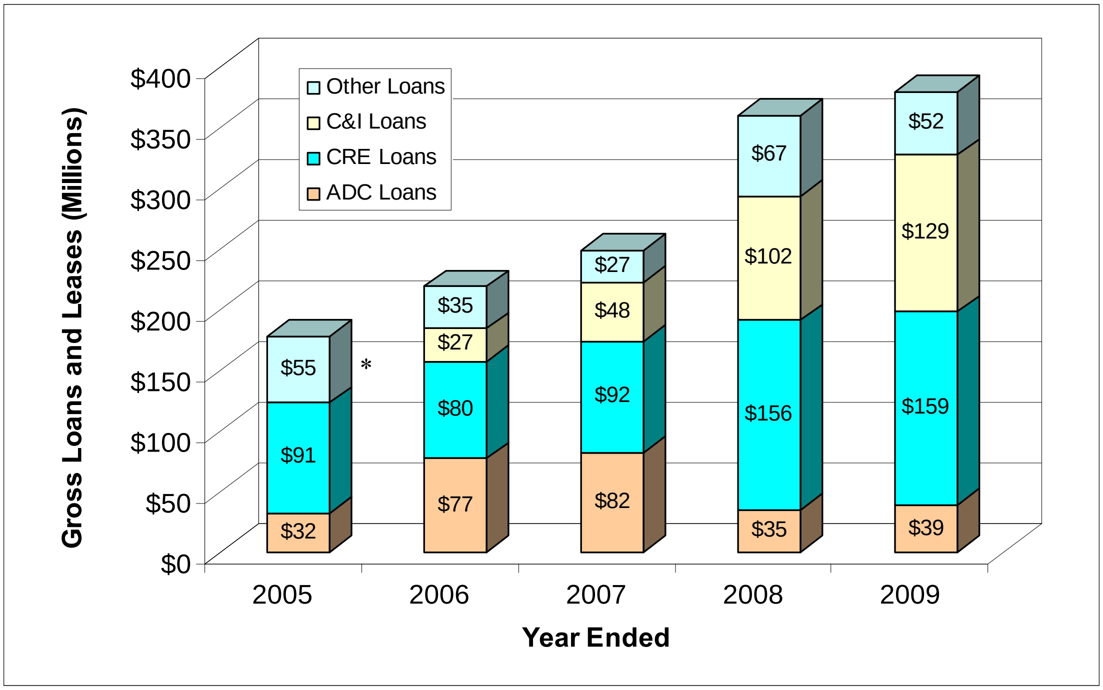
In 2009, Park Avenue experienced a significant deterioration in the quality of its loan portfolio and investment securities. During the September 2009 examination, examiners determined that approximately $104 million (or 19 percent of Park Avenue's total assets) needed to be classified. Almost 90 percent of these classifications consisted of loans, with the remainder consisting of investment securities and other real estate. After making a large loan loss provision in December 2009, Park Avenue reported a net loss of almost $20 million for 2009, rendering the institution *Critically Undercapitalized*.

Loan Growth and Capital Management

Beginning in 2004, Park Avenue embarked on a rapid loan growth strategy centered in CRE and ADC lending. Much of this growth was fueled by brokered deposits. As early as 2006, examiners began to express concern about the bank's concentration in CRE loans. During 2008, Park Avenue's management significantly reduced the bank's exposure to ADC loans and placed increased emphasis on C&I lending. This decision had the effect of diversifying the institution's loan portfolio, and may have been a contributing factor in the bank's low loss (based on total assets) to the DIF.[8] Figure 1 illustrates the general composition and growth of Park Avenue's loan portfolio in the years preceding the institution's failure.

[7] Institutions may include DTAs in their Tier 1 Capital consistent with the limitations defined in the FDIC Rules and Regulations. See the glossary for more information.
[8] Park Avenue's estimated loss to the DIF of 11 percent of the bank's total assets is less than half of the average estimated loss rate of 24 percent for all insured institutions that failed between January 1, 2008 and June 1, 2010. (The average loss rate does not include the failure of Washington Mutual.)

Figure 1: Composition and Growth of Park Avenue's Loan Portfolio

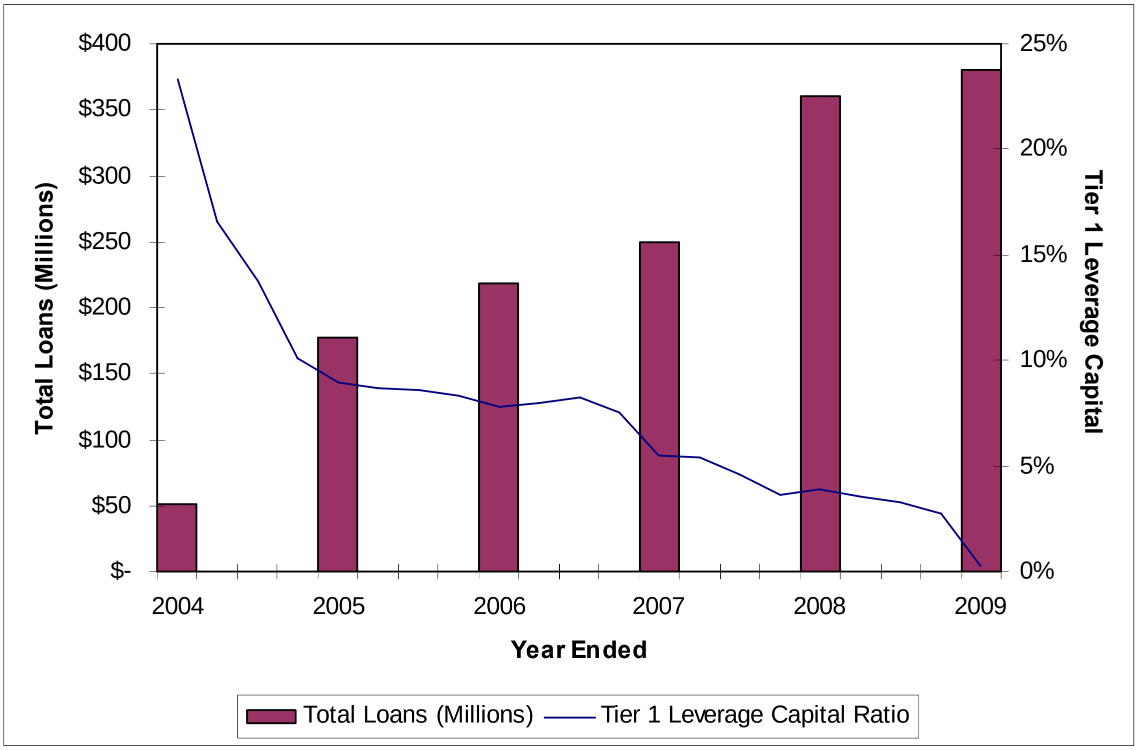


Source: Reports of Condition and Income (Call Reports) for Park Avenue. Due to rounding, some figures may be slightly higher or lower than actual amounts.
* For presentation purposes, approximately $3 million in C&I loans is included in Other Loans for 2005.

The growth in Park Avenue's loan portfolio placed downward pressure on the bank's capital ratios. To mitigate this downward pressure, the bank raised $5.1 million in new capital during 2006, and an additional $834,000 in new capital during the first quarter of 2007. Notwithstanding these capital infusions, the institution's Tier 1 Leverage Capital Ratio fell below the 7.25 percent minimum threshold defined in the bank's 2007-2009 Strategic Plan as of December 31, 2007. Continued loan growth and pre-tax losses during the first quarter of 2008 caused Park Avenue to fall below *Well Capitalized* for PCA purposes as of March 31, 2008. The drop in Park Avenue's capital limited the bank's ability to absorb losses when the credit quality of its assets deteriorated. It also significantly increased the institution's liquidity risk profile as it became restricted from accepting, renewing, or rolling over brokered deposits without a waiver from the FDIC. As of March 31, 2008, $151.2 million of Park Avenue's $310.9 million in total deposits (or 49 percent) were brokered deposits.

Park Avenue's Board and management failed to recognize or promptly address the risks associated with the bank's declining trend in capital ratios. Minutes of Board meetings held between December 2007 and March 2008 contained no discussion about the Tier 1 Leverage Capital Ratio falling below the 7.25 percent threshold established in the bank's strategic plan. The Board minutes also did not reference the bank's declining capital ratios or the consequences of falling below *Well Capitalized* for PCA purposes. The first reference to issues pertaining to the bank's PCA capital category appeared in the June 2008 Board minutes. Shortly after the bank fell below *Well Capitalized*, management renewed significant amounts of brokered deposits without a waiver from the FDIC, in apparent violation of section 29, *Brokered Deposits*, of the FDI Act and Part 337, *Unsafe* *and Unsound Banking Practices*, of the FDIC Rules and Regulations. Figure 2 illustrates the trend in Park Avenue's Tier 1 Leverage Capital Ratios relative to growth in the loan portfolio between 2004 and 2009.

Figure 2: Trend in Tier 1 Leverage Capital Ratios Relative to Loan Growth



Source: UBPRs for Park Avenue.

Park Avenue's growth rate in 2008 was approximately 27 percent, much higher than the 15 percent annual growth rate projected in the 2007-2009 Strategic Plan. Board minutes during the first half of 2008 included discussions about the bank's capital-raising efforts but did not discuss the risks associated with the bank's growth or deviation from the strategic plan. Further, Park Avenue's Board continued to allow the bank's management to grow average total assets through September 2009, a year after the institution had fallen below *Adequately Capitalized* for PCA purposes. Such growth represented an apparent violation of the growth restrictions imposed by PCA on institutions that are less than *Adequately Capitalized*.[9] Contributing to Park Avenue's average total asset growth during this period were loan originations with particularly poor underwriting. In some cases, these loans experienced problems soon after they were originated and contributed to the financial problems experienced by the bank. Three examples follow.

- The President and CEO, and the CLO approved a $1.5 million line of credit in June 2009 despite a recommendation from the bank's own financial analyst that the line of credit not be approved. The analyst cited the borrower's poor credit history, a federal tax lien, and speculative collateral valuations as reasons not to

[9] See the discussion in the *Prompt Corrective Action* section of this report for more information pertaining to Park Avenue's apparent violation of the growth restrictions of PCA and the FDIC's supervisory response.

approve the line of credit. In addition, the Senior Vice President of Commercial Lending did not approve the line of credit as required by the bank's Credit Policy. Examiners determined that the $1.5 million extended under the line should be classified as doubtful during the September 2009 examination.

- The President and CEO, and the CLO approved a $1.5 million line of credit in March 2009 for a borrower that, according to an examiner's analysis, was insolvent at the time the line of credit was approved. Among other things, the borrower had a negative net worth, an outstanding state tax lien, and inadequate cash flow to service the borrowing. In addition, the President and CEO, and the CLO exceeded their Board-delegated lending authority when approving the credit line. Further, the bank disbursed all of the funds under the line of credit before recording liens on properties used to secure the loan. Examiners determined that the entire amount of the credit line should be classified as substandard during the September 2009 examination.

- The President and CEO, and the CLO approved a $1.1 million line of credit in January 2009 for a borrower that, according to its 2008 audited financial statements, had a significant capital deficit. In addition, the bank's collateral consisted of a second lien position on the borrower's assets. Further, the Senior Vice President of Commercial Lending did not approve the line of credit as required by the bank's Credit Policy. Examiners determined that approximately $100,000 of the line should be classified as doubtful and the remaining $1 million classified as loss during the September 2009 examination.

Park Avenue's President and CEO advised examiners in September 2009 that growth occurred earlier in the year because management believed that new capital would be coming into the institution. According to Park Avenue's Board and management, the institution's efforts to raise new capital were impaired by two principal factors. First, the bank was unable to obtain approval from the NYSBD for a change in control application submitted in connection with the President and CEO's purported $6.5 million capital infusion in October and November 2008[10] and an additional proposed capital infusion totaling $15 million. Secondly, a protracted dispute between management and certain of the bank's shareholders made attracting outside investors difficult. Notwithstanding the Board's and management's assertions, the financial condition of the bank was deteriorating significantly in 2008 and 2009, limiting the bank's ability to attract needed capital. In addition, despite multiple requests, the NYSBD was unable to obtain sufficient information pertaining to the source of these capital infusions to assure itself that the funds complied with applicable laws and regulations. As previously stated, the President and CEO pled guilty to misrepresenting the true source of the $6.5 million capital contribution.

Park Avenue's President and CEO resigned on October 30, 2009. According to the Board's Chairman, the President and CEO's proposed capital infusion was the

[10] As previously stated, Park Avenue purported to raise a total of $6.6 million in new capital during the fourth quarter of 2008. Of this amount, $6.5 million was purported to have been contributed by the President and CEO.

cornerstone of the bank's recapitalization efforts. Ultimately, Park Avenue was unsuccessful in raising needed capital. The NYSBD closed the bank on March 12, 2010 because it could not raise sufficient capital to continue safe and sound operations.

Oversight of the Lending Function

A lack of effective Board and management oversight of the lending function contributed to the financial problems that developed at Park Avenue. Examiners identified repeat weaknesses in Park Avenue's loan underwriting, credit administration, and related loan monitoring practices between 2005 and the bank's failure. Examiners also identified recurring apparent violations of laws and regulations and contraventions of statements of policy during their examinations of the institution. A brief description of these weaknesses follows.

Loan Underwriting

Weak underwriting practices included, but were not limited to:

- Originating loans when the underlying financial information did not justify making the loan.
- Originating loans without the approvals required by the bank's Credit Policy.
- Originating loans for which a conflict of interest existed. For example, examiners identified instances in which the President and CEO extended credit for entities in which he had a business interest.
- Instances in which overdrafts were approved solely by the President and CEO in contravention of the bank's Credit Policy. In some cases, large overdrafts were approved for entities that had no borrowing relationship with the bank, effectively creating an unsecured line of credit without the benefit of sound underwriting.
- Inadequate controls for identifying related borrowers, resulting in apparent violations of the legal lending limits defined in the New York Banking Law.
- Not always obtaining appraisals when required. Examiners noted that Park Avenue's appraisal reviews generally consisted of completing a checklist without regard to the size, risk, and complexity of the loan.

Credit Administration

Credit administration weaknesses generally consisted of loan files that lacked current, relevant financial information on borrowers (e.g., financial statements, appraisals, insurance coverage, or real estate tax searches).

Monitoring

Weak loan monitoring practices included, but were not limited to:

- Not conducting a comprehensive stress test of the bank's loan portfolio to assess the impact that various economic scenarios might have on asset quality, earnings, capital, and liquidity as prescribed in Appendix A, *Interagency Guidelines for Real Estate Lending Policies*, to Part 365, *Real Estate Lending Standards*, of the FDIC Rules and Regulations.

- An ineffective loan review function that contributed to management not recognizing and downgrading problem loans in a timely manner.

- A deficient Allowance for Loan and Lease Losses (ALLL) methodology and, as a result, an underfunded ALLL.

Apparent Violations and Contraventions

Apparent violations of statutes and regulations and contraventions of statements of policy were noted in such areas as:

- Extending credit to insiders as defined in Part 215, *Loans to Executive Officers, Directors, and Shareholders of Member Banks*, of the Federal Reserve Board's regulations (Regulation O).

- Extending credit above the bank's legal lending limit as defined in the New York Banking Law.

- Implementing a Bank Secrecy Act (BSA) program pursuant to Part 326, *Minimum Security Devices and Procedures and Bank Secrecy Act Compliance*, of the FDIC Rules and Regulations.

- Reviewing real estate appraisals as defined in Part 323, *Appraisals*, of the FDIC Rules and Regulations.

- Reporting loans that exceed supervisory loan-to-value limits as defined in Appendix A to Part 365.

- Soliciting and accepting brokered deposits as defined in Part 337 of the FDIC Rules and Regulations.

- Restricting growth, requiring approval of certain expansion proposals, and maintaining minimum capital requirements as defined in Part 325, *Capital Maintenance*, of the FDIC Rules and Regulations.

- Engaging in covered transactions as defined in Section 23B of the Federal Reserve Act with affiliates in the absence of comparable transactions, on terms and under circumstances, including credit standards, that in good faith would be offered to, or would apply to, nonaffiliated companies.

The FDIC's Supervision of Park Avenue

The FDIC, in coordination with the NYSBD, provided ongoing supervisory oversight of Park Avenue through regular on-site risk management examinations, visitations, and offsite monitoring activities. Through its supervisory efforts, the FDIC identified key risks in Park Avenue's operations and brought these risks to the attention of the institution's Board and management. Such risks included lax Board and management oversight, unsatisfactory earnings, weak risk management practices (including with respect to the lending function), and repeat apparent violations of laws and regulations and contraventions of statements of policy. Further, Park Avenue never received a satisfactory composite or management component rating following the bank's charter conversion in 2004. Such ratings were forward-looking and properly reflected the bank's risky management practices. In addition, examiners identified a number of questionable business transactions during the September 2009 examination that became the subject of a criminal investigation.

In October 2005, Park Avenue adopted a Bank Board Resolution (BBR) that focused on addressing BSA program deficiencies identified during the April 2005 examination. Included within the BBR were provisions to strengthen the bank's earnings performance and strategic planning. However, management's efforts to improve its earnings and strategic planning were not successful. Examiners identified new, and in some cases, repeat internal control and risk management weaknesses during the May 2006 and June 2007 examinations. The FDIC seriously considered implementing Memorandums of Understanding (MOU) with Park Avenue to address the weaknesses identified during these examinations. However, due to various reasons described later, MOUs were not implemented. Instead, examiners made recommendations in the reports of examination and senior New York Regional Office (NYRO) officials and examiners made recommendations during meetings and telephone discussions with bank management to address the weaknesses.

In retrospect, obtaining a commitment from Park Avenue for more affirmative action to address the weaknesses identified during the May 2006 and June 2007 examinations, such as through an MOU, may have been beneficial. Such an approach could have furthered the FDIC's ongoing efforts to set an appropriate supervisory tenor of expectations. However, given management's lack of compliance with supervisory enforcement actions implemented in subsequent years, it is uncertain whether the MOUs would have influenced Park Avenue's Board and management to take more effective and timely actions to address examiner concerns.

Based on the weaknesses identified during the July 2008 examination, the FDIC and NYSBD issued parallel C&Ds against Park Avenue that became effective in February 2009. In July 2009, the FDIC and NYSBD notified the bank's Board that its actions to comply with the C&Ds were deficient and reminded the Board of the potential consequences of material noncompliance with the orders, such as civil money penalties. Park Avenue's Board and management were ultimately unsuccessful in returning the bank to a safe and sound condition and, as a result, the NYSBD closed Park Avenue on March 12, 2010. At the time of our review, the FDIC was reviewing the causes of Park Avenue's failure, including the circumstances pertaining to the bank's lack of compliance with the C&Ds and apparent violation of PCA's growth restrictions to determine whether additional regulatory actions would be appropriate.

Supervisory History

The FDIC and NYSBD conducted a total of six risk management examinations and five visitations of Park Avenue between April 2004 and the bank's failure. Table 2 summarizes key supervisory information pertaining to these examinations and visitations, including the supervisory actions taken by the FDIC.

Table 2: On-site Examinations and Visitations of Park Avenue

Examination Start Date	Type of Examination	Regulator	Supervisory Ratings (UFIRS)	Contraventions and/or Violations	Informal or Formal Actions Taken**
4/12/04	Risk Management	FDIC	333413/3	None	-
09/13/04	Visitation	FDIC/NYSBD	-	***	-
4/25/05	Risk Management	FDIC/NYSBD	223322/3	Yes	BBR Effective 10/20/05
10/24/05	Visitation	FDIC/NYSBD	-	***	BBR Remained in Effect
01/3/06	Visitation	FDIC/NYSBD	-	***	BBR Remained in Effect
5/1/06	Risk Management	FDIC/NYSBD	233332/3	Yes	BBR Remained in Effect
6/25/07	Risk Management	FDIC/NYSBD	233332/3	Yes	BBR Remained in Effect
7/21/08	Risk Management	FDIC/NYSBD	434342/4	Yes	C&D Effective February 11, 2009
4/20/09	Visitation	FDIC/NYSBD	-	***	C&D Remained in Effect
5/19/09	Visitation	FDIC/NYSBD	-	***	C&D Remained in Effect
9/28/09*	Risk Management	FDIC/NYSBD	555543/5	Yes	C&D Remained in Effect

Source: OIG analysis of examination reports and information in the FDIC's Virtual Supervisory Information on the Net system for Park Avenue.
* The bank failed before the FDIC issued the September 2009 examination report. As discussed in the narrative below, the FDIC issued an interim ratings downgrade in September 2009 to 545542/5 based on an off-site analysis of Park Avenue's June 30, 2009 Call Report. The FDIC further downgraded the bank's ratings effective March 12, 2010 to 555543/5 based on the results of the September 2009 examination.
** Informal enforcement actions often take the form of BBRs or MOUs. Formal enforcement actions often take the form of C&Ds, but under severe circumstances can also take the form of deposit insurance termination proceedings.
*** The scope of the visitation did not include reviewing the bank's compliance with laws and regulations, which is customary, as visitations are inherently limited to certain areas.

The FDIC's offsite monitoring procedures generally consisted of reviewing the bank's regulatory filings and contacting the institution's management from time to time to discuss current and emerging business issues and ongoing efforts to address regulatory concerns. The purpose of the September 2004 visitation was principally to follow up on the findings and recommendations of the April 2004 examination and to review the bank's management and operations following the change in control. The purpose of the October 2005 visitation was to assess the bank's progress in addressing the deficiencies and apparent violations identified during the April 2005 examination. The purpose of the January 2006 visitation was to assess the bank's progress in addressing the findings of the October 2005 visitation as well as to review management's progress in addressing the October 2005 BBR.

The purpose of the April 2009 visitation was to determine the sufficiency of management's responses to the parallel C&Ds issued in February 2009 and to evaluate the financial information in the bank's March 31, 2009 Call Report. The purpose of the May 2009 visitation was to review the exposure for other-than-temporary-impairment in the bank's securities portfolio. Based on an off-site analysis of Park Avenue's June 30, 2009 Call Report, the FDIC issued an interim ratings downgrade to 545542/5 effective September 11, 2009. Although the bank failed before the FDIC issued the September 2009 examination report, the FDIC further downgraded the bank's ratings to 555543/5 based on the results of the examination. The downgrade became effective March 12, 2010, the day that the bank was closed.

As previously discussed, Park Avenue adopted a BBR in October 2005 that included provisions for strengthening the institution's earnings performance and strategic planning. However, the bank was not successful in improving its earnings performance or achieving key goals defined in its strategic plans. The July 2008 examination identified a significant deterioration in Park Avenue's overall financial and operational condition, and on February 11, 2009, the FDIC and NYSBD issued parallel C&Ds, requiring, among other things, that the bank:

- Operate with adequate management supervision and Board oversight to prevent any future unsafe or unsound banking practice or violation of law or regulation.

- Engage an independent party to assess, among other things, the bank's management and staffing needs and the performance of the Board Chairman, directors, and senior executive officers.

- Develop a capital plan that addressed, among other things, the bank's plans for maintaining a Tier 1 Capital Ratio and Tier 1 Risk-based Capital Ratio of at least 8 percent and 10 percent, respectively.

- Revise its strategic plan to better govern its operations.

- Develop a written budget and profit plan to improve its earnings.

- Revise its loan policies and procedures.

- Develop a plan for reducing its adversely classified assets and CRE loan concentration.

As part of its obligations under the C&D, Park Avenue provided the FDIC and NYSBD with quarterly progress reports addressing each of the provisions in the C&D. Based on the results of the April 2009 visitation and a review of Park Avenue's responses to the C&D requirements, the FDIC and NYSBD formally notified the bank's Board in July 2009 that management's actions to comply with the C&Ds were deficient. The FDIC and NYSBD also reminded the Board of the potential consequences of material noncompliance with the orders, such as civil money penalties. Park Avenue's Board and management were not successful in returning the institution to a safe and sound condition. Consequently, the NYSBD closed the institution in March 2010.

Supervisory Response to Key Risks During the 2006 and 2007 Examinations

Examiners identified a number of internal control weaknesses and risky management practices during the May 2006 and June 2007 examinations. In some cases, the weaknesses and risky practices had been identified and reported in prior examination reports. Most notably, examiners determined the following areas to be less than satisfactory in both examinations:

- **Management.** Key provisions of the October 2005 BBR were either not effectively addressed or were addressed after agreed-to timeframes. In addition, risk management programs, policies, and procedures were unsatisfactory (particularly with respect to the BSA program); the bank's internal audit program needed to be improved; apparent violations of the FDIC Rules and Regulations with respect to BSA and appraisals existed; the bank embarked on an aggressive growth strategy without establishing the necessary infrastructure or risk management controls; and Call Reports contained erroneous information. Further, management did not ensure that deficiencies and recommendations reported during prior examinations were addressed.

- **Asset Quality.** Park Avenue exhibited weak loan underwriting and credit administration practices, such as originating loans with little or no borrower equity, extending credit without appropriate approvals, and using unapproved appraisers. In addition, examiners noted instances in which loan files were not properly maintained, appraisal reviews and property inspections were not adequate or performed, and real estate tax searches were not conducted. In addition, adversely classified loans and leases had increased from 5 percent of Tier 1 Capital and reserves at the May 2006 examination to 29 percent of Tier 1 Capital and reserves at the June 2007 examination. Further, the ALLL methodology needed to be enhanced to comply with industry guidelines.

- **Earnings.** The bank did not achieve certain key financial benchmarks and goals in the Board-approved earnings plan, such as return on assets and non-interest expenses to average assets. In addition, net income was fully attributable to a

DTA, and high overhead expenses and a high cost of funds were limiting the bank's ability to achieve profitability on a pre-tax basis. Further, the bank was employing aggressive accounting practices with respect to its non-accrual loans and deferred fee income.

- **Liquidity.** The risk management policy and practices were deficient in several respects. Among other things, the bank had a high net non-core funding dependence ratio due to its heavy dependence on brokered deposits, a heavy reliance on purchased funds, and a limited contingency funding capability.

Based on the results of the May 2006 and June 2007 examinations, examiners determined that Park Avenue's overall condition was less than satisfactory and assigned supervisory composite ratings of "3" at each examination. Such ratings were forward-looking and properly reflected the bank's risky management practices. Examiners also made recommendations to Park Avenue's Board and management to address the weaknesses identified during the examinations and requested that the bank provide a written response to the issues contained in the examination reports.

The FDIC seriously considered implementing an MOU based on the results of the May 2006 examination. However, the FDIC decided not to pursue such an action based on written assurances by Park Avenue's Board and management that the concerns identified in the examination report would be addressed. In addition, the FDIC was continuing to receive status reports on the bank's efforts to address the provisions of the October 2005 BBR. Examiners also considered implementing an MOU based on the results of the June 2007 examination. However, the June 2007 examination report was not transmitted to the bank until March 6, 2008, approximately 8 months after the examination began. According to NYRO staff, the report was delayed due to an extended review period.

NYRO officials advised us that they met with the President and CEO and the Chairman of Park Avenue in May 2008 to discuss the June 2007 examination findings. During the meeting, management presented information and described actions taken following the conclusion of the on-site portion of the examination that indicated sufficient corrective action had been taken or was underway. In its written response to the June 2007 examination report, Park Avenue's management disputed a number of the examination findings or indicated that corrective action had already taken place. Confirming the status of the report's findings would have required additional on-site work at the bank. Because the next examination was scheduled to begin in July 2008, the FDIC decided not to pursue an MOU at that time. Instead, the FDIC decided to revisit the findings (including the potential need for an enforcement action) at the next examination.

In retrospect, obtaining a written commitment from Park Avenue for more affirmative action to address the weaknesses identified during the May 2006 and/or June 2007 examinations, such as through an MOU, may have been beneficial. For example, an MOU would have likely prompted a visitation following the May 2006 examination and/or required the bank to submit status reports on its efforts to address key examiner concerns (including those not covered by the October 2005 BBR). Such an approach could have also furthered the FDIC's ongoing efforts to set an appropriate supervisory tenor of expectations. However, given management's lack of compliance with supervisory enforcement actions implemented in subsequent years, it is uncertain whether the MOUs would have influenced Park Avenue's Board and management to take more effective and timely actions to address examiner concerns.

Prompt Corrective Action

Section 38, *Prompt Corrective Action*, of the FDI Act establishes a framework of mandatory and discretionary supervisory actions pertaining to all institutions. The section requires regulators to take progressively more severe actions, known as "prompt corrective actions," as an institution's capital level deteriorates. The purpose of section 38 is to resolve problems of insured depository institutions at the least possible long-term cost to the DIF. Part 325, *Capital Maintenance*, of the FDIC Rules and Regulations defines the capital measures used in determining the supervisory actions that will be taken pursuant to section 38 for FDIC-supervised institutions. Part 325 also establishes procedures for the submission and review of capital restoration plans and for the issuance of directives and orders pursuant to section 38. The FDIC is required to closely monitor institution compliance with capital restoration plans, 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.

The FDIC implemented supervisory actions with respect to Park Avenue that were consistent with the PCA provisions of section 38. Among other things, the FDIC notified Park Avenue of changes in its PCA capital category; requested and evaluated capital restoration plans; monitored the institution's financial condition and activities; and expressed concern to the bank's Board and management regarding issues of apparent noncompliance. While the FDIC monitored and advised management of its concerns regarding Park Avenue's apparent violation of the growth restrictions defined in PCA, a more aggressive approach may have been warranted. Doing so would have been consistent with the FDIC's guidance in this area and would have provided another avenue for instilling urgency in the bank's Board and management to implement corrective measures. Table 3 illustrates Park Avenue's capital levels relative to the PCA thresholds for *Well Capitalized* institutions during the years preceding the bank's failure.

Table 3: Park Avenue's Capital Levels

Year Ended	Tier 1 Leverage Capital	Tier 1 Risk-Based Capital	Total Risk-Based Capital	PCA Capital Category
Well Capitalized Thresholds	**5% or more**	**6% or more**	**10% or more**	
Park Avenue's Capital Levels				
Dec-04	23.34	44.92	46.18	*Well Capitalized*
Dec-05	8.93	12.81	13.97	*Well Capitalized*
Dec-06	7.78	11.87	13.02	*Well Capitalized*
Dec-07	5.54	7.73	8.98	*Adequately Capitalized*
Dec-08	3.86	4.91	6.16	*Undercapitalized*
Dec-09	0.30	0.39	0.77	*Critically Undercapitalized*

Source: UBPRs for Park Avenue.
Note: Many of the capital ratios in the table reflect the results of amended Call Reports filed by Park Avenue after an initial Call Report had been filed. The narrative below provides a chronological description of the changes in the bank's capital categories and the FDIC's implementation of PCA.

Park Avenue was considered *Well Capitalized* until March 31, 2008. The institution fell to *Adequately Capitalized* at that time as a result of asset growth and continued pre-tax losses on operations. During the July 2008 examination, examiners determined that Park Avenue had renewed over $30 million in brokered deposits during May 2008 without a waiver from the FDIC. Examiners also noted that the bank had begun offering above-market-rate promotional time deposits in June 2008 for the purpose of replacing its maturing brokered deposits. However, examiners determined that the terms of these promotional deposits failed to comply with Part 337 of the FDIC Rules and Regulations. In a letter dated August 20, 2008, the FDIC notified Park Avenue's Board that the bank had fallen to *Adequately Capitalized* based on the March 31, 2008 Call Report.[11] The notification included a reminder regarding the restrictions imposed on *Adequately Capitalized* institutions, including restrictions pertaining to the use of brokered deposits without a waiver from the FDIC.

In a letter dated November 19, 2008, the FDIC notified Park Avenue's Board that the bank had fallen to *Undercapitalized* based on its September 30, 2008 Call Report. The letter recommended that the Board carefully review all of the mandatory PCA restrictions applicable to *Undercapitalized* institutions and submit a capital restoration plan (PCA Plan) to the FDIC by December 19, 2008. At that time, the bank had just raised $6.6 million in purported capital. However, deterioration in the quality of the bank's assets during the fourth quarter of 2008, together with an $8.7 million write-down of its DTA, effectively offset the purported capital infusion and further depleted the bank's capital levels. As a result, Park Avenue reported an *Undercapitalized* position in its December 31, 2008 Call Report.

[11] FDIC policy requires that institutions be notified in writing when they fall to *Undercapitalized*, *Significantly Undercapitalized*, or *Critically Undercapitalized*. The policy does not require notification for institutions that fall to *Adequately Capitalized*. The NYRO decided to notify Park Avenue of its *Adequately Capitalized* capital category as a courtesy.

Park Avenue submitted a PCA Plan on December 19, 2008 and provided the FDIC with periodic updates to the plan in the months that followed as financial conditions at the institution deteriorated. On February 11, 2009, the FDIC and NYSBD issued parallel C&Ds requiring, among other things, the submission of a Capital Plan within 30 days of the effective date of the orders. In a letter dated February 12, 2009, the FDIC notified Park Avenue's Board that it had reviewed the bank's PCA Plan and subsequent revisions, but that a decision regarding the acceptability of the plan(s) had not been made. The letter stated that the FDIC was extending its 60-day "review" period for the PCA Plan until April 13, 2009 in order to allow for concurrent reviews of both the PCA Plan and the Capital Plan required by the C&Ds.[12] Park Avenue submitted a Capital Plan as required by the C&Ds on March 13, 2009. At that time, DSC officials determined that the PCA Plan and Capital Plan served substantially the same purpose and that reviewing two separate plans was not practical. As a result, DSC decided to focus its review and attention on the Capital Plan, as it was the more current of the two plans.

Notwithstanding the April 13, 2009 extended review date, the FDIC formally rejected the bank's Capital Plan in a June 4, 2009 letter to Park Avenue's Board.[13] The letter noted that the plan lacked sufficient detail in several areas and that the capital infusion described in the plan was dependent upon the NYSBD's approval of a change in control application which was uncertain at that time. The FDIC directed the Board to immediately submit a new or revised Capital Plan. Park Avenue submitted a revised Capital Plan on July 21, 2009. In a letter dated August 5, 2009, the FDIC notified the bank's Board that the revised plan was unacceptable. Among other things, the plan lacked details regarding a planned $25 million capital infusion and included income projections that were considered unrealistic. The FDIC directed Park Avenue's Board to immediately submit another Capital Plan. Park Avenue never submitted another Capital Plan. However, the FDIC continued to have regular communication with the bank's management regarding its efforts to raise needed capital.

In a letter dated August 25, 2009, the FDIC re-affirmed Park Avenue's *Significantly Undercapitalized* status based on the bank's June 30, 2009 Call Report.[14] In a letter dated January 22, 2010, the FDIC notified the bank that it had fallen to *Critically Undercapitalized* based on a preliminary loss estimate of $20 million for 2009. Park

[12] Section 325.104(c) of the FDIC Rules and Regulations states that the FDIC shall provide written notice to a bank as to whether its capital restoration plan required under PCA has been approved within 60 days of receiving the plan. However, the FDIC may extend the time within which such notice shall be provided. According to the FDIC's *Case Manager Procedures Manual,* extensions beyond the 60-day timeframe should be rare, and the reason(s) for extensions should be documented.

[13] We found no documentation pertaining to extensions of the FDIC's review period beyond April 13, 2009. Consequently, the FDIC's notification regarding the acceptability of Park Avenue's capital restoration plan did not conform to DSC guidance on extensions or with the intent of section 38 of the FDI Act regarding the need for expeditious action on such plans. However, Park Avenue was operating under existing C&Ds that required the bank to maintain a Tier 1 Capital Ratio and Tier 1 Risk-based Capital Ratio of at least 8 percent and 10 percent, respectively. In addition, the FDIC had regular discussions with Park Avenue's management regarding the bank's ongoing efforts to improve its capital position. As a result, in our view, the delayed notification was inconsequential to the supervision or failure of the bank.

[14] The FDIC originally notified Park Avenue's Board that the bank had fallen to a *Significantly Undercapitalized* position in a letter dated May 18, 2009. The notification was based on the bank's March 31, 2009 Call Report.

Avenue continued to explore strategic alternatives for improving its capital position, such as seeking new investors or selling one or more of its retail branches. However, these efforts were not successful. As a result, the NYSBD closed Park Avenue on March 12, 2010.

Apparent Violation of PCA's Growth Restrictions

As previously stated, Park Avenue fell to *Undercapitalized* of as September 30, 2008. Section 38 prohibits *Undercapitalized* institutions from growing their average total assets unless the institution satisfies certain conditions defined in the statute.[15] Park Avenue did not satisfy these statutory conditions, as the bank did not have an accepted capital restoration plan. Notwithstanding the growth restrictions defined in PCA, the bank's average total assets grew for the next 4 consecutive quarters while the bank was either *Undercapitalized* or *Significantly Undercapitalized*. Table 4 summarizes Park Avenue's average total assets and Tier 1 Leverage Capital Ratios between September 2008 and September 2009.

Table 4: Asset Growth and Capital, September 2008 through September 2009

Financial Measure	Sept-08	Dec-08	Mar-09	Jun-09	Sept-09
Average Assets ($000	477,621	496,765	525,754	538,932	551,513
Tier 1 Leverage Capital Ratio	3.61	3.86	3.54	3.32	2.74

Source: UBPRs for Park Avenue.

In its November 19, 2008 PCA notification letter, the FDIC recommended that Park Avenue's Board carefully review the mandatory restrictions of Section 38, including the restrictions pertaining to asset growth, and develop policies and procedures to ensure compliance. After the bank filed its December 31, 2008 Call Report, the FDIC's Case Manager contacted the President and CEO to determine why the bank's average total assets had grown. According to the Case Manager, the President and CEO indicated that the growth was primarily attributable to funding pre-existing loan commitments.

The FDIC sent another PCA notification letter in May 2009 after Park Avenue's March 31, 2009 Call Report reflected a drop in the bank's PCA capital category to *Significantly Undercapitalized*. The notification again recommended that the Board review all mandatory PCA restrictions applicable to the bank. However, there is no indication that the FDIC contacted the bank's management to determine why the institution's average total assets had increased in apparent violation of PCA. At that time, an examiner from another FDIC regional office was serving as the Case Manager for Park Avenue while the permanent Case Manager was on another assignment. The change in Case Manager was a factor in why Park Avenue was not contacted regarding the asset growth reflected in the March 31, 2009 Call Report because the examiner temporarily serving in that role was not particularly familiar with Park Avenue's history.

[15] Section 38(e)(3) states that an *Undercapitalized* insured depository institution shall not permit its average total assets during any calendar quarter to exceed its average total assets during the preceding calendar quarter unless (1) the appropriate Federal banking agency has accepted the institution's capital restoration plan, (2) any increase in total assets is consistent with the plan, and (3) the institution's ratio of tangible equity to assets increases during the calendar quarter at a rate sufficient to enable the institution to become *Adequately Capitalized* within a reasonable time.

After Park Avenue's June 30, 2009 Call Report (which was required to be filed by July 30, 2009) reflected a third consecutive quarter of asset growth, the FDIC formally notified the bank's Board in an August 25, 2009 letter that, despite a tenuous capital category and declining capital ratios, the bank's assets continued to grow in apparent violation of PCA. On September 2, 2009, the Case Manager contacted the President and CEO to reiterate the FDIC's concerns regarding the bank's asset growth and to ask what action management was taking to stem the growth. The President and CEO stated that the Board was aware of the growth restrictions imposed on the bank and that a special Board meeting had been held the previous day to discuss the FDIC's August 25, 2009 letter. However, the President and CEO was unable to provide a satisfactory explanation as to why average total assets continued to grow. In the months that followed, the FDIC actively monitored the bank's asset growth and communicated regularly with the bank's Board and management regarding relevant concerns. At the time of our review, the FDIC was continuing to review the circumstances pertaining to the bank's apparent violation of PCA to determine whether additional regulatory actions would be appropriate.

While the FDIC monitored and advised management of its concerns regarding Park Avenue's apparent violation of the growth restrictions defined in PCA, more aggressive action may have been warranted. For example, the FDIC could have provided written notification to the bank's Board regarding the continued asset growth in apparent violation of PCA and the potential consequences pertaining thereto after the filing of the March 31, 2009 Call Report. The FDIC also could have required the bank to report more frequently on its asset growth and/or restricted the bank from originating new loans without prior approval from regulators. A more aggressive approach would have been consistent with the FDIC's guidance in this area and would have provided another avenue for instilling urgency in the institution's Board and management to implement corrective measures.

Capital Purchase Program

On October 3, 2008, the President signed the Emergency Economic Stabilization Act of 2008 into law. Among other things, the Act authorized the Secretary of the Department of the Treasury to establish TARP, which is administered by the Treasury. Under TARP, the Treasury implemented the Capital Purchase Program (CPP) through which the Treasury purchased senior preferred stock (and, if appropriate, warrants of common stock) from viable institutions of all sizes. Qualifying financial institutions were permitted to apply for funds under the CPP after consulting with their primary federal regulator.[16]

On November 17, 2008, the FDIC received an application for $11.4 million in CPP funds from Park Avenue. The FDIC subsequently requested clarification from Park Avenue regarding certain information in its CPP application, including information pertaining to the bank's efforts to raise new capital. On February 24, 2009, the Case Manager contacted the President and CEO of Park Avenue and discussed the CPP process and requirements for obtaining favorable consideration of the bank's application. At that

[16] See TARP in the glossary for more information on the CPP.

time, the bank was under a C&D and its financial condition was deteriorating. On February 25, 2009, Park Avenue formally withdrew its application for CPP funds. On October 8, 2010, the President and CEO pled guilty to criminal charges of defrauding the TARP by misrepresenting the bank's true capital position in connection with the CPP application. Specifically, the President and CEO misled the FDIC and NYSBD by representing that $6.5 million in capital raised during October and November 2008 consisted of the President and CEO's personal funds. In fact, the President and CEO had engaged in a "round-trip" loan transaction, in which the $6.5 million had been borrowed from the bank itself. Accordingly, such funds should not have been accorded treatment as regulatory capital. The capital position of banks applying for CPP funds was a critical element in the TARP qualification process. In this case, Park Avenue withdrew its CPP application before it could be approved or disapproved.

Corporation Comments

After we issued our draft report, management provided additional information for our consideration, and we revised our report to reflect this information, as appropriate. On December 22, 2010, the DSC Director provided a written response to the draft report. That response is provided in its entirety as Appendix 4 of this report. In the response, the DSC Director reiterated the causes of Park Avenue's failure described in our report. With regard to our assessment of the FDIC's supervision of the bank, the Director summarized the supervisory activities described in our report and noted that the actions taken by the Board and management were generally not timely or adequate to correct the risk management weaknesses that existed at the bank. The response added that DSC has issued guidance to enhance its supervision of institutions with CRE concentrations.

Objectives, Scope, and Methodology

Objectives

On July 21, 2010, the President signed into law the Financial Reform Act. 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 IDRs of failures when the associated losses are not material, but involve unusual circumstances. Although the estimated loss for Park Avenue does not meet the amended threshold requiring an MLR, the OIG determined that the circumstances pertaining to the failure of Park Avenue warranted an in-depth review as authorized by the Financial Reform Act.

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

We conducted this performance audit from May 2010 to October 2010 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 included an analysis of Park Avenue's operations from the time of its charter conversion in 2004 until its failure on March 12, 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 audit procedures:

- Analyzed key documentation, including:
    - Examination reports issued by the FDIC and NYSBD between 2004 and 2009.
    - Institution data in Call Reports, UBPRs, and other reports.
    - FDIC and NYSBD correspondence.
    - Relevant reports prepared by DSC and the Division of Resolutions and Receiverships relating to the institution's failure.

Objectives, Scope, and Methodology

  - o Pertinent FDIC regulations, policies, procedures, and guidance.

- Interviewed DSC examination staff in the Washington, D.C. Office, NYRO, and New York Field Office.

- Interviewed NYSBD staff to obtain their perspectives on the failure and to discuss their role in the supervision of the institution.

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, and interviews of examiners to understand Park Avenue'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. Therefore, we did not evaluate the effectiveness of information system controls. We relied on our analysis of information from various sources, including examination reports, 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. 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 was 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 performed tests to determine whether the FDIC had complied with the provisions of PCA and limited tests to determine compliance with certain aspects of the FDI Act and FDIC Rules and Regulations. The results of our tests are 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. In this regard, we interviewed appropriate FDIC and NYSBD staff regarding potential and actual fraudulent activities in connection with Park Avenue.

Objectives, Scope, and Methodology

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 comprehensive 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 http://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 comprehensive 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, *PCA*, and section 39, *Standards for Safety and Soundness*) in the banking crisis.

Glossary of Terms

Term	Definition
Acquisition, Development, and Construction (ADC) Loans	ADC loans are a component of CRE that provide funding for acquiring and developing land for future construction, and that provide interim financing for residential or commercial structures.
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.
Affiliate	Under section 23A of the Federal Reserve Act (12 U.S.C. section 371c), an affiliate generally includes, among other things, a bank subsidiary, or a company that (1) controls the bank and any other company that is controlled by the company that controls the bank, (2) is sponsored and advised on a contractual basis by the bank, or (3) is controlled by or for the benefit of shareholders who control the bank or in which a majority of directors hold similar positions in the bank.
Allowance for Loan and Lease Losses (ALLL)	The ALLL is an estimate of uncollectible amounts that is used to reduce the book value of loans and leases to the amount that is expected to be collected. It is established in recognition that some loans in the institution's overall loan and lease portfolio will not be repaid. Boards are responsible for ensuring that their institutions have controls in place to consistently determine the allowance in accordance with the institutions' stated policies and procedures, generally accepted accounting principles, and supervisory guidance.
Bank Board Resolution (BBR)	A BBR is an informal commitment adopted by a financial institution's Board (often at the request of the FDIC) directing the institution's personnel to take corrective action regarding specific noted deficiencies. A BBR may also be used as a tool to strengthen and monitor the institution's progress with regard to a particular component rating or activity.
Bank Secrecy Act (BSA)	Congress enacted the BSA of 1970 to prevent banks and other financial service providers from being used as intermediaries for, or to hide the transfer or deposit of money derived from, criminal activity. BSA requires financial institutions to maintain appropriate records and to file certain reports, including cash transactions over $10,000 via the Currency Transactions Reports. These reports are used in criminal, tax, or regulatory investigations or proceedings.
Call Report	Reports of Condition and Income, often referred to as Call Reports, include basic financial data for insured commercial banks in the form of a balance sheet, an income statement, and supporting schedules. According to the Federal Financial Institutions Examination Council's (FFIEC) instructions for preparing Call Reports, national banks, state member banks, and insured nonmember banks are required to submit a Call Report to the FFIEC's Central Data Repository (an Internet-based system used for data collection) as of the close of business on the last day of each calendar quarter.
Cease and Desist Order (C&D)	A C&D is a formal enforcement action issued by a financial institution regulator pursuant to 12 U.S.C. section 1818 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

Glossary of Terms

	improved and the action is no longer needed or the bank has materially complied with its terms.
Commercial Real Estate (CRE) Loans	CRE loans are land development and construction loans (including 1-to-4 family residential and commercial construction loans) and other land loans. CRE loans also include loans secured by multifamily property and nonfarm nonresidential property, where the primary source of repayment is derived from rental income associated with the property or the proceeds of the sale, refinancing, or permanent financing of the property.
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.
Deferred Tax Asset (DTA)	DTAs are assets that reflect, for reporting purposes, amounts that will be realized as reductions of future taxes or as future receivables from a taxing authority. DTAs may arise because of specific limitations requiring that certain net operating losses or tax credits be carried forward if they cannot be used to recover taxes previously paid. These "tax carryforwards" are realized only if the institution generates sufficient future taxable income during the carryforward period. The FDIC Capital Maintenance Regulation (Part 325) established limits on the amount of certain DTAs that may be included in Tier 1 Capital for risk-basked and leverage capital purposes for state, nonmember banks. Under Part 325, for regulatory purposes, DTAs that are dependent upon future taxable income are limited to the lesser of: (1) the amount of such DTAs that the institution expects to realize within 1 year of the quarter-end report date, based on its projection of future taxable income for that year, or (2) 10 percent of Tier 1 Capital before certain deductions are included.
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 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.
Federal National Mortgage Association (Fannie Mae)	Fannie Mae is a shareholder-owned corporation with a government charter. The organization plays a critical role in the U.S. home mortgage market by purchasing home mortgages from original lenders, repackaging them as mortgage-backed securities, and either selling or holding them in its investment portfolio.
Loan-to-Value	A ratio for a single loan and property calculated by dividing the total loan amount at origination by the market value of the property securing the credit plus any readily marketable collateral or other acceptable collateral.
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

Glossary of Terms

	defined as any estimated loss in excess of $200 million.
Memorandum of Understanding (MOU)	A Memorandum of Understanding is an informal agreement between an institution and the FDIC, which is signed by both parties. The state authority may also be a party to the agreement. MOUs are designed to address and correct identified weaknesses in an institution's condition.
Nonaccrual Status	The status of an asset, often a loan, which is not earning the contractual rate of interest in the loan agreement, due to financial difficulties of the borrower. Typically, interest accruals have been suspended because full collection of principal is in doubt, or interest payments have not been made for a sustained period of time. Loans with principal and interest unpaid for at least 90 days are generally considered to be in a nonaccrual status.
Peer Group	Institutions are assigned to 1 of 15 peer groups based on asset size, number of branches, and whether the institution is located in a metropolitan or non-metropolitan area.
Preferred Shares	Preferred shares (or stock) are special equity securities having characteristics of both equity and debt instruments. Preferred shares are senior in priority to common shares, but subordinate to bonds. Preferred shares typically do not have voting rights, but the shares often have priority over common shares in the payment of dividends and upon liquidation. Preferred shares may carry a dividend that is paid prior to any dividends to common stockholders.
Prompt Corrective Action (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, 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.
Substandard	One of three types of classifications used by examiners to describe adversely classified assets. The term is generally used to describe an asset that is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Substandard assets are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.
Tier 1 (Core) Capital	Defined in Part 325 of the FDIC Rules and Regulations, 12 C.F.R. section 325.2(v), as **The sum of**: • Common stockholder's equity (common stock and related surplus, undivided profits, disclosed capital reserves, foreign currency translation

Glossary of Terms

	adjustments, less net unrealized losses on available-for-sale securities with readily determinable market values); • Non-cumulative perpetual preferred stock; and • Minority interest in consolidated subsidiaries; **Minus:** • Certain intangible assets; • Identified losses; • Investments in securities subsidiaries subject to section 337.4; and • Deferred tax assets in excess of the limit set forth in section 325.5(g).
Troubled Asset Relief Program (TARP)	TARP is a program of the United States Department of the Treasury to purchase assets and equity from financial institutions to strengthen the financial sector. TARP was established under the Emergency Economic Stabilization Act of 2008, which established the Office of Financial Stability within the Department of the Treasury. Under TARP, Treasury will purchase up to $250 billion of preferred shares from qualifying institutions as part of the Capital Purchase Program. Qualifying financial institutions refer to private and public U.S.-controlled banks, savings associations, bank holding companies, and certain savings and loan holding companies (engaged exclusively in financial activities) that are deemed healthy and viable. The CPP application period for publicly-held and privately-held financial institutions closed on November 14, 2008 and December 8, 2008, respectively.
Uniform Bank Performance Report (UBPR)	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.
Uniform Financial Institutions Rating System (UFIRS)	Financial institution regulators and examiners use the UFIRS to evaluate a bank's performance in six components represented by the CAMELS acronym: **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, is assigned a rating of 1 through 5, with 1 having the least regulatory concern and 5 having the greatest concern.

Acronyms

ADC	Acquisition, Development, and Construction
ALLL	Allowance for Loan and Lease Losses
BBR	Bank Board Resolution
BSA	Bank Secrecy Act
C&D	Cease and Desist Order
C&I	Commercial and Industrial
CAMELS	**C**apital, **A**sset Quality, **M**anagement, **E**arnings, **L**iquidity and **S**ensitivity to Market Risk
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CLO	Chief Lending Officer
CRE	Commercial Real Estate
DIF	Deposit Insurance Fund
DSC	Division of Supervision and Consumer Protection
DTA	Deferred Tax Asset
FDI	Federal Deposit Insurance
MOU	Memorandum of Understanding
NYSBD	New York State Banking Department
OCC	Office of the Comptroller of the Currency
OIG	Office of Inspector General
PCA	Prompt Corrective Action
TARP	Troubled Asset Relief Program
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System

Corporation Comments

FDIC

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

December 22, 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, In-Depth Review of The Park Avenue Bank, New York, New York (Assignment No. 2010-049)

Pursuant to Section 38(k) of the Federal Deposit Insurance Act as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Federal Deposit Insurance Corporation's Office of Inspector General (OIG) conducted an In-Depth Review of The Park Avenue Bank (Park Avenue), which failed on March 12, 2010. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Report (Report) received on October 28, 2010.

Park Avenue failed primarily due to lax oversight by the Board and management and a lack of sound corporate governance. In April 2004, Park Avenue converted to a state non-member charter and embarked on an aggressive growth strategy centered in poorly underwritten and administered commercial real estate (CRE) loans. Furthermore, the Board and management failed to promptly or effectively respond to negative trends in Park Avenue's financial and operational condition. Due to high overhead expenses associated with converting charters, Park Avenue never achieved pre-tax profitability. The combination of these factors with the continued aggressive growth strategy in a deteriorating economy led to a rapid deterioration in asset quality, negative earnings, and ultimately insufficient liquidity and capital.

From the 2004 charter conversion through 2009, the FDIC and the New York State Banking Department jointly and separately conducted six full-scope examinations and five visitations. The 2005, 2006, and 2007 examinations identified key risk management weaknesses, and recommendations for improvement were made to the Board and management. The 2008 examination found Park Avenue in troubled condition, and a formal enforcement action was issued. Ultimately, the actions taken by the Board and management were generally not timely or adequate to correct the risk management weaknesses.

In recognition of the threat that institutions with high risk profiles, such as Park Avenue, pose to the Deposit Insurance Fund, DSC has issued guidance to enhance our supervision of institutions with concentrated CRE lending. A Financial Institution Letter, *Managing Commercial Real Estate Concentrations in a Challenging Environment*, was issued that re-emphasizes the importance of robust credit risk-management practices with concentrated CRE exposures.

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