

# Office of Inspector General



Office of Material Loss Reviews  
Report No. MLR-10-014

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**Material Loss Review of the Bank of  
Wyoming, Thermopolis, Wyoming**

January 2010



## Why We Did The Audit

On July 10, 2009, the State of Wyoming Department of Audit, Division of Banking (WDB), closed the Bank of Wyoming, Thermopolis, Wyoming, and named the FDIC as receiver. On July 22, 2009, the FDIC notified the Office of Inspector General (OIG) that the Bank of Wyoming's total assets at closing were \$72.8 million and the estimated material loss to the Deposit Insurance Fund (DIF) was \$25.3 million. As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, the OIG conducted a material loss review of the failure of the Bank of Wyoming.

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

## Background

The Bank of Wyoming was a state-chartered, nonmember bank established in November 1978 as the First State Bank of Thermopolis. The bank assumed its current name in January 2006. Bank of Wyoming was wholly-owned by State Holding Company, which also owned two non-bank subsidiaries: (1) State Holding Company Statutory Trust, established in 2005 to facilitate the issuance of trust preferred securities and (2) Hot Springs County Title Company, Inc., which was sold in 2008. The bank's Chairman of the Board controlled the State Holding Company with approximately 51 percent of the outstanding stock. The bank opened a branch in Casper, Wyoming, in 2005, which was later sold to another bank in March 2009, and did not have any other branches at the time of closing.

## Audit Results

### Causes of Failure and Material Loss

The Bank of Wyoming's failure can be attributed to the Board of Directors (Board) and management's pursuit of loan growth funded significantly with brokered and other non-core deposits. The bank's loan portfolio was concentrated in commercial real estate (CRE) and acquisition, construction, and development (ADC) loans made to out-of-area borrowers, obtained through loan brokers and participations purchased. Poor underwriting practices and weak loan administration, as well as deterioration of some real estate markets, translated quickly into a significant decline in the quality of the institution's loan portfolio and led to unacceptable levels of classified assets characterized by increasing delinquency and nonperformance. In addition, the Bank of Wyoming's Board and management failed to implement adequate risk management practices to manage the bank's rapid growth and reliance on non-core funding. Ultimately, the Bank of Wyoming's poor asset quality, strained liquidity, insufficient earnings, and inadequate capital all contributed to its failure.

### The FDIC's Supervision of the Bank of Wyoming

Between 2005 and 2009, the FDIC and the WDB conducted regular examinations of the Bank of Wyoming in which they identified risks in the bank's operations. These risks were brought to the attention of the institution's Board and management through regular discussions and correspondence, Reports of Examination, visitations, offsite reviews, and informal and formal enforcement actions. The FDIC and the WDB recognized the growth in ADC and CRE lending funded primarily with brokered deposits and time deposits of \$100,000 or more and issued an MOU in September 2007 in an effort to

stop unsafe and unsound practices and deficiencies related to the bank's aggressive growth strategy. Following further deterioration in the bank's overall condition and failure to implement all of the recommendations of the MOU, the Bank of Wyoming stipulated to a C&D that was effective October 17, 2008. The C&D remained in effect until the bank was closed in July 2009. The FDIC and the WDB closely monitored the Bank of Wyoming's condition after the C&D was issued until the institution was closed.

The Bank of Wyoming's growth in ADC and CRE lending funded with volatile, non-core deposits resulted in a high-risk profile for the institution. The FDIC's supervisory response to these risks was generally timely and consistent with FDIC policies and practices. However, while bank management took steps to address the extent of its non-core funding based on examiners' findings at the 2006 examination, management failed to follow through on a commitment to slow loan growth following that examination. Loan growth, coupled with a decline in the real estate market and weak loan underwriting and credit administration practices identified in subsequent examinations, contributed to the deterioration in the bank's financial condition. This outcome brings into question whether earlier and/or more formal supervisory action may be warranted in such circumstances, i.e., an extended pattern of loan growth and non-core funding above peer group averages.

With respect to PCA, the FDIC properly implemented applicable PCA provisions of section 38. However, PCA's role in mitigating the losses to the DIF was limited because PCA did not require action until the institution was at serious risk of failure.

## **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 January 15, 2010, the Director, DSC, provided a written response to the draft report. That response is provided in its entirety as Appendix 4 of this report. DSC reiterated the OIG's conclusions regarding the causes of the Bank of Wyoming's failure. With regard to our assessment of supervision, DSC noted that the June 2007 examination resulted in a recommendation for an MOU that became effective in September 2007, and that the December 2007 joint visitation, which reviewed the bank's overall condition and the Board's compliance and progress with the MOU, found that management was not in compliance with all MOU provisions. Based on these findings, the FDIC accelerated the next examination, at which time examiners determined that asset quality had further deteriorated to a level that raised significant regulatory concern and DSC took action through an October 2008 formal enforcement action. Further, in its response, DSC stated that "In recognition that strong supervisory attention is necessary for institutions with high CRE/ADC concentrations and volatile funding sources, such as [the Bank of Wyoming], DSC has issued updated guidance reminding examiners to take appropriate action when these risks are imprudently managed."

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**Federal Deposit Insurance Corporation**

3501 Fairfax Drive, Arlington, Virginia 22226

Office of Material Loss Reviews

**DATE:** January 21, 2010

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

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

**SUBJECT:** *Material Loss Review of the Bank of Wyoming,  
Thermopolis, Wyoming (Report No. MLR-10-014)*

As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, the Office of Inspector General (OIG) conducted a material loss<sup>1</sup> review of the failure of the Bank of Wyoming, Thermopolis, Wyoming. On July 10, 2009, the State of Wyoming Department of Audit, Division of Banking (WDB), closed the Bank of Wyoming and named the FDIC as receiver. On July 22, 2009, the FDIC notified the OIG that the Bank of Wyoming's total assets at closing were \$72.8 million and the estimated material loss to the Deposit Insurance Fund (DIF) was \$25.3 million. As of December 31, 2009, the estimated loss to the DIF from the Bank of Wyoming's failure had increased to \$28.5 million.

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

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

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

<sup>2</sup> The FDIC's supervision program promotes the safety and soundness of FDIC-supervised institutions, protects consumers' rights, and promotes community investment initiatives by FDIC-supervised insured depository institutions. The FDIC's Division of Supervision and Consumer Protection (DSC) (1) performs examinations of FDIC-supervised institutions to assess their overall financial condition, management policies and practices (including internal control systems), and compliance with applicable laws and regulations and (2) issues related guidance to institutions and examiners.

This report presents the FDIC OIG’s analysis of the Bank of Wyoming’s failure and the FDIC’s efforts to ensure the bank’s Board of Directors (Board) and management operated the bank in a safe and sound manner.

This report does not contain formal recommendations. Instead, as major causes, trends, and common characteristics of financial institution failures are identified in our reviews, we will communicate those to management for its consideration. As resources allow, we may also conduct more in-depth reviews of specific aspects of the FDIC’s supervision program and make recommendations, as warranted. Appendix 1 contains details on our objectives, scope, and methodology; Appendix 2 contains a glossary of terms; and Appendix 3 contains a list of acronyms used in this report. Appendix 4 contains the Corporation’s comments on this report.

## Background

The Bank of Wyoming was a state-chartered, nonmember bank established in November 1978 as the First State Bank of Thermopolis. The bank assumed its current name in January 2006. Bank of Wyoming was wholly-owned by State Holding Company, which also owned two non-bank subsidiaries: (1) State Holding Company Statutory Trust, established in 2005 to facilitate the issuance of trust preferred securities and (2) Hot Springs County Title Company, Inc., which was sold in 2008. The bank’s Chairman of the Board controlled the State Holding Company with approximately 51 percent of the outstanding stock. The bank opened a branch in Casper, Wyoming in 2005, which was later sold to another bank in March 2009, and did not have any other branches at the time of closing. Table 1 provides details on Bank of Wyoming’s financial condition as of June 30, 2009 and for the 4 preceding calendar years.

**Table 1: Selected Financial Information for the Bank of Wyoming**

Financial Measure	Jun-2009	Dec-2008	Dec-2007	Dec-2006	Dec-2005
Total Assets (\$000s)	\$70,188*	\$118,376	\$114,914	\$93,239	\$70,721
Total Loans (\$000s)	\$59,341	\$86,672	\$86,574	\$76,698	\$55,979
Total Deposits (\$000s)	\$66,598	\$100,890	\$100,904	\$77,322	\$62,541
Total Brokered Deposits (\$000s)	\$7,990	\$25,590	\$30,031	\$29,903	\$12,306
Brokered Deposits/Total Deposits	12.00%	25.36%	29.76%	38.67%	19.68%
Net Income (Loss) (\$000s)	(\$4,593)	(\$1,428)	\$1,560	\$1,515	\$1,428

Source: Uniform Bank Performance Reports (UBPR) for Bank of Wyoming.

\*Asset decrease reflects March 2009 sale of branch.

## Causes of Failure and Material Loss

The Bank of Wyoming’s failure can be attributed to the Board and management’s pursuit of loan growth funded significantly with brokered and other non-core deposits. The bank’s loan portfolio was concentrated in commercial real estate (CRE) and acquisition, construction, and development (ADC) loans made to out-of-area borrowers, obtained

through loan brokers and participations<sup>3</sup> purchased. Poor underwriting practices and weak loan administration, as well as the deterioration of some real estate markets, translated quickly into a significant decline in the quality of the institution's loan portfolio and led to unacceptable levels of classified assets characterized by increasing delinquency and nonperformance. In addition, the Bank of Wyoming's Board and management failed to implement adequate risk management practices to manage the bank's rapid growth and reliance on non-core funding. Ultimately, the Bank of Wyoming's poor asset quality, strained liquidity, insufficient earnings, and inadequate capital all contributed to its failure.

The cause of Bank of Wyoming's failure is evidenced by its adversely classified assets. As of the June 2007 examination, adversely classified assets had increased since the prior examination almost 140 percent to \$3.8 million, which represented 43 percent of the total of Tier 1 Capital and the allowance for loan and lease losses (ALLL). In addition, ADC and CRE represented 179 and 334 percent of the bank's total risk-based capital, respectively. Further, the June 2007 examination determined that total loans made to borrowers outside of Wyoming (out-of-area loans) represented 513 percent of Tier 1 Capital and 52 percent of total loans. As of the April 2008 examination, adversely classified assets had increased further by 252 percent and represented 127 percent of Tier 1 Capital and ALLL. Past-due loans, at 6.21 percent of total loans, exceeded the bank's peer group by almost two and one-half times. By the March 2009 final examination, the condition of the bank deteriorated to a critically deficient state that represented an imminent threat to its viability.

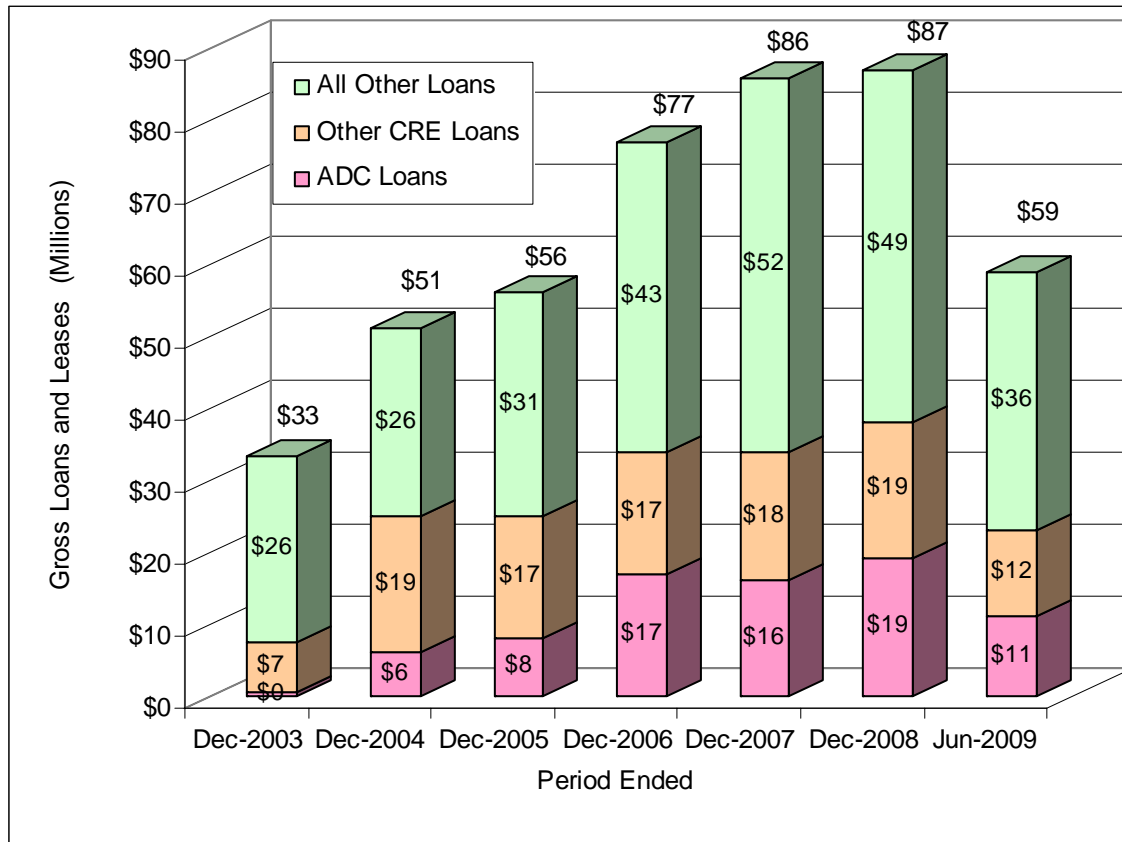
### **ADC and CRE Loan Concentrations**

The Bank of Wyoming's management decision to concentrate in ADC and CRE lending to out-of-area borrowers was the principal factor leading to the bank's deteriorating financial condition and subsequent failure. Further, deficient oversight of its ADC and CRE loan concentrations negatively impacted the bank's ability to effectively manage operations in a declining economic environment. Figure 1 illustrates the general composition and growth of the Bank of Wyoming's loan portfolio in the years preceding the institution's failure. As reflected in the figure, concentrations in ADC and other CRE loans were significant – ranging from 40 percent to 49 percent of gross loans and leases over the period 2004 to 2008.

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<sup>3</sup> Participation loans are made by more than one lender and serviced by the lead bank or lead lender. Participation loans make it possible for smaller banks to finance larger borrowers when the gross loan amount involved exceeds the legal lending limit of an individual bank.

**Figure 1: Composition of the Bank of Wyoming's Loan Portfolio**



Source: OIG analysis of UBPRs and Consolidated Reports of Condition and Income (Call Reports) for the Bank of Wyoming.

Financial Institution Letter (FIL) 104-2006 entitled, *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices*, dated December 12, 2006, recognizes that there are substantial risks posed by CRE concentrations and, in particular, ADC concentrations. Such risks include unanticipated earnings and capital volatility during a sustained downturn in the real estate market. The December 2006 guidance defines institutions with significant CRE concentrations as those reporting loans for construction, land and development, and other land (i.e., ADC) representing 100 percent or more of total capital; or institutions reporting total CRE loans representing 300 percent or more of total capital, where the outstanding balance of CRE has increased by 50 percent or more during the prior 36 months. Due to the risks associated with CRE and ADC lending, regulators consider institutions with significant CRE and ADC concentrations to be of greater supervisory concern.

As shown in Table 2, the Bank of Wyoming's concentrations in ADC loans consistently represented more than 100 percent of Total Capital from 2005 to 2009, exceeding the criteria for institutions warranting greater supervisory concern once the FDIC's guidance took effect in December 2006. In addition, ADC loans as a percent of the bank's total



capital and total loans were significantly above its peer group averages during the same period.

**Table 2: Bank of Wyoming’s ADC Concentrations Compared to Peer Group**

Period Ended	ADC Loans as a Percent of Total Capital			ADC Loans as a Percent of Total Loans		
	Bank of Wyoming	Peer Group	Bank of Wyoming Percentile	Bank of Wyoming	Peer Group	Bank of Wyoming Percentile
Dec 2005	102.99	18.61	94	15.00	3.14	94
Dec 2006	195.60	20.45	97	21.93	3.46	96
Dec 2007	165.90	39.79	94	18.44	6.30	89
Dec 2008	203.40	37.01	96	21.60	5.97	93
Jun 2009	258.00	20.00	99	18.61	3.55	97

Source: UBPR data for Bank of Wyoming.

Further, consistent with the December 2006 guidance, the Bank of Wyoming’s CRE concentrations also warranted greater supervisory concern in 2008 and 2009, as shown in Table 3. In addition, CRE loans as a percent of the bank’s total capital and total loans were significantly above the bank’s peer group averages from 2007 to 2009.

**Table 3: Bank of Wyoming’s CRE Concentrations Compared to Peer Group\***

Period Ended	CRE Loans as a Percent of Total Capital			CRE Loans as a Percent of Total Loans		
	Bank of Wyoming	Peer Group	Bank of Wyoming Percentile	Bank of Wyoming	Peer Group	Bank of Wyoming Percentile
Dec 2007	222.64	96.43	82	24.74	15.00	71
Dec 2008	347.42	100.59	95	36.89	16.94	90
Jun 2009	463.23	72.69	99	33.42	13.13	91

Source: UBPR data for the Bank of Wyoming.

\* Percentages for Bank of Wyoming and peers exclude owner-occupied CRE.

Between October 2003 and December 2004, the Bank of Wyoming increased its total loans by approximately 85 percent. Examiners noted this growth during the March 2005 examination but stated that the institution’s risk management appeared to be accurately identifying problem credits in a timely fashion. Notably, as a result of the March 2005 examination, examiners (1) downgraded the bank’s “Capital adequacy” component rating<sup>4</sup> to a “3” based on the declining trend in capital ratios caused by asset growth and the increased risk profile and (2) required the bank to submit a formal capital plan. During the July 2006 examination, FDIC examiners noted that the bank continued to experience significant asset growth from several large out-of-area loans with portions participated to other banks. Examiners noted that the loans were well diversified by

<sup>4</sup> Financial institution regulators and examiners use the Uniform Financial Institutions Rating System (UFIRS) to evaluate a bank’s performance in six components represented by the CAMELS acronym: Capital adequacy, Asset quality, Management practices, Earnings performance, Liquidity position, and Sensitivity to market risk. Each component, and an overall composite score, is assigned a rating of 1 through 5, with 1 having the least regulatory concern and 5 having the greatest concern.

repayment source, loan type, as well as geographically, and that the bank's Board established a limit on out-of-area loans at 40 percent of total loans and 350 percent of total capital. Nevertheless, by the June 2007 examination, the financial condition of the institution had deteriorated to a less than satisfactory condition due to a significant decline in asset quality and an increase in risk exposure in the loan portfolio.

### **Loan Underwriting and Credit Administration**

Weaknesses in the Bank of Wyoming's loan underwriting and credit administration practices were a contributing factor to the asset quality problems that developed in the institution's loan portfolio, specifically CRE and out-of-area lending, when the real estate market began to deteriorate in 2007. Examiners' concerns with the bank's credit administration practices began during the 2007 examination and noted that:

- Nearly \$2.6 million in loans were over 90 days past-due, while still accruing interest.
- Loans classified as Loss at the prior examination and those identified internally were not properly charged off in a timely manner or as required by Call Report instructions.
- The volume of loan file documentation exceptions was excessive.
- Valuations and verifications of non-real estate collateral were lacking.
- Credit and borrower analysis was marginal and needed to be enhanced.
- Procedures and controls for obtaining, reviewing, and approving real estate appraisals were weak and needed to be strengthened.
- The loan policy was inadequate because it did not address all of the types of lending the bank engaged in.
- The loan portfolio had large concentrations in land development and construction, and commercial real estate lending, which exposed the bank to additional risk.

In addition, the bank was cited for an excessive amount of lending-related apparent violations of laws and contraventions of the FDIC's Statement of Policies, including three apparent violations of Regulation O, which governs extensions of credit to officers and directors of a bank, and numerous violations of *FDIC Rules and Regulations Part 323 – Appraisals* (Part 323).

The 2008 and 2009 examinations further identified weak underwriting practices, which included:

- renewing or extending credit without full collection or capitalization of interest;
- extending credit through the use of overdrafts;
- extending credit without appropriate controls over construction financing;
- extending credit without formal take-out commitments;
- extending credit without obtaining complete and current financial information;
- extending credit inadequately supported by cash flow or collateral, or both;
- extending credit to highly-leveraged or unproven start-up companies; and
- over-relying on borrower's net worth without considering the borrower's liquidity.

## Reliance on Non-Core Funding

In the years preceding its failure, the Bank of Wyoming became increasingly dependent on non-core funding sources – including brokered and large time deposits – to fund loan growth and maintain adequate liquidity. Table 4 provides details on the bank’s non-core funding sources during the years prior to its failure. When properly managed, such funding sources offer important benefits, such as ready access to funding in national markets when core deposit growth in local markets lags planned asset growth. However, non-core funding sources also present potential risks, such as higher costs and increased volatility. According to the *DSC Risk Management Manual of Examination Policies*, placing heavy reliance on potentially volatile funding sources to support asset growth is risky because access to these funds may become limited during distressed financial or economic conditions. Under such circumstances, institutions could be required to sell assets at a loss in order to fund deposit withdrawals and other liquidity needs.

**Table 4: Bank of Wyoming’s Non-Core Funding Sources**

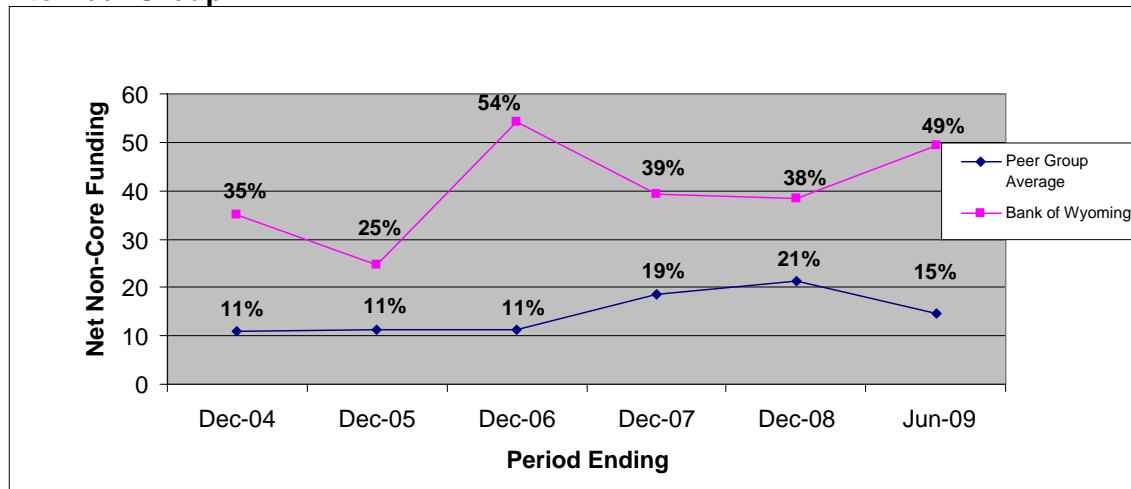
Period Ending	Time Deposits of \$100,000 or More (\$000s)	Brokered Deposits (\$000s)	Total Federal Home Loan Bank Borrowings (FHLB) (\$000s)
Jun-09	\$26,914	\$7,990	\$220
Mar-09	\$22,961	\$16,161	\$8,728
Dec-08	\$13,977	\$25,590	\$8,732
Dec-07	\$10,964	\$30,031	\$4,239
Dec-06	\$31,600	\$29,903	\$7,405
Dec-05	\$18,553	\$12,306	\$276
Dec-04	\$11,349	\$13,097	\$3,017
Dec-03	N/A	N/A	N/A

Source: UBPRs for Bank of Wyoming.

Further, the Bank of Wyoming’s net non-core funding dependence ratio<sup>5</sup> significantly and consistently outpaced its peer group, as illustrated in Figure 2. From December 2006 until June 2009, the institution’s net non-core funding dependence ratio was in the 87<sup>th</sup> to 99<sup>th</sup> percentile, and its brokered deposit levels were in the 95<sup>th</sup> to 99<sup>th</sup> percentile compared to its peer group. These ratios indicate that the institution’s dependence on potentially volatile funding was consistently higher than almost all of the other institutions in its peer group.

<sup>5</sup> The net non-core funding dependence ratio is a measure of the degree to which an institution relies on non-core funding to support longer-term assets (e.g., loans that mature in more than one year). An elevated ratio reflects heavy reliance on potentially volatile funding sources that may not be available in times of financial stress.

**Figure 2: Bank of Wyoming's Net Non-Core Funding Dependence Ratio Compared to Peer Group**



Source: OIG analysis of the UBPRs for the Bank of Wyoming.

WDB examiners commented in the March 2005 examination report that traditional core deposits had not kept pace with the bank's strong loan growth and were not readily attainable within its marketplace. As a result, the bank's non-core funding dependence ratio increased from 18 percent to 45 percent from December 31, 2003 to March 31, 2006.

FDIC examiners also noted the bank's reliance on non-core funding in the July 2006 examination; however, they stated that sufficient funding sources were available and that management had the ability to slow loan growth to ease liquidity constraints. During the 2006 and 2007 examinations, examiners cited other factors potentially mitigating the bank's funding and liquidity concerns. These factors included:

- a new branch in Casper, Wyoming, that the bank President believed would generate sufficient core deposits to replace some brokered deposits and borrowings;
- adequate liquidity management; and
- a sufficient matching of the bank's asset maturities to liability maturities.

By 2007, however, liquidity continued to tighten as a result of continued loan growth financed with brokered deposits and other non-core funding. By year-end 2007, the bank's borrowing capacity with the FHLB was significantly reduced as the quality of loans the bank pledged as collateral deteriorated. Three months later, in March 2008, the FHLB further discounted the market value of three pledged securities, resulting in a 54 percent reduction in total borrowing capacity, from \$24.3 million in January 2008 to \$11.2 million in March 2008.

The April 2008 examination revealed a continuing pattern of heavy reliance on non-core funding, despite a Memorandum of Understanding (MOU) issued in September 2007, which required the bank to (1) not increase the amount of brokered deposits from the amount outstanding on the effective date of the MOU, (2) establish an appropriate range

for the bank's net non-core funding dependence ratio, and (3) submit written plans for reducing the bank's net non-core dependence ratio and reducing its reliance on brokered deposits. Specifically, examiners found that although brokered deposit levels had slightly decreased, the bank had purchased deposits from the Certificate of Deposit Account Registry Service (CDARS) Program,<sup>6</sup> which are considered to be brokered deposits per Part 337.6 of the FDIC Rules and Regulations. Therefore, as of March 31, 2008, brokered deposits of \$31.0 million included \$18.7 million in traditional brokered deposits and \$12.3 million in time deposits through the CDARS program. In addition, examiners reported the bank's liquidity management, liquidity policy, and reporting needed improvement.

In April 2008, the bank's Board approved an amended Asset Liability and Funds Management Policy to establish limits on net non-core fund dependence (48 percent) and brokered deposits limits (30 percent, excluding CDARS deposits). However, examiners found both limits to be "unduly" high and not consistent with the intent and requirements of the MOU. In addition, the bank had still not prepared an acceptable written plan to reduce the bank's reliance on brokered deposits. The Bank of Wyoming subsequently stipulated to a Cease and Desist Order (C&D), effective October 17, 2008, which repeated requirements to develop and implement (1) a policy with an appropriate range for the bank's net non-core funding dependence ratio, (2) contingency funding plans, and (3) a written plan to reduce the bank's net non-core fund dependence ratio. Pursuant to the FDIC's Rules and Regulations, the C&D lowered the Bank of Wyoming's PCA capital category from *Well Capitalized* to *Adequately Capitalized*. As a result, the bank was restricted from accepting, renewing, or rolling over brokered deposits without a waiver from the FDIC.

In the January 2009 visitation, FDIC and WDB examiners determined the bank's liquidity level was deficient and continuing to decline because of its inability to obtain, renew, or roll over brokered deposits, and reduced borrowing capacity. As the bank exited out of its brokered deposit contracts, it pursued 6- and 12-month certificates of deposit via an Internet listing service, certificates of deposit from other Wyoming banks, and a collateralized borrowing line with the Federal Reserve Bank of Kansas City. However, because the FDIC had assigned it a capital category of *Adequately Capitalized*, the bank was subject to FDIC Rules and Regulations under Part 337 – *Unsafe and Unsound Banking Practices* (Restrictions on the Use of Brokered Deposits and High-Rate Deposits),<sup>7</sup> which limits the deposit rates that can be paid by institutions that are less than *Well Capitalized*. The Bank of Wyoming acknowledged non-compliance with Part 337, and examiners required the certificates of deposit to be reported as brokered deposits on the bank's March 31, 2009 Call Report.

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<sup>6</sup> CDARS is a program in which depositors may attain full FDIC insurance on deposits of up to \$50 million.

<sup>7</sup> FDIC's Rules and Regulations Part 337, *Unsafe and Unsound Banking Practices*, limits the deposit rates that can be paid by institutions that are less than *Well Capitalized*. In general, any insured depository institution that is not *Well Capitalized* may not pay an effective yield on any deposit that exceeds 75 basis points of either of the following rates, depending on its circumstances: (1) the effective yield paid on comparable deposits within its normal market area or (2) 120 percent of the current yield on similar maturity U.S. Treasury obligations.

On January 29, 2009, as required by the C&D, the bank's Board approved a revised Interest Rate Risk and Asset/Liability Management Policy, which established maximum limits for brokered deposits, the net non-core dependence ratio, the loans-to-deposit ratio, the loans-to-assets ratio, and a liquidity ratio, which the FDIC deemed reasonable. However, the FDIC noted the bank was operating outside the new policy limits and had yet to submit an adequate written plan to reduce the bank's net non-core dependence ratio. At that time, brokered deposits made up 25 percent of the total deposit base and 53 percent of the non-core funding. At the March 2009 examination, the FDIC concluded that the Bank of Wyoming's liquidity position was deficient and represented an ongoing threat to the institution. Critically deficient asset quality severely limited the bank's ability to obtain Federal Funds lines and other borrowings. At this final examination, examiners concluded that the bank's asset quality, capital, earnings, and management were also critically deficient and outside financial support would be required to continue its viability.

## **The FDIC's Supervision of the Bank of Wyoming**

Between 2005 and 2009, the FDIC and the WDB conducted regular examinations of the Bank of Wyoming in which they identified risks in the bank's operations. These risks were brought to the attention of the institution's Board and management through regular discussions and correspondence, Reports of Examination (ROE), visitations, offsite reviews, and informal and formal enforcement actions. The FDIC and the WDB recognized the growth in ADC and CRE lending funded primarily with brokered deposits and time deposits of \$100,000 or more, and issued an MOU, effective September 2007, in an effort to stop unsafe and unsound practices and deficiencies related to the bank's aggressive growth strategy. Following further deterioration in the bank's overall condition and failure to implement all of the recommendations of the MOU, the Bank of Wyoming stipulated to a C&D that was effective October 17, 2008. The C&D remained in effect until the bank was closed in July 2009. The FDIC and the WDB closely monitored the Bank of Wyoming's condition after the C&D was issued until the institution was closed.

The Bank of Wyoming's growth in ADC and CRE lending funded with volatile, non-core deposits resulted in a high-risk profile for the institution. The FDIC's supervisory response to these risks was generally timely and consistent with DSC policies and practices. However, while bank management assured examiners they had taken and planned actions that mitigated the non-core funding and concentration risks identified by examiners at the 2006 examination, management failed to follow through on a commitment to slow loan growth following that examination. Loan growth, coupled with a decline in the real estate market and weak loan underwriting and credit administration practices identified in subsequent examinations, contributed to the deterioration in the bank's financial condition. This outcome brings into question whether earlier and/or more formal supervisory action may be warranted in such circumstances, i.e., an extended pattern of loan growth and non-core funding above peer group averages.

## Supervisory History

From March 2005 through March 2009, the FDIC and WDB collectively conducted five full-scope examinations, two visitations, and two offsite reviews of the Bank of Wyoming. Table 5 summarizes key information pertaining to the FDIC's and the WDB's supervision of the Bank of Wyoming until the institution failed, including the institution's supervisory ratings.

**Table 5: Bank of Wyoming's Supervisory History from 2005 to 2009**

Examination Start Date	Agency	Supervisory Ratings (UFIRS)	Supervisory Action/Explanation
03/21/2005	WDB	322122/2	N/A
07/17/2006	FDIC	221122/2	N/A
12/31/2006 Offsite Review	FDIC	N/A	Reviewed brokered deposits and out-of-area participations. Recommended that the next examination be accelerated to no later than July 2007.
03/31/2007 Offsite Review	FDIC	N/A	Reviewed brokered deposits and out-of-area participations. Recommended an on-site visit approximately 6 months from the date of the MOU issued as a result of the June 2007 examination, to determine progress.
06/18/2007	FDIC/WDB	333332/3	Issued an MOU.
12/17/2007 Visitation	FDIC/WDB	N/A	Reviewed the condition of the bank and the Board's overall compliance and progress with the MOU.
04/28/2008	FDIC/WDB	344332/4	Issued a C&D.
01/12/2009 Visitation	FDIC/WDB	N/A	Reviewed Board's compliance with the C&D, and asset quality, ALLL, earnings, capital, and liquidity.
03/02/2009	FDIC/WDB	555543/5	None.

Source: The FDIC's Virtual Supervisory Information on the Net and ROEs for the Bank of Wyoming.

### Offsite Reviews and Visitations

In addition to examinations, the FDIC and WDB provided continuing monitoring of the Bank of Wyoming through offsite reviews and visitations.

**December 2006 Offsite Review.** FDIC examiners conducted an offsite review of the bank in response to concerns noted at the previous examination, particularly that the loan portfolio had high classifications and the practice of using brokered deposits to purchase out-of-area participations was alarming to the examiners. According to the 2005 examination report, total loans had grown approximately 85 percent since the last examination, while the level of adversely classified assets had grown over 144 percent. In addition, the 2006 examination report identified that the bank's reliance upon non-core

funding sources had significantly increased from 18 percent to 45 percent as of March 31, 2006. The offsite review recommended that the next examination be accelerated, as scheduling permitted, to no later than July 2007.

**March 2007 Offsite Review.** Based upon the same issues addressed in the December 2006 offsite review, this review was conducted concurrently with the June 2007 full-scope examination. Examiners recommended that an on-site visit be conducted approximately 6 months from the date the MOU was issued as a result of the June 2007 examination, to determine the bank's progress in addressing the MOU provisions.

**December 2007 Visitation.** This joint FDIC and WDC visitation was conducted to specifically review the condition of the institution and the Board's overall compliance and progress with the MOU. Emphasis was placed on reviewing loan underwriting, credit administration, and compliance with applicable laws and regulations. Examiners reported that the institution's asset quality continued to deteriorate due to increasing risk in the loan portfolio. Adversely classified assets had almost doubled since the June 2007 examination and represented a moderately high 73 percent of the institution's Tier 1 Capital and reserves. The majority of the credits were related to participations. In addition, past-due loans significantly increased, and the institution's Watch List,<sup>8</sup> as of November 30, 2007, was inaccurate. Examiners stated that management had developed but not yet implemented a new loan risk rating system and was struggling with a plan to reduce the reliance on brokered deposits and lower the net non-core funding dependence ratio. However, management stated that no brokered deposits had been purchased or renewed since mid-2006. Examiners also stressed that the bank's Board and management must concentrate their efforts on correcting the asset quality problems. Further, examiners reported that management was in compliance with only 5 of the 13 provisions of the MOU.

**January 2009 Visitation.** This second joint visitation found that the deterioration of the bank's overall condition had accelerated, resulting in greater supervisory concern. The report stated that "the volume and severity of problems may be beyond management's ability to control or correct." Examiners also noted that:

- Asset classifications had accelerated to nearly 256 percent of Tier 1 Capital and ALLL. Past-due and nonaccrual loans represented 22.3 percent of gross loans as compared to 6.2 percent at the previous examination.
- Earnings were deficient due to the large amount of loan loss provisions needed to cover loans losses during 2008.
- Liquidity was deficient and borrowing capacity was strained because of the bank's inability to obtain, renew, or roll over brokered deposits.
- The Tier 1 Capital to total asset ratio was well below the C&D requirement of 9.5 percent.

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<sup>8</sup> A Watch List is a detailed loan report that represents the bank's internal grading or assessment of quality of its loan portfolio.



- The bank was not in compliance with 18 of 22 provisions of the C&D issued in October 2008.

During the period 2005 through 2009, the FDIC and the WDB pursued one informal enforcement action and one formal enforcement action to address weak risk management practices identified by the examiners.

**September 2007 MOU.** Issued as a result of the June 2007 examination, the MOU contained six actions the bank needed to address relating to its loan portfolio. Specifically, the MOU required the bank to (1) develop a plan to correct deficiencies in the assets listed for Special Mention; (2) reduce the assets classified as Substandard to not more than \$2.5 million within 180 days; (3) not extend directly or indirectly any additional credit to a borrower whose loan or other credit had been classified Substandard and was uncollected, unless it was approved by the Board; (4) within 30 days from the date of the MOU, maintain an adequate ALLL; (5) within 10 days from the date of the MOU, charge-off all assets classified as Loss as identified in the ROE; and (6) amend its loan policy to address all deficiencies noted in the ROE. Additionally, the MOU required the Bank of Wyoming's management to maintain Tier 1 Capital at 8 percent, restrict dividend payments, reduce the non-core dependence ratio, submit a plan to restrict and reduce reliance on brokered deposits, and develop and implement a new loan policy and a new liquidity policy.

**October 2008 C&D.** This corrective action was taken in response to the April 2008 examination and the Board and management's failure to correct weaknesses in compliance with the outstanding MOU. The C&D contained 22 affirmative actions that required the bank to, among other things, retain qualified management, increase Board participation in the affairs of the bank, and increase Tier 1 Capital to equal or exceed 9.5 percent of the bank's total assets.

### **Supervisory Concern Related to ADC and CRE Loan Concentrations**

The Bank of Wyoming's consistent growth in ADC and CRE lending resulted in a high-risk loan profile for the institution. Although examiners noted the increasing risk in examination reports prior to 2007, in their view, the overall condition of the bank and other factors sufficiently mitigated that risk, and supervisory action was not warranted nor could it be supported before 2007. Unfortunately, the combination of loan growth, the real estate decline, and poor underwriting and credit administration practices caused a rapid deterioration in the bank's portfolio that was evident at the 2007 examination. Supervisory actions taken at that time and later could not sufficiently mitigate the bank's vulnerability to substantial losses.

### **March 2005 and July 2006 Examinations**

Examiners noted the bank's loan growth starting with the March 2005 examination and criticized existing capital levels, which were deemed less than satisfactory, and required bank management to develop a capital plan. In the July 2006 examination report, examiners raised concerns over continued asset growth from out-of-area lending, but

found the loans to be well diversified by repayment source and loan type, as well as geographically. As discussed earlier, the bank's ADC concentration exceeded the parameters for concentrations warranting greater concern at that time, recognizing that the FDIC's guidance on *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* had not yet been issued. In addition, ADC loans as a percentage of the bank's total capital and total loans were significantly above its peer group averages.

#### June 2007 Examination

By the June 2007 examination, the financial condition of the institution had deteriorated due to a decline in asset quality as evidenced by a significant increase in adversely classified assets. As a result of this examination, an MOU was issued in September 2007, as previously described. According to the FDIC, stronger and earlier supervisory actions were not taken regarding the bank's concentrations because (1) while the bank's risk profile was increasing, the condition of the bank prior to the 2007 examination remained satisfactory; (2) the bank received \$3 million in additional capital in late 2005 to mitigate the increased risk profile, including ADC and CRE loan concentrations; (3) the real estate markets and U.S. economy were still healthy prior to 2007; and (4) the FDIC guidance on *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* was not issued until December 2006.

#### April 2008 Examination

The April 2008 examination reported that asset quality had deteriorated to a level that raised significant regulatory concern and posed considerable risk to the institution. Poor credit decisions and underwriting practices, along with deteriorating market conditions, led to an increase in adversely classified items. Past-due loans, at 6.21 percent, exceeded the bank's peer group by almost two and one-half times. Management also failed to correct 5 of the 13 deficiencies identified in the MOU, and a C&D was issued. The January 2009 visitation reported that the condition of the bank had further deteriorated and resulted in greater supervisory concern. The report stated that the volume and severity of problems may have been beyond management's ability to control or correct. Examiners noted that Board and management actions were necessary to preserve the soundness of the institution and encouraged the bank to take immediate action(s) to effect compliance with the C&D and to track the progress closely. The examiners reported that barring significant improvement in asset quality and profitability during 2009, continued net losses were anticipated and would continue to erode capital.

#### **Supervisory Concern Related to Reliance on Non-Core Funding**

As early as 2005, examiners expressed concerns about the bank's reliance on non-core funding to support increased loan growth. Because the majority of this funding was from brokered deposits, the FDIC encouraged the bank to monitor its capital position to ensure the bank remained *Well Capitalized*, and brokered deposits would still be available as a funding source. When examiners became alarmed at the July 2006 examination that the

bank's reliance on non-core funding sources had significantly increased, from 18 percent to 45 percent, the FDIC responded by more closely monitoring the bank's use of brokered deposits through offsite monitoring in December 2006 and March 2007. The results of the offsite monitoring caused examiners to recommend an accelerated examination. In June 2007, examiners continued to express concern over an increasing 56 percent net non-core funding dependence ratio, with brokered deposits making up 40 percent of the institution's total deposit base.

Despite the bank's lack of responsive action to address repeated examiner concerns regarding its reliance on non-core liabilities, examiners did not require the bank to reduce its net non-core dependency ratio or set a policy with an appropriate range for the bank's ratio until the MOU in September 2007. According to the FDIC, the July 2006 examination cited several factors that mitigated the risk associated with the bank's high non-core dependence ratio. Specifically:

- Bank management anticipated that the new branch in Casper would generate sufficient core deposits to replace some brokered deposits.
- Bank management stated that it had the ability to slow loan growth to ease liquidity constraints.
- The bank had over \$14 million in brokered deposits maturing beyond 2 years (over 50 percent of total brokered deposits), and the bank's assets and liabilities were sufficiently matched. The use of longer-maturity brokered deposits and match-funding<sup>9</sup> mitigated short-term liquidity risk.

The Casper branch did generate core deposits (it had nearly \$20 million in deposits when it was sold in March 2009); however, the bank's loan growth was faster than the deposit growth from this branch. In addition, management did not slow down loan growth as it had committed to doing.

Further deterioration in the bank's condition and failure to implement the MOU provisions caused the FDIC and WDB to reiterate, in the April 2008 examination, that the Board needed to be more proactive in (1) reducing the bank's dependence on non-core funding sources, (2) focusing on continued reduction in the volume of non-core liabilities, (3) acquiring additional core deposits, and (4) maintaining more short-term investments. This guidance was repeated in provisions in the October 2008 C&D. However, at the time these supervisory actions were taken, the majority of the Bank of Wyoming's asset and non-core funding growth had already occurred. The deteriorating economic environment, coupled with the declining quality of the loan portfolio, were negatively impacting earnings and capital and seriously limiting the institution's funding alternatives. Ultimately, by early 2009, the bank's liquidity risk continued to escalate and its reputation became vulnerable.

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<sup>9</sup> A bank is said to match-fund a loan or other asset by buying (taking) a deposit of the same maturity.

In retrospect, when a bank has an extended pattern of growth in, and dependence on, non-core funding, as did the Bank of Wyoming, a more formal supervisory action may be warranted that requires bank management to commit to a plan to reduce the institution's dependence on non-core funding sources.

### Implementation of PCA

The purpose of PCA is to resolve problems of insured depository institutions at the least possible long-term cost to the DIF. PCA establishes a system of restrictions and mandatory and discretionary supervisory actions that are to be triggered depending on an institution's capital levels. Part 325, *Capital Maintenance*, of the FDIC's Rules and Regulations implements PCA requirements by establishing a framework for taking prompt corrective action against insured nonmember banks that are not adequately capitalized. Enforcement actions addressing the Bank of Wyoming's capital deficiencies were taken in accordance with PCA capital-related provisions. Based on the supervisory actions taken, the FDIC properly implemented applicable PCA provisions of section 38 in a timely manner, as follows:

- Based on the preliminary results of the March 2009 examination, on April 2, 2009, the FDIC sent the Bank of Wyoming a PCA letter notifying the bank that it was considered *Undercapitalized* and that it could not accept, renew, or roll over any brokered deposits. As of December 31, 2008, the bank's capital ratios were:
  - Total Risk-Based Capital Ratio      6.68 percent
  - Tier 1 Risk-Based Capital Ratio      5.41 percent
  - Tier 1 Leverage Ratio                  3.92 percent
- The WDB issued a notice to restore impaired capital on April 29, 2009 and stated that the bank had 60 days to comply or it would be closed.
- On May 26, 2009, the FDIC sent a letter to the Bank of Wyoming's Board notifying it that, despite its capital ratios having improved to *Adequately Capitalized* because of the sale of the bank's Casper, Wyoming branch, the capital restoration plan was determined to be inadequate and would not be accepted due to, in part, the lack of any definitive capital infusion. The letter further stated that the bank was still considered *Undercapitalized* for PCA purposes and required the bank to submit a revised plan.

PCA's role in mitigating the losses to the DIF was limited because PCA did not require action until the institution was at serious risk of failure. The WDB closed the Bank of Wyoming on July 10, 2009, due to its poor asset quality and deficient capital, and appointed the FDIC as receiver.

## 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 January 15, 2010, the Director, DSC, provided a written response to the draft report. That response is provided in its entirety as Appendix 4 of this report. DSC reiterated the OIG's conclusions regarding the cause of the Bank of Wyoming's failure. With regard to our assessment of supervision, DSC noted that the June 2007 examination resulted in a recommendation for an MOU that became effective in September 2007, and that the December 2007 joint visitation, which reviewed the bank's overall condition and the Board's compliance and progress with the MOU, found that management was not in compliance with all MOU provisions. Based on these findings, the FDIC accelerated the next examination, at which time examiners determined that asset quality had further deteriorated to a level that raised significant regulatory concern and took action through an October 2008 formal enforcement action. Further, in its response, DSC stated that "In recognition that strong supervisory attention is necessary for institutions with high CRE/ADC concentrations and volatile funding sources, such as [the Bank of Wyoming], DSC has issued updated guidance reminding examiners to take appropriate action when these risks are imprudently managed."

## Objectives, Scope, and Methodology

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### Objectives

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

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

We conducted this performance audit from October 2009 to January 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 concentrated on the Bank of Wyoming's operations from 2005 until its failure on July 10, 2009. Our review also entailed an evaluation of the regulatory supervision of the institution over the same period.

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

- Analyzed ROEs and visitation reports prepared by the FDIC and the WDB from 2005 to 2009.
- Reviewed the following:
  - Bank data and correspondence maintained at DSC's San Francisco Regional Office and Field Office.
  - Reports prepared by the Division of Resolutions and Receiverships (DRR) and DSC relating to the bank's closure.
  - Pertinent DSC policies and procedures.

## Objectives, Scope, and Methodology

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- Interviewed the following officials:
  - DSC management in Washington, D.C., the San Francisco Regional Office, and the Kansas City Regional Office.
  - FDIC examiners from the Billings, Montana Field Office who participated in examinations and visitations of the Bank of Wyoming.
  - Officials from the WDB to discuss the historical perspective of the institution, its examinations, and other activities regarding the state's supervision of the bank.

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

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

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

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

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

## Glossary of Terms

Term	Definition
<b>Adversely Classified Assets</b>	Assets subject to criticism and/or comment in an examination report. Adversely classified assets are allocated on the basis of risk (lowest to highest) into three categories: Substandard, Doubtful, and Loss.
<b>Allowance for Loan and Lease Losses (ALLL)</b>	Federally insured depository institutions must maintain an ALLL that is adequate to absorb the estimated loan losses associated with the loan and lease portfolio (including all binding commitments to lend). To the extent not provided for in a separate liability account, the ALLL should also be sufficient to absorb estimated loan losses associated with off-balance sheet loan instruments such as standby letters of credit.
<b>Call Report</b>	Consolidated Reports of Condition and Income (also known as the Call Report) are reports that are required to be filed by every national bank, state member bank, and insured nonmember bank pursuant to the Federal Deposit Insurance Act. These reports are used to calculate deposit insurance assessments and monitor the condition, performance, and risk profile of individual banks and the banking industry.
<b>Cease and Desist Order (C&amp;D)</b>	A C&D is a formal enforcement action issued by a financial institution regulator to a bank or affiliated party to stop an unsafe or unsound practice or a violation of laws and regulations. A C&D may be terminated when the bank's condition has significantly improved and the action is no longer needed or the bank has materially complied with its terms.
<b>Concentration</b>	A concentration is a significantly large volume of economically related assets that an institution has advanced or committed to a certain industry, person, entity, or affiliated group. These assets may, in the aggregate, present a substantial risk to the safety and soundness of the institution.
<b>Federal Home Loan Bank (FHLB)</b>	One of 12 Federal Home Loan Banks from which financial institutions in America borrow funds to finance housing, economic development, infrastructure, and jobs.
<b>Memorandum of Understanding (MOU)</b>	An informal corrective administrative action for institutions considered to be of supervisory concern, but which have not deteriorated to the point where they warrant formal administrative action. As a general rule, an MOU is to be considered for all institutions rated a composite 3.
<b>Participation Loans</b>	Participation loans are made by more than one lender and serviced by the lead bank or lead lender. Participation loans make it possible for smaller banks to finance larger borrowers when the gross loan amount involved exceeds the legal lending limit of an individual bank.
<b>Prompt Corrective Action (PCA)</b>	The purpose of PCA is to resolve the problems of insured depository institutions at the least possible long-term cost to the DIF. Part 325, subpart B, of the FDIC Rules and Regulations, 12 Code of Federal Regulations, section 325.101, et. seq., implements section 38, <i>Prompt Corrective Action</i> , of the FDI Act, 12 United States Code section 1831(o), by establishing a framework for taking prompt supervisory actions against insured nonmember banks that are less than adequately



## Glossary of Terms

	<p>capitalized. The following terms are used to describe capital adequacy: (1) <i>Well Capitalized</i>, (2) <i>Adequately Capitalized</i>, (3) <i>Undercapitalized</i>, (4) <i>Significantly Undercapitalized</i>, and (5) <i>Critically Undercapitalized</i>.</p> <p>A PCA Directive is a formal enforcement action seeking corrective action or compliance with the PCA statute with respect to an institution that falls within any of the three categories of undercapitalized institutions.</p>
<b>Risk-Based Capital</b>	A “supplemental” capital standard under Part 325 of the FDIC Rules and Regulations. Under the risk-based framework, a bank’s qualifying total capital base consists of two types of capital elements, “core capital” (Tier 1) and “supplementary capital” (Tier 2).
<b>Tier 1 (Core) Capital</b>	<p>Defined in Part 325 of the FDIC Rules and Regulations, 12 C.F.R. section 325.2 (A), as</p> <p><b>The sum of:</b></p> <ul style="list-style-type: none"> <li>• Common stockholder’s equity (common stock and related surplus, undivided profits, disclosed capital reserves, foreign currency translation adjustments, less net unrealized losses on available-for-sale securities with readily determinable market values);</li> <li>• Non-cumulative perpetual preferred stock; and</li> <li>• Minority interest in consolidated subsidiaries;</li> </ul> <p><b>Minus:</b></p> <ul style="list-style-type: none"> <li>• Certain intangible assets;</li> <li>• Identified losses;</li> <li>• Investments in securities subsidiaries subject to section 337.4; and</li> <li>• Deferred tax assets in excess of the limit set forth in section 325.5(g).</li> </ul>
<b>Tier 2 (Supplemental) Capital</b>	<p>Tier 2 capital is defined in Part 325 of the FDIC Rules and Regulations, and is generally the sum of:</p> <ul style="list-style-type: none"> <li>• Allowances for loan and lease losses, up to a maximum of 1.25 percent of risk-weighted assets;</li> <li>• Cumulative perpetual preferred stock, long-term preferred stock and related surplus;</li> <li>• Perpetual preferred stock (dividend is reset periodically);</li> <li>• Hybrid capital instruments; and</li> <li>• Term subordinated debt and intermediate-term preferred stock.</li> </ul>
<b>Uniform Bank Performance Report (UBPR)</b>	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.

## Acronyms

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ADC	Acquisition, Development and Construction
ALLL	Allowance for Loan and Lease Losses
C&D	Cease and Desist Order
CAMELS	<u>C</u> apital, <u>A</u> sset Quality, <u>M</u> anagement, <u>E</u> arnings, <u>L</u> iquidity, and <u>S</u> ensitivity to Market Risk
CDARS	Certificate of Deposit Account Registry Service
CRE	Commercial Real Estate
DIF	Deposit Insurance Fund
DRR	Division of Resolutions and Receiverships
DSC	Division of Supervision and Consumer Protection
FDI	Federal Deposit Insurance
FDIC	Federal Deposit Insurance Corporation
FHLB	Federal Home Loan Bank
FIL	Financial Institution Letter
MOU	Memorandum of Understanding
OIG	Office of Inspector General
PCA	Prompt Corrective Action
ROE	Report of Examination
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System
WDB	State of Wyoming Department of Audit, Division of Banking

## Corporation Comments



Federal Deposit Insurance Corporation  
550 17th Street NW, Washington, D.C. 20429-9990

Division of Supervision and Consumer Protection

January 15, 2010

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

**FROM:** Sandra L. Thompson  
Director

**SUBJECT:** Draft Audit Report Entitled, Material Loss Review of Bank of Wyoming,  
Thermopolis, Wyoming (Assignment No. 2009-068)

Pursuant to Section 38(k) of the Federal Deposit Insurance Act (FDI Act), the Federal Deposit Insurance Corporation's Office of Inspector General (OIG) conducted a material loss review of Bank of Wyoming (BOW) which failed on July 10, 2009. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Report (Report) received on December 23, 2009.

The Report concludes BOW failed due to the Board's and management's aggressive pursuit of loan growth funded with brokered and other non-core deposits. BOW's management decision to concentrate the loan portfolio in commercial real estate (CRE) and acquisition, construction, and development loans (ADC), through out-of-area purchased loan participations, and its reliance on brokered deposits were the principal factors leading to BOW's deteriorating financial condition and failure. BOW's poor underwriting practices of bank-originated loans, overall weak loan administration, and deterioration of out-of-area real estate markets resulted in increased delinquencies and non-performing assets and a significant decline in loan quality. BOW did not have the capital to absorb the losses and adequately support its risk profile.

As part of DSC's supervisory program, from March 2005 through March 2009, the FDIC and the State of Wyoming Division of Banking (WDB) jointly and separately conducted five full-scope examinations, two visitations, and two off-site reviews; all of which included recommendations regarding out-of-area participations and non-core funding.

The June 2007 examination resulted in a recommendation for a Memorandum of Understanding (MOU) that became effective in September 2007. The December 2007 joint visitation, which reviewed BOW's overall condition and the Board's compliance and progress with the MOU, found that management was only in compliance with 5 of the 13 MOU provisions. Based on these findings, DSC accelerated the next examination. At that time examiners found that stated asset quality had further deteriorated to a level that raised significant regulatory concern and posed considerable risk to BOW and DSC took action through an October 2008 formal enforcement action. In recognition that strong supervisory attention is necessary for institutions with high CRE/ADC concentrations and volatile funding sources, such as BOW, DSC has issued updated guidance reminding examiners to take appropriate action when these risks are imprudently managed.

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