Office of Inspector General

Office of Material Loss Reviews
Report No. IDR-11-005

In-Depth Review of the Failure of Wheatland Bank, Naperville, Illinois

January 2011

Office of Inspector General

Executive Summary

In-Depth Review of the Failure of Wheatland Bank, Naperville, Illinois

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Why We Did The Audit

The Illinois Department of Financial and Professional Regulation (IDFPR) closed Wheatland Bank (Wheatland or the Bank), Naperville, Illinois on April 23, 2010 for conducting its business in an unsafe and unsound manner and named the FDIC as receiver. On May 14, 2010, the FDIC notified the Office of Inspector General (OIG) that Wheatland's total assets at closing were $480 million and the estimated loss to the Deposit Insurance Fund (DIF) was $133 million. As of November 30, 2010, the estimated loss to the DIF had increased to $147 million. The OIG contracted with KPMG LLP (KPMG) to conduct a review of Wheatland's failure.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Financial Reform Act) amends section 38(k) of the Federal Deposit Insurance Act (FDI Act) by increasing the material loss review (MLR) threshold from $25 million to $200 million for losses that occur for the period January 1, 2010 through December 31, 2011. The Financial Reform Act also requires the OIG to review all other losses incurred by the DIF to determine (a) the grounds identified by the state or Federal banking agency for appointing the Corporation as receiver and (b) whether any unusual circumstances exist that might warrant an in-depth reviews of the loss. KPMG's fieldwork had begun at the time the Financial Reform Act was enacted. Although the estimated loss for Wheatland did not meet the amended threshold requiring an MLR, the OIG determined that certain circumstances pertaining to the failure of the Bank warranted an in-depth review as authorized by the Financial Reform Act.

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

Background

Wheatland was a state nonmember bank that became insured on November 17, 2006 and opened for business on February 5, 2007. Headquartered in Naperville, Illinois, 30 miles west of Chicago, the Bank did not have any branch offices or affiliates.

Wheatland commenced operations pursuing a community bank business plan that emphasized Commercial Real Estate (CRE) lending and, in particular, Acquisition, Development, and Construction (ADC) loans. Growth in excess of business plan projections occurred soon after the Bank opened for business. To fund its asset growth and operations, the Bank offered high-yield Certificates of Deposit (CD) and increased its use of brokered deposits in 2008.

Executive Summary

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Audit Results

Causes of Failure and Loss

Wheatland's failure can be attributed to the Board of Directors' (Board) and management's aggressive growth strategy for a de novo institution—funded by volatile, high-rate deposits—that led to high CRE and ADC loan concentrations. Overall, management and the Board failed to establish appropriate practices to mitigate the risk associated with this strategy. Weak credit administration practices along with continued aggressive growth in a deteriorating economy contributed to a precipitous deterioration in asset quality and, ultimately, poor earnings and insufficient liquidity and capital. The Board and Bank management failed to address regulatory warnings regarding excessive growth, insufficient staffing, asset quality deterioration, and a lack of risk diversification. Disagreements among members of the Board and Bank management were in part to blame for the Bank's failure to implement timely corrective action to resolve these issues.

The FDIC's Supervision of Wheatland

The FDIC's and the IDFPR's examinations and visitations of Wheatland followed examination procedures and guidance applicable to a de novo bank and identified key risks, including asset growth far exceeding business plans, high CRE and ADC loan concentrations, credit administration weaknesses, and dependence on high rate CDs as a funding source, all of which eventually contributed to the Bank's failure. These concerns were addressed by the regulators through supervisory actions in 2008 and 2009. However, by that point in time, the actions could not effectively address the Board's failure to curtail growth and improve asset quality in a deteriorating economy, practices which had an adverse financial impact and led to the bank's failure in 2010.

Wheatland signed a Bank Board Resolution (BBR) in September 2008 to correct deficiencies noted at the February 2008 examination. Nevertheless, due to adverse changes in the economy, and the combination of Wheatland's risk management weaknesses, excessive asset growth, and high CRE and ADC loan concentrations, the financial condition of the Bank significantly deteriorated by the February 2009 examination. By the time the Bank's Board agreed to a Consent Order with more stringent requirements in December 2009, the viability of the institution was seriously in question as a consequence of the high level of classified loans and eroding capital protection.

In retrospect, the regulators may have benefited from a more forward-looking approach to addressing the 2007 and 2008 examination findings and overall risk profile, especially given the excessive growth beyond the Bank's original business plan. Such an approach may have involved earlier and stronger supervisory actions, including restriction of asset growth to a more reasonable level for a de novo institution, particularly with the Bank's strategy to concentrate asset growth in CRE and ADC loans.

Based on the supervisory actions taken with respect to Wheatland, the FDIC properly implemented applicable PCA provisions of section 38 of the FDI Act.

Management Response

After we issued our draft report, management officials provided additional information for our consideration, and we revised our report to reflect this information, as appropriate. The Director, DSC, provided a written response to the draft report dated January 5, 2011. That response is provided in its entirety on page II-2 of this report.

In the response, the DSC Director reiterated the causes of Wheatland's failure and summarized the regulators' supervisory activities, as described in our report. The response also stated that, in recognition that stringent supervisory attention is necessary for de novo institutions, DSC has extended its supervisory program so these institutions receive a full-scope examination every year for 7 years, as opposed to 3 years. According to DSC, de novo business plans are being closely monitored against approved financial projections throughout the 7-year period. Additionally, DSC issued a Financial Institution Letter in August 2009 that describes the program changes for de novo institutions and warns that changes in business plans undertaken without required prior approval may subject an institution or its insiders to civil money penalties.

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

Office of Material Loss Reviews
Office of Inspector General

DATE: January 21, 2011

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 Wheatland Bank, Naperville, Illinois* (Report No. IDR-11-005)

The subject final report is provided for your information and use. Please refer to the Executive Summary, included in the report, for the overall audit results. The report did not contain recommendations, thus a response was not required. However, the Division of Supervision and Consumer Protection provided a written response dated January 5, 2011. We incorporated the response into Part II of the final report.

If you have questions concerning the report, please contact me at (703) 562-6352 or Mike Lombardi, Audit Manager, at (703) 562-6328. We appreciate the courtesies extended to the audit staff.

Attachment

cc: M. Anthony Lowe, Regional Director, DSC
Elaine D. Drapeau, Chief, Office of Internal Control and Review, DSC
James H. Angel, Jr., Director, OERM
Jorge A. Solis, Division Director, IDFPR

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Part I

Report by KPMG LLP

In-Depth Review of the Failure of
Wheatland Bank
Naperville, Illinois

Prepared for the
Federal Deposit Insurance Corporation
Office of Inspector General

January 20, 2011

KPMG LLP

2001 M Street, NW
Washington, DC

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KPMG LLP
2001 M Street, NW
Washington, DC 20036

January 20, 2011

Executive Summary

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

In-Depth Review Report on the Failure of Wheatland Bank, Naperville, Illinois

Dear Mr. Beard:

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

The OIG had initially retained KPMG LLP (KPMG) to perform an MLR of Wheatland. At the time the Financial Reform Act was enacted, our fieldwork had already started. Although the estimated loss for Wheatland did not meet the amended threshold requiring an MLR, the OIG determined that certain circumstances pertaining to the failure of the Bank warranted an in-depth review as authorized by the Financial Reform Act. As a result, the OIG determined that KPMG should complete the audit and issue this report.[1]

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

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

Causes of Failure

Wheatland's failure can be attributed to the Board of Directors' (Board) and management's aggressive growth strategy for a de novo institution—funded by volatile, high-rate deposits—that led to high Commercial Real Estate (CRE) and, in particular, Acquisition, Development and Construction (ADC) loan concentrations. Overall, management and the Board failed to establish appropriate practices to mitigate the risk associated with this strategy. Weak credit administration practices along with continued aggressive growth in a deteriorating economy contributed to a precipitous deterioration in asset quality, and ultimately, poor earnings and insufficient liquidity and capital. The Board and Bank management failed to address regulatory warnings regarding excessive growth, insufficient staffing, asset quality deterioration, and a lack of risk diversification. Disagreements among members of the Board and Bank management were in part to blame for the Bank's failure to implement timely corrective action to resolve these issues.

Evaluation of Supervision

The FDIC's and the Illinois Department of Financial and Professional Regulation's (IDFPR) examinations and visitations of Wheatland followed applicable examination procedures and guidance for a de novo Bank. Examiners identified key risks, including asset growth far exceeding business plans, high CRE and ADC loan concentrations, credit administration weaknesses, and dependence on high-rate Certificates of Deposit as a funding source, all of which eventually contributed to the Bank's failure. These concerns were addressed by the regulators through supervisory actions in 2008 and 2009. However, by that point in time, the actions could not effectively address the Board's failure to curtail growth and improve asset quality in a deteriorating economy, practices which had an adverse financial impact and led to the Bank's failure in 2010.

Due to adverse changes in the economy, and the combination of Wheatland's risk management weaknesses and high CRE and ADC loan concentrations, the financial condition of the Bank had significantly deteriorated by the February 2009 examination. In retrospect, the regulators may have benefited from a more forward-looking approach to addressing the 2007 and 2008 examination findings and overall risk profile, especially given excessive growth beyond the Bank's original business plan. Such an approach may have involved earlier and stronger supervisory actions, including restriction of asset growth to a more reasonable level for a de novo institution, particularly with the Bank's strategy to concentrate asset growth in CRE and ADC loans.

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

We conducted our performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS). These standards require that we plan and perform the performance audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The information included in this report was obtained during our fieldwork, which occurred during the period from June through October 2010.

Very truly yours,

KPMG LLP

Background

On April 23, 2010, the Illinois Department of Financial and Professional Regulation (IDFPR) closed Wheatland Bank (Wheatland) for conducting its business in an unsafe and unsound manner and appointed the FDIC as receiver. On May 14, 2010, the FDIC notified the Office of Inspector General (OIG) that Wheatland's total assets at closing were $480 million and the estimated loss to the Deposit Insurance Fund (DIF) was $133 million. As of November 30, 2010, the DIF loss for Wheatland had increased to $147 million.

Wheatland was a state nonmember bank that became insured on November 17, 2006 and opened for business on February 5, 2007. Headquartered in Naperville, Illinois, 30 miles west of Chicago, the Bank did not have any branch offices or affiliates. The Bank commenced operations pursuing a community banking business plan emphasizing Commercial Real Estate (CRE) lending and, in particular, Acquisition, Development, and Construction (ADC) loans.

Table 1 provides details on Wheatland's financial condition as of December 31, 2009, and for the 2 preceding calendar years.

Table 1: Financial Condition of Wheatland

Financial Data ($000s)	12/31/2009	12/31/2008	12/31/2007
Total Assets	435,055	483,689	213,168
Total Loans	399,387	399,091	191,080
Loan Growth	-6.37%	105.95%	N/A
Total Deposits	438,502	438,598	168,789
Brokered Deposits	38,535	99,687	42,666
Tier 1 Leverage Capital Ratio	-1.74%	7.97%	26.02%
Total Risk-Based Capital Ratio	-2.25%	10.56%	22.11%
Asset Growth	-10.05%	126.91%	N/A
PD+NA* Loans/Gross Loans	42.37%	3.10%	0.00%
Return on Average Assets	-8.94%	-1.12%	-2.91%
RE Loans/Total Assets	78.40%	73.07%	78.89%
ADC Loans/Total Capital**	1459.03%	306.45%	182.79%
CRE Loans/Total Capital**	3513.04%	706.49%	332.64%

Source: Uniform Bank Performance Reports (UBPR) for Wheatland and Division of Supervision and Consumer Protection's (DSC) Supervisory History.
*Past due and non-accrual.
** Ratios as of December 31, 2009, increased due to declining capital levels.

Causes of Failure and Loss

Wheatland's failure can be attributed to the Board's and management's aggressive growth strategy—funded by volatile, high-rate deposits—that led to high CRE and, in particular, ADC loan concentrations. Overall, management and the Board failed to establish appropriate practices to mitigate the risk associated with this strategy. Weak credit administration practices along with continued aggressive growth in a deteriorating economy contributed to a precipitous deterioration in asset quality, and ultimately poor earnings and insufficient liquidity and capital. The Board and Bank management failed to address regulatory warnings regarding excessive growth, insufficient staffing, asset quality deterioration, and a lack of risk diversification. Disagreements among members of the Board and Bank management were in part to blame for the Bank's failure to implement timely corrective action to resolve these issues.

Board and Management

Wheatland's Board and management failed to properly identify, measure, monitor, control, and mitigate growing risks associated with the Bank's excessive growth and concentrations in CRE and ADC loans. In addition, management failed to correct deficiencies in key risk management practices, react sufficiently to an economic downturn, and establish adequate contingency liquidity plans to ensure the Bank operated in a safe and sound manner.

Examiners at the February 2009 examination were critical of management's performance. Specifically, management's appetite for growth in CRE and ADC loans continued despite a downturn in the economy and plummeting real estate market values. In addition, while CRE and ADC loans were originally expected to account for slightly less than half the portfolio, they instead accounted for two-thirds. Further, management's willingness to lend to a select clientele base, which primarily included local developers, led to numerous concentrations with individual borrowers and their related parties and a heightened level of risk exposure.

Examiners at the February 2010 examination noted that two senior officials were the main drivers behind the excessive growth and poor risk selection that had placed the Bank in its deteriorated financial position. Further, examiners noted that the Board had not supervised the Bank in a sound manner, and that the Board and management failed to address regulatory warnings regarding excessive asset growth, insufficient staffing, asset quality deterioration, and a lack of risk diversification.

Disagreements among members of the Board and the two senior officials were in part to blame for their inability to take timely and decisive action to resolve issues noted by the regulators. Examiners noted that, during 2007 and 2008, management—with the support of the Board—ignored growth restrictions and examiners' criticisms. However, by the February 2009 examination, there was a split among management and the Board into two groups on the direction of the Bank, with each group taking sides with one of the two senior officials. This situation led to the eventual termination of one of the senior officials in June 2009. A replacement was hired, but he resigned by October 2009. His replacement assumed duties in January 2010. The Board also went through substantial changes in 2009 and early 2010.

Growth Strategy and Compliance with Business Plans

Management's risk appetite relating to aggressive loan growth, particularly in CRE and ADC lending, contributed to the deterioration of the Bank's financial condition. Management pursued this strategy from its inception in 2007, dramatically exceeding the original business plan approved for deposit insurance, and did so lacking appropriate standards and risk management practices. Wheatland notified the FDIC after the growth occurred, not prior, and growth continued to exceed the original and subsequent asset growth projections. Rapid loan growth compromised loan underwriting and administration, with eventual loan losses compromising capital.

Examiners at the August 2007 examination noted that through its first 6 months of operation, Wheatland had achieved growth levels that were not projected in the business plan to be met until the second quarter of the second year of operation. Six months later, at the February 2008 examination, examiners noted that, as of December 31, 2007, assets had grown to $213.2 million in less than 1 year. By comparison, the original business plan had only projected growth of the Bank's total assets in years 2 and 3 to $125.5 and $152.5 million, respectively.

To support this excessive growth, the Bank paid premium interest rates to attract deposits, which compressed the Net Interest Margin (NIM). The overwhelming majority of the deposit base consisted of short-term Certificates of Deposit (CD) that were due to mature in the next 12 months. The ability to attract deposits at reasonable rates in order to fund loan demand and replace any maturing deposits was essential for the Bank's business plan to be successful.

Table 2 provides a comparison of Wheatland's original business plan projections after 2 years of operations and the actual figures as of year-end 2008.

Table 2: Business Plan Projections Versus Actual Year-End 2008

Assets and Liabilities	Original Business Plan Projection for Year 2 ($000s)	Actual 12/31/08 ($000s)
Assets		
Securities	28,192	60,331
Loans	86,282	399,091
Other	11,069	24,267
Total Assets	125,543	483,689
Liabilities		
Demand Deposits	20,276	6,490
Savings Accounts	11,706	6,037
Money Market Accounts (MMA)	11,497	43,331
Time Deposits <$100,000	32,218	267,754
Time Deposits >$100,000	28,219	114,986
Other	314	6,874
Total Liabilities	104,230	445,472

Source: UBPR for Wheatland and February 2009 Report of Examination.

As illustrated, loan growth far exceeded original projections and represented a large portion of the total asset growth. Within the loan portfolio, ADC loans represented a larger than anticipated portion of the originally projected loan mix. Examiners at the February 2009 examination noted that the original business plan at the end of year 2 projected ADC loans to be 20 percent of the volume of total loans. Actual volume was 33 percent of total loans. As discussed previously, this growth was supported largely by CDs, which also exceeded original projections in volume and by percentage of total assets.

Business Plan Revisions

A provision in the Order granting deposit insurance stated that the Bank must operate within the parameters of its 3-year business plan. The Bank had to submit to the FDIC any proposed major deviations or material changes from the plan, a minimum of 60 days before the proposed change was implemented. In that regard, Wheatland management amended the original business plan on several occasions. The first amendment occurred in March 2007 as a result of a higher than projected level of capital stock being sold during the organization of the Bank. The IDFPR, at its June 30, 2007 examination, required another amendment due to a material deviation in the Bank's asset growth compared to projected growth. Subsequently, the Bank submitted updated financial projections in December 2007 and June 2008 for the FDIC's approval.

Table 3 summarizes the business plan revisions submitted by Wheatland and decisions by the FDIC.

Table 3: Wheatland's Business Plan Revisions

Revised Business Plan Submission Date	Significant Updates	FDIC Response
March 2007	Sold $6 million more in capital stock than originally projected.	Approved.
June 2007	Stock offering to increase capital up to $39 million in 4th quarter of 2007.	Approved contingent upon revised financial projections.
December 2007	Updated financial projections.	Rejected.
June 2008	Updated financial projections.	Rejected.
August 2008	Updated financial projections based on growth that already occurred.	Approved contingent upon $15 million capital injection.

Source: Reports of Examination and correspondence.

Examiners at the February 2009 examination noted that the revised business plans submitted by the Bank in December 2007 and June 2008 were unacceptable due to the high level of projected assets. Examiners did accept the revised business plan submitted in August 2008, which included more realistic projections based on the Bank's growth up to that point in time. However, the approval was contingent upon a $15 million capital injection, which never materialized. In the 2009 examination report, examiners noted management's continual failure to adhere to business plans submitted to the regulatory agencies. Examiners also noted that management had revised business plans to reflect practices, rather than revise practices to operate within the approved business plan. As noted earlier, the Order granting deposit insurance required that the business plan revisions be submitted by the Bank for regulatory approval before the actual changes occurred.

Loan Concentrations

Wheatland's concentrations in CRE and ADC lending were significant, particularly for a de novo institution. These loan concentrations left the Bank particularly vulnerable to a downturn in the real estate market and were a major factor contributing to the Bank's failure in 2010.

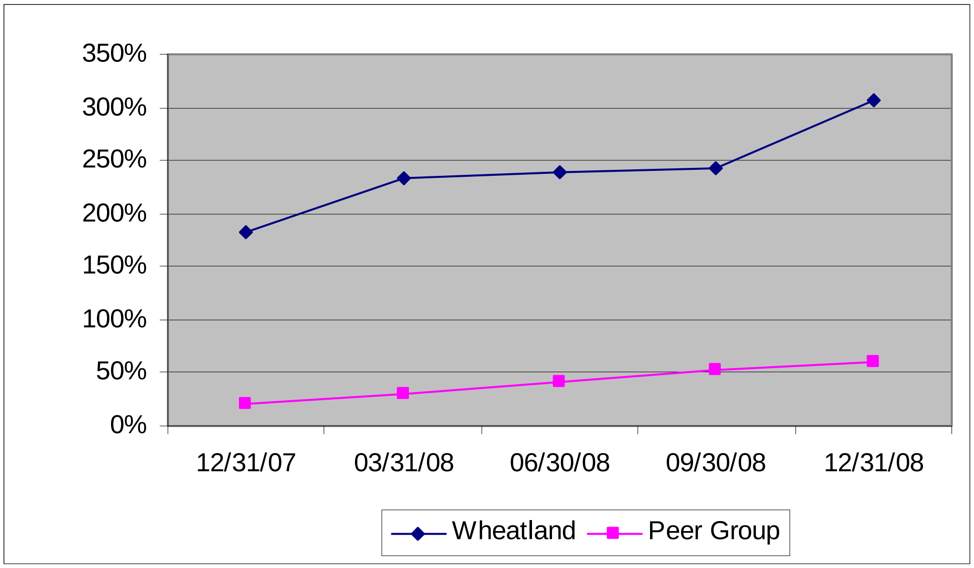
Interagency guidance entitled, *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* (Joint Guidance), issued on December 12, 2006, established levels of concentrations that may warrant greater supervisory scrutiny. The Joint Guidance states as follows:

> An institution that has experienced rapid growth in CRE lending, has notable exposure to a specific type of CRE, or is approaching or exceeds the following supervisory criteria may be identified for further supervisory analysis of the level and nature of its CRE concentration risk:
>
> - total reported loans for construction, land development, and other land represent 100 percent or more of the institution's total capital; or
>
> - total commercial real estate loans as defined in this guidance represent 300 percent or more of the institution's total capital, and the outstanding balance of the institution's commercial real estate portfolio has increased by 50 percent or more during the prior 36 months.

Examiners at the August 2007 state examination noted that, as of June 30, 2007, CRE lending represented the largest share of the loan portfolio with a concentration of credit totaling 226 percent of total capital. ADC loans totaled more than $29 million and represented 143 percent of total capital. As shown in Figure 1, the ADC concentration levels continued to grow during 2008 and exceeded those of the Bank's peer group.[2]

[2] Wheatland's peer group included banks opened in 2007 having assets less than $750 million.

Figure 1: ADC Loans as a Percentage of Total Capital Compared to Peer Group



Source: UBPRs for Wheatland.
Note: Year 2009 was excluded as the percentage was inflated due to diminishing capital.

The Joint Guidance states that management reporting should be timely and in a format that clearly indicates changes in the portfolio's risk profile, including risk-rating migrations. In addition, CRE reporting should include a well-defined process through which management reviews and evaluates concentration and other risk management data, as well as special ad hoc analyses in response to potential market events that could affect the CRE loan portfolio.

Examiners at the February 2008 examination noted that management did not formally monitor large concentrations to individual borrowers and related parties. Further, examiners at the August 2008 visitation noted that, in contrast with the Joint Guidance, management had not yet implemented the appropriate reports to manage and monitor construction and development loans.

Examiners at the February 2009 examination noted that, despite the economic challenges faced by financial institutions, management's focus had been primarily on loan growth rather than risk diversification and asset quality. During 2008, management continued its aggressive growth strategy, increasing total loans by more than $200 million (almost 110 percent) and well in excess of the most recent regulator-approved business plan. Examiners at the February 2010 examination noted that management continued to be deficient in its ability to manage the Bank's concentration levels and that the Bank's concentrations in commercial loans represented 67 percent of total assets.

Credit Administration Practices

Credit administration deficiencies, namely inadequate loan monitoring and loan staffing levels, and an Allowance for Loan and Lease Losses (ALLL) methodology that did not adequately reflect the risk of the loan portfolio, all contributed to the failure of the Bank.

Loan Monitoring

Examiners at the February 2008 examination noted that overall loan administration procedures were marginal. They also noted there were material deficiencies with large concentrations of loans to individual borrowers, including inadequate identification and documentation of the borrowers' individual and global cash flows. Examiners also noted deficiencies centered on monitoring equity in construction lending and related construction timelines. Additional loan administration problems included the following:

- for condominium conversion projects, files typically lacked updates on current sales information and any changes that affected the loan; and

- file documentation associated with conversations or meetings with loan customers was less than acceptable.

Examiners at the August 2008 visitation noted continued deficiencies with regard to monitoring equity in construction lending and related construction time lines. In addition, the Bank needed to improve documentation of changes in construction plans and the impact on collateral value, as well as debt service coverage.

Examiners at the February 2009 examination noted that credit administration practices required improvement. Examiners noted that management had been unsuccessful in addressing credit administration and credit quality issues on certain loans adversely classified or criticized at the prior examination in February 2008.

Common characteristics of classified and criticized loans at the 2009 examination were:

- projects remaining under construction far beyond original plans;
- inadequate oversight of construction draws;
- lack of sales for completed projects;
- illiquid borrowers/guarantors unable to service debt outside of sales;
- establishment and replenishment of interest reserves outside the construction phase of projects;
- lack of financial information and financial analysis; and
- lack of meaningful real estate appraisal review.

Examiners noted that there was a substantial chance of continued deterioration, especially considering that Wheatland had 33 percent of gross loans in ADC lending, an area adversely affected by economic conditions at the time.

With respect to loan appraisals, examiners at the February 2009 examination noted that appraisal review procedures needed to be enhanced. The Bank's procedures required that the credit analyst or officer review appraisals for all non-commercial credits and CRE loans of $2 million or less. These reviews were documented only by the reviewer's signature on the appraisal report and/or by the reviewer noting the review date on the Bank's internal system. Management, however, had not implemented any type of review checklist to perform these evaluations. There was no review process documenting the report's compliance with appraisal guidelines or providing narrative comments on the assumptions used by the appraiser or the general quality of the appraisal itself.

Loan Department Staffing

At the August 2007 FDIC visitation, examiners noted that, while the loan department staffing at the time appeared adequate, credit administration duties were carried out by two senior management officials with assistance provided by two credit analysts and three backroom employees. Examiners noted that, given the Bank was projecting continued rapid growth, particularly in commercial-related loans, the hiring of additional loan officers may be warranted in the near future. Examiners explained to both senior management officials that, while they were successful in overseeing large portfolios during previous jobs, they were serving primarily as loan officers in those jobs, and their goals were limited to the production of new loans and administration of their portfolios. While they still had these duties at this de novo institution, they also had other significant responsibilities such as oversight of non-loan committees, strategic planning, and management of employees.

Examiners at the February 2008 examination again noted that, while loan department staffing appeared adequate to service the loan portfolio for credits already recorded, the portfolio was forecasted to grow almost $120 million in each of the next 3 years, and familiarity with credits and relationships may diminish. Further, the majority of the increase was forecasted in CRE and ADC loans, which may be more time consuming and require frequent management and monitoring of individual credits. Examiners further noted that a Wheatland senior official indicated that management would add staffing as needed, but the official did not believe additional loan officers were necessary at the time.

Examiners at the February 2009 examination continued to note concerns regarding staff levels. Although a staffing analysis performed by an outside firm indicated that the Bank's staffing was adequate, it was performed prior to the examination and did not take into account deficiencies found in credit administration. Examiners noted that the firm's report assessed staffing levels based on current and forecasted production volumes, along with the current list of tasks and associated timeframes to complete the tasks. Examiners determined that, given all of the deficiencies cited in the examination, it was questionable that adequate staffing was in place to focus on and correct the problems noted, and at the same time adequately perform normal day-to-day functions.

ALLL Methodology

According to the *Interagency Policy Statement on the Allowance for Loan and Lease Losses* (Policy Statement on ALLL), the ALLL represents one of the most significant estimates in an institution's financial statements and regulatory reports. As a result, each institution is responsible for developing, maintaining, and documenting a comprehensive, systematic, and consistently applied process for determining the ALLL.

Examiners at the February 2008 examination noted that as of December 31, 2007, the ALLL totaled $2.4 million and was considered appropriate given the risk of the loan portfolio. Further, management intended to maintain the ALLL at 1.25 percent of average monthly loan balances during the initial 3 years of operation, as outlined in the business plan.

As the loan portfolio deteriorated, examiners at the February 2009 examination noted that the ALLL was 0.86 percent of total loans as of December 31, 2008, which was inadequate given the volume of problem credits and inherent risks in the remaining portfolio. Further, examiners noted that the ALLL methodology had been revised since the prior examination and the process did not fully conform to the requirements of Financial Accounting Standards (FAS) 5 and FAS 114.[3] The Bank's methodology accounted for average historical losses and attempted to allow for risk-based adjustments based upon six qualitative factors. Adjustments were based on changes up to +/- 75 basis points for increasing or decreasing risks, respectively, for each qualitative factor. However, examiners considered the Bank's actual qualitative adjustments low given the asset quality deterioration and determined that the adjustments were not reflective of the risks and exposures in each portfolio type. Further, they concluded that inadequate internal loan grading noted during the examination had an impact on the calculated impairment and understated the necessary ALLL.

Examiners at the February 2010 examination noted that after writing off loan losses totaling $1.65 million identified during the examination, the ALLL was 8.78 percent of total loans as of December 31, 2009, which was inadequate given the volume of problem credits and inherent risks in the remaining portfolio. As a result of poor internal impairment analysis when the Bank's loan portfolio started to deteriorate, the ALLL did not reflect the actual credit risk of the loan portfolio.

Funding Strategy

Examiners at the August 2007 examination noted a steep decline in liquidity due to the rapid loan growth experienced since inception. The resulting loan-to-deposit ratio was 114 percent versus Wheatland's internal guidelines of 95 percent. Funding for the loan portfolio had primarily come from CDs and MMAs. The original business plan called for a different deposit structure. The plan called for CDs and MMAs to amount to

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

approximately 54 percent of total assets as of June 30, 2007. However, the actual figure was approximately 75 percent. Examiners further noted that, during the examination, management began utilizing brokered deposits as an additional funding source. Management acquired $8.7 million in brokered CDs with maturities ranging from 6 months to 36 months. This additional funding source was riskier and had a higher cost than the originally planned funding.

Table 4 illustrates that while Wheatland did increase its MMA deposits each year, these more stable, lower-rate deposits could not be generated at a pace to support asset growth. At 2008 and 2009 years-end, CDs represented 87 percent and 85 percent of total deposits, respectively.

Table 4: Wheatland's Funding Sources

Period Ending ($000s)	Total Deposits ($000s)	Time Deposits Under $100,000 ($000s)	Time Deposits of $100,000 or More ($000s)	MMAs ($000s)	Other ($000s)
12/31/2007	168,789	110,361	24,888	24,917	8,623
12/31/2008	438,598	267,754	114,986	43,331	12,527
12/31/2009	438,502	314,428	59,017	56,644	8,413

Source: UBPRs for Wheatland.

Examiners at the February 2008 examination noted that deposit growth had been almost entirely centered in CDs, which comprised 84 percent of total deposits as of January 31, 2008. To attract these deposits, the Bank had maintained its CD interest rates well above market rates. As of February 2008, Wheatland's CD rates were 200-300 basis points over the average of local competitor rates and 130 basis points higher than the highest promotional rate offered by any competitor. Further, liquidity levels were strained due to the rapid loan growth experienced by the Bank. As of January 2008, the loan-to-deposit ratio was 112 percent and the loan-to-asset ratio was 91 percent, higher than the Board-approved parameters of 95 percent and 85 percent, respectively.

Examiners at the February 2009 examination noted that the liquidity position was inadequate. The Bank's continued use of volatile funding sources and a high-cost deposit base was a concern. Access to those funding sources would be limited if the Bank became undercapitalized. The ability to obtain a sufficient volume of funds on reasonable terms to meet future liquidity needs was questionable. Examiners further noted that total deposits were comprised of an inordinate amount of time deposits, which exposed the institution to an increased level of liquidity, volatility, and future funding risk. Examiners also noted that it was imperative that management revise its funding plan to contemplate a significantly reduced reliance upon brokered deposits and high-rate CDs, as well as anticipate declines in borrowing capacity from existing sources.

Examiners at the February 2010 examination noted that, while the level of liquid assets appeared to be sufficient to meet known funding needs over the next 90 days based on a February 18, 2010 liquidity report, the liquidity risk profile continued to be elevated given the Bank's overall poor financial condition. Examiners further noted that liquidity risk may critically impact the institution given the Bank's distressed financial condition and limited ability to raise deposits. In that regard, over the next 12 months, the Bank would have approximately $263 million in CDs maturing that could be hard to replace.

Asset growth since the Bank's inception funded by volatile, high-rate CDs made it difficult for the Bank to adjust to a declining economic landscape. Wheatland did not have a sufficient contingent liquidity plan to replace maturing deposits and manage its funding strategy during a crisis. An updated contingency plan was approved by the Board in January 2010 but had limited impact as the Bank was already in the midst of major liquidity problems that contributed to its ultimate failure.

The FDIC's Supervision of Wheatland

The FDIC's and the IDFPR's examinations and visitations of Wheatland followed examination procedures and guidance applicable to a de novo bank and identified key risks, including asset growth far exceeding business plans, high CRE and ADC loan concentrations, credit administration weaknesses, and dependence on high-rate CDs as a funding source, all of which eventually contributed to the Bank's failure. From 2007 until the Bank failed in April 2010, the FDIC conducted three examinations (one independent and two joint with the IDFPR), and two visitations (one concurrent with an IDFPR examination). Additionally, offsite review of the Bank included an analysis of the Bank's growth in June 2008 and daily liquidity monitoring beginning in March 2009. Wheatland signed a Bank Board Resolution (BBR) in August 2008 to correct deficiencies noted at the February 2008 examination. Subsequently, a Consent Order with more stringent requirements was issued in December 2009. However, by the time the FDIC and the IDFPR obtained the Board's consent to the issuance of the Consent Order, the viability of the institution was seriously in question as a consequence of the high level of classified loans and eroding capital protection.

Due to adverse changes in the economy, and the combination of Wheatland's risk management weaknesses, excessive asset growth, and high CRE and ADC loan concentrations, the financial condition of the Bank had significantly deteriorated by the February 2009 examination. In retrospect, the regulators may have benefited from a more forward-looking approach to addressing the 2007 and 2008 examination findings and overall risk profile, especially given the excessive growth beyond the Bank's original business plan. Such an approach may have involved earlier and stronger supervisory actions, including restriction of asset growth to a more reasonable level for a de novo institution, particularly with the Bank's strategy to concentrate asset growth in CRE and ADC loans.

Supervisory History

Starting in August 2007, the FDIC and the IDFPR conducted two visitations and four safety and soundness examinations of Wheatland. As a result of the Bank's deteriorated financial condition at the time of the February 2008 examination, the Bank agreed to a BBR in August 2008. The following year, as a result of the February 2009 examination and management's inadequate implementation of the BBR provisions intended to correct risk management deficiencies, the FDIC and IDFPR issued a Consent Order, which became effective on December 31, 2009. The Consent Order required, among other things, that Wheatland restrict asset growth, the Board take a more active role in the affairs of the Bank, the Bank have and retain qualified management, and the Bank increase and maintain a Tier 1 Capital Ratio of 10 percent and a Total Risk-Based-Capital Ratio of 13 percent within 90 days of the issuance of the Consent Order.

Table 5 summarizes Wheatland's examination history and supervisory actions from 2007 through 2010.

Table 5: Wheatland's Examination History from 2007 to 2010

Examination Start Date	Examination as of Date	On-Site Supervisory Effort	Supervisory Ratings* (UFIRS)	Supervisory Action In Place
8/2/2007	3/31/2007	State Examination**	222322/2	Insurance Order
2/4/2008	9/30/2007	FDIC Examination	223332/3	BBR
8/18/2008	6/30/2008	FDIC Visitation	233332/3	BBR
2/9/2009	12/31/2008	Joint Examination	455544/5	BBR - Consent Order proposed
2/1/2010	12/31/2009	Joint Examination***	555555/5	Consent Order

Source: Supervisory History, Reports of Examination and Report of Visitation.
*Financial institution regulators and examiners use the Uniform Financial Institutions Rating System (UFIRS) to evaluate a bank's performance.
**FDIC visitation conducted concurrently with the state examination.
*** Started as a visitation in January 2010 and was converted to a joint examination in February 2010.

The FDIC also monitored the condition of the Bank through its offsite review process. For example, Wheatland was identified for offsite review by the Growth Monitoring System (GMS),[4] as of March 31, 2008. The offsite review was completed on June 20, 2008 while the FDIC's Chicago Regional Office was reviewing the February 2008 examination results, which already noted the Bank's rapid growth.

Supervisory Responses to Risks Identified at Wheatland

Through its supervisory efforts, the FDIC and the IDFPR identified and documented key risks at the Bank, as previously detailed in the *Causes of Failure and Loss* section of this report. However, by the time the Bank's Board consented to the Order in December 2009, the viability of the institution was seriously in question as a consequence of the high level of classified loans and eroding capital protection.

Orders Granting Deposit Insurance and Issuing a State Charter

The FDIC conducted a Report of Investigation prior to granting deposit insurance to the Bank. The FDIC and the IDFPR each had requirements in the Order Granting Deposit Insurance and in the Order Issuing a Charter, respectively, prior to the Bank's opening. These Orders required, among other things, that:

[4] GMS is an offsite rating tool that identifies institutions experiencing rapid growth and/or having a funding structure highly dependent on non-core funding sources. Offsite reviews are triggered when a bank is in the 98 or 99th percentile of the distribution.

- for a period of 3 years from the date the Bank commences general banking business, the Bank must receive prior written consent from the IDFPR and the FDIC before engaging in any significant deviation or change from the plan of operation or proposed business activities that were presented in the application for the institution;

- for 3 years, the Bank must maintain a Tier 1 Capital to Total Assets ratio of no less than 10 percent and maintain and fully fund an adequate ALLL;

- the Bank shall have an audit of its financial statements conducted by an independent public accountant annually for the first 3 years after the charter is issued; and

- no shareholders own more than 10 percent of Bank stock.

The capital requirement for Wheatland was higher than what is required of institutions to be considered *Well Capitalized*. This provision was included in the Orders to address the Bank's planned concentration in higher-risk CRE and ADC loans. The FDIC and IDFPR analyzed and reviewed Wheatland's compliance with these Orders at subsequent examinations.

<u>August 2007 State Examination and FDIC Visitation</u>

Based on the requirements of the Orders granting deposit insurance and issuing a charter, and due to the asset growth the Bank experienced since inception, the IDFPR examination required management to submit an amended business plan within 90 days with revised figures and projections that more accurately reflected how the Bank would be operated over the following 3 years. The Bank had achieved growth levels that were not projected in the business plan until the second quarter of the second year of operation. Examiners further noted that the Bank's funding approach included more CDs and MMAs than the deposit structure outlined in the original business plan. Examiners recommended that the amended business plan should include the updated funding projections. While still well above the capital levels required by the Orders, examiners noted that the capital ratios were below the level in business plan projections because of higher than anticipated growth and operating losses.

Examiners noted that asset quality was satisfactory and there were no adverse classifications. Examiners also noted that CRE and ADC lending represented the largest share of the portfolio and recommended that management should continue to closely monitor the concentrations because of the institution's de novo status, rapid growth in the loan portfolio, and the inherent risk associated with construction lending. They further noted that management was cognizant of the concentrations.

While credit administration was considered adequate, examiners made specific recommendations that management further stratify CRE and ADC reporting by including information related to pre-sold versus speculative housing, raw versus improved land,

and owner occupied versus non-owner occupied properties. Further, examiners recommended that management should document instances where credits were funded outside policy guidelines.

Examiners noted that the level of liquidity was adequate and not uncommon for a de novo institution. Brokered deposit limits of 30 percent of total deposits had been established by the Bank. In regards to funds management practices, management was encouraged to institute a "sources and uses report" to more effectively manage the liquidity position.

As noted in Table 5, examiners rated the Bank a "2" in the Asset Quality and Management components as well as the overall risk management composite rating. In retrospect, greater emphasis should have been placed on the following risk factors in assigning these ratings: (1) Wheatland had only been in operation for a few months, (2) the Bank had grown well beyond its initial business plan, (3) the existence of high CRE and ADC concentrations, and (4) weak credit administration practices.

According to the *Risk Management Manual of Examination Policies* (Examination Manual), an Asset Quality rating of "2" indicates that the level and severity of issues warrant a limited level of supervisory attention. A "3" rating generally indicates that an elevated level of supervisory attention is required. For the Management component, a rating of "2" is associated with minor weaknesses that are not material to the safety and soundness of the institution. On the other hand, a "3" rating indicates that risk management practices are less than satisfactory given the nature of the institution's activities. Given the risks described above, rating the Asset Quality and Management components a "3" may have been prudent to establish a more stringent supervisory tenor during the Bank's formative period and when it posed a heightened risk to the DIF, even though the loans in the portfolio had not shown significant deterioration yet.

February 2008 FDIC Examination

Examiners at the February 2008 examination noted that an amended business plan, as of year-end 2007, was submitted for regulatory approval and was being reviewed for appropriateness during the examination. As of December 31, 2007, assets had grown to $213 million and already exceeded the projections included in the amended plan. In March 2008, the FDIC examiners recommended that the amended business plan not be accepted. The examiners noted that the overall plan by management was considered aggressive, with total asset growth rates of 64 percent and 39 percent, respectively, for 2008 and 2009.

In terms of rising CRE and ADC concentration levels and loan portfolio risk, examiners noted that the level of adversely criticized assets, at 48 percent of Tier 1 Capital plus the ALLL, required management's attention.[5] Examiners further noted at the examination that management did not formally monitor individual concentrations to large borrowers. Examiners recommended that such concentrations be presented at least quarterly at Board

[5] Adversely criticized assets include adversely classified loans and loans listed for Special Mention.

meetings. In addition, examiners recommended that monitoring practices for CRE loans should be expanded to address sensitivity and risk analysis.

With respect to credit administration deficiencies, examiners noted that management should closely monitor the volume of loans to individuals with lower credit quality characteristics, and that all criticized loans should be placed on the Bank's "Watch List" and reported to the Board until material deficiencies are resolved. Examiners further recommended that management should:

- update the loan policy to include leasing and sale requirements for income-producing property and collection of supporting documents during the construction period;

- monitor the progress of construction projects to ensure consistency with original timelines;

- establish procedures for addressing the limitation or partial recourse or non-recourse of borrowers and requirements for guarantor support;

- establish procedures for construction/land development loans refinanced from another institution to ensure disbursements do not exceed actual construction costs; and

- ensure an appropriate level of hard equity is maintained throughout the term of construction loans.

Rejection of the Bank's year-end amended business plan was partly based on the potential lack of loan staffing when considering projected loan growth. FDIC examiners recommended that the Bank perform a management staffing review for the loan department in order to determine the staffing resources that would be needed to address projected growth levels.

Examiners noted that while the framework and analysis for the ALLL appeared appropriate, the Bank should address areas in FAS 5 and FAS 114. Concerns noted by the examiners included: (1) a lack of support for risk-rated loss factors assigned under the Bank's FAS 5 analysis; and (2) the Bank's specific allocation under FAS 114 assigned a standard 3 percent reserve amount against delinquent credits, which appeared to be more of a FAS 5 allocation rather than the required impairment test for individual loans.

In response to Wheatland's funding strategy, examiners noted that, given the anticipated loan levels, management had not developed a formal backup or contingency plan should deposit growth be less than forecasted or CD retention rates lower than projected. Examiners further noted that the liquidity monitoring tools of the Board and Asset and Liability Management Committee required improvement.

Supervisory Actions: As a result of this examination, Wheatland's CAMELS composite rating was downgraded from a "2" to a "3." An MOU was originally recommended to the Bank. The Board did not sign the MOU, but after discussions with FDIC Chicago Regional Office personnel, passed a BBR containing similar provisions to those that were included in the MOU. The resolution was passed in a meeting on August 16, 2008. Among other things, the BBR stated that the Bank would:

- Conduct a written review of the Bank's staffing requirements, with particular emphasis on loan underwriting, administration, and collection needs.

- Implement a 3-year business plan and profit plan consistent with the Bank's loan, investment, and funds management policies.

- Develop a plan for improving liquidity and reducing the dependency on volatile liabilities.

- Revise written lending policy consistent with the comments and recommendations in the examination addressing CRE and ADC lending.

- Require complete loan documentation, realistic repayment terms, and current financial information to support outstanding indebtedness from each commercial borrower and implement an effective loan review program.

- Develop a monitoring system to manage and monitor concentrations of credit by collateral type and individual, and have a monitoring system for CRE concentrations that would address sensitivity and risk analysis.

- Revise its methodology for determining adequacy for the ALLL for deficiencies identified in the examination.

The BBR modified one provision in the proposed MOU that addressed the Bank's asset growth. The effect of this modified provision on the Bank's growth was addressed by examiners in the August 2008 visitation, as discussed in the next section of the report.

August 2008 Visitation

Examiners at the August 2008 visitation noted that the proposed MOU had included a provision that was modified in the BBR that stated, in part: "Effective immediately, the Bank shall not increase its total assets by more than 3 percent during any consecutive three month period without first providing at least 30 days advance written notice to the Regional Director and Assistant Director." The BBR resolution stated, in part: "Effective immediately, the Bank shall not increase its total assets by more than 15 percent over the projections in its revised business plan described above without first providing at least 30 days advance written notice to the agencies."

The *Formal and Informal Action Procedures Manual* states that "The FDIC generally uses MOUs instead of BBRs, especially when there is reason to believe the deficiencies noted during an examination need a more structured program or specific terms to effect corrective action." Given the Bank's aggressive growth beyond business plans, proceeding with the MOU as originally worded may have been more prudent. Examiners at the August 2008 visitation noted that the updated provision approved by the Board allowed the Bank to exceed projected asset growth in its business plan by as much as $75 million more than the proposed MOU requirement, before notifying regulatory agencies. On December 30, 2008, this provision was revised by Wheatland's Board to reduce planned growth from 15 percent to 5 percent, due to continued financial deterioration and an FDIC Chicago Regional Office recommendation.

February 2009 Joint Examination

Examiners at the February 2009 examination noted management's continual failure to adhere to the Bank's business plans. The business plan had been revised several times without prior regulatory approval. Further, management had revised the business plans to reflect practices, rather than revise practices to operate within an approved business plan. An August 2008 revised business plan was accepted by regulators, but growth and deviation from the plan continued.

At the time of this examination, financial deterioration was advanced. The level of classified assets had reached 228 percent of Tier 1 Capital plus the ALLL. With respect to concentrations, examiners noted that while management reported on concentrations to the Board monthly, better efforts to diversify risk needed to be employed. Examiners further recommended that CRE concentrations be stress tested for sensitivity and risk analysis. The examination noted that this process was approved in the BBR but not implemented.

Due to the deterioration noted in asset quality, examiners concluded that Wheatland's Board and management must immediately reduce the volume of adversely classified and criticized loans to prevent further deterioration within the portfolio. Further, management needed to implement comprehensive written workout plans for all credits that were adversely classified or criticized. Examiners recommended that the workout plans fully document the current status of the relationship, be updated monthly, provide an action plan to reduce the credit balances or loss exposure, and be presented to the Board.

In reviewing the ALLL, examiners noted that due to the Bank not fully conforming to the requirements of FAS 5 and FAS 114, the reserve level was considered low given the asset quality deterioration and was not reflective of the risks and exposures in each portfolio type. Examiners noted that the impairment difference appeared to be the result, in part, of a lack of a comprehensive "Watch List," as several adversely classified and impaired credits were not appropriately rated and were not on the Bank's internal "Watch List." Examiners highlighted the importance of a sound loan review and risk rating system in determining the risk of the portfolio.

Examiners noted that the liquidity position was inadequate. The Bank's continued use of volatile funding sources and a high-cost deposit base was a concern. Access to those funding sources would be limited if the Bank became undercapitalized, and the ability to obtain a sufficient volume of funds on reasonable terms to meet future liquidity needs was questionable. Examiners noted that it was imperative that management revise its funding plan to contemplate a significantly reduced reliance on brokered deposits and CDs, as well as anticipate declines in borrowing capacity from existing sources. While Bank plans called for reducing deposit rates, the Bank would need to continue to pay rates somewhat higher than market in order to retain deposits or garner new deposits. Further, as liquidity levels continued to come under pressure, and with the likely need to find new funding sources, management had to increase its monitoring and reporting of funds management. Examiners also noted that the contingency liquidity plan needed to be refined and updated.

Supervisory Actions: Based on the February 2009 examination findings, a Consent Order was presented to the Bank on August 13, 2009. Changes in the Bank's management team and legal firm, and several requests for changes in the Consent Order's provisions, delayed its finalization. The Bank's Board stipulated to the Consent Order on December 18, 2009, and it became effective on December 31, 2009. The Consent Order required Wheatland, among other things, to:

- Have and maintain a Tier 1 Capital Ratio of 10 percent and a Total Risk-Based Capital Ratio of 13 percent.

- Retain qualified management in specific key positions with certain experience and qualifications to fill those roles.

- Increase Board participation, including monthly meetings to cover reports of income and expenses, investment activity, operating policies, committee reports, audit reports, internal control reviews, reconciliation of general ledger accounts, and compliance with the Consent Order.

- Restrict growth in total assets to a maximum of 3 percent for any 3-month period without submitting a growth plan to the regulators prior to implementation, and a maximum increase in total assets of 10 percent annually.

- Submit a written profit plan and a realistic comprehensive budget.

- Submit a written plan to reduce all individual loan concentrations representing 25 percent or more of Tier 1 Capital plus the ALLL identified in the examination or arising thereafter.

- Replenish the ALLL with more than $7 million and correct the year-end 2008 Report of Condition and Income (Call Report) and ensure an adequate ALLL is provided in future Call Reports.

- Develop a plan to address liquidity and rate sensitivity and submit a daily liquidity analysis report to regulators.

- Charge off all loans classified "Loss" in the February 2009 examination.

- Develop a written plan to reduce the Bank's risk position in each asset and credit relationship in excess of $1 million and more than 90 days delinquent or classified "Substandard" in the examination.

- Revise written lending and collection policies to provide effective guidance and control over the Bank's lending function, abate additional loan deterioration, and address weaknesses detailed in the examination.

February 2010 Joint Examination

Examiners at the February 2010 examination noted that a substantial net loss of over $41 million was recognized for year-end 2009 due to a low NIM and large charge-offs resulting in the need to replenish the ALLL. An additional provision expense of $2.1 million was needed to bring the ALLL to an appropriate level as of December 31, 2009, which would further deplete earnings and capital. Examiners also noted that liquidity risk may critically impact the Bank given its distressed financial condition and the limited ability to raise deposits.

Examiners noted that management's focus on loan growth over risk diversification and asset quality during the first 2 years of operation, despite regulatory warnings, resulted in large adverse classification levels, significant charge-offs, and material provisions to the ALLL, which had fully depleted capital. As of December 31, 2009, the Tier 1 Leverage Capital was negative 1.80 percent.

Implementation of PCA

The purpose of Prompt Corrective Action (PCA) is to resolve the problems of insured depository institutions at the least possible long-term cost to the DIF. Part 325 of the FDIC's Rules and Regulations implements PCA requirements by establishing a framework for taking PCA against insured state-charted nonmember banks that are not adequately capitalized. The FDIC is required to closely monitor the institution's condition and compliance with its capital restoration plan, mandatory restrictions defined under section 38(e) of the FDI Act, and discretionary safeguards imposed by the FDIC (if any) to determine if the purposes of PCA are being achieved. Based on the supervisory actions taken, the FDIC properly implemented the applicable PCA provisions of section 38.

Table 6 illustrates Wheatland's capital level categories as of each examination date. The Bank was considered *Well Capitalized* for PCA purposes until it filed its December 31, 2009 Call Report.

Table 6: Summary of Capital Level Categories for Wheatland

Key Capital Ratios (%)	Well Capitalized Thresholds*	Dec-09	Dec-08	Sep-07	Mar-07
Total Risk-Based Capital Ratio	10%	-2.32%	10.50%	18.03%	119.31%
Tier 1 Risk-Based Capital Ratio	6%	-2.32%	9.23%	16.91%	118.13%
Tier 1 Leverage Ratio	5%	-1.80%	8.04%	18.99%	125.65%
Capital Category	-	Critically Under-capitalized	Well Capitalized	Well Capitalized	Well Capitalized

Source: Reports of Examination for Wheatland Bank.
* Minimum capital requirements to be considered *Well Capitalized* for PCA purposes.

The Order Granting Deposit Insurance required that Wheatland maintain a Tier 1 Capital to total assets ratio of 10 percent of more for at least 3 years after deposit insurance was effective. Early in the Bank's operations, capital levels remained high. For example, as of September 30, 2007 and December 31, 2007, the Tier 1 Leverage Capital ratio was 19 percent and 26 percent, respectively. A capital injection of $22.8 million, which occurred during the fourth quarter of 2007, contributed significantly to the Bank's year-end capital level.

At the February 2009 examination, while the Bank was still *Well Capitalized* for PCA purposes, examiners noted that capital levels were a concern given the Bank's overall risk profile. Examiners noted that prior to the commencement of the examination, management recognized the need to raise additional capital given the projected asset growth, along with the necessity to comply with the provision in the Order Granting Deposit Insurance requiring the Bank to maintain the Tier 1 Capital Ratio at no less than 10 percent and the Total Risk Based Capital Ratio at no less than 13 percent. The ratios were below these thresholds at the end of the third quarter of 2008, due to continued asset growth. The FDIC, in a letter dated December 10, 2008, notified the Bank that its Tier 1 Leverage Capital level was below the threshold required by the Order Granting Deposit Insurance.

The FDIC issued a PCA letter on February 3, 2010 notifying Wheatland that, based on analysis of the year-end 2009 Call Report, the Bank's capital position had declined to *Critically Undercapitalized* for PCA purposes and section 38 required the FDIC to impose certain mandatory actions, including submission of a capital restoration plan and restrictions on asset growth, acquisitions, and payment of dividends. The PCA letter required that Wheatland file a capital restoration plan by March 15, 2010.

Wheatland officials discussed with the FDIC's Chicago Regional Office officials a potential capital raising effort in March 2010 but an actual capital restoration plan was not submitted by the Bank. On April 23, 2010 the IDFPR closed Wheatland due to unsafe and unsound business practices, and appointed the FDIC as receiver.

Objectives, Scope, and Methodology

Objectives

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

The OIG had initially retained KPMG to perform an MLR of Wheatland. At the time the Financial Reform Act was enacted, our fieldwork had already started. Although the estimated loss for Wheatland did not meet the amended threshold requiring an MLR, the OIG determined that certain circumstances pertaining to the failure of the Bank warranted an in-depth review as authorized by the Financial Reform Act. As a result, the OIG determined that KPMG should complete the audit and issue this report.

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

Scope and Methodology

The scope of this audit included an analysis of Wheatland from its opening in February 2007 until its failure on April 23, 2010. Our review also entailed an evaluation of the regulatory supervision of the institution over the same period.

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

- Analyzed examination and visitation reports prepared by the FDIC and the IDFPR examiners from 2007 to 2010.

- Reviewed the following documentation:

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

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

- Pertinent DSC policies and procedures.

- Interviewed relevant FDIC officials who had supervisory responsibilities pertaining to Wheatland, which included DSC examination staff in Illinois.

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

- Researched various Banking laws and regulations.

KPMG relied primarily upon the materials provided by the FDIC OIG and DSC, including information and other data collected during interviews. KPMG did not perform specific audit procedures to ensure the information and data were complete and accurate. KPMG is, however, aware that Circular 12000.1, *Cooperation with the Office of Inspector General*, dated September 28, 2007, requires that all FDIC employees, contractors, and subcontractors cooperate with the OIG in order for the OIG to carry out its statutory mandate. To that end, all employees, contractors, and subcontractors must:

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

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

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

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

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

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

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

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

Related Coverage of Financial Institution Failures

On May 1, 2009, the OIG issued an internal memorandum that outlined major causes, trends, and common characteristics of FDIC-supervised financial institution failures that had resulted in a material loss to the DIF. Since May 1, 2009, the OIG has issued additional MLR and IDR reports related to failures of FDIC-supervised institutions and these reports can be found at www.fdicig.gov. The memorandum also indicated that the OIG planned to provide more comprehensive coverage of those issues and make related recommendations, when appropriate.

In December 2010, the OIG issued an audit report entitled, *Follow-up Audit of FDIC Supervision Program Enhancements* (Report No. MLR-11-010), the objectives of which were 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. We expect to make that report available on our Web site following presentation to the FDIC's Audit Committee in January 2011.

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
Adversely Classified Assets	Assets subject to criticism and/or comment in an examination report. Adversely classified assets are allocated on the basis of risk (lowest to highest) into three categories: Substandard, Doubtful, and Loss.
Allowance for Loan and Lease Losses (ALLL)	Federally insured depository institutions must maintain an ALLL that is adequate to absorb the estimated loan losses associated with the loan and lease portfolio (including all binding commitments to lend). To the extent not provided for in a separate liability account, the ALLL should also be sufficient to absorb estimated loan losses associated with off-balance sheet loan instruments such as standby letters of credit.
Call Report	Consolidated Reports of Condition and Income (also known as Call Reports) are reports that are required to be filed by every national bank, state member bank, and insured nonmember bank pursuant to the FDI 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.
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.
Consent Order	A formal enforcement action issued by financial institution regulators to a bank or affiliated party to stop an unsafe or unsound practice or violation. A Consent Order may be terminated by the regulators when they have determined that the bank's condition has significantly improved and the action is no longer needed or the bank has materially complied with its terms.
FDIC's Supervision Program	The FDIC's supervision program promotes the safety and soundness of FDIC-supervised institutions, protects consumers' rights, and promotes community investment initiatives by FDIC-supervised institutions. The FDIC's Division of Supervision and Consumer Protection (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.

Term	Definition
Material Loss	As defined by section 38(k)(2)(B) of the FDI Act, and as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, for the period beginning January 1, 2010 and ending December 31, 2011, a material loss is defined as any estimated loss to the DIF in excess of $200 million.
Prompt Corrective Action (PCA)	The purpose of PCA is to resolve the problems of insured depository institutions at the least possible long-term cost to the Deposit Insurance Fund. Part 325, subpart B, of the FDIC Rules and Regulations, 12 Code of Federal Regulations, section 325.101, et. seq., implements section 38, *Prompt Corrective Action*, of the FDI Act, 12 United States Code Section 1831(o), by establishing a framework for determining capital adequacy and taking supervisory actions against depository institutions that are in an unsafe or unsound condition. The following terms are used to describe capital adequacy: (1) Well Capitalized, (2) Adequately Capitalized, (3) Undercapitalized, (4) Significantly Undercapitalized, and (5) Critically Undercapitalized. A PCA Directive is a formal enforcement action seeking corrective action or compliance with the PCA statute with respect to an institution that falls within any of the three categories of undercapitalized institutions.
Uniform Bank Performance Report (UBPR)	The UBPR is an analysis of financial institution financial data and ratios that includes extensive comparisons to peer group performance. The report is produced by the Federal Financial Institutions Examination Council for the use of banking supervisors, bankers, and the general public and is produced quarterly from Call Report data submitted by banks.
Uniform Financial Institutions Rating System (UFIRS)	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.

Acronyms

ADC	Acquisition, Development, and Construction
ALLL	Allowance for Loan and Lease Losses
ASC	Accounting Standard Codification
BBR	Bank Board Resolution
CAMELS	Capital, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk
CD	Certificate of Deposit
CRE	Commercial Real Estate
DIF	Deposit Insurance Fund
DSC	Division of Supervision and Consumer Protection
FAS	Financial Accounting Standard
FDI	Federal Deposit Insurance
GAGAS	Generally Accepted Government Auditing Standards
GMS	Growth Monitoring System
IDFPR	Illinois Department of Financial and Professional Regulation
LTV	Loan-to-Value
MMA	Money Market Account
MOU	Memorandum of Understanding
NIM	Net Interest Margin
OIG	Office of Inspector General
PCA	Prompt Corrective Action
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System

Part II

OIG Evaluation of Management Response

OIG Evaluation of Management Response

After we issued our draft report, management officials provided additional information for our consideration, and we revised our report to reflect this information, as appropriate. The Director, DSC, provided a written response to the draft report dated January 5, 2011. That response is provided in its entirety on page II-2 of this report.

In the response, the DSC Director reiterated the causes of Wheatland's failure and summarized the regulators' supervisory activities, as described in our report. The response also stated that, in recognition that stringent supervisory attention is necessary for de novo institutions, DSC has extended its supervisory program so these institutions receive a full-scope examination every year for 7 years, as opposed to 3 years. According to DSC, de novo business plans are being closely monitored against approved financial projections throughout the 7-year period. Additionally, DSC issued a Financial Institution Letter in August 2009 that describes the program changes for de novo institutions and warns that changes in business plans undertaken without required prior approval may subject an institution or its insiders to civil money penalties.

CORPORATION COMMENTS

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

January 5, 2011

TO: Stephen Beard
Assistant Inspector General for Material Loss Reviews

/Signed/
FROM: Sandra L. Thompson [signed by Victor J. Valdez for Sandra L. Thompson]
Director

SUBJECT: FDIC Response to the Draft Audit Report Entitled, In-Depth Review of the Failure of Wheatland Bank, Naperville, Illinois (Assignment No. 2010-063)

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 failure of Wheatland Bank, (Wheatland) Naperville, Illinois, which failed on April 23, 2010. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Report received on November 24, 2010.

Wheatland failed primarily because of the Board of Directors' (Board) and management's aggressive growth strategy for this de novo institution funded by volatile deposits; high concentrations in commercial real estate (CRE) and acquisition, development, and construction (ADC) loans; and the failure to establish adequate risk management practices. Weak credit administration practices along with continued aggressive growth in a deteriorating economy contributed to a rapid deterioration in asset quality, poor earnings, and ultimately insufficient liquidity and capital.

From 2007 through 2010, the Illinois Department of Financial and Professional Regulations (IDFPR) and the FDIC jointly and separately conducted four full-scope examinations and two visitations. By August 2007 Wheatland's asset growth far exceeded original projections approved in the Deposit Insurance application, and an amended business plan was required. The February 2008 examination noted continued aggressive asset growth and expressed concern regarding appropriate staffing levels to address loan underwriting and credit administration weaknesses. Based on the findings of the 2008 examination, Wheatland was downgraded to a composite "3" rating and a Bank Board Resolution was issued. The 2009 examination noted management's continued failure to adhere to business plans submitted to regulatory agencies and found Wheatland in troubled condition. Wheatland was downgraded to a composite "5" rating, and a formal enforcement action was issued. Based on the results of the February 2010 examination, the FDIC and IDFPR determined Wheatland was no longer viable without an immediate capital infusion which failed to materialize.

In recognition that stringent supervisory attention is necessary for de novo institutions, DSC extended its supervisory program so these institutions receive a full scope examination every year for seven years, as opposed to three years. De novo business plans receive careful analysis prior to an institution's opening and are closely monitored against approved financial projections throughout the seven year period. A Financial Institution Letter issued in August 2009 described the program changes for de novo institutions and warned that changes in business plans undertaken without required prior approval may subject an institution or its insiders to civil money penalties.

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