Office of Inspector General

Office of Material Loss Reviews
Report No. MLR-10-015

Material Loss Review of Mirae Bank, Los Angeles, California

January 2010

Office of Inspector General

Executive Summary

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Why We Did The Audit

On June 26, 2009, the California Department of Financial Institutions (CDFI) closed Mirae Bank (Mirae) and named the FDIC as receiver. On July 22, 2009, the FDIC notified the Office of Inspector General that Mirae's total assets at closing were $410.0 million and the estimated material loss to the Deposit Insurance Fund (DIF) was $49.7 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 Mirae.

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

Mirae was insured by the FDIC on July 1, 2002 as a state-chartered, nonmember, minority-owned bank headquartered in Los Angeles, California that principally serviced the Korean-American market. Specifically, Mirae operated in the highly competitive Koreatown area of Los Angeles. Customers in its market were known to "chase" favorable rates resulting in higher-than-normal deposit turnover. Accordingly, Mirae's business strategy included offering above-market deposit rates to attract customers. The bank's loan portfolio was concentrated in Commercial Real Estate (CRE) lending. In 2006, Mirae became a wholly-owned subsidiary of Mirae Bancorp. The bank also operated four branch offices, the last of which opened in the first quarter of 2009. Since 2008, Mirae operated two loan production offices – one in Seattle, Washington and the other in Denver, Colorado. The bank established a subsidiary, MRB Property Holding LLC, in 2009, to hold other real estate properties and conduct business operations of car washes in foreclosure.

Audit Results

Causes of Failure and Material Loss

Mirae failed because its Board and management pursued an aggressive growth strategy centered in CRE lending and failed to ensure sound loan underwriting practices. In particular, Mirae failed to appropriately review a significant portion of its loan portfolio underwritten by one individual. Although Mirae's CRE concentrations were not considered extraordinarily high within the context of regulatory guidance, certain of those concentrations involved loans to businesses highly susceptible to adverse economic conditions. Mirae's aggressive growth strategy was initially profitable, but weaknesses in Mirae's Board and management oversight related to loan underwriting and risk management practices were exposed when the economy started to contract. Mirae's funding strategy of paying above-market rates for deposits and its increasing reliance on wholesale funding, such as brokered deposits, proved to be unsustainable once the bank's financial condition started to deteriorate. Ultimately, losses in the loan portfolio eroded the bank's capital and liquidity became strained. Collectively, these factors led to the failure of the bank.

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The FDIC's Supervision of Mirae

Our review focused on the FDIC's supervision of Mirae from 2005 until its failure in 2009. During this period, the FDIC conducted on-site examinations as required and subjected Mirae to offsite monitoring. The FDIC became aware of Mirae's growth strategy in 2005, and by 2006 the FDIC determined Mirae's overall condition to be less than satisfactory due to the bank's increased risk profile by funding rapid asset growth with high-cost volatile funds. The FDIC recommended that Mirae's Board adopt a resolution to address these areas. In the 2007 examination, examiners found the overall condition of the bank improved but considered assigning Mirae a less than satisfactory composite rating. However, after taking into consideration information provided by management and actions taken by management to address concerns, the FDIC and CDFI determined that Mirae's condition warranted a higher composite rating. The higher 2007 composite rating increased the time between on-site examinations and shifted offsite oversight to the field office during a period when Mirae's condition was weakening. In hindsight, more supervisory attention at the 2007 examination to the loans originated by one individual, who generated a significant portion of the loan growth, would have been prudent. Further, the following factors should have resulted in the FDIC providing greater supervisory attention to Mirae following the 2007 examination: (1) Mirae's noted increasing risk profile, (2) deteriorating economic conditions to which Mirae was vulnerable, and (3) offsite monitoring flags that identified potential concerns.

With respect to PCA, based on the supervisory actions taken, the FDIC properly implemented applicable PCA provisions of section 38 in a timely manner. However, by the time Mirae's capital levels fell below the required thresholds necessary to implement PCA, the bank's condition had deteriorated to the point at which the institution could not raise additional capital in the time period necessary to prevent a liquidity failure and was subsequently closed on June 26, 2009.

Management Response

On January 15, 2010, the Director, DSC, provided a written response to the draft report. DSC's response reiterated the OIG's conclusions regarding the cause of Mirae's failure. With respect to our assessment of FDIC's supervision, DSC's response also reiterates the supervisory history, including supervisory actions, presented in the report. DSC's response also states that examiners made recommendations in 2007 to further enhance Mirae's credit administration practices due to one bank official being responsible for originating 51 percent of the substandard loans identified during the 2007 examination. As a point of clarification, although we did find that examiners made such recommendations, we did not find any evidence that examiners were aware of the bank official's involvement in the substandard loans identified in the examination report. In that regard, our report states that examiners did not have the opportunity to consider information associated with loans originated by this individual at the 2007 examination because the information had not been included in the field office correspondence file at the time examiners were planning the examination.

Contents

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

Office of Material Loss Reviews
Office of Inspector General

DATE: January 21, 2010

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

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

SUBJECT: *Material Loss Review of Mirae Bank, Los Angeles, California* (Report No. MLR-10-015)

As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, the Office of Inspector General (OIG) conducted a material loss[1] review of the failure of Mirae Bank (Mirae), Los Angeles, California. On June 26, 2009, the California Department of Financial Institutions (CDFI) closed the institution and named the FDIC as receiver. On July 22, 2009, the FDIC notified the OIG that Mirae's total assets at closing were $410.0 million and the estimated material loss to the Deposit Insurance Fund (DIF) was $49.7 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[2] of the institution, including implementation of the PCA provisions of section 38 of the FDI Act. This report presents the FDIC OIG's analysis of Mirae's failure and the FDIC's efforts to ensure Mirae's Board of Directors (Board) and management operated the bank in a safe and sound manner. We are not making 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

[1] 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.
[2] 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.

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 specific loan details discussed in the report. Appendix 3 contains a glossary of terms and Appendix 4 contains a list of acronyms used in this report. Appendix 5 contains the Corporation's comments on this report.

Background

Mirae was insured by the FDIC on July 1, 2002 as a state-chartered, nonmember, minority-owned bank headquartered in Los Angeles, California that principally serviced the Korean-American market. Specifically, Mirae operated in the highly competitive Koreatown area of Los Angeles. Customers in its market were known to "chase" favorable rates, resulting in higher-than-normal deposit turnover. Accordingly, Mirae's business strategy included offering above-market deposit rates to attract customers. The bank's loan portfolio was concentrated in Commercial Real Estate (CRE) lending. In 2006, Mirae became a wholly-owned subsidiary of Mirae Bancorp. The bank also operated four branch offices, the last of which opened in the first quarter of 2009. Since 2008, Mirae operated two loan production offices – one in Seattle, Washington and the other in Denver, Colorado. The bank established a subsidiary, MRB Property Holding LLC, in 2009, to hold other real estate properties and conduct business operations of car washes in foreclosure. Mirae received a capital infusion of $5 million from Mirae Bancorp in the fourth quarter of 2008 as its financial condition deteriorated, but otherwise, the holding company provided only minimal financial support. Table 1 provides a summary of Mirae's financial condition from 2005 to 2009.

Table 1: Financial Condition of Mirae, 2005 to 2009

Financial Measure	Mar- 2009	Dec-2008	Dec-2007	Dec-2006	Dec-2005
Total Assets ($000s)	480,619	423,077	425,022	371,323	265,024
Total Loans ($000s)	346,429	357,920	350,800	296,594	173,700
Total Deposits ($000s)	409,951	336,952	335,738	313,452	220,410
Total Brokered Deposits ($000s)	85,985	64,364	19,373	8,000	5,000
Net Income (Loss) ($000s)	(7,165)	(30,514)	1,598	2,845	2,647

Source: Uniform Bank Performance Reports (UBPRs) for Mirae.

Throughout its nearly 7-year existence, Mirae experienced turmoil among its Board of Directors and significant management turnover. Examiners noted a struggle for control within the Board at Mirae in 2002 and 2004. In addition, significant changes in management were noted in 2005 and 2007.

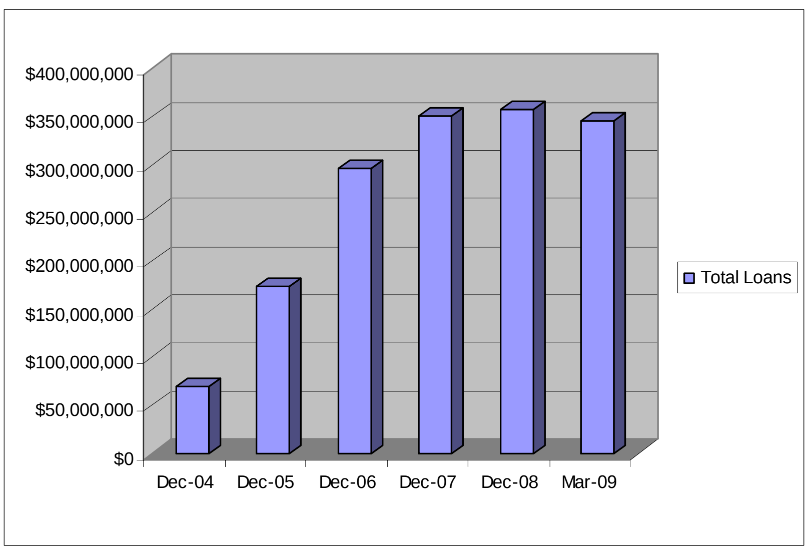
Causes of Failure and Material Loss

Mirae failed because its Board and management pursued an aggressive growth strategy centered in CRE lending and failed to ensure sound loan underwriting practices. In particular, Mirae failed to appropriately review a significant portion of its loan portfolio underwritten by one individual. Although Mirae's CRE concentrations were not considered extraordinarily high within the context of regulatory guidance, certain of those concentrations involved loans to businesses highly susceptible to adverse economic conditions. Mirae's aggressive growth strategy was initially profitable, but weaknesses in Mirae's Board and management oversight related to loan underwriting and risk management practices were exposed when the economy started to contract. Mirae's funding strategy of paying above-market rates for deposits and its increasing reliance on wholesale funding, such as brokered deposits, proved to be unsustainable once the bank's financial condition started to deteriorate. Ultimately, losses in the loan portfolio eroded the bank's capital and liquidity became strained. Collectively, these factors led to the failure of the bank.

Aggressive Growth Beginning in 2005

As noted in the June 2005 and July 2006 examination reports, the bank set goals to increase assets to $300 million by the end of 2006, and to $512 million by the end of 2007. During the period December 2004 through December 2008, the bank increased total loans by 416 percent. Figure 1 shows the growth in total loans between 2004 and 2009.

Figure 1: Mirae's Total Loan Growth, 2004 to 2009



Source: UBPRs for Mirae.

Management achieved this growth principally through expanding CRE lending which represented $259 million in loans, or 695 percent of Tier 1 Capital as of December 31, 2008. According to Financial Institution Letter (FIL) 104 -2006 issued December 12, 2006 titled, *Concentrations in Commercial Real Estate Lending, Sound Risk Management*

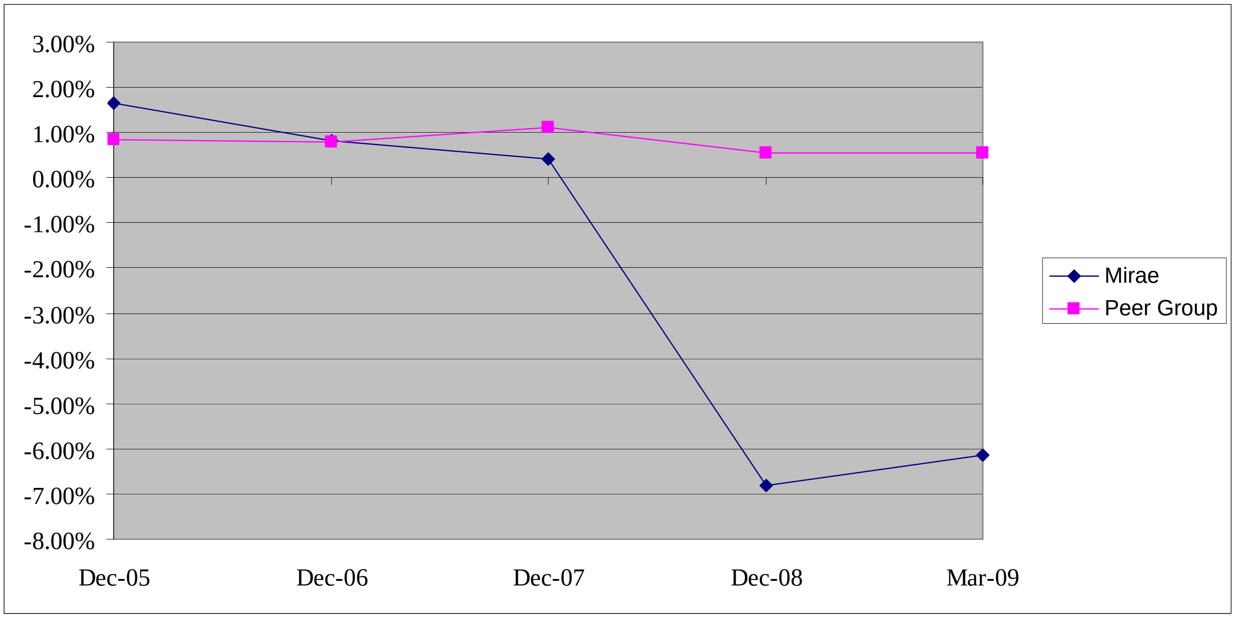
Practices, rising CRE concentrations could expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in the general CRE market. Although the guidance does not define a CRE concentration, CRE loans exceeding 300 percent of Total Capital represent one of the thresholds used to identify institutions warranting greater supervisory scrutiny. However, owner-occupied properties are excluded when calculating CRE loan concentrations levels. When the owner-occupied properties were excluded from Mirae's loan portfolio, the December 2008 CRE concentration calculation was reduced to 393 percent of Tier 1 Capital.[3] The following specific concentrations were included within the total CRE concentration:

- Gasoline stations with convenience stores - $66 million, representing 313 percent of Tier 1 Capital;
- Hotels and motels - $51 million, representing 243 percent of Tier 1 Capital; and
- Car washes - $34 million, representing 160 percent of Tier 1 Capital.

Although the bank's growth strategy supported profitability through December 2007, according to the 2009 examination report, these loan subgroups were particularly susceptible to risks during an economic downturn. Further, examiners in 2007 cited the bank's significant reliance on Small Business Administration (SBA) loan generation and gains on sale of the guaranteed portion of these loans as risky, because SBA loan demand is cyclical and there is high credit risk in the unguaranteed portion of these loans that was retained by the bank. The bank sold the SBA-guaranteed portion of the loans to increase earnings, thereby increasing its return on average assets. As the Los Angeles economy declined in 2008, the bank began experiencing significant losses. Figure 2 depicts Mirae's return on assets compared to its peer group.

[3] Although FIL 104-2006 refers to CRE concentrations in terms of total capital, the 2009 examination report refers to CRE concentrations in terms of Tier 1 Capital. Total capital is comprised of both Tier 1 Capital and Tier 2 Capital, which includes the bank's ALLL. Accordingly, Mirae's CRE concentration percentage in relationship to Total Capital would be slightly less than the percentages presented relative to Tier 1 Capital.

Figure 2: Mirae's Return on Assets Compared to Peer Group



Source: UBPRs for Mirae.

Mirae also paid substantial loan referral fees to achieve its asset growth goals. Specifically, the bank paid $3.1 million in loan origination fees between December 2004 and March 2009 to outside parties. The largest amount, $1.5 million, was paid in 2006. As discussed later in the report, an outside loan broker, who became an employee of the bank in December 2005, generated approximately 91 loans for the bank totaling $155 million. This individual received agreed-upon commission fees ranging from 1.5 percent to 2 percent of the loan referrals, depending on the loan type, in addition to a base salary. In the 2009 examination, a significant number of this individual's loans were classified.

Loan Underwriting

The Board failed to ensure that bank's loan underwriting practices included current and complete borrower financial information, properly calculated collateral value, and documented guarantor collateral position. Specifically, the 2009 examination reported the following weak credit underwriting practices:

- Loans were often approved based upon financial statements that were stale and frequently self-prepared.
- Deficient guarantor data included failure to acquire financial information on all significant business interests shown in the self-prepared statements.
- Collateral support, especially for car wash and gas station loans, often relied on business enterprise value[4] to meet loan-to-value requirements.

[4] According to the 2009 Report of Examination (ROE), such valuation represents an attempt to quantify an intangible value that may duplicate the income valuation of the underlying property.

- Loan modification agreements were prevalent, often granted on a temporary basis without identification of how payment ability would improve.
- Secondary collateral was taken when granting concessionary terms without fully documenting the equity position or potential value.

In addition, according to the 2009 examination report, management's desire for loan growth led to nearly universal acceptance of one individual's referred loan packages, neglect of prudent underwriting, and elevated loan concentrations in high-risk business lines. Examiners reported that bank management approved at least 77 of this individual's loan referrals from January 2004 until October 2007, when the first loan denial occurred, and approved an additional 14 loans from October 2007 through March 2009. Bank management's approval of these loan referrals occurred despite its knowledge in 2006 of allegations that this individual artificially inflated a borrower's down payment, dating back to a loan originated in 2005. Despite these allegations, bank management did not maintain accurate records of loans originated by this individual and did not terminate the employee until March 2009, when significant problems associated with the loans became apparent. Appendix 2 provides examples of some loans that were originated by this individual. The FDIC is evaluating the individual's activities for any improprieties, including possible self-dealing.

Allowance for Loan and Lease Losses (ALLL)

In addition to the underwriting deficiencies, the Board implemented a policy to restrict additions to the ALLL to 15 percent per quarter starting in late 2008. Establishing such a limitation is not permitted under generally accepted accounting principles. Notwithstanding, the bank tried to implement this improper strategy to spread out the time period for recognizing losses and depleting earnings. The 2009 examination identified 30 loans that needed to be downgraded and recommended that the ALLL should be increased by a minimum of $16 million.

Liquidity Funding Strategy

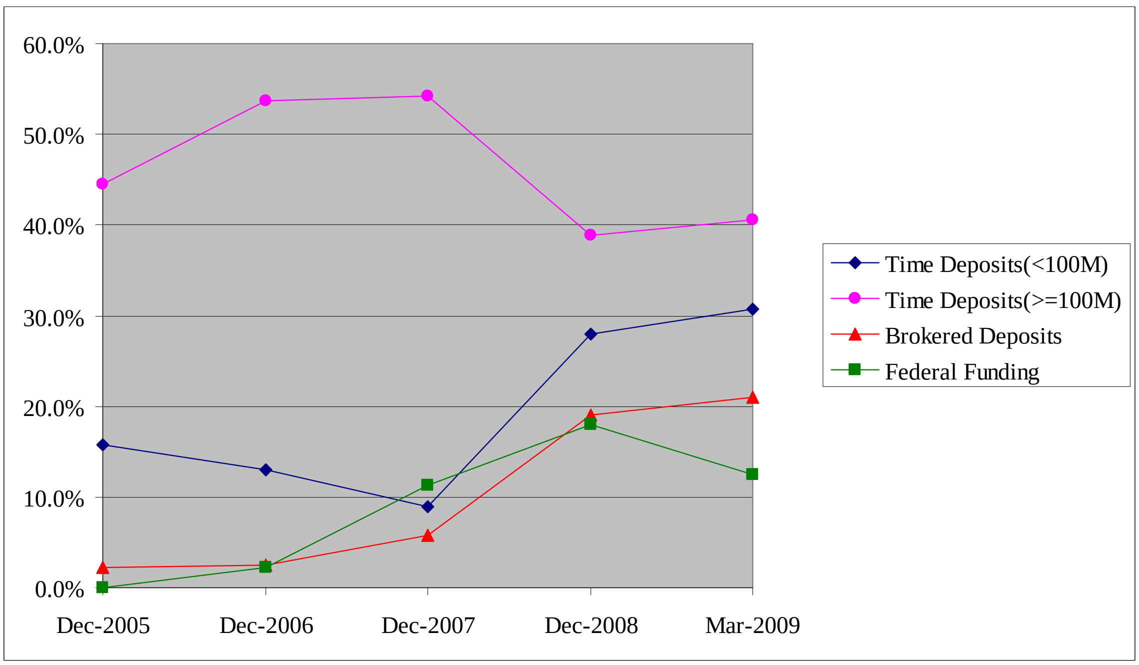
Until early 2005, Mirae was able to use core deposits to fund its growth by offering competitive rates within the Korean bank community, where rates are usually higher than those offered by other institutions. Additionally, the bank had a few large depositors, with one of the largest being the State of California.[5] However, to fund its loan growth, Mirae developed a significant reliance on potentially volatile and high-cost funding sources. Specifically, approximately two-thirds of the asset growth between March 2005 and June 2006 was funded through higher-cost jumbo Certificates of Deposit (CDs). The bank paid interest rates on jumbo CDs that were nearly 40 basis points higher than other institutions in the Koreatown area of Los Angeles. The rates it paid on CDs less than $100,000 was 88 basis points higher than the local Korean peer group and 119 basis points higher than the bank's peer group. By the 2007 examination, jumbo CDs represented over 52 percent of total deposits, while CDs of $100,000 or less had

[5] The 2005 examination report noted that the balances maintained by these depositors fluctuated significantly and were not considered stable sources of funds.

decreased $5.4 million since the last examination. The bank's net non-core dependency ratio increased from 23 percent as of March 31, 2005 to 53 percent as of June 30, 2006.[6]

In April 2007, the Board approved an alternative funding strategy to replace approximately $73 million in jumbo CDs with lower cost brokered deposits and Federal Home Loan Bank (FHLB) advances. The bank improved its liquidity ratio[7] in 2008 by utilizing its Federal Funds borrowing lines[8] to invest in securities. Further improvements were made in the liquidity ratio when the bank offered above-market deposit rates at its new branch in early 2009 and used the funds to invest in Federal Funds sold and securities. Although Mirae's funding strategy improved its liquidity ratio, the strategy increased Mirae's dependency on volatile funds that were subject to regulatory restrictions once its capital levels decreased. Figure 3 depicts Mirae's funding strategy for the period 2005 to 2009.

Figure 3: Mirae's Funding Strategy, 2005 to 2009



Source: UBPRs for Mirae.

Furthermore, the bank's deteriorating condition resulted in the loss of its largest depositor, the State of California, in the second half of 2008. The state's $34.5 million in deposits were removed after the bank failed to maintain the State's minimum standards

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[6] Non-core funding includes funding that can be very sensitive to changes in interest rates such as brokered deposits, CDs greater than $100,000, and borrowed money. Higher ratios reflect a reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions.
[7] Defined as Federal funds sold, cash, and due from and unpledged available-for-sale securities divided by total deposits.
[8] Federal Funds transactions involve lending (federal funds sold) or borrowing (federal funds purchased) of immediately available reserve balances. Usually, the Federal Funds transactions are for 1 day or overnight borrowing and lending.

for financial condition.[9] Neither the CDFI nor the FDIC monitors deposits that are tied to such a rating. DSC officials agreed that developing a monitoring system might be helpful in the early detection of deteriorating financial conditions at banks that could cause deposits to be withdrawn. Mirae experienced additional deposit losses totaling approximately $51 million because some customers became dissatisfied with the bank's deposit rates and the devaluation of the Korean currency (the Won) provided an incentive to many of Mirae's customers to transfer their money to Korea. The bank increased its brokered deposits by $57 million to offset these deposit losses, and was able to obtain significant new deposits of $83.5 million at its newest branch by offering above-market rates.

The FDIC's Supervision of Mirae

Our review focused on the FDIC's supervision of Mirae from 2005 until its failure in 2009. During this period, the FDIC conducted on-site examinations as required and subjected Mirae to offsite monitoring. The FDIC became aware of Mirae's growth strategy in 2005, and by 2006 the FDIC determined Mirae's overall condition to be less than satisfactory due to the bank's increased risk profile by funding rapid asset growth with high-cost volatile funds. The FDIC recommended that Mirae's Board adopt a resolution to address these areas. In the 2007 examination, examiners found the overall condition of the bank improved but considered assigning Mirae a less than satisfactory composite rating. However, after taking into consideration information provided by management and actions taken by management to address concerns, the FDIC and CDFI determined that Mirae's condition warranted a higher composite rating. The higher 2007 composite rating increased the time between on-site examinations and shifted offsite oversight to the field office during a period when Mirae's condition was weakening. In hindsight, more supervisory attention at the 2007 examination to the loans originated by one individual, who generated a significant portion of the loan growth, would have been prudent. Further, the following factors should have resulted in the FDIC providing greater supervisory attention to Mirae following the 2007 examination: (1) Mirae's noted increasing risk profile, (2) deteriorating economic conditions to which Mirae was vulnerable, and (3) offsite monitoring flags that identified potential concerns.

Supervisory History

The FDIC and CDFI conducted joint on-site examinations of Mirae from November 2002 through June 2009, except for the 2002 and 2006 examinations that were conducted by the CDFI and the FDIC, respectively. Prior to 2006, Mirae received composite "2" CAMELS ratings.[10] In 2006, Mirae received a composite "3" CAMELS rating and was

[9] The State relies on Highline Data to determine which institutions can hold public deposits. Highline Data rates banks on a scale of 1 to 99, with a minimum score of 10 required by the State of California. Mirae's rating fell to a 2 based on June 30, 2008 UBPR information.

[10] Financial institution regulators and examiners use the Uniform Financial Institutions Rating System (UFIRS) to evaluate a bank's performance in six components represented by the CAMELS acronym: **C**apital adequacy, **A**sset quality, **M**anagement practices, **E**arnings performance, **L**iquidity position, and

subject to a Bank Board Resolution (BBR), a type of informal enforcement action. In the 2007 examination, the overall condition of the bank was found to have improved and the FDIC advised Mirae that it was relinquishing interest in the BBR.

Although the FDIC and CDFI were in agreement that the bank had met the provisions of the BBR, the regulators initially disagreed on the 2007 rating. The FDIC believed that the bank merited a composite “3” rating and the CDFI examiners believed that a composite “2” rating was warranted. The agencies ultimately agreed to assign Mirae a composite “2” rating based on additional information provided by the bank and actions taken by the bank’s management, during the report review period. Two components – liquidity and earnings – were each rated “3”. This composite rating played a pivotal role in the supervision of Mirae for two reasons: (1) the bank’s examination cycle was extended from 12 to 18 months[11] and (2) supervision of the bank was transferred from the regional office to the field office and may have resulted in reduced supervisory attention to Mirae during this period.

The 2009 examination found that the overall condition of the bank had deteriorated dramatically and its composite CAMELS rating was downgraded to a “5”. In April 2009, the FDIC and CDFI issued a Cease and Desist Order (C&D) to Mirae that required the bank, among other things, to:

- increase its Tier 1 Capital by not less than $30 million and thereafter maintain its Tier 1 Capital in an amount not less than 8 percent of its total assets and
- not increase the amount of its brokered deposits above the amount outstanding at the date of the order and submit a written plan for reducing reliance on volatile funding sources.

The bank was unable to meet the conditions of the C&D and the bank was closed 2 months later. Table 2 summarizes examination and visitation activity for Mirae, from 2005 to 2009.

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.

[11] Section 337.12 of the FDIC Rules and Regulations, which implements section 10(d) of the FDI Act, requires annual full-scope, on-site examinations of every state nonmember bank at least once during each 12-month period, and allows for 18-month intervals for certain small institutions (total assets of less than $500 million) if certain conditions are satisfied. Mirae met these conditions by being *Well Capitalized* and being assigned a "1" or "2" management component rating and a "1" or "2" composite rating.

Table 2: Examinations and Visitations of Mirae, 2005 to 2009

Examination Start Date	Examination Type	Examination as of Date	Agency*	Supervisory Ratings	Supervisory Action
06/27/2005	Examination	03/31/2005	CDFI/FDIC	222222/2	
07/10/2006	Examination	03/31/2006	FDIC	223333/3	BBR (10/10/2006)
04/10/2007	Special Purpose Visit		FDIC	N/A	
07/16/2007	Examination	03/31/2007	CDFI/FDIC	222332/2	Released from BBR (01/03/2008)
02/23/2009	Examination	12/31/2008	FDIC/CDFI	555555/5	C&D (04/27/2009)

Source: ROEs for Mirae and DSC supervisory documents.
* Examinations of Mirae for this period were conducted jointly, with the lead agency listed first, unless otherwise indicated.

Supervisory Concern Related to Aggressive Growth

The 2005 examination noted concern with Mirae's aggressive growth projections in the event of an economic downturn. Further, examiners noted that the bank was somewhat sensitive to CRE market conditions even though its exposure was determined to be less than the 300 percent of Tier 1 Capital – the level of concentration identified by the FDIC as warranting greater supervisory scrutiny. Table 3 provides examiner comments on Mirae's CRE concentrations, from 2005 to 2009.

Table 3: Mirae's CRE Concentrations Reported by Examiners

Examination Start Date	Examiner Comments on CRE to Tier 1 Capital Concentration	CRE to Tier 1 Capital Concentration Excluding Owner-Occupied	Examiner-Identified Specific Concentrations of 25 Percent or More	Specific Concentration Percent of Tier 1 Capital
06/27/2005	None Reported	None Reported	None Reported	None Reported
07/10/2006	485 percent	Not Identified	• Car Wash Industry	116 percent
07/16/2007	502 percent	203 percent	• Car Wash Industry • Hotels and Motels	119 percent 111 percent
02/23/2009	695 percent	393 percent	• Gas Stations with Convenience Stores • Hotels and Motels • Car Washes	313 percent 243 percent 160 percent

Source: ROEs for Mirae.

In light of the growth in assets, the 2006 examination made recommendations to enhance the bank's CRE credit concentrations monitoring systems, including the need to:

- establish CRE limits relative to Tier 1 Capital;
- monitor concentrations, including unfunded commitments, relative to Tier 1 Capital and Board limits;
- identify concentrations by geographic market as well as loan type; and
- report quarterly on market conditions in the bank's real estate lending areas.

Given that the overall condition of the bank was found to be less than satisfactory in 2006, in part because of the rapid asset growth, the FDIC contemplated issuing a Memorandum of Understanding (MOU) to the bank.[12] However, following internal discussions that included consideration of management's proactive approach to resolving examiner-identified issues, the FDIC agreed to recommend the adoption of a BBR. The BBR is a less structured informal enforcement action than an MOU and only requires action by the institution's Board. The provisions of the BBR included limitations related to asset growth and concentrations. As part of the July 2007 examination, examiners concluded that the bank had taken sufficient steps to address the provisions of the BBR.

Supervisory Concern Related to Loan Underwriting

Examiners did not identify poor underwriting concerns in Mirae's portfolio during the 2005 and 2006 examinations. In 2007, loan underwriting was considered to be generally adequate for the size and complexity of the loan portfolio. However, the 2007 examination recommended further improvements to credit administration practices and noted that the bank needed to put additional effort into obtaining updated financial information, especially for the commercial and SBA loans. The bank was also cited for returning loans to accrual status without a demonstrated performance period. Examiners did not identify weak credit underwriting in the loan portfolio until the 2009 examination.

However, the FDIC may have missed an opportunity in 2007 to focus on loans originated by the individual, discussed earlier in the report, who was responsible for originating much of Mirae's loan growth. Follow-up activity related to the allegation reported to regulators that was ongoing before the start of the 2007 examination noted a complete break-down in Mirae's underwriting, approval process, and internal controls related to one loan originated by this individual. In addition, this follow-up activity raised questions about why it took Mirae 8 months to submit information to regulators about the allegations.

Although the allegation only related to one loan, examiners did not have the opportunity to consider the follow-up review results during the examination planning phase because they were not included in the field office correspondence file. DSC officials explained that these results had not been filed because the FDIC had not made a final determination regarding the disposition of the allegation. According to FDIC officials, correspondence files that are used for examination planning usually do not contain copies of correspondence and documentation associated with ongoing reviews. FDIC officials stated that consideration would be given to including initial review results in the

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[12] Generally an MOU is used when there is reason to believe the deficiencies noted during an examination need a more structured program or specific terms to effect corrective action.

correspondence file to help ensure that examiners are aware of all relevant communications.

Lacking this information, the 2007 examination and resulting report did not focus on loans originated by this individual, even though they represented 51 percent of the total substandard loans identified in the 2007 examination. When examiners did focus on loans originated by this individual during the 2009 examination – almost 2 years later – these loans comprised $83 million, or 391 percent of Tier 1 Capital, and $45 million of classified loans. Moreover, examiners determined that the remaining $37 million in loans were deficient enough to merit special mention.

Supervisory Concern Related to ALLL

Beginning in 2006, each of the examinations had recommended increases in the ALLL. Specifically, examiners first raised concerns about the bank's ALLL methodology in 2006 because portfolio segmentation by loan type was needed to better support its ALLL calculation. The 2007 examination noted that the methodology had improved and was more consistent with the *2006 Interagency Policy Statement on Allowance for Loan and Lease Losses*.[13] By the 2009 examination, examiners cited the bank for its inappropriate practice of limiting increases in the ALLL factors to 15 percent per quarter. Table 4 provides Mirae's adversely classified assets and ALLL amounts from 2005 to 2009.

Table 4: Mirae's Adversely Classified Assets and ALLL Amounts

Asset Quality (Dollars in Thousands)						
	Examiner Adversely Classified Asset Amounts				ALLL Amounts	
Examination Date	Substandard	Doubtful	Loss	Total Adversely Classified Items	ALLL Computed by Mirae	Increase in ALLL Computed by Examiners
6/27/05	$221	$0	$25	$246	$980	$0
7/10/06	$637	$72	$637	$1,346	$2,347	$250
7/16/07	$6,837	$1,567	$927	$9,331	$3,650	$385
2/23/09	$65,627	$8,909	$7,334	$81,870	$9,771	$16,000

Source: ROEs for Mirae.

[13] The policy statement reiterates key concepts and requirements included in generally accepted accounting principles and existing ALLL supervisory guidance. An appropriate ALLL covers estimated credit losses on individually evaluated loans that are determined to be impaired, as well as estimated credit losses inherent in the remainder of the loan and lease portfolio.

Offsite Review Program

The FDIC has developed various offsite tools, including the offsite review list, to monitor insured institutions between examinations. One of the measures used to produce the offsite review list is the Statistical CAMELS Offsite Rating (SCOR), which uses statistical techniques to measure the likelihood that an institution will receive a rating downgrade in the next examination. Mirae was flagged for offsite review each quarter from December 2007 through December 2008 based on bank-filed Call report data. The offsite review captured Mirae's consistently high growth and escalating financial decline as the bank suffered increasing distress in its loan portfolio. Financial indicators such as the Net Interest Margin and Return on Assets were also showing significant declines for the bank. The SCOR probability of a downgrade increased with each quarter until, by September 2008, the probability of a CAMELS composite downgrade to a "4" was 94 percent.

All the offsite reviews for Mirae were completed by the field office, with the exception of the final review in December 2008 which was completed by regional office personnel. This occurred despite guidance in the *Case Manager Procedures Manual*, which states that only certain institutions meeting defined criteria should be reassigned to the field office for offsite monitoring by Field Supervisors and Supervisory Examiners. Criteria for field office reassignment includes institutions having composite ratings of "1" or "2" at the two most recent examinations. Mirae, rated a composite "3" at the 2006 examination, did not meet the criteria for reassignment to the field offsite review and monitoring should have remained at the regional office. DSC officials acknowledged that the responsibility for conducting offsite review for Mirae was erroneously assigned to the field in February 2008.

Further, according to the *Case Manager Procedures Manual*, an Assistant Regional Director (ARD) must approve offsite reviews, whether conducted by a Field Supervisor or Case Manager. In the case of Mirae, the Field Supervisor delegated responsibility to conduct the offsite reviews to a Supervisory Examiner. For the March and June 2008 offsite reviews, the ARD delegated approval of the offsite reviews. In one case, the same Supervisory Examiner who prepared the offsite review comments also approved them, having been delegated ARD responsibilities during that time. This represented a fundamental breakdown in the tenet of separation of duties and may have resulted in reduced supervisory attention to Mirae when there were strong indicators of the bank's financial decline, including the bank's Highline rating for this period, which had dropped to a 2 (on a scale of 1 to 99) as discussed earlier in the report.

As part of its offsite monitoring process during 2008, the FDIC held discussions with bank management in March 2008, and again in August 2008, to discuss management's actions to address the decline in asset quality. However, the offsite review comments do not indicate that the CDFI was contacted or that an accelerated examination was warranted. FDIC officials informed us that there were resource constraints in the region in 2008 that would have precluded them from accelerating the examination of Mirae. Several larger institutions in the region were at or near failing and the workload had to be prioritized. FDIC officials considered the following factors in their decision not to accelerate the examination: (1) the bank's minimal exposure to construction and land development, (2) the level of non-owner occupied CRE, and (3) a $5 million capital injection made by the holding company. By the time the examination commenced in February 2009, the bank's condition had significantly deteriorated. An interim downgrade to a composite "4" was issued to the bank on March 24, 2009 while the examination was ongoing. The final examination results, as reported in the examination report, lowered the bank to an overall composite "5".

Supervisory Concern Related to Liquidity Funding Strategy

Examiners noted in 2005 that Mirae's funding needs would increase as the Board pursued an aggressive growth strategy and that the bank had experienced a noticeable acceleration of funding costs compared to the national peer. By the 2006 examination, examiners were reporting the bank's significant reliance on volatile and high-cost funding sources. Enhancements were needed to monitor the stability of deposits, especially given that liquidity ratios were incorrectly reported to the Board. Due to the high rates being paid on deposits, which attract rate shoppers, examiners recommended that management expand its monitoring of the volatility of the entire jumbo CD portfolio to determine whether (1) adequate contingency funding plans were in place and (2) the bank's budget assumptions regarding deposit composition and costs of funds were supportable. In addition, the BBR included provisions related to the bank's liquidity.

The 2007 examination report stated that the bank had instituted in-depth analysis of volatile deposits, covering the entire CD portfolio, on a quarterly basis. The analysis included reports that rank deposits by volatility, sort deposits by rates, and track deposit renewals. Examiners stated that the results were back-tested to validate the current findings and adjust future reports as necessary. Additionally, examiners reported that management had launched several new products to promote core deposits. On a regular basis, management monitored peer interest rates to control costs of funds and prevent the bank from paying rates higher than the market average. However, examiners also noted that liquidity risk had not reduced and remained high, and recommended that management develop and implement a cash flow modeling report to project sources and uses of funds to assist in identifying any potential funding shortfalls.

At the 2009 examination, examiners noted that the bank continued to struggle to obtain and maintain a sufficient volume of funds on reasonable terms. Mirae's over-reliance on non-core and higher-cost funding sources had become increasingly worse since the previous examination and examiners noted that Mirae's liquidity strategy failed to fully consider implications associated with the bank's deteriorating financial condition. For instance, the bank's contingent liquidity plan did not consider restrictions to brokered deposits set forth in Part 337.6 of the FDIC's Rules and Regulations. Additionally, the bank failed to consider that once it became *Undercapitalized,* it would face rate restrictions on all its deposits.

Implementation of PCA

The purpose of PCA is to resolve problems of insured depository institutions at the least possible long-term cost to the DIF. Part 325 of the FDIC's Rules and Regulations implements PCA requirements by establishing a framework for taking prompt corrective action against insured state-chartered nonmember banks that are not adequately capitalized. The FDIC implemented PCA for Mirae, as follows:

- On April 9, 2009 the FDIC formally notified the bank that its PCA status was *Undercapitalized* based on December 31, 2008 Call Report information, and adjusted for the preliminary findings from the February 2009 examination. The FDIC also informed the bank that it was required to file a written capital restoration plan by May 25, 2009.

- On May 6, 2009 the FDIC notified Mirae that it was deemed to be *Significantly Undercapitalized* based on March 31, 2009 Call report data. In addition to the capital restoration plan, the FDIC requested that by May 19, 2009, the bank provide a summary of the specific steps taken by management to comply with the mandatory restrictions required under section 38.

PCA's focus is on capital, which can be a lagging indicator of an institution's financial health. Although the FDIC followed PCA guidance, by the time Mirae's capital levels fell below the required thresholds necessary to implement PCA, the bank's condition had deteriorated to the point at which the institution could not raise additional capital in the time period necessary to prevent a liquidity failure.

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 5 of this report. DSC's response reiterated the OIG's conclusions regarding the cause of Mirae's failure. With respect to our assessment of FDIC's supervision, DSC's response also reiterates the supervisory history, including supervisory actions, presented in the report. DSC's response also states that examiners made recommendations in 2007 to further enhance Mirae's credit administration practices due to one bank official being responsible for originating 51 percent of the substandard loans identified during the 2007 examination. As a point of clarification, although we did find that examiners made such recommendations, we did not find any evidence that examiners were aware of the bank official's involvement in the substandard loans identified in the examination report. In that regard, our report states that examiners did not have the opportunity to consider information associated with loans originated by this individual at the 2007 examination because the information had not been included in the field office correspondence file at the time examiners were planning the examination.

Objectives, Scope, and Methodology

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

Scope and Methodology

The scope of this audit included an analysis of Mirae Bank operations from 2002 until its failure on June 26, 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 reports of examination prepared by the FDIC and the CDFI examiners from 2002 to 2009, focusing on supervisory activities between 2005 and 2009.
- Reviewed the following:
    - Bank data and records maintained at the Division of Resolutions and Receiverships' (DRR) Irvine, California office.
    - Correspondence and pertinent examination work papers maintained at DSC's San Francisco and Los Angeles, California offices.
    - Pertinent DSC policies and procedures.
- Interviewed the following FDIC officials:
    - DSC management in Washington, D.C., and the San Francisco Regional Office.

- FDIC examiners from the DSC Los Angeles West Field Office, who participated in examinations or reviews of examinations of Mirae.

- Met with officials from the CDFI to discuss the historical perspective of the institution, its examinations, and other activities regarding the state's supervision of the bank.

- Researched various banking laws and regulations, including State of California laws.

We performed the audit field work at DRR offices in Irvine, California and DSC offices in San Francisco, California.

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 Mirae Bank's management controls pertaining to causes of failure and material loss as discussed in the body of this report.

We obtained data from various FDIC systems but determined that information system controls were not significant to the audit objectives and, therefore, did not evaluate the effectiveness of information system controls. We relied on our analysis of information from various sources, including reports of examination, correspondence files, and testimonial evidence to corroborate data obtained from systems that was 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 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. The results of our tests 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.

Examples of Broker/Employee-Referred Loans

No.	Original Note Amount	Original Note Date	Amount Charged-off by Mirae	DSC/CDFI Examination Date	Examiner Classification/Amount
1.	$4,200,000	09/08/05	$542,555	Not Examined	Not Identified in ROE
2.	$4,680,000	11/16/05	Not Identified	02/23/09	Substandard/$4,479,000
3.	$4,200,000	12/20/05	Not Identified	02/23/09	Loss/$2,468,000 Substandard/$1,615,000
4.	$8,500,000	02/24/06	$5,170,687	02/23/09	Substandard/$3,000,000
5.	$800,000	02/28/06	$598,953	Not Examined	Not Identified in ROE
6.	$1,000,000	02/28/06	$136,237	Not Examined	Not Identified in ROE
7.	$1,700,000	03/08/06	$1,200,001	07/16/07	Substandard/$1,650,000
8.	$4,100,000	03/13/06	Not Identified	02/23/09	Doubtful/$3,975,000
9.	$2,500,000	03/13/06	Not Identified	02/23/09	Substandard/$2,303,000
10.	$1,850,000	03/20/06	$1,333,997	07/16/07 02/23/09	Substandard/$1,834,000 Substandard/$500,000
11.	$1,820,000	09/11/06	$167,778	Not Examined	Not Identified in ROE
12.	$2,415,000	01/10/07	Not Identified	02/23/09	Loss/$1,264,000 Substandard/$1,117,000
13.	$3,100,000	02/08/07	Not Identified	02/23/09	Substandard/$2,996,000
14.	$3,000,000	02/13/07	Not Identified	02/23/09	Substandard/$2,956,000
15.	$500,000	02/22/07	Not Identified	02/23/09	Substandard/$495,000
16.	$4,700,000	03/28/07	Not Identified	02/23/09	Substandard/$4,537,000
17.	$675,000	05/02/07	$157,360	Not Examined	Not Identified in ROE
18.	$1,000,000	07/13/07	Not Identified	02/23/09	Substandard/$987,000
19.	$1,350,000	01/17/08	Not Identified	02/23/09	Substandard/$1,337,000

Source: Examiners' work papers and OIG analysis.

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.
Bank Board Resolution (BBR)	Informal commitments adopted by a financial institution's Board directing the institution's personnel to take corrective action regarding specific noted deficiencies.
Cease and Desist Order (C&D)	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.
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.
Memorandum of Understanding (MOU)	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.
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 DIF. Part 325, subpart B, of the FDIC Rules and Regulations, 12 Code of Federal Regulations, section 325.101, et. seq., implements section 38, *Prompt Corrective Action*, of the FDI Act, 12 United States Code section 1831(o), by establishing a framework for taking prompt supervisory actions against insured nonmember banks that are less than adequately capitalized. The following terms are used to describe capital adequacy: (1) Well Capitalized, (2) Adequately Capitalized, (3) Undercapitalized, (4) Significantly Undercapitalized, and (5) Critically Undercapitalized. 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.

Glossary of Terms

Statistical CAMELS Offsite Rating (SCOR)	An FDIC financial model that uses statistical techniques, offsite data, and historical examination results to assign an offsite CAMELS rating and to measure the likelihood that an institution will receive a CAMELS downgrade at the next examination.
Uniform Bank Performance Report (UBPR)	The UBPR is an individual analysis of financial institution financial data and ratios that includes extensive comparisons to peer group performance. The report is produced by the Federal Financial Institutions Examination Council for the use of banking supervisors, bankers, and the general public and is produced quarterly from Call Report data submitted by banks.

Acronyms

ADC	Acquisition, Development, and Construction
ALLL	Allowance for Loan and Lease Losses
ARD	Assistant Regional Director
BBR	Bank Board Resolution
CAMELS	Capital, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk
C&D	Cease and Desist Order
CD	Certificates of Deposit
CDFI	California Department of Financial Institutions
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
SBA	Small Business Administration
SCOR	Statistical CAMELS Offsite Rating
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System

Corporation Comments

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

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 Mirae Bank, Los Angeles, California (Assignment No. 2009-066)

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 Mirae Bank (MB) which failed on June 26, 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 that MB's failure was due to its board and management pursuing an aggressive growth strategy centered in commercial real estate and failing to ensure loan underwriting practices were sound. The Report states that MB's aggressive growth was initially profitable; however, weaknesses in MB's Board and management oversight of loan underwriting and risk management practices were exposed as the economy contracted. The Report indicates MB's funding strategy of paying above-market rates for deposits and reliance on wholesale funding, such as brokered deposits, proved unsustainable once MB's financial condition began to deteriorate. Ultimately, MB's capital and liquidity became strained.

The Report focuses on the FDIC's supervision covering the period from 2005 until MB was closed in 2009. As part of the supervisory program during that period, FDIC and the California Department of Financial Institutions (CDFI) conducted on-site examinations in June 2005, July 2006, July 2007, and February 2009; while in April 2007, FDIC performed a special purpose visitation. During this timeframe, DSC conducted regular offsite monitoring of MB.

As a result of the July 2006 examination, MB was downgraded to a "3" composite CAMELS rating. Based on recommendations and findings provided at the exit meetings, MB's senior management adopted a Bank Board Resolution. The July 2007 examination noted that MB management's actions had improved its overall condition; however, examiners made recommendations to further enhance credit administration practices due to one bank official being responsible for originating 51% of the substandard loans identified during the 2007 examination. The FDIC's 4th quarter 2008 offsite review reflected MB's deteriorating asset quality, declining capital, unsatisfactory earnings and strained liquidity position, which resulted in an interim ratings change to a composite "4" in the 1st quarter of 2009. Findings of the February 2009 examination resulted in a Cease and Desist Order issued in April 2009. FDIC and the CDFI appropriately monitored and supervised MB until the time that it was closed.

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