Office of Inspector General

September 2009
Report No. AUD-09-025

Material Loss Review of Corn Belt Bank and Trust Company, Pittsfield, Illinois

AUDIT REPORT

Office of Audits

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Federal Deposit Insurance Corporation

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Why We Did The Audit

On February 13, 2009, the Illinois Department of Financial and Professional Regulation, Division of Banking (IDFPR) closed Corn Belt Bank and Trust Company (Corn Belt), Pittsfield, Illinois, and named the FDIC as receiver. On March 4, 2009, the FDIC notified the Office of Inspector General (OIG) that Corn Belt's total assets at closing were $261.7 million and the estimated loss to the Deposit Insurance Fund (DIF) was $100.7 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 Corn Belt.

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

Corn Belt was a state-chartered nonmember bank insured on October 25, 1946. With two branch offices and a small trust department, Corn Belt was engaged principally in traditional banking activities within its market place. Corn Belt was closely held by Corn Belt Bancorp, Inc., a one-bank holding company, with no subsidiaries or affiliates.

Corn Belt's assets consisted principally of farm loans, commercial real estate (CRE) loans, and commercial and industrial (C&I) loans. Prior to 2005, Corn Belt was principally a farm lender, but as Corn Belt pursued a rapid growth strategy, CRE loans increased the complexity of the loan portfolio.

FDIC guidance describes a risk management framework and practices to effectively identify, measure, monitor, and control risk to the safety and soundness of an institution. The FDIC has issued specific guidance regarding industry and individual concentrations of credit and concentrations in higher-risk CRE loans. The guidance addresses effective oversight by bank management, including the board of directors (Board), and sound loan underwriting, administration, and portfolio management practices.

Audit Results

Causes of Failure and Material Loss - Corn Belt failed because bank management did not implement sound risk management practices, particularly in the areas of loan underwriting and credit administration, during a period of rapid growth in its loan portfolio from 2003 through 2005. Corn Belt also failed to effectively manage key risks in its loan portfolio, including individual credit concentrations and loans with high loan-to-value (LTV) ratios, or to implement an effective loan grading system and methodology for computing an adequate allowance for loan and lease losses (ALLL). Further, Corn Belt relied heavily on non-core funding sources, especially brokered deposits, to fund growth in its loan portfolio without establishing adequate risk mitigation controls. FDIC and IDFPR examiners repeatedly expressed concern about Corn Belt's high-risk practices in these areas in the years leading up to its failure. However, the actions taken by Corn Belt's Board and management to address examiner concerns were not adequate. As economic conditions declined, the institution's weak risk management practices resulted in significant asset deterioration. Losses and additional ALLL provisions quickly depleted capital and earnings while significantly impairing the institution's liquidity position. Corn Belt was significantly undercapitalized when it was closed.

Assessment of FDIC Supervision - The FDIC, in conjunction with IDFPR, provided ongoing supervision of Corn Belt through regular risk management examinations, visitations, and offsite monitoring. Examiners were actively engaged in overseeing the institution in the years before its failure and identified the key risks that ultimately caused Corn Belt to fail. Such risks included rapid loan growth without adequate underwriting and credit administration, excessive credit concentrations, loans with high LTV ratios, weak loan grading and ALLL practices, and heavy reliance on non-core funding sources. Examiners brought these risks to the attention of Corn Belt's Board and management before the risks resulted in serious financial problems. The FDIC and IDFPR also pursued both formal and informal corrective actions when other attempts to address risks identified by examiners were unsuccessful.

While such actions were positive, we concluded that more proactive supervisory action may have influenced Corn Belt's Board and management to constrain its excessive risk taking and to take more timely and effective action in response to examiner concerns. Specifically, the FDIC could have required Corn Belt to hold a greater amount of capital or to submit a capital contingency plan sooner than had been required in 2008 given the institution's high-risk profile. In addition, the FDIC could have pursued a formal enforcement action following the 2007 examination (rather than a second Memorandum of Understanding) as a result of the institution's failure to adequately address provisions in prior informal corrective actions. By the time the FDIC issued a formal enforcement action on December 31, 2008, Corn Belt's failure was highly probable due to the significant asset deterioration that had occurred and its impact on earnings, capital, and liquidity.

With respect to PCA, we concluded that the FDIC implemented the provisions of PCA consistent with section 38 of the FDI Act. However, PCA was not effective in limiting losses to the DIF because PCA did not result in action until the institution was at risk of failure.

This report presents the FDIC OIG's analysis of Corn Belt's failure and the FDIC's efforts to ensure Corn Belt's 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 allow, we may also conduct more in-depth reviews of specific aspects of the FDIC's supervision program and make recommendations, as warranted.

Management Response

The Director, Division of Supervision and Consumer Protection (DSC), provided a written response to the draft report. DSC summarized the OIG's conclusions regarding the causes of Corn Belt's failure and the resulting material loss to the DIF and DSC's supervisory activities related to Corn Belt. DSC also acknowledged that higher capital requirements can be an effective supervisory tool and that it has provided further guidance to enhance the supervision of institutions with high levels of volatile non-core funding.

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

Office of Audits
Office of Inspector General

DATE: September 4, 2009

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

/Signed/

FROM: Russell A. Rau
Assistant Inspector General for Audits

SUBJECT: *Material Loss Review of Corn Belt Bank and Trust Company, Pittsfield, Illinois*
(Report No. AUD-09-025)

As required by section 38(k) of the Federal Deposit Insurance Act (FDI Act), the Office of Inspector General (OIG) conducted a material loss[1] review of the failure of Corn Belt Bank and Trust Company (Corn Belt), Pittsfield, Illinois. The Illinois Department of Financial and Professional Regulation, Division of Banking (IDFPR) closed Corn Belt on February 13, 2009 and named the FDIC as receiver. On March 4, 2009, the FDIC notified the OIG that Corn Belt's total assets at closing were $261.7 million and that the estimated loss to the Deposit Insurance Fund (DIF) was $100.7 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. The report is to consist of a review of the agency's supervision of the institution, including the agency's implementation of FDI Act section 38, *Prompt Corrective Action* (PCA); a determination as to why the institution's problems resulted in a material loss to the DIF; and recommendations to prevent future losses.

The objectives of this material loss review were to: (1) determine the causes of Corn Belt's failure and the resulting material loss to the DIF and (2) evaluate the FDIC's supervision[2] of Corn Belt, including the FDIC's implementation of the PCA provisions of section 38 of the FDI Act. This report presents the FDIC OIG's analysis of Corn Belt's failure and the FDIC's efforts to ensure Corn Belt's 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

[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.

reviews, we will communicate those to management for its consideration. As resources allow, we may also conduct more in-depth reviews of specific aspects of the FDIC's supervision program and make recommendations, as warranted. Appendix 1 contains details on our objectives, scope, and methodology; Appendix 2 contains a glossary of terms; Appendix 4 is a comparison of informal and formal action provisions; and Appendix 5 contains a list of acronyms used in the report.

BACKGROUND

Established in 1946, Corn Belt was a state-chartered nonmember savings bank. The institution had three locations, consisting of a main office in Pittsfield, Illinois (located approximately 100 miles north of St. Louis, Missouri), and two full-service branches in Jacksonville, Illinois, and Clayton, Missouri. Corn Belt was controlled by a local family since 1973. The President and Chairman of Corn Belt, who was a member of this family, owned over 90 percent of the stock in Corn Belt Bancorp, Inc., a one-bank holding company that owned the institution, with no other subsidiaries or affiliates. Much of Corn Belt's lending was in real estate, particularly farm loans in the swine industry and commercial real estate (CRE) loans, and construction and industrial (C&I) loans. In addition, the institution operated a small trust department. Table 1, below, summarizes key financial measures related to Corn Belt in the years prior to its failure.

Table 1: Financial Condition of Corn Belt in the Years Prior to its Failure

Financial Measure	**Dec-08**	**Dec-07**	**Dec-06**	**Dec-05**	**Dec-04**	**Dec-03**
Total Assets ($000s)	$260,201	$337,011	$314,722	$283,573	$186,004	$146,424
Total Deposits ($000s)	$233,788	$284,950	$271,104	$239,025	$151,763	$127,374
Total Loans ($000s)	$199,366	$268,676	$254,691	$233,568	$148,047	$114,438
Net Loan Growth Rate	*-28.82%*	*5.23%*	*8.57%*	*57.98%*	*29.45%*	*17.90%*
Tier 1 Leverage Capital Ratio (%)	2.94	8.06	8.19	8.24	7.77	8.22
Return on Assets (%)	-5.79	0.76	1.33	1.52	1.91	1.80
Loan Mix (% of Avg. Gross Loans)						
All Loans Secured by Real Estate	71.32%	68.08%	70.88%	74.11%	72.70%	70.73%
Construction and Development	8.44%	4.01%	4.97%	2.46%	1.57%	1.75%
CRE - Nonfarm/nonresidential	24.71%	24.78%	25.97%	25.57%	15.53%	14.12%
Family Residential - with Home Equity and Multifamily Loans	9.45%	10.49%	12.35%	12.84%	15.12%	13.94%
Farmland	28.72%	28.79%	27.59%	33.23%	40.49%	40.93%
C&I Loans	22.94%	25.60%	23.37%	18.71%	17.18%	18.05%
Funding						
Net Loans/Deposits	80.31%	92.57%	92.46%	96.60%	96.30%	88.64%
Core Deposits/Average Assets	36.44%	27.98%	23.90%	36.09%	53.37%	60.30%
Brokered Deposits/Average Assets	42.62%	48.39%	54.95%	39.53%	19.46%	11.12%
Examination Information						
Date of Examination	09/29/08	11/26/07	12/11/06	12/12/05	08/02/04	07/14/03
Component and Composite Ratings	555554/5	343333/3	233232/3	223232/2	222222/2	233222/3

Source: Uniform Bank Performance Reports (UBPR) and Reports of Examination (ROE) for Corn Belt.

CAUSES OF FAILURE AND MATERIAL LOSS

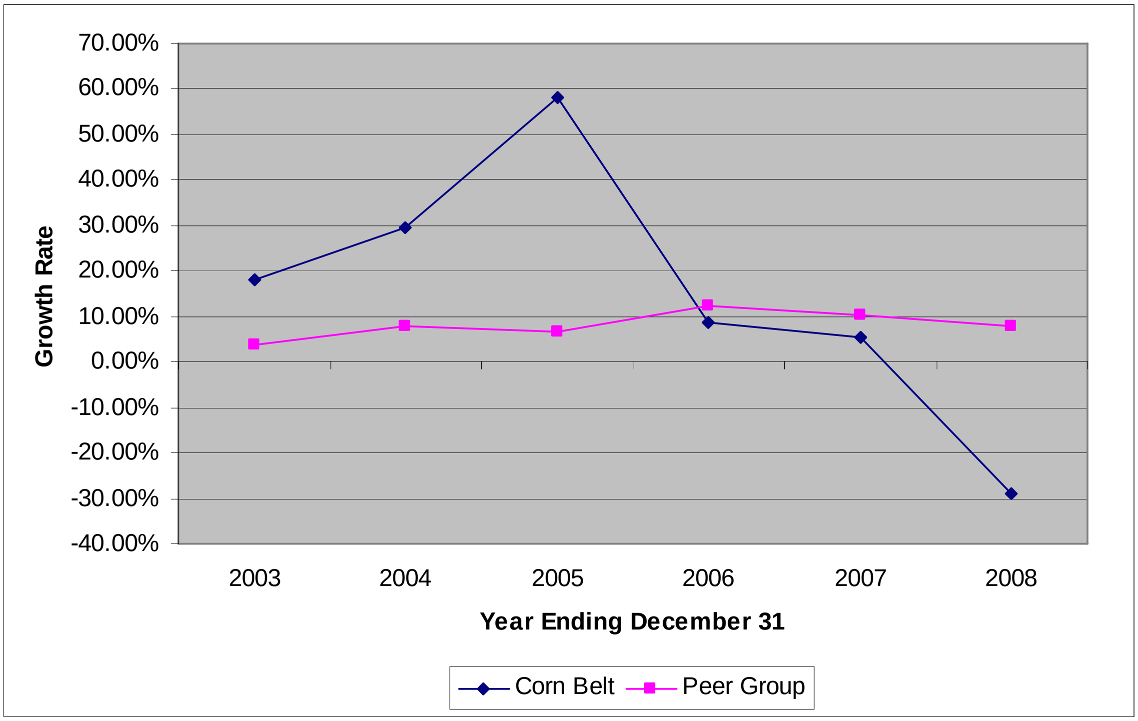
Corn Belt failed because its board of directors (Board) and management did not implement adequate risk management practices, particularly in the areas of loan underwriting and credit administration, during a period of rapid growth in its loan portfolio from 2003 through 2005. In particular, Corn Belt did not effectively manage key risks in its loan portfolio, including individual credit concentrations and loans with high loan-to-value (LTV) ratios, or implement an effective loan grading system and methodology for computing an adequate allowance for loan and lease losses (ALLL). Further, Corn Belt relied heavily on non-core funding sources, especially brokered deposits, to fuel growth in its loan portfolio without establishing adequate risk mitigation controls. The FDIC and IDFPR examiners repeatedly expressed concern about Corn Belt's high-risk practices in these areas in the years leading up to its failure. However, the actions taken by Corn Belt's Board and management to address examiner concerns were not adequate. As economic conditions declined, significant asset deterioration occurred due to the institution's weak risk management practices. The associated losses and additional ALLL provisions quickly depleted capital and earnings while significantly impairing the institution's liquidity position. On February 13, 2009, Corn Belt was closed because it did not have sufficient capital.

Rapid Growth Without Adequate Risk Management

During 2003 through 2005, Corn Belt increased its loan portfolio at a pace that significantly exceeded both the institution's peer group and its own internal growth plans. Figure 1, on the following page, illustrates the rapid growth of Corn Belt's loan portfolio relative to its peer group during this period. Examiners expressed concern during the July 2003 examination that rapid growth in Corn Belt's loan portfolio, together with pervasive risk management weaknesses, described later in this report, presented significant risk to the future quality of Corn Belt's assets. In the April 2004 response to examiner concerns, Corn Belt's Board approved a written growth plan containing what the examiners determined to be "reasonable parameters." However, Corn Belt increased its loan portfolio in 2004 and 2005 at a rate that far exceeded those parameters.

During the December 2005 examination, examiners again expressed concern that Corn Belt's poor strategic planning and growth management could lead to serious future problems. Although Corn Belt curbed its loan growth considerably starting in 2006, the poor risk management practices that plagued the institution during its critical growth period did, in fact, result in serious asset quality problems in the years that followed when economic conditions worsened.

Figure 1: Annual Growth of Corn Belt's Loan Portfolio Relative to Peers' Growth



Source: OIG Analysis of UBPRs for Corn Belt.

Summarized below are the more salient weaknesses in Corn Belt's risk management practices that contributed to the institution's failure.

Loan Underwriting and Credit Administration. Corn Belt's loan portfolio consisted of a complex mix of construction, commercial, and agricultural loans that required a sustained level of effort to adequately underwrite and monitor the loans. Weaknesses in Corn Belt's loan underwriting and credit administration practices, particularly during the 2003 and 2005 examinations, were a significant contributing factor to the asset quality problems that examiners began to identify at the 2007 examination.

With the exception of the August 2004 examination, every examination conducted from 2003 until the institution's failure identified pervasive loan underwriting and credit administration deficiencies. Such deficiencies included the lending staff's (1) failure to obtain or document sufficient financial information (e.g., financial statements, income information, cash flow statements, tax returns, and credit reports) on borrowers and (2) lack of knowledge or understanding of key borrower and/or credit relationships. For example, in 2003 examiners found that loan officers failed to obtain or document sufficient financial information on borrowers before advancing funds or at the time of renewal or extension. In the 2008 ROE, examiners stated that the majority of the exceptions involved the lack of financial information for borrowers or guarantors, primarily for those borrowers whose loans were adversely classified. When financial information was obtained, there was generally no indication that it had been reviewed or analyzed by the loan officer. Without such information, bank management could not assemble a clear picture of a borrower's financial capacity and repayment ability.

Additionally, examiners expressed concern during several examinations that the institution's loan function was not adequately staffed.

Examiners also identified deficiencies in Corn Belt's loan policy in many of the examinations conducted from 2003 until the institution's failure. Deficiencies in the loan policy included inadequate guidance for charged-off loans and debt-to-income ratios. Further, examiners identified instances in which interest on loans was capitalized when the borrower was experiencing financial difficulties, which had the effect of delaying the recognition of problem loans.

According to DSC, in addition to the bank's loan underwriting and credit administration practices, management's appetite for riskier loans was another major factor contributing to the bank's asset quality problems, .

Credit Concentrations. In every examination that was conducted from 2003 until the institution's failure, examiners reported that Corn Belt's loan portfolio contained excessive credit concentrations[3] to individual borrowers. Although examiners recommended that Corn Belt take steps to reduce these concentrations and pursued formal and informal corrective actions in this regard, Corn Belt's efforts to address the concentrations were not adequate. Table 2, below, summarizes the individual concentrations identified by examiners during the last four examinations of Corn Belt.

Table 2: Summary of Credit Concentrations in Corn Belt's Loan Portfolio

Examination Date	**Number of Individual Concentrations**	**Combined Amount of Concentrations** (Millions)	**Percentage of Total Loan Portfolio**	**Percentage of Tier 1 Capital**	**Amount Classified** (Millions)	**Amount of Special Mention Loans** (Millions)
12/12/05	6	$92.7	45%	432%	$0.0	$40.2
12/11/06	6	$102.1	39%	410%	$9.2	$12.0
11/26/07	8	$112	35%	410%	$8.6	$0.0
09/29/08	6	$85.8	35%	1,071%	$53.5	$2.5

Source: OIG Analysis of FDIC and IDFPR ROEs.

At the September 2008 examination, examiners determined that three individual concentrations accounted for $21.8 million in loans classified substandard and $10.5 million in loans classified loss. These same three concentrations represented 39 percent of Corn Belt's total loan classifications during this examination. Examiners concluded that the dramatic increase in classified loans identified in the September 2008 examination resulted from deteriorating financial positions and questionable collateral values. In many instances, examiners noted that credits were performing marginally or had only modest cash flows. Other credits were considered borderline during the previous examination, but the economic downturn magnified weaknesses in several borrowers' cash flows and balance sheets.

[3] For purposes of this discussion, credit concentrations are obligations of 25 percent or more of Tier 1 Capital to an individual borrower, small interrelated group of individuals, single repayment source, or individual project.

Loans with High LTV Ratios. In every examination conducted from June 2003 to the institution's failure, examiners identified numerous loans with LTV ratios that were well in excess of limitations recommended in supervisory guidance.[4] In one case, a high LTV loan was held by a borrower that had been identified as an individual credit concentration. Examiners reported that the high LTV ratios exposed Corn Belt to significant risk. Examiners also noted that reports submitted to Corn Belt's Board regarding the number and amount of high LTV loans were often inaccurate because the reports did not include all high LTV loans. The inaccurate reports hindered Corn Belt's ability to effectively manage risks associated with the high LTV loans. DSC stated that even with accurate reports on high LTV loans, another significant issue was management's high risk tolerance in booking these loans.

Loan Grading and ALLL. During the November 2007 examination, examiners identified significant differences between their assessment of the quality of Corn Belt's loans and the grades assigned by Corn Belt's internal loan grading system. Such weaknesses can, and did, result in a failure to recognize actual losses and in an underfunded ALLL and provision for probable losses. The examiners recommended that management perform a complete re-evaluation of all loan grades within the portfolio to ensure that the ALLL was adequately funded.

During the September 2008 examination, examiners identified a significant amount of classified loans that had not been properly graded by Corn Belt's internal loan grading system, resulting in a greatly underfunded ALLL. A total of 41 relationships, with loans totaling $60.5 million, were classified by examiners during the September 2008 examination but had been identified as acceptable or better by Corn Belt's management. Examiners concluded that Corn Belt's procedures for the early identification of problem or deteriorating credits and for grading loans were wholly ineffective. Table 3, on the following page, summarizes examiner classifications of Corn Belt's loans in the years leading to the institution's failure.

[4] Part 365 of the FDIC Rules and Regulations, Appendix A (*Interagency Guidelines for Real Estate Lending Policies*) provides, in part, that the aggregate amount of all loans in excess of the supervisory LTV limits should not exceed 100 percent of total capital. In addition, within the aggregate limit, total loans exceeding the supervisory limits for commercial, agricultural, multifamily or other non-1-4 family residential properties should not exceed 30 percent of total capital. Corn Belt regularly exceeded both thresholds.

Table 3: Corn Belt's Adversely Classified Assets and ALLL

	Asset Quality (Dollars in Thousands)					
	Assets Adversely Classified by Examiners				ALLL Amounts	
Examination Date	Substandard	Doubtful	Loss	Total Adversely Classified Items	ALLL Computed by Corn Belt	Increase in ALLL Computed by Examiners
07/14/03	$8,961	$0	$14	$8,975	$1,045	$800
08/02/04	$3,439	$0	$19	$3,458	$1,576	$0
12/12/05	$3,405	$0	$271	$3,676	$2,184	$595
12/11/06	$22,775	$0	$312	$23,087	$3,320	$700
11/26/07	$25,931	$0	$1,956	$27,887	$4,881	$1,800
09/29/08	$70,989	$0	$13,354	$84,343	$5,107	$19,611

Source: FDIC and IDFPR ROEs.

In addition to noting weaknesses in Corn Belt's loan grading system, examiners noted deficiencies in Corn Belt's ALLL methodology in every examination conducted from 2003 until the institution's failure. Specifically, later examinations identified that Corn Belt's ALLL practices did not comply with the 2006 *Interagency Policy Statement on the Allowance for Loan and Lease Losses (ALLL) and Questions and Answers on Accounting for Loan and Lease Losses* (2006 ALLL Policy Statement).[5] The rapid deterioration in Corn Belt's loan portfolio underscores the importance of appropriately estimating the ALLL in order to ensure an accurate representation of earnings and to provide for adequate capital levels.

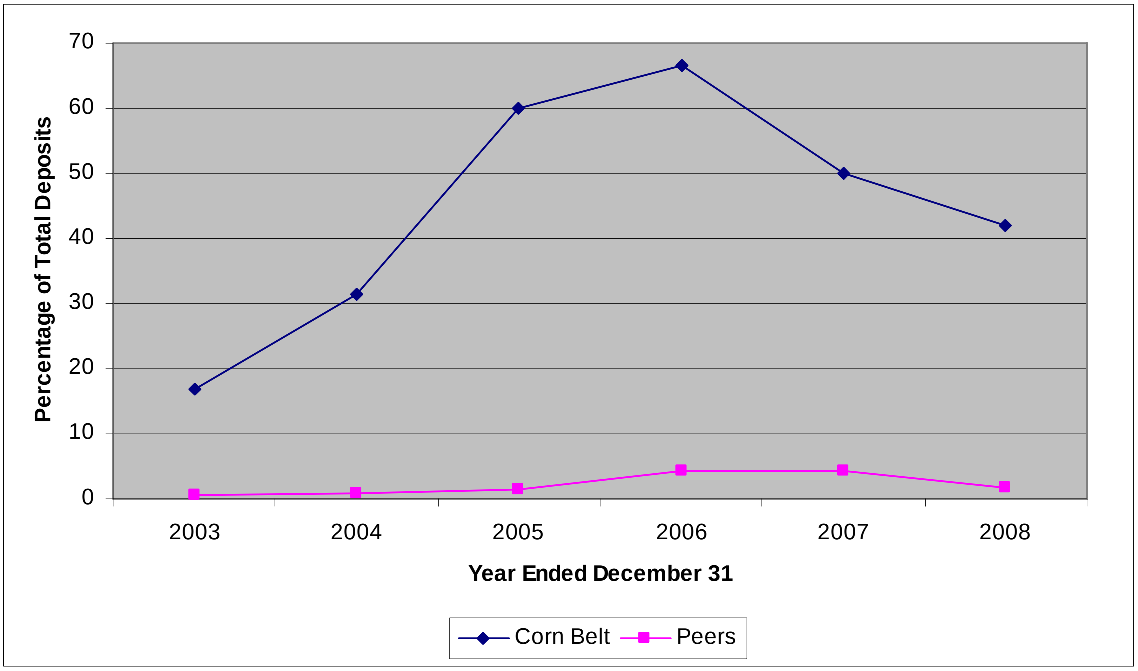
Reliance on Non-Core Funding

Corn Belt's heavy reliance on non-core funding[6] to support its rapid loan growth was a contributing factor in the institution's failure. At the time of Corn Belt's July 2003 examination, examiners noted that Corn Belt's liquidity position was only "marginally adequate" because over half of the institution's deposits had been obtained from brokers and a deposit listing service. Examiners recommended that Corn Belt's Board revise its policy limit on the amount of deposits that the institution could obtain from national markets and take steps to reduce its dependency on non-core funding. However, Corn Belt advised examiners in 2003 that the institution would continue to pursue a wholesale funding strategy because obtaining funds from national markets was considered more cost-efficient than obtaining funds from local markets. Without a limit on the amount of non-core funding that Corn Belt could obtain from national markets, Corn Belt used brokered deposits to increase its loan portfolio during 2004 and 2005, elevating the institution to the 99th percentile of its peer group with respect to its net non-core funding

[5] Under the 2006 ALLL Policy Statement, institutions are expected to have controls in place to consistently determine their ALLL in accordance with Generally Accepted Accounting Principles (GAAP), the institution's stated policies and procedures, management's best judgment, and relevant supervisory guidance.
[6] Corn Belt's non-core funding sources consisted principally of brokered deposits. A deposit listing service and Federal Home Loan Bank (FHLB) borrowings were also used.

dependence. Figure 2, below, illustrates Corn Belt's reliance on brokered deposits during its rapid growth period compared to the growth of its peers.

Figure 2: Corn Belt's Brokered Deposits Relative to Peers' Brokered Deposits



Source: OIG Analysis of UBPRs for Corn Belt.

During the December 2005 examination, examiners made several recommendations to improve Corn Belt's liquidity risk profile. Among other things, examiners recommended that Corn Belt diversify its funding sources and develop a contingency funding plan to prepare for the possibility that the institution would fall below the "well capitalized" category for PCA purposes. Given Corn Belt's reliance on brokered deposits, maintaining a "well capitalized" position was critically important because the FDIC can restrict the use of brokered deposits for institutions that fall to the "adequately capitalized" level or below. Corn Belt's Board passed a Bank Board Resolution (BBR) on March 24, 2006, requiring the development of a plan to improve the institution's liquidity risk profile.

Although Corn Belt took some steps to reduce its liquidity risk profile based on the BBR, examiners concluded during the December 2006 examination that these efforts were not adequate and made additional recommendations to the Board for improving Corn Belt's liquidity. These recommendations related to Corn Belt adopting a plan to improve its management of liquidity risk and developing the plan in consideration of the following examination comments:

- Develop an internal audit function to cover the liquidity area.
- Establish more conservative limits for national market deposits.
- Ensure the liquidity ratio is being calculated according to the guidelines in the bank's asset, liability, and liquidity management policy.

- Include appropriate discussions in the Asset/Liability Committee and board minutes when the bank is operating outside of established benchmarks.
- Improve generation of core deposit base.

Based on the results of the December 2006 examination, the FDIC entered into a Memorandum of Understanding (MOU) with Corn Belt on April 2, 2007. The MOU required, among other things, that Corn Belt develop a plan to improve the institution's liquidity position and to reduce its dependence on volatile liabilities to fund loans and long-term assets. In the November 2007 examination, examiners noted that Corn Belt had taken some action to address the liquidity provisions of the MOU; however, the institution continued to operate without a satisfactory liquidity position due to its leveraged funding strategy of using brokered deposits and wholesale borrowings to fund aggressive loan growth. Of particular note, examiners reported that Corn Belt had reduced the amount of its brokered deposits but that it also increased its use of an Internet deposit listing service to obtain funding that had characteristics similar to those of brokered deposits.

Based on the results of the November 2007 examination, the FDIC entered into another MOU with Corn Belt on March 20, 2008 that again required Corn Belt to develop a plan to improve its liquidity position and reduce its dependence on volatile funding. However, during the September 2008 examination, examiners found that Corn Belt's liquidity position was critically deficient and continued to be strained by an overreliance on brokered deposits. Examiners also identified serious asset quality problems in Corn Belt's loan portfolio. The resulting large loss provision caused Corn Belt's capital position to fall from "well capitalized" to "significantly undercapitalized" for PCA purposes. Accordingly, Corn Belt was prohibited from accepting, renewing, or rolling over brokered deposits.

Corn Belt's Chief Financial Officer advised examiners during the September 2008 examination that the institution's liquidity position had become critical and that the institution's sources of liquidity would likely be exhausted by January 2009. The FDIC issued a Cease and Desist Order (C&D) on December 31, 2008 that required Corn Belt to cease and desist from various actions, including operating with inadequate liquidity in light of the bank's asset and liability mix. The C&D stipulated that within 30 days, Corn Belt was to adopt a written contingency funding plan, acceptable to both the FDIC and IDFPR, that identified sources of liquid assets to meet the bank's contingency funding needs over time horizons of 1, 2, and 3 months. However, the institution was already at serious risk of failure at that time.

Attention to Examiners' Concerns

During the July 2003 examination, examiners identified and reported a number of concerns that they determined could lead to serious future financial problems at the institution. Such concerns included rapid loan growth without adequate underwriting and credit administration, excessive individual credit concentrations, loans with high LTV ratios, weak loan grading and ALLL practices, and a heavy reliance on non-core funding sources. In the years that followed, examiners repeatedly reported that Corn Belt was not taking adequate action to address these concerns. Examiners communicated these concerns to Corn Belt's Board and management through ROEs, recommendations, suggestions, and formal and informal corrective actions. The ineffectiveness of Corn Belt's actions to address examiner concerns was a contributing factor in the institution's failure.

As previously discussed, examiners consistently recommended that Corn Belt diversify its funding sources and develop a contingency plan to do so rather than rely on non-core deposits to fund its significant asset growth. When Corn Belt did decrease its brokered deposits, it obtained funding from an Internet deposit listing service rather than increase its core deposits. From the 2005 through 2008 examinations, Corn Belt was either slow to respond or not responsive to examiners' repeated concerns regarding individual concentrations as noted below:

- December 2005 Examination – "Increased efforts are needed by management and the Board to monitor compliance with the lending policy. Management and the Board have allowed the number and outstanding balances of individual concentrations to grow dramatically despite the Loan Policy stating a goal of the bank was to diversify loans to avoid a concentration of credit to specific industries, persons, or entities. Policy guidance in this area was inadequate and warranted expansion to place appropriate limits on the number and volume of concentrations. While the Board receives a quarterly report of concentrations, management has failed to include several concentrations noted at this examination."

- December 2006 Examination – "Management should formulate a plan to reduce the risk in [individual] loan concentrations…Loan Policy should be amended to include appropriate limits on the number and volume of concentrations." Corn Belt stated that management was attempting to correct this deficiency.

- November 2007 Examination – "Management has exhibited inadequate risk diversification practices. Although progress has been made in decreasing the two largest relationship concentrations, the overall level of concentrations to capital was not materially different from the last examination." Corn Belt explained that reductions in concentrations did not occur as quickly as anticipated but expected reductions in two other individual concentrations.

- September 2008 Examination – Management continued inadequate risk diversification practices and failed to reduce concentrations of credit. The Board entered into informal agreements that emphasized reducing credit concentrations; however, the Board was not successful in reducing the risk posed by the concentrations. Specifically, Corn Belt's plan was to reduce the concentrations by selling participations in the loans or refinancing the loans with other banks, but the bank's declining capital levels and the quality of some of the concentrations hindered the bank's plans.

Additionally, from the 2005 through 2008 examinations, examiners expressed repeated concerns in the ROEs about Corn Belt's capital:

- December 2005 Examination – Examiners were concerned that Corn Belt's Total Risk-Based Capital ratio declined from 11 percent at December 31, 2004 to 10.1 percent at September 30, 2005. This decline was due to asset growth, primarily in loans. If the ratio fell below 10 percent, Corn Belt would be adversely impacted in its insurance assessment and its ability to obtain brokered deposits. Corn Belt's capital contingency plan was to increase its holding company line of credit, issue holding company stock to existing shareholders, issue additional trust-preferred securities through the holding company, and issue non-voting common stock to new shareholders. The holding company would inject funds from these sources into the bank. Management would also slow its growth if these funds could not be raised.

- December 2006 Examination – Significant asset growth in the last year and the replenishment of the ALLL at this examination were the primary reasons for the decline in the capital ratios. Growth was mainly in commercial and non-residential real estate loans, which are assigned the highest risk weightings for risk-based capital purposes. "Management constantly monitors the Total Risk-Based Capital position due to the thin margin with which the bank remains in the 'well-capitalized' category." Management's capital model for 2007 through 2009 projected 8 percent growth during 2007 and indicated that no holding company capital infusions would be necessary even though the holding company had $2 million available on its line of credit to inject into the bank. However, bank management expected asset growth would be 10 percent in 2007.

- November 2007 Examination – "Although there has not been any major change in the capital ratios, the increased severity in loan classifications, negligible forecasted earnings retention, and continued asset growth placed additional pressure on capital. Management appropriately monitors the capital ratios, in particular the Total Risk-Based Capital ratio. Management is very committed to maintaining the bank's 'well-capitalized' position because of the bank's continued reliance on brokered deposits for funding bank assets. The present earnings performance is not sufficient to augment capital. In order to prevent falling out of the 'well-capitalized' category, management has determined that a capital infusion will be necessary before year-end 2007. The holding company has proven to be a viable source of capital in the past." Corn Belt's options were to sell participations in its loans and not renew its participations in loans at another financial institution. Corn Belt agreed to develop a capital contingency plan.

- September 2008 Examination – The excessive level of adversely classified assets, the severity of the classifications, and the provision required for an adequate ALLL rendered capital "significantly undercapitalized" per PCA. Earnings were not expected to support capital for some time. To maintain adequate capital ratios, management began shrinking its assets. Because its capital ratios were below PCA requirements, Corn Belt was no longer able to use brokered deposits to fund its growth. Corn Belt paid maturing brokered deposits by reducing the amount of federal funds sold or obtaining time deposits from an Internet listing service. Also, the Illinois Banking Act prohibited dividend payments. The holding company was no longer a source of capital due to its outstanding debt.

These repeated examination concerns demonstrate that bank management did not take adequate action to address Corn Belt's problems.

ASSESSMENT OF FDIC SUPERVISION

The FDIC, in conjunction with the IDFPR, provided ongoing supervision of Corn Belt through regular risk management examinations, visitations, and offsite monitoring. Examiners were actively engaged in overseeing the institution in the years before its failure and identified the key risks that ultimately caused Corn Belt to fail. Such risks included rapid loan growth without adequate underwriting and credit administration, excessive credit concentrations, loans with high LTV ratios, weak loan grading and ALLL practices, and heavy reliance on non-core funding sources. Examiners brought these risks to the attention of Corn Belt's Board and management before the risks resulted in serious financial problems.

The FDIC and IDFPR also pursued both formal and informal corrective actions when other attempts to address risks identified by examiners were unsuccessful. While such corrective actions were positive, we concluded that the FDIC could have taken earlier and more assertive actions with respect to (1) requiring Corn Belt to hold additional capital commensurate with the risk in its loan portfolio and funding strategy and (2) pursuing formal enforcement action, rather than a second MOU, when bank management had not taken adequate action on prior informal actions.

Historical Snapshot of FDIC Supervision

As reflected in Table 4, on the following page, the FDIC, in coordination with the IDFPR, conducted nine on-site examinations or visitations from 2003 until the institution's failure. Through these supervisory efforts, FDIC and state examiners identified key risks in Corn Belt's business practices. Examiners presented these risks to Corn Belt's Board and management through discussions and recommendations in ROEs. The FDIC and IDFPR also pursued informal corrective actions to address examiner concerns, including BBRs and MOUs. Following the November 2007 examination, the FDIC became increasingly concerned about the financial condition of Corn Belt and decided to conduct an unscheduled examination in September 2008. During this examination, the examiners identified serious financial problems with the institution and issued a C&D on December 31, 2008.

Table 4: On-Site Supervisory Efforts

Date	On-Site Supervisory Effort	Supervisory Composite Rating	Action As a Result of Examination	Date Action Terminated
07/14/03	FDIC Examination	3	BBR 12/19/03	11/1/04
03/22/04	Joint Visitation	No Rating	Not Applicable	
08/02/04	Joint Examination	2	None	
12/12/05	FDIC Examination	2	BBR 3/24/06	4/2/07
04/24/06	Joint Visitation	No Rating	Not Applicable	
12/11/06	Joint Examination	3	MOU 4/2/07	3/25/08
07/11/07	Joint Visitation	No Rating	Not Applicable	
11/26/07	Joint Examination	3	MOU 3/20/08	2/13/09
9/29/08	Joint Examination	5	C&D 12/31/08	2/13/09

Source: FDIC and IDFPR ROEs and Actions.

In addition to on-site examination work, the FDIC performed various off-site supervisory activities to monitor the condition of Corn Belt and its progress in addressing previously identified risks and weaknesses. For example, FDIC examiners contacted Corn Belt in 2003 and 2005 as part of the FDIC's Calling Program, which is part of the off-site supervisory program. In the Calling Program, the FDIC and Corn Belt's management discussed the general condition of the bank as to capital, asset quality, management, earnings, liquidity, and sensitivity to market risk. Further, the FDIC's case managers for Corn Belt reviewed quarterly progress reports submitted by the institution pursuant to BBRs and MOUs.

OIG Assessment of FDIC Supervision

Although the FDIC and IDFPR pursued both formal and informal corrective actions when other attempts to address risks identified by examiners were unsuccessful, we concluded that more proactive supervisory action may have influenced Corn Belt's Board and management to constrain its excessive risk taking and to take more timely and effective action in response to examiner concerns. Specifically, the FDIC could have required Corn Belt to hold a greater amount of capital or to submit a capital contingency plan sooner than had been required given the institution's high-risk profile. In addition, the FDIC could have pursued a formal enforcement action following the 2007 examination (rather than a second MOU), as a result of the institution's failure to adequately address provisions in two prior informal corrective actions – the BBR in 2006 and the MOU in 2007. By the time the FDIC issued a formal enforcement action on December 31, 2008, Corn Belt's failure was highly probable.

Capital Adequacy. In each of the examinations conducted from July 2003 until November 2007, Corn Belt was considered "well capitalized" for PCA purposes. However, examiners expressed concern during this period that Corn Belt's capital position was only marginally adequate because of its high-risk profile. In addition, Corn Belt's heavy dependence on brokered deposits meant that maintaining a "well capitalized" designation for PCA purposes was critically important for avoiding a potential liquidity crisis. As reflected in Table 5 which follows, Corn Belt maintained a

Total Risk-based Capital ratio that was just above the 10-percent-minimum level for the "well capitalized" category for 2006 and 2007.

Table 5: Corn Belt's Total Risk-Based Capital

Examination Date	2003	2004	2005	2006	2007	2008
Total Risk-Based Capital	10.72%	12.54%	11.05%*	10.18%	10.01%	4.51%

Source: FDIC and IDFPR ROEs.
* Examination comments state that Total Risk-Based Capital is 10.1%, and the *Examination Ratios* section states 11.05%.

According to DSC's *Risk Management Manual of Examination Policies*, institutions are expected to maintain capital commensurate with the nature and extent of risks to the institution and management's ability to identify, measure, monitor, and control risks. In this regard, the adequacy of capital for safety and soundness purposes may differ from minimum leverage and risk-based standards, PCA regulations, and certain other capital-based rules. The manual also states that the minimums set forth in the leverage and risk-based capital standards apply to sound, well-run institutions and that most institutions do, and are generally expected to maintain capital levels above the minimums, based on the institution's particular risk profile. In all cases, institutions should maintain capital commensurate with the level and nature of risks to which they are exposed, including the volume and severity of adversely classified assets.

To its credit, the FDIC entered into an MOU with Corn Belt in March 2008 requiring, among other things, that the institution (1) maintain a Total Risk-based Capital ratio of at least 10 percent and (2) develop a written Capital Contingency Plan. Provisions in the March 24, 2006 BBR and the April 2, 2007 MOU did not require Corn Belt to develop a Capital Contingency Plan or maintain designated capital ratios. It was prudent for the FDIC to have taken supervisory action with respect to capital when the institution was still "well capitalized." However, requiring Corn Belt to hold additional capital during and after its rapid growth period from 2003-2005 could have provided the institution an additional cushion for absorbing losses and could have influenced the institution to reduce its excessive risk taking before serious financial problems developed. In addition, requiring Corn Belt to submit a capital contingency plan sooner than March 2008 would have elevated supervisory attention in this area and could have provided Corn Belt an additional incentive to take more effective and timely actions to address examiner concerns.

Informal and Formal Enforcement Actions. Informal actions to address the bank's overall risk and internal control deficiencies were not effective, and formal enforcement actions were needed earlier. After the 2006 examination, the FDIC entered into an MOU with Corn Belt on April 2, 2007 to address a number of weaknesses that had been identified and reported by examiners in prior ROEs and BBRs. During the November 2007 examination, the examiners noted that although Corn Belt had taken some action to address the provisions of the April 2007 MOU, the actions were not adequate. The FDIC entered into a second MOU with Corn Belt on March 20, 2008.

The provisions of the second MOU were substantially the same as the prior MOU, except that the latter MOU added a capital-related provision. (See Appendix 4 for our comparison of the provisions of these MOUs and a subsequent C&D.) During the September 2008 examination, the examiners found that Corn Belt's actions to address the March 2008 MOU were also inadequate, and the FDIC subsequently issued a C&D on December 31, 2008.

Section 8(b) of the FDIC Act authorizes the FDIC to issue C&Ds when the facts reasonably support the conclusion that an insured depository institution has engaged, or is about to engage in, an unsafe or unsound practice in conducting the business of the institution or a violation of a law, rule, regulation, or written agreement with the FDIC. As described in Table 6, below, at least three examinations showed that Corn Belt engaged in practices that supported the issuance of a C&D.

Table 6: Institution Practices Supporting Issuance of a C&D

Practices that Would Support the Issuance of a C&D Per Section 8(b) of the FDI Act	Examination that Noted Corn Belt Exhibited the Practice		
	2006	2007	2008
Failure to provide adequate supervision and direction over the officers of the bank to prevent unsafe and unsound practices, and violation(s) of laws, rules, and regulations.	✓	✓	✓
Failure to make provision for an adequate allowance for loan losses.	✓	✓	✓
Operating with an inadequate level of capital for the kind and quality of assets held.		✓	✓
Engaging in hazardous lending and lax collection practices.	✓	✓	✓
Operating without adequate liquidity, in light of the bank's asset and liability mix.		✓	✓
Excessive volume of loans subject to adverse classification, overdue loans, and non-earning assets.		✓	✓

Source: ROEs for Corn Belt.

According to the *Risk Management Manual of Examination Policies*, Section. 15.1, *Formal Administrative Actions*, the FDIC may take either a formal or informal action regarding banks with composite ratings of 3, 4, or 5 unless specific circumstances argue strongly to the contrary. Banks with composite ratings of 4 or 5 will have problems of sufficient severity to warrant formal action, which usually is a C&D. Corn Belt's composite rating was a 3 at the 2006 and 2007 examinations and a 5 at the 2008 examination.

Corn Belt's management had a history of failing to adequately address the provisions of its BBRs and MOUs. In light of the institution's failure to adequately address risks in the prior BBRs and MOU, the FDIC could have pursued a formal enforcement action, such as a C&D, following the November 2007 examination in lieu of the use of a second MOU in March 2008. A formal enforcement action at that time may have helped to prevent the bank's failure or to mitigate the level of losses incurred.

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 Rules and Regulations implements PCA requirements by establishing a framework for taking prompt corrective action against insured nonmember banks that are not adequately capitalized. Based on the supervisory actions taken, the FDIC properly implemented applicable PCA provisions of section 38. However, PCA was not effective in limiting losses to the DIF because it did not result in action until after the institution was at serious risk of failure.

In the case of Corn Belt, capital was a lagging indicator of the institution's financial health. As discussed earlier in this report, examiners noted during their examinations that the ALLL was often underfunded, which resulted in an overstatement of the bank's capital position. The effectiveness of PCA depends upon the accuracy of financial information submitted by institutions in Reports of Condition and Income (Call Report). Further, by the time Corn Belt's capital level fell below the required threshold necessary to implement PCA, the institution's condition had deteriorated to the point at which it could not raise needed capital to maintain the "well capitalized" category of PCA.

Summary of Actions Taken Related to PCA

With respect to PCA, we concluded that the FDIC implemented the notification provisions of PCA consistent with section 38 of the FDI Act. However, PCA was not effective in limiting losses to the DIF because it did not require action until after the institution was at serious risk of failure given the significant asset deterioration that had occurred and its impact on earnings, capital, and liquidity.

On October 31, 2008, the FDIC notified Corn Belt that its capital category for purposes of PCA had fallen to "significantly undercapitalized." The FDIC's notification included a reminder of the requirements that Corn Belt had become subject to based on its PCA capital category. Such requirements included, among other things, a prohibition on the acceptance, renewal, or rolling over of any brokered deposits. The October 2008 notification required Corn Belt to submit a written capital restoration plan and a summary of the steps taken by the institution's management to comply with the mandatory restrictions of section 38 to the FDIC by December 14, 2008.

On January 15, 2009, the FDIC notified Corn Belt's management that a capital restoration plan submitted on December 19, 2008 in response to the PCA notification was vague because it did not provide specific details on the institution's plans to increase its Tier 1 Capital. Accordingly, the FDIC requested that Corn Belt submit a new capital restoration plan. The new plan, which was submitted on February 9, 2009, was reviewed by the FDIC and determined it to be unacceptable because it was based on unrealistic assumptions. On February 10, 2009, the FDIC notified Corn Belt that its proposed capital restoration plan was not approved. The FDIC's notification also included a statement that, as indicated in prior correspondence to the institution on October 31, 2008, and January 15, 2009, Corn Belt had failed to provide a summary of the specific steps taken to comply with the mandatory restrictions of section 38 as well as a written acknowledgment that the Board had considered the FDIC's correspondence. Corn Belt was closed on February 13, 2009 because it did not have sufficient capital to operate its business.

CORPORATION COMMENTS

On September 1, 2009 the Director, Division of Supervision and Consumer Protection (DSC), provided a written response to the draft report. DSC's response is provided in its entirety as Appendix 3 of this report.

DSC summarized the OIG's findings that Corn Belt failed primarily due to bank management's aggressive pursuit of rapid asset growth while failing to implement sound risk management practices, followed by a deterioration in asset quality during the economic downturn that led to loan losses depleting capital and earnings and impairing liquidity. Further, DSC reiterated the OIG's observations that examiners provided ongoing supervision and identified key risks and brought those risks to the attention of management. DSC stated that the regulators pursued various and increasingly more stringent actions to address Corn Belt's increasing risk profile but noted the OIG conclusions that these actions did not lead to management's correction of the deficiencies and that additional capital restrictions may have been effective.

In its response, DSC acknowledged that higher capital requirements can be an effective supervisory tool and that it has provided further guidance to enhance the supervision of institutions with high levels of volatile non-core funding.

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, on or after July 1, 1993, 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 the audit from March 2009 through August 2009 in accordance with generally accepted government auditing standards. However, due to the limited scope and objectives established for material loss reviews, which are generally applied to just one financial institution, it may not have been feasible to address certain aspects of the standards, as described on the next page.

Scope and Methodology

The scope of this audit included an analysis of Corn Belt's operations from June 30, 2000 until its failure on February 13, 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 examination and visitation reports prepared by FDIC and IDPFR examiners from 2000 to 2008.

- Reviewed the following:

  - Bank data and correspondence maintained at DSC's Chicago Regional Office and Springfield Field Office.

  - Reports prepared by the Division of Resolutions and Receiverships (DRR) and DSC relating to the bank's closure.

  - Records provided by Corn Belt's external auditor.

  - Bank records, maintained by DRR's Dallas Regional Office, for information that would provide insight into the bank's failure, various annual reports, and accompanying financial statements.

    - Pertinent DSC policies and procedures.

- Interviewed the following FDIC officials:

    - DSC management in Washington, D.C.; the Chicago Regional Office, Chicago, Illinois; and the Springfield Field Office, Springfield, Illinois.

    - DRR official at the Dallas Regional Office.

    - FDIC examiners from the Springfield Field Office, Springfield, Illinois, who participated in examinations of Corn Belt.

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

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

We performed the audit field work at the DSC Chicago Regional Office and Springfield Field Office in Illinois and at the DRR Dallas Regional Office, in Dallas, Texas.

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

Due to the limited nature of the audit objectives, we did not assess DSC's overall internal control or management control structure. We performed a limited review of Corn Belt's management controls pertaining to its operations as discussed earlier in this report. For purposes of the audit, we did not rely on computer-processed data to support our significant findings and conclusions. Our review centered on interviews, ROEs and correspondence, and other evidence to support our audit.

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

Regarding compliance with laws and regulations, we analyzed documentation to determine whether the FDIC had complied with provisions of PCA and performed limited tests to determine compliance with certain aspects of the FDI Act. The results of our 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.

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.
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.
Component and Composite Ratings	Financial institution regulators and examiners use the Uniform Financial Institutions Rating System to evaluate a bank's performance in six components represented by the CAMELS acronym: **C**apital adequacy, **A**sset quality, **M**anagement practices, **E**arnings performance, **L**iquidity position, and **S**ensitivity to market risk. Each component, and an overall composite score, is assigned a rating of 1 through 5, with 1 having the least regulatory concern and 5 having the greatest concern.
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.
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 1831o, 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.
Special Mention	Assets subject to criticism and/or comment in an examination report. These assets have potential weaknesses that deserve bank management's close attention. If left uncorrected, the asset's potential weaknesses may result in the deterioration of the asset's repayment prospects or the bank's credit position at some future date. These assets do not expose the bank to sufficient risk to warrant an adverse classification.
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 Federal Financial Institutions Examination Council produces the report quarterly, from banks' Call Report data, for use by banking supervisors, bankers, and the general public.

CORPORATION COMMENTS

FDIC

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

Division of Supervision and Consumer Protection

September 1, 2009

TO: Russell A. Rau
Assistant Inspector General for Audits

FROM: Sandra L. Thompson
Director

SUBJECT: Draft Audit Report Entitled, Material Loss Review of Corn Belt Bank and Trust Company, Pittsfield, Illinois (Assignment No. 2009-027)

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 Corn Belt Bank and Trust Company (Corn Belt), which failed on February 13, 2009. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Audit Report (Report) received on August 17, 2009.

The OIG found that Corn Belt failed primarily due to management's aggressive pursuit of rapid asset growth while failing to implement sound risk management practices. Deterioration in asset quality during the economic downturn led to loan losses depleting capital and earnings and impairing liquidity.

The Report concludes that the FDIC, in conjunction with the Illinois Department of Financial and Professional Regulation (IDFPR), provided ongoing supervision of Corn Belt through regular risk management examinations, visitations, and offsite monitoring. Further, examiners identified key risks and brought those risks to the attention of management. As early as 2003, the FDIC and IDFPR used various and increasingly more stringent enforcement actions to address Corn Belt's increasing risk profile These actions ultimately resulted in a Cease and Desist Order in 2008 and appropriate restrictions under the Prompt Corrective Action provisions of Section 38. The OIG notes that these actions did not lead to management's correction of the deficiencies and additional capital restrictions may have been effective. DSC acknowledges that higher capital requirements can be an effective supervisory tool and has provided further guidance to enhance the supervision of institutions with high levels of volatile non-core funding.

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

COMPARISON OF MOUs AND C&D ORDER

MOU APRIL 2007	MOU MARCH 2008	C&D DECEMBER 2008
Formulate, adopt, and submit a written plan of action to lessen risk position in each “Substandard” asset that aggregated $100,000 or more.	Formulate, adopt, and submit a written plan of action to lessen the risk position in each “Substandard” asset that aggregated $100,000 or more.	Cease and desist from operating with an excessive level of adversely classified assets, delinquent loans, and nonaccrual loans.
Formulate a plan to reduce risk in loan concentrations of credit.	Reduce the risk in each loan concentration of credit listed in the ROE to less than 25% of the bank’s Tier 1 Capital and adopt procedures to prevent future concentrations.	Cease and desist from engaging in hazardous lending and lax collection practices, including poor selection of credit risk, inadequate diversification or risk, inappropriate lending controls and infrastructure, and ineffective loan grading systems.
Correct deficiencies in loans listed for Special Mention in ROE.	Correct deficiencies in loans listed for Special Mention in the ROE.	Not Applicable
Correct the violations noted in the ROE and adopt procedures that assure compliance with laws and regulations.	Correct the violations in the ROE and adopt procedures that assure compliance with laws and regulations.	Not Applicable
Make provision for loan losses to replenish the ALLL for loans charged off in the2006 ROE and future losses of other loans. Document basis of an appropriate ALLL in the Board minutes.	Make provision for loan losses to replenish the ALLL for loans charged off in the 2007 ROE and future losses of other loans. Document the basis of an appropriate ALLL in the Board minutes.	Not Applicable
Review adequacy of the ALLL, provide an adequate allowance, and report such allowance in Call Reports. Note actions taken in the Board minutes.	Review adequacy of the ALLL, provide an adequate allowance, and report such allowance in Call Reports. Note actions taken in the Board minutes.	Review adequacy of the ALLL, provide for an adequate ALLL, and accurately report same. Note action taken in the Board minutes.
Adopt a plan to improve liquidity and reduce dependency upon volatile liabilities to fund loans and long-term assets.	Formulate and adopt a plan for improving liquidity and reducing dependency upon volatile liabilities to fund loans and long-term assets.	Cease and desist from operating with inadequate liquidity in light of the bank’s asset and liability mix. Submit liquidity analysis report and list of uninsured deposits at the end of each week.
Shall not increase total assets by more than 5% during any consecutive 3-month period without an advance 30-day written notice to the FDIC and IDFPR.	Shall not increase total assets by more than 2% during any consecutive 3-month period without an advance notice to FDIC and IDFPR.	Shall not increase total assets from balance at C&D date without prior written approval of the FDIC and IDFPR.
Conduct written review of staffing requirements and commence hiring or training staff in loan administration and collection and regulatory and policy compliance.	Conduct written review of staffing requirements and commence hiring or training staff in loan administration and collection and hire a chief financial officer.	Have and retain qualified management, such as a new chief executive officer, senior lending officer, and chief financial officer, and adequately staff the collections department.

MOU APRIL 2007	MOU MARCH 2008	C&D DECEMBER 2008
Not Applicable	Shall not extend credit to any borrower who is already obligated in any manner to the bank on any extensions of credit that were charged off or classified.	Shall not extend any additional credit to any borrower who is already obligated in any manner to the bank on any extensions of credit, especially any borrower whose loan or other credit has been classified “Loss,” “Substandard,” or “Doubtful” or is listed for Special Mention.
Not Applicable	Maintain Tier 1 Capital at a level equal to or exceeding 7.5% and Total Risk-based Capital of at least 10% per Part 325 of the FDIC Rules and Regulations.	Have and maintain Tier 1 Capital as a percentage of its total assets at a minimum of 8% per Part 325 of the FDIC Rules and Regulations.
Not Applicable	Formulate written Capital Contingency Plan that includes capital sources. Submit the plan to the FDIC and IDFPR.	Adopt a written Contingency Funding Plan acceptable to the FDIC and IDFPR.
Not Applicable	Eliminate from its books all assets classified as “Loss” in the 2007 ROE.	Not Applicable
Not Applicable	Comply with the FDIC regulation and obtain approval from the FDIC before adding any individual to the Board or employing any individual as a senior officer.	Notify the FDIC and IDFPR of any changes in any of bank’s directors or senior executive officers and obtain these agencies’ approval for addition of officers or Board members.
Not Applicable	Review compliance with Board policy ratios, note noncompliance in the Board minutes, and develop a plan to bring the bank into compliance.	Not Applicable
Not Applicable	Implement a profit plan.	Not Applicable
Not Applicable	Not Applicable	Increase participation of the Board in the bank’s activities.
Provide progress reports each quarter, as to these provisions, to the FDIC and IDFPR.	Provide progress reports each quarter, as to these provisions, to the FDIC and IDFPR.	Provide progress reports each quarter, as to these provisions, to the FDIC and IDFPR.

ACRONYMS USED IN THE REPORT

Acronym	Definition
ALLL	Allowance for Loan and Lease Losses
BBR	Bank Board Resolution
C&D	Cease-and-Desist Order
C&I	Commercial and Industrial
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
GAAP	Generally Accepted Accounting Principles
IDFPR	Illinois Department of Financial and Professional Regulation
LTV	Loan-to-Value
MOU	Memorandum of Understanding
OIG	Office of Inspector General
PCA	Prompt Corrective Action
ROE	Report of Examination
UBPR	Uniform Bank Performance Report