2009 Mid-Atlantic Anti-Money Laundering Conference

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Bank's Life Cycle

- Application Process
- Supervision
- Enforcement Actions
- Failure

Bank's Life Cycle
Application Process

- Traditional De Novo
  - ✓Background check on senior management and board members
  - ✓Development of AML Program
  - ✓Business Plan

Bank's Life Cycle
Application Process (continued)

- P&A or Merger with Problem
  - ✓ USA Patriot Act § 327 amended §18(a) FDI Act:
    - "shall take into consideration the effectiveness of any insured depository institution involved in the proposed merger transaction in combating money laundering activities, including in overseas branches"
  - ✓ Leverage/adoption of existing AML Program
  - ✓ Background check on senior management, board members
  - ✓ Due diligence on PE or institutional investor groups

Bank's Life Cycle
De Novo Supervision

- **Growth & Performance According to Business Plan**
- **Inability to Reach Objectives**
- **Deliberate Deviations**

Bank's Life Cycle
De Novo Supervision

- Resultant Institution from P&A or Merger
  - ✓Personnel
  - ✓Information Technology
  - ✓Update Policies and Procedures

Ongoing Supervision – Independent Testing Program

- Governance and oversight of the AML program
- Written AML policies and procedures
- AML risk assessment methodology
- "Know Your Customer" policy
- Employee training and education
- Suspicious activity identification, escalation and reporting
- Transaction monitoring technology
- Recordkeeping and retention

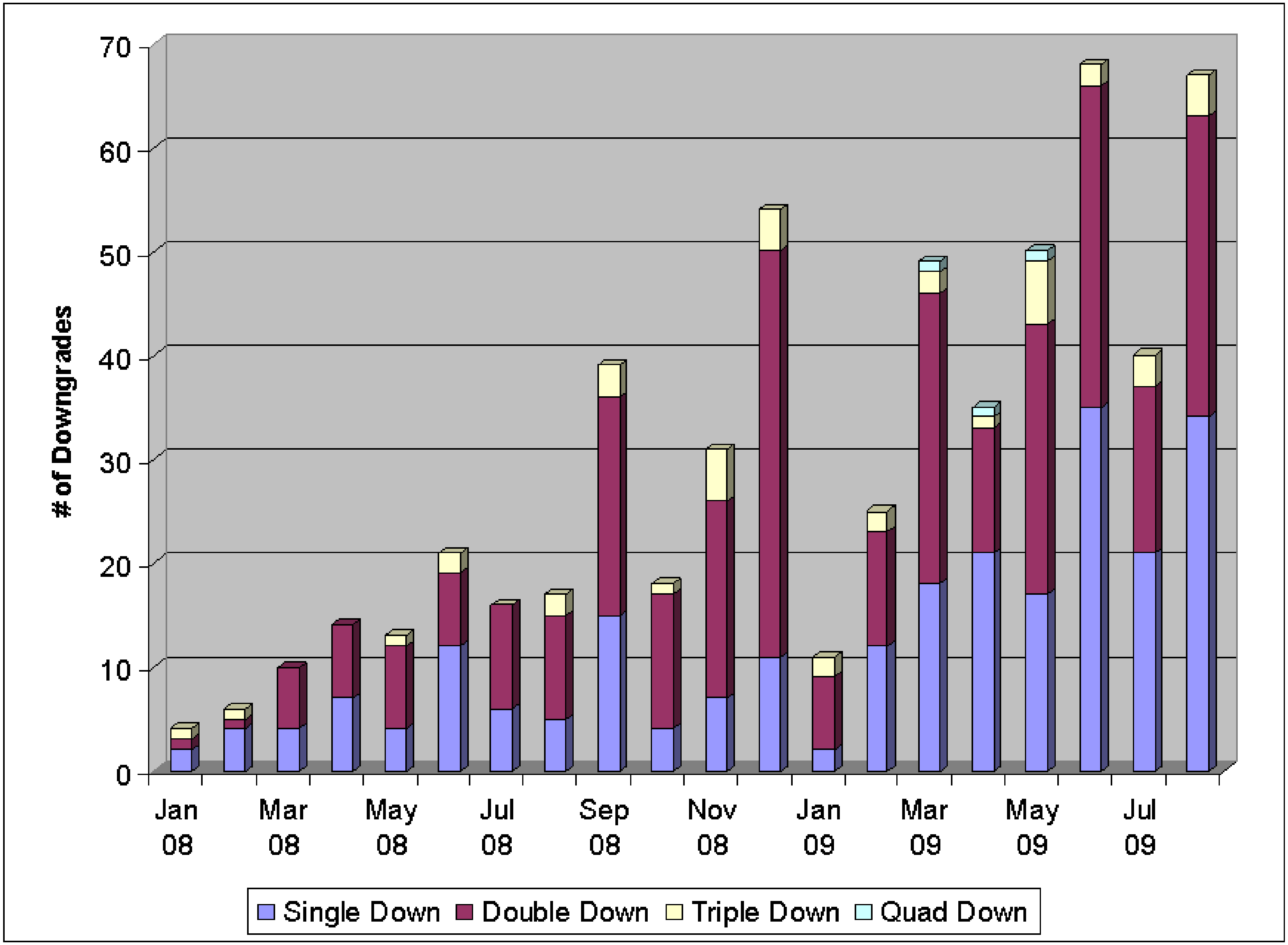
Common Weaknesses – BSA/AML Independent Testing

- **Lack of independence from BSA/AML program duties**
- **Lack of independence from management influence**
- **No direct reporting to Board of Directors or Outside Committee**
- **Scope of audit and testing is inconsistent with the risk assessment**
- **Scope of audit is too narrow**
- **Transaction testing isn't adequate or evident**
- **Lack of enterprise-wise coverage**
- **Inadequate follow-up on outstanding issues**
- **Lack of necessary skill to perform audit**

Bank's Life Cycle - Enforcement Actions

- Informal Actions
  - ✓ BBR
  - ✓ MOU
- Formal Actions
  - ✓ C&D
  - ✓ CMP
- FDI §8(w)
  - ✓ Termination of deposit insurance for money laundering or cash transaction reporting offenses

Downgrades to Problem Status – January 2008 through August 2009



Bank's Life Cycle
Failure (continued)

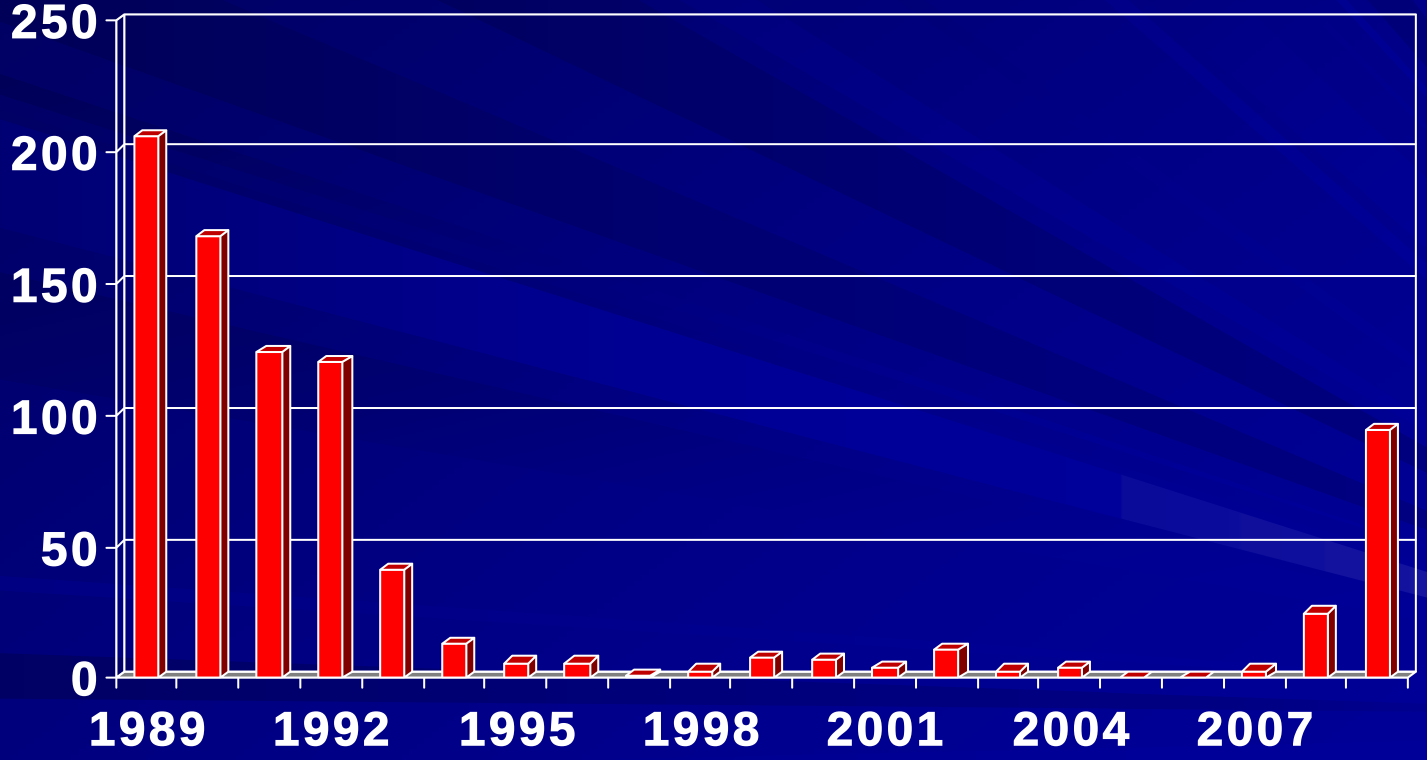
- <u>Aggressive growth strategy</u>
- <u>Excessive concentrations</u>
- <u>Management control weaknesses</u>
- Inadequate underwriting and credit administration practices
- Heavy reliance on non-core funding
- ALLL methodology weaknesses and slow funding
- Compensation arrangements - tied to volume, not performance
- Capital and Liquidity levels not sufficient

Bank's Life Cycle
Failure (continued)

- Material Loss Reviews have found risk management examinations to be timely.

- Bank Supervision practices noted:
  - ✓ Risks generally identified by examiners
  - ✓ Risks not mitigated by management's actions
  - ✓ Stronger enforcement actions suggested
  - ✓ Earlier actions based upon practices suggested

Number of Bank Failures
1989-2009



VELOCITY STATE BANK

	June 2008	Dec 2007	Dec 2006	Dec 2005	Dec 2004
TA($000s)	$2,000,000	1,500,000	1,000,000	800,000	700,000
UFIRS Rating: (as of date): Enforcement Action:	454553/5 June '08 8(b)- Proposed	222122/2 May '07	222122/2 May '06	222212/2 May '05 BBR	222322/2 May '04
ROA	(9.47%)	2.01%	2.43%	2.20%	1.62%
Tier 1 Capital %	6.56%	10.95%	9.94%	10.22%	8.98%
TRB Capital %	8.86%	11.33%	10.67%	11.87%	10.53%
ADC/Total Capital %	690.00%	525.00%	500.00%	250.00%	236.00%
CRE/Total Capital %	880.00%	678.00%	692.00%	601.00%	669.00%
Adv. Class. Items %	178.00%	21.00%	18.00%	19.00%	30.00%
Net Non-Core %	50.00%	49.00%	25.00%	11.00%	9.00%

Beginning State Bank

	Sept 2008	Dec 2007	Dec 2006	Dec 2005
TA($000s)	$270,000	$290,000	$210,000	$90,000
UFIRS Rating: (as of date): Enforcement Action:	554543/5 March ‘08 8(b)	233322/3 March ‘07 MOU	223322/2 May ‘06	NA
Net Income	($18,000)	($5,880)	($1,000)	($990)
Tier 1 Capital %	2.00%	7.50%	15.50%	36.00%
TRB Capital %	3.50%	9.60%	18.50%	37.00%
CRE/Total Capital	1,723.00%	677.00%	344.00%	270.00%
ADC/Total Capital	787.00%	330.00%	140.00%	65.00%
Adv. Class. Items %	201.00%	36.00%	3.00%	NA
Net Non-Core %	23.00%	20.00%	28.00%	(3.00%)