2009 Mid-Atlantic Anti-Money Laundering Conference

September 22, 2009

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Federal Deposit Insurance Corporation

Division of Supervision & Consumer Protection
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

The chart represents the number of downgrades from January 2008 to August 2009. Each bar indicates the number of downgrades per month, categorized by the type of downgrades:

- Single Down
- Double Down
- Triple Down
- Quad Down

The months are represented from left to right, with the corresponding number of downgrades shown in each bar. The data shows a significant increase in downgrades from July 2008 to June 2009, particularly in the categories of Double Down and Quad Down.
Bank’s Life Cycle
Failure (continued)

- **Aggressive growth strategy**
- **Excessive concentrations**
- **Management control weaknesses**
- 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
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
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<tbody>
<tr>
<td>TA($000s)</td>
<td>$2,000,000</td>
<td>1,500,000</td>
<td>1,000,000</td>
<td>800,000</td>
<td>700,000</td>
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<td>UFIRS Rating:</td>
<td>454553/5</td>
<td>222122/2</td>
<td>222122/2</td>
<td>222212/2</td>
<td>222322/2</td>
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<td>(as of date): Enforcement Action:</td>
<td>June ‘08 May ‘07</td>
<td>May ‘06 May ‘05 BBR</td>
<td>May ‘04</td>
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<tr>
<td>ROA</td>
<td>(9.47%)</td>
<td>2.01%</td>
<td>2.43%</td>
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<td>Tier 1 Capital %</td>
<td>6.56%</td>
<td>10.95%</td>
<td>9.94%</td>
<td>10.22%</td>
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<tr>
<td>TRB Capital %</td>
<td>8.86%</td>
<td>11.33%</td>
<td>10.67%</td>
<td>11.87%</td>
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<td>ADC/Total Capital %</td>
<td>690.00%</td>
<td>525.00%</td>
<td>500.00%</td>
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<tr>
<td>CRE/Total Capital %</td>
<td>880.00%</td>
<td>678.00%</td>
<td>692.00%</td>
<td>601.00%</td>
<td>669.00%</td>
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<td>Adv. Class. Items %</td>
<td>178.00%</td>
<td>21.00%</td>
<td>18.00%</td>
<td>19.00%</td>
<td>30.00%</td>
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<td>Net Non-Core %</td>
<td>50.00%</td>
<td>49.00%</td>
<td>25.00%</td>
<td>11.00%</td>
<td>9.00%</td>
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## Beginning State Bank

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