Audit Report

OIG-15-031

SAFETY AND SOUNDNESS: Material Loss Review of The National Republic Bank of Chicago

May 8, 2015

Office of Inspector General

Department of the Treasury

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Audit Report

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Abbreviations

ALLL	allowance for loan and lease losses
C&D	cease and desist
CRE	commercial real estate
CRP	capital restoration plan
DIF	Deposit Insurance Fund
FDIC	Federal Deposit Insurance Corporation
IMCR	individual minimum capital ratio
MRA	matter requiring attention
NRB	The National Republic Bank of Chicago
OCC	Office of the Comptroller of the Currency
OIG	Office of Inspector General
PCA	prompt corrective action
ROE	report of examination
Treasury	Department of the Treasury

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May 8, 2015

Thomas J. Curry
Comptroller of the Currency

This report represents the results of our material loss review of the failure of The National Republic Bank of Chicago (NRB), Chicago, Illinois and the Office of the Comptroller of the Currency's (OCC) supervision of the bank. OCC closed NRB and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on October 24, 2014. Section 38(k) of the Federal Deposit Insurance Act mandated this review because of the magnitude of the bank's estimated loss to the Deposit Insurance Fund (DIF).[1,2] As of March 31, 2015, FDIC estimated that loss at $111.6 million.

The objectives of our review were to determine the causes of the bank's failure; assess OCC's supervision of the bank including implementation of the prompt corrective action (PCA) provisions of section 38; and make recommendations for preventing any such loss in the future. To accomplish these objectives, we reviewed the supervisory files and interviewed OCC and FDIC officials involved in the regulatory enforcement matters. Appendix 1 contains a more detailed description of our objectives, scope, and methodology. Appendix 2 contains background information on NRB's history and OCC's assessment fees and examinations hours.

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[1] Section 38(k) defines a loss as material if it exceeds $50 million for calendar years 2014 and thereafter (with a provision that the threshold can be raised temporarily to $75 million if certain conditions are met).

[2] Certain terms that are underlined when first used in this report, are defined in *Safety and Soundness: Material Loss Review Glossary*, OIG-11-065 (April 11, 2011). That document is available on the Department of the Treasury (Treasury) Office of Inspector General's (OIG) website at http://www.treasury.gov/about/organizational-structure/ig/Pages/by-date-2011.aspx.

In brief, NRB failed primarily because of undue influence by the chairman of the board over the bank's operations and critical decisions, as well as deficient senior management oversight and governance. These underlying causes further led to the bank having improper credit administration processes; aggressive growth resulting in a high concentration in commercial real estate (CRE) loans without commensurate credit risk management practices and adequate capital, particularly in the hotel/motel industry and to gas station/convenience stores throughout the United States; overreliance on brokered deposits; and irregular banking transactions.

Regarding supervision, we found that although OCC's supervision did not prevent a material loss to the DIF, it was appropriate. OCC addressed the concentration in CREs; and credit administration and risk management issues in a timely manner. OCC also timely identified irregular banking transactions being used to maintain the appearance that the bank was in a better financial position than it actually was. OCC was also timely in the issuance of appropriate enforcement actions. In addition, as the bank's capital levels deteriorated, OCC appropriately imposed PCA restrictions on the bank, which resulted in the resignation of NRB's chairman and president.

Certain matters involving NRB are currently being reviewed by Treasury OIG's Office of Investigation.

We are not making any recommendations to OCC as a result of our material loss review of NRB. We provided a draft of this report to OCC for its review. In a written response, which is included as appendix 3, OCC stated that it agreed with our findings.

Causes of NRB's Failure

Chairman of the Board Unduly Influenced Bank Operations and Senior Management Oversight and Governance Was Deficient

NRB primarily failed because of undue influence by the chairman of the board over the bank's operations and critical decisions, as well as deficient senior management oversight and governance. These

underlying causes further led to the bank having improper credit administration processes; aggressive growth and concentration in CRE loans without commensurate credit risk management and adequate capital; overreliance on brokered deposits; and irregular banking transactions. The management and board's failure to adjust quickly or effectively to the changing economic conditions and the declining real estate market resulted in further deterioration of the bank's asset quality, leading to significant increases in its problem assets and loan losses. In turn, these loan losses significantly diminished earnings and capital, and ultimately, led to NRB's failure.

According to OCC examiners, the bank operated under a flat management structure, in which the chairman of the board dominated critical decisions within the bank without regard to legal or regulatory requirements. Outside board members allowed this behavior to occur leading to lax internal control, uncontrolled lending activities, and inaccurate books and records. OCC also noted that the board did not review sufficient information prior to approving loans and failed to hold management accountable for analyzing and monitoring loans in the bank's portfolio.

The chairman had a dominant influence on strategic decisions pertaining to the loan portfolio, and negotiated all loan terms, provided approvals prior to any underwriting analysis, and changed loan terms post approval. The president, under the direction of the chairman, was given an excessive level of authority with insufficient staffing to address supervisory concerns and monitor the high risk loan portfolio. The president did not delegate loan responsibilities and caused significant mismanagement of the loan department. The president also authorized loan modifications, including advances of new funds to borrowers, without sufficient documentation or analysis. In addition, the president's practice to advance funds on existing loans for payments on underperforming related debt without sufficient analysis was an unsafe and unsound, and irregular, practice.

According to OCC examiners, as the bank added new staff, the chairman and president would terminate employees that did not comply with their rules, which resulted in a high level of employee turnover. The chairman and president instructed NRB staff to

comply with OCC examiners' recommendations while examiners were on-site; and then would instruct them to revert back to the prior practices once OCC examiners concluded their on-site examinations.

The chairman and president resigned on July 2, 2014, as a result of the issuance of an OCC PCA Directive that directed the board to dismiss both executives. An OCC official told us that the chairman and president were an impediment to resolving the bank's problems. She also noted that the chairman continued to indirectly assert authority over the board after his resignation.

As discussed above, the undue influence by the chairman of the board and the deficient senior management oversight and governance, led to the following conditions.

Improper Credit Administration Processes

OCC's Loan Portfolio Management booklet of the Comptroller's Handbook states that the principal approach to control loan quality is a solid loan approval process. When individual credits are underwritten with sound credit principles, the credit quality of the portfolio is much more likely to be sound; in contrast, when an unsound loan is granted, its quality is not likely to improve. In addition, OCC's Real Estate and Construction Lending Handbook states that when evaluating the adequacy of real estate lending policies and practices, examiners should consider the expertise and size of the lending and loan administration staff.

NRB did not have proper credit administration processes with sound credit principles in place, partly due to insufficient staffing relative to the size of the bank. OCC officials and examiners told us that NRB was a $1.3 billion bank, but had the staffing of a $300 million bank. They also told us that bank management acted with disregard for banking regulations and guidance by having insufficient staff, and did not have many people involved in credit risk management. As discussed above, the credit administration functions were primarily performed by the chairman of the board and the president, with whom staff had limited interaction. However, according to OCC officials and documentation, the bank's organizational structure was deficient and management

lacked the expertise necessary to properly approve loans. In addition, NRB management did not consistently perform loan underwriting and monitoring. Furthermore, the board did not review sufficient information prior to loan approvals and its processes allowed the chairman and president to make changes post approval. Management also granted unwarranted loan policy exceptions, especially to the bank's largest borrower, which resulted in a significant and negative impact on the bank's financial condition.

Aggressive Growth, High Concentration in CRE Loans, and Overreliance on Brokered Deposits

NRB's board and management developed a high-risk loan growth strategy that resulted in high concentration in CRE loans; particularly in the hotel/motel industry and to gas station/convenience stores throughout the United States. The growth stemmed from the liberal underwriting standards, as discussed above, used to originate many of the CRE loans as short-term construction loans with the intention of refinancing or selling them to a third party. Many of these loans went to borrowers who were unable to find other permanent financing in the then-current market.

The market for permanent financing shutdown in late 2008, resulting in rapid loan growth at the bank in 2009 because the borrowers were no longer able to utilize end (take-out) financing.[3] Concurrent with the market shutdown, third-party financers withdrew financing commitments they had made to purchase NRB's loans. Absent a market to sell its previously short-term construction loans, the bank decided to provide permanent financing.

According to the OCC Concentrations of Credit booklet, OCC defines concentration risk as risk in a loan portfolio that arises when a disproportionate number of an insured depository institution's loans are concentrated in one or a small number of financial sectors, geographical areas, or borrowers. In addition, the

[3] End, or take-out, financing is a type of long-term financing. Long-term, take-out loans replace interim financing, such as a short-term construction loan.

bank board and management are required to ensure that banks have an effective process in place to identify, measure, monitor, and control concentration risk.

NRB's board and management failed to implement and/or adhere to credit and concentration risk management, and strategic and capital planning practices commensurate with the bank's concentration in CRE loans. For the years ending 2011, 2012, and 2013, NRB's total CRE concentration represented 608 percent, 827 percent, and 729 percent, respectively, of total risk-based capital. Despite OCC examiners' repeated criticisms, risk associated with the bank's CRE concentration remained high, and the bank remained noncompliant with an OCC-issued formal agreement article concerning concentrations of credit.

The aggressive growth was primarily funded with brokered deposits, which led to a high concentration without commensurate risk management practices or adequate capital; and in turn, the deterioration of the bank's asset quality as repayments from larger borrowers slowed. OCC's Liquidity booklet states that the reliance on alternative sources of funding from the wholesale and brokered markets exposes banks to more rate and liquidity sensitivity than the reliance on traditional retail deposits.

OCC required, through a formal agreement issued on April 2, 2010, that the board adopt and implement a program to reduce the bank's reliance on brokered deposits to no more than 60 percent of the bank's total liabilities by December 31, 2010. In anticipation of the formal agreement, the board updated bank policies in February 2010 to measure brokered deposits in relation to total liabilities, setting a 60 percent limit. The volume of brokered deposits to total liabilities stayed below 60 percent from March 31, 2010. However, given the bank's troubled condition, funding the majority of balance sheet assets from volatile sources had placed the bank in a highly susceptible liquidity-risk position.

An OCC official stated that it is rare to see a bank as highly concentrated in the hotel/motel industry as NRB. NRB was considered a high-earning bank before the market for their loans shut down, but its lack of asset diversity caused a strain on the bank. The risk of the concentration was magnified by the fact that the loans were granted to unfit customers and were poorly

underwritten. OCC officials and examiners identified NRB's high concentration in CRE – which NRB funded primarily with brokered deposits – as a significant cause of the bank's failure.

Irregular Banking Transactions

The aggressive loan growth discussed above led NRB's management to use irregular banking transactions to maintain the appearance that the bank was in a better financial position than it actually was. Bank management obtained appraisals on loans that did not meet minimum appraisal standards, advanced additional loan funds, and granted modifications without obtaining updated appraisals or evaluations. In addition, bank management engaged in irregular loan practices, including (1) advancing new funds to borrowers without sufficient documentation for a loan modification; (2) applying loan proceeds from one borrower to service the loan of another related (and sometimes unrelated) borrower; (3) failing to obtain new loan agreements and borrowers' signatures for new loan advances; (4) permitting loan extensions and draws exceeding the original notes and recorded mortgages; and (5) upgrading loans to pass ratings after substitution of borrowers despite a negligible change in credit risk. These actions resulted in understated problem loan levels and allowance for loan and lease losses (ALLL), and consequently, materially inaccurate financial reports.

An OCC official explained that NRB artificially propped-up its poor lending decisions to make its investments look better. Examiners added that NRB was able to do this by prolonging loan repayments and using funds from other loans to mask delinquencies; both practices are outside of normal accepted banking practices. Another official stated that once OCC stopped NRB's ability to mask its issues, the loans stopped performing and the bank's losses, which were always looming, began to surface.

OCC's Supervision of NRB

OCC's supervision did not prevent a material loss to the DIF. However, based on our review, we concluded that OCC's supervision of NRB was appropriate. OCC addressed the concentration in CRE loans; and identified credit administration and risk management issues in a timely manner. OCC also timely

identified irregular banking transactions being used to maintain the appearance that the bank was in a better financial position than it actually was. As shown in the chart below, OCC was timely in the issuance of appropriate enforcement actions. In addition to several repeated matters requiring attention (MRAs), OCC issued a formal agreement, imposed two individual minimum capital ratio (IMCR) directives, and issued a cease and desist (C&D) order. In addition, as the bank's capital levels deteriorated, OCC imposed PCA restrictions on the bank, one of which resulted in the resignation of NRB's chairman and president.

Table 1 summarizes the results of OCC's full-scope safety and soundness and limited-scope examinations of NRB from 2009 until the bank's closure.[4]

Table 1: Summary of OCC's Examinations and Enforcement Actions for NRB

		Examination Results			
Date started/ Completed	**Assets (in (billions)**	**CAMELS rating**	**Number of MRAs**	**Number of corrective actions**	**Enforcement actions**
8/31/2009 1/28/2010 Full-scope examination	$1.2	3/333232	3	3	Formal agreement (4/2/2010) IMCR (3/17/2010)
7/12/2010 9/20/2010 Limited-scope examination	$1.3	3/333232	2	2	Formal agreement; IMCR remained in effect
9/27/2010 4/1/2011 Full-scope examination	$1.3	3/333232	5	6	Formal agreement; IMCR remained in effect
4/11/2011 11/25/2011 Limited-scope examination	$1.3	3/343232	6	5	Formal agreement remained in effect; and the IMCR increased

[4] OCC conducted its examinations and performed off-site monitoring of NRB in accordance with the timeframes prescribed in the OCC Comptroller's Handbook.

		Examination Results			
Date started/ Completed	Assets (in (billions)	CAMELS rating	Number of MRAs	Number of corrective actions	Enforcement actions
2/6/2012 10/2/2012 Full-scope examination	$1.3	3/343232	11	13	Formal agreement; IMCR remained in effect
10/9/2012 1/22/2013 Limited-scope Examination	$1.3	3/343232	13	9	Formal agreement; IMCR remained in effect
2/4/2013 4/29/2013 Full-scope examination	$1.2	5/555543	26	21	Formal agreement; IMCR remained in effect
8/5/2013 11/22/2013 Limited-scope examination	$1.1	5/555543	28	14	C&D order (8/31/2013) (Note: the C&D order replaced the formal agreement and IMCR).
2/24/2014 9/16/2014 Full-scope examination	$1.0	5/555544	11	36	PCA (7/2/21014)

Source: OCC supervisory files.

Supervision of NRB Was Appropriate

As discussed above, NRB failed primarily because of undue influence by the chairman of the board over the bank's operations and critical decisions, as well as deficient senior management oversight and governance. These underlying causes further led to the bank having improper credit administration processes; aggressive growth and concentration in CRE loans without commensurate credit risk management and adequate capital, and overreliance on brokered deposits; and irregular banking transactions. OCC timely identified these unsafe and unsound practices. The following is a summary of key actions taken by OCC relating to these areas.

- In the 2009 full-scope report of examination (ROE) issued January 28,2010, OCC examiners noted weaknesses in board oversight of credit concentrations funded by brokered deposits and unwarranted exceptions granted in construction lending to the bank's largest borrower. OCC issued MRAs relating to these problems. As a result of this examination, OCC issued an IMCR and formal agreement to address these concerns. The IMCR required the bank to maintain tier 1 capital of 9 percent of adjusted total assets; tier 1 capital of 10 percent of risk-weighted assets; and total risk-based capital of 12 percent of risk-weighted assets.

- In the 2011 limited-scope ROE, issued November 25, 2011, examiners noted that the board and management were not fully compliant with the formal agreement and had not addressed all MRAs from the September 2010 ROE. As a result of this examination, OCC imposed a higher IMCR to address weaknesses identified in concentrations of credit. The IMCR required the bank to maintain tier 1 capital of 10 percent of adjusted total assets; tier 1 capital of 11 percent of risk-weighted assets; and total risk-based capital of 12 percent of risk-weighted assets.

- In the 2011 full-scope ROE, issued October 2, 2012, examiners noted that OCC continued to have significant regulatory concerns in the areas of capital, concentration management, liquidity, and credit monitoring/administration. OCC issued six new MRAs to NRB. In addition, OCC identified noncompliance with the formal agreement and the MRAs relating to portfolio stress testing for concentrations of credit, problem assets action plans, standards for acceptable financial information on borrowers and guarantors, global cash flow analysis, and troubled debt restructure identification.

- In the 2012 limited-scope ROE, issued January 22, 2013, examiners focused on compliance with the formal agreement, IMCR, and outstanding MRAs. They noted that the bank remained in noncompliance with the formal agreement and failed to address the numerous cited MRAs. In addition, OCC determined that NRB had violations relating to call reports, appraisals, and the loans to one borrower regulation.

- In the 2012 full-scope ROE, issued April 29, 2013, examiners determined, as a result of widespread unsafe or unsound practices identified, that OCC would be presenting the board with a C&D order requiring the timely correction of the deficient practices, including the requirement to achieve and maintain minimum capital levels. NRB continued to be in noncompliance with the formal agreement. The bank also did not address prior issued MRAs relating to portfolio stress testing for concentrations of credit, appraisal and evaluation processes, loan staffing, problem loan identification, inadequate independent loan review, credit monitoring, problem asset action plans, standards for acceptable financial information on borrowers and guarantors, global cash flow analysis, troubled debt restructure identification, and ALLL adequacy and methodology. OCC issued 13 new MRAs to NRB. OCC imposed the C&D order on August 31, 2013, which replaced the formal agreement that was in effect at the time. One MRA stated that NRB's process for determining an appropriate ALLL was flawed. This resulted in a significantly underfunded ALLL balance and a violation of law for filing an inaccurate call report for the period ended December 31, 2012. OCC's analysis of the ALLL determined that a provision of approximately $58 million was required.

- In May 2013, the bank filed an informal appeal with OCC's Special Supervision office related to the 2012 examination findings. The appeal principally related to the OCC-directed ALLL provision for $58 million. Instead, the board authorized a $40.6 million provision. As a result of the appeal, OCC reassessed the ALLL provision and required the bank to add an additional $5.04 million for a total ALLL provision of $45.64 million. OCC then required the bank to file amended call reports for periods ended December 31, 2012, and March 31, 2013, which resulted in the bank's PCA category changing from well capitalized to adequately capitalized for those periods.

- In the 2013 limited-scope ROE, issued November 22, 2013, examiners noted that the chairman, president, and executive vice president did not demonstrate the willingness or ability to correct problems and implement appropriate risk management systems. OCC identified internal control deficiencies resulting in

new violations of law including Bank Secrecy Act[5] noncompliance, and MRAs, stating that board and management oversight needed immediate attention and stressed that the replacement or strengthening of management and the board was necessary. On July 2, 2014, OCC presented the board with a PCA Directive requiring remedial or protective actions, including the dismissal of the chairman and president, both of whom decided to resign their positions with the bank.

- On June 4, 2014, the bank filed an appeal with OCC's Ombudsman[6] regarding, among other things, an OCC-directed ALLL provision of approximately $47 million, challenging the amount and methodology of the ALLL required as of December 31, 2013. On August 29, 2014, the Ombudsman determined that a lesser provision for ALLL was required, setting it at approximately $40 million. In September 2014, the bank filed amended call reports as of December 31, 2013, March 31, 2014, and June 30, 2014, which resulted in the bank's PCA category changing from undercapitalized to significantly undercapitalized and then less than a week later, to critically undercapitalized, respectively.

- In the 2013 full-scope ROE, issued September 16, 2014, OCC identified seven new MRAs regarding noncompliance with the C&D, credit risk monitoring, cash basis accounting processes and documentation, CRE construction and loan monitoring, executive expenses, interest rate risk management, and investment management. NRB was also in noncompliance with numerous MRAs. At the time of the 2013 examination, OCC had cited NRB with over 20 MRAs in total.

- On October 24, 2014, approximately 1 month after OCC downgraded NRB to critically undercapitalized, OCC closed the bank and appointed FDIC as receiver.

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[5] The Bank Secrecy Act requires financial institutions to assist United States government agencies to detect and prevent money laundering and to report suspicious activity that might signify money laundering, tax evasion, or other criminal activities.

[6] The OCC Ombudsman's office performs two critical functions: it provides national banks with a process for appealing examiner decisions, and it assists national bank customers who have questions or complaints.

OCC's Use of PCA Was Appropriate

The purpose of PCA is to resolve problems of insured depository institutions with the least possible long-term loss to the DIF. PCA requires Federal banking agencies to take certain actions when an institution's capital drops below certain levels. PCA also gives regulators flexibility to supervise institutions based on criteria other than capital levels.

NRB was adequately capitalized as of April 29, 2013. Due to rapid deterioration in asset quality that crippled the bank's overall financial performance, the bank became undercapitalized as of April 29, 2014; significantly undercapitalized as of September 8, 2014, with the filing of an amended December 31, 2013, call report; and critically undercapitalized as of September 12, 2014 with the filing of an amended June 30, 2014, call report.

As NRB's capital levels deteriorated, we believe OCC took appropriate action within its PCA authorities. OCC determined on October 23, 2014, that there was no reasonable prospect that the bank would become adequately capitalized without Federal assistance. The bank's overall condition remained less than satisfactory, the risk profile remained high, and the bank remained in a troubled condition. Because of NRB's failure to submit a viable capital restoration plan (CRP), as discussed below, and the substantial dissipation of the bank's assets and earnings, OCC placed NRB into receivership on October 24, 2014. The following are the key actions relating to capital taken by OCC:

- On July 2, 2014, OCC presented the board with a PCA Directive, requiring certain remedial or protective actions, including the dismissal of the chairman of the board and the president. The chairman and president resigned their respective positions with the bank that same day.

- In a letter dated September 10, 2014, OCC notified the bank that it was significantly undercapitalized. The letter required the board to submit an acceptable CRP to OCC by September 24, 2014.

- NRB provided its CRP on October 1, 2014, but OCC rejected it because OCC was unable to determine that the CRP was based on realistic assumptions and the CRP did not foresee restoration of NRB's capital within a reasonable period.

- On October 24, 2014, OCC closed the bank and appointed FDIC as receiver. The action, in this case less than one month, was within the PCA required timeframe after OCC downgraded NRB to critically undercapitalized.

We are not making any recommendations to OCC as a result of our material loss review of NRB. We provided a draft of this report to OCC for its review. In a written response, which is included as appendix 3, OCC stated that it agreed with our findings.

* * * * *

We appreciate the courtesies and cooperation provided to our staff during the audit. If you wish to discuss the report, you may contact me at (202) 927-5776 or Dana Duvall, Audit Manager, at (202) 927-9648. Major contributors to this report are listed in appendix 4.

/s/

Susan Barron
Audit Director

We conducted a material loss review of The National Republic Bank of Chicago (NRB), Chicago, Illinois, in response to our mandate under section 38(k) of the Federal Deposit Insurance Act.[7] This section provides that if the Deposit Insurance Fund incurs a material loss with respect to an insured depository institution, the inspector general for the appropriate Federal banking agency is to prepare a report to the agency that

- ascertains why the institution's problems resulted in a material loss to the insurance fund;
- reviews the agency's supervision of the institution; including its implementation of the prompt corrective action (PCA) provision of section 38; and
- makes recommendations for preventing any such loss in the future.

At the time of NRB's failure on October 24, 2014, section 38(k) defines a loss as material if it exceeded $50 million. The law also requires the inspector general to complete the report within 6 months after it becomes apparent that a material loss to the Deposit Insurance Fund has been incurred. We initiated this material loss review of NRB based on the loss estimated by the Federal Deposit Insurance Corporation (FDIC), which was $111.6 million at the time of closing. As of March 31, 2015, FDIC estimated that the loss remained to be $111.6 million.

To accomplish our reporting objectives under section 38(k), we conducted fieldwork at the Office of the Comptroller of the Currency's (OCC) headquarters in Washington, D.C.; OCC's field office in Chicago, Illinois; and FDIC's regional offices in Chicago, Illinois and Dallas, Texas. We conducted our fieldwork from November 2014 through March 2015.

To assess the adequacy of OCC's supervision of NRB, we determined (1) when OCC first identified the bank's safety and soundness problems, (2) the gravity of the problems, and (3) the

[7] 12 U.S.C. § 1831o(k).

supervisory response OCC took to get the bank to correct the problems. We also assessed whether OCC (1) might have discovered problems earlier; (2) identified and reported all the problems; and (3) issued comprehensive, timely, and effective enforcement actions that dealt with any unsafe or unsound activities.

Specifically, we performed the following work:

- We determined that the period covered by our audit would be from June 30 2009, through the bank's failure on October 24, 2014. This period included quarterly monitoring, five full-scope safety and soundness examinations, and four limited-scope examinations of NRB by OCC.

- We reviewed OCC's supervisory files and records for the bank from 2009 through 2014. We analyzed examination reports, supporting workpapers, and related supervisory and enforcement correspondence. We performed these analyses to gain an understanding of the problems identified, the approach and methodology OCC used to assess the bank's condition, and the action used by OCC to compel bank management to address deficient conditions. We did not conduct an independent or separate detailed review of the external auditor's work or associated workpapers other than those incidentally available through the supervisory files.

- We interviewed and discussed various aspects of the supervision with OCC officials, examiners and attorneys to obtain their perspectives on the bank's condition and the scope of the examinations. In addition, we interviewed FDIC personnel to obtain their perspectives on the bank's condition during their involvement with the supervision of the bank.

- We selectively reviewed NRB documents that had been taken by FDIC and inventoried by FDIC Division of Resolutions and Receivership personnel upon receivership. From FDIC's inventory list, we identified documents for our review that were most likely to shed light on the reasons for the bank's failure and OCC's supervision of the bank.

- We assessed OCC's actions based on its internal guidance and the requirements of the Federal Deposit Insurance Act.[8]

We conducted this performance audit 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.

[8] 12 U.S.C. § 1811et seq.

The National Republic Bank of Chicago History

The National Republic Bank of Chicago (NRB), Chicago, Illinois, was a community bank established in 1897. NRB was designated as an Asian/Pacific Islander Minority Depository Institution (MDI).[9] NRB was acquired by NRBC Holding Corporation (NRBC) in 1984. The bank and NRBC were reorganized for tax purposes into S corporations in 1999. The chairman of the bank was the substantial owner of NRBC, owning approximately 99 percent. The bank operated through its main office and one branch, both located in Chicago, Illinois.

NRB pursued a loan growth strategy that commenced in 1999, funded primarily by brokered deposits. Since 1999, the bank grew from $190 million in total assets to approximately $1.3 billion at December 31, 2011. Thereafter, the bank's total assets decreased to approximately $954.4 million as of June 30, 2014. As of the date of failure on October 24, 2014, NRB had $968.2 million in total assets.

OCC Assessment Paid by NRB

OCC funds its operations in part through semiannual assessments on national banks and federal savings associations. OCC publishes annual fee schedules, which include general assessments to be paid by each institution based on the institution's total assets. If the institution is a problem bank (i.e., it has a CAMELS composite rating of 3, 4, or 5), OCC also applies a surcharge to the institution's assessment to cover additional supervisory costs. These surcharges are calculated by multiplying the sum of the general assessment by 50 percent for 3-rated institutions or by 100 percent for 4- and 5-rated institutions. Table 2 shows the amounts that NRB paid from 2009 through 2014.

[9] An MDI is defined as any Federally insured depository institution where 51 percent or more of the voting stock is owned by minority individuals, or there is 51 percent minority representation on the board of directors.

Table 2: Assessments Paid by NRB to OCC, 2009—2014

Billing Period	Exam Rating	Amount Paid
1/1/2009-6/30/2009	3	$117,280
7/1/2009-12/31/2009	3	127,127
1/1/2010-6/30/2010	3	135,064
7/1/2010-12/31/2010	3	204,152
1/1/2011-6/30/2011	3	206,520
7/1/2011-12/31/2011	3	203,247
1/1/2012-6/30/2012	3	213,095
7/1/2012-12/31/2012	5	211,562
1/1/2013-6/30/2013	5	204,659
7/1/2013-12/31/2013	5	260,262
1/1/2014-6/30/2014	5	255,742
7/1/2014-12/31/2014	5	232,582

Source: OCC.

Number of OCC Staff Hours Spent Examining NRB

Table 3 shows the number of OCC staff hours spent examining NRB from 2009 to 2014.

Table 3: Number of OCC Hours Spent Examining NRB, 2009-2014

Examination Start Date	Number of Examination Hours
8/31/2009	1,653
9/27/2010	2,668
2/6/2012	3,531
2/4/2013	928
2/24/2014	2,101

Source: OCC.

Office of the Comptroller of the Currency

Washington, DC 20219

May 8, 2015

Ms. Susan Barron
Director, Banking Audits
Office of Inspector General
Department of the Treasury
Washington, DC 20220

Subject: Response to Draft Report

Dear Ms. Barron:

We have received and reviewed your draft report titled "Material Loss Review of National Republic Bank of Chicago," Chicago, Illinois (NRB). Section 38(k) of the Federal Deposit Insurance Act mandates this report because of the magnitude of the bank's estimated loss to the Deposit Insurance Fund. Your objectives were to determine the causes of NRB's failure; assess the Office of the Comptroller of the Currency's (OCC) supervision of the bank, including implementation of the prompt corrective action (PCA) provisions of section 38; and make recommendations for preventing such a loss in the future. To accomplish these objectives, you reviewed the supervisory files and interviewed OCC and Federal Deposit Insurance Corporation officials.

You concluded that NRB failed primarily because of the chairman of the board's undue influence over the bank's operations and critical decisions, as well as deficient senior management oversight and governance. These underlying causes further led to the bank having improper credit administration processes; aggressive growth resulting in a high concentration in commercial real estate (CRE) loans without commensurate credit risk management practices and adequate capital, particularly in the hotel/motel industry and to gas station/convenience stores throughout the United States; overreliance on brokered deposits; and irregular banking transactions.

You found that OCC examiners generally followed guidance in supervising NRB and OCC's use of PCA was appropriate and addressed the concentration in CRE loans; and credit administration and risk management issues in a timely manner. The OCC also timely identified irregular banking transactions used by the bank to maintain the appearance that it was in a better financial position than it actually was. OCC was also timely in the issuance of appropriate enforcement actions. In addition, as the bank's capital levels deteriorated, OCC appropriately imposed PCA restrictions on the bank, which resulted in the resignation of NRB's chairman and president. We agree with these findings.

If you need additional information, please contact me or Toney Bland, Senior Deputy Comptroller for Midsize and Community Bank Supervision, at 202-649-5420.

Sincerely,

/s/

Thomas J. Curry
Comptroller of the Currency

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Dana Duvall, Audit Manager
John Tomasetti, Auditor-in-Charge
Daniel Gerges, Auditor
Kajuana Britt, Program Analyst
April Ellison, Referencer

Department of the Treasury

Deputy Secretary
Office of Strategic Planning and Performance Management
Office of the Deputy Chief Financial Officer, Risk and Control Group

Office of the Comptroller of the Currency

Comptroller of the Currency
Liaison Officer

Office of Management and Budget

OIG Budget Examiner

Federal Deposit Insurance Corporation

Chairman
Acting Inspector General

United States Senate

Chairman and Ranking Member
Committee on Banking, Housing, and Urban Affairs

Chairman and Ranking Member
Committee on Finance

United States House of Representatives

Chairman and Ranking Member
Committee on Financial Services

United States Government Accountability Office

Comptroller General of the United States