



Audit Report



OIG-11-006

SAFETY AND SOUNDNESS: Failed Bank Review of Key West Bank

October 25, 2010

Office of
Inspector General

Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

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MEMORANDUM FOR JOHN E. BOWMAN
ACTING DIRECTOR
OFFICE OF THRIFT SUPERVISION

FROM: Susan L. Barron /s/
Director, Banking Audits

SUBJECT: Failed Bank Review of Key West Bank

This memorandum presents the results of our review of the failure of Key West Bank. Key West Bank opened in February 1999 and operated one branch in Key West, Florida. The thrift was a wholly owned subsidiary of Key West Bancgroup, Inc., a unitary thrift holding company. The Office of Thrift Supervision (OTS) closed Key West Bank and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on March 26, 2010. As of December 31, 2009, the thrift had \$88 million in total assets. FDIC estimated that the loss to the Deposit Insurance Fund is \$23.1 million.

Because the loss to the Deposit Insurance Fund is less than \$200 million, as set forth by section 38(k) of the Federal Deposit Insurance Act (FDIA), we conducted a review of the failure of Key West Bank that was limited to (1) ascertaining the grounds identified by OTS for appointing the FDIC as receiver and (2) determining whether any unusual circumstances exist that might warrant a more in-depth review of the loss. In performing our review we (1) examined documentation related to the appointment of FDIC as receiver, (2) reviewed OTS reports of examination, and (3) interviewed OTS examination personnel.

We conducted this performance audit during August and September 2010 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.

Causes of Key West Bank's Failure

The primary cause of Key West Bank's failure was its excessive concentrations in higher-risk adjustable-rate mortgages, including a significant number of interest only loans, which were funded primarily with brokered deposits and borrowings from the Federal Home Loan Bank of Atlanta. These conditions were exacerbated by the severe downturn in real estate values in its primary lending area, Florida's Key West region. By 2009, the bank's liquidity was deficient when substantial amounts of brokered deposits were scheduled to mature. In addition, the Federal Home Loan Bank of Atlanta froze the bank's credit availability, and there were no other funding sources to meet emergency cash needs. As the bank's asset quality deteriorated, problem assets and the loan loss provision significantly increased. In turn, the provision for loan losses contributed to a net loss which significantly diminished earnings and capital, and when combined with the lack of additional funding sources, ultimately led to Key West Bank's closure by OTS.

Conclusion

Based on our review of the causes of Key West Bank's failure and the grounds identified by OTS for appointing FDIC as receiver, we determined that there were no unusual circumstances surrounding the bank's failure or the supervision exercised by OTS. Accordingly, we have determined that a more in-depth review of the bank's failure by our office is not warranted.

We provided a draft of this memorandum to OTS management for comment. In its response, OTS stated that the primary causes of Key West Bank's failure summarized in this memorandum are consistent with the information contained in its reports of examinations and documents in support of the grounds for receivership. The response is provided as Attachment 1. A list of the recipients of this memorandum is provided as Attachment 2.

We appreciate the courtesies and cooperation provided to our staff during the audit. If you have any questions, you may contact me at (202) 927-5776 or Jai Mathai, Audit Manager, at (202) 927-0356.

Attachments



Office of Thrift Supervision
Department of the Treasury

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Thomas A. Barnes
Deputy Director, Examinations, Supervision, and Consumer Protection

October 7, 2010

MEMORANDUM FOR: Susan L. Barron,
Director, Banking Audits
Office of Inspector General
U.S. Department of the Treasury

FROM: Thomas A. Barnes /s/
Deputy Director

SUBJECT: Draft Failed Bank Review of
Key West Bank

Thank you for the opportunity to comment on your draft memorandum entitled "Failed Bank Review of Key West Bank." Because the estimated loss of \$23.1 million to the Deposit Insurance Fund is below the \$200 million threshold set forth in section 38(k) of the Federal Deposit Insurance Act, the review of the failure of Key West Bank was limited to ascertaining the grounds identified by OTS for appointment of a receiver and determining whether any unusual circumstances exist warranting a more in depth review.

The memorandum summarizes the primary causes of Key West Bank's failure, which are consistent with the information contained in the OTS Reports of Examination and documents in support of the grounds for the receivership. Specifically, the memorandum cites concentrations in higher risk adjustable-rate mortgage loans, including interest only loans, funded by brokered deposits and Federal Home Loan Bank borrowings, combined with the severe downturn in the Key West Florida real estate market, as the primary causes of the bank's failure.

The memorandum identified no unusual circumstances surrounding the failure or the supervision exercised by OTS warranting a more in depth review by the Office of Inspector General. No recommendations for OTS were made in the memorandum.

Thank you again for the opportunity to review and respond to the draft report. OTS appreciates the professionalism and courtesies provided by the staff of the Office of Inspector General.

Department of the Treasury

Deputy Secretary
Office of Strategic Planning and Evaluations
Office of Accounting and Internal Control

Office of Thrift Supervision

Acting Director
Liaison Officer

Office of Management and Budget

OIG Budget Examiner