# Office of Inspector General

Office of Audits and Evaluations
Report No. AUD-15-003

## In-Depth Review of the Failure of Vantage Point Bank, Horsham, Pennsylvania

March 2015

Office of Inspector General

**Executive Summary**

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## Why We Did The Audit

Section 38(k) of the Federal Deposit Insurance Act (FDI Act), as amended, provides, in general, that if the Deposit Insurance Fund (DIF) incurs a material loss with respect to an insured depository institution, the Inspector General of the appropriate federal banking agency shall prepare a report to that agency that includes a review of the agency's supervision of the institution. Section 38(k) establishes a material loss review (MLR) threshold of $50 million for losses that occur on or after January 1, 2014. For losses under the MLR threshold, the appropriate Office of Inspector General must determine the grounds upon which the state or federal banking agency appointed the Corporation receiver and whether any unusual circumstances exist that might warrant an in-depth review of the loss.

On February 28, 2014, the Pennsylvania Department of Banking and Securities (PDBS) closed Vantage Point Bank (VPB) and the FDIC was appointed receiver. As of September 30, 2014, the estimated loss of VPB's failure was approximately $11 million. Although the loss estimate does not meet the MLR threshold, the Director of the FDIC's Division of Risk Management Supervision (RMS) requested that we conduct an in-depth review because VPB's failure involved unusual circumstances. Specifically, the bank engaged in material changes to its business plan during its de novo period without regulatory approval. The objectives of this in-depth review were to (1) determine the causes of VPB's failure and resulting loss to the DIF and (2) evaluate the FDIC's supervision of the institution, including the FDIC's implementation of the Prompt Corrective Action (PCA) provisions of Section 38 of the FDI Act. The scope of our work included an emphasis on VPB's deviation from its business plan and the FDIC's supervisory response to the associated risks.

## Background

VPB was a state-chartered nonmember bank that opened on December 26, 2007. The bank's revenues consisted of two principal sources: interest revenue from traditional banking services and non-interest revenue from financial services and mortgage banking activities. VPB's traditional banking services involved generating income from the spread between the interest paid on liabilities (e.g., deposits) and collected on earning assets (e.g., loans). The bank's financial services involved selling financial advisory products, non-bank investments, and insurance to generate fee income. VPB's mortgage banking activities initially involved the bank acting as a broker to assist applicants in obtaining residential mortgage loans from other lenders. VPB subsequently expanded its mortgage banking operation in 2011 by establishing a number of limited-purpose Loan Production Offices (LPO) to originate, book, and sell residential mortgage loans to third-party investors for a fee. With the exception of the mortgage banking operation (which originated loans in various parts of the country), VPB's primary market area was the greater Philadelphia region. At the time of its closure, VPB operated one office in Horsham, Pennsylvania, which is located about 20 miles north of downtown Philadelphia.

## Audit Results

### Primary Causes of Failure and Material Loss

VPB failed primarily because its Board of Directors (Board) and management did not effectively manage the risks associated with the bank's rapid expansion of its mortgage banking operation. After 3 years of operation, VPB had not achieved a pre-tax profit on operations. High overhead expenses and lower-than-expected interest revenue from traditional banking services contributed to the bank's recurring pre-tax operating losses. In addition, VPB's capital positon was less than satisfactory, and the bank's management had limited success in raising new capital due to ongoing adverse economic conditions.

In an effort to improve its earnings, VPB embarked on a rapid expansion of its mortgage banking operation beginning in mid-2011. At that time, historically low interest rates were generating considerable demand for mortgage loans and refinancing. The FDIC determined that VPB's expansion of its mortgage banking operation represented a material deviation from the business plan approved in the bank's Order Granting Deposit Insurance (referred to herein as the "original business plan"), which called for developing mortgage banking expertise in a conservative manner. During the second half of 2011, VPB grew from 46 to 158 employees and opened a number of LPOs. VPB continued to expand its mortgage banking operation throughout 2012, and by the end of that year, the bank had 238 employees and 14 LPOs in seven states.

Although the expansion of the mortgage banking operation generated significant revenue, VPB continued to generate pre-tax operating losses due in large part to higher-than-projected overhead costs associated with the LPOs. In addition, VPB did not implement appropriate controls over its expanded mortgage banking operation. In mid-2013, mortgage rates increased, and demand for mortgage loans and refinancing declined precipitously. As a result, VPB closed all of its LPOs and terminated the majority of its employees. The costs associated with unwinding the mortgage banking operation, together with financial reporting adjustments made in December 2013, contributed to VPB reporting a $3.8 million loss for calendar year 2013. The loss materially impaired VPB's capital position. The PDBS closed VPB on February 28, 2014 because the bank did not have sufficient capital to continue operations and had no viable means of raising additional capital.

### The FDIC's Supervision of Vantage Point Bank

The FDIC, in coordination with the PDBS, provided ongoing supervisory oversight of VPB through regular on-site examinations, visitations, and various offsite monitoring activities. Through these supervisory efforts, examiners identified risks in VPB's operations and brought these risks to the attention of VPB's Board and management through examination reports, letters summarizing visitation results, correspondence, and informal and formal enforcement actions. Such risks included the bank's less than satisfactory earnings and capital, weak business planning practices, and rapid expansion into mortgage banking without adequate risk management controls.

As described in the report, the FDIC's approach to monitoring VPB for compliance with the original business plan was consistent with supervisory guidance for the first 3 years of the bank's operation. However, monitoring in subsequent years was generally not adequate. In addition, the FDIC should have taken stronger supervisory action during the April 2012 examination when examiners confirmed that VPB had materially deviated from its original business plan without obtaining prior FDIC approval to do so. More effective monitoring and stronger supervisory action would have been consistent with supervisory guidance for newly insured banks and may have prompted VPB to better control the expansion of its mortgage banking operation, mitigating the losses incurred by the bank and, to some extent, the DIF. We also noted that enforcement action information related to VPB had not been recorded in the FDIC's automated system of record as prescribed by FDIC policy. With respect to PCA, we determined that the

FDIC implemented supervisory actions that were generally consistent with relevant provisions of Section 38.

Our report also notes that supervisory guidance issued to newly insured banks does not describe the factors to be considered when determining whether a change or deviation in a business plan is major or material. Clarifying existing guidance would help to ensure prompt and full disclosure of major changes and material deviations in bank business plans and better enable the FDIC to address the associated risks. It would also provide the FDIC with a stronger foundation on which to take supervisory action, when needed.

## Recommendations and Corporation Comments

Our report contains three recommendations addressed to the Director, RMS, that are intended to improve the effectiveness of the FDIC's supervision of newly insured institutions, such as VPB. The Director, RMS, provided a written response, dated March 13, 2015, to a draft of this report. In the response, the Director concurred with all three of the report's recommendations. The Director's planned and completed actions are responsive to the recommendations and all of the recommendations are resolved.

# Contents

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

Office of Audits and Evaluations
Office of Inspector General

**DATE:** March 30, 2015

**MEMORANDUM TO:** Doreen R. Eberley, Director
Division of Risk Management Supervision

**/Signed/**

**FROM:** Mark F. Mulholland
Assistant Inspector General for Audits

**SUBJECT:** *In-Depth Review of the Failure of Vantage Point Bank, Horsham, Pennsylvania* (Report No. AUD-15-003)

Section 38(k) of the Federal Deposit Insurance Act (FDI Act), as amended, provides, in general, that if the Deposit Insurance Fund (DIF)[1] incurs a material loss with respect to an insured depository institution, the Inspector General of the appropriate federal banking agency shall prepare a report to that agency that includes a review of the agency's supervision of the institution. Section 38(k) establishes a material loss review (MLR) threshold of $50 million for losses that occur on or after January 1, 2014. For losses under the MLR threshold, the appropriate Office of Inspector General (OIG) must determine the grounds upon which the state or federal banking agency appointed the Corporation receiver and whether any unusual circumstances exist that might warrant an in-depth review of the loss.

On February 28, 2014, the Pennsylvania Department of Banking and Securities (PDBS) closed Vantage Point Bank (VPB), and the FDIC was appointed receiver. As of September 30, 2014, the estimated loss to the DIF was approximately $11 million. Although the loss estimate does not meet the MLR threshold, the Director of the FDIC's Division of Risk Management Supervision (RMS) requested that the OIG conduct an in-depth review because VPB's failure involved unusual circumstances. Specifically, the bank engaged in material changes to its business plan during its de novo period without regulatory approval. The objectives of this in-depth review were to (1) determine the causes of VPB's failure and resulting loss to the DIF and (2) evaluate the FDIC's supervision of the institution, including the FDIC's implementation of the Prompt Corrective Action (PCA) provisions of Section 38 of the FDI Act. The scope of our work included an emphasis on VPB's deviation from its business plan and the FDIC's supervisory response to the associated risks.

We conducted this performance audit in accordance with generally accepted government auditing standards. Appendix 1 of this report includes additional information about our objectives, scope, and methodology; Appendix 2 contains a chronology of key events

[1] Terms that are underlined when first used in this report are defined in Appendix 4, *Glossary of Key Terms*.

related to VPB's business plans; Appendix 3 contains a description of the scope of visitations conducted of VPB; Appendix 4 contains a glossary of key terms; Appendix 5 contains a list of acronyms and abbreviations; Appendix 6 contains the Corporation's comments on this report; and Appendix 7 contains a summary of the Corporation's corrective actions.

## Background

VPB was a state-chartered nonmember bank that opened on December 26, 2007. The bank's revenues consisted of two principal sources: interest revenue from traditional banking services and non-interest revenue from financial services and mortgage banking activities. VPB's traditional banking services generally involved taking deposits and making loans to consumers and businesses, and generating income from the spread between the interest paid on deposits and the interest collected on loans. The bank's financial services involved selling financial advisory products, non-bank investments, and insurance to generate fee income. VPB's mortgage banking activities initially involved the bank acting as a broker to assist applicants in obtaining residential mortgage loans from other lenders. VPB significantly expanded its mortgage banking operation in 2011 by establishing a number of limited-purpose Loan Production Offices (LPO) to originate, book, and sell residential mortgage loans to third-party investors for a fee. This latter type of lending is sometimes referred to as correspondent lending.

With the exception of the mortgage banking operation (which originated loans in various parts of the country), VPB's primary market area was the greater Philadelphia region. At the time of its closure, VPB operated one office in Horsham, Pennsylvania, which is located about 20 miles north of downtown Philadelphia. Table 1 summarizes selected financial information pertaining to VPB as of December 31, 2013 and for the 5 preceding calendar years.

**Table 1: Selected Financial Information for Vantage Point Bank, 2008-2013**

| Financial Data ($000) | Dec-2013 | Dec-2012 | Dec-2011 | Dec-2010 | Dec-2009 | Dec-2008 |
|---|---|---|---|---|---|---|
| Total Assets | 63,453 | 80,595 | 78,386 | 72,826 | 71,119 | 67,862 |
| Total Loans | 44,125 | 66,269 | 59,225 | 49,506 | 44,508 | 33,536 |
| Total Deposits | 62,472 | 64,922 | 67,861 | 59,813 | 63,622 | 61,731 |
| Return on Average Assets | -4.94% | -3.32% | -0.56% | -0.33% | 1.71% | -5.31% |
| Net Interest Margin | 2.61% | 3.02% | 2.89% | 3.44% | 3.31% | 1.40% |
| Non-Interest Income /Average Assets | 13.59% | 14.91% | 4.98% | 2.93% | 2.02% | 1.19% |
| Non-Interest Expense /Average Assets | 20.07% | 18.26% | 8.67% | 6.74% | 5.96% | 7.14% |
| Loan Growth | -33.94% | 12.19% | 19.78% | 12.01% | 31.91% | 0% |
| Net Income | -3,804 | -2,695 | -421 | -249 | 1,200 | -2,857 |

Source: Uniform Bank Performance Reports (UBPRs) for VPB.

## Primary Causes of Failure and Loss

VPB failed primarily because its Board of Directors (Board) and management did not effectively manage the risks associated with the bank's rapid expansion of its mortgage banking operation. After its first 3 years of operation, VPB had not achieved a pre-tax profit on operations as projected in its business plan.[2] High overhead expenses and lower-than-expected interest revenue from traditional banking services were contributing factors in the recurring pre-tax operating losses reported by the bank since its inception. In addition, VPB was struggling at that time to generate the revenues it had projected from its financial services activities. Further, VPB's capital position was less than satisfactory, and the bank's management had limited success in raising new capital due to ongoing adverse economic conditions. VPB's inability to raise new capital inhibited the bank's ability to grow its balance sheet and generate earnings from traditional banking services.

In an effort to improve its earnings, VPB embarked on a rapid expansion of its mortgage banking operation beginning in mid-2011. At that time, historically low interest rates were generating considerable demand for mortgage loans and refinancing. The FDIC determined that VPB's expansion of its mortgage banking operation represented a material deviation from the business plan approved in the bank's Order Granting Deposit Insurance (referred to herein as the "original business plan"), which called for developing mortgage banking expertise in a conservative manner. During the second half of 2011, VPB grew from 46 to 158 employees and opened a number of LPOs. VPB continued to expand its mortgage banking operation throughout 2012, and by the end of that year, the bank had 238 employees and 14 LPOs in seven states.

Although the expansion of the mortgage banking operation generated significant revenue, VPB continued to generate pre-tax operating losses due in large part to higher-than-projected overhead costs associated with the LPOs. In addition, VPB did not implement appropriate controls over its expanded mortgage banking operation, exposing the bank to operational, regulatory compliance, and fair lending risks. Further, VPB did not develop a viable strategy to downsize its mortgage banking operation should market conditions deteriorate unexpectedly.

In mid-2013, mortgage rates increased, and demand for mortgage loans and refinancing declined precipitously. As a result, VPB closed all of its LPOs and terminated the majority of its employees. The costs associated with unwinding the mortgage banking operation, together with financial reporting adjustments made in December 2013, contributed to VPB reporting a loss of $3.8 million for calendar year 2013. The loss materially impaired VPB's capital position. The PDBS closed VPB on February 28, 2014 because the bank did not have sufficient capital to continue operations and had no viable means of raising additional capital.

[2] Although VPB reported positive net income for 2009 in its regulatory filings, it was able to do so because of the potential tax benefit associated with a deferred tax asset.

## The FDIC's Supervision of Vantage Point Bank

The FDIC, in coordination with the PDBS, provided ongoing supervisory oversight of VPB through regular on-site examinations, visitations, and various offsite monitoring activities. Through these supervisory efforts, examiners identified risks in VPB's operations and brought these risks to the attention of VPB's Board and management through examination reports, letters summarizing visitation results, correspondence, and informal and formal enforcement actions. Such risks included the bank's less than satisfactory earnings and capital, weak business planning practices, and rapid expansion into mortgage banking without adequate risk management controls.

As described later, the FDIC's approach to monitoring VPB for compliance with the original business plan was consistent with supervisory guidance for the first 3 years of the bank's operation. However, monitoring in subsequent years was generally not adequate. In addition, the FDIC should have taken stronger supervisory action during the April 2012 examination when examiners confirmed that VPB had materially deviated from its original business plan without obtaining prior FDIC approval to do so. More effective monitoring and stronger supervisory action would have been consistent with supervisory guidance for newly insured banks and may have prompted VPB to better control the expansion of its mortgage banking operation, mitigating the losses incurred by the bank and, to some extent, the DIF. We also noted that enforcement action information related to VPB had not been recorded in the FDIC's automated system of record as prescribed by FDIC policy. With respect to PCA, we determined that the FDIC implemented supervisory actions that were generally consistent with relevant provisions of Section 38.

Our report also notes that supervisory guidance issued to newly insured banks does not describe the factors to be considered when determining whether a change or deviation in a business plan is major or material. Clarifying existing guidance would help to ensure prompt and full disclosure of major changes and material deviations in bank business plans and better enable the FDIC to address the associated risks. It would also provide the FDIC with a stronger foundation on which to take supervisory action, when needed.

### Supervisory History

The FDIC, in coordination with the PDBS, conducted five on-site examinations and seven visitations of VPB. The frequency of these examination activities was consistent with relevant statutory and regulatory requirements and FDIC guidance for newly insured institutions.[3] Table 2 summarizes key supervisory information pertaining to safety and soundness examinations and visitations of VPB. In addition, Appendix 3 summarizes the scope of the seven visitations conducted of VPB.

[3] Section 337.12 of the FDIC Rules and Regulations, which implements Section 10(d) of the FDI Act, defines the examination frequency requirements for state nonmember banks. In addition, internal FDIC guidance states that newly chartered and insured banks should undergo a limited-scope examination within the first 6 months of operation; a full-scope examination within 12 months; and annual examinations through year 7.

**Table 2: Examinations and Visitations of Vantage Point Bank, 2008-2013**

| Examination or Visitation Start Date | Examination or Visitation | Regulator(s) | Supervisory Ratings (UFIRS) | Informal or Formal Action Taken* |
|---|---|---|---|---|
| June 23, 2008 | Visitation | FDIC and PDBS | N/A | None |
| December 15, 2008 | Examination | FDIC and PDBS | 323413/3 | Joint MOU effective June 17, 2009. |
| August 17, 2009 | Visitation | FDIC and PDBS | N/A | Joint MOU still in effect. |
| January 11, 2010 | Examination | FDIC and PDBS | 333322/3 | Joint MOU still in effect. |
| July 12, 2010 | Visitation | FDIC | N/A | Joint MOU still in effect. |
| February 14, 2011 | Examination | FDIC and PDBS | 333322/3 | Joint MOU still in effect. Information Technology (IT)-BBR effective July 19, 2011. |
| September 20, 2011 | Visitation | FDIC and PDBS | N/A | Joint MOU and IT-BBR still in effect. |
| January 30, 2012 | Visitation | FDIC | N/A | Joint MOU and IT-BBR still in effect. |
| April 2, 2012 | Examination | FDIC and PDBS | 333422/3 | Joint MOU and IT-BBR still in effect. |
| December 3, 2012 | Visitation | FDIC and PDBS | N/A | Joint MOU and IT-BBR still in effect. |
| April 29, 2013 | Examination | FDIC and PDBS | 434533/4 | Consent Orders issued by the FDIC and PDBS effective December 9, 2013. IT-BBR lifted on December 9, 2013. |
| December 9, 2013 | Visitation | FDIC and PDBS | 545555/5** | Consent Orders still in effect. |

Source: OIG analysis of reports of examination and letters summarizing visitation results, and information in the FDIC's Virtual Supervisory Information on the Net (ViSION) system.
***** Informal actions often take the form of a Bank Board Resolution (BBR) or Memorandum of Understanding (MOU). Formal enforcement actions often take the form of a Cease and Desist Order, Consent Order, or PCA Directive.
** On December 24, 2013, prior to the completion of the visitation, the FDIC and PDBS implemented an interim downgrade of VPB's supervisory ratings based on further deterioration in the bank's financial condition.

As reflected in the table, VPB received less than satisfactory supervisory ratings for the entire period that it was open. In addition, the bank was subject to two supervisory actions related to the bank's financial risk management controls and practices. Specifically, the FDIC and PDBS entered into an MOU with the bank's Board in June 2009 to address the risks identified during the December 2008 examination. During that examination, examiners found that losses were more than double initial projections in the business plan, capital needed improvement, and Board and senior management oversight was insufficient. Among other things, the MOU required the Board to evaluate the bank's business plan to determine whether its projections, financial targets, and goals remained relevant and that measures for improving capital were realistic.

The MOU remained in place and unmodified until December 9, 2013, at which time the FDIC and PDBS issued parallel Consent Orders. The FDIC's Consent Order, which was based on the results of the April 2013 examination, remained in effect until VPB's closure. The Consent Order included requirements for the bank to develop a strategic plan, profit and budget plan, and capital plan as well as to cease expansion of the mortgage banking operation until all deficiencies identified by the examiners had been addressed.

## Monitoring Vantage Point Bank for Compliance with Its Business Plan

On August 28, 2009, the FDIC issued Financial Institution Letter 50-2009 (FIL-50-2009), entitled *Enhanced Supervisory Procedures for Newly Insured FDIC-Supervised Depository Institutions*. According to the FIL, experience has shown that newly insured banks pose an elevated risk to the DIF, particularly during an economic downturn. Specifically, the FIL states that banks insured less than 7 years were over represented among institutions that failed during 2008 and 2009, with most failures occurring between the fourth and seventh years of the banks' operations. Common characteristics of newly insured banks that became troubled or failed include such things as rapid growth, significant deviations from approved business plans, non-compliance with conditions of deposit insurance orders, and weak risk management practices. FIL-50-2009 adds that a number of newly insured banks have pursued changes in their business plans during the first few years of operation, which, in some cases, led to increased risk and financial problems where accompanying controls and risk management practices were inadequate. The FIL also notes that material changes in business plans by newly insured banks warrant more in-depth analysis to adequately assess the potential risk to the institution and the DIF.

To address the elevated risk posed by newly insured banks, FIL-50-2009 extended the de novo period during which the FDIC applies enhanced supervisory procedures from 3 to 7 years. Such procedures include more frequent examination activities, heightened monitoring, and higher capital requirements. In addition, FIL-50-2009 states that newly insured banks remain subject to the conditions in their Orders Granting Deposit Insurance (including the requirement to obtain prior FDIC approval of material changes in business plans) during the 7-year de novo period. Further, the FDIC required banks that had not reached the end of their third year of operation—such as VPB—to submit updated financial statements and business plans covering years 4 through 7 of their operation.

An FDIC Regional Directors (RD) Memorandum issued in 2009 (referred to as the RD Memorandum in this report) describes the enhanced supervisory and examination procedures applicable to banks during their de novo period. With respect to monitoring banks for compliance with their business plans, the RD Memorandum states that newly insured banks will be required to notify the FDIC before they establish an LPO that is not included in the original business plan. The purpose of this requirement is to allow an opportunity for the FDIC to assess the overall impact that the LPO might have on the bank's operations and risk profile and determine whether it represents a material deviation from the bank's approved business plan. The RD Memorandum and associated RMS internal guidance also describe the following responsibilities for RMS Case Managers and examiners.

Case Manager Responsibilities

- Reviewing business plan submissions covering years 4 through 7 for reasonableness of assumptions and consistency with current operations and economic conditions.

- Preparing a memorandum to the file that includes an evaluation of the bank's compliance with its original 3-year business plan and business plan covering years 4 through 7.
- Monitoring (on a quarterly basis) bank performance in relation to its business plans throughout the 7-year de novo period.
- Using off-site monitoring systems, such as ViSION, to track business plan change requests and evaluations of bank compliance with approved business plans.
- Evaluating proposed business plan changes to determine whether they represent a major change or material deviation from the most recently approved plan. If a proposed change is not considered material, a memorandum to the file should be prepared that includes an evaluation of compliance with the most recently approved plan and an analysis of the new plan. If a proposed change is considered material, it should be analyzed and a recommendation provided to the RMS office in Washington, D.C.[4]

Examiner Responsibilities

- Evaluating compliance with outstanding conditions of deposit insurance orders as part of the examination process and documenting findings in reports of examination.
- Closely reviewing bank compliance with business plans and associated updates during examinations and visitations throughout the 7-year de novo period.

The FDIC's monitoring of VPB for compliance with the original business plan during the first 3 years of the bank's operation was consistent with the requirements of the RD Memorandum. For example, examiners reviewed VPB's business plans during on-site examinations and documented their findings in reports of examination; the Case Manager reviewed and responded to a proposed change in VPB's business plan; and, although not required by policy or guidance, the FDIC formally reminded VPB's Board on multiple occasions of its responsibility to seek prior FDIC approval of any planned major change or material deviation in the bank's approved business plan.

Examiners continued to report on the need for VPB to develop an acceptable business plan in reports of examination and letters summarizing visitation results following the first 3 years of VPB's operation. However, the FDIC's monitoring during this period was generally not adequate. For example, we noted that:

- The FDIC did not detect in a timely manner that VPB had failed to submit an updated business plan to regulators covering years 4 through 7 of the bank's operation. FIL-50-2009 and FDIC correspondence to the bank's Board required

[4] For example, activities such as changes in asset/liability mix or establishing an LPO, which are not referenced in a bank's original business plan, would require obtaining concurrence from the RMS office in Washington, D.C.

that an updated plan be submitted not later than October 26, 2010. The oversight was not detected until the February 2011 on-site examination.

- The Case Manager did not prepare memoranda to the file documenting an evaluation of VPB's compliance with its original business plan or assessments of subsequent business plan submissions.

- The Case Manager did not identify the potential material deviation associated with VPB's expansion of its mortgage banking operation until a PDBS official brought the matter to the Case Manager's attention in March 2012. A more thorough and timely review of VPB's revised business plan submitted in December 2011 could have identified the potential material deviation sooner.

- With one exception, ViSION and other RMS information systems did not reflect the FDIC's receipt, review, and assessment of VPB's business plan submissions.

- Although specific timeframes for responding to bank management regarding business plan submissions are not included in the RD Memorandum or associated guidance, we determined that the FDIC's responses to VPB's business plan submissions were generally not timely. In many instances, the FDIC responded to the submissions when the results of examinations or visitations were transmitted to the bank, rather than responding as the submissions were received. In some cases, this approach delayed feedback to the bank on proposed business plans by several months.

Between July 2011 and VPB's failure, five business plans were submitted to the FDIC. None of these plans was deemed adequate by the FDIC, resulting in VPB operating without an approved business plan for more than 3 years. Competing work priorities for the Case Manager contributed to the weak monitoring practices described above.

### Supervisory Response to Vantage Point Bank's Expansion of Its Mortgage Banking Operation

The RD Memorandum states that when a bank has implemented a material change in its business plan without providing prior notice or obtaining the FDIC's prior non-objection, the assessment of civil money penalties (CMPs) or other enforcement action against the bank or other appropriate parties should be considered. According to the RD Memorandum, if a decision is made not to pursue an enforcement action in such instances, RMS Regional Offices should document the reasons for the decision in a memorandum and forward it to the RMS Office in Washington, D.C.

While there were indications of a strategic shift in VPB's mortgage banking operation as early as 2010, the first clear evidence for the FDIC that the shift was material occurred when the bank submitted a revised business plan in December 2011. VPB provided the revised plan in response to a letter, dated October 31, 2011, from the FDIC which advised the bank's Board that examiners had determined in a recent visitation that the business plan required substantial revision.[5] The December 2011 business plan stated that VPB was expanding its mortgage banking operation (including correspondent lending) and that it had opened five LPOs in three states in connection with the expansion.

During the following on-site examination, which began on April 2, 2012, examiners confirmed that VPB's expansion of its mortgage banking operation represented a material deviation from the bank's original business plan. Although examiners determined that VPB's controls over the mortgage banking operation were adequate at that time, they noted that the revised business plan submitted in December 2011 did not adequately address the mortgage banking operation in terms of personnel, operations, limits, controls, earnings, liquidity, and capital. Examiners recommended that VPB's management provide the FDIC with an updated business plan, which was submitted on June 12, 2012. The FDIC did not provide VPB with written feedback on that business plan until the December 2012 visitation, at which time examiners determined that the plan did not adequately address the expansion of the bank's mortgage banking operation or provide sufficient support to analyze its effectiveness.

The FDIC should have taken stronger supervisory action during the April 2012 examination when examiners confirmed that VPB was materially deviating from its original business plan. At that time, VPB's financial condition was weak, the bank was operating without an approved business plan, and the President and Chief Executive Officer (CEO) had just resigned. Further, the bank was exhibiting several of the risk characteristics identified in FIL-50-2009 that led to significant problems or failure among newly insured banks. Stronger supervisory action could have included lowering VPB's management and/or composite ratings; assessing CMPs; and/or requiring the bank to halt the expansion of its mortgage banking operation until a business plan was approved by the FDIC and PDBS and there was reasonable assurance that sufficient controls and resources existed to effectively implement the plan.[6] Such a tenor would have been consistent with the FDIC's supervisory guidance for newly insured banks and the Corporation's forward looking approach to bank supervision, which collectively require institutions with weak risk management practices to be subject to increased supervisory analysis and a proactive supervisory response when risks are not properly managed.

The FDIC implemented a Consent Order with VPB in December 2013 that, among other things, required the bank to halt further expansion of its mortgage banking operation until the weaknesses identified during the April 2013 examination were addressed. By that time, however, VPB's financial condition had deteriorated significantly and the mortgage banking operation had been significantly downsized. More proactive supervisory action during earlier periods may have prompted VPB's Board to better manage the expansion of its mortgage banking operation, mitigating the losses incurred by the bank and, to some extent, the DIF.

[5] See Appendix 2 for a detailed chronology of key events related to VPB's business plans.
[6] We found no memorandum to the file documenting reasons for not pursuing an enforcement action as described in the RD Memorandum.

### Recording Enforcement Action Information in FIAT

We found that both the MOU and Consent Order for VPB had been entered into the Formal and Informal Action Tracking (FIAT) System—the FDIC's primary information system of record for recording information about formal and informal actions. However, FIAT generally did not contain current and complete information regarding the FDIC's monitoring of the MOU, such as assessments of VPB's compliance with the MOU, the receipt and review of bank progress reports, requests to bank management for information, or the reasons for the FDIC's decision in subsequent years to waive bank progress reports. FDIC policy requires Case Managers to record such information in FIAT on an ongoing basis. Doing so helps to ensure appropriate and timely monitoring of enforcement actions; serves to mitigate the risks associated with staff departures and changes; and provides support for important supervisory decisions.

In October 2013, the RMS New York Regional Office (NYRO) completed an internal review of its supervisory practices related to enforcement actions and use of FIAT. Among other things, the review found that FIAT did not always contain complete and current information for the NYRO's formal and informal enforcement actions that were outstanding as of September 20, 2013. According to RMS officials, several factors likely contributed to this issue, including a heavy workload, competing priorities for Case Managers during the financial crisis, and FIAT capabilities that do not fully support user needs. Because similar circumstances may exist in other regional offices, it would be prudent for RMS to reinforce to its Case Managers the policy requirement to record and maintain current and complete enforcement action information in FIAT. Doing so would also be beneficial for training purposes as RMS plans to increase the number of its permanent Case Manager positions during 2015 (as described later).

### Implementation of Prompt Corrective Action

Section 38 of the FDI Act, *Prompt Corrective Action*, establishes a framework of mandatory and discretionary supervisory actions pertaining to all insured depository institutions. The section requires regulators to take progressively more severe actions, known as "prompt corrective actions," as an institution's capital level declines. The purpose of Section 38 is to resolve the problems of insured depository institutions at the least possible cost to the DIF. Part 325, *Capital Maintenance*, of the FDIC Rules and Regulations defines the capital measures used in determining the supervisory actions to be taken pursuant to Section 38 for FDIC-supervised institutions. Part 325 also establishes procedures for the submission and review of capital restoration plans (CRP) and for the issuance of directives and orders pursuant to Section 38. The FDIC is required to closely monitor institution compliance with CRPs, mandatory restrictions defined under Section 38(e), and discretionary safeguards imposed by the FDIC (if any) to determine if the purposes of PCA are being achieved.

With respect to VPB, the FDIC implemented supervisory actions that were generally consistent with relevant provisions of Section 38. Among other things, the FDIC reviewed and monitored the institution's Consolidated Reports of Condition and Income (Call Reports), held discussions with VPB's management regarding its efforts to raise needed capital, and notified the bank when its capital levels fell below *Adequately Capitalized*.

## Conclusion and Recommendations

In reviewing the circumstances pertaining to VPB's failure, the Director, RMS, noted that several of the red flags highlighted in the FDIC's bank examination training program covering the lessons learned from the recent banking crisis were present at VPB and identified by examiners. However, the associated risks were not fully mitigated. To address this weakness, the Director, RMS, took the following actions:

- Directed RMS' Internal Control and Review Section to conduct a review of VPB's failure. The review, which was completed in September 2014, resulted in eight recommendations to RMS management to ensure, among other things, that sufficient resources are dedicated to assessing business plan submissions; key supervisory information is recorded in automated information systems; and existing enforcement actions are revised or updated, when warranted, to more proactively address deficiencies.

- Requested that the OIG conduct an in-depth review to determine the causes of VPB's failure and resulting loss to the DIF and to evaluate the FDIC's supervision of the bank, particularly with respect to VPB's deviation from its business plan.

- Initiated a national review of RMS' procedures for evaluating business plans and responding to unapproved material deviations by bank management during the de novo period. The review, which was ongoing at the close our audit, will assess whether existing procedures should be altered or expanded and whether additional guidance is warranted. RMS anticipates completing this review during the first quarter of 2015.

RMS also plans to increase the number of its permanent Case Manager positions in 2015 and to reassign Case Manager duties from those RMS field supervisors who have them to Case Managers in the regional offices. These changes are intended to better balance workload and help ensure that the FDIC is prepared for a future crisis.

More effective monitoring of VPB for compliance with its business plans and stronger supervisory action during the April 2012 examination would have been consistent with supervisory guidance for newly insured banks. It may have also prompted VPB to better control the expansion of its mortgage banking operation, mitigating the losses incurred by the bank and, to some extent, the DIF. We are making two recommendations to address the issues and lessons learned described above. RMS should coordinate its response to these recommendations with the planned and ongoing reviews described above.

We recommend that the Director, RMS:

(1) Review and update, as appropriate, supervisory guidance and associated training related to newly insured banks to address the lessons learned and issues described in this report, including the need for:

   a. thorough and timely (at least quarterly) monitoring of changes and deviations in bank business plans;

   b. prompt communication to bank management regarding issues involving the adequacy of business plans;

   c. clear expectations regarding the timing, type, and documentation of supervisory monitoring activities pertaining to business plan compliance; and

   d. proactive supervisory action when banks materially deviate from their approved business plans without regulatory approval.

(2) Reinforce to Case Managers the policy requirement to record and maintain current and complete information pertaining to enforcement actions in FIAT.

## Supervisory Guidance Related to Business Plans

It is the policy of the FDIC that orders granting deposit insurance for state nonmember banks include a condition that banks operate within the parameters of their approved business plans. In addition, before a bank may consummate a proposed major change or material deviation from its approved business plan, the bank must obtain the FDIC's prior approval. However, the FDIC's supervisory guidance issued to newly insured banks does not describe the factors to be considered when determining whether a change or deviation should be considered major or material.

The RD Memorandum contains guidance that is intended to help examiners identify potential major changes and material deviations in bank business plans. According to the RD Memorandum, such changes may be evidenced by (among other things) shifts in asset or liability mix; variances in loan, deposit, or total asset volumes from original projections; the establishment of branch offices and LPOs; or the introduction or discontinuation of specific business strategies (such as the initiation of subprime lending or the gathering of brokered deposits). Notwithstanding the guidance and examples in the RD Memorandum, a significant degree of professional judgment is required in determining whether a change or deviation is major or material.

### Conclusion and Recommendation

Providing banks with guidance for determining whether changes or deviations in business plans are major or material (similar to the guidance contained in the RD Memorandum) could help bank management more readily identify such changes and deviations. This, in turn, would help ensure prompt and full disclosure of major changes and material deviations by banks and better enable the FDIC to address the associated risks. In addition, the FDIC would have a stronger foundation on which to take supervisory action, when needed. RMS' internal review of VPB's failure also concluded that providing banks with guidance in this area would be beneficial.

We recommend that the Director, RMS:

(3) Review and clarify, as appropriate, supervisory guidance for newly insured banks to include information regarding what constitutes a major change or material deviation in bank business plans.

## Corporation Comments and OIG Evaluation

The Director, RMS, provided a written response, dated March 13, 2015, to a draft of this report. The response is presented in its entirety in Appendix 6. In the response, the Director concurred with all three of the report's recommendations. In a separate communication, an RMS official informed us that corrective actions described in the response pertaining to Recommendations 1 and 3 would be completed by December 31, 2015. The RMS official also provided us with documentation evidencing that corrective action for Recommendation 2 had been completed on January 28, 2015. A summary of the Corporation's corrective actions is presented in Appendix 7. The planned and completed corrective actions are responsive to the recommendations and the recommendations are resolved.

# Objectives, Scope, and Methodology

## Objectives

The objectives of this in-depth review were to (1) determine the causes of VPB's failure and the resulting loss to the DIF and (2) evaluate the FDIC's supervision of the institution, including the FDIC's implementation of the PCA provisions of Section 38 of the FDI Act. The scope of our work included an emphasis on VPB's deviation from its business plan and the FDIC's supervisory response to address the associated risks.

We conducted this performance audit from April 2014 through December 2014 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.

## Scope and Methodology

The scope of the audit included a review of VPB's financial condition, risk management controls and practices, and business planning activities from the point when the institution applied for federal deposit insurance in 2007 through its closure on February 28, 2014. The audit also included an evaluation of the FDIC's supervision of VPB over the same period.

To determine the causes of VPB's failure and resulting loss to the DIF, we reviewed relevant reports, correspondence, and other analyses prepared by RMS and the PDBS. For example, we reviewed reports of examination and visitation results, correspondence, UBPRs, and a supervisory history prepared by RMS. In addition, we interviewed RMS officials in the NYRO and Philadelphia Field Office, as well as PDBS officials, to obtain their perspectives on the principal causes of VPB's failure.

To evaluate the FDIC's supervision of VPB, we assessed whether the supervisory approach and actions taken with respect to VPB were commensurate with its risk profile and relevant laws, regulations, policies, and guidelines. Specifically, we:

- Researched various banking laws and regulations and FDIC policy, procedures, and guidance to obtain an understanding of the requirements that were relevant to VPB in the context of the issues that contributed to the bank's failure. In this regard, particular emphasis was placed on the business plan requirements contained in FIL-50-2009 and the RD Memorandum.

- Reviewed institution records, reports of examination, visitation results, examination workpapers, and supervisory information contained in ViSION, FIAT, and other FDIC information systems to determine the nature and timing of supervisory actions taken to address risks at the bank.

## Objectives, Scope, and Methodology

- Analyzed VPB's deposit insurance application and related reports of investigation to ascertain VPB's initial business strategies. We also reviewed VPB's various business plan submissions and the FDIC handling of those submissions.

- Reviewed examination findings and the resulting supervisory actions to determine if the severity of the weaknesses and violations were consistent with the supervisory actions taken.

We obtained data from various FDIC systems but determined that information system controls were not significant to the audit objectives and, therefore, we did not evaluate the effectiveness of information system controls. We relied primarily upon hard-copy and electronic information provided by RMS and PDBS, as well as testimonial evidence provided during interviews.

Regarding compliance with laws, regulations, policy, and guidance, we performed certain tests to determine whether the FDIC had complied with relevant PCA provisions in Section 38 of the FDI Act. We also assessed compliance with aspects of the FDIC Rules and Regulations, including the examination frequency requirements defined in Section 337.12. Further, we assessed the FDIC's implementation of the business plan requirements described in FIL 50-2009 and the RD Memorandum. The results of our compliance tests, including any instances of significant non-compliance, are discussed in this report, where appropriate. Additionally, we assessed the risk of fraud and abuse related to our audit objectives in the course of evaluating audit evidence.

# Chronology of Key Events Related to Vantage Point Bank's Business Plans

| Date | Event |
|---|---|
| March 12, 2007 | The FDIC conditionally approves the deposit insurance order for VPB. A condition of the order is that VPB operate within the parameters of its business plan and notify the FDIC of any major deviation or material change 60 days in advance. |
| August 8, 2007 | VPB requests that its beginning paid-in capital requirement in the federal deposit insurance order be reduced from $12 million to $10 million because of difficulties raising additional capital. In connection with the request, VPB submits a revised business plan reflecting lower growth objectives. |
| September 10, 2007 | The FDIC approves VPB's request for a reduced beginning paid-in capital requirement. |
| December 26, 2007 | VPB begins operations. |
| April 4, 2008 | The FDIC sends a letter to VPB's Board reminding its members of their responsibility to provide the FDIC with prior written notice of any proposed major deviation or material change to the bank's approved business plan. The letter adds that the bank may not consummate a material change to its business plan without the FDIC Regional Director's written non-objection. |
| December 15, 2008 | The FDIC and PDBS begin a joint examination. Examiners note that VPB's net operating losses are well above initial projections and have eroded the bank's capital levels beyond what was expected in the business plan. Further, VPB's growth and profitability goals in the draft 2009 business plan are dependent on raising additional capital in an adverse economic environment. Examiners determine that VPB generally operated within the parameters of its business plan and that there had not been any major deviations. |
| June 17, 2009 | The FDIC, PDBS, and VPB enter into an MOU based on the results of the December 2008 examination. One of the MOU's provisions requires VPB to evaluate its business plan to determine whether the projections, financial targets, and goals remain relevant in the current operating environment. |
| August 18, 2009 | In response to the MOU, VPB provides the FDIC with a revised business plan that presents financial projections for the remainder of the bank's 3-year de novo period. |
| August 28, 2009 | The FDIC issues FIL-50-2009, entitled *Enhanced Supervisory Procedures for Newly Insured FDIC-Supervised Depository Institutions*. Among other things, the FIL extends the de novo period for newly insured FDIC-supervised institutions (including VPB) from 3 to 7 years and requires institutions that have not yet reached the end of their third year of operation to submit updated financial statements and business plans covering years 4 through 7. |

## Chronology of Key Events Related to Vantage Point Bank's Business Plans

| Date | Event |
|---|---|
| November 5, 2009 | The FDIC sends a letter to VPB's Board Chairman and CEO referencing the requirement in FIL-50-2009 to provide the FDIC with an updated business plan covering years 4 through 7 within 60 days of the end of the bank's third operating year (i.e., October 26, 2010). The letter includes a reminder that any material change in the bank's business plan during the de novo period requires prior FDIC approval. |
| January 11, 2010 | The FDIC and PDBS begin a joint examination. Examiners determine that VPB's Board had approved a revised business plan covering the remaining 18 months of the bank's original 3-year de novo period. Examiners are not critical of the revised business plan. Examiners also determine that VPB had generally operated within the parameters of the business plan and no major deviations had occurred. |
| June 7, 2010 | VPB requests that the FDIC approve a change in its business plan to establish a new title insurance subsidiary to complement the bank's mortgage banking operation. The request notes that title insurance is not specifically addressed in its approved business plan. The revised business plan also indicates that VPB operates as both a mortgage broker and correspondent lender and is conservatively developing mortgage banking expertise. |
| June 29, 2010 | The FDIC notifies VPB by email that the proposed title insurance subsidiary is permissible and does not represent a significant change in the bank's approved business plan. |
| October 26, 2010 | VPB's updated business plan covering years 4 through 7 of operation, as required by FIL-50-2009, is due. However, VPB does not submit the plan. |
| February 14, 2011 | The FDIC and PDBS begin a joint examination. Examiners determine that VPB has not yet submitted an updated business plan and financial projections for years 4 through 7 as required by FIL-50-2009. |
| June 15, 2011 | The FDIC and PDBS transmit the February 2011 report of examination to VPB's Board. The transmittal letter indicates that an updated business plan covering years 4 through 7 has not yet been submitted to the FDIC. |
| July 20, 2011 | VPB submits an updated business plan covering years 4 through 7. The business plan's description of the bank's mortgage banking activities is substantially the same as the prior business plan. However, the plan notes that VPB plans to apply for capital through the Department of the Treasury's Small Business Lending Fund (SBLF) program in order to grow its balance sheet. The bank also plans to cut staff to reduce expenses. |
| September 20, 2011 | The FDIC and PDBS begin a visitation and learn that VPB had recently been notified that its application for capital through the SBLF would not be approved. |
| October 31, 2011 | The FDIC sends VPB's Board a letter stating that the bank's business plan requires substantial revision because growth, income, and capital projections are predicated on the receipt of SBLF funds, which will not be forthcoming. The letter requests a revised business plan within 45 days. |

# Chronology of Key Events Related to Vantage Point Bank's Business Plans

| Date | Event |
|---|---|
| December 19, 2011 | VPB submits a revised business plan stating that the bank is expanding its mortgage banking operation to include the funding of loans and their sale to third-party investor banks. The business plans states that the bank has opened five additional LPOs in three states in connection with the expansion. |
| February 27, 2012 | The PDBS sends an email to the FDIC Case Manager asking whether a satisfactory, updated business plan had been received from VPB. The email adds that the PDBS had not yet approved all of the bank's LPOs because additional information was needed to do so. |
| March 8, 2012 | A PDBS official sends an email to the FDIC EIC for VPB stating that the bank is opening LPOs and that such activity represents a change in the bank's business plan. The email expresses concern that VPB has not notified the FDIC of this activity. |
| March 13, 2012 | The FDIC Case Manager sends an email to PDBS stating that the Case Manager will seek to locate VPB's business plan and review it as soon as possible. |
| March 22, 2012 | The FDIC Case Manager sends an email to the FDIC EIC for VPB stating that the Case Manage is behind in reviewing VPB's business plan and progress reports. The Case Manager requests that the EIC follow up on the LPOs during the upcoming examination. |
| April 2, 2012 | The FDIC and PDBS begin a joint examination. Examiners determine that the expansion of the mortgage banking operation represents a material change to the bank's business plan and that the FDIC was not notified of the expansion until VPB submitted its revised business plan in December 2011. Examiners also determine that controls over the mortgage banking operation are adequate, but that the business plan does not adequately address the operation in terms of personnel, operations, limits, controls, earnings, liquidity, and capital. |
| May 23, 2012 | The FDIC and PDBS hold an exit meeting with VPB management and discuss the results of the April 2012 examination. |
| June 12, 2012 | In response to the exit meeting, VPB provides the FDIC with an updated business plan and transition plan. Among other things, the business plan includes a more comprehensive description of the mortgage banking operation and financial projections for the remainder of the bank's de novo period. The plan states that the bank is increasing the number of its loan originators and LPOs and plans to open approximately one new LPO per month. The transition plan details how VPB will fulfill the roles of its departed President and CEO. |
| August 17, 2012 | The FDIC transmits the April 2012 report of examination to VPB. The report of examination states that VPB's management must develop a revised business plan within 30 days that adequately addresses the expansion of the mortgage banking operation. |
| September 19, 2012 | In response to the FDIC's transmission of the report of examination, VPB re-submits its June 2012 business plan and transition plan and states that the bank has not received any comment from the FDIC on the plans. |

# Chronology of Key Events Related to Vantage Point Bank's Business Plans

| Date | Event |
|---|---|
| December 3, 2012 | The FDIC and PDBS commence a visitation which identifies concerns pertaining to the adequacy of VPB's business plan and expansion of the mortgage banking operation. |
| January 8, 2013 | As a result of the visitation findings, the FDIC Case Manager sends an email to VPB officials asking if a new business plan has been developed. |
| January 14, 2013 | VPB provides the FDIC with an updated business plan reflecting a proposed stock purchase by an outside investor. |
| January 25, 2013 | The FDIC and PDBS transmit the results of a visitation conducted in December 2012 to VPB's Board. In its transmittal letter, the regulators indicate that the June 2012 business plan (which was subsequently re-submitted to the FDIC in September 2012) does not adequately address the bank's expansion into mortgage banking or provide sufficient support to analyze its effectiveness. Further, the business plan does not include a capital plan. The transmittal letter refers to the mortgage banking operation as "high-risk" and cautions the Board about potential losses should loan production decrease unexpectedly. |
| February 10, 2013 | The FDIC Case Manager sends an email to VPB officials indicating that the FDIC is reviewing the January 2013 business plan. The email contains 24 questions about the business plan and mortgage banking operation. |
| February 12, 2013 | The FDIC Case Manager sends an email to VPB officials with an additional 18 questions about the business plan and mortgage banking operation. |
| February 17, 2013 | VPB sends an email to the FDIC Case Manager with responses to the questions about the business plan and mortgage banking operation. |
| March 12, 2013 | The FDIC approves a change-in-control application in connection with the potential purchase of VPB's stock by the outside investor. |
| April 3, 2013 | The FDIC Case Manager sends an email to VPB officials with 12 follow-up questions about the business plan and 8 questions about the mortgage banking operation budget. |
| April 11, 2013 | The FDIC Case Manager and VPB officials hold a telephone conference call and VPB provides responses to the 12 follow-up questions about the business plan. |
| April 25, 2013 | VPB sends an email to the FDIC Case Manager with responses to the 8 questions about the mortgage banking operation budget. |
| April 29, 2013 | The FDIC and PDBS begin a joint examination. Based on significant revisions that were made to the bank's earnings for 2012 and the first quarter of 2013, examiners determine that the projections in the business plan are no longer attainable or reasonable. |

# Chronology of Key Events Related to Vantage Point Bank's Business Plans

| Date | Event |
|---|---|
| June 5, 2013 | FDIC, PDBS, and VPB officials hold a conference call to discuss the withdrawal of the stock purchase offer by the outside investor. The investor withdrew due to VPB's losses in the first quarter of 2013, a reduction in VPB's equity capital, concerns with VPB's financial reporting, and a reduction in mortgage activity during May 2013. The FDIC advises VPB to withdraw its proposed business plan and not submit another until the examination report is issued and corrective action plans are in place. |
| June 11, 2013 | VPB sends a letter to the FDIC withdrawing its January 2013 proposed business plan. VPB does not submit another business plan. |
| October 31, 2013 | FDIC, PDBS, and VPB officials hold a meeting to discuss VPB's deteriorating financial condition. The regulators send a letter to VPB informing the bank it is in troubled condition, that the composite rating is downgraded, and that the regulators intend to propose a formal enforcement action. |
| November 18, 2013 | The FDIC and PDBS transmit the results of the April 2013 examination to VPB. The report of examination states that the bank must submit a realistic business plan that addresses the significant operating losses from the mortgage banking operation and integrates the need for a capital infusion. |
| February 28, 2014 | VPB is closed. |

# Scope of Visitations Conducted of Vantage Point Bank, 2008-2013

The table below summarizes the scope of the seven visitations that were conducted of VPB between 2008 and 2013.

| Visitation Date | Scope of the Visitation |
|---|---|
| June 2008 | VPB’s overall financial condition and compliance with the Order Granting Deposit Insurance. |
| August 2009 | VPB’s overall financial condition and compliance with the June 2009 MOU. |
| July 2010 | VPB’s actions to address recommendations contained in the January 2010 report of examination pertaining to weaknesses in the bank’s investment portfolio and management of investment activities. |
| September 2011 | VPB’s actions to address concerns raised by examiners during the February 2011 examination. |
| January 2012 | VPB’s private label residential mortgage-backed securities. |
| December 2012 | VPB’s overall financial condition, actions to address prior examination findings, and compliance with the July 19, 2011, IT-BBR. |
| December 2013 | VPB’s overall financial condition, supervisory ratings, and actions to address recommendations and findings in the April 2013 report of examination. |

Source: OIG analysis of VPB visitation results.

# Glossary of Key Terms

| Term | Definition |
|---|---|
| **Bank Board Resolution (BBR)** | A BBR is an informal commitment adopted by a financial institution's Board (often at the request of the FDIC) directing the institution's personnel to take corrective action regarding specific noted deficiencies. BBRs may also be used as a tool to strengthen and monitor an institution's progress with regard to a particular supervisory component rating or activity. The FDIC is not a party to these resolutions, but may review or draft the documents as a means of initiating corrective action. |
| **Call Report** | Consolidated Reports of Condition and Income (also known as Call Reports) are reports that each insured depository institution must file pursuant to the FDI Act. These reports are used to calculate deposit insurance assessments and monitor the condition, performance, and risk profile of individual banks and the banking industry. |
| **Capital Restoration Plan (CRP)** | Section 325.104(a)(1) of the FDIC Rules and Regulations requires a bank to file a written CRP with the appropriate FDIC regional director within 45 days of the date that the bank receives notice or is deemed to have received notice that the bank is *Undercapitalized*, *Significantly Undercapitalized*, or *Critically Undercapitalized*, unless the FDIC notifies the bank in writing that the plan is to be filed within a different period. |
| **Case Manager** | A Case Manager is an individual with responsibility over a caseload of institutions or companies to enhance the FDIC's risk assessment and supervision activities. A Case Manager facilitates communication and coordination among the FDIC, other regulators, and the banking industry, so that a consistent regulatory voice is presented, while minimizing regulatory burden to the extent possible. |
| **Cease and Desist or Consent Order** | A formal enforcement action issued by financial institution regulators to a bank or affiliated party to stop an unsafe or unsound practice or violation. A Cease and Desist Order may be terminated by the regulators when they have determined that the bank's condition has significantly improved and the action is no longer needed or the bank has materially complied with its terms. A Consent Order is a Cease and Desist Order that has been stipulated to by the bank's Board. |
| **Civil Money Penalty (CMP)** | Section 8(i) of the FDI Act grants the FDIC authority to impose CMPs against insured depository institutions. CMPs may be assessed for violations of final and temporary orders, written agreements with the FDIC, and laws and regulations; unsafe and unsound practices; and breaches of fiduciary duty. |
| **Correspondent Lending** | Correspondent lending is the process of a correspondent lender (usually a bank) originating and funding home loans in their own name. Shortly after the loan closes, the correspondent lender sells the loans to larger mortgage lenders who service the loans and may also sell them to the secondary market. Correspondent lenders employ their own underwriters and initially fund loans with their own money. |

# Glossary of Key Terms

| Term | Definition |
|---|---|
| **Deferred Tax Asset** | Deferred Tax Assets are assets that reflect, for reporting purposes, amounts that will be realized as reductions of future taxes or as future receivables from a taxing authority. Deferred Tax Assets may arise because of specific limitations requiring that certain net operating losses or tax credits be carried forward if they cannot be used to recover taxes previously paid. These "tax carry-forwards" are realized only if the institution generates sufficient future taxable income during the carry-forward period. |
| **De Novo Bank** | A de novo bank is a newly established bank that is in its first 7 years of operation. De novo banks are subject to additional supervisory oversight and regulatory controls, including the development and maintenance of a business plans and increased examination frequency. |
| **Deposit Insurance Fund (DIF)** | The DIF was created in 2006, when the Federal Deposit Insurance Report Act of 2005 provided for the merging of the Bank Insurance Fund and the Savings Association Insurance Fund. The FDIC administers the DIF, the goal of which is to (1) insure deposits and protect depositors of DIF-insured institutions and (2) resolve failed DIF-insured institutions at the least possible cost (unless a systemic risk determination is made). The DIF is primarily funded from deposit insurance assessments. |
| **Forward-Looking Approach** | The forward-looking approach to bank supervision was re-emphasized by the FDIC in 2011 as part of the lessons learned from the most recent financial crisis. Its goal is to proactively identify and assess the potential impact of an institution's new and/or growing risks and ensure early supervisory intervention, as appropriate. |
| **Receiver** | The FDIC as Receiver succeeds to the rights, powers, and privileges of a failed institution and its stockholders, officers, and directors. The FDIC as Receiver may collect all obligations and money due to an institution, preserve or liquidate its assets and property, and perform any other function of the institution consistent with its appointment. The FDIC as Receiver is functionally and legally separate from the FDIC acting in its corporate capacity as regulator and deposit insurer. |
| **Formal and Informal Action Tracking (FIAT) System** | FIAT is a central source of information for RMS formal and informal enforcement actions. The system reflects work tasks of Case Managers, Review Examiners, and other staff involved in processing and monitoring enforcement actions. FIAT generates various reports that are used by the FDIC's Washington, regional, and field offices. |
| **Formal Enforcement Action** | An action taken pursuant to the powers granted to regulators under Section 8 of the FDI Act. Each situation and circumstance determines the most appropriate action to be taken. |
| **Informal Enforcement Action** | A voluntary commitment made by an institution's Board. These actions are designed to correct identified deficiencies or ensure compliance with federal and state banking laws and regulations. Informal actions are neither publicly disclosed nor legally enforceable. |

## Glossary of Key Terms

| Term | Definition |
|---|---|
| **Loan Production Office (LPO)** | A loan production office is a banking office that takes loan applications and arranges financing for corporations and small businesses, but it does not accept deposits. Loan applications are subject to approval by the lending institution. |
| **Material Loss Review (MLR)** | When an institution failure results in a material loss to the DIF, the FDI Act requires the appropriate Inspector General to conduct an MLR to report the causes of the failure and the primary federal regulator's supervision of the institution. Effective July 21, 2010, Section 38(k) of the FDI Act defines a loss as material if it exceeds $50 million for calendar year 2014 and thereafter (with a provision that the threshold can be raised temporarily to $75 million should certain conditions be met). |
| **Memorandum of Understanding (MOU)** | An MOU is an informal agreement between the institution and the FDIC, which is signed by both parties. State banking agencies may also be party to such agreements. MOUs are designed to address and correct identified weaknesses in an institution's condition. |
| **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 1831(o), by establishing a framework for determining capital adequacy and taking supervisory actions against depository institutions that are in an unsafe or unsound condition. The following terms are used to describe capital adequacy: (1) *Well Capitalized*, (2) *Adequately Capitalized*, (3) *Undercapitalized*, (4) *Significantly Undercapitalized*, and (5) *Critically Undercapitalized*. |
| **Small Business Lending Fund (SBLF)** | The SBLF is a $30 billion fund that encourages lending to small businesses by providing Tier 1 capital to qualified community banks with assets of less than $10 billion. The U.S. Department of the Treasury provides banks with capital by purchasing Tier 1-qualifying preferred stock or equivalents in each bank. |
| **Uniform Bank Performance Report (UBPR)** | The UBPR is an analysis of financial institution financial data and ratios that includes extensive comparisons to peer group performance. The report is produced by the Federal Financial Institutions Examination Council for the use of banking supervisors, bankers, and the general public and is produced quarterly from Call Report data submitted by banks. |
| **Uniform Financial Institutions Rating System (UFIRS)** | Financial institution regulators and examiners use the UFIRS to evaluate a bank's performance in six components represented by the CAMELS acronym: Capital adequacy, Asset quality, Management practices, Earnings performance, Liquidity position, and Sensitivity to market risk. Each component, and an overall composite, is assigned a rating of "1" through "5," with "1" having the least regulatory concern and "5" having the greatest concern. |

# Glossary of Key Terms

| Term | Definition |
| --- | --- |
| **Virtual Supervisory Information on the Net (ViSION)** | An FDIC information system that provides access to a broad range of information related to insured financial institutions in support of the Corporation's insurance and supervision programs. RMS personnel use the system to perform supervisory-related functions, such as tracking applications, accessing examination information, and monitoring enforcement actions. Analysts in the Division of Insurance and Research also rely on information in ViSION to perform insurance-related functions, such as analyzing trends in the banking industry and calculating deposit insurance assessment rates for financial institutions. |
| | |

# Acronyms and Abbreviations

| Acronym | Explanation |
|---|---|
| BBR | Bank Board Resolution |
| Board | Board of Directors |
| CEO | Chief Executive Officer |
| CMP | Civil Money Penalty |
| CRP | Capital Restoration Plan |
| DIF | Deposit Insurance Fund |
| FDI | Federal Deposit Insurance |
| FIAT | Formal and Informal Action Tracking |
| FIL | Financial Institution Letter |
| LPO | Loan Production Office |
| MLR | Material Loss Review |
| MOU | Memorandum of Understanding |
| NYRO | New York Regional Office |
| OIG | Office of Inspector General |
| PCA | Prompt Corrective Action |
| PDBS | The Pennsylvania Department of Banking and Securities |
| RD | Regional Director |
| RMS | Risk Management Supervision |
| SBLF | Small Business Lending Fund |
| UBPR | Uniform Bank Performance Report |
| UFIRS | Uniform Financial Institutions Rating System |
| ViSION | Virtual Supervisory Information on the Net |
| VPB | Vantage Point Bank |

# Corporation Comments

FDIC
Federal Deposit Insurance Corporation
550 17th Street NW, Washington D.C. 20429-9990 Division of Risk Management Supervision

March 13, 2015

**TO:** Stephen M. Beard
Deputy Inspector General for Audits and Evaluations

**FROM:** Doreen R. Eberley /**Signed**/
Director

**SUBJECT:** Response to the Draft Audit Report Entitled, In-Depth Review of Vantage Point Bank, Horsham, Pennsylvania (Assignment No. 2014-030)

Pursuant to Section 38(k) of the Federal Deposit Insurance (FDI) Act, as amended by the Dodd¬ Frank Wall Street Reform and Consumer Protection Act, the Federal Deposit Insurance Corporation's (FDIC) Office of Inspector General (OIG) conducted an In-Depth Review of Vantage Point Bank, Horsham, Pennsylvania, which failed on February 28, 2014.

Although the loss estimate did not meet the material loss review threshold, the Director of the FDIC’s Division of Risk Management Supervision (RMS) requested that the FDIC’s OIG conduct an In-Depth review of Vantage Point Bank (VPB) because its failure involved unusual circumstances. Specifically, the bank engaged in material changes to its business plan during its de novo period without regulatory approval. The objectives of the In-Depth Review were to: (1) determine the causes of VPB’s failure and resulting loss to the DIF and (2) evaluate the FDIC’s supervision of VPB, including the FDIC’s implementation of the Prompt Corrective Action provisions of Section 38 of the FDI Act. The scope of OIG’s work included emphasis on VPB’s deviation from its business plan and the FDIC’s supervisory response to the associated risks. This memorandum is the response of RMS to the OIG's Draft Report (Report) received on February 11, 2015.

VPB failed primarily because its Board of Directors (Board) and management did not effectively manage the risks associated with the bank’s unapproved rapid expansion of its mortgage banking operation. VPB did not implement appropriate controls over its expanded mortgage banking operation, exposing the bank to operational, regulatory compliance, and fair lending risks. Further, VPB did not develop a viable strategy to downsize its mortgage banking operation should market conditions deteriorate unexpectedly. High overhead expenses and lower-than-expected interest revenue from traditional banking services were contributing factors in the recurring pre-tax operating losses reported by the bank since its inception. The costs associated with unwinding the mortgage banking operation, together with financial reporting adjustments made in December 2013 materially impaired VPB’s capital position. VPB was closed because it did not have sufficient capital to support its operations and had no viable means of raising additional capital.

# Corporation Comments

The Report covers the period 2008 through failure. During that period, the FDIC and the Pennsylvania Department of Banking and Securities conducted five onsite examinations, seven onsite visitations, and several offsite monitoring analyses. The Report finds that the FDIC's approach to monitoring VPB for compliance with the original business plan was consistent with supervisory guidance for the first three years of the bank's operation. However, as the Report noted, monitoring in subsequent years was not adequate. We agree with the OIG's observations that, in retrospect, it would have been prudent for RMS to have executed more effective monitoring and tracking of VPB for compliance with its four through seven year business plans and taken stronger supervisory action during the April 2012 examination, which would have been consistent with supervisory guidance for newly insured banks. The Report makes three recommendations intended to improve the effectiveness of the FDIC's supervision of newly insured institutions, such as VPB. RMS agrees with these recommendations. The actions RMS will take to address these recommendations are briefly described below.

__OIGs Audit Recommendation 1:__ *Review and update, as appropriate, supervisory guidance and associated training related to newly insured banks to address the lessons learned and issues described in this report, including the need for:*

*a. thorough and timely (at least quarterly) monitoring of changes and deviations in bank business plans,*
*b. prompt communication to bank management regarding issues involving the adequacy of business plans,*
*c. clear expectations regarding the timing, type, and documentation of supervisory monitoring activities pertaining to business plan compliance, and*
*d. proactive supervisory action when banks materially deviate from their approved business plans without regulatory approval.*

RMS concurs with this recommendation. RMS will review and update, if necessary, supervisory guidance and associated training related to newly insured banks to address the lessons learned and issues described in this Report, including all areas described above. More specifically, to enhance our supervision of institutions such as VPB, RMS is in the final stages of completing a national horizontal review of our procedures for evaluating de novo business plans and responding to unapproved material deviations during the de novo period. The horizontal review included a sample of de novo institutions from each Region. Findings of this horizontal review will help assess whether existing de novo application and business plan procedures should be clarified and whether additional guidance is warranted. In addition, RMS, together with support from the Legal Division and Corporate University, delivered a day-long Applications Training Program for Regional management and Case Managers during 2014. The training was delivered to each Regional and Area Office, and emphasized a holistic approach to the review of applications, techniques to support a forward-looking supervisory approach, and the need to fully consider and favorably resolve each applicable statutory factor. RMS also conducted a national Case Manager training initiative that concluded in January 2015, which reinforced policy requirements for, among other areas, de novo applications, business plan changes, identifying and mitigating emerging risks (including taking prompt action and communication on potential material findings), and best practices for effective portfolio monitoring. Lastly, RMS plans to increase the number of its permanent Case Manager positions in 2015, which is intended to better balance workload and prepare the FDIC for a future crisis.

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## Corporation Comments

**<u>OIGs Audit Recommendation 2:</u>** *Reinforce to Case Managers the policy requirement to record and maintain current and complete information pertaining to enforcement actions in the Formal and Informal Action Tracking (FIAT) System.*

RMS concurs with this recommendation. RMS has reinforced to Case Managers the policy requirement to record and maintain current and complete information pertaining to enforcement actions in FIAT. RMS conducted a national Case Manager training initiative that concluded in January 2015, which reinforced policy requirements for enforcement actions, including identifying best practices to address and correct common errors associated with FIAT.

**<u>OIGs Audit Recommendation 3:</u>** *Review and clarify, as appropriate, supervisory guidance for newly insured banks to include information regarding what constitutes a major change or material deviation in bank business plans.*

RMS concurs with this recommendation. As noted previously, RMS will review and clarify supervisory guidance for newly insured banks to include information regarding what constitutes a major change or material deviation in bank business plans.

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

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## Summary of the Corporation's Corrective Actions

This table presents corrective actions taken or planned by the Corporation in response to the recommendations in the report and the status of the recommendations as of the date of report issuance.

| Rec. No. | Corrective Action: Taken or Planned | Expected/ Actual Completion Date | Monetary Benefits | Resolved:[a] Yes or No | Open or Closed[b] |
|---|---|---|---|---|---|
| 1 | RMS will review and update, if necessary, its supervisory guidance and associated training related to newly insured banks to address the lessons learned and issues described in this report. As part of this effort, RMS is currently conducting a national review of its procedures for evaluating de novo business plans and responding to unapproved material deviations during the de novo period. In addition, RMS recently provided training to its Case Managers that reinforced policy requirements related to, among other things, handling changes in bank business plans and identifying and mitigating emerging risks at banks. | 12/31/15 | $0 | Yes | Open |
| 2 | RMS provided training to its Case Managers that reinforced policy requirements to record and maintain current and complete information in FIAT. | 01/28/15 | $0 | Yes | Closed |
| 3 | RMS will review and clarify supervisory guidance for newly insured banks to include information regarding what constitutes a major change or material deviation in bank business plans. | 12/31/15 | $0 | Yes | Open |

[a] Resolved – (1) Management concurs with the recommendation, and the planned, ongoing, and completed corrective action is consistent with the recommendation.
(2) Management does not concur with the recommendation, but alternative action meets the intent of the recommendation.
(3) Management agrees to the OIG monetary benefits, or a different amount, or no ($0) amount. Monetary benefits are considered resolved as long as management provides an amount.

[b] Recommendations will be closed when (a) Corporate Management Control notifies the OIG that corrective actions are complete or (b) in the case of recommendations that the OIG determines to be particularly significant, when the OIG confirms that corrective actions have been completed and are responsive.