Audit Report

OIG-12-035

SAFETY AND SOUNDNESS: Material Loss Review of Amcore Bank, N.A.

December 28, 2011

Office of Inspector General

DEPARTMENT OF THE TREASURY

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Abbreviations

BSA	Bank Secrecy Act
CRE	commercial real estate
EIC	examiner-in-charge
FDIC	Federal Deposit Insurance Corporation
MRA	matter requiring attention
OIG	Department of the Treasury Office of Inspector General
OCC	Office of the Comptroller of the Currency
PCA	prompt corrective action
ROE	report of examination

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OIG

Audit Report

The Department of the Treasury
Office of Inspector General

December 28, 2011

John G. Walsh
Acting Comptroller of the Currency

This report presents the results of our review of the failure of Amcore Bank, N.A. (Amcore), of Rockford, Illinois, and of the Office of the Comptroller of the Currency's (OCC) supervision of the institution. OCC closed Amcore and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on April 23, 2010. This review was mandated by section 38(k) of the Federal Deposit Insurance Act because of the magnitude of Amcore's estimated loss to the Deposit Insurance Fund.[1,2] Although Amcore's estimated loss varied during our review, it remained above $200 million for most of the time, and as such we considered the loss material. The estimated loss reached a high of $320.9 million as of December 31, 2010, and as of October 31, 2011, FDIC estimated the loss at $154.5 million. FDIC also estimated that Amcore's failure resulted in a loss of $8.7 million to its Transaction Account Guarantee Program.

Our objectives were to determine the causes of Amcore's failure; assess OCC's supervision of the bank, including implementation of the prompt corrective action (PCA) provisions of section 38; and make recommendations for preventing such a loss in the future. To accomplish these objectives, we reviewed the supervisory files and interviewed OCC and FDIC officials. We also reviewed the documentation of Amcore's external auditor related to its

[1] At the time of Amcore's failure, section 38(k) defined a loss as material if it exceeded the greater of $25 million or 2 percent of the institution's total assets. Effective July 21, 2010, section 38(k) defines a loss as material if it exceeds $200 million for calendar years 2010 and 2011, $150 million for calendar years 2012 and 2013, and $50 million for calendar years 2014 and thereafter (with a provision that the threshold can be raised temporarily to $75 million if certain conditions are met).
[2] Definitions of certain terms, which are underlined where first used in this report, are available in OIG-11-065, *Safety and Soundness: Material Loss Review Glossary* (April 11, 2011). That document is available on the Department of the Treasury Office of Inspector General's (OIG) website at http://www.treasury.gov/about/organizational-structure/ig/Pages/by-date-2011.aspx.

evaluation under applicable professional standards of the bank's status as a going concern for the audits of the bank's 2007, 2008, and 2009 financial statements.[3] We conducted our fieldwork from June 2010 through March 2011. Appendix 1 contains a more detailed description of our review objectives, scope, and methodology. Appendix 2 contains background information on Amcore's history and OCC's assessment fees and examination hours.

In brief, Amcore failed primarily because it had high concentrations in commercial real estate (CRE) loans and ineffective credit risk management, underwriting, and credit administration. These factors, combined with severe declines in real estate markets, resulted in Amcore's asset quality deterioration, and the bank's eventual failure. Regarding supervision, OCC's Midsize Bank Supervision office[4] did not take timely supervisory actions to address Amcore's problems, nor did OCC take forceful enforcement actions until it was too late to avert Amcore's failure. Although concerns were raised by an OCC lead credit expert,[5] OCC did not act promptly to address those concerns. In addition, OCC's examination workpapers and records were incomplete and did not include emails that were important to the supervisory record. We also noted that the 2005 report of examination (ROE)[6] was issued more than 9 months after the end of the supervisory cycle. Nevertheless, as Amcore's capital levels deteriorated, OCC acted

[3] Statement of Auditing Standards 59 describes an auditor's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time, not to exceed 1 year beyond the date of the financial statements being audited. Continuation of an entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. The auditor's evaluation is based on his or her knowledge of relevant conditions and events that exist at or have occurred prior to the date of the auditor's report.
[4] OCC's Midsize Bank Supervision is responsible for regulating companies that generally have between $10 billion and $50 billion in assets, either in a single charter or aggregated among several charters. Due to the complexity of these organizations, oversight is centralized under one deputy comptroller. OCC assigns a dedicated examiner-in-charge (EIC) for continuous supervision of each midsize bank. Although Amcore's assets were below the $10 billion threshold for a midsize bank, it became part of the Midsize Bank Supervision program when the asset threshold was lower.
[5] The lead credit expert serves in a quality assurance role in OCC's Midsize Bank Supervision group. The responsibilities of a lead expert include (1) providing feedback on supervisory documents prior to submission to the bank and (2) performing independent reviews of the bank. The lead expert is a resource for the examination team, providing an independent perspective of the bank's performance.
[6] A report of examination is a summary of examiners' conclusions about the bank's condition drawn from the results of examination activities throughout the 12-month supervisory cycle.

timely to impose PCA restrictions but those restrictions did not prevent the bank's failure.

We are reaffirming a recommendation made in two previous material loss reviews issued by our office that OCC emphasize to its examiners the importance of maintaining adequate workpaper documentation for examinations.[7] In addition, we are making three new recommendations. Specifically, we recommend that OCC ensure (1) Midsize Bank Supervision examiners and the supervisory office[8] appropriately consider subject matter experts' opinions in examinations and maintain relevant documentation, (2) emails are maintained in the supervisory record as appropriate, and (3) ROEs are issued timely.

In a written response, OCC outlined the steps that it had taken, or plans to take, to address our recommendations. The steps described are responsive to the recommendations. OCC's response is included in full as appendix 3.

With respect to our review of the external auditor's workpapers for its audits of Amcore's 2007, 2008, and 2009 financial statements, we concluded that the auditor complied with professional standards applicable to its evaluation of Amcore's status as a going concern.

Causes of Amcore's Failure

High Concentration in Commercial Real Estate Loans

The primary cause of Amcore's failure was its high concentration in CRE loans.[9] OCC broadly defines concentrations as groups or classes of credit exposures that share common risk characteristics or sensitivities to economic, financial, or business developments.

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[7] OIG, *Safety and Soundness: Material Loss Review of National Bank of Commerce* (OIG-09-042; issued Aug. 6, 2009) and *Safety and Soundness: Material Loss Review of the First National Bank of Nevada and First Heritage Bank, National Association* (OIG-09-033; issued Feb. 27, 2009).

[8] The supervisory office supports and oversees the EIC. Midsize Bank Supervision personnel who have responsibility for support and oversight include supervisory office staff and an assistant deputy comptroller.

[9] Construction and land development loans, nonfarm/nonresidential real estate loans, and multifamily residential real estate loans collectively constitute CRE loans.

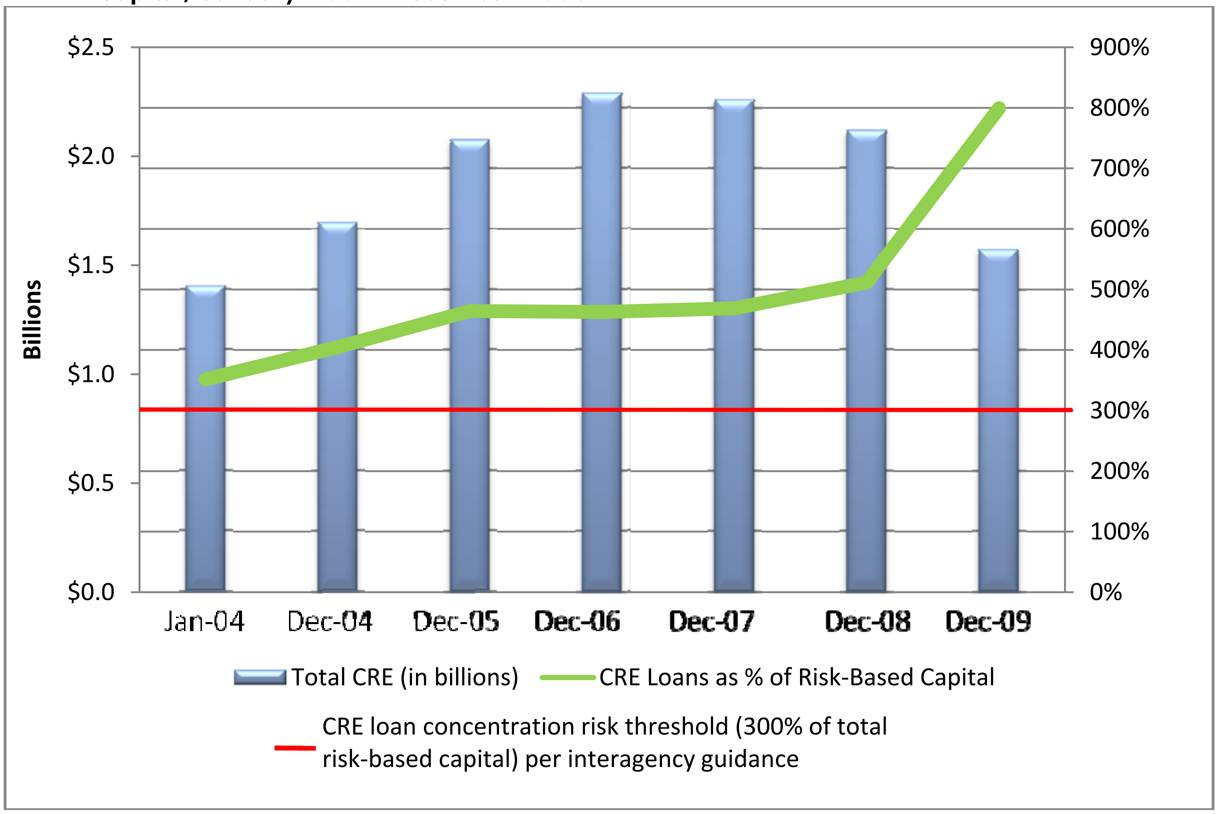
According to OCC, a concentration exists when the common credit exposures exceed 25 percent of the bank's capital structure. In addition, interagency guidance dated December 2006, *Concentration in Commercial Real Estate Lending, Sound Risk Management Practices*,[10] states that a bank is potentially exposed to CRE concentration risk if either (1) loans for construction, land development, and other land exceed 100 percent of total risk-based capital or (2) total CRE loans represent over 300 percent of total risk-based capital and the balance of the portfolio increases more than 50 percent in the prior 36 months. Amcore's CRE concentration exceeded 300 percent of its total risk-based capital for the period covered by our review—2004 through the bank's failure in 2010. In June 2007, OCC identified Amcore as the only bank in its Midsize Bank Supervision portfolio that exceeded both thresholds identified in the interagency guidance. Figure 1 on page 5 shows Amcore's CRE loan growth from 2004 to 2009.

Amcore's CRE loan portfolio grew steadily from 2004, reaching a high of more than $2.2 billion in December 2006. Although the portfolio decreased after December 2006, Amcore's concentration of CRE loans continued to increase as the bank's capital levels rapidly declined through March 2010.

The bank's most significant CRE growth came in the form of riskier construction and land development loans in Illinois and Wisconsin. This portfolio grew from approximately $280 million in 2004 to over $800 million in 2007. By 2005, the bank's loans for construction, land development, and other land exceeded 100 percent of total risk-based capital. Amcore's considerable CRE concentration, including risky construction and land development loans, made it highly susceptible to negative market fluctuations.

[10] This joint guidance was issued by OCC, the Board of Governors of the Federal Reserve System, and FDIC. OCC published this guidance as Bulletin 2006-46, Interagency Guidance on CRE Concentration Risk Management, dated Dec. 6, 2006.

Figure 1: Amcore's CRE Loan Growth and Concentration as a Percentage of Risk-Based Capital, January 2004–December 2009



Source: OIG analysis of Amcore call reports.

The risk associated with these high concentrations in CRE loans exposed the bank to significant losses during the economic downturn that began in 2007. The quality of Amcore's CRE loans deteriorated rapidly during this time which forced the bank to recognize extensive loan losses and make large provisions to its allowance for loan and lease losses, eroding its earnings and capital. Amcore reported commercial banking losses, primarily from CRE loans, of $85.8 million in 2008 and $135 million in 2009.

Inadequate Risk Management, Underwriting, and Credit Administration

Amcore's risk management practices were inadequate, and its underwriting and credit administration were ineffective. Throughout the period covered by our review, OCC examiners documented weaknesses in the bank's practices including:

- ineffective appraisal function
- ineffective internal loan review function and inability to properly risk rate loans
- incomplete allowance for loan and lease losses analysis
- inadequate multi-variable stress testing of the CRE loan portfolio
- insufficient financial analyses of the borrower and guarantor support for commercial projects
- inadequate loan documentation
- excessive loan exceptions

In its December 2007 ROE, OCC examiners stated that Amcore's board oversight and risk management practices governing the commercial lending function were unsatisfactory. In this same ROE, OCC identified Amcore's poor credit underwriting and administration, ineffective risk management processes, increasing credit risk, incomplete allowance for loan and lease losses analysis, and violations of appraisal requirements. OCC also reported that Amcore management did not implement risk management practices commensurate with its large CRE portfolio.

OCC's Supervision of Amcore

OCC performed examinations of Amcore in accordance with laws and regulations. In spite of this, OCC did not address the severity of Amcore's problems in a timely manner. Likewise, OCC did not take forceful enforcement actions until it was too late to avert the bank's failure. In this regard, an OCC lead credit expert raised a number of concerns with Amcore in 2006 and 2007. However, the Midsize Bank supervisory office did not promptly address these concerns. In addition, OCC's examination workpapers and records did not contain all essential information required to support conclusions about supervisory activities. We also noted that the 2005 ROE was issued more than 9 months after the end of the supervisory cycle. As Amcore's capital levels deteriorated, however, OCC did act timely to impose PCA restrictions but those restrictions did not prevent the bank's failure.

The following table summarizes OCC's safety and soundness examinations of Amcore and related enforcement actions from March 2004 to April 2010. Compliance examination information is also included in the table when it involved a change in CAMELS ratings or an enforcement action relevant to our audit.

Table 1. OCC Examinations of Amcore (March 2004-April 2010)

Examination report date[a]/ Type of examination	Assets (billions)	Examination Results: CAMELS rating	No. of MRAs	Number of Recommendations	Enforcement actions
12/31/2005 Full-scope examination	$4.6	2/222222	1	10	Formal agreement (a formal enforcement action) issued 5/31/2005 to address consumer-related compliance deficiencies.
6/15/2006 Supervisory letter[b] –non-compliance with the Bank Secrecy Act (BSA)[c]	$5.3	2/223222	0	0	None. This supervisory letter notified Amcore of a downgrade to the CAMELS management component rating and the intent to issue a Consent Order (a formal enforcement action) for BSA compliance deficiencies.
3/31/2007 Full-scope examination	$5.3	2/223222	3	10	Consent Order issued 8/10/2006 to address BSA and compliance deficiencies.
12/31/2007 Targeted examination of asset quality	$5.3	3/233222	8	0	Amcore notified of intent to issue a formal agreement for credit deficiencies. Consent Order remained in place.
3/31/2008 Full-scope examination	$5.2	3/233322	8	0	Formal Agreement and Consent Order related to the BSA and compliance deficiencies terminated on 4/14/2008. Formal agreement issued 5/15/2008 to address credit deficiencies.

Table 1. OCC Examinations of Amcore (March 2004-April 2010)

Examination report date[a]/ Type of examination	Assets (billions)	Examination Results			
		CAMELS rating	No. of MRAs	Number of Recommendations	Enforcement actions
2/10/2009 Supervisory letter - credit	$5.0	4/443432	0	0	No new enforcement action. This supervisory letter notified Amcore of downgrades to the CAMELS composite rating and component ratings.
4/30/2009 Full-scope examination	$5.1	5/453543	0	0	Notice of intent to establish individual minimum capital ratios issued 2/12/2009. Consent Order issued 6/25/2009.
11/19/2009 Supervisory letter– credit[d]	$4.4	5/554554	0	0	No new enforcement action. This supervisory letter notified Amcore of downgrades to the CAMELS component ratings.

Source: OCC ROEs, supervisory letters, and enforcement actions

[a] Under the continuous supervision model used by Midsize Bank Supervision, the report date for full-scope examinations generally coincides with the end of the 1-year supervisory cycle. The report should be issued to the bank within the supervisory cycle or within a reasonable time period after the end of the cycle. However, as discussed in this report, the 2005 ROE was issued more than 9 months after the end of the cycle, which exceeds a reasonable time period.

[b] A supervisory letter summarizes the results of each targeted examination performed by OCC. As part of the continuous supervision process used by Midsize Bank Supervision, OCC performs targeted examinations on individual assessment areas throughout the supervisory cycle. This table lists only those supervisory letters that resulted in CAMELS rating changes.

[c] The Bank Secrecy Act requires U.S. financial institutions to assist U.S. government agencies to detect and prevent money laundering. Among other things, it requires financial institutions to keep records of cash purchases of negotiable instruments, file reports of cash transactions exceeding $10,000, and report suspicious activity that might signify money laundering, tax evasion, or other criminal activities.

[d] This examination was directed by OCC's Special Supervision Division.

Midsize Bank Supervision Did Not Address an OCC Expert's Concerns

In accordance with 12 U.S.C. § 1820(j), *Consultation Among Examiners*, each appropriate federal banking agency shall ensure that examiners consult on examination activities and achieve an agreement and resolve any inconsistencies in the recommendations to be given to an institution as a consequence of any examination.

In the case of Amcore, a breakdown in OCC's supervision occurred during a period when Amcore was experiencing significant growth in CRE loans. As a result, OCC missed the opportunity to take timely action to address the bank's underwriting and credit administration weaknesses as soon as warranted. In 2005, Amcore hired a Chief Credit Officer with relatively little credit experience. OCC responded, appropriately, to both the bank's significant CRE portfolio growth and the concern with the Chief Credit Officer's inexperience by including Amcore as part of a 2006 CRE horizontal loan review[11] of selected banks across the Midsize Bank Supervision portfolio. As a result of this review, in July 2006, the OCC lead credit expert expressed concerns that Amcore needed to slow down CRE growth until the bank strengthened its supporting infrastructure. In addition, the lead credit expert recommended that matters requiring attention (MRAs) related to inadequate borrower analysis and policy compliance deficiencies be added to the October 2006 supervisory letter. However, OCC did not issue the MRAs as recommended.

A March 2007 OCC Midsize Bank Supervision internal memorandum, *Quality Assurance Process Enhancements*, assigned the supervisory office with responsibilities for resolving any issues raised by a lead expert to the satisfaction of both the expert and the examiner-in-charge (EIC) prior to OCC issuing a supervisory product to the bank. This requirement, however, was not followed for Amcore. Specifically, the supervisory office responsible for Amcore requested the expert's opinions while drafting the March 2007 ROE. In response, the expert requested that concerns regarding poor underwriting practices and the bank's weak control systems be added to the ROE. The supervisory office did not include the expert's concerns in the May 2007 ROE. Although emails documented communication between the lead expert, the supervisory office and Midsize Bank Supervision senior management, the supervisory record did not include these emails as documentation nor did it reflect that the expert's concerns were evaluated or resolved. In this regard, the lead credit expert

[11] Horizontal reviews are coordinated reviews of particular functional areas across multiple institutions.

expressed concern to Midsize Bank Supervision senior management that by not timely and effectively communicating the bank's condition to Amcore management, OCC was doing the bank a disservice.

A supervisory official told us that the lead credit expert's opinion was considered but the recommendations were not accepted because a judgment call had to be made on enforcement actions and issues communicated to the bank based on all sources of information. The supervisory office and examiners were also managing competing demands for OCC and bank resources during 2006 due to the formal agreement in place in the compliance area. We were told that the supervisory office did not necessarily disagree with the lead credit expert, but due to limited resources, they wanted more time to focus on the commercial credit area and do a more in-depth review before fully accepting the expert's recommendations. We concluded that during 2006 and 2007, examiners had already performed sufficient testing of commercial credit loan files, but failed to recognize the severity of the problem. We believe that, based on the results of the horizontal review and other documentation, the lead credit expert correctly identified significant problems with Amcore's CRE loan portfolio in 2006, that these concerns were not resolved as required by the Midsize Bank Supervision quality assurance guidance, and that a stronger OCC response was warranted. Ultimately, formal enforcement action related to the bank's commercial credit weaknesses was not taken until May 2008, almost 2 years after the lead expert raised concerns.

Examination Documentation Was Incomplete

According to OCC policy, workpapers are required to be legible and concise, with descriptions of work, communications with banks, and conclusions reached that are free of ambiguities.[12] Examination documentation should also include copies of emails where appropriate. In this regard, OCC guidance states examiners are required to print and file official records that "add to the proper understanding or execution of an OCC action or responsibility" in OCC's electronic recordkeeping system, Examiner View.[13]

[12] OCC Policies and Procedures Manual 5400-8 "Supervision Work Papers" dated Oct. 23, 2002.
[13] OCC Brochure, *Managing E-mail and Instant Messages as Official Records*.

Our review of OCC's 2004 through 2006 workpapers revealed that examiners did not follow OCC's workpaper documentation requirements. Examiners did not clearly document how the reviews for individual loans were aggregated and evaluated to reach its determination on Amcore's credit risk. We also noted that many emails that were relevant to the supervision of Amcore were not in Examiner View, including important emails related to the lead credit expert's concerns with Amcore.[14]

2005 ROE Delayed

OCC guidance states that in addition to communicating with the bank throughout a supervisory cycle, OCC must provide the bank's board of directors with a ROE at least once during every supervisory cycle.[15] Because of the continuous supervision model in Midsize Bank Supervision, the ROE usually reports a summary of examiners' conclusions about the bank's condition drawn from the results of supervisory activities throughout the examination cycle.

While OCC performed timely examinations of Amcore in accordance with laws and regulations, the ROE communicating a summary of the bank's composite CAMELS ratings and significant risks for the supervisory cycle that ended in March 2005 was not issued until December 2005. When asked about the delay, OCC did not provide a plausible explanation. In the case of the 2005 ROE, we believe the delay in issuing the ROE exceeded a reasonable time period.

OCC Appropriately Used Prompt Corrective Action

We concluded that OCC used its authority in an appropriate and timely manner under PCA. As Amcore's capital levels deteriorated, OCC acted timely to impose PCA restrictions on the bank.

The purpose of PCA is to resolve problems of insured depository institutions with the least possible long-term loss to the Deposit Insurance Fund. PCA requires federal banking agencies to take

[14] Because of gaps in the examination documentation available in Examiner View, we requested OCC separately search for and provide relevant internal emails related to Amcore.
[15] OCC Large Bank Supervision Comptroller's Handbook. This handbook covers the Midsize Bank Supervision portfolio with regards to ROE written communications.

certain actions when an institution's capital drops to certain levels. PCA also gives regulators flexibility based on criteria other than capital levels to help reduce deposit insurance losses caused by unsafe and unsound practices.

As Amcore's capital levels fell below the regulatory minimums for the various PCA capital categories, OCC took the following key actions:

- Amcore's capital level fell from well-capitalized to adequately capitalized for the quarter ended March 31, 2009. On June 9, 2009, OCC notified Amcore of the change and that it was restricted from accepting or renewing brokered deposits unless a waiver was obtained from FDIC.

- On June 25, 2009, OCC issued a consent order setting minimum capital levels for the bank to be achieved by September 30, 2009, and requiring the bank to submit an appropriate capital plan within 30 days. Amcore submitted the capital plan on July 24, 2009. On November 4, 2009, OCC notified the bank that the capital plan was not acceptable because it did not provide assurance that capital levels required by the consent order would be achieved. At the time, in accordance with PCA, OCC also notified the bank that it was considered significantly undercapitalized based on the September 30, 2009, call report, and required the bank to submit a capital restoration plan or a disposition plan[16] by December 4, 2009. OCC also notified the bank of restrictions on asset growth, payment of capital distributions and management fees, certain expansion activities, and certain payments to senior executive officers. The bank was now prohibited from accepting, renewing, or rolling over brokered deposits; accepting employee benefit plan deposits; and making golden parachute and indemnification payments.

- The bank submitted a capital restoration plan to OCC on December 4, 2009, and OCC rejected the plan on January 8, 2010. The bank remained significantly undercapitalized and was ultimately closed on April 23, 2010.

[16] A disposition plan details the board of director's proposal to sell, merge, or liquidate the bank under 12 U.S.C. § 181.

Recommendations

As a result of our material loss review of Amcore, we are reaffirming a recommendation made in two previous material loss reviews related to examination workpaper documentation.[17] In these reports, OCC concurred with our recommendations to emphasize to examiners OCC's policy on the preparation of supervision workpapers. This area warrants continued attention by OCC. In addition, we are making three new recommendations.

We recommend that the Comptroller of the Currency:

1. Ensure the input of lead experts is considered in supervisory decisions, Midsize Bank supervisory office personnel follow established OCC guidance to resolve issues raised by the lead expert to the satisfaction of the expert and the EIC, and resolution of recommendations is documented. In this regard, OCC should determine whether there are other concerns by lead experts that are currently unresolved and ensure appropriate agreement is reached on those matters.

   Management Response

   OCC changed the reporting structure for Midsize Bank Supervision so that lead experts now report to the Midsize Bank Supervision Risk Officer. The Risk Officer reports directly to the Deputy Comptroller and does not have direct supervisory responsibility for specific banks. This reporting line assures the lead experts are not inhibited in expressing their independent, objective perspectives on supervisory matters. To ensure that lead expert input is fully considered in supervisory decisions, Midsize Bank Supervision has incorporated mandatory lead expert reviews in its supervisory product workflow. Lead experts record their comments, recommendations, and any concerns in the supervisory product document maintained in the tracking system. EIC's must then address the lead expert's comments, and any differences must be resolved to the satisfaction of both parties prior to finalizing and issuing the product to the bank. Any supervisory matters that have not

[17] OIG-09-042, Aug.6, 2009, and OIG-09-033, Feb. 27, 2009.

been resolved at the EIC/lead expert level are elevated to the Risk Officer for resolution. Versions of the supervisory product, reflecting the exchange of views and resolution of issues, are permanently retained in the tracking system as an audit trail. OCC confirmed that they currently have no unresolved concerns between the EICs and the lead experts.

OIG Comment

OCC's response addresses our recommendation.

2. Ensure that relevant emails are maintained in the supervisory record (Examiner View) as appropriate.

   Management Response

   OCC agreed with our conclusion that Amcore's examination documentation was incomplete. OCC stated that the standards communicated in its policies and procedures are complete, clear, and sufficient. Midsize Bank Supervision will reinforce to examining staff the importance of consistent and ongoing compliance with documentation expectations.

   OIG Comment

   OCC's commitment to reinforce supervisory documentation expectations as described in its policies and procedures is responsive to our recommendation.

3. Implement policies and controls to monitor and ensure that ROEs are issued timely.

   Management Response

   OCC has implemented an automated system for tracking and monitoring all written supervisory communications, including ROEs, from submission by examiners through the time they are issued to the bank. This allows Midsize Bank Supervision to promptly identify any ROE or other communication that is not being reviewed and processed in a timely manner, and to address other issues. OCC will also reinforce to all staff the importance of issuing ROEs and other supervisory products in a timely manner.

OIG Comment

OCC's response addresses our recommendation.

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We appreciate the courtesies and cooperation provided to our staff during the audit. If you wish to discuss the report, you may contact me at (202) 927-5904 or Deborah Harker, Audit Manager, at (202) 927-5762. Major contributors to this report are listed in appendix 4.

/s/
Kieu T. Rubb
Audit Director

We conducted this material loss review of Amcore Bank, N.A. (Amcore) of Rockford, Illinois, in response to our mandate under section 38(k) of the Federal Deposit Insurance Act.[18] This section provides that if the Deposit Insurance Fund incurs a material loss with respect to an insured depository institution, the inspector general for the appropriate federal banking agency is to prepare a report to the agency that

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

We initiated a material loss review of Amcore based on the loss estimate by the Federal Deposit Insurance Corporation (FDIC), which on the date of failure (April 23, 2010) was $197 million. During the period of our review, Amcore's estimated loss amount varied, remaining above $200 million for most of the period, and reaching as high as $320.9 million (as of December 31, 2010). Because Amcore's estimated loss remained above $200 million for most of the review period, we considered Amcore's loss material. As of October 31, 2011, FDIC estimated that the loss to the Deposit Insurance Fund from Amcore's failure would be $154.5 million.

Our objectives were to determine the causes of Amcore's failure and assess the Office of the Comptroller of the Currency's (OCC) supervision of the bank. To accomplish our review, we conducted fieldwork at OCC headquarters in Washington, D.C., and its field office in Chicago, Illinois. We interviewed personnel from OCC headquarters and the field office, and from FDIC's Division of Supervision and Consumer Protection and Division of Resolutions and Receivership. We conducted our fieldwork from June 2010 through March 2011.

[18] 12 U.S.C. § 1831o(k).

To assess the adequacy of OCC's supervision of Amcore, we performed the following work:

- We reviewed OCC's supervisory files and records for Amcore from 2004 through 2010. We analyzed examination reports, supporting workpapers, and related supervisory correspondence to gain an understanding of the problems identified, the approach and methodology OCC used to assess the bank's condition, and the regulatory action OCC used to compel bank management to address deficient conditions.

- We interviewed OCC officials and examiners and discussed various aspects of Amcore supervision to obtain their perspective on the bank's condition and the scope of the examinations. We also interviewed FDIC officials responsible for monitoring Amcore for federal deposit insurance purposes.

- We interviewed personnel from FDIC's Division of Resolutions and Receiverships involved in the receivership process, which was conducted before and after Amcore's closure and appointment of a receiver.

- Because of gaps noted with OCC's examination documentation, we obtained and reviewed OCC internal email related to Amcore. We also obtained written assurances from OCC officials and staff that we were provided all such emails.

- We assessed OCC's actions based on its internal guidance and requirements of the Federal Deposit Insurance Act.[19]

We obtained by Inspector General subpoena and reviewed the audit documentation of Amcore's external auditor related to its audits of the bank's 2007, 2008, and 2009 financial statements. The focus of our review of that documentation was on the auditor's evaluation under applicable professional standards of the bank's status as a going concern.

[19] 12 U.S.C. § 1811 et seq.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

History of Amcore Bank, N.A.

Amcore Bank, N.A. (Amcore) was established as a federally chartered national bank on September 7, 1931. The bank was wholly owned by Amcore Financial, Inc., a single-bank holding company. The bank's headquarters was located in Rockford, Illinois. As of December 31, 2009, Amcore conducted business at 66 branch locations throughout northern Illinois and southern Wisconsin. On April 23, 2010, the Office of the Comptroller of the Currency (OCC) closed Amcore and appointed the Federal Deposit Insurance Corporation as receiver.

OCC Assessments Paid by Amcore

OCC funds its operations in part through semiannual assessments on national banks. OCC publishes annual fee schedules, which include general assessments to be paid by each institution based on the institution's total assets. If the institution is a problem bank (i.e., it has a CAMELS composite rating of 3, 4, or 5), OCC also applies a surcharge to the institution's assessment to cover additional supervisory costs. These surcharges are calculated by multiplying the sum of the general assessment by 50 percent for 3-rated institutions or by 100 percent for 4- and 5-rated institutions. Table 2 shows the assessments that Amcore paid to OCC from 2004 through 2010.

Table 2: Assessments Paid by Amcore to OCC, 2004–2010

Billing Period	Exam Rating	Amount Paid	Percent of Total Collections
January 2004	2	$352,870	0.147%
July 2004	2	368,827	0.148%
January 2005	2	386,465	0.135%
July 2005	2	401,725	0.137%
March 2006	2	424,864	0.140%
September 2006	2	430,496	0.135%
March 2007	2	434,266	0.130%
September 2007	2	435,343	0.127%
March 2008	3	406,340	0.114%
September 2008	3	607,412	0.168%
March 2009	4	608,676	0.159%
September 2009	5	788,894	0.210%

Billing Period	Exam Rating	Amount Paid	Percent of Total Collections
March 2010	5	$641,872	0.168%

Source: OCC $MART database.

Number of OCC Staff Hours Spent Examining Amcore

Table 3 shows the number of OCC staff hours spent examining Amcore from 2004 to 2009.

Table 3: Number of OCC Hours Spent on Examining Amcore, 2004-2009

Examination Cycle Start Date	Number of Examination Hours
3/2/2004	5,995
3/2/2005	6,823
3/2/2006	7,947
3/2/2007	9,813
3/2/2008	6,569
3/2/2009	7,294

Source: OCC Examiner View.
*Hours are totaled for safety and soundness examinations, information technology examinations, and compliance examinations.

MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: Kieu T. Rubb, Audit Director

From: John Walsh, Acting Comptroller of the Currency /s/

Date: December 15, 2011

Subject: Response to Material Loss Review of Amcore Bank, N. A.

We have received and reviewed your draft report titled "Material Loss Review of Amcore Bank, N.A." Your objectives were to determine the cause of the failure of Amcore Bank, N.A. (Amcore), assess the OCC's supervision of the bank, including implementation of the Prompt Corrective Action (PCA) provisions of section 38 of the Federal Deposit Insurance Act; and make recommendations for preventing such a loss in the future.

You concluded that Amcore failed primarily because it had high concentrations in commercial real estate loans and ineffective credit risk management, underwriting, and credit administration. These factors, combined with severe declines in real estate markets, resulted in Amcore's asset quality deterioration, and the bank's eventual failure.

You also concluded that, in the case of Amcore, there were shortcomings in the OCC's execution of its supervisory process. The paragraphs below outline the steps that we have taken, or will take, to address the recommendations included in your report.

Ensure the input of lead experts is considered in supervisory decisions, Midsize Bank supervisory office personnel follow established OCC guidance to resolve issues raised by the lead expert to the satisfaction of the expert and the EIC, and resolution of recommendations is documented. In this regard, OCC should determine whether there are other concerns by lead experts that are currently unresolved and ensure appropriate agreement is reached on those matters.

The role of the Lead Expert is critical to Midsize Bank Supervision (MBS) supervisory and quality assurance processes. Individuals are selected for the Lead Expert positions on the basis of their extensive experience and knowledge, and are among the most highly regarded technical experts in their specialty areas. MBS is committed to ensuring the valuable insights and recommendations of these subject matter experts are fully leveraged in supervisory decisions and communications.

MBS Lead Experts now report independently to the MBS Risk Officer. The Risk Officer reports directly to the Deputy Comptroller and does not have direct supervisory responsibility for specific banks or companies. This reporting line assures the Lead Experts are not inhibited in expressing their independent, objective perspectives on supervisory matters.

To ensure that Lead Expert input is fully considered in supervisory decisions, MBS has incorporated mandatory Lead Expert reviews in our supervisory product workflow. We utilize an automated work product tracking system to document Lead Expert reviews for supervisory products, including Reports of Examination (ROEs). Lead Experts record their comments, recommendations, and any concerns in the supervisory product document housed in the tracking system. Examiners-in-Charge (EIC) must then address the Lead Expert's comments, and any differences must be resolved to the satisfaction of both parties prior to finalizing and issuing the product to the bank. Any supervisory matters that have not been resolved at the EIC/Lead Expert level are elevated to the MBS Risk Officer for resolution. Versions of the supervisory product, reflecting the exchange of views and resolution of issues, are permanently retained in the tracking system as an audit trail.

Each MBS Lead Expert has confirmed their concerns have been recorded in our automated work product tracking system and resolved to their satisfaction, with no unresolved concerns outstanding. Going forward, each MBS Lead Expert will record concerns in our automated work product tracking system and will notify the Risk Officer and Deputy Comptroller of any unresolved concerns in order to ensure appropriate agreement is reached.

Ensure that relevant emails are maintained in the supervisory record (Examiner View) as appropriate.

We agree with your conclusion that, in the case of Amcore, examination documentation was incomplete. The OCC recognizes the importance of a clear and complete supervisory record and has set unambiguous standards for paper and electronic supervision work papers. These standards are communicated to all employees, including examiners, in Policies and Procedures Manual (PPM) 5400-8(REV) "Supervision Work Papers" and PPM 3120-1 (REV) "OCC Records Management Program." This existing guidance is complete, clear and sufficient to compel all examiners to ensure that their work papers and the supervisory record (Examiner View) are complete. Nevertheless, MBS senior management will reinforce to examining staff the importance of consistent and ongoing compliance with OCC's documentation expectations.

Implement policies and controls to monitor and ensure that ROEs are issued timely.

We agree that communication is essential to high quality bank supervision. OCC is committed to effective communication with the banks it supervises. To be effective, all communication, including ROEs, must be timely. MBS has implemented an automated system for tracking and

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monitoring all written supervisory communications, including ROEs, from submission by examiners through the time they are issued to the bank. This system allows MBS management to promptly identify any ROE or other communication that is not being reviewed and processed in a timely manner, and to address causal issues. To supplement this automated control, MBS management will also reinforce to all MBS staff the importance of issuing ROEs and other supervisory products timely.

Thank you for the opportunity to review and comment on your draft report. If you have questions or need additional information, please contact Jennifer Kelly, Senior Deputy Comptroller for Midsize and Community Bank Supervision, at 202-874-5020.

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