



Audit Report



OIG-20-039

FINANCIAL REGULATION AND OVERSIGHT

Safety and Soundness: Failed Bank Limited Review – City National Bank of New Jersey

June 24, 2020

Office of Inspector General
Department of the Treasury

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

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MEMORANDUM FOR BRIAN BROOKS
ACTING COMPTROLLER OF THE CURRENCY

FROM: Susan Barron /s/
Deputy Assistant Inspector General for Financial Sector
Audits

SUBJECT: Failed Bank Limited Review of City National Bank of New
Jersey, Newark, New Jersey

This memorandum presents the results of our review of the failure of City National Bank of New Jersey (City National), a minority-owned depository institution located in Newark, New Jersey. City National was chartered as a national bank on June 8, 1973, and was 100 percent owned by City National Bancshares Corporation (holding company). City National operated from its main office and a branch in Newark, New Jersey, and one branch in New York City. As of September 30, 2019, the bank had total assets of \$120.6 million. On November 1, 2019, the Office of the Comptroller of the Currency (OCC) closed City National and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver. As of May 31, 2020, FDIC estimated the loss to the Deposit Insurance Fund to be \$2.5 million.

In April 2009, the holding company issued \$9.4 million in preferred stock to the Department of the Treasury (Treasury) under the Troubled Asset Relief Program (TARP),¹ Capital Purchase Program. In October 2013, Treasury approved a plan to retire the bank's TARP obligations at a discount, involving a cash payment of \$2.36 million contingent upon the holding company raising \$21 million in capital. In 2015, the holding company used the proceeds from the capital raised to retire the bank's TARP obligation.

¹ TARP is a program established under Section 101 of the Emergency Economic Stabilization Act of 2008. The Act provides authority for the Federal Government to purchase and insure certain types of troubled assets for the purposes of providing stability to and preventing disruption in the economy. The Capital Purchase Program, one of several programs under TARP, was created in October 2008 to stabilize the financial system by providing capital to viable financial institutions of all sizes throughout the nation. TARP was closed to new investments on December 31, 2009.

Because the loss to the Deposit Insurance Fund is less than \$50 million, as set forth by section 38(k) of the Federal Deposit Insurance Act, we limited our review of City National's failure to (1) ascertaining the grounds identified by OCC for appointing FDIC as receiver, and (2) determining whether any unusual circumstances exist that might warrant a more in-depth review of the loss. In performing our review, we (1) examined documentation related to the appointment of FDIC as receiver, (2) reviewed OCC reports of examination for the 5-year period before the bank's failure, and (3) interviewed OCC examination personnel. We performed our fieldwork from January 2020 through March 2020.

We also reviewed the Government Accountability Office's Standards for Internal Control in the Federal Government and identified Control Environment and Control Activities as the internal control components that are significant to our audit objectives.² As part of the Control Environment component, we determined that two underlying principles are most significant to our objectives: (1) the oversight body and management should demonstrate a commitment to integrity and ethical values and (2) management should demonstrate a commitment to recruit, develop, and retain competent individuals. For the Control Activities component, the underlying principles that are most significant to our objectives are (1) management should design control activities to achieve objectives and respond to risks and (2) management should implement control activities through policies. To evaluate the implementation of these internal control components and principles, we interviewed OCC personnel and reviewed reports of examination and OCC guidance on problem bank supervision. We did not identify any weaknesses or items requiring further inquiry regarding internal controls. However, because our review was limited to these internal control components and underlying principles, it may not have disclosed all internal control deficiencies that may have existed at the time of this audit.

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 we obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

² The Government Accountability Office's Standards for Internal Control in the Federal Government (1) provides managers criteria for designing, implementing, and operating an effective internal control system, (2) defines the standards through components and principles and explains why they are integral to an entity's internal control system, and (3) clarifies which processes management considers part of internal control.

Cause of City National Bank of New Jersey's Failure

OCC appointed FDIC as receiver based on the following grounds: (1) City National experienced substantial dissipation of assets or earnings due to unsafe or unsound practices, (2) the bank was in an unsafe or unsound condition to transact business, (3) the bank's unsafe or unsound practices or conditions were likely to cause insolvency or substantial dissipation of assets or earnings, (4) the bank's unsafe or unsound practices or conditions were likely to weaken the institution's condition, (5) the bank had incurred or was likely to incur losses that would deplete all, or substantially all of its capital, and there was no reasonable prospect for the institution to become adequately capitalized without federal assistance, (6) the bank was undercapitalized and had no reasonable prospect of becoming adequately capitalized, and (7) the bank was undercapitalized and failed to submit an acceptable capital restoration plan to OCC.

The primary cause of City National's failure was the board and management's decision to undertake a new business strategy that led to dramatically increased transaction activity from an expanded base of money service business customers. The bank pursued this business strategy without implementing adequate policies, procedures, risk management commensurate with the risk of its activities, or controls to comply with the Bank Secrecy Act. The bank's increase in money service business customer activity resulted in severe Bank Secrecy Act/Anti-Money Laundering compliance deficiencies. Additionally, the bank's expenses, particularly high noninterest expenses related to compensation and Bank Secrecy Act/Anti-Money Laundering remediation, outpaced income, leading to continued losses. Due to City National's continued deficiencies and unsafe or unsound practices, the bank substantially dissipated its assets and earnings and depleted its capital. The board's efforts to obtain additional capital or find potential buyers were unsuccessful; therefore, the bank had no reasonable means to obtain adequate capital.

Conclusion

Based on our review of the causes of City National's failure and the grounds OCC identified for appointing FDIC as receiver, we determined that there were no circumstances surrounding the bank's failure that necessitate an in-depth review. We provided a draft of this memorandum to OCC management for comment. In its response, OCC management stated that it takes no exception with our conclusions. We provide a list of the recipients of this memorandum as Attachment 1.

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

Attachment

Department of the Treasury

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

Office of the Comptroller of the Currency

Comptroller of the Currency
Liaison Officer

Office of Management and Budget

OIG Budget Examiner

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