



# Audit Report



OIG-13-002

SAFETY AND SOUNDNESS: Failed Bank Review of Palm Desert National Bank

October 11, 2012

Office of  
Inspector General

DEPARTMENT OF THE TREASURY





DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

OFFICE OF  
INSPECTOR GENERAL

October 11, 2012

OIG-13-002

MEMORANDUM FOR THOMAS J. CURRY  
COMPTROLLER OF THE CURRENCY

FROM: Jeffrey Dye /s/  
Director, Banking Audits

SUBJECT: Failed Bank Review of Palm Desert National Bank, Palm Desert,  
California

This memorandum presents the results of our review of the failure of Palm Desert National Bank (Palm Desert) located in Palm Desert, California. The bank was chartered in 1981 and was wholly owned by Palm Desert Investments, a one-bank holding company. The Office of the Comptroller of Currency (OCC) closed Palm Desert and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on April 27, 2012. As of December 31, 2011, Palm Desert had approximately \$125.8 million in total assets. As of August 31, 2012, FDIC estimated the loss to the Deposit Insurance Fund at \$23.4 million.

Because the loss to the Deposit Insurance Fund is less than \$150 million, as set forth by section 38(k) of the Federal Deposit Insurance Act (FDIA), we conducted a review of the failure of Palm Desert that was limited to (1) ascertaining the grounds identified by OCC for appointing the FDIC as receiver and (2) determining whether any unusual circumstances exist that might warrant a more in-depth review of the loss. In performing our review we (1) examined documentation related to the appointment of FDIC as receiver and (2) interviewed an OCC problem bank specialist. We performed our fieldwork from May to June 2012.

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.

## **Causes of Palm Desert National Bank's Failure**

OCC appointed FDIC as receiver based on the following grounds: (1) the bank had 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 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 it to become adequately capitalized without federal assistance; (4) the bank's unsafe or unsound practices or condition were likely to seriously prejudice the interests of the Deposit Insurance Fund; and (5) the bank was critically undercapitalized.

The primary cause of Palm Desert's failure was its board of directors' and management's implementation of a poorly timed and executed aggressive growth strategy in commercial real estate (CRE) loans, including residential land acquisition and construction and development loans, beginning in 2004. In 2007, the decline in the real estate market exposed weaknesses in the bank's credit administration and risk management practices. Examples of the bank's inadequate credit administration and risk management included poor underwriting practices, the failure to support collateral valuations, and an inadequate allowance for loan and lease losses methodology. The board and management's lack of oversight, failure to adjust to changing economic conditions, and failure to address the bank's excessive CRE concentrations, resulted in an unsafe and unsound concentration in CRE loans. This led to excessive losses, high levels of classified assets, erosion of capital through deficient earnings, and ultimately, failure.

## **Conclusion**

Based on our review of the causes of Palm Desert's failure and the grounds identified by OCC for appointing FDIC as receiver, we determined that there were no unusual circumstances surrounding the bank's failure that would necessitate an in-depth review. We provided a draft of this memorandum to OCC management for comment. In its response, OCC stated it agreed with our conclusion as to the causes of Palm Desert's failure and that it had no concerns with our determination that an in-depth review of the bank's failure was not warranted. The response is provided as Attachment 1. A list of the recipients of this memorandum is provided as Attachment 2.

We appreciate the courtesies and cooperation provided to our staff during the audit. If you have any questions, you may contact me at (202) 927-0384 or Theresa Cameron, Audit Manager, at (202) 927-1011.

Attachments

O

**MEMORANDUM**

---

Comptroller of the Currency  
Administrator of National Banks

---

Washington, DC 20219

To: Jeffrey Dye, Director, Banking Audits

From: Thomas J. Curry, Comptroller of the Currency /s/

Date: September 10, 2012

Subject: Response to Failed Bank Review of Palm Desert National Bank, Palm Desert,  
California

---

We have received and reviewed your draft report titled "Failed Bank Review of Palm Desert National Bank, Palm Desert, California (Palm Desert)." The loss to the Deposit Insurance Fund is less than \$150 million, therefore, as set forth by section 38(k) of the Federal Deposit Insurance Act, you conducted a review of the failure of Palm Desert that was limited to: (1) ascertaining the grounds identified by the OCC for appointing the FDIC as receiver and, (2) determining whether any unusual circumstances exist that might warrant a more in-depth review of the loss. In performing your review you: (1) examined documentation related to the appointment of FDIC as receiver and (2) interviewed an OCC problem bank specialist.

You conducted your audit during May and June 2012 in accordance with generally accepted government auditing standards. Those standards require that you plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for your findings and conclusions. You believe that the evidence obtained provides a reasonable basis for your findings and conclusions.

You concluded that the primary cause of Palm Desert's failure was its implementation of a poorly timed and executed aggressive growth strategy in commercial real estate loans, including residential land acquisition and construction and development loans. We agree.

You determined that there were no unusual circumstances surrounding the bank's failure. As a result, you determined that a more in-depth review of the bank's failure by the OIG is not warranted. We have no concerns with your determination.

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

**Department of the Treasury**

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

**Office of the Comptroller of the Currency**

Comptroller of the Currency  
Liaison Officer

**Office of Management and Budget**

OIG Budget Examiner