



Audit Report



OIG-11-029

SAFETY AND SOUNDNESS: Material Loss Review of First National Bank of the South

November 16, 2010

Office of Inspector General

Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

November 16, 2010

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MEMORANDUM FOR JOHN WALSH
ACTING COMPTROLLER OF THE CURRENCY

FROM: Jeffrey Dye /s/
Director, Banking Audits

SUBJECT: Failed Bank Review of First National Bank of the South

This memorandum presents the results of our review of the failure of First National Bank of the South (FNBS) located in Spartanburg, South Carolina. The bank opened in 2000 as First National Bank of Spartanburg and changed to its current name in 2002. By 2009, FNBS had opened 13 branches, all located in South Carolina. In 2008, FNBS acquired Carolina National Bank and Trust of Columbia, South Carolina, increasing its assets by \$220 million. FNBS was a wholly-owned subsidiary of First National Bancshares, Inc., a one bank holding company. The Office of the Comptroller of the Currency (OCC) closed FNBS and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on July 16, 2010. As of March 31, 2010, FNBS had \$682 million in total assets. FDIC estimated that the loss to the Deposit Insurance Fund is \$74.9 million.

Because the loss to the Deposit Insurance Fund is less than \$200 million, as set forth by section 38(k) of the Federal Deposit Insurance Act (FDIA), we conducted a review of the failure of FNBS 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, (2) reviewed OCC reports of examination, and (3) interviewed an OCC problem bank specialist and examination personnel.

We conducted this performance audit in September and October 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Causes of First National Bank of the South's Failure

OCC appointed FDIC receiver based on the following grounds: (1) the bank had experienced substantial dissipation of assets or earnings due to unsafe and unsound practices, (2) the bank was in an unsafe and unsound condition to transact business, and (3) the bank's capital had been severely impaired.

The primary causes of FNBS's failure were its aggressive growth strategy, excessive concentrations in high risk land and commercial real estate (CRE) loans, and lack of sufficient risk management systems. By 2008, due to deficient risk controls, FNBS had a significant concentration of poorly underwritten CRE loans and asset quality began to deteriorate. Examples of the bank's weak credit risk management included failure to recognize borrowers' limited ability to repay loans, frequent loan renewals with interest-only repayment plans on projects that were complete, and insufficient staff to ensure timely and accurate credit risk ratings. These conditions were exacerbated by the downturn in real estate values in coastal markets and upstate South Carolina. The resultant loan losses led to capital erosion which ultimately led to FNBS's failure.

Conclusion

Based on our review of the causes of FNBS'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 or the supervision exercised by OCC. Accordingly, we have determined that a more in-depth review of the bank's failure by our office is not warranted.

We provided a draft of this memorandum to OCC management for comment. In its response, OCC stated it agreed with our conclusion as to the causes of FNBS'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



MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: Jeffrey Dye, Director, Banking Audits

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

Date: November 5, 2010

Subject: Response to Failed Bank Review of First National Bank of the South

We have received and reviewed your draft report titled "Failed Bank Review of First National Bank of the South (FNBS)." Because the loss to the Deposit Insurance Fund is less than \$200 million, as set forth by section 38(k) of the Federal Deposit Insurance Act, you conducted a review of the failure of FNBS 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; (2) reviewed OCC reports of examination; and, (3) interviewed OCC personnel.

You conducted this performance audit during September and October 2010 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 based on your audit objectives. You believe that the evidence obtained provides a reasonable basis for your findings and conclusions based on your audit objectives.

You concluded that the primary causes of FNBS's failure were its aggressive growth strategy, excessive concentrations in high risk land and commercial real estate loans, and lack of sufficient risk management systems. We agree.

You determined that there were no unusual circumstances surrounding the bank's failure or the supervision exercised by OCC. 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 Mid-size and Community Bank Supervision, at 202-874-5020.

Department of the Treasury

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

Office of the Comptroller of the Currency

Acting Comptroller of the Currency
Liaison Officer

Office of Management and Budget

OIG Budget Examiner