Office of Audits
Report No. AUD-11-007

Material Loss Review of Premier Bank, Jefferson City, Missouri

May 2011

Office of
Inspector General

Executive Summary

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Why We Did The Audit

On October 15, 2010, the Missouri Division of Finance (MDF) closed Premier Bank (Premier), Jefferson City, Missouri, and appointed the FDIC as receiver. On November 18, 2010, the FDIC notified the Office of Inspector General (OIG) that Premier's total assets at closing were $1 billion, and the estimated loss to the Deposit Insurance Fund (DIF) was $405 million. As required by section 38(k) of the Federal Deposit Insurance Act, and as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the OIG conducted a material loss review of the failure of Premier.

The audit objectives were to (1) determine the causes of Premier's failure and the resulting material loss to the DIF and (2) evaluate the FDIC's supervision of Premier, including the FDIC's implementation of the Prompt Corrective Action (PCA) provisions of section 38.

Background

Premier was a state-chartered nonmember bank insured by the FDIC on May 15, 1995. The bank was headquartered in Jefferson City, Missouri, which is the state capital. The bank operated eight offices in Missouri and one office in Grapevine, Texas. Premier was wholly owned by Premier Bancshares, Inc. (PBI), a one-bank holding company. Ownership was widely held, with no shareholder owning or controlling 5 percent or more of the holding company's stock. In 2003, Bank management began emphasizing loan growth with a focus on commercial real estate (CRE), primarily acquisition, development, and construction (ADC) loans. Growth was supported by brokered deposits and borrowings. The bank's growth was also supported by capital injections from PBI.

Audit Results

Causes of Failure and Material Loss

Premier's failure was attributed to the Board of Directors and management's growth strategy that centered on CRE and ADC lending, which, absent prudent risk management practices, increased the bank's vulnerability to adverse economic conditions. To fund its growth, the bank became increasingly reliant on wholesale funding sources, the availability of which was critical to the bank's ability to maintain a strong financial position. Ultimately, the flaws in the bank's strategy and lending deficiencies were exposed when the real estate market began to weaken in 2007 and led to significant loan-related losses, poor earnings, and the erosion of the bank's capital as market conditions rapidly deteriorated. Premier engaged in various efforts to diversify its portfolio, address weaknesses, and raise additional capital following the downturn. However, the bank's efforts proved unsuccessful, and MDF closed the bank on October 15, 2010.

The FDIC's Supervision of Premier Bank

The FDIC and the MDF conducted timely examinations of Premier and monitored its condition through periodic offsite analysis and contacts. The FDIC and state examinations of Premier consistently identified key risks associated with its growth strategy and increasing reliance on wholesale funding. Prior to 2007, the bank was assigned satisfactory ratings, and neither the FDIC nor the MDF considered

Premier to be a cause for significant supervisory concern based on its solid financial condition. However, supervisory concern increased in 2007 when the downturn in the real estate market resulted in a dramatic rise in nonperforming assets and a considerable deterioration in the bank's overall financial condition. Accordingly, the FDIC and the MDF began to downgrade the bank's composite and component ratings in 2007, and the MDF imposed an informal supervisory enforcement action. After the 2007 examination, the FDIC and the MDF closely monitored Premier's condition by conducting onsite examinations every 6 months. The increased supervisory attention led to further downgrades and the issuance of a formal enforcement action in 2009. Despite Premier's efforts to address its deficiencies, the bank's financial condition became critically deficient.

Recognizing that Premier's financial condition and markets were generally favorable during earlier examinations, the FDIC could have placed greater emphasis on Premier's increasing risk profile in 2006. Doing so may have resulted in downgrading the bank's supervisory ratings sooner and pursuing an informal enforcement action earlier. A more proactive supervisory approach may have influenced the bank to curb its CRE and ADC lending, increase its capital levels, and strengthen risk management controls before real estate markets deteriorated. With respect to the issues discussed in this report, the FDIC has taken a number of actions to increase supervisory attention to banks that have risk profiles similar to Premier, including instituting a training initiative on forward-looking supervision and issuing additional supervisory guidance on CRE and ADC concentrations, appraisals, and funds management.

With respect to PCA, based on the supervisory actions taken, the FDIC properly implemented applicable PCA provisions of section 38 in a timely manner.

Management Response

The Director, Division of Risk Management Supervision (RMS), provided a written response, dated May 12, 2011, to a draft of the report. In the response, RMS reiterated the OIG's conclusions regarding the causes of Premier's failure. With regard to our assessment of the FDIC's supervision of Premier, RMS's response discussed the number of examinations and visitations and the offsite monitoring conducted between 2006 and 2010 described in the report. Further, RMS's response reiterated supervisory actions taken in response to the deterioration in Premier's asset quality and overall condition, which started in 2007. As discussed in the report, supervisory actions included initiating a 6-month examination cycle and issuing a cease and desist order that included a provision requiring Premier to submit a plan to reduce the bank's brokered deposits. Further, RMS referenced guidance that the FDIC has issued to re-emphasize the importance of robust credit risk-management practices for institutions with concentrated CRE exposures and set forth broad supervisory expectations. RMS also referenced FDIC guidance issued for institutions, such as Premier, with concentrated CRE/ADC lending and reliance on non-core funding.

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Federal Deposit Insurance Corporation
3501 Fairfax Drive, Arlington, Virginia 22226

Office of Audits
Office of Inspector General

DATE: May 18, 2011

MEMORANDUM TO: Sandra L. Thompson, Director
Division of Risk Management Supervision

/Signed/

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

SUBJECT: *Material Loss Review of Premier Bank, Jefferson City, Missouri* (Report No. AUD-11-007)

As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, and as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Financial Reform Act), the Office of Inspector General (OIG) conducted a material loss review (MLR) of the failure of Premier Bank (Premier), Jefferson City, Missouri. The Missouri Division of Finance (MDF) closed the institution on October 15, 2010 and appointed the FDIC as receiver. On November 18, 2010, the FDIC notified the OIG that Premier's total assets at closing were $1 billion, and the estimated loss to the Deposit Insurance Fund (DIF) was $405 million. The estimated loss exceeds the $200 million MLR threshold for losses occurring between January 1, 2010 and December 31, 2011, as established by the Financial Reform Act.

When the DIF incurs a material loss with respect to an insured depository institution for which the FDIC is appointed receiver, the FDI Act states that the Inspector General of the appropriate Federal banking agency shall make a written report to that agency. The report is to consist of a review of the agency's supervision of the institution, including the agency's implementation of FDI Act section 38, *Prompt Corrective Action* (PCA); a determination as to why the institution's problems resulted in a material loss to the DIF; and recommendations to prevent future losses.

The objectives of this material loss review were to (1) determine the causes of Premier's failure and the resulting material loss to the DIF and (2) evaluate the FDIC's supervision of Premier, including the FDIC's implementation of the PCA provisions of section 38 of the FDI Act. The report does not contain formal recommendations. Instead, as major causes, trends, and common characteristics of institution failures are identified in our MLRs, we will communicate those to FDIC management for its consideration. As resources allow, we may also conduct more comprehensive reviews of specific aspects of the FDIC's supervision program and make recommendations as warranted.[1]

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[1] A further discussion of OIG-related coverage of financial institution failures can be found in the *Objectives, Scope, and Methodology* section of our report.

Appendix 1 contains details on our objectives, scope, and methodology. We also include several other appendices to this report. Appendix 2 contains a glossary of key terms, including material loss, the FDIC's supervision program, and the Uniform Financial Institutions Rating System (UFIRS), otherwise known as the CAMELS ratings. Appendix 3 contains a list of acronyms. Appendix 4 contains the Corporation's comments on this report.

We note that, in conjunction with other organizational changes made to enhance the FDIC's ability to carry out its new and enhanced responsibilities under the Financial Reform Act, the Division of Supervision and Consumer Protection (DSC) became the Division of Risk Management Supervision effective February 13, 2011. As a result of the timing of our review and draft report issuance, we refer to DSC throughout this report.

Background

Premier was a state-chartered nonmember bank insured by the FDIC on May 15, 1995. The bank was headquartered in Jefferson City, Missouri, which is the state capital. The bank operated eight offices in Missouri and one office in Grapevine, Texas. Premier was wholly owned by Premier Bancshares, Inc., (PBI) a one-bank holding company. Ownership was widely held, with no shareholder owning or controlling 5 percent or more of the holding company's stock. In 2003, Bank management began emphasizing loan growth with a focus on commercial real estate (CRE), primarily acquisition, development, and construction (ADC) loans. Growth was supported by brokered deposits and borrowings. The bank's growth was also supported by capital injections from PBI. Table 1 provides details on Premier's financial condition as of June 2010 and for the 5 preceding calendar year ends.

Table 1: Financial Information for Premier, 2005 to 2010

Financial Measure ($000)	Jun-10	Dec-09	Dec-08	Dec-07	Dec-06	Dec-05
Total Assets	1,182,738	1,256,121	1,523,574	1,578,586	1,167,953	735,951
Total Loans	688,133	972,105	1,220,840	1,347,535	1,007,535	624,153
Total Deposits	1,028,265	1,071,209	1,232,925	1,315,930	1,009,877	605,085
Brokered Deposits	70,715	161,866	365,993	299,933	197,337	205,154
FHLB Borrowings	128,00	128,000	153,800	89,800	41,800	49,800
Net Income (Loss)	(25,141)	(79,666)	(31,992)	3,104	7,712	5,302

Source: Uniform Bank Performance Reports (UBPR) for Premier.

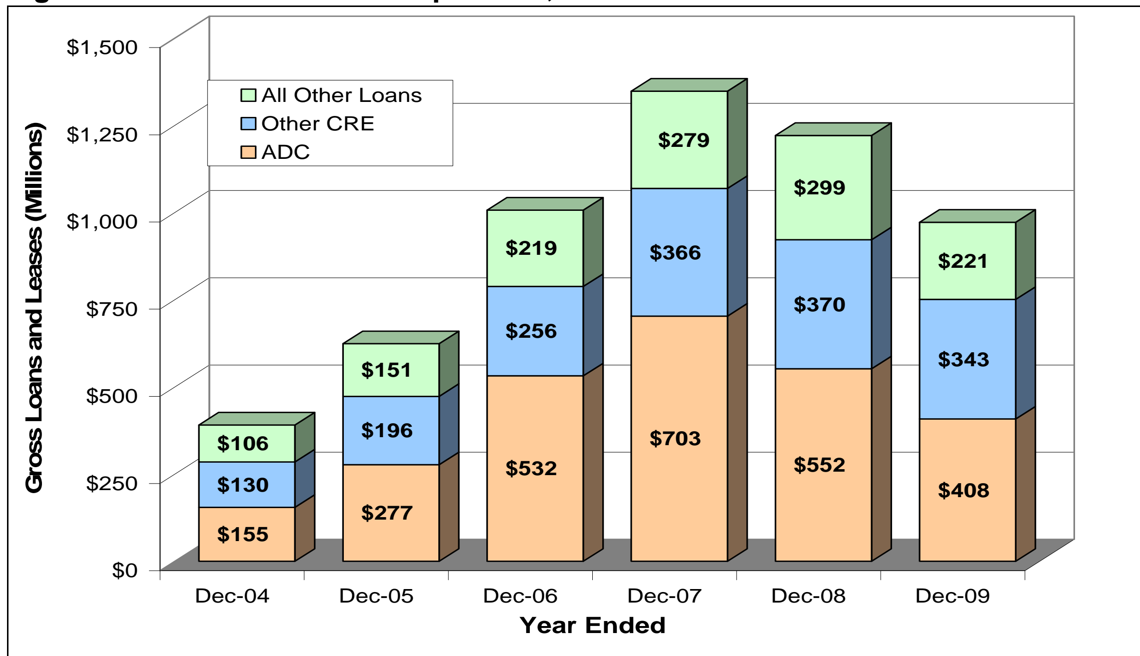
Causes of Failure and Material Loss

Premier's failure was attributed to the institution's Board of Directors (Board) and management's growth strategy that centered on CRE and ADC lending, which, absent prudent risk management practices, increased the bank's vulnerability to adverse economic conditions. To fund its growth, the bank became increasingly reliant on wholesale funding sources, the availability of which was critical to the bank's ability to maintain a strong financial position. Ultimately, the flaws in the bank's strategy and lending deficiencies were exposed when the real estate market began to weaken in 2007 and led to significant loan-related losses, poor earnings, and the erosion of the bank's capital as market conditions rapidly deteriorated. Premier engaged in various efforts to diversify its portfolio, address weaknesses, and raise additional capital following the downturn. However, the bank's efforts proved unsuccessful, and the MDF closed the bank on October 15, 2010.

Board and Management's Growth Strategy

Premier's business model centered on rapid asset growth. Specifically, between December 2004 and December 2007, the bank's loan portfolio increased from about $391 million to $1.35 billion, with ADC loans increasing by 350 percent during this period. Figure 1 illustrates Premier's loan composition, which by 2005, consisted primarily of CRE and ADC loans.

Figure 1: Premier's Loan Composition, 2004 to 2009



Source: UBPRs for Premier.

Premier grew by expanding its market presence throughout Missouri. The bank also opened a branch in Texas. The bank's expansion strategy centered on finding and hiring experienced personnel from competitors in other locales and opening new branches once

they did so. Although the Board and management operated without a written strategic plan during its growth period, the Board and management held strategic planning sessions semi-annually. In 2006 and 2007, the bank also purchased over $230 million in ADC loan participations, many of which were originated outside of the bank's traditional market areas. Management believed these out-of-market participations decreased the overall risk in the loan portfolio through geographic diversification. However, the bank's rapid increase in ADC loans, through both originations and participations, drastically increased the bank's concentration levels, and, by extension, the bank's risk profile. Further, as discussed later, management did not institute sound risk management practices commensurate with the bank's loan portfolio.

In December 2006, the Federal banking agencies issued guidance entitled, *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* (Joint Guidance), that reinforced existing regulations and guidelines for real estate lending and safety and soundness.[2] The Joint Guidance focuses on those CRE loans for which cash flow from real estate is the primary source of repayment (i.e., ADC lending). The guidance was issued because the agencies had observed that CRE concentrations had been rising and could create safety and soundness concerns in the event of a significant downturn.

The Joint Guidance states that rising CRE concentrations can expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in the general CRE market. Earlier supervisory guidance emphasized that ADC lending is a highly specialized field with inherent risks that must be managed and controlled to ensure that this activity remains profitable.[3] DSC's *Risk Management Manual of Examination Policies* (Examination Manual) also states that an institution's Board is responsible for establishing appropriate risk limits, monitoring exposure, and evaluating the effectiveness of the institution's efforts to manage and control risk. As discussed below, Premier failed to effectively manage and control risk associated with its CRE and ADC portfolios.

Due to the risks associated with CRE and ADC lending, regulators consider institutions with significant CRE and ADC concentrations to be of greater supervisory concern. The Joint Guidance defines institutions that may be identified for further supervisory analysis of the level and nature of their concentration risk as those reporting loans for construction, land and development, and other land (i.e., ADC) representing 100 percent or more of total capital; or institutions reporting total CRE loans representing 300 percent or more of total capital, where the outstanding balance of CRE has increased by 50 percent or more during the prior 36 months. As shown in Table 2, Premier's CRE and ADC loan concentrations consistently exceeded these supervisory thresholds and the bank's peer group averages in the years preceding its failure.

[2] The guidance was issued jointly by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the FDIC (collectively referred to as the agencies in the guidance).
[3] Financial Institution Letter (FIL)-110-98 entitled, *Internal and Regulatory Guidelines for Managing Risks Associated with Acquisition, Development, and Construction Lending,* dated October 8, 1998.

Table 2: Premier's CRE and ADC Concentrations Compared to Peer Group

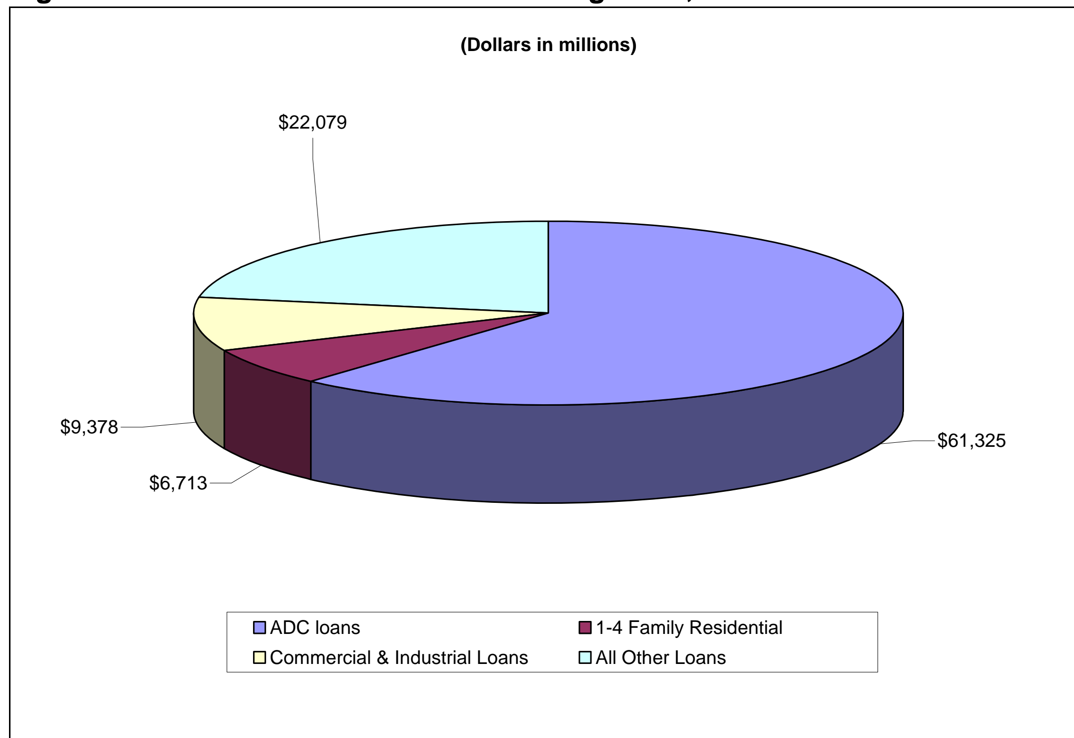
Year Ending	CRE Loans as a Percentage of Total Capital		ADC Loans as a Percentage of Total Capital	
	Premier	Peer Group	Premier	Peer Group
2004	554	331	295	81
2005	600	358	344	104
2006	682	390	454	136
2007	608	405	396	147
2008	663	421	397	139
2009	1,319	386	715	98

Source: UBPRs for Premier.

Note: The increase in CRE and ADC loan concentrations as a percentage of total capital in 2008 and 2009 was attributable to a decrease in capital rather than an increase in CRE or ADC loans. Also, we included owner-occupied properties in CRE loan totals when computing percentages of total capital even though the 2006 Joint Guidance specifically excludes such properties because UPBRs prior to 2007 did not breakout those amounts. Premier's non-owner occupied CRE as a percentage of the institution's total capital equaled 557, 571, and 1,116 percent for the years ended 2007 though 2009, respectively.

The Board and management implemented a more conservative lending culture in mid-2007. However, the bank's ability to effect improvement in its condition was limited by the poor quality of the loan portfolio and weak real estate market. The drastic increase in non-performing assets ultimately led to an increase in recognized loan losses that depleted earnings and eroded capital. Specifically, Premier's highly concentrated CRE and ADC lending strategy led to a $131 million increase in the bank's adversely classified assets between the 2006 and 2007 examinations. Further, the bank charged-off an average of over $30 million in loans annually after 2007. As reflected in Figure 2, ADC loans accounted for over 60 percent of total charge-offs between 2007 and 2010.

Figure 2: Premier's Loan and Lease Charge-offs, 2007 to 2010



Source: Reports of Condition and Income (Call Reports) for Premier.

Risk Management Practices

The Joint Guidance states that concentrations in CRE lending, coupled with weak loan underwriting and depressed CRE markets, contributed to significant credit losses in the past. According to the Joint Guidance:

- strong risk management practices are an important element of a sound CRE lending program, particularly when an institution has a concentration in CRE loans;

- financial institutions with CRE concentrations should ensure that risk management practices appropriate to the size of the portfolio, as well as the level and nature of concentrations and the associated risk to the institution, are implemented; and

- financial institutions should establish a risk management framework that effectively identifies, monitors, and controls CRE concentration risk.

In addition, FIL-22-2008, *Managing Commercial Real Estate Concentrations in a Challenging Environment*, issued March 17, 2008, describes key risk management processes for institutions with CRE concentrations. Such processes include maintaining prudent, time-tested lending policies with a strong credit review and risk rating system to identify deteriorating credit trends early and maintaining updated financial and analytical information for borrowers. For example, institutions should emphasize global financial analysis of obligors that includes analyzing borrowers' complete financial resources and obligations. The guidance further states that inappropriately adding interest reserves on loans where the underlying real estate project is not performing as expected can erode collateral protection and mask loans that would otherwise be reported as delinquent.

Loan Underwriting and Credit Administration

According to Premier's 2007 examination report, management's appetite for growth created a culture that allowed for 100 percent financing and interest reserves for purchasing and improving properties, resulting in no hard cash investment being required of the borrower. Further, examiners identified loans where the repayments relied heavily on gains from sales of other properties. Once the real estate market slowed, the borrowers' repayment capacity became severely impaired. These practices exposed Premier to considerable market risk. Additionally, in 2006 and 2007, the Board and management failed to perform adequate due diligence or institute adequate risk management controls for out-of-territory participations it purchased. The weak practices associated with the participations, coupled with the fact that out-of-territory participations are inherently risky, added to the erosion of asset quality and the increases in adverse classifications.

Further, although examiners found Premier's loan policy to be acceptable, the policy lacked sufficient guidance related to (1) the loan review program, (2) limits regarding portfolio diversification, (3) limits for 100-percent financing and interest reserves,

(4) non-amortizing loans, (5) participation loans, and (6) maximum exposure limits for individual concentrations. In addition, examiners found instances where the bank was in noncompliance with its loan policy, including not:

- Obtaining and reviewing current financial and income data;
- Properly obtaining and/or recertifying appraisals; and
- Ensuring that "borrowers demonstrate sufficient cash flow, liquidity, and net worth to support interest carry, and if necessary, principal reduction."

Although the Board and management began to implement a more disciplined lending culture in 2007, the changes did not keep the past-due and high level of nonaccrual loans from negatively affecting the bank's capital adequacy, earnings performance, liquidity, and sensitivity to market risks.

Premier was also cited for being in apparent violation of, or contravention to, regulatory requirements — another indication of weak risk management practices. Specifically, the 2006 and 2007 examination reports noted that Premier was in apparent violation of Part 323 of the FDIC Rules and Regulations, *Appraisals*, which provides minimum standards for all transactions that require the preparation of an appraisal by a state certified or licensed appraiser. In addition, the April 2008 and April 2009 examination reports cited Premier for apparent contraventions of Part 365 of the FDIC Rules and Regulations, *Real Estate Lending Standards*, Appendix A, *Interagency Guidelines for Real Estate Lending Policies*, which requires loans purchased or originated with loan-to-values in excess of supervisory limits to be identified in bank records and the aggregate amount reported to the Board quarterly.

Allowance for Loan and Lease Losses (ALLL)

The *Interagency Policy Statement on the Allowance for Loan and Lease Losses* (ALLL Policy Statement) reiterates key concepts and requirements related to generally accepted accounting principles and existing supervisory guidance. Specifically, the ALLL Policy Statement requires that an institution's process for determining the ALLL be based on a comprehensive, well-documented, and consistently applied analysis of its loan portfolio that considers all significant factors that affect collectability. That analysis should include an assessment of changes in economic conditions and collateral values and their direct impact on credit quality.

Premier's ALLL methodology was consistent with the ALLL Policy Statement. However, examiners determined that Premier did not make sufficient qualitative adjustments to reflect current real estate market conditions and did not consistently discount appraisals for impairments, which resulted in the ALLL being underfunded in 2007, 2008, and 2009. During the May 2010 examination, the Board voted to charge-off all of the remaining items on Premier's books that had been classified as losses during this examination. Table 3 shows the ALLL amounts computed by Premier compared to the amounts calculated by examiners between October 2006 and May 2010.

Table 3: Premier's Adversely Classified Assets and ALLL, 2006 to 2010

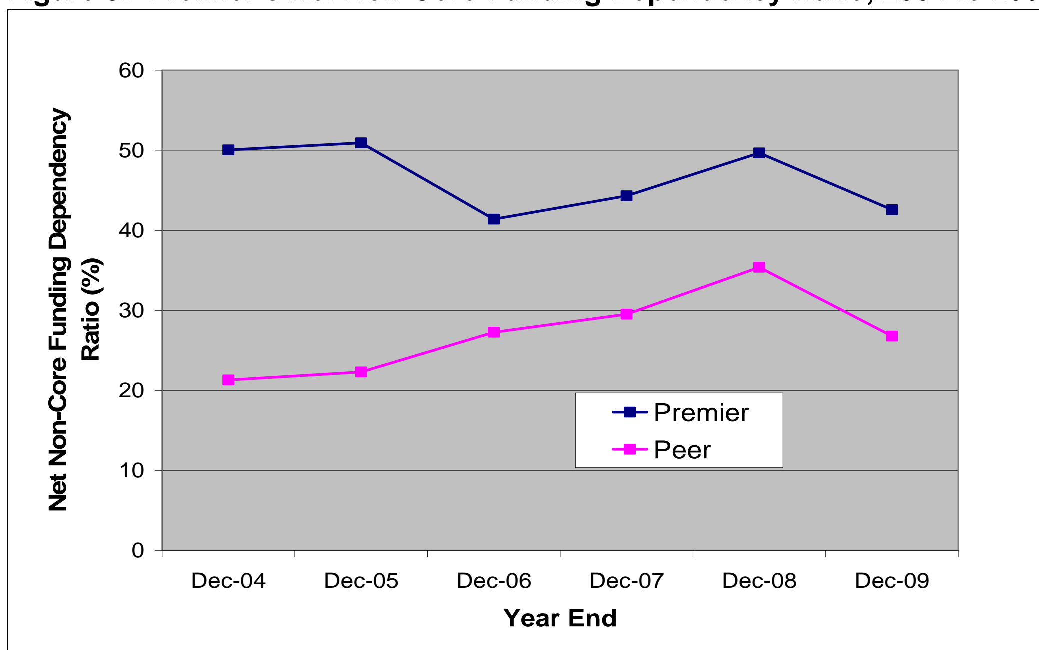
Asset Quality (Dollars in Thousands)						
Examination Date	Examiner Adversely Classified Asset Amounts				ALLL Amounts	
	Substandard	Doubtful	Loss	Total Adversely Classified Items	ALLL Computed by Premier	Increase in ALLL Computed by Examiners
Oct-2006	7,581	0	0	7,581	6,955	0
Sept -2007	135,131	2,148	1,336	138,615	12,640	8,000
Apr-2008	198,323	10,000	2,986	211,309	24,038	20,000
Oct-2008	245,458	0	2,730	248,188	32,327	0
Apr-2009	328,263	15,852	5,134	349,249	38,611	5,000
Oct-2009	389,857	16,501	1,825	408,183	43,470	5,000
May-2010	425,578	18,103	21,315	464,996	60,378	0

Source: Examination reports for Premier.

Funding Strategy

The bank's significant and rapid asset growth exceeded its capability to attract core deposits, which resulted in an increased reliance on brokered deposits and wholesale funding. When properly managed, non-core funding sources offer important benefits, such as ready access to funding in national markets when core deposit growth in local markets lags planned asset growth. However, non-core funding sources also present potential risks, such as higher costs and increased volatility. According to the Examination Manual, placing heavy reliance on potentially volatile funding sources to support asset growth is risky because access to these funds may become limited during distressed financial or economic conditions. As shown in Figure 3, Premier's net non-core funding dependency ratio was consistently higher than the dependency ratio of its peer group. The net non-core funding dependency ratio is a measure of the degree to which an institution relies on non-core funding to support longer-term assets (e.g., loans that mature in more than 1 year). An elevated ratio reflects heavy reliance on potentially volatile funding sources.

Figure 3: Premier's Net Non-Core Funding Dependency Ratio, 2004 to 2009



Source: UBPRs for Premier.

Premier also relied on capital injections to support growth. PBI funded capital through offerings of holding company stock, issuance of trust preferred securities, and advances on available borrowing lines. PBI's issuance of trust preferred securities provided $110 million in additional bank capital. PBI's reliance on trust preferred securities to fund Premier increased PBI's financial leverage, making PBI less resilient to adverse economic conditions.

By 2008, the bank's serious and deteriorating loan quality problems and resulting drain on earnings and capital began to affect the availability of brokered and borrowed funds. Specifically, Part 337 of the FDIC Rules and Regulations, *Unsafe and Unsound Banking Practices*, outlines restrictions on brokered deposits when an institution falls below *Well Capitalized*. As discussed later in this report, Premier's capital level fell below *Well Capitalized* in 2009 and progressively worsened.

While Premier was still *Well Capitalized,* management began structuring the terms and maturities of brokered deposits to control the bank's exposure to such deposits. Additionally, in 2009, management began to list Certificate of Deposit (CD) rates on the Internet in order to increase non-brokered deposits. Although the Internet deposits did not meet the regulatory definition of brokered deposits, those types of CDs are sensitive to market interest rates and potentially subject to interest rate restrictions under Part 337. Notably, the interest rate environment remained favorable and did not impede management's ability to maintain core deposit funding and attract Internet deposits. Nonetheless, examiners characterized Premier's liquidity position as deficient in the 2009 examinations. According to the examination reports, the bank's liquidity position was extremely vulnerable given the detrimental impact of the significant deterioration in the bank's asset quality on earnings, capital, and access to replacement funding.

The FDIC's Supervision of Premier

The FDIC and the MDF conducted timely examinations of Premier and monitored its condition through periodic offsite analysis and contacts. The FDIC and state examinations of Premier consistently identified key risks associated with its growth strategy and increasing reliance on wholesale funding. Prior to 2007, the bank was assigned satisfactory ratings, and neither the FDIC nor the MDF considered Premier to be a cause for significant supervisory concern based on its solid financial condition. However, supervisory concern increased in 2007 when the downturn in the real estate market resulted in a dramatic rise in nonperforming assets and a considerable deterioration in the bank's overall financial condition. The FDIC and the MDF began to downgrade the bank's composite and component ratings in 2007, and the MDF imposed an informal supervisory enforcement action. After the 2007 examination, the FDIC and the MDF closely monitored Premier's condition by conducting onsite examinations every 6 months. The increased supervisory attention led to further downgrades and the issuance of a formal enforcement action in 2009. Despite Premier's efforts to address its deficiencies, the bank's financial condition became critically deficient.

Recognizing that Premier's financial condition and markets were generally favorable during earlier examinations, the FDIC could have placed greater emphasis on Premier's increasing risk profile in 2006. Doing so may have resulted in downgrading the bank's supervisory ratings sooner and pursuing an informal enforcement action earlier. A more proactive supervisory approach may have influenced the bank to curb its CRE and ADC lending, increase its capital levels, and strengthen risk management controls before real estate markets deteriorated. With respect to the issues discussed in this report, the FDIC has taken a number of actions to increase supervisory attention to banks that have risk profiles similar to Premier, including instituting a training initiative on forward-looking supervision and issuing additional supervisory guidance on CRE and ADC concentrations, appraisals, and funds management.

Supervisory History

Historically, Premier received composite "1" or "2" CAMELS ratings. Our review focused on the FDIC's and the MDF's supervision of Premier between 2006 and 2010. During that period, the FDIC and the MDF conducted seven onsite safety and soundness examinations, exceeding the requirements of the FDI Act.[4] Table 4 summarizes Premier's examination history from 2006 to 2010, including the supervisory ratings and enforcement actions taken.

[4] Section 337.12 of the FDIC Rules and Regulations, which implements section 10(d) of the FDI Act, requires annual full-scope, onsite examinations of every state nonmember bank at least once during each 12-month period and allows for 18-month intervals for certain small institutions (with total assets of less than $500 million) if certain conditions are satisfied.

Table 4: Premier's Examination History, 2006 to 2010

Examination Start Date	Examination as of Date	Agency	Supervisory Ratings (UFIRS)	Informal or Formal Action Taken*
10/2/2006	6/30/2006	FDIC	111221/1	None
9/10/2007	6/30/2007	MDF	233332/3	Agreement dated 12/10/07
4/07/2008	3/31/2008	FDIC	343432/4	Agreement still in effect
10/14/2008	9/30/2008	MDF	444543/4	Cease and Desist Order (C&D) dated 2/17/09
4/13/2009	3/31/2009	FDIC	554554/5	C&D still in effect
10/19/2009	9/30/2009	MDF	555555/5	C&D still in effect
5/24/2010	3/31/2010	FDIC	554545/5	C&D still in effect

Source: Examination reports and enforcement actions for Premier.

*Informal corrective actions often take the form of a Bank Board Resolution or a Memorandum of Understanding (MOU). Formal corrective actions often take the form of a C&D, Supervisory Directive, or, under severe circumstances, insurance termination proceedings. The agreement issued in 2007 by the MDF and the FDIC was similar to an MOU.

As part of the offsite review process, FDIC officials contacted bank officials to follow up on risk trends. For example, in June 2007, several months prior to the MDF examination, the FDIC's offsite analysis of the March 31, 2007 Call Report prompted the FDIC to contact Premier to discuss how the bank was monitoring its ADC exposure. Bank management recognized that market conditions were beginning to negatively impact the bank's financial condition and that foreclosures were expected to increase. However, at the time, Premier did not believe the impact would be significant because its risk was spread across different markets. Nonetheless, given the bank's size and deteriorating condition, the FDIC decided to participate in the MDF's 2007 examination. Thereafter, the FDIC maintained regular communication with bank officials and participated in each of the MDF's subsequent examinations.

Supervisory Response to Key Risks

Prior to 2007, examination reports highlighted the risks associated with the bank's growth strategy and its continued reliance on non-core funding sources, including the extent to which these risks made the bank vulnerable to adverse economic conditions. However, examiners did not downgrade the bank until the downturn in the economy affected the bank's financial condition. In retrospect, a more forward-looking assessment of Premier's risk exposure in 2006 may have been prudent.

2006 Supervisory Activity

Premier received a composite rating of "1" in 2006, indicating no cause for supervisory concern and weaknesses that were moderate and well within the capabilities and willingness of the Board and management to correct. In hindsight, downgrades in the bank's Asset Quality and Management components may have been prudent.

The examination report stated that asset quality remained strong based on the low level of adversely classified assets and past-due and nonaccrual loans, and examiners assigned

this component a “1” rating. However, the report identified a number of credit underwriting and administration weaknesses and the potential downside of such weaknesses. Examiners recommended that the Board strengthen its analysis and monitoring of the CRE portfolio and the real estate lending section of its loan policy. Of particular concern to examiners was the extent to which the bank allowed borrowers to finance 100 percent of the costs associated with purchasing and improving properties and the lack of specific limits for this practice.

The examination report stated that management’s performance and risk management practices were strong relative to the bank’s size and risk profile and assigned a Management component rating of “1.” Senior management was considered to be proactive in identifying controls and procedures that could be improved. Further, management actively evaluated the impact of various asset growth scenarios to maintain capital at levels sufficient to keep the bank *Well Capitalized*. Accordingly, Capital was assigned a “1” rating – meaning that the bank’s capital level was strong relative to its risk profile. The examination report also stated that capital adequacy remained strong based on capital injections provided by PBI which it funded through a combination of sources, including stock offerings, trust preferred securities, and short-term borrowings. PBI provided Premier over $60 million in capital injections between the 2006 and 2007 examinations. The examination report further stated that the Total Risk-Based Capital ratio was managed very close to the 10 percent minimum required. As noted in a subsequent April 2008 examination report, minimum regulatory capital ratios are intended for well-diversified banks whose overall condition is fundamentally sound and that have no material financial weaknesses. As discussed later, Premier may not have fully exhibited these characteristics.

Although Premier relied on non-core funding, examiners generally found that Premier’s bank liquidity levels and management practices were adequate prior to 2007. Specifically, examiners noted that the bank had developed a diverse group of non-core funding sources, established funding limits and guidelines for monitoring tools to address the risks associated with each funding source, and had a written contingency funding plan in place. Nonetheless, Premier’s liquidity prospects and costs were significantly dependent upon its ability to maintain a financially strong institution.

According to the Examination Manual, the Asset Quality rating reflects the quantity of existing and potential credit risk associated with the loan and investment portfolios. The ability of management to identify, measure, monitor, and control credit risk is also reflected in the rating. An Asset Quality rating of “1” indicates strong asset quality and credit administration practices, identified weaknesses are minor in nature, and risk exposure is modest in relation to capital protection and management’s abilities. Further, a Management rating of “1” indicates strong performance by management and strong risk management practices relative to the institution’s size, complexity, and risk profile.

In hindsight, downgrading the Asset Quality and Management component ratings and Premier’s composite rating and/or pursuing an informal supervisory enforcement action may have been prudent, taking into consideration Premier’s risk exposure in 2006.

Specifically, Premier's CRE and ADC concentrations were significant, management promoted a liberal credit culture, examiners had identified risk management practices that needed to be strengthened, and the bank was reliant on funding sources that were highly dependent on management's ability to maintain a financially strong institution.

Taking a more proactive supervisory approach in 2006 may have influenced the bank to curb its CRE and ADC lending, increase its capital levels, and strengthen risk management controls before real estate markets deteriorated. Further, an informal enforcement action could have been used to require the Board to commit to a plan for reducing the bank's risk exposure. In light of Premier's financial performance and condition at that time, we recognize that the FDIC would have faced considerable challenges convincing the Board and management that their strategy and practices were creating unwarranted risk that needed to be constrained and mitigated.

2007 Supervisory Activity

The September 2007 examination was the first to identify deterioration in Premier's overall condition. Adversely classified assets increased from about $8 million to $139 million since the previous examination. Examiners stated that a lack of adequate oversight had contributed to the sharp increase in adverse classifications and that management's and the Board's emphasis on rapid loan growth allowed for a liberal credit culture. Further, examiners stated that a failure to address prior recommendations to limit risky concentrations of credit reflected poorly on management. Accordingly, the MDF downgraded Premier to a composite "3" rating. Financial institutions assigned a "3" rating exhibit some degree of supervisory concern, are generally less capable of withstanding business fluctuations, and are more vulnerable to outside influences. The examination also resulted in examiners formally designating Premier as a "troubled" institution subject to closer regulatory supervision.

Following the 2007 examination, the MDF and the FDIC entered an Agreement (similar to an MOU) with Premier on December 10, 2007. The Agreement required the bank to, among other things:

- Revise the structure of the loan approval process,
- Review and revise the loan policy,
- Restrict the use of interest reserves,
- Develop and implement a written plan to reduce the risk position of each loan relationship aggregating $1 million or more that had been classified in the 2007 examination,
- Immediately reduce to zero the total amount of assets classified as loss in the 2007 examination as well as reduce the total amount of loans classified as doubtful,

- Correct loan documentation exceptions,
- Maintain the ALLL at a reasonable level in relation to the degree of risk inherent in the bank's loan portfolio,
- Maintain Tier 1 Leverage Capital at a minimum of 7 percent of Total Assets,
- Develop and submit a 3-year strategic plan,
- Correct violations of law and regulations, and
- Develop a plan to monitor and control ADC concentrations.

The agreement also required Premier to advise the FDIC and the MDF in writing of the bank's actions to comply with each part of the Agreement.

2008 through 2010 Supervisory Activity

After the 2007 examination, the level of supervisory attention increased significantly, and the FDIC and the MDF instituted a 6-month onsite examination cycle. The examinations for 2008 through 2010 identified further deterioration in the bank's financial condition. For example, the April 2008 examination found the overall condition of the bank to remain poor, resulting in a composite "4" rating, even though the bank had satisfied the requirements of the Agreement except for the provision related to maintaining an appropriate ALLL. Following the MDF examination in October 2008, a C&D was put into place on February 17, 2009. The C&D included provisions to (1) conduct a management study, (2) reduce the risk position in each relationship/asset aggregating $1 million or more that was classified or listed for special mention in the October 2008 examination report, (3) strictly adhere to the loan policy, (4) maintain Tier 1 Capital at no less than 8 percent of total assets and other capital ratios such that the bank remains *Well Capitalized*, (5) restrict dividends and bonuses, and (6) require written plans to address profits, contingency funding, brokered deposits, and ADC concentrations. The C&D also required the bank to submit quarterly progress reports to the FDIC and the MDF.

The bank's condition continued to decline, and the FDIC further downgraded the bank to a composite "5" rating in April 2009. Premier's composite rating remained a "5" at the MDF's October 2009 examination. Examiners found further deterioration in the ADC portfolio and noted that management was unable to reduce the level of problem assets or increase capital to levels commensurate with the bank's risk profile. PBI was no longer considered a source of strength because of its high debt levels. Examiners acknowledged management's efforts to comply with the C&D and employ contingent liquidity strategies. In addition, the examination report stated that the bank hired experienced personnel to manage a Special Assets Division created to resolve problem assets. Nevertheless, by the May 2010 examination, the overall condition of the bank remained critically deficient, and the bank's continued viability was in serious jeopardy.

Supervisory Lessons Learned

According to the Examination Manual, the quality of an institution's management, including its Board and executive officers, is perhaps the single most important element in the successful operation of a bank. The Board has overall responsibility and authority for formulating sound policies and objectives for the bank and for effectively supervising the institution's affairs. The Examination Manual further states that:

> …to effectively prevent serious problems in an institution, the conditions and circumstances that may lead to problems must be identified and corrected early. Corrective action should be taken immediately upon identifying excessive risk taking…when corrective action is not taken until conditions have deteriorated it is often too late to avoid failure. Moral suasion and informal agreements are normally sufficient where the unacceptable risk-taking is identified early, but formal action must be considered, even when an institution is rated 1 or 2, if circumstances warrant.

In hindsight, a more forward-looking assessment of Premier's risk profile in 2006 may have been prudent and led to downgrading Premier's Asset Quality and Management component ratings and possibly the composite rating. Such action may have led to an informal action earlier and helped to curb the bank's growth appetite sooner. Further, such action would have reinforced supervisory expectations, increased supervisory oversight, and required the Board to commit to a plan and a timeline for implementing corrective actions at a critical time.

The perspectives gained from this bank failure are not unique to Premier. The FDIC has taken a number of actions to increase supervisory attention to banks that have risk profiles similar to Premier. Of note, in March 2010, the FDIC completed a training initiative for its entire supervisory workforce that emphasizes the need to assess a bank's risk profile using forward-looking supervision. Further, FDIC regional officials stated that they began to emphasize the basic tenet of prudent diversification and discuss funding sources as part of regional training conferences and meetings with field offices and territories in 2008. The FDIC has also issued updated guidance to examiners regarding CRE loan examination procedures in view of more challenging market conditions, particularly in ADC lending, and supervisory expectations for FDIC-supervised institutions to update real estate appraisals and evaluations. The FDIC has also issued updated guidance related to funding liquidity risk management.

Implementation of PCA

Section 38, *Prompt Corrective Action,* of the FDI Act establishes a framework of mandatory and discretionary supervisory actions pertaining to all institutions. The section requires regulators to take progressively more severe actions, known as "prompt corrective actions," as an institution's capital levels deteriorate. The purpose of PCA is to resolve problems of insured depository institutions at the least possible long-term cost to the DIF. Part 325, *Capital Maintenance*, of the FDIC Rules and Regulations defines

the capital measures used in determining the supervisory actions that will be taken pursuant to section 38 for FDIC-supervised institutions. Part 325 also establishes procedures for the submission and review of capital restoration plans and for the issuance of directives and orders pursuant to section 38. The FDIC is required to closely monitor an institution's compliance with its capital restoration plan, mandatory restrictions defined under section 38(e), and discretionary safeguards (if any) imposed by the FDIC to determine if the purposes of PCA are being achieved.

Based on the supervisory actions taken with respect to Premier, the FDIC properly implemented applicable PCA provisions of section 38. Table 5 illustrates Premier's capital levels relative to the PCA thresholds for *Well Capitalized* Institutions.

Table 5: Premier's Capital Levels Relative to PCA Thresholds

Period Ending	Tier 1 Leverage	Tier 1 Risk-Based	Total Risk-Based	Capital Classification
***Well Capitalized* Threshold**	**5% or more**	**6% or more**	**10% or more**	
Dec-06	9.44	9.29	10.05	*Well Capitalized*
Dec-07	9.94	10.41	11.66	*Well Capitalized*
Dec-08	7.96	9.19	10.45	*Well Capitalized*
Mar-09	6.68	8.00	9.27	*Adequately Capitalized*
Jun-09	5.91	7.35	8.63	*Adequately Capitalized*
Sept-09	4.93	6.20	7.49	*Adequately Capitalized*
Dec-09	3.24	4.13	5.45	*Undercapitalized**
Mar-10	2.71	3.35	4.65	*Significantly Undercapitalized*
Jun-10	1.49	1.90	3.20	*Significantly Undercapitalized*
Sept-10	0.91	1.19	2.37	*Critically Undercapitalized*

Source: UBPRs and examination reports for Premier and Part 325 of the FDIC Rules and Regulations.
*When the bank filed its December 31, 2009 Call Report, the capital ratios placed the bank in the *Undercapitalized* capital category. However, the bank amended its December 31, 2009 Call Report in April 2010, causing the bank's capital category to fall to *Significantly Undercapitalized.*

Following the October 2008 examination, the MDF sent a letter to Premier in January 2009 reiterating that, given the bank's deficiencies, a formal enforcement action was imminent. As discussed earlier in this report, the February 2009 C&D included a provision requiring the bank to maintain Tier 1 Capital at no less than 8 percent of total assets and to maintain other capital ratios such that the bank would remain *Well Capitalized*. Additionally, the C&D included a provision that required the bank to submit a plan to reduce the volume of brokered deposits and develop a capital restoration plan if the bank's Total Risk-Based Capital ratio declined to 10.5 percent.

The FDIC's efforts to monitor Premier's capital position subsequent to the issuance of the February 2009 C&D follows:

- **May 21, 2009**. The FDIC issued a letter to Premier, notifying the bank that it was *Adequately Capitalized* based on the March 31, 2009 Call Report. The letter

reminded the bank of the requirements and restrictions regarding brokered deposits applicable to institutions that become *Adequately Capitalized.*

- **November 17, 2009.** The FDIC issued a letter to Premier, notifying the bank that it was *Undercapitalized* based on the September 30, 2009 Call Report. The letter reminded the bank of the associated restrictions under section 38, including restrictions on asset growth, acquisitions, new activities, new branches, dividends, other capital distributions, and management fees. The FDIC's letter also reminded the bank that a written capital restoration plan was required by December 14, 2009.

- **December 4, 2009.** The FDIC granted Premier an extension to file the capital restoration plan until December 21, 2009.

- **January 27, 2010.** The FDIC notified Premier that its capital restoration plan, dated December 18, 2009, was unacceptable because the plan was based on assumptions that were generally not realistic or attainable. Accordingly, the FDIC informed Premier that, effective immediately, it was subject to all of the provisions of section 38 applicable to *Significantly Undercapitalized* institutions.

- **May 12, 2010.** The FDIC issued a letter to Premier, notifying the bank that it was *Significantly Undercapitalized* based on the March 31, 2010 Call Report. The letter reiterated restrictions pertaining to *Significantly Undercapitalized* banks.

- **July 15, 2010.** The FDIC issued a letter to Premier, notifying the bank that it was *Critically Undercapitalized* based on the results of the May 2010 examination. The letter outlined further restrictions under section 38, including the fact that the FDIC was required to place the bank into receivership within 90 days of July 15, 2010, unless the FDIC determined that a different action was warranted.

Under section 38, the 90-day resolution period was scheduled to end on October 13, 2010. On October 8, 2010, DSC's Director and the FDIC's Acting General Counsel granted a 30-day extension because a planned sale of the bank was unexpectedly cancelled. Premier explored a number of strategic alternatives for raising capital, including applying for funds under the Department of the Treasury's Troubled Asset Relief Program,[5] but its capital-raising efforts were not successful. Ultimately, the MDF took possession of Premier on October 15, 2010.

OIG Evaluation of Corporation Comments

The Director, RMS, provided a written response, dated May 12, 2011, to a draft of the report. That response is provided in its entirety as Appendix 4 of this report. In the response, RMS reiterated the OIG's conclusions regarding the causes of Premier's failure. With regard to our assessment of the FDIC's supervision of Premier, RMS's

[5] The bank withdrew its Troubled Asset Relief Program application on March 11, 2009.

response discussed the number of examinations and visitations and the offsite monitoring conducted between 2006 and 2010 described in the report. Further, RMS's response reiterated supervisory actions taken in response to the deterioration in Premier's asset quality and overall condition, which started in 2007. As discussed in the report, supervisory actions included initiating a 6-month examination cycle and issuing a C&D that included a provision requiring Premier to submit a plan to reduce the bank's brokered deposits. Further, RMS referenced guidance that the FDIC has issued to re-emphasize the importance of robust credit risk-management practices for institutions with concentrated CRE exposures and set forth broad supervisory expectations. RMS also referenced FDIC guidance issued for institutions, such as Premier, with concentrated CRE/ADC lending and reliance on non-core funding.

Objectives, Scope, and Methodology

Objectives

We performed this audit in accordance with section 38(k) of the FDI Act, as amended by the Financial Reform Act, which provides, in general, that if the 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, reviewing the agency's supervision of the institution. The Financial Reform Act amends section 38(k) by increasing the MLR threshold from $25 million to $200 million for losses that occur for the period January 1, 2010 through December 31, 2011. The FDI Act requires that the report be completed within 6 months after it becomes apparent that a material loss has been incurred.

Our audit objectives were to (1) determine the causes of the Premier's failure and resulting material loss to the DIF and (2) evaluate the FDIC's supervision of the institution, including implementation of the PCA provisions of section 38.

We conducted this performance audit from November 2010 to March 2011 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 this audit included an analysis of Premier's operations from 2006 until its failure on October 15, 2010. Our review also entailed an evaluation of the regulatory supervision of the institution over the same period.

To achieve the objectives, we performed the following procedures and techniques:

- Analyzed examination reports prepared by the FDIC and the MDF examiners from 2006 to 2010.

- Reviewed the following:

  - Bank data and correspondence maintained at the DSC's Kansas City Regional Office and Columbia Field Office.

  - Reports prepared by the Division of Resolutions and Receiverships (DRR) and DSC relating to the bank's closure.

Objectives, Scope, and Methodology

- Pertinent DSC policies and procedures and various banking laws and regulations.

- Interviewed the following FDIC officials:

    - DSC management in Washington, D.C., and the Kansas City Regional Office, Columbia Field Office, and St. Louis Field Office.

    - DRR officials at the Dallas Regional Office.

    - FDIC examiners from the DSC's Columbia Field Office and Richmond Field Office who participated in examinations or reviews of examinations of Premier.

- Interviewed officials from the MDF to discuss the historical perspective of the institution, its examinations, and other activities regarding the MDF's supervision of the bank.

Internal Control, Reliance on Computer-processed Information, Performance Measurement, and Compliance with Laws and Regulations

Consistent with the audit objectives, we did not assess DSC's overall internal control or management control structure. We relied on information in DSC systems, reports, examination reports, and interviews of examiners to understand Premier's management controls pertaining to the causes of failure and material loss as discussed in the body of this report.

We obtained data from various FDIC systems but determined that information system controls were not significant to the audit objectives and, therefore, did not evaluate the effectiveness of information system controls. We relied on our analysis of information from various sources, including examination reports, correspondence files, and testimonial evidence to corroborate data obtained from systems that was used to support our audit conclusions.

The Government Performance and Results Act of 1993 (the Results Act) directs Executive Branch agencies to develop a customer-focused strategic plan, align agency programs and activities with concrete missions and goals, and prepare and report on annual performance plans. For this material loss review, we did not assess the strengths and weaknesses of DSC's annual performance plan in meeting the requirements of the Results Act because such an assessment is not part of the audit objectives. DSC's compliance with the Results Act is reviewed in program audits of DSC operations.

Objectives, Scope, and Methodology

Regarding compliance with laws and regulations, we performed tests to determine whether the FDIC had complied with provisions of PCA and limited tests to determine compliance with certain aspects of the FDI Act and the FDIC's Rules and Regulations. The results of our tests were discussed, where appropriate, in the report. Additionally, we assessed the risk of fraud and abuse related to our objectives in the course of evaluating audit evidence.

Related Coverage of Financial Institution Failures

On May 1, 2009, the OIG issued an internal memorandum that outlined major causes, trends, and common characteristics of FDIC-supervised financial institution failures that had resulted in a material loss to the DIF. The memorandum indicated that the OIG planned to provide more in-depth coverage of those issues and make related recommendations, when appropriate. Since May 1, 2009, the OIG has issued additional MLR reports related to failures of FDIC-supervised institutions, and these reports can be found at www.fdicig.gov. In addition, the OIG issued an audit report entitled, *Follow-up Audit of FDIC Supervision Program Enhancements* (Report No. MLR-11-010), in December 2010. The objectives of the audit were to (1) determine the actions that the FDIC has taken to enhance its supervision program since May 2009, including those specifically in response to the May 2009 memorandum, and (2) identify trends and issues that have emerged from subsequent MLRs.

Further, with respect to more in-depth coverage of specific issues, in May 2010, the OIG initiated an evaluation of the role and federal regulators' use of section 38, *Prompt Corrective Action* and section 39, *Standards for Safety and Soundness* of the FDI Act in the banking crisis.

Glossary of Terms

Term	Definition
Acquisition, Development, and Construction (ADC) Loans	ADC loans are a component of Commercial Real Estate that provide funding for acquiring and developing land for future construction and that provide interim financing for residential or commercial structures.
Adversely Classified Assets	Assets subject to criticism and/or comment in an examination report. Adversely classified assets are allocated on the basis of risk (lowest to highest) into three categories: Substandard, Doubtful, and Loss.
Allowance for Loan and Lease Losses (ALLL)	The ALLL is an estimate of uncollectible amounts that is used to reduce the book value of loans and leases to the amount that is expected to be collected. It is established in recognition that some loans in the institution's overall loan and lease portfolio will not be repaid. Boards of directors are responsible for ensuring that their institutions have controls in place to consistently determine the allowance in accordance with the institutions' stated policies and procedures, generally accepted accounting principles, and supervisory guidance.
Call Report	Reports of Condition and Income, often referred to as Call Reports, include basic financial data for insured commercial banks in the form of a balance sheet, an income statement, and supporting schedules. According to the Federal Financial Institutions Examination Council's (FFIEC) instructions for preparing Call Reports, national banks, state member banks, and insured nonmember banks are required to submit a Call Report to the FFIEC's Central Data Repository (an Internet-based system used for data collection) as of the close of business on the last day of each calendar quarter.
Cease and Desist Order (C&D)	A C&D is a formal enforcement action issued by a financial institution regulator pursuant to 12 United States Code (U.S.C.) section 1818 to a bank or affiliated party to stop an unsafe or unsound practice or a violation of laws and regulations. A C&D may be terminated when the bank's condition has significantly improved and the action is no longer needed or the bank has materially complied with its terms.
Commercial Real Estate (CRE) Loans	CRE loans are land development and construction loans (including 1-to-4 family residential and commercial construction loans) and other land loans. CRE loans also include loans secured by multifamily property and nonfarm nonresidential property, where the primary source of repayment is derived from rental income associated with the property or the proceeds of the sale, refinancing, or permanent financing of the property.
Concentration	A concentration is a significantly large volume of economically related assets that an institution has advanced or committed to a certain industry, person, entity, or affiliated group. These assets may, in the aggregate, present a substantial risk to the safety and soundness of the institution.

Glossary of Terms

Contingency Funding (or Liquidity) Plan	A written plan that defines strategies for addressing liquidity shortfalls in emergency situations. Such plans delineate policies to manage a range of stress environments, establish clear lines of responsibility, and articulate clear implementation and escalation procedures. Contingency funding plans should be regularly tested and updated to ensure that they are operationally sound. DSC uses the term contingency funding plan and contingency liquidity plan interchangeably.
FDIC's Supervision Program	The FDIC's supervision program promotes the safety and soundness of FDIC-supervised institutions, protects consumers' rights, and promotes community investment initiatives by FDIC-supervised institutions. The FDIC's DSC (1) performs examinations of FDIC-supervised institutions to assess their overall financial condition, management policies and practices (including internal control systems), and compliance with applicable laws and regulations and (2) issues related guidance to institutions and examiners.
Federal Home Loan Bank (FHLB)	FHLBs provide long-and short-term advances (loans) to their members. Advances are primarily collateralized by residential mortgage loans and government and agency securities. Community financial institutions may pledge small business, small farm, and small agri-business loans as collateral for advances. Advances are priced at a small spread over comparable U.S. Department of the Treasury obligations.
Financial Holding Company	A financial entity engaged in a broad range of banking-related activities, created by the Gramm-Leach-Bliley Act of 1999. These activities include: insurance underwriting, securities dealing and underwriting, financial and investment advisory services, merchant banking, issuing or selling securitized interests in bank-eligible assets, and generally engaging in any non-banking activity authorized by the Bank Holding Company Act. The Federal Reserve Board is responsible for supervising the financial condition and activities of financial holding companies.
Global Cash Flow Analysis	A global cash flow analysis is a comprehensive evaluation of borrower capacity to perform on a loan. During underwriting, proper global cash flow must thoroughly analyze projected cash flow and guarantor support. Beyond the individual loan, global cash flow must consider all other relevant factors, including: guarantor's related debt at other financial institutions, future economic conditions, as well as obtaining current and complete operating statements of all related entities. In addition, global cash flow analysis should be routinely conducted as a part of credit administration. The extent and frequency of global cash flow analysis should be commensurate to the amount of risk associated with the particular loan.

Glossary of Terms

Interest Reserve	An interest reserve allows a lender to periodically advance loan funds to pay interest charges on the outstanding balance of the loan. The interest is capitalized and added to the loan balance. Frequently, ADC loan budgets will include an interest reserve to carry the project from origination to completion and may cover the project's anticipated sellout or lease-up period.
Loan Participation	The transfer of an undivided interest in all or part of the principal amount of a loan from a seller, known as the "lead," to a buyer, known as the "participant," without recourse to the lead, pursuant to an agreement between the lead and the participant. "Without recourse" means that the loan participation is not subject to any agreement that requires the lead to repurchase the participant's interest or to otherwise compensate the participant upon the borrower's default on the underlying loan.
Loan-to-Value	A ratio for a single loan and property calculated by dividing the total loan amount at origination by the market value of the property securing the credit plus any readily marketable collateral or other acceptable collateral.
Material Loss	As defined by section 38(k)(2)(B) of the FDI Act, and as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, for the period beginning January 1, 2010 and ending December 31, 2011, a material loss is defined as any estimated loss in excess of $200 million.
Memorandum of Understanding (MOU)	An MOU is an informal agreement between the institution and the FDIC, signed by both parties. The State Authority may also be party to the agreement. MOUs are designed to address and correct identified weaknesses in an institution's condition.
Nonaccrual Loan	A loan that is not earning the contractual rate of interest in the loan agreement, due to financial difficulties of the borrower. Typically, interest accruals have been suspended because full collection of principal is in doubt or interest payments have not been made for a sustained period of time. Loans with principal and interest unpaid for at least 90 days are generally considered to be in a nonaccrual status.
Offsite Review Program	The FDIC's Offsite Review Program is designed to identify emerging supervisory concerns and potential problems so that supervisory strategies can be adjusted appropriately. Offsite reviews are performed quarterly for each bank that appears on the Offsite Review List. Regional management is responsible for implementing procedures to ensure that Offsite Review findings are factored into examination schedules and other supervisory activities.
Peer Group	Institutions are assigned to 1 of 15 peer groups based on asset size, number of branches, and whether the institution is located in a metropolitan or non-metropolitan area.

Appendix 2

Glossary of Terms

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 (C.F.R.), section 325.101, et. seq., implements section 38, *Prompt Corrective Action*, of the FDI Act, 12 U.S.C. 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) A*dequately Capitalized*, (3) *Undercapitalized*, (4) *Significantly Undercapitalized*, and (5) *Critically Undercapitalized*.
Risk-Based Capital	A "supplemental" capital standard under Part 325 of the FDIC Rules and Regulations. Under the risk-based framework, a bank's qualifying total capital base consists of two types of capital elements, "core capital" (Tier 1) and "supplementary capital" (Tier 2).
Tier 1 (Core) Capital	Defined in Part 325 of the FDIC Rules and Regulations, 12 C.F.R. section 325.2(v), as **The sum of**: • Common stockholder's equity (common stock and related surplus, undivided profits, disclosed capital reserves, foreign currency translation adjustments, less net unrealized losses on available-for-sale securities with readily determinable market values); • Non-cumulative perpetual preferred stock; and • Minority interest in consolidated subsidiaries. **Minus:** • Certain intangible assets; • Identified losses; • Investments in financial subsidiaries subject to section 362, subpart E; and • Deferred tax assets in excess of the limit set forth in section 325.5(g).
Troubled Asset Relief Program (TARP)	TARP is a program of the United States Department of the Treasury to purchase assets and equity from financial institutions to strengthen the financial sector.

Glossary of Terms

Trust Preferred Security (TruP)	TruPs are hybrid instruments possessing characteristics typically associated with debt obligations. Under the basic structure of trust preferred securities, a corporate issuer, such as a bank holding company, first organizes a business trust or other special purpose entity. This trust issues two classes of securities: common securities, all of which are purchased and held by the corporate issuer, and trust preferred securities, which are sold to investors. The business trust's only assets are deeply subordinated debentures of the corporate issuer, which the trust purchases with the proceeds from the sale of its common and preferred securities. The corporate issuer makes periodic interest payments on the subordinated debentures to the business trust, which uses these payments to pay periodic dividends on the TruPs to the investors. The subordinated debentures have a stated maturity and may also be redeemed under other circumstances. Most TruPs are subject to a mandatory redemption upon the repayment of the debentures.
Uniform Bank Performance Report (UBPR)	The UBPR is an individual analysis of financial institution financial data and ratios that includes extensive comparisons to peer group performance. The report is produced by the FFIEC 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 UFIRS to evaluate a bank's performance in six components represented by the CAMELS acronym: **C**apital adequacy, **A**sset quality, **M**anagement practices, **E**arnings performance, **L**iquidity position, and **S**ensitivity to market risk. Each component, and an overall composite score, is assigned a rating of 1 through 5, with 1 having the least regulatory concern and 5 having the greatest concern.
Wholesale Funding	Wholesale funding sources include, but are not limited to, Federal funds, public funds, FHLB advances, the Federal Reserve's primary credit program, foreign deposits, brokered deposits, and deposits obtained through the Internet or CD listing services. Financial institutions may use wholesale funding sources as an alternative to core deposits to satisfy funding and liability management needs.

Acronyms

Acronym	Definition
ADC	Acquisition, Development, and Construction
ALLL	Allowance for Loan and Lease Losses
C&D	Cease and Desist Order
CAMELS	**C**apital, **A**sset Quality, **M**anagement, **E**arnings, **L**iquidity and **S**ensitivity to Market Risk
CD	Certificates of Deposit
CRE	Commercial Real Estate
DIF	Deposit Insurance Fund
DRR	Division of Resolutions and Receiverships
DSC	Division of Supervision and Consumer Protection
FDI	Federal Deposit Insurance
FHLB	Federal Home Loan Bank
FIL	Financial Institution Letter
MDF	Missouri Division of Finance
MLR	Material Loss Review
MOU	Memorandum of Understanding
OIG	Office of Inspector General
PBI	Premier Bancshares, Inc.
PCA	Prompt Corrective Action
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System

Corporation Comments

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

May 12, 2011

TO: Mark Mulholland
Deputy Assistant Inspector General for Audits

/Signed/
FROM: Sandra L. Thompson
Director

SUBJECT: FDIC Response to the Draft Audit Report Entitled, Material Loss Review of Premier Bank, Jefferson City, Missouri (Assignment No. 2011-005)

Pursuant to Section 38(k) of the Federal Deposit Insurance Act, and 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 a Material Loss Review of Premier Bank (Premier), which failed on October 15, 2010. This memorandum is the response of the Division of Risk Management Supervision (RMS) to the OIG's Draft Report received on April 18, 2011.

Premier failed due to the Board's and management's growth strategy focused on commercial real estate (CRE) and acquisition, development and construction (ADC) lending and the lack of effective risk management practices which left the bank vulnerable to degrading market conditions. Growth was funded primarily by non-core deposits and a capital injection from Premier Bancshares Inc. As the real estate market weakened in 2007, Premier incurred loan-related losses resulting in reduced earnings and depleted capital. Efforts to diversify its portfolio and raise additional capital to support safe and sound operations were unsuccessful.

From 2006 to 2010 the FDIC and the Missouri Department of Finance conducted six onsite risk management examinations, three onsite visitations and on-going offsite monitoring. The 2007 examination findings warranted an increase in supervisory oversight and a six-month onsite examination cycle was implemented. Examiners downgraded Premier as a result of the FDIC 2008 examination due to deficient asset quality and poor overall conditions. As a result of the October 2008 examination, examiners issued a cease and desist order that included a provision requiring Premier to submit a plan to reduce the volume of brokered deposits. The FDIC's examination of April 2009 found the bank in further decline and examiners downgraded Premier's composite rating.

RMS issued *Interagency Guidance on CRE Monitoring* in 2006 and a Financial Institution Letter to banks on *Managing Commercial Real Estate Concentrations in a Challenging Environment* in 2008 that re-emphasized the importance of robust credit risk-management practices for institutions with concentrated CRE exposures and set forth broad supervisory expectations. Additionally, RMS issued a FIL in 2009 on *The Use of Volatile or Special Funding Sources by Financial Institutions that are in a Weakened Condition* for institutions, such as Premier, with concentrated CRE/ADC lending and reliance on volatile non-core funding.

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