



Failed Bank Review

First City Bank of Florida | Fort Walton Beach, Florida

March 2021

FBR-21-002

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Federal Deposit Insurance Corporation
Office of Inspector General
Office of Program Audits and Evaluations



Date: March 15, 2021

Memorandum To: Doreen R. Eberley
Director, Division of Risk Management Supervision

From: */Signed/*
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Assistant Inspector General for Program Audits and Evaluations

Subject | **Failed Bank Review Memorandum** | First City Bank of Florida |
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Background

On October 16, 2020, the Florida Office of Financial Regulation (OFR) closed the First City Bank of Florida (FCB) and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver. FCB was a state-chartered nonmember bank located in Fort Walton Beach, Florida. The FDIC first insured FCB on November 17, 1948. FCB was wholly owned by Florida First City Banks, Inc. (FFCB), a single bank holding company. The Chairman of FCB's Board of Directors (Board) was also the Chief Executive Officer (CEO) of the bank, and he owned 69 percent of FFCB's common stock. The remaining Board members owned 4 percent of the stock, and unaffiliated shareholders held the remaining 27 percent.¹ The FDIC considered the Chairman and CEO as a "dominant bank official."²

According to the FDIC's Division of Finance, as of November 30, 2020, the estimated loss to the Deposit Insurance Fund (DIF) was approximately \$10 million or 7 percent of the bank's \$136 million in total assets. The OFR took possession and closed FCB, because it had experienced longstanding issues related to capital, asset quality, and earnings, and had become "imminently insolvent" as of June 30, 2020.³

¹ One unaffiliated shareholder owned 10 percent of FFCB's common stock and no other shareholder owned 5 percent or more.

² A "dominant official" is an individual, family, shareholder, or group of persons with close business dealings, or otherwise acting in concert, that appears to exert an influential level of control or policymaking authority, regardless of whether the individual or any other members of the family or group have an executive officer title or receive any compensation from the institution. (Regional Directors Memorandum 2015-016: *Identifying and Assessing Dominant Officials or Policymakers*).

³ The term "imminently insolvent" means a condition in which the financial institution has total capital accounts of less than 2 percent of its total assets. Fla. Stat. § 655.005(1)(o) (2020). When the FDIC insures any portion of a bank's deposits, the OFR is required to appoint the FDIC as liquidator or receiver for the bank upon the OFR's determination of insolvency, or threat of imminent insolvency. Fla. Stat. § 658.80 (2020). Based on FCB's June 30, 2020 Call Report and subsequent reports to the OFR, the OFR found FCB was "imminently insolvent," having total capital accounts less than 2 percent of its total assets.

This Memorandum examines whether the subject bank failure warrants an In-Depth Review.⁴

Causes of Failure

According to the FDIC's Supervisory History, FCB provided traditional banking products and services to its local community. From 2002 to 2008, the bank embarked on a growth strategy centered in Commercial Real Estate (CRE) and Acquisition, Development, and Construction (ADC), but did so without proper risk mitigation strategies, and with poor credit underwriting practices. When the recession (2007-2009) began, the bank had a significant exposure to CRE (602 percent of Tier 1 Capital).

FCB's failure occurred due to prolonged earnings problems and "voluminous poor quality assets" that eroded the bank's capital levels. The decline in FCB's financial condition initially resulted from its growth strategy that began in 2002. This growth strategy focused on CRE and ADC lending without appropriate risk mitigation and credit underwriting practices. Over subsequent years, the bank continued to struggle financially and never recovered from the impact of the recession (2007-2009) on CRE markets. As a result, adversely classified assets remained high, and the bank was unprofitable for 12 years, from 2008 until its failure in 2020.

FCB Management and Board oversight of the bank and its CRE and ADC lending was inadequate, which resulted in the significant deterioration in asset quality and related losses. FCB Management was unable to address repeat findings noted in FDIC and OFR examinations conducted between 2010 and 2018, such as reducing problem asset concentrations. Further, FCB Management was unable to address the terms of a Cease and Desist (C&D) Order issued jointly by the FDIC and OFR in October 2009,⁵ or obtain sufficient capital to remain solvent.

As of June 30, 2020, the bank became "Critically Undercapitalized" for Prompt Corrective Action (PCA)⁶ purposes due to continued operating losses. An FDIC visitation on July 6, 2020 determined that the bank's financial condition had deteriorated even further and confirmed that failure was imminent. FCB's efforts to merge with another bank were disrupted by the pandemic.

⁴ When the DIF incurs a loss under \$50 million, the Federal Deposit Insurance Act requires the Inspector General of the appropriate federal banking agency to determine the grounds identified by the state or federal banking agency for appointing the FDIC as receiver and to determine whether any unusual circumstances exist that might warrant an In-Depth Review of the loss. Federal Deposit Insurance Act (FDI Act), 12 U.S.C. § 1831o(k)(5). An In-Depth Review is a formal evaluation of the FDIC's supervision of the failed institution, including the FDIC's implementation of the Prompt Corrective Action (PCA) provisions of Section 38 of the FDI Act.

⁵ Key provisions of the C&D Order included reducing adversely classified loans, maintaining appropriate capital ratios, and improving liquidity. In 2017, the Board stipulated to a modification of the C&D Order, which updated provisions based on the August 21, 2017 examination findings.

⁶ Section 38 of the FDI Act provides the FDIC with the authority to resolve the problems of insured depository institutions at the least possible long-term loss to the Deposit Insurance Fund. The Act authorizes the FDIC to take actions based on five capital categories for banks ranging from **Well Capitalized** to **Critically Undercapitalized**. 12 U.S.C. 1831o.

FDIC Supervision

Based on its examination in 2008, the FDIC downgraded FCB to a Composite “3” rating⁷ and in coordination with the OFR, issued a Memorandum of Understanding. The FDIC identified that FCB’s “overall condition had deteriorated because of weak lending practices, coupled with deterioration in the local real estate market, which resulted in asset quality problems and an inadequate Allowance for Loan and Lease Losses (ALLL).”⁸

In May 2009, FDIC examiners noted a significant decline in the bank’s financial condition and downgraded the bank to a Composite “5” rating. In response to this examination, the FDIC and OFR issued the joint C&D Order requiring that FCB maintain a total capital ratio⁹ of at least 12 percent, restricting FCB from accepting or renewing brokered deposits, and prohibiting the payment of cash dividends. The bank did not comply with several of the C&D Order provisions, as it did not effectively reduce adversely classified assets, originated additional brokered deposits, and failed to maintain specified capital levels.

FDIC examiners recognized FCB’s Chairman and CEO as a “dominant official” and determined that other FCB executives played substantial roles in the daily operations of the bank. FDIC examiners also determined that the Board performed oversight of Management’s actions and actively reviewed bank policies and procedures. These factors mitigated the influence presented by the “dominant” Chairman/CEO.

The bank consistently received Composite “5” ratings at every examination after 2009 due to continued problems related to asset quality and earnings. By October 2010, FCB became “Significantly Undercapitalized”¹⁰ for PCA purposes. Between 2010 and 2020, FCB continued to struggle with its capitalization and liquidity. Operating losses reduced capital ratios to a “Critically Undercapitalized” position for PCA purposes as of June 30, 2020. On October 16, 2020, the OFR closed FCB and appointed the FDIC as receiver.

OIG Analysis

When conducting Failed Bank Reviews, the OIG considers a series of factors to determine whether unusual circumstances warrant further review. These factors include: (1) the magnitude and significance of the loss to the DIF in relation to the total assets of the failed institution; (2) the extent to

⁷ Financial institution regulators evaluate a bank’s performance in six components represented by the CAMELS acronym: **C**apital adequacy, **A**sset quality, **M**anagement capabilities, **E**arnings sufficiency, **L**iquidity position, and **S**ensitivity to market risk. Examiners assign each CAMELS component and an overall, composite score, a rating of “1” (strong) through “5” (critically deficient), with “1” having the least supervisory concern and “5” having the greatest concern.

⁸ The ALLL represents estimated credit losses within a bank’s portfolio of loans and leases, and its purpose is to absorb net charge-offs likely to be realized.

⁹ The total capital ratio is the ratio of the FDIC-supervised institution’s total capital to standardized total risk-weighted assets. 12 C.F.R. § 324.10(a)(3).

¹⁰ The FDIC deems a supervised institution “Significantly undercapitalized” if it is significantly below the required minimum level of any relevant capital measure outlined in Part 324 of the FDIC Rules and Regulations. 12 U.S.C. 1831o and 12 C.F.R. § 324.403(b)(4).

which the FDIC's supervision identified and effectively addressed the issues that led to the bank's failure or the loss to the DIF; (3) indicators of fraudulent activity that significantly contributed to the loss to the DIF; and (4) other relevant conditions or circumstances that significantly contributed to the bank's failure or the loss to the DIF. If, during the course of our review, we learn about fraudulent activity at the failed bank, it is our practice to refer the matter to investigators for consideration and potential action. In addition, where we identify significant programmatic weaknesses in the FDIC's supervision, we will determine if there is a need for follow-up work and the appropriate course of action.

In conducting this Failed Bank Review, we assessed key documents related to the bank's failure, including the Division of Risk Management Supervision's (RMS) Supervisory History, the Division of Resolutions and Receiverships' (DRR) Failing Bank Case, and examination reports dated 2009, 2010, and 2015 to 2019.¹¹

With respect to the first factor, the loss to the DIF in relation to FCB's total assets was 7 percent, which is lower than the average losses to the DIF for other recent failures. We did not find this loss to be of sufficient magnitude or significance to warrant an In-Depth Review. With respect to the second factor, we found that the FDIC's supervision identified and effectively addressed the issues that led to the bank's failure and the loss to the DIF. With respect to the third factor, we did not identify any indicators of fraudulent activity that significantly contributed to the loss amount. With respect to the fourth factor, we did not identify other relevant conditions or circumstances that significantly contributed to the bank's failure or the loss to the DIF.

Conclusion

FCB suffered from longstanding capital and loan quality problems, resulting from poor credit underwriting and administration practices, and significant exposure to CRE markets. The bank was unable to recover from the financial crisis that began in 2007 despite the subsequent improvement in economic and real estate market conditions. As identified in the FDIC examinations, the Board and Management failed to execute actions and address recommendations to improve FCB's safety and soundness. In addition, FCB's capital levels and earnings continued to decline, and the bank ultimately failed.

Based on our review, we did not find unusual circumstances that would warrant an In-Depth Review of the loss.

¹¹ This review does not constitute an audit conducted in accordance with Generally Accepted Government Auditing Standards.