



Audit Report



OIG-15-029

SAFETY AND SOUNDNESS: Failed Bank Review of Frontier Bank, Federal Savings Bank, Palm Desert, California

April 8, 2015

Office of
Inspector General

Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

April 8, 2015

OIG-15-029

MEMORANDUM FOR THOMAS J. CURRY
COMPTROLLER OF THE CURRENCY

FROM: Jeffrey Dye /s/
Director, Banking Audits

SUBJECT: Failed Bank Review of Frontier Bank, Federal Savings Bank,
Palm Desert, California

This memorandum presents the results of our review of the failure of Frontier Bank, Federal Savings Bank (Frontier). Frontier was established in 1998, and was a wholly owned subsidiary of Western Community Bancshares, Inc., since 2005. The bank's main office was located in Park City, Utah, a resort community near Salt Lake City. In 2001, the bank expanded operations into Southern California, where it operated under the name El Paseo Bank. In 2012, the bank's Utah operations were sold and its main office was moved to Palm Desert, California, with a branch in Rancho Mirage, California. As of June 30, 2014, Frontier had approximately \$86.4 million in total assets. The Office of the Comptroller of the Currency (OCC) closed Frontier and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on November 7, 2014. As of January 31, 2015, FDIC estimated the loss to the Deposit Insurance Fund to be \$4.7 million.

In 2008, the holding company issued \$7.3 million in preferred stock to the Department of the Treasury (Treasury) under Treasury's Troubled Asset Relief Program (TARP), Capital Purchase Program.¹ The holding company injected substantially all of the TARP funds into Frontier. Treasury expects that none of the remaining TARP funds will be repaid.

Because the loss to the Deposit Insurance Fund is less than \$50 million, as set forth by section 38(k) of the Federal Deposit Insurance Act (FDIA), we conducted a review of the failure of Frontier that was limited to (1) ascertaining the grounds

¹ TARP is a program established under the Emergency Economic Stabilization Act of 2008 with the goal of stabilizing the U.S. financial system and preventing a systemic collapse. The Capital Purchase Program, one of several programs under TARP, was created in October 2008 to stabilize the financial system by providing capital to viable financial institutions of all sizes throughout the nation. The program was closed to new investments on December 31, 2009.

identified by OCC for appointing the FDIC as receiver, and (2) determining whether any unusual circumstances exist that might warrant a more in-depth review of the loss. In performing our review, we (1) examined documentation related to the appointment of FDIC as receiver, and (2) interviewed OCC examination personnel. We performed our audit fieldwork from December 2014 to February 2015.

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

Cause of Frontier Bank, Federal Savings Bank'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 or unsound practices, (2) the bank was in an unsafe or unsound condition to transact business, (3) the bank's unsafe or unsound practices or conditions were likely to cause insolvency or substantial dissipation of assets or earnings, (4) the bank's unsafe or unsound practices or conditions were likely to weaken the institution's condition, (5) the bank had incurred or was likely to incur losses that would deplete all or substantially all of its capital and there was no reasonable prospect for it to become adequately capitalized, (6) the bank was undercapitalized and had no reasonable prospect of becoming adequately capitalized, and (7) the bank was undercapitalized and had failed to submit a capital restoration plan acceptable to the OCC within the time prescribed.

The primary cause of Frontier's failure was its loan growth strategy that resulted in significant concentrations in commercial real estate (CRE) loans, including sub-concentrations in nonresidential, construction, and land loans in the bank's local markets. Frontier's board and management pursued this strategy without commensurate risk management practices or adequate capital and failed to react quickly or effectively to changing market conditions to protect the bank from a prolonged period of deteriorating asset quality. Beginning in 2003, 5 years after the bank's formation, the board and management's growth strategy became increasingly focused on CRE. When the real estate market began to show signs of weakening in 2007, the consequences of the board and management's lax oversight and failure to adjust promptly or effectively to changing economic conditions and the declining real estate market became increasingly apparent. As Frontier's risk management continued

to be ineffective and concentrations remained elevated, the bank's condition deteriorated. The problems created by the board and management's strategy led to the substantial dissipation of the bank's assets and earnings as well as the depletion of the bank's capital.

Conclusion

Based on our review of the causes of Frontier's failure and the grounds identified by OCC for appointing FDIC as receiver, we determined that there were no circumstances surrounding the bank's failure that would necessitate an in-depth review. We provided a draft of this memorandum to OCC management for comment. In its response, OCC stated that it agreed with our conclusion as to the causes of Frontier's failure and that it had no concerns with our determination that an in-depth review of the bank's failure is 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.

Attachments



Office of the
Comptroller of the Currency

MEMORANDUM

To: Jeffrey Dye, Director, Banking Audits

From: Thomas J. Curry, Comptroller of the Currency

Date: April 1, 2015

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

The Office of the Comptroller of the Currency (OCC) has received and reviewed the Treasury Office of Inspector General (OIG) draft memorandum titled "Failed Bank Review of Frontier Bank, Federal Savings Bank" (Frontier). The loss to the Deposit Insurance Fund is less than \$50 million. Therefore, as set forth by section 38(k) of the Federal Deposit Insurance Act, the OIG conducted a review of the failure of Frontier that was limited to: (1) ascertaining the grounds identified by the OCC for appointing the Federal Deposit Insurance Corporation (FDIC) as receiver and (2) determining whether any unusual circumstances exist that might warrant a more in-depth review of the loss. In performing the review the OIG (1) examined documentation related to the appointment of FDIC as receiver, (2) reviewed OCC reports of examination for the 5-year period before the bank's failure, and (3) interviewed OCC examination personnel.

The OIG conducted the audit from December 2014 to February 2015 in accordance with generally accepted government auditing standards. Those standards require that the OIG plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the OIG findings and conclusions. The OIG believes that the evidence obtained provides a reasonable basis for the findings and conclusions.

The OIG concluded the primary cause of Frontier's failure was its loan growth strategy that resulted in significant concentrations in commercial real estate (CRE) loans, including sub-concentrations in nonresidential, construction, and land loans in the bank's local markets. Frontier's board and management pursued this strategy without commensurate risk management practices or adequate capital and failed to react quickly or effectively to changing market conditions to protect the bank from a prolonged period of deteriorating asset quality. Beginning in 2003, 5 years after the bank's formation, the board and management's growth strategy increasingly focused on CRE. When the real estate market began to show signs of weakening in 2007, the consequences of the board and management's lax oversight and failure to adjust promptly or effectively to changing economic conditions and the declining real estate market became increasingly apparent. As Frontier's risk management continued to be ineffective and concentrations remained elevated, the bank's condition deteriorated. The problems created by the board and management's strategy led to the

substantial dissipation of the bank's assets and earnings as well as the depletion of the bank's capital. We agree.

The OIG determined that there were no circumstances surrounding the bank's failure that would necessitate an in-depth review. The OCC has no concerns with the determination.

If you need additional information, please contact Toney Bland, Senior Deputy Comptroller for Midsize and Community Bank Supervision, at 202-649-5420.

Department of the Treasury

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

Office of the Comptroller of the Currency

Comptroller of the Currency
Liaison Officer

Office of Management and Budget

OIG Budget Examiner