



Audit Report



OIG-16-036

SAFETY AND SOUNDNESS: Failed Bank Review of Hometown National Bank, Longview, Washington

February 10, 2016

Office of
Inspector General

Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

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MEMORANDUM FOR THOMAS J. CURRY
COMPTROLLER OF THE CURRENCY

FROM: Susan Barron /s/
Director, Banking Audits

SUBJECT: Failed Bank Review of Hometown National Bank

This memorandum presents the results of our review of the failure of Hometown National Bank (HNB), located in Longview, Washington. HNB began operations in a single location as a federally chartered national bank on May 15, 2000. HNB was a wholly-owned subsidiary of Hometown Financial Services, Inc. (holding company), which was dissolved in 2012 following a \$5 million injection by investors into the bank. The Office of the Comptroller of the Currency (OCC) closed HNB and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on October 2, 2015. As of June 30, 2015, HNB had approximately \$4.9 million in total assets. As of November 30, 2015, FDIC estimated the loss to the Deposit Insurance Fund to be \$1.6 million.

Because the loss to the Deposit Insurance Fund was less than \$50 million, as set forth by section 38(k) of the Federal Deposit Insurance Act, we conducted a review of the failure of HNB that was limited to (1) ascertaining the grounds identified by OCC for appointing FDIC as receiver and (2) determining whether any unusual circumstances exist that might warrant a more in-depth review of the loss. In performing our review, we (1) examined documentation related to the appointment of FDIC as receiver, (2) reviewed OCC reports of examination for the 5-year period before the bank's failure, and (3) interviewed an OCC problem bank specialist and examiner-in-charge.

We performed our fieldwork between October and December 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.

Causes of HNB's Failure

OCC appointed FDIC as receiver based on the following grounds: (1) the bank had experienced substantial dissipation of assets or earnings due to unsafe or unsound practices; (2) the bank was in an unsafe or unsound condition to transact business; (3) the bank'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 bank's condition; (5) the bank had incurred or was likely to incur losses that will deplete all or substantially all of its capital, and there was no reasonable prospect for the bank to become adequately capitalized without Federal assistance; (6) the bank was undercapitalized and had no reasonable prospect of becoming adequately capitalized; (7) the bank was undercapitalized, and had failed to submit a capital restoration plan acceptable to the OCC within the time prescribed; and (8) the bank was critically undercapitalized.

The primary causes of HNB's failure were (1) deficient Board and management oversight and supervision; (2) weak credit administration and risk management practices; and (3) excessive concentrations in commercial real estate (CRE). Prior to 2012, HNB had never been profitable. In 2012, the bank received a \$5 million capital infusion from a group of 15 investors, which led to the dissolution of the bank's holding company, as well as changes in Board membership and leadership. The new management embarked on new, risky lines of business, including a loan production office that was never approved by OCC because HNB did not submit an acceptable business plan. In addition, the bank was not able to generate sufficient earnings to support overhead and cover loan losses attributable to its significant CRE loan concentrations. Despite repeated criticisms of unsafe or unsound practices by OCC, the Board and management failed to implement and adhere to strategic and capital planning, and credit risk management commensurate with the bank's risk profile. HNB's condition and asset quality deteriorated, losses significantly increased, and its capital and earnings further declined, which in turn, led to the bank's failure.

There are certain matters of HNB that are under investigation by the Department of the Treasury Inspector General's Office of Investigations.

Conclusion

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

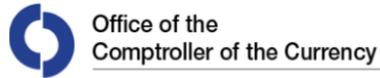
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causes of the failure of HNB and that it had no concerns with our determination that an in-depth review of the bank's failure is not warranted. The response is provided as Attachment 1. A list of the recipients of this memorandum is provided as Attachment 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) 927-5776 or Dana Duvall, Audit Manager, at (202) 927-9648.

Attachments

MEMORANDUM**MEMORANDUM**

To: Susan Barron, Director, Banking Audits

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

Date: February 4, 2016

Subject: Response to Hometown National Bank, Longview, Washington

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 Hometown National Bank" (HNB). 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 HNB 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 October to December 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 HNB's failure was (1) deficient Board and management oversight and supervision; (2) weak credit administration and risk management practices; and (3) excessive concentrations in commercial real estate (CRE). HNB had been unable to grow to profitability from inception. In 2012, the bank received a \$5 million capital infusion from a group of 15 investors, which led to the dissolution of the bank's holding company, as well as changes in Board membership and leadership. The new management embarked on new, risky lines of business, including an unapproved loan production office without proper notice and submission of an acceptable business plan to the OCC. The HNB was not able to generate sufficient earnings to support overhead and cover loan losses attributable to significant CRE loan concentrations. Despite repeated criticisms of unsafe or unsound practices by the OCC, the Board and management failed to implement and adhere to appropriate strategic and capital planning and credit risk management commensurate with the bank's risk profile. HNB's condition and asset quality deteriorated, losses significantly increased, and its capital and earnings further declined, leading ultimately to failure. We agree.

The OIG determined that there were no circumstances surrounding HNB's failure that would necessitate an in-depth review. However, there are certain matters of HNB that are under investigation by the OIG's Office of Investigation. 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

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

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