



Audit Report



OIG-12-056

SAFETY AND SOUNDNESS: Failed Bank Review of Home Savings of America, Little Falls, Minnesota

June 18, 2012

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: Jeffrey Dye /s/
Director, Banking Audits

SUBJECT: Failed Bank Review of Home Savings of America, Little Falls,
Minnesota

This memorandum presents the results of our review of the failure of Home Savings of America (Home Savings), a subsidiary of Home Savings Bancorp, located in Little Falls, Minnesota. Home Savings opened in September 1934 as a federal mutual savings association and was converted to a federal stock savings association in 1995. It had four offices, one in Little Falls and three others in California. Home Savings was regulated by the Office of Thrift Supervision (OTS) until July 21, 2011. On that date, the Office of the Comptroller of the Currency (OCC) assumed regulatory responsibilities for federal savings associations pursuant to P.L. 111-203. OCC closed Home Savings and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on February 24, 2012. As of December 31, 2011, the bank had \$434.1 million in total assets. As of May 31, 2012, FDIC estimated that the loss to the Deposit Insurance Fund to be \$38.8 million.

Because the loss to the Deposit Insurance Fund is less than \$150 million, as set forth by section 38(k) of the Federal Deposit Insurance Act (FDIA), we conducted a review of the failure of Home Savings that was limited to (1) ascertaining the grounds identified by OCC for appointing the FDIC as receiver and (2) determining whether any unusual circumstances exist that might warrant a more in-depth review of the loss. In performing our review we (1) examined documentation related to the appointment of FDIC as receiver and (2) interviewed OCC examination personnel.

We performed our fieldwork from February to April 2012. 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 Home Savings of America's Failure

OCC appointed FDIC receiver based primarily on the following grounds: (1) the bank had experienced substantial dissipation of assets or earning due to unsafe or unsound practices, (2) 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 it to become adequately capitalized without federal assistance, (3) the bank's unsafe or unsound practices or conditions were likely to seriously prejudice the interests of the Deposit Insurance Fund, and (4) the bank was critically undercapitalized.

The primary cause of Home Savings' failure was its pursuit of an aggressive growth strategy, featuring option adjustable rate mortgages (ARM), without prudent concentration risk management practices. In addition, most of Home Savings' loans were underwritten based on borrower's stated income and assets, meaning the borrower's income and assets were not verified. This strategy resulted in significant concentrations of higher-risk option ARMs secured by one-to-four family homes in California. During the economic crisis, deteriorating conditions significantly reduced home values in California, increased foreclosure rates, and contributed to a high volume of negatively amortizing option ARM loans in Home Savings' portfolio. As a result, Home Savings' asset quality significantly deteriorated, leading to large losses, erosion of capital and, ultimately, failure.

OCC opened an Order of Investigation into certain questionable activities by the management of Home Savings. After OCC notified the Treasury Inspector General's Office of Investigations (OI) of these questionable activities, OI also opened an investigation. Both investigations are ongoing.

Conclusion

Based on our review of the causes of Home Savings' 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. In making this determination, we took into consideration that the federal savings association functions of OTS, Home Savings' regulator until July 2011, transferred to OCC. We provided a draft of this memorandum to OCC management for comment. In its response, OCC stated that it agreed with our

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conclusion as to the causes of Home Saving's failure and that it had no concerns with our determination regarding an in-depth review of the bank's failure. The response is provided as Attachment 1. A list of the recipients of this memorandum is provided as Attachment 2.

We appreciate the courtesies and cooperation provided to our staff during the audit. If you have any questions, you may contact me at (202) 927-0384 or James Lisle, Audit Manager, at (202) 927-6345.

Attachments



MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: Jeffrey Dye, Director, Banking Audits

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

Date: June 13, 2012

Subject: Response to Failed Bank Review of Home Savings of America, Little Falls, Minnesota

We have received and reviewed your draft report titled "Failed Bank Review of Home Savings of America (Home Savings), Little Falls, Minnesota." The loss to the Deposit Insurance Fund is less than \$150 million, therefore, as set forth by section 38(k) of the Federal Deposit Insurance Act, you conducted a review of the failure of Home Savings that was limited to: (1) ascertaining the grounds identified by the OCC for appointing the FDIC as receiver and, (2) determining whether any unusual circumstances exist that might warrant a more in-depth review of the loss. Your report presents the results of your review of Home Savings' failure and the former Office of Thrift Supervision's (OTS) supervision of the institution. In performing your review you: (1) examined documentation related to the appointment of FDIC as receiver and (2) interviewed OCC examination personnel.

You conducted your audit during February, March and April 2012 in accordance with generally accepted government auditing standards. Those standards require that you plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for your findings and conclusions. You believe that the evidence obtained provides a reasonable basis for your findings and conclusions.

You concluded that the primary cause of Home Savings' failure was its pursuit of an aggressive growth strategy, featuring option adjustable rate mortgages (ARM), without prudent concentration risk management practices. We agree.

You determined that there were no unusual circumstances surrounding the bank's failure. As a result, you determined that a more in-depth review of the bank's failure by the OIG is not warranted. We have no concerns with your determination.

Thank you for the opportunity to review and comment on your draft report. If you need additional information, please contact Jennifer Kelly, Senior Deputy Comptroller for Midsize and Community Bank Supervision, at 202-874-5020.

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