



# Audit Report



OIG-13-045

SAFETY AND SOUNDNESS: Failed Bank Review of First Federal Bank, Lexington, Kentucky

July 31, 2013

Office of  
Inspector General

DEPARTMENT OF THE TREASURY





DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

OFFICE OF  
INSPECTOR GENERAL

July 31, 2013

OIG-13-045

MEMORANDUM FOR THOMAS J. CURRY  
COMPTROLLER OF THE CURRENCY

FROM: Susan Barron /s/  
Director, Banking Audits

SUBJECT: Failed Bank Review of First Federal Bank

This memorandum presents the results of our review of the failure of First Federal Bank (First Federal), located in Lexington, Kentucky, and the supervision of the bank by the Office of the Comptroller of the Currency (OCC) and the former Office of Thrift Supervision (OTS). OTS regulated First Federal until July 21, 2011, when OCC assumed regulatory responsibility for federal savings associations pursuant to Public Law 111-203.

First Federal was chartered in 1935 in Lexington, Kentucky, as First Federal Savings and Loan Association of Lexington. First Federal changed to its present name in 2000 and has a main office and three branches in Lexington, Kentucky and one branch in Georgetown, Kentucky. OCC closed First Federal and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on April 19, 2013. As of December 31, 2012, First Federal had approximately \$100.1 million in total assets. As of May 31, 2013, FDIC estimated the loss to the Deposit Insurance Fund to be \$9.7 million.

Because the loss to the Deposit Insurance Fund was less than \$150 million, as set forth by section 38(k) of the Federal Deposit Insurance Act, we conducted a review of the failure of First Federal 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, (2) reviewed OCC and OTS reports of examination for the 5-year period before the bank's failure, and (3) interviewed OCC personnel.

We performed our fieldwork during May and June 2013. 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 First Federal Bank's Failure**

OCC appointed FDIC as receiver based on the following grounds: (1) the bank 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 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 without federal assistance; (4) the bank's unsafe or unsound practices or conditions were likely to cause substantial dissipation of assets or earnings; (5) the bank's unsafe or unsound practices or conditions were likely to weaken the bank's condition; (6) the bank was undercapitalized, and had no reasonable prospect of becoming adequately capitalized; and (7) the bank was critically undercapitalized.

The primary causes of First Federal's failure were its (1) aggressive growth that focused on commercial real estate lending and commercial nonmortgage loans and (2) ineffective board and management. Despite repeated criticism from the former OTS, followed by OCC, the board and management failed to implement appropriate risk management and credit administration practices, resulting in increased levels of problem assets that adversely affected earnings and substantially depleted capital. While this occurred, First Federal purchased a mortgage banking business amid a deteriorating mortgage market as well as two new branch sites that ultimately increased non-interest expenses and led to an increase in the bank's already rapid depletion of capital and eventually to its failure.

Our review of First Federal revealed certain matters that we referred to the Treasury Inspector General's Office of Investigation.

## **Conclusion**

Based on our review of the causes of First Federal'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 that it agreed with our conclusion as to the causes of the failure of First Federal and that it had no concerns with our determination that an in-depth review of the bank's failure is not warranted. The

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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



Office of the  
Comptroller of the Currency

## MEMORANDUM

To: Susan Barron, Director, Banking Audits

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

Date:

Subject: Response Draft Report for the Failed Bank Review of First Federal Bank

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We have received and reviewed your draft report titled "Failed Bank Review of the First Federal Bank (First Federal)" located in Lexington, Kentucky. 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 First Federal that was limited to: (1) ascertaining the grounds identified by the Office of the Comptroller of the Currency (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 your review you (1) examined documentation related to the appointment of FDIC as receiver, (2) reviewed OCC and Office of Thrift Supervision reports of examination for the 5-year period before the bank's failure, and (3) interviewed OCC personnel.

You conducted your audit during May and June 2013 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 causes of First Federal's failure were its (1) aggressive growth that focused on commercial real estate lending and commercial nonmortgage loans; and (2) ineffective board and management. We agree.

You determined that there were no circumstances surrounding the bank's failure that would necessitate an in-depth review. 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 202-649-5420.

**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  
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