



Executive Summary:

Review of the Failure of Bank of Whitman

2013-IE-B-002

March 22, 2013

Purpose

Consistent with the requirements of section 38(k) of the Federal Deposit Insurance Act, 12 U.S.C. 1831o(k), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Office of Inspector General conducted an in-depth review of the failure of Bank of Whitman (Whitman) because the loss to the Deposit Insurance Fund presented unusual circumstances due to various questionable transactions and business practices involving senior management.

Background

Whitman began operations on September 29, 1977, as a state nonmember bank headquartered in Colfax, Washington, and converted to state member bank status in 2004. Whitman was supervised by the Federal Reserve Bank of San Francisco (FRB San Francisco) under delegated authority from the Board of Governors of the Federal Reserve System, and by the Washington State Department of Financial Institutions (State). On August 5, 2011, the State closed Whitman and appointed the Federal Deposit Insurance Corporation as receiver.

Findings

Whitman failed because of the convergence of several factors. The bank altered its traditional agricultural lending strategy and expanded into new market areas, which resulted in rapid growth and high commercial real estate concentrations as well as credit concentrations to individual borrowers. Whitman's corporate governance weaknesses allowed the bank's senior management to dominate the institution's affairs and undermine the effectiveness of key control functions. Whitman's credit concentrations and poor credit risk management practices, along with a decline in the local real estate market, resulted in asset quality deterioration, significant losses, and eroded capital. At that point, management engaged in a series of practices to mask the bank's true condition. The escalating losses depleted earnings and left the bank in a *critically undercapitalized* condition.

With respect to supervision, FRB San Francisco complied with the premembership requirements and examination frequency guidelines for the time frame we reviewed, 2005 through 2011, and conducted regular offsite monitoring. However, our analysis of FRB San Francisco's supervision of Whitman revealed that FRB San Francisco identified the bank's fundamental weaknesses during its first examination in 2005 but did not take decisive action to resolve those weaknesses until September 2009. In our opinion, FRB San Francisco had multiple opportunities from 2005 to 2009 to take stronger supervisory action to address the bank's persistent deficiencies.

Recommendation

We recommend that the Director of the Division of Banking Supervision and Regulation review the supervisory approach for premembership examinations and determine whether enhancements to the current approach outlined in Supervision and Regulation Letter 11-2, *Examinations of Insured Depository Institutions Prior to Membership or Mergers into State Member Banks*, are appropriate.

Management's Response

Banking Supervision and Regulation staff acknowledged the conclusions and lessons learned in the report and will follow up on the report's recommendation.

Access the full report: www.federalreserve.gov/oig/files/FRB_Failed_Bank_Review_Whitman_full_March2013.pdf

For more information, contact the OIG at 202-973-5000 or visit www.federalreserve.gov/oig.