

# SR003\_7: Failed Bank Report

## First Integrity Bank, National Association

111 N.E. Fourth Street  
Staples, MN 56479

(1/20/1920 – 5/30/2008)

# Report Objective

---

This report has **two** objectives, using the bank's **data**\*:

1. To examine the bank finances in the quarters prior to its failure.
2. To analyze the bank finances using our Key Performance Indicator (KPI) scoring approach to determine if the bank's failure is something we could have predicted.

\*Data source: FDIC and company filings.

# Bank Background

<b>FDIC Certificate #</b>	12736
<b>Parent Holding Company</b>	FIRST INTEGRITY BANCORPORATION
<b>Bank Charter Class</b>	National Bank
<b>Asset Concentration</b>	Commercial Lending Specialization
<b>Product Specialty</b>	Commercial Lending Services, Personal Banking Services, Real Estate Loan Services
<b>Number of Branches</b>	3 (as of March 31, 2008)
<b>Number of Employees</b>	32 (as of March 31, 2008)

## Executives

<b>President/CEO</b>	David A. Duhn
<b>President</b>	K. Patrick Kruchten
<b>COO</b>	Cathy A. Meyer

# What took place?

---

**F**irst Integrity Bank NA, Staples, MN was closed by the Office of the Comptroller of the Currency (OCC) on May 30<sup>th</sup>, 2008. The Federal Deposit Insurance Corporation (FDIC) was named Receiver. The estimated cost to the FDIC Deposit Insurance Fund is \$2,300,000, compared to the average cost of \$389,206,944. First International Bank and Trust of Watford City, ND acquired all deposits and most assets.

# Bank Financial Snapshot

Financial Data Overlay (thousands)			
	2007 Q1	2008 Q1	Percentage Change
<b>Assets</b>	\$ 51,498	\$ 52,916	↑ 2.8%
<b>Liabilities</b>	\$ 45,126	\$ 52,585	↑ 16.5%
<b>Net Income</b>	-\$ 120	-\$ 2,558	↓ 2,031.7%

- The average net income change for all the FDIC banks was -44.95% in the same period.
- The average net income change for all the commercial lending specialization banks was -25.87% in the same period.
- Compared with the whole industry and other commercial lending specialization banks, First Integrity Bank had a 2032% decrease in Net Income.

# Key Performance Indicators


KPI Summary for 2008 Q1	
Normalized Income Rating	Very Poor
Delinquent Asset Rating	Good
Asset: Liability Rating	Very Poor
Real Estate Asset Rating*	Excellent
Bankability Composite Score	-18.05** (Very Poor)

Possible ratings: *Excellent, Good, Moderate, Poor, Very Poor.*

\*This rating is relevant to the current “financial crisis” fueled by mortgage security backed loans.

\*\*This is out of 100.

# Normalized Income Analysis

	2006Q4	2007Q1	2007Q2	2007Q3 	2007Q4	2008Q1
Normalized Income	-0.19%	-0.23%	-0.05%	-4.98%	-1.47%	-4.83%
SD's from Average*	-0.904	-1.11	-0.643	-12.9	-2.23	-9.89
Ranking	Moderate	Poor	Moderate	Very Poor	Very Poor	Very Poor

- First Integrity Bank had a normalized income of -4.83% in the first quarter of 2008, the quarter before it failed.
- Banks of the same asset concentration hierarchy (commercial lending specialization) had an average normalized income of 0.20%. The standard deviation of the normalized incomes was 0.43%, which means that First Integrity Bank was almost 10 SD's below the average.

\*Average of banks of the same asset concentration hierarchy



Indicates sign of bank in financial distress

# Delinquent Asset Analysis

	2006Q4 	2007Q1	2007Q2	2007Q3	2007Q4	2008Q1
Delinquent Asset	3.2998%	2.6292%	3.7274%	3.8028%	7.3535%	0.5235%
SD's from Average*	1.63	1.08	1.81	1.66	3.53	-0.53
Ranking	Poor	Poor	Poor	Poor	Very Poor	Good

- First Integrity Bank had a delinquent assets ratio 0.5% in the first quarter of 2008.
- Banks of the same asset concentration hierarchy (commercial lending specialization) had an average delinquent asset of 1.5282%. The standard deviation of the delinquent assets was 1.89%, which means that First Integrity Bank was about -0.53 SD's below the average.
- Since the fourth quarter of 2006, First Integrity Bank's delinquent assets ratio has always been poor in relation to banks of the same asset concentration hierarchy, but all the delinquent assets are considered past due within 1-3 months.
- Surprisingly, during the quarter right before the bank failed, the percentage of delinquent assets suddenly dropped to 0.52%.

\*Average of banks of the same asset concentration hierarchy



Indicates sign of bank in financial distress

# Real Estate Loan Asset Analysis

	2006Q4	2007Q1	2007Q2	2007Q3	2007Q4	2008Q1
Real Estate Loan Asset Ratio	37.39%	36.27%	36.57%	34.12%	35.56%	33.99%
SD's from Average*	-1.12	-1.20	-1.21	-1.38	-1.31	-1.42
Ranking	Good	Excellent	Excellent	Excellent	Excellent	Excellent

- First Integrity Bank, National Association had a 33.99% of R/A ratio in 2008 Q1, the quarter before it failed.
- In 08 Q1, banks of the same asset concentration hierarchy (commercial lending specialization) had an average R/A ratio of 55.64%. The standard deviation of the R/A ratio was 15.14%, which means that First Integrity Bank was 1.42 SD's below the average.

\*Average of banks of the same asset concentration hierarchy

# Asset: Liability Analysis

	2006Q4	2007Q1	2007Q2	2007Q3	2007Q4 	2008Q1
Asset: Liability Ratio	114.78%	114.12%	113.27%	107.31%	105.51%	100.63%
Median A/L Ratio*	110.60%	110.70%	110.74%	110.97%	110.95%	110.93%
Ranking	Good	Good	Good	Poor	Very Poor	Very Poor

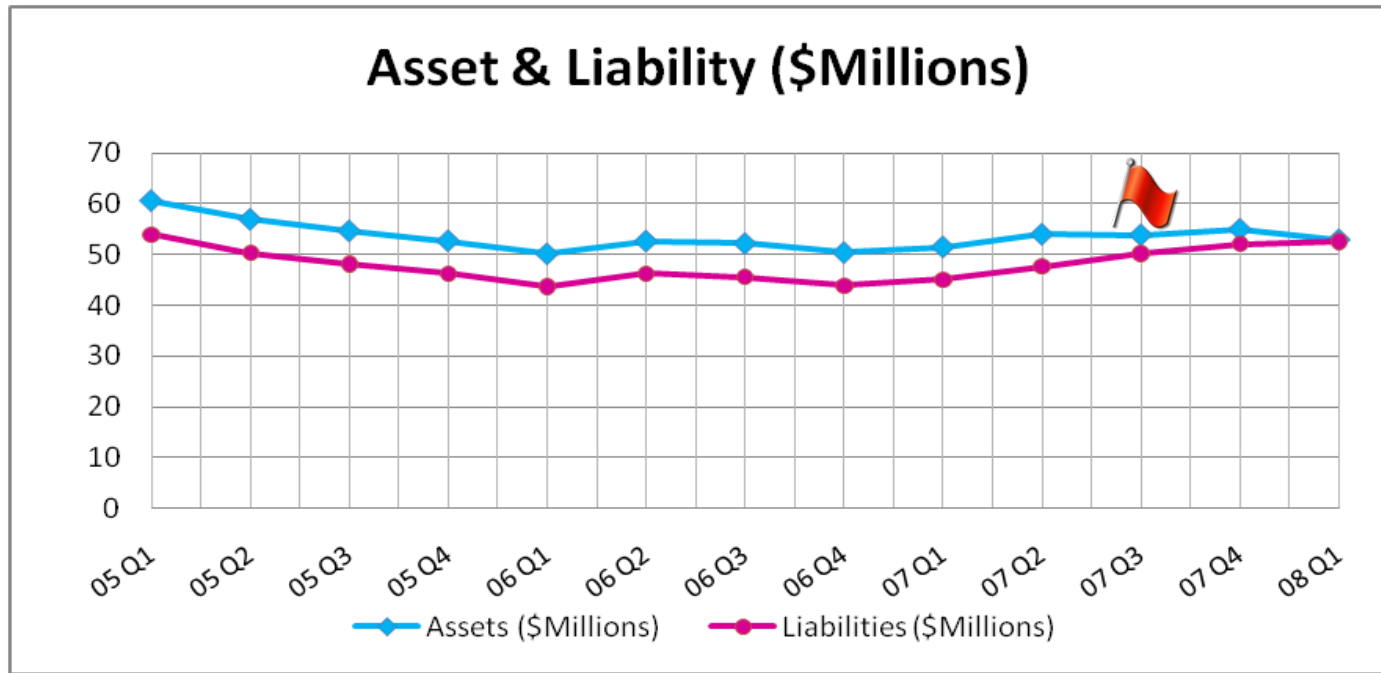
- First Integrity Bank, National Association's A/L ratio had been declining in all 6 quarters prior to failure.
- The bank's A/L ratio decreased nearly 6% in 07 Q3 and 5% in 08 Q1.

\*Median of banks of the same asset concentration hierarchy



Indicates sign of bank in financial distress

# Asset & Liability History

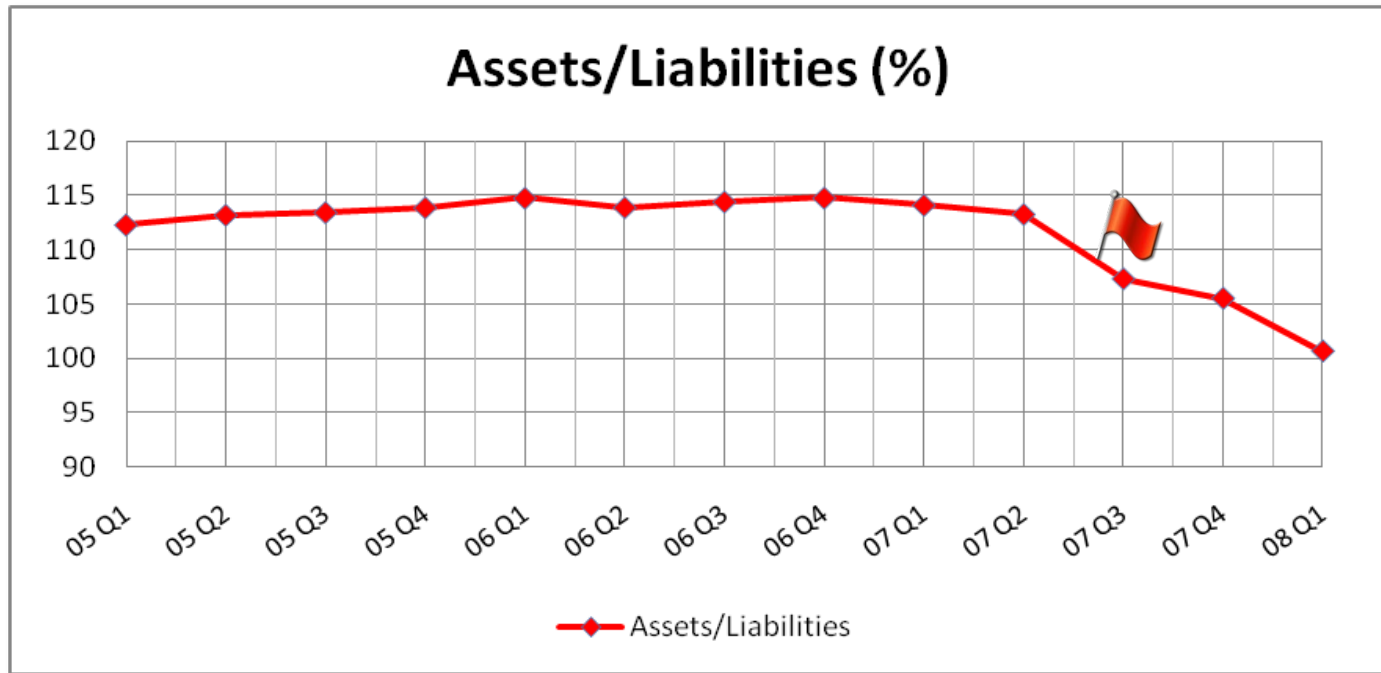


- The difference between asset and liability was getting close in 07 Q3 and almost intersect in 08 Q1.



Indicates sign of bank in financial distress

# Asset/Liability History

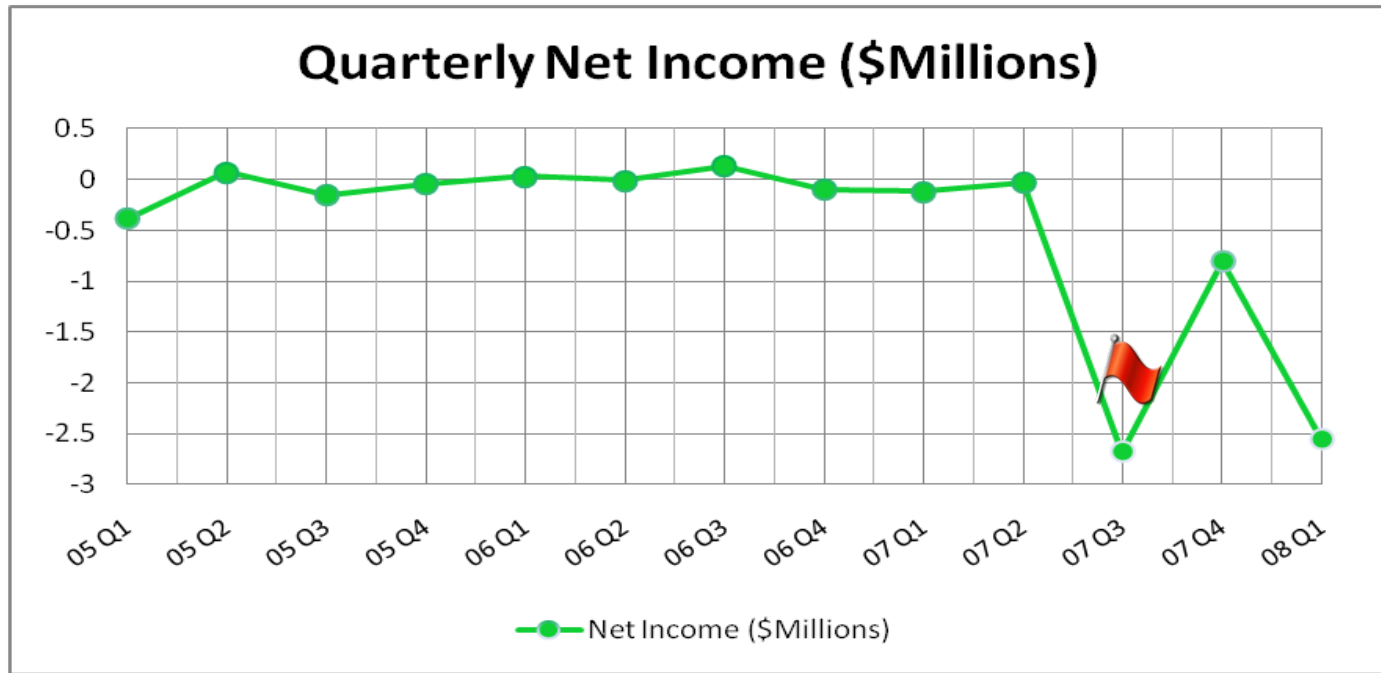


- The A/L ratio was declining since 06 Q4.



Indicates sign of bank in financial distress

# Net Income History

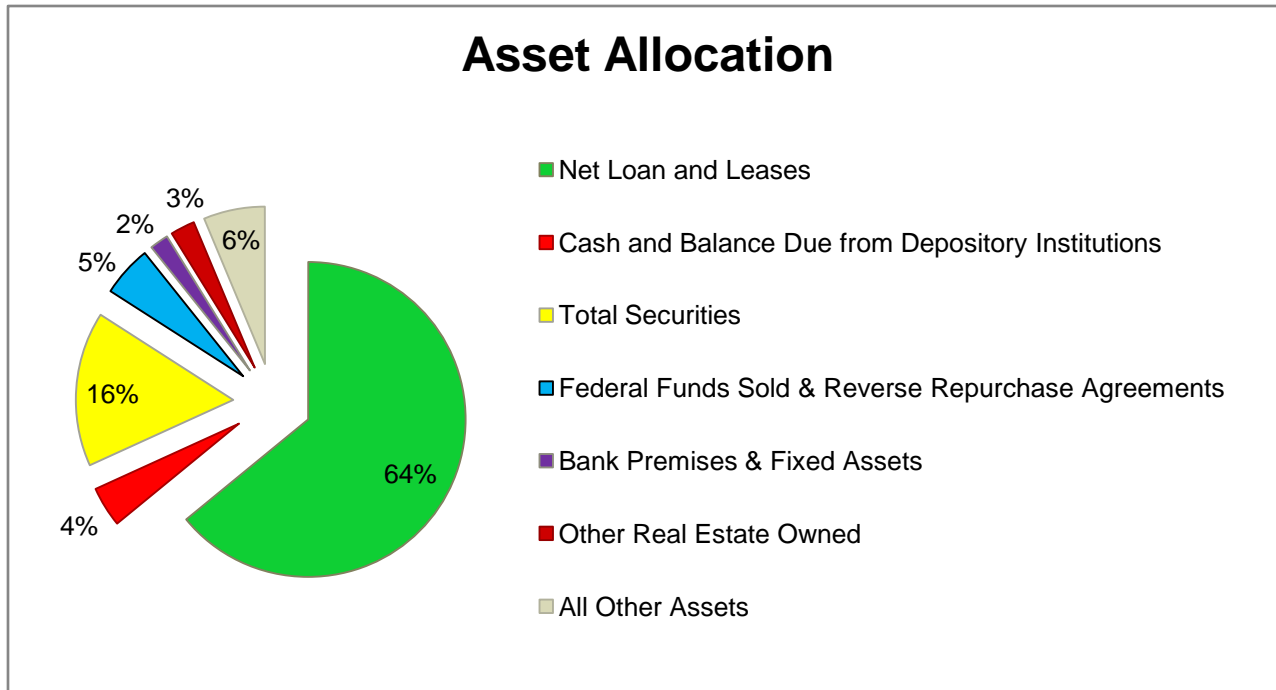


- The bank recorded big losses in 07 Q3 and 08 Q1.



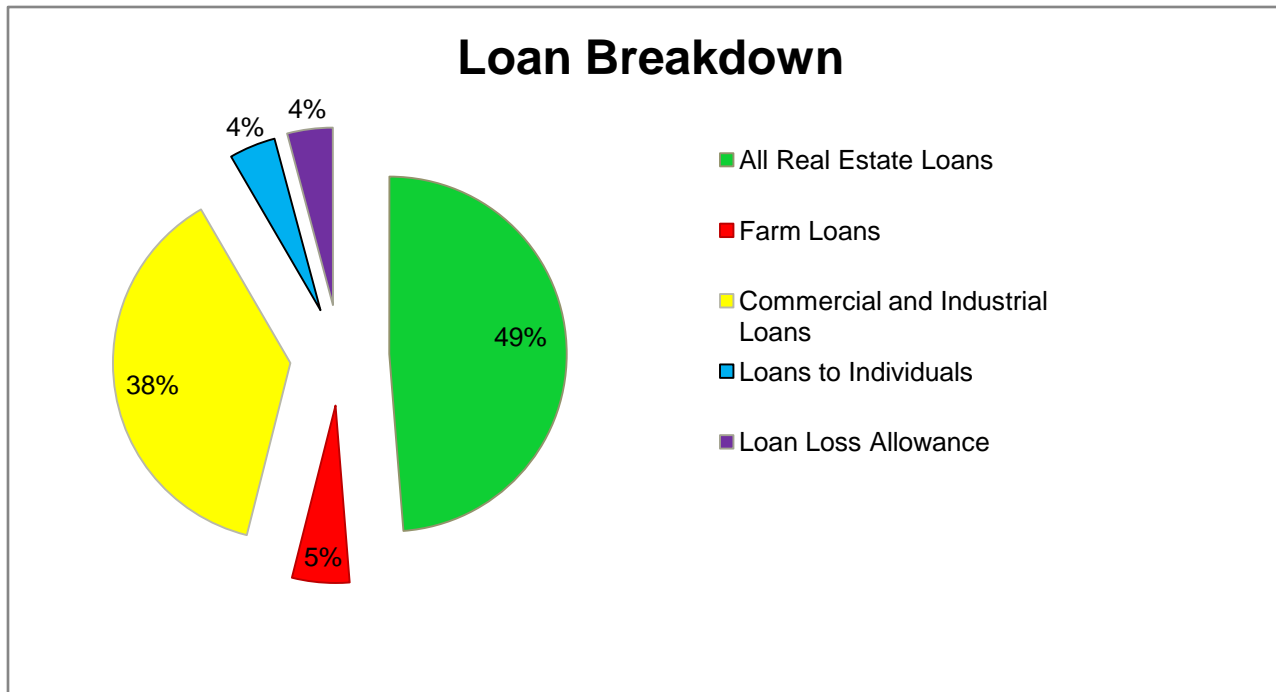
Indicates sign of bank in financial distress

# Asset Allocation



- The average percentage of Net Loans for banks of the same Asset Concentration Hierarchy in the first quarter of 2008 was 71.77%.
- The average Net Loan percentage of all banks in the first quarter of 2008 was 64.77%.

# Loan Breakdown



- The average percentage of Real Estate Loans for banks of the same Asset Concentration Hierarchy in the first quarter of 2008 was 75.94%.
- The average percentage for all banks in the first quarter of 2008 was 70.74%.

# Events Timeline

**Aug. 16, 07** - First Integrity Bank pays \$100 for Weeks Fish Camp at foreclosure sale.

**Mar. 4, 08** - SEC voted to disclose information for the secondary market ETF investors in Form N-1A.

**Mar. 7, 08** - The Fed will initiate a series of term repurchase transactions that are expected to cumulate to \$100 billion.

**Mar. 19, 08** - Fannie Mae and Freddie Mac is expected to provide support to the U.S. mortgage market, up to \$200 billion immediate liquidity.

**May 29, 08** - U.S.-Canada mutual recognition arrangement: U.S. Securities markets and certain U.S. financial service firms could gain greater freedom to operate in Canada under SEC.

**June. 02, 08** - First Integrity Bank was closed by federal regulators and its deposits would be transferred to First International Bank and Trust.

**June 10, 08** - FDIC releases a supervisory letter to all banks on interest reserves that examines the risks that this underwriting practice presents.

**June 11, 08** - SEC voted on a comprehensive series of credit rating agency reforms to bring increased transparency to credit rating process.

**June 17, 08** - New HOPE NOW guidelines to deal with issues surrounding second mortgages and short sales.

**June. 26, 08** - FDIC adopts Basel II-Based Standardized Approach as an alternative risk-based capital framework available to all banks except the largest and most complex banks

**June. 26, 08** - FRS, FDIC, and OCC issued the host state loan-to-deposit ratios, which help indicate branches outside of the home state that were established or acquired for the purpose of deposit production.

# Events Timeline

- Jul. 13, 08** - Paulson Announces a three-part plan for GSEs: a temporary increase in the line of credit, a temporary authority for Treasury to purchase equity, and an advisory role is given to the Fed.
- Aug. 20, 08** - FDIC's implementation in Loan Modification Program will help to modify troubled IndyMac mortgages loans.
- Sept. 17, 08** - SEC clarified that bank support of money market mutual funds generally are not required to present the fund on-balance sheet, but disclosure of the nature of the support provided is expected.
- Sept. 18, 08** - SEC requires that certain institutional money managers report their new short sales of certain publicly traded securities.
- Sept. 19, 08** - SEC prohibited short selling in 779 financial institutions.
- Sept. 20, 08** - Treasury Secretary Hank Paulson releases \$700 billion proposal to purchase troubled mortgage-related assets.
- Oct. 7, 08** - Emergency Economic Stabilization Act of 2008 Temporarily Increases Basic FDIC Insurance Coverage from \$100,000 to \$250,000 per Depositor.
- Oct. 14, 08** - FDIC creates new program to guarantee bank debts and fully insure non-interest bearing deposit transaction accounts.
- Oct. 14, 08** - The Treasury Department will invest up to \$250 billion in the nation's banks via the Capital Purchase Program.
- Nov. 20, 08** - FDIC announces the availability of IndyMac Loan Modification Model.
- Nov. 25, 08** - Created the Term Asset-Backed Securities Loan Facility to support the issuance of asset-backed securities collateralized by loans.

# Events Timeline

- Dec. 3, 08** - SEC approved measures to strengthen oversight of credit rating agencies.
- Dec. 16, 08** - Troubled banks have to provide certain position level and counterparty level data and QFC counterparty and portfolio identifiers to FDIC in a timely manner.
- Dec. 23, 08** - Treasury provides TARP funds to focal Banks by purchasing \$2.8 billion investment from 49 banks.
- Dec. 30, 08** - The Fed announced that it will purchase mortgage-backed securities.
- Jan. 15, 09** - The Senate voted to allow access to the remaining bailout funds of \$350 billion.
- Jan. 27, 09** - As part of the Capital Purchase Program, Treasury announced investments of \$386 million in 23 healthy banks.
- Feb. 10, 09** - Geithner rolls out the Financial Stability Plan, promises to perform “stress tests” on big banks, and commit \$100 billion to boost the TALF.
- Feb. 10, 09** - A Capital Assistance Program to help ensure banks hold sufficient capital, produce a more consistent and forward-looking assessment of risks on banks' balance and their potential capital needs.
- Feb. 10, 09** - A Public-Private Investment Fund will combine public and private capital with government financing to help free up capital to support new lending.
- Feb. 10, 09** - Treasury and Fed expended the Term Asset-Backed Securities Lending facility up to \$1 trillion.
- Feb. 18, 09** - President Obama signs the American Recovery and Reinvestment Act of 2009, which limits bonuses of the highest earning executives.

# Events Timeline

---

**Mar. 4, 09** - Treasury announced loan modification guidelines under the Administration's Homeowner Affordability and Stability Plan.

**Mar. 23, 09** - Using TARP capital and capital from private investors, the Public-Private Investment Program will generate \$500 billion in purchasing power to buy legacy assets.

**May 29, 09** - FDIC tightens the deposit interest rates paid by banks that are less than well capitalized. Generally, such banks will be permitted to offer to "national rate" plus 75 basis points.

**June 9, 09** - 10 Of the largest U.S financial institutions are expected to make CPP repayments to Treasury.

**Jul. 2, 09** - FDIC proposed guidelines require private equity firms to hold bank purchases for 3yrs and maintain capital levels.

# Report Summary – *Surprise?*

Based on the methods with which we analyzed, First Integrity Bank, its failure was **not a surprise**.

Here are the indications that First Integrity Bank should fail:

- 1) **First Integrity Bank's normalized income was ranked very poor in the last 3 quarters, which in total lost over 10% of its asset.**
- 2) **Delinquent Loan was ranked between poor and very poor in 5 out of 6 quarters.**
- 3) **First Integrity Bank asset: liability ratio was ranked very poor in the last 2 quarters. In the last quarter, the bank almost has zero equity.**
- 4) **Its Bankability Composite Score was -18.05 before its failure, which was considered to be very poor. In fact, First Integrity Bank was ranked very poor in the last three quarters prior to failure.**

The combination of all these four measures being poor obviously shows that the bank could fail anytime.

# References

---

**CNN:**

<http://www.cnn.com>

**FDIC:**

<http://www.fdic.gov>

**Federal Reserve:**

<http://www.federalreserve.gov/>

**Google News:**

<http://news.google.com/>

**Money Economics:**

<http://www.moneyeconomics.com/1911>

**SEC:**

<http://www.sec.gov/>

**The Wall Street Journal:**

[http://online.wsj.com/public/resources/documents/info-Failed\\_Banks-sort.html](http://online.wsj.com/public/resources/documents/info-Failed_Banks-sort.html)

**Treasury:**

<http://www.treas.gov/>

**Wikipedia:**

<http://www.wikipedia.org/>

**Yahoo Finance:**

<http://finance.yahoo.com/>



# Contact Information

---

For additional information regarding this report series, you can contact us at:

**By E-mail:**

[info@moneyeconomics.com](mailto:info@moneyeconomics.com)

**By Mail:**

Money Economics  
P.O. Box 587  
Alameda, CA 94501

**By Phone:\***

510.550.1694

*\*For media inquiry only please.*