



# SR003\_7: Failed Bank Report

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## Silver Falls Bank

217 East Main Street  
Silverton, OR 97381

(4/24/2000 – 2/20/2009)

# Report Objective

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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>	<b>35399</b>
<b>Bank Charter Class</b>	Federal Reserve Non-Member
<b>Asset Concentration</b>	Commercial Lending Specialization
<b>Product Specialty</b>	Commercial and Customer Banking Services, Investment Services, Personal Loans
<b>Number of Branches</b>	3 (as of December 31, 2008)
<b>Number of Employees</b>	33 (as of December 31, 2008)

<b>Executives</b>	
<b>CEO/President</b>	Stephen Way

# What took place?

**S**ilver Falls Bank, Silverton, OR was closed by the Oregon Department of Consumer and Business Services on February 20<sup>th</sup>, 2009. The Federal Deposit Insurance Corporation (FDIC) was named Receiver. The estimated cost to the FDIC Deposit Insurance Fund is \$50,000,000, compared to the average cost of \$389,206,944. Citizens Bank of Corvallis, OR acquired all deposits and some assets.

# Bank Financial Snapshot

Financial Data Overlay (thousands)			
	2007 Q4	2008 Q4	Percentage Change
<b>Assets</b>	\$ 139,220	\$ 134,206	↓ 3.6%
<b>Liabilities</b>	\$ 127,222	\$ 131,321	↑ 3.2%
<b>Net Income</b>	\$ 2,017	-\$ 9,157	↓ 554%

- The average net income change for all FDIC banks was -83.49% in the same period.
- The average net income change for all the commercial lending specialization banks was -99.60% in the same period.
- Compared with the whole industry and other commercial lending specialization banks, Silver Falls Bank's decline from Net Income is relatively large (-554%) during 2008.

# Key Performance Indicators


KPI Summary for 2008 Q4	
Normalized Income Rating	Very Poor
Delinquent Asset Rating	Very Poor
Asset: Liability Rating	Very Poor
Real Estate Asset Rating*	Very Poor
Bankability Composite Score	-31.06** (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

	2007Q3	2007Q4	2008Q1	2008Q2	2008Q3 	2008Q4
Normalized Income	0.42%	0.34%	-0.26%	0.04%	-1.84%	-4.58%
SD's from Average*	0.583	0.386	-0.731	0.0144	-2.17	-4.25
Ranking	Moderate	Moderate	Moderate	Moderate	Very Poor	Very Poor


- Silver Falls Bank had a normalized income of -4.58% in the fourth quarter of 2008, the quarter before it failed.
- Banks of the same asset concentration hierarchy (commercial lending specialization) had an average normalized income of -0.24%. The standard deviation of the normalized incomes was 1.02%, which means that Silver Falls Bank was 4.25 SD's below the average.

\*Average of banks of the same asset concentration hierarchy



Indicates sign of bank in financial distress

# Delinquent Asset Analysis

	2007Q3	2007Q4	2008Q1	2008Q2 	2008Q3	2008Q4
Delinquent Asset	1.3084%	3.3955%	2.8180%	9.7824%	11.1101%	8.0242%
SD's from Average*	0.05	1.19	0.68	4.52	5.02	2.92
Ranking	Moderate	Poor	Moderate	Very Poor	Very Poor	Very Poor


- Silver Falls Bank had a delinquent assets out of total assets ratio 8.02% in the fourth quarter of 2008, the quarter before it failed.
- Banks of the same asset concentration hierarchy (commercial lending specialization) had an average delinquent asset of 1.7356%. The standard deviation of the delinquent assets was 2.15%, which means that Silver Falls Bank was about 3 SD's above the average.
- Since the second quarter of 2008, Silver Falls Bank's delinquent assets ratio has been much higher than the average. Its delinquent asset ratio was in a bad condition before its failure.

\*Average of banks of the same asset concentration hierarchy



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# Real Estate Loan Asset Analysis

	2007Q3 	2007Q4	2008Q1	2008Q2	2008Q3	2008Q4
Real Estate Loan Asset Ratio	87.05%	88.72%	88.65%	90.04%	83.76%	80.20%
SD from Average*	2.09	2.17	2.18	2.24	1.82	1.60
Ranking	Very Poor	Very Poor	Very Poor	Very Poor	Very Poor	Very Poor

- Sliver Falls Bank had a 80.20% of R/A ratio in 08 Q4, the quarter before it failed.
- In 08 Q4, banks of the same asset concentration hierarchy (commercial lending specialization) had an average R/A ratio of 56.72%. The standard deviation of the R/A ratio was 14.63%, which means that Sliver Falls Bank was 1.60 SD's above the average.

\*Average of banks of the same asset concentration hierarchy



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# Asset: Liability Analysis

	2007Q3	2007Q4	2008Q1	2008Q2	2008Q3 	2008Q4
Asset: Liability Ratio	109.66%	109.43%	108.81%	108.50%	106.55%	102.20%
Median A/L Ratio*	110.97%	110.95%	110.93%	110.69%	110.65%	110.52%
Ranking	Poor	Poor	Poor	Poor	Very Poor	Very Poor

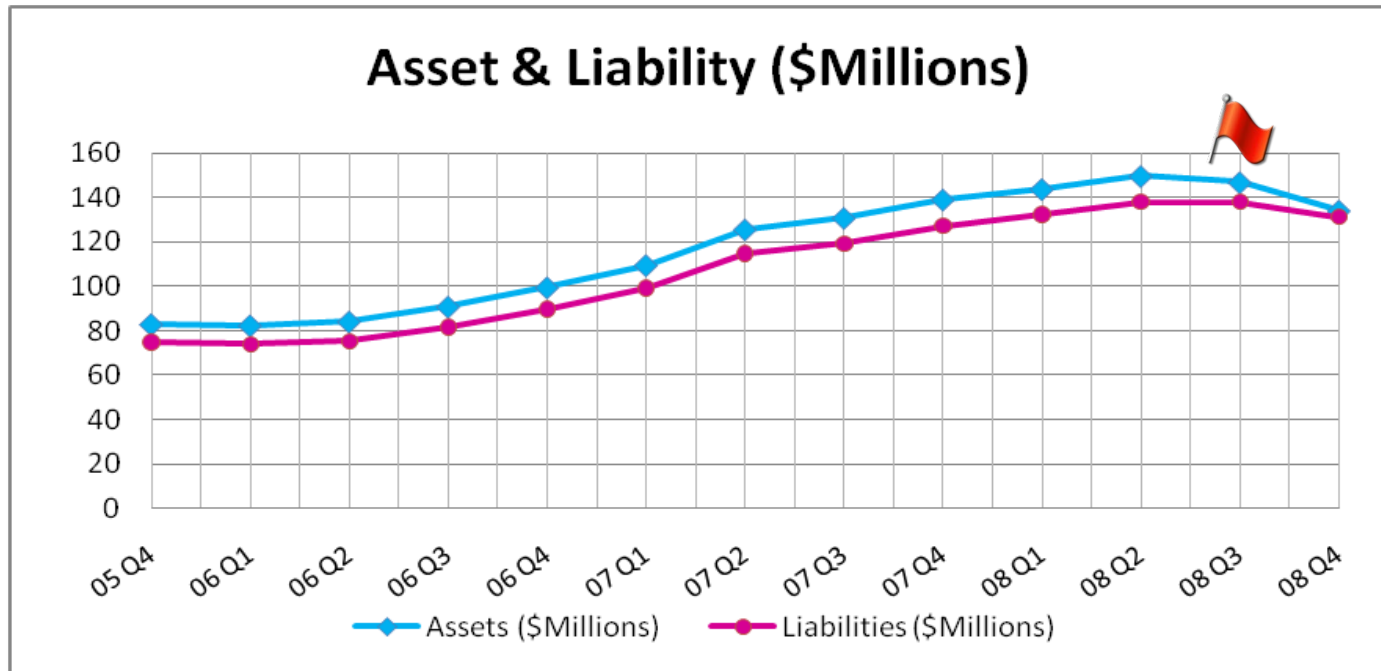
- Sliver Falls Bank experienced decreasing A/L ratio in all 6 quarters.
- The bank fell into the worst ranking in 08 Q3.
- Of the banks failed in 09 Q1, 90.48% of them had an A/L ratio under 107%.
- Of the bank with an A/L ratio under 106% in 08 Q4, 12% failed in the subsequent quarter.

\*Median of banks of the same asset concentration hierarchy



Indicates sign of bank in financial distress

# Asset & Liability History

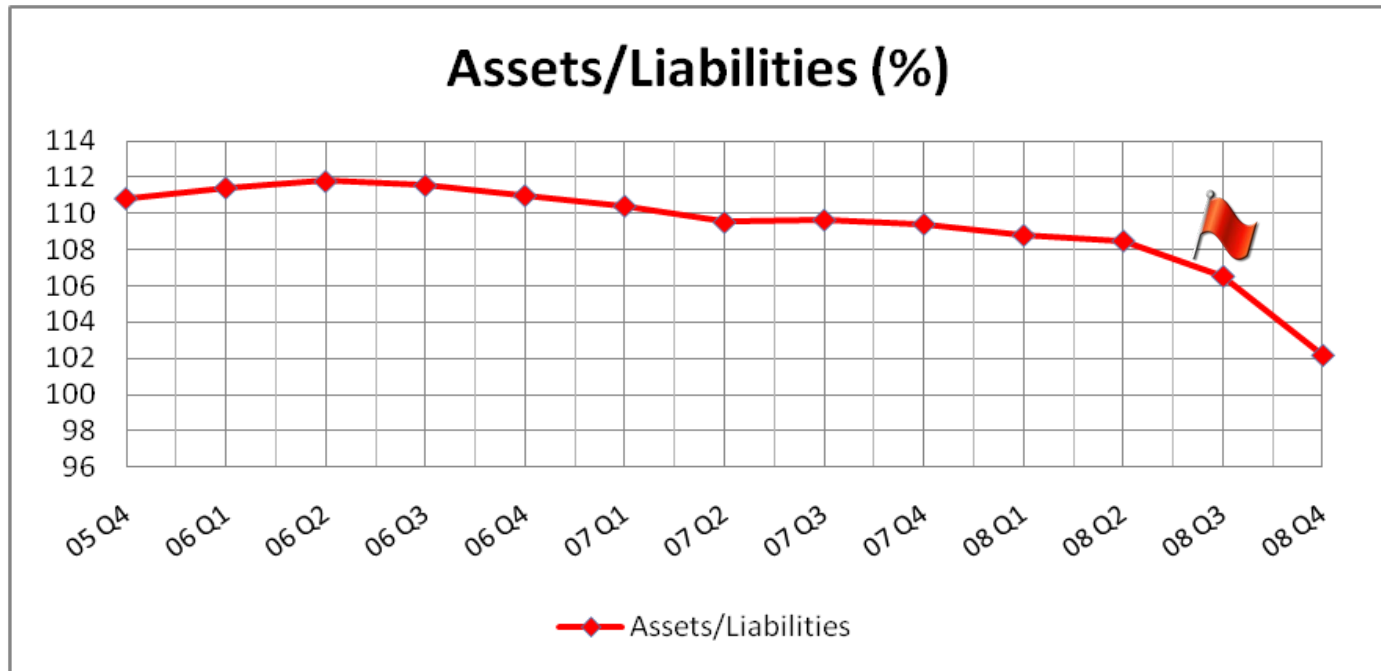


- The difference between asset and liability was getting closer in 08 Q3.



Indicates sign of bank in financial distress

# Asset/Liability History

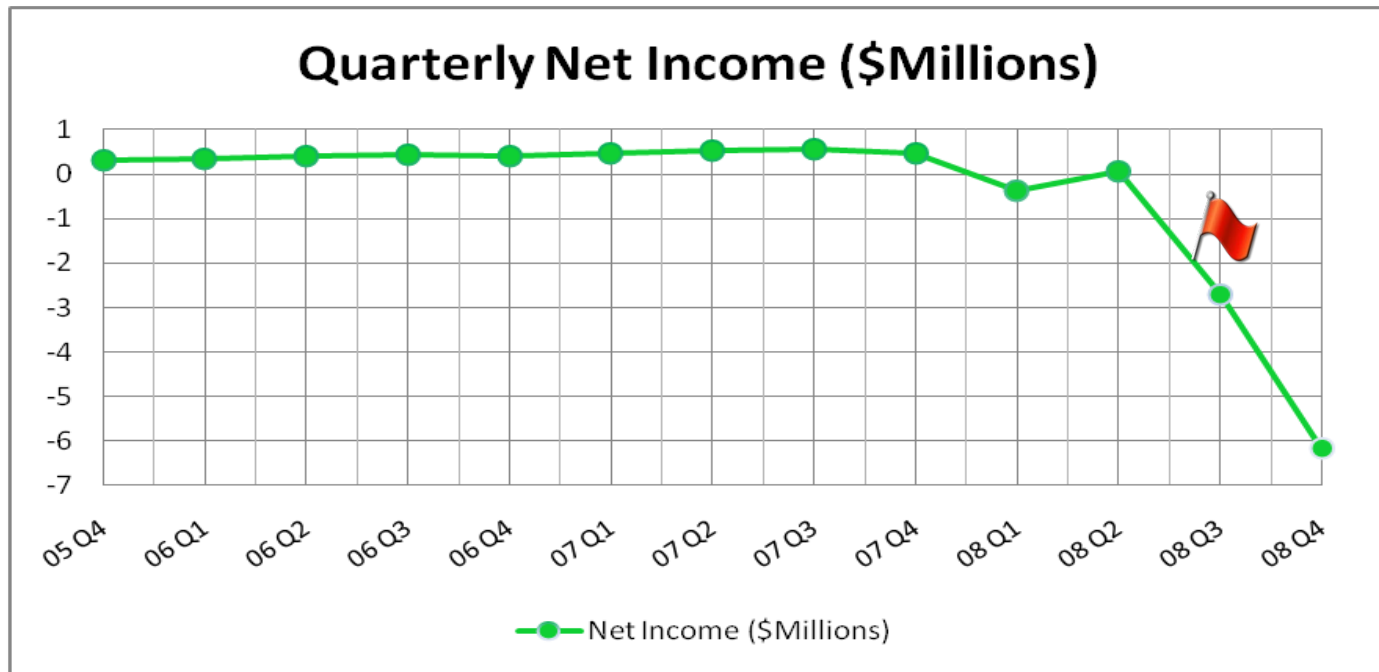


- The A/L ratio was decreasing since 07 Q3.



Indicates sign of bank in financial distress

# Net Income History

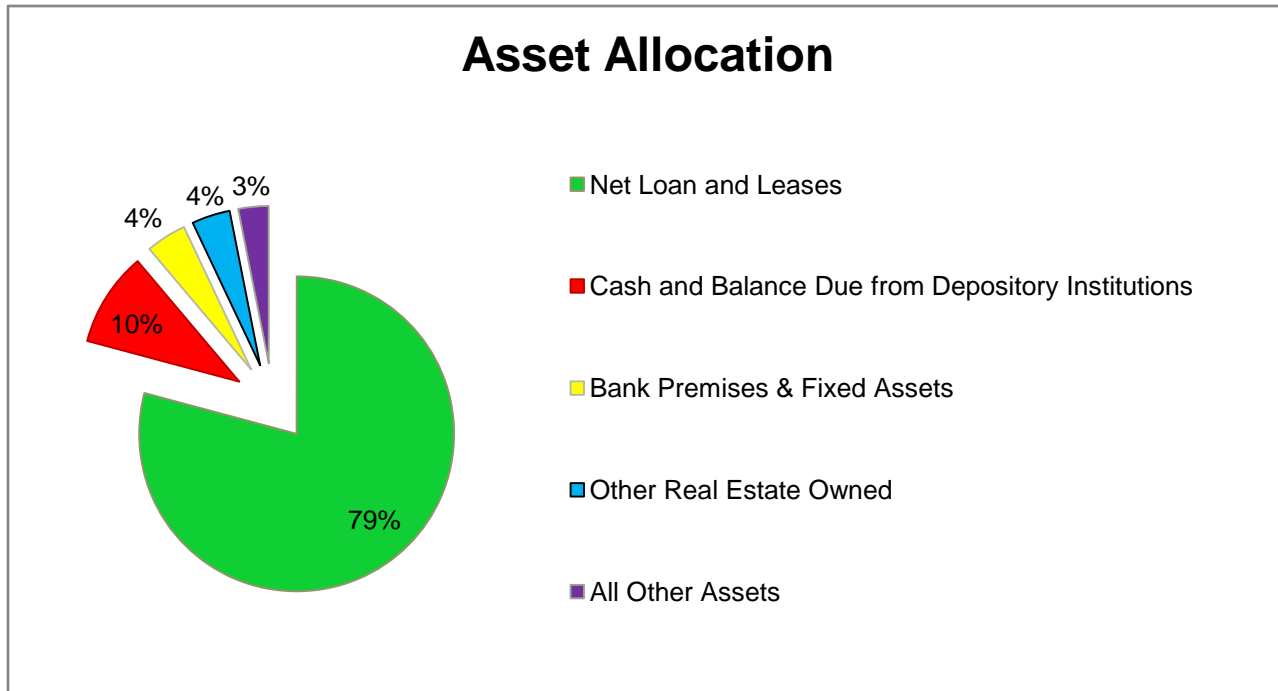


- The bank recorded a big loss in the last two quarters prior to failure.



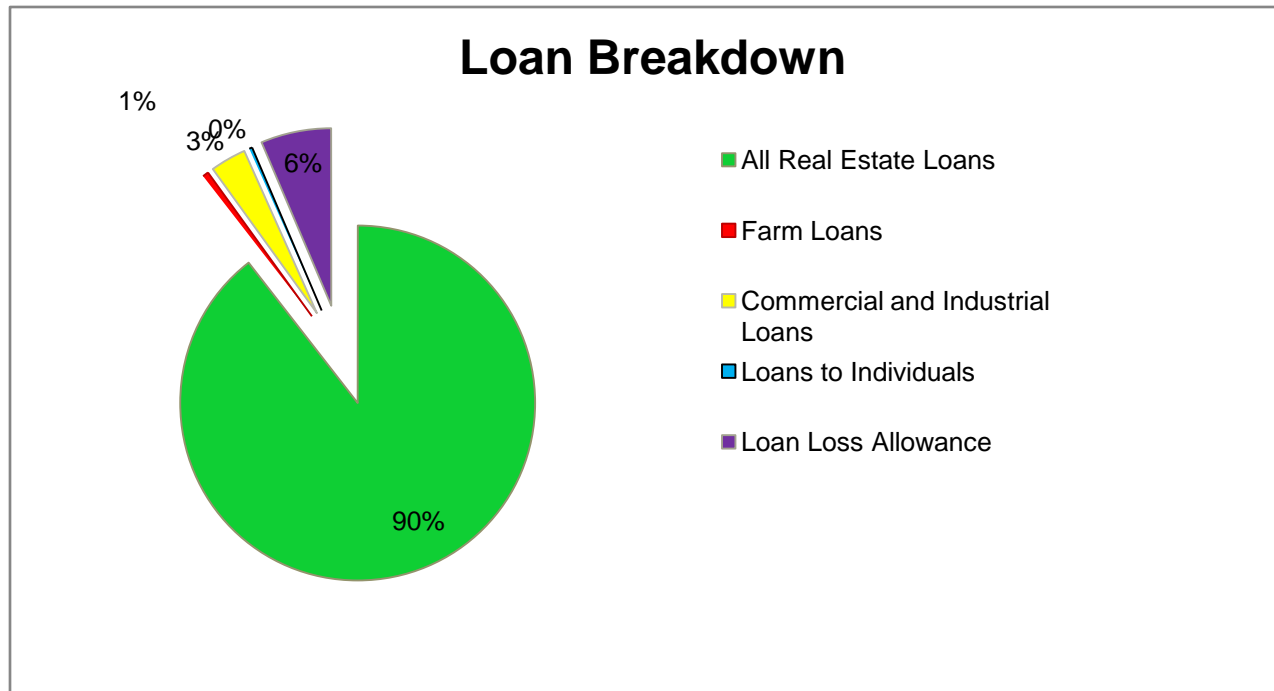
Indicates sign of bank in financial distress

# Asset Allocation



- The average percentage of Net Loans for banks of the same Asset Concentration Hierarchy in the fourth quarter of 2008 was 72.53%.
- The average Net Loan percentage of all banks in the fourth quarter of 2008 was 66.14%.

# Loan Breakdown



- The average percentage of Real Estate Loans for banks of the same Asset Concentration Hierarchy in the fourth quarter of 2008 was 76.45%.
- The average percentage for all banks in the fourth quarter of 2008 was 71.23%.

# Events Timeline

- 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 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.
- Sept. 30, 08** - Silver Falls Bank had capital that's equal to less than 10% of their total 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.

# Events Timeline

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- Nov. 25, 08** - Created the Term Asset-Backed Securities Loan Facility to support the issuance of asset-backed securities collateralized by loans.
- 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. 16, 09** - [Silver Falls Bank is operating under close scrutiny from federal and state regulators.](#)
- 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.

# Events Timeline

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- Feb. 18, 09** - President Obama signs the American Recovery and Reinvestment Act of 2009, which limits bonuses of the highest earning executives.
- Feb. 20, 09** - Silver Fall Bank was closed by the Oregon Department of Consumer and Business Services. Citizens Bank assumed all of the Deposits of Silver Falls Bank.
- 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, Sliver Falls Bank, its failure was **not a surprise**.

Here are the indications that the bank should fail:

- 1) **The bank lost over 6% of its total asset in the last 2 quarters.**
- 2) **Delinquent Loan was ranked very poor in the last 3 quarters. The ratio was even exceeded 10% in 08 Q3.**
- 3) **The real estate loan: asset analysis was ranked very poor in all 6 quarters.**
- 4) **Sliver Falls Bank's asset: liability ratio was ranked between poor and very poor in all 6 quarters. The ratio was 102.2% in the last quarter, which is much lower than the dangerous line 107%.**
- 5) **Its Bankability Composite Score was -31.06 before its failure, which was considered to be very poor.**

The combination of all these five indications shows that failure of the bank was within our prediction.

# References

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