

# SR003\_7: Failed Bank Report

## Cooperative Bank

201 Market Street  
Wilmington, NC 28401

(1/1/1898 – 6/20/2009)

# 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>     | 27837   |
| <b>Parent Holding Company</b> | COOPERATIVE BANKSHARES, INC.  |
| <b>Bank Charter Class</b>     | Federal Reserve Non-member  |
| <b>Asset Concentration</b>    | Commercial Lending Specialization   |
| <b>Product Specialty</b>      | Business and Personal Banking Services,<br>Individual Retirement Accounts;<br>Loan Products: Real Estate, Agricultural,<br>Residential Mortgage and Home Equity Loans |
| <b>Number of Branches</b>     | 25 (as of March 31, 2009)   |
| <b>Number of Employees</b>    | 224 (as of March 31, 2009)  |

| <b>Executives</b> |                   |
|-------------------|-------------------|
| <b>CEO/CFO</b>    | Todd L. Sammons   |
| <b>Chairman</b>   | James D. Hundley  |
| <b>COO</b>        | O.C. Burrell, Jr. |

# What took place?

**C**ooperative Bank, Wilmington, NC was closed by the North Carolina Commissioner of Banks on June 19th, 2009. The Federal Deposit Insurance Corporation (FDIC) was named Receiver. The estimated cost to the FDIC Deposit Insurance Fund is \$217,000,000, compared to the average cost of \$389,206,944. First Bank of Troy, NC will acquire all nonbrokered deposits and some assets.

# Bank Financial Snapshot

| Financial Data Overlay (thousands) |                   |                   |                   |
|------------------------------------|-------------------|-------------------|-------------------|
|                                    | 2008 Q1           | 2009 Q1           | Percentage Change |
| <b>Assets</b>                      | <b>\$ 958,700</b> | <b>\$ 966,778</b> | <b>↑ 0.8%</b>     |
| <b>Liabilities</b>                 | <b>\$ 878,538</b> | <b>\$ 930,729</b> | <b>↑ 5.9%</b>     |
| <b>Net Income</b>                  | <b>\$ 990</b>     | <b>\$ 1,174</b>   | <b>↑ 18.6%</b>    |

- The average net income change for all FDIC banks was -59.6% in the same period.
- The average net income change for all the commercial lending specialization banks was -107.5% in the same period.
- Compared with the whole industry and other commercial lending specialization banks, Cooperative Bank had a positive increase from net income, which was a rare phenomena as a failed bank during 2009.

# Key Performance Indicators

| KPI Summary for 2009 Q1     |                    |
|-----------------------------|--------------------|
| Normalized Income Rating    | Moderate           |
| Delinquent Asset Rating     | Poor               |
| Asset: Liability Rating     | Very Poor          |
| Real Estate Asset Rating*   | Very Poor          |
| Bankability Composite Score | 8.68** (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

|                    | 2007Q4   | 2008Q1   | 2008Q2   | 2008Q3 | 2008Q4  | 2009Q1   |
|--------------------|----------|----------|----------|--------|--|----------|
| Normalized Income  | 0.22%    | 0.10%    | -0.01%   | -0.89% | -3.67%   | 0.12%    |
| SD's from Average* | 0.217    | -0.0135  | -0.0639  | -1.01  | -3.36  | 0.227    |
| Ranking            | Moderate | Moderate | Moderate | Poor   | Very Poor  | Moderate |


- Cooperative Bank had a normalized income of 0.12% in the first quarter of 2009, the quarter before it failed.
- Banks of the same asset concentration hierarchy (commercial lending specialization) had an average normalized income of -0.01%. The standard deviation of the normalized incomes was 0.58%, which means that Cooperative Bank was 0.227 SD's above the average.
- Since the fourth quarter of 2007, (with the exception of 2009Q1) Cooperative Bank's normalized income in relation to banks of the same asset concentration hierarchy has declined each quarter.

\*Average of banks of the same asset concentration hierarchy



Indicates sign of bank in financial distress

# Delinquent Asset Analysis

|                    | 2007Q4   | 2008Q1   | 2008Q2   | 2008Q3  | 2008Q4   | 2009Q1  |
|--------------------|----------|----------|----------|---------|----------|--|
| Delinquent Asset   | 2.1058%  | 2.4246%  | 2.6650%  | 1.1710% | 2.6820%  | 5.5690%  |
| SD's from Average* | 0.43     | 0.47     | 0.68     | -0.17   | 0.44     | 1.54   |
| Ranking            | Moderate | Moderate | Moderate | Good    | Moderate | Poor   |


- Cooperative Bank had a delinquent assets out of total assets ratio 5.6% in the first quarter of 2009, the quarter before it failed.
- Banks of the same asset concentration hierarchy (commercial lending specialization) had an average delinquent asset of 1.9142%. The standard deviation of the delinquent assets was 2.37%, which means that Cooperative Bank was about 1.5 SD's above the average.
- Since the fourth quarter of 2007, Cooperative Bank's delinquent assets ratio has been stable and around the average. However, right before the bank fails, its delinquent asset ratio suddenly increased into a poor condition.

\*Average of banks of the same asset concentration hierarchy



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# Real Estate Loan Asset Analysis

|                              | 2007Q4  | 2008Q1    | 2008Q2    | 2008Q3    | 2008Q4    | 2009Q1    |
|------------------------------|--|-----------|-----------|-----------|-----------|-----------|
| Real Estate Loan Asset Ratio | 85.71%   | 85.37%    | 86.56%    | 87.40%    | 91.07%    | 85.62%    |
| SD from Average*             | 1.97   | 1.96      | 2.01      | 2.07      | 2.35      | 2.50      |
| Ranking                      | Very Poor  | Very Poor | Very Poor | Very Poor | Very Poor | Very Poor |

- Cooperative Bank had a 85.62% of R/A ratio in 09 Q1, the quarter before it failed.
- In 09 Q1, banks of the same asset concentration hierarchy (commercial lending specialization) had an average R/A ratio of 56.23%. The standard deviation of the R/A ratio was 14.37%, which means that Cooperative Bank was 2.50 SD's above the average.

\* Average of banks of the same asset concentration hierarchy



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# Asset: Liability Analysis

|                              | 2007Q4   | 2008Q1  | 2008Q2  | 2008Q3  | 2008Q4  | 2009Q1    |
|------------------------------|----------|---------|---------|---------|--|-----------|
| Asset:<br>Liability<br>Ratio | 109.51%  | 109.12% | 108.83% | 107.74% | 103.81%  | 103.87%   |
| Median A/L<br>Ratio*         | 110.95%  | 110.93% | 110.69% | 110.65% | 110.52%  | 110.57%   |
| Ranking                      | Moderate | Poor    | Poor    | Poor    | Very Poor  | Very Poor |

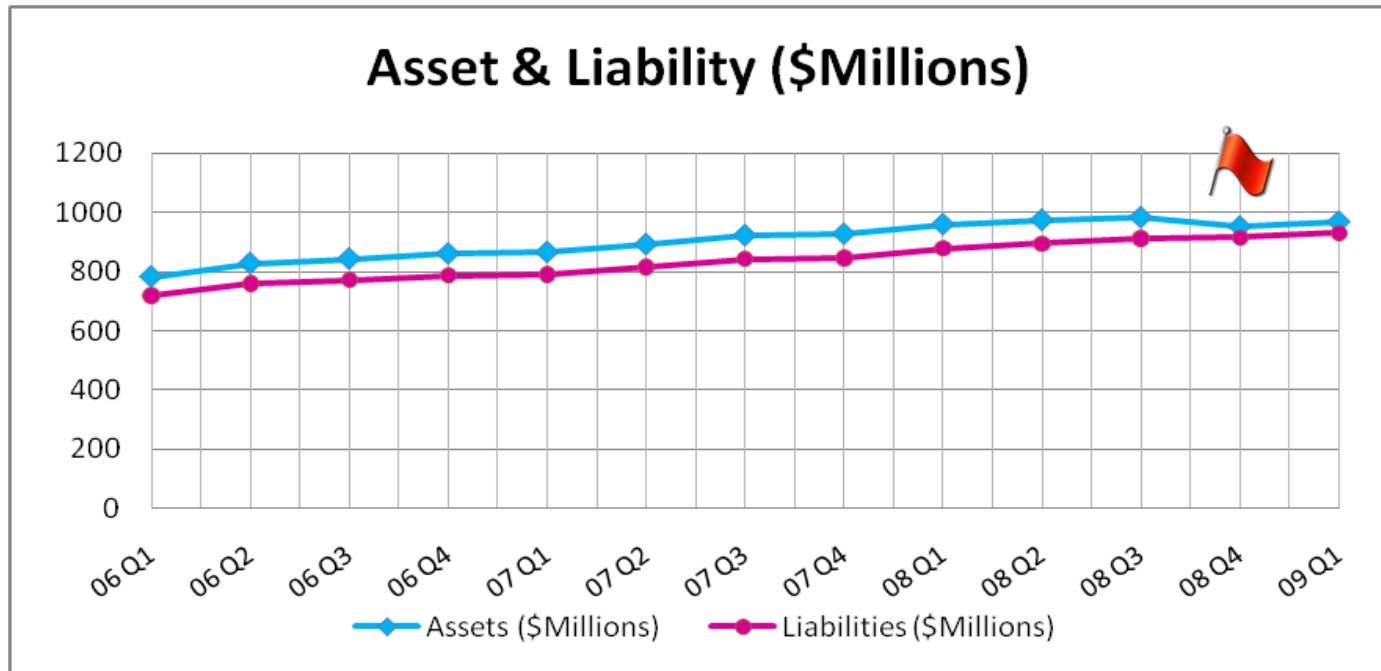
- Cooperative Bank experienced decreasing A/L ratio from 07 Q4 to 08 Q4.
- The bank fell into the worst ranking in 08 Q4.
- Of the banks failed in Q2 09, 87.50% of them had an A/L ratio under 107%.
- Of the bank with an A/L ratio under 106% in Q1 09, 10.75% failed in the subsequent quarter.

\* Average of banks of the same asset concentration hierarchy



Indicates sign of bank in financial distress

# Asset & Liability History

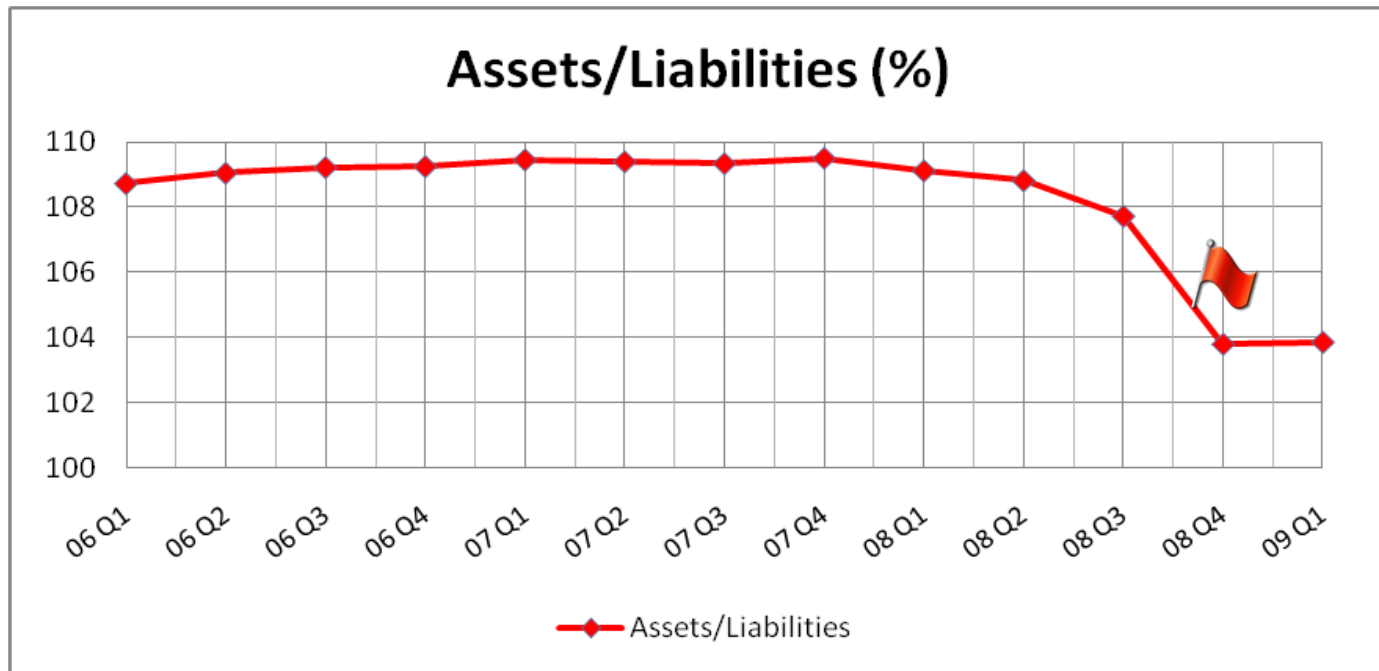


- The difference between asset and liability was getting closer in 08 Q4.



Indicates sign of bank in financial distress

# Asset/Liability History

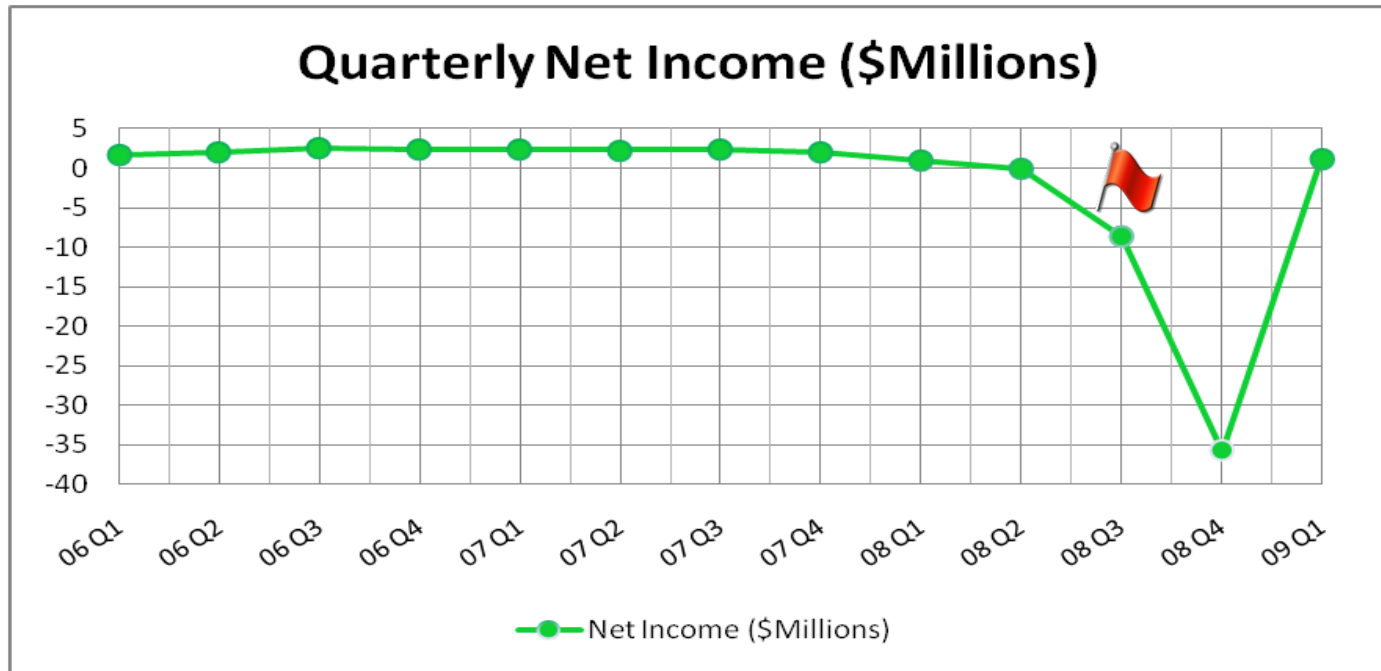


- The A/L ratio decreased nearly 4% in 08 Q4.



Indicates sign of bank in financial distress

# Net Income History

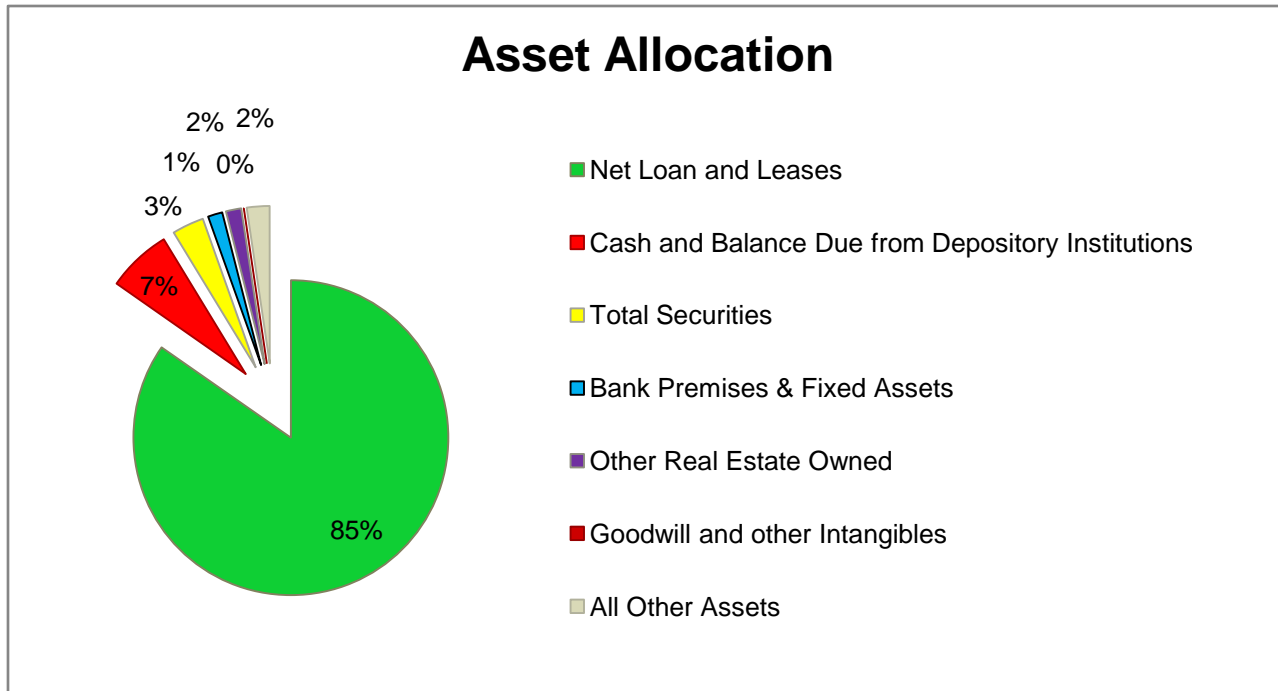


- The bank recorded a big loss in 08 Q4.



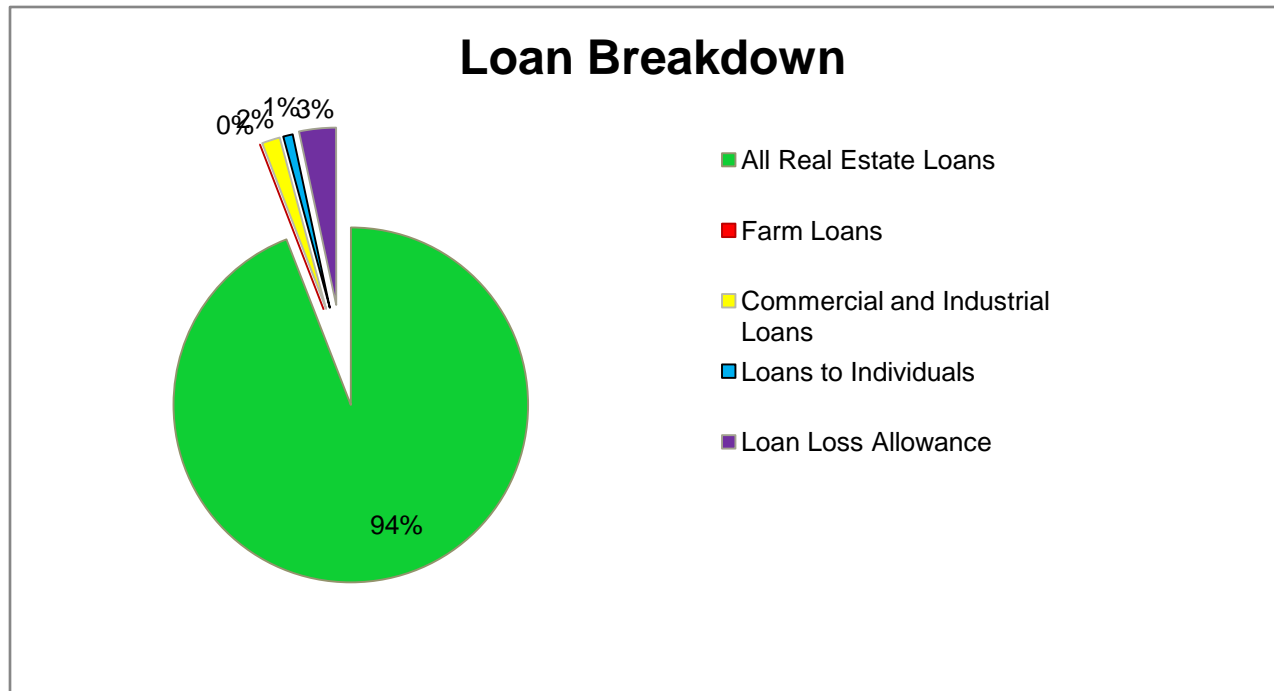
Indicates sign of bank in financial distress

# Asset Allocation



- The average percentage of Net Loans for banks of the same Asset Concentration Hierarchy in the first quarter of 2009 was 71.42%.
- The average Net Loan percentage of all banks in the first quarter of 2009 was 64.89%.

# Loan Breakdown



- The average percentage of Real Estate Loans for banks of the same Asset Concentration Hierarchy in the first quarter of 2009 was 76.90%.
- The average percentage for all banks in the first quarter of 2009 was 71.75%.

# 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.
- Mar. 31, 08** - 62 basis point reduction in interest rate spread.
- Mar. 31, 08** - Net income for 1Q declined from the prior year period from \$2.1 million to \$752,000.
- May 20, 09** - Declared 2Q dividend of \$0.05 per share.
- 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

# Events Timeline

- 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.
- 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.
- Jul. 24, 08** - Net income for 2Q of \$402,000.
- 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.

# Events Timeline

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- Oct. 14, 08** - The Treasury Department will invest up to \$250 billion in the nation's banks via the Capital Purchase Program.
- Oct. 31, 08** - Reported a net loss for the nine months ended 9/30.
- 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.
- 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.

# Events Timeline

- Feb. 10, 09** - Treasury and Fed expanded 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.
- Feb. 18, 09** - Interim CEO announced that the bank is in "troubled condition" and undercapitalized.
- Mar. 4, 09** - Treasury announced loan modification guidelines under the Administration's Homeowner Affordability and Stability Plan.
- Mar. 18, 09** - Under a cease-and-desist order.
- 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.
- Apr. 15, 09** - It expects to post a loss of \$30.6 million for 2008 and it is search of \$25 million cash infusion from investors to meet the capitalization requirements.
- Apr. 22, 09** - Received delisting warning letter from NASDAQ.
- 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.
- June 19, 09** - Cooperative Bank was closed by the North Carolina Office of Commissioner of Banks. First Bank assumed all of the deposits.
- 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, Cooperative Bank, its failure was **not a surprise**.

Here are the indications that Cooperative Bank should fail:

- 1) **The bank lost over 3% of its total asset in 08 Q4.**
- 2) **Delinquent Loan was doubled in the last quarter, compared to the previous five quarters.**
- 3) **The bank's real estate loan: asset analysis was ranked very poor in all 6 quarters.**
- 4) **Cooperative Bank's asset: liability ratio was ranked between poor and very poor in the last 5 quarters prior to failure. In 09 Q1, the ratio was 103.87%, which is much lower than the dangerous line 107%.**
- 5) **Its Bankability Composite Score was 8.68 before its failure, which was considered to be very poor.**

The combination of all these five indications shows that the failure of Cooperative Bank is within our prediction.

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