Executive Summary:

Review of the Failure of NBRS Financial

2016-SR-B-005 **March 31, 2016**

Purpose

Consistent with the requirements of section 38(k) of the Federal Deposit Insurance Act, 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 NBRS Financial because the failure presented unusual circumstances that warranted an in-depth review.

Background

NBRS Financial, located in Rising Sun, Maryland, operated as a national bank serving local communities for more than 120 years before transitioning from a national to a state charter in 2002. The bank was supervised by the Federal Reserve Bank of Richmond (FRB Richmond) and the Maryland Office of the Commissioner of Financial Regulation (State). On October 17, 2014, the State closed NBRS Financial and appointed the Federal Deposit Insurance Corporation as receiver.

Findings

NBRS Financial failed because of the convergence of several factors. The bank consolidated authority in an individual who served as the President, Chief Executive Officer, and Chairman of the board of directors. This individual's dominant influence on the bank's operations limited the institution's ability to overcome its deteriorating financial condition. The President surrounded himself with an inexperienced senior management team while allegedly engaging in improper business practices for his own benefit. In addition, NBRS Financial's board of directors exercised ineffective oversight of the bank's operations. The board of directors approved a strategic plan that relied heavily on a perceived economic opportunity for the local economy that never materialized, and it also failed to adapt to changing market conditions in a timely manner. The bank developed high concentrations in commercial real estate and extended large loans to single borrowers, which exacerbated the bank's concentration risk and resulted in numerous regulatory violations. NBRS Financial's board of directors and management also failed to establish adequate credit risk management practices and internal controls commensurate with the risks within the bank's loan portfolio. These concentrations and poor credit risk management practices, along with a deteriorating real estate market, resulted in asset quality deteriorations, significant losses, and an erosion of capital.

With respect to supervision, FRB Richmond complied with the applicable examination frequency guidelines, conducted regular offsite monitoring, and implemented applicable prompt corrective action provisions during the time frame under review—2006 through 2014. FRB Richmond's supervisory activity during this period included formal enforcement actions in the form of a written agreement and a prompt corrective action directive. Our review of FRB Richmond's supervision of NBRS Financial revealed that FRB Richmond took strong supervisory action in 2009 and seized an opportunity to take even stronger supervisory action in 2012. Our review resulted in one finding related to the potential fraud and insider abuse risks that dominant management officials can present. We observed this theme with NBRS Financial and reported on it in prior failed bank reviews.

Recommendation

Our report recommends that the Board of Governors of the Federal Reserve System develop guidance or training related to the opportunity to highlight potential indicators of internal abuse or heightened fraud risk in situations involving dominant officials. The Director of the Division of Banking Supervision and Regulation concurred with our recommendation and outlined planned corrective actions to address the recommendation.