

OFFICE OF THRIFT SUPERVISION

Receivership of a Federal Savings Bank

Date: December 18, 2009
Order No.: 2009-63
Docket No.: 01792

The Acting Director of the Office of Thrift Supervision (OTS), or his designee, in cooperation with the Federal Deposit Insurance Corporation (FDIC), has determined to appoint the FDIC as receiver of First Federal Bank of California, FSB, Santa Monica, California (Savings Bank).

**GROUND FOR APPOINTMENT OF THE FDIC AS
RECEIVER FOR THE SAVINGS BANK**

The Acting Director, or his designee, based on the administrative record, finds and determines the following:

- (i) The Savings Bank is in an unsafe and unsound condition to transact business; and
- (ii) The Savings Bank, by resolution of its board of directors, has consented to the appointment of a receiver;

The Savings Bank is a Federally chartered savings bank, the accounts of which are insured by the Deposit Insurance Fund. The Savings Bank's home office is in Santa Monica, California. The Savings Bank's Thrift Financial Report (TFR) for the period ending September 30, 2009, reported approximately \$6.144 billion in assets, \$5.883 billion in liabilities, \$261.1 million in core capital, and a net loss for the nine months ending September 30, 2009, of approximately \$138.0 million. For calendar year 2008, the Savings Bank reported a net loss of \$395.9 million.

As a result of its history of option ARM lending,¹ the Savings Bank faces serious problems. These problems stem from the Savings Bank's single family residential (SFR) loan

¹ An option ARM loan is an adjustable mortgage that permits the borrower to choose among several payment options, including a traditional payment of principal and interest, an interest-only payment or a minimum payment that may be less than the amount of interest due and may not pay down any principal. In the latter option, the amount of any unpaid interest is added to the principal balance, increasing the amount that the borrower owes and the interest the borrower will have to pay. This is referred to as negative amortization. Option ARM loans have built in recalculation features based upon the remaining term of the loan or the level of negative amortization. Once those terms expire or the loan reaches the designated principal amount, the borrower's payment is recalculated (recast).

portfolio, including approximately \$3.6 billion of option ARMs. These loans were made with reduced documentation requirements. Due to negative amortization on the loans, and the significant decline in property values in the Savings Bank's market areas, the loan-to-value (LTV) ratios on the loans have vastly increased, to the extent that 33 percent of the Savings Bank's SFR loans in California have LTV ratios exceeding 120 percent. The problems affect all aspects of the Savings Bank's operations, including asset quality, earnings and capital, and also affect the Savings Bank's ability to raise new capital in any attempt to recapitalize.

Asset Quality

Nonperforming assets (NPAs) (\$567.7 million), option ARM loans that have been modified (troubled debt restructurings, or TDRs) (\$1,161.9 million), and classified assets (\$1,658 million) are high, and represented 112.4 percent, 230.0 percent, and 328.4 percent, respectively, of Tier 1 (Core) Capital plus general valuation allowances (GVAs) (\$505.1 million) at September 30, 2009. This is a 71.9 percent, 78.9 percent, and 159.6 percent increase, respectively, from December 31, 2008. Total nonperforming assets as of September 30, 2009, represented 9.24 percent of total assets, compared with a peer median of 2.45 percent. Total classified assets as of September 30, 2009 represented 27 percent of total assets, compared with a peer median of 3.35 percent.

Factoring in the additions to capital that the Savings Bank has recognized and has projected to record at the end of the fourth quarter following the recently enacted tax legislation,² the problem asset ratios are still high with NPAs at 95.4 percent, TDRs at 195.2 percent and classified assets at 278.7 percent of increased Core Capital plus GVAs, respectively.

There is a significant portfolio of option ARM loans with a high risk of becoming nonperforming. Approximately \$2.7 billion of the Savings Bank's SFR loans as of September 30, 2009, are option ARM loans that have yet to recast, have recently recast, or have been modified. These higher-risk loans represent 73 percent of all SFR loans, 44 percent of total assets, and 537 percent of Tier 1 (Core) Capital plus GVAs.

Option ARM loans originated between 2004 and 2007 are high-risk, due to their original reduced documentation, their current high LTVs, and/or their potential future payment shock. The Savings Bank's management has acknowledged that the financial performance of the Savings Bank's option ARM portfolio demonstrated that the product was vastly more risky than anticipated.

The Savings Bank has engaged in an extensive loan modification effort. To date, \$1.5 billion of the \$2.7 billion option ARM portfolio has been modified. Under most of the modifications, the loans require payments only of interest for a certain period. In addition, 72

² The Worker, Homeownership, and Business Assistance Act of 2009 (WHBAA) extended the Net Operating Loss carry-back period from two to five years for certain losses. The Savings Bank's management asserts that the legislation entitles the Savings Bank to a tax refund of \$90 million upon filing of its 2009 tax return. Management has booked \$76 million of that amount based upon negative income through September 30, 2009.

percent of all modified SFR loans have loan-to-value (LTV) ratios of over 100 percent, as of September 30, 2009. Loans with such high LTV ratios present substantial risks of future losses. The modified loans remain problem assets.³

OTS has analyzed the potential life-of-loan losses on the SFR portfolio in two different ways: (i) by conducting a static stress assessment on the loans; and (ii) by analyzing the losses on the loans based on their LTV ratio. Under these analyses, OTS expects the Savings Bank to lose at least \$399 million, and as much as \$557 million on its existing SFR loan portfolio.

Income

Prior losses related to option ARMs have already had a negative effect on earnings. For the quarter and nine months ended September 30, 2009, the Savings Bank reported losses of \$43.4 million and \$138.0 million, respectively. For calendar year 2008, the Savings Bank reported a loss of \$395.9 million. Although much of the estimated life of loan losses embedded in the loan portfolio has already been reflected in losses in the Institution's income statements (and are included in GVAs and specific valuation allowances), the Institution could realize as much as \$227 million in additional credit losses through its income statement during the life of the loans. Furthermore, the Savings Bank operates in a market that has been adversely affected by recent events more than most other markets, and continues to experience uncertainty.

Capital

The Savings Bank has experienced a significant decline in capital as a result of loan losses. From December 31, 2007, to September 30, 2009, the Savings Bank's total risk-based capital ratio fell from 21.42 percent to 8.91 percent, and the Savings Bank's core capital fell from 10.97 percent to 4.25 percent.⁴ The additional losses discussed above will have a substantial negative effect on capital. Based on its analysis, OTS concludes that existing capital is insufficient to address these potential losses. The Savings Bank itself has recognized it needs to raise at least \$450 million.

Absent a capital raise, the Savings Bank does not have a viable long-term business plan. For the reasons set forth below, the possibility of the Savings Bank raising additional capital is remote, at best.

³ The loan modifications do not eliminate the risk inherent in the asset. The modifications make the loans less risky in the near term, but do not cure a troubled loan. While the payment stream for the modified loan may be restructured eliminating imminent payment shock, the Savings Bank's program does not lower the amount of principal due, improve the credit quality of the borrower, change the borrower's employment status, or eliminate any decline in collateral value that may have occurred since origination. The same factors that made it a troubled loan prior to modification remain, except for the elimination of the potential for future negative amortization and the prospect of near-term recast.

⁴ Total risk-based capital and core capital are 11.13 percent and 5.49 percent as of September 30, 2009, if the WHBAA refund is included in the Savings Bank's capital.

Capital Raising Difficulties

The Savings Bank's asset and capital problems require the Savings Bank to access new capital in the market to return to viability. However, based on several factors, OTS concludes that the possibility of the infusion of new capital into the Savings Bank is remote. Most significantly: (i) over 100 investors have considered the opportunity to invest in the Savings Bank and have declined to do so; (ii) the Savings Bank has attempted to secure capital for over a year without success; (iii) difficulties in raising capital as a result of the resignation of previous auditors of the Savings Bank; and (iv) management's efforts to engage in a public stock offering have failed.

DISCUSSION OF GROUNDS FOR APPOINTMENT OF A RECEIVER FOR THE SAVINGS BANK

Section 5(d)(2)(A) of the Home Owners' Loan Act (HOLA), 12 U.S.C. § 1464(d)(2)(A), provides that OTS may appoint a receiver for any insured savings association if OTS determines that one or more grounds specified in section 11(c)(5) of the Federal Deposit Insurance Act (FDIA), 12 U.S.C. § 1821(c)(5), exist.

Unsafe or Unsound Condition to Transact Business

Under section 11(c)(5)(C), OTS may appoint a receiver for a savings association if a savings association is in an unsafe or unsound condition to transact business.

An unsafe or unsound condition has been identified as one where an institution is operated in a manner that causes an unacceptable risk to its depositors' funds. See Franklin Savings Association v. Director, OTS, 934 F.2d 1127, 1145 (10th Cir. 1991), cert. denied, 503 U.S. 937 (1992). Based on the facts set forth above, the Acting Director, or his designee, concludes that the Savings Bank is in an unsafe and unsound condition to transact business.

Consent

Under section 11(c)(5)(I), OTS may appoint a receiver for an association if the association's board of directors, by resolution, has consented to such an appointment. The board of directors of the Savings Bank, by resolution dated December 4, 2009, agreed to the appointment of a conservator or receiver.

On May 18, 2009, an Amended Order to Cease and Desist (Amended Order) became effective. The Amended Order required the Savings Bank to provide OTS with a Contingency Plan within fifteen days if it failed to meet the capital requirements required by the Amended Order by September 30, 2009. Verbally, in an October 2, 2009 meeting with management, and then by letter, dated October 7, 2009, OTS provided the Savings Bank with notice that it was required to submit a Contingency Plan because it had failed to meet the capital requirements by September 30, 2009.

By letter dated, October 15, 2009, the Chairman of the Board and Chief Executive Officer, Babette Heimbuch, provided three alternative plans. The first plan called for the Savings Bank to achieve the capital levels required by the Amended Order by means of a public offering of securities. A schedule provided as an attachment to the letter stated that the capital would be raised by December 2, 2009. In the event that the public offering failed, the Board proposed as a second alternative to “consent within 10 days to the OTS’ appointment of a receiver if the OTS believes that no alternative capital raising activities are feasible” and to “cooperate with the OTS and FDIC in the orderly transition of the Bank’s affairs to the receiver.” The third option was to implement a Liquidation Plan consistent with an attached plan.

On October 26, 2009, supervisory staff informed management of the Savings Bank that the Contingency Plan needed to have a capital target of an infusion of at least \$450 million to the Savings Bank and that the time for the consent should be reduced from ten days to two days. Following this discussion, also on October 26, 2009, Ms. Heimbuch submitted an Amended Contingency Plan that again contained three options. The first option was to achieve compliance with the required capital levels by means of a public equity offering resulting in minimum gross proceeds to the Savings Bank of at least \$515 million with approximately \$450 million to be contributed to the Savings Bank by December 2, 2009. Second, in the event this capital raise failed, in pertinent part, the Board proposed to “consent, within two (2) days, to the OTS’s appointment of a receiver if the OTS believes that no alternative capital raising activities are feasible” and again cooperate with the OTS and FDIC to facilitate the transition to a receiver. The Board again proposed the same third option.

By letter dated October 28, 2009, Regional Director C.K. Lee responded that the OTS took no objection to the proposed capital raise contained in the Amended Contingency Plan. The letter goes on to state that with respect to the second option proposed by the Board, the OTS expected the consent to be provided within two days of December 2, 2009 if the capital raise was unsuccessful as of that date.

The Savings Bank failed to raise capital by December 2, 2009.

On December 4, 2009, OTS provided the board of directors of the Savings Bank with a form of consent to the appointment of a conservator or receiver by OTS. On December 4, 2009, the board of directors of the Savings Bank resolved to consent to the appointment of a conservator or receiver by the OTS. The form as executed by the board of directors eliminated language in a “WHEREAS” clause that is included in OTS’s standard form of consent, which states that the board has concluded that “the Savings Association is experiencing severe supervisory and/or financial problems that the board of directors of the Savings Association has concluded that the Savings Association is unlikely to be able to resolve successfully without federal intervention and the appointment of a conservator or receiver.” Instead, the Institution’s consent stated that the “the board of directors of the Savings Association (‘Board’) is required under the Savings Association’s Amended Contingency Plan dated as of October 25, 2009 to consent to the appointment of a conservator or receiver and to enter into the Consent.”

On December 11, 2009, the Savings Bank's then-Chairman of the Board addressed the revised language by stating that "We do not believe that the Bank's WHEREAS clause impacts or dilutes in any way OTS' ability to seize the Bank and appoint a receiver or conservator, and it was not intended to do so. The operative language of the consent, which is the important part of the document following the "NOW THEREFORE" language, is as you requested it."

Neither Section 1821(c)(5) nor the general definitions in section 3 of the FDIA define the term "consent". Moreover, the FDIA does not require that a consent be manifested through any specific form, or contain any specific wording. Accordingly, the mere fact that the consent was not provided on OTS's model consent form does not provide a basis for objection to the consent.

OTS concludes that the consent in this case was voluntary. The Savings Bank included the option of a consent to receivership in the October 15, 2009, letter of its own initiative. OTS neither required nor suggested that the alternatives included in a contingency plan include an option for the board to consent to a receivership. After the Savings Bank raised the idea of a consent to receivership in the contingency plan, OTS staff indicated that the consent should be provided within two days after OTS concluded that no public offering was feasible, rather than the ten days suggested by the Savings Bank, and that OTS would accept a contingency plan with this feature. However, the request for a two-day period rather than a ten-day period does not alter the ultimate fact that the Savings Bank's board offered a commitment to consent, and OTS's request only addresses details of that consent. Moreover, the fact that OTS stated that it would accept a contingency plan with this term merely indicates that OTS was responding to the specific terms of the contingency plan proffered by the Savings Bank, and should not be construed as meaning that OTS would reject any contingency plan that did not include this term.

Based on the facts set forth above, the Acting Director concludes that the Savings Bank's board of directors has consented to the appointment of a conservator or receiver, consistent with section 11(c)(5)(I) of the FDIA.

The Acting Director, or his designee, therefore, has determined that grounds for the appointment for a receiver for the Savings Bank exist under section 5(d)(2) of the HOLA, and sections 11(c)(5)(C) and (I) of the FDIA, 12 U.S.C. §§ 1821(c)(5)(C) and (I).

ACTIONS ORDERED OR APPROVED

Appointment of a Receiver

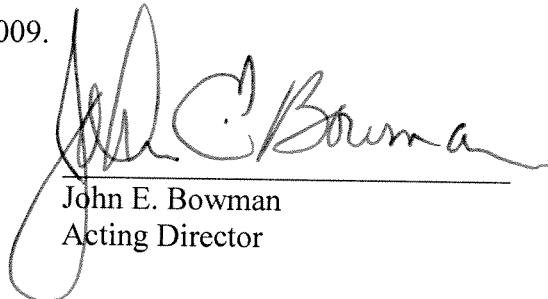
The Acting Director, or his designee, hereby appoints the FDIC as receiver for the Savings Bank, for the purpose of liquidation or winding up the affairs of the Savings Bank, pursuant to section 5(d)(2) of the HOLA, 12 U.S.C. § 1464(d)(2), and section 11(c)(6)(B) of the FDIA, 12 U.S.C. § 1821(c)(6)(B).

DELEGATION OF AUTHORITY TO ACT FOR OTS

The Acting Director, or his designee, hereby authorizes: (i) the OTS Western Regional Director, or his designee; or (ii) the Deputy Chief Counsel for Business Transactions of the Chief Counsel's Office, or his designee, to: (1) certify orders; (2) sign, execute, attest or certify other documents of OTS issued or authorized by this Order; (3) designate the person or entity that will give notice of the appointment of a receiver for the Savings Bank and serve the Savings Bank with a copy of this Order pursuant to 12 C.F.R. § 558.2; and (4) perform such other actions of OTS necessary or appropriate for the implementation of such Order. All documents to be issued under the authority of this Order must be first approved, in form and content, by the Chief Counsel's Office. Further, the Acting Director, or his designee, authorizes the Deputy Chief Counsel for Business Transactions, or his designee, to make any subsequent technical corrections, that might be necessary, to this Order, or any documents issued under the authority of this Order.

By Order of the Acting Director of OTS, or his designee, effective: (a) as to the above matters regarding the delegation of authority, immediately upon signature; and (b) as to the above matters regarding the appointment of the FDIC as receiver, immediately upon service of this Order on the Savings Bank.

Executed this 18th day of December, 2009.



John E. Bowman
Acting Director