

in

{{7-31-97 p.C-4360}}

[11,413] **In the Matter of Bank of the Federated States of Micronesia, Kolonia, Pohnpei, Federated States of Micronesia, Docket No. FDIC 97-019b (5-13-97)**

Respondent agrees to cease and desist from unsafe and unsound banking practices such as operating with inadequate management; operating with inadequate equity capital and reserves in relation to the volume and quality of assets held by the bank; operating with an inadequate allowance for loan and lease losses; following hazardous lending and lax collection practice; and operating in such a manner as to produce low earnings.

- [.1] **Management—Qualifications Specified**
- [.2] **Board of Directors—Increase Participation**
- [.3] **Capital—Tier 1—Increase/Maintain**
- [.4] **Loan and Lease Losses—Eliminate**
- [.5] **Loans—Review Program—Develop/Implement**
- [.6] **Loan and Lease Losses—Adequate Allowance—Establish/Maintain**
- [.7] **Management—Business Plan Required**
- [.8] **Shareholders—Cease and Desist Order—Disclosure**
- [.9] **Cease and Desist Order—Compliance Reports Required**

In the Matter of

**BANK OF THE FEDERATED STATES
OF MICRONESIA, KOLONIA, POHNPEI, FEDERATED STATES OF
MICRONESIA**

(Insured State Nonmember Bank)

ORDER TO

CEASE AND DESIST

FDIC-97-019b

Bank of the Federated States of Micronesia, Kolonia, Pohnpei, Federated States of Micronesia ("Bank"), having been advised of its right to a Notice of Charges and of Hearing detailing the unsafe or unsound banking practices and violation of laws and/or regulations alleged to have been committed by the Bank and of its right to a hearing on the alleged charges under Section 8(b)(1) of the Federal Deposit Insurance Act ("Act"), 12 U.S.C. § 1818(b)(1), and having waived those rights, entered into a STIPULATION AND CONSENT TO THE ISSUANCE OF AN ORDER TO CEASE AND DESIST ("CONSENT AGREEMENT") with counsel for the Federal Deposit Insurance Corporation ("FDIC"), dated March 20, 1997, whereby solely for the purpose of this proceeding and without admitting or denying the alleged charges of unsafe or unsound banking practices and violation of laws and/or regulations, the Bank consented to the issuance of an ORDER TO CEASE AND DESIST ("ORDER") by the FDIC.

The FDIC considered the matter and determined that it had reason to believe that the Bank had engaged in unsafe or unsound banking practices and had committed violation of laws and/or regulations. The FDIC, therefore, accepted the CONSENT AGREEMENT and issued the following:

ORDER TO CEASE AND DESIST

IT IS HEREBY ORDERED, that the Bank, its institution-affiliated parties, as that term is defined in Section 3(u) of the Act, 12 U.S.C. § 1813(u), and its successors and assigns cease and desist from the following unsafe and unsound banking practices and violation of laws and/or regulations:

- (a) operating with inadequate management;
- (b) operating with inadequate equity capital and reserves in relation to the volume and quality of assets held by the Bank;
- (c) operating with an inadequate allowance for loan and lease losses;
- (d) following hazardous lending and lax collection practices;
- (e) operating in such a manner as to produce low earnings; and

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- (f) operating in violation of Section 353.3(a)(1) of the FDIC Rules and Regulations, 12 C.F.R. § 353.3(a)(1), as more fully described on Page 8.9 of the FDIC's Report of Examination of the Bank

as of February 29, 1996.

IT IS FURTHER ORDERED, that the Bank, its institution-affiliated parties, and its successors and assigns, take affirmative action as follows:

[.1] The Bank shall have and retain qualified management.

(a) Each member of management shall have qualifications and experience commensurate with his or her duties and responsibilities at the Bank. Management shall include a chief executive officer with proven ability in managing a Bank of comparable size, and experience in upgrading a low quality loan portfolio, improving earnings, and other matters needing particular attention. Management shall also include a senior lending officer with significant appropriate lending, collection, and loan supervision experience and experience in upgrading a low quality loan portfolio. Each member of management shall be provided appropriate written authority from the Bank's Board of Directors to implement the provisions of this ORDER.

(b) The qualifications of management shall be assessed on its ability to:

- (i) comply with the requirements of this ORDER;
- (ii) operate the Bank in a safe and sound manner;
- (iii) comply with applicable laws and regulations; and
- (iv) restore all aspects of the Bank to a safe and sound condition, including asset quality, capital adequacy, earnings, and management effectiveness.

(c) During the life of this ORDER, the Bank shall notify the Regional Director of the FDIC's San Francisco Regional Office ("Regional Director") and the Banking Commissioner of the Federated States of Micronesia ("Commissioner") in writing when it proposes to add any individual to the Bank's board of directors or employ any individual as a senior executive officer. The notification must be received at least 30 days before such addition or employment is intended to become effective and should include a description of the background and experience of the individual or individuals to be added or employed.

(d) The Bank may not add any individual to its Board of Directors or employ any individual as a senior executive officer if the Regional Director issues a notice of disapproval pursuant to Section 32 of the Act, 12 U.S.C. § 1831i.

[.2] During the life of this ORDER, the Board of Directors shall increase its participation in the affairs of the Bank, assuming full responsibility for the approval of sound policies and objectives and for the supervision of all of the Bank's activities, consistent with the role and expertise commonly expected for directors of banks of comparable size. This participation shall include meetings to be held no less frequently than monthly (two of the three meetings held during a calendar quarter may be conducted telephonically), at which, at a minimum, the following areas are reviewed and approved: reports of income and expenses; new, overdue, renewal, insider, charged-off, and recovered loans, investment activity; operating policies; and individual committee actions. Board minutes shall document these reviews and approval, including the names of any dissenting directors.

[.3] 3. (a) During the life of this ORDER the Bank shall, at all times, maintain Tier 1 capital of not less than \$5,500,000 and shall have Tier 1 capital in such an amount as to equal or exceed ten (10.0) percent of the Bank's total assets.

The level of Tier 1 capital to be maintained during the life of this ORDER pursuant to Subparagraph 3(a) shall be in addition to a fully funded allowance for loan and lease losses, the adequacy of which shall be satisfactory to the Regional Director and the Commissioner as determined at subsequent examinations and/or visitations.

(c) Any increase in Tier 1 capital necessary to meet the requirements of Paragraph 3 of this ORDER may be accomplished by the following:

- (i) the sale of common stock; or
- (ii) the sale of noncumulative perpetual preferred stock; or
- (iii) the direct contribution of cash by the board of directors and/or shareholders of the Bank; or [{{7-31-97 p.C-4362}}](#)
- (iv) any other means acceptable to the Regional Director and the Commissioner; or
- (v) any combination of the above means.

Any increase in Tier 1 capital necessary to meet the requirements of Paragraph 3 of this ORDER may not be accomplished through a deduction from the Bank's allowance for loan and lease losses.

(d) If all or part of the increase in Tier 1 capital required by Paragraph 3 of this ORDER is accomplished

by the sale of new securities, the Board of Directors shall forthwith take all necessary steps to adopt and implement a plan for the sale of such additional securities, including the voting of any shares owned or proxies held or controlled by them in favor of the plan. Should the implementation of the plan involve a public distribution of the Bank's securities (including a distribution limited only to the Bank's existing shareholders), the Bank shall prepare offering materials fully describing the securities being offered, including an accurate description of the financial condition of the Bank and the circumstances giving rise to the offering, and any other material disclosures necessary to comply with any applicable securities laws. Prior to the implementation of the plan and, in any event, not less than fifteen (15) days prior to the dissemination of such materials, the plan and any materials used in the sale of the securities shall be submitted to the FDIC, Registration and Disclosure Section, 550-17th Street, N.W., Washington, D.C. 20429, for review. Any changes requested to be made in the plan or materials by the FDIC shall be made prior to their dissemination. If the increase in Tier 1 capital is provided by the sale of noncumulative perpetual preferred stock, then all terms and conditions of the issue, including but not limited to those terms and conditions relative to interest rate and convertibility factor, shall be presented to the Regional Director and the Commissioner for prior approval.

(e) In complying with the provisions of Paragraph 3 of this ORDER, the Bank shall provide to any subscriber and/or purchaser of the Bank's securities, a written notice of any planned or existing development or other changes which are materially different from the information reflected in any offering materials used in connection with the sale of Bank securities. The written notice required by this Paragraph shall be furnished within ten (10) days from the date such material development or change was planned or occurred, whichever is earlier, and shall be furnished to every subscriber and/or purchaser of the Bank's securities who received or was tendered the information contained in the Bank's original offering materials.

(f) For the purposes of this ORDER, the terms "Tier 1 capital" and "total assets" shall have the meanings ascribed to them in Part 325 of the FDIC Rules and Regulations, 12 C.F.R. § § 325.2 (t) and 325.2 (v).

[.4] 4. (a) Within 20 days from the effective date of this ORDER, the Bank shall eliminate from its books, by charge-off or collection, all assets classified "Loss" as of February 29, 1996, that have not been previously collected, charged-off, or re-written to the satisfaction of the Regional Director and the Commissioner as determined at subsequent examinations or visitations. Elimination of these assets through proceeds of other loans made by the Bank is not considered collection for the purpose of Paragraph 4.

(b) With respect to re-written loans as referenced in Subparagraph 4(a), above, the Regional Director and the Commissioner will generally find as acceptable re-written loans:

(i) that do not evidence any significant deterioration since the date that the loan was re-written; and

(ii) that, at the time that the loan was re-written, the principal and interest as originally scheduled has been brought current or is no more than 89 days delinquent as to either principal or interest and repayment of the loan is no longer tied to or dependent on payroll deductions. If the re-written loan is or subsequently becomes 90 days or more past due according to the original terms, the re-written loan should be categorized as Loss and charged-off.

(c) Within 10 days after eliminating from its books any asset in compliance with Paragraph 3 of this ORDER, the Bank shall file with the FDIC amended Consolidated Reports of Condition and Income which shall accurately reflect the financial condition of the Bank as of December 31, 1995. Thereafter, during the life of this ORDER, the Bank shall file with the FDIC Consolidated Reports of Condition and Income which accurately reflect the financial condition of the Bank as of the end of the period for which the Reports are filed, including any adjust- ~~{7-31-97 p.C-4363}~~ment in the Bank's books made necessary or appropriate as a consequence of any examination of the Bank by the Banking Commissioner of the Federated States of Micronesia or the FDIC during that reporting period.

[.5] 5. (a) Within 60 days from the effective date of this ORDER, the Bank shall revise, adopt, and implement written lending and collection policies to provide effective guidance and control over the Bank's lending function. Such policies and their implementation shall be in a form and manner acceptable to the Regional Director and the Commissioner as determined at subsequent examinations and/or visitations.

(b) The initial revisions to the Bank's loan policy and practices required by this Paragraph shall, at a minimum, address all deficiencies listed on Pages 8.2 and 8.3 of the FDIC's Report of Examination of the Bank as of February 29, 1996, and shall include the following:

(i) provisions, consistent with FDIC instructions for the preparation of Reports of Condition and Income, under which the accrual of interest income is discontinued and previously accrued interest is reversed on delinquent loans;

(ii) provisions which prohibit the capitalization of interest or loan related expense unless the Board of Directors supports in writing and records in the minutes of the corresponding Board of Directors meeting why an exception thereto is in the best interests of the Bank;

(iii) provisions which require complete loan documentation, realistic repayment terms and current credit information adequate to support the outstanding indebtedness of the borrower. Such documentation shall include current financial information, profit and loss statements or copies of tax returns and cash flow projections or, in the case of consumer credit, payroll stubs or other suitable documentation to validate income levels;

(iv) provisions which define limitations on the amount that can be loaned in relation to established collateral values;

(v) provisions which establish standards for unsecured credit and the use of payroll allotments;

(vi) provisions which require the preparation and maintenance of a loan "watch list" which shall include relevant information on all loans in excess of \$15,000 which are classified as "Substandard" or "Doubtful" as of February 29, 1996 or by the FDIC or the Commissioner in subsequent Reports of Examination and all other loans which warrant individual review and consideration by the Board of Directors as determined by the loan committee or active management. The loan "watch list" shall be presented to the Board of Directors for review at least monthly with such review noted in the minutes; and

(vii) the Board of Directors shall adopt procedures whereby officer compliance with the revised loan policy is monitored and responsibility for exceptions thereto assigned. The procedures adopted shall be reflected in minutes of a Board of Directors meeting at which a quorum is present and the vote of each director present is noted.

[.6] 6. Within 30 days from the effective date of this ORDER, the Bank shall establish and thereafter maintain an adequate allowance for loan and lease losses.

Additionally, within 60 days from the effective date of this ORDER, the board of directors shall develop or revise, adopt and implement a comprehensive policy for determining the adequacy of the allowance for loan and lease losses. For the purpose of this determination, the adequacy of the allowance shall be determined after the charge-off of all loans or other items classified "Loss." The policy shall provide for a review of the allowance at least once each calendar quarter. Said review should be completed at least ten (10) days prior to the end of each quarter, in order that the findings of the board of directors with respect to the loan and lease loss allowance may be properly reported in the quarterly Reports of Condition and Income. The review should focus on the results of the Bank's internal loan review, loan and lease loss experience, trends of delinquent and non-accrual loans, an estimate of potential loss exposure of significant credits, concentrations of credit, and present and prospective economic conditions. A deficiency in the allowance shall be remedied in the calendar quarter it is discovered, prior to submitting the Report of Condition, by a charge to current operating earnings. The minutes of the Board of Directors meeting at which such review is undertaken shall indicate the results of the review. Upon completion of the review, the Bank shall increase and maintain its allowance for loan and lease losses consistent with the allowance on loan and lease loss policy established. Such policy and its implementation shall be satisfactory to the Regional Director and the Commissioner as determined at subsequent examinations and/or visitations.

[.7] 7. Within 90 days from the effective date of this ORDER, and within the first 30 days of each calendar year thereafter, the Board of Directors of the Bank shall develop a written earnings plan consisting of goals and strategies for improving the earnings of the Bank for each calendar year. The written earnings plan shall include, at a minimum:

(i) identification of the major areas in, and means by which the Board of Directors will seek to improve the Bank's operating performance;

(ii) realistic and comprehensive budgets;

(iii) a budget review process to monitor the income and expenses of the bank to compare actual figures with budgetary projections on not less than a quarterly basis;

(iv) a description of the operating assumptions that form the basis for, and adequately support, major projected income and expense components; and

(v) shall consider and establish definitive levels and/or percentages with respect to each major asset category of loans, securities, cash, cash equivalents, fixed, and other assets which will insure a satisfactory level of bank liquidity.

Such written earnings plan and any subsequent modification thereto shall be submitted to the Regional Director and the Commissioner. The Board of Directors shall approve the written earnings plan, which approval shall be recorded in the minutes of the meeting of the Board of Directors of the Bank. Thereafter, the Bank shall follow the written earnings plan and/or any subsequent modification thereto.

8. Within 30 days from the effective date of this ORDER, the Bank shall eliminate and/or correct all violations of laws which are more fully set out on Page 8.9 of the FDIC's Report of Examination of the Bank as of February 29, 1996. Thereafter, during the life of this ORDER, the Bank shall take all necessary steps to ensure future compliance with all applicable laws and regulations.

9. During the life of this ORDER, the Bank shall not pay cash dividends without the prior written consent of the Regional Director and the Commissioner.

[.8] 10. Following the effective date of this ORDER, the Bank shall send to its shareholders or otherwise furnish a description of this ORDER in conjunction with the Bank's next shareholder communication and also in conjunction with its notice or proxy statement preceding the Bank's next shareholder meeting. The description shall fully describe the ORDER in all material respects. The description and any accompanying communication, statement, or notice shall be sent to the FDIC, Registration and Disclosure Section, 550-17th Street, N.W., Washington, D.C. 20429, at least fifteen (15) days prior to dissemination to shareholders. Any changes requested to be made by the FDIC shall be made prior to dissemination of the description, communication, notice, or statement.

[.9] 11. On the tenth day of the fourth month following the effective date of this ORDER, and on the tenth day of every third month thereafter, the Bank shall furnish written progress reports to the Regional Director and the Commissioner detailing the form and manner of any actions taken to secure compliance with this ORDER and the results thereof. Such reports may be discontinued when the corrections required by this ORDER have been accomplished and the Regional Director and the Commissioner has released the Bank in writing from making further reports.

This ORDER shall become effective ten (10) days from the date of its issuance.

The provisions of the ORDER shall remain effective and enforceable except to the extent that, and until such time as, any provisions of this ORDER shall have been modified, terminated, suspended, or set aside by the FDIC.

Pursuant to delegated authority.

Dated at San Francisco, California, this 13th day of May, 1997.