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[¶5061**] FDIC Docket No. FDIC-84-23b, FDIC-84-67k (2-19-86).**

FDIC issued a cease and desist order against a bank for extending credit without the normal complement of documentation, operating with inadequate loan loss reserves, engaging in hazardous lending and lax collection practices, operating with an inadequate level of capital, operating with inadequate liquidity, and violating laws and regulations. The FDIC also assessed civil money penalties against some of the bank's directors for receiving credit from the bank in excess of the legal lending limit even though the bank had not suffered any actual losses.

[.1] Examiners—Loan Classification—Review by ALJ
As the fact finder, the ALJ is entitled to review the factual predicates for loan classifications. Once it is shown that the facts support adverse classifications, the ALJ should defer to the training, experience, and expertise of the bank examiners.

[.2] Lending and Collection Policy and Procedures—Inadequate Documentation
Documentation of loans is important to safe and sound banking because it guarantees that a complete credit analysis will be performed prior to approval of the loan. Documentation also ensures that a bank's board of directors will have sufficient information to fulfill its fiduciary duties to supervise and monitor the lending activities of the bank.

[.3] Examiners—Bias
A highly discretionary governmental activity such as the conducting of a bank examination, will not be overturned due to bias of a government agent unless it is shown that the bias is directed specifically at the person who alleges the harm by the activity.

[.4] Examiners—Bias
Prior involvement in bank examinations, which increases an examiner's expertise, does not create a legal bias. The experience and the resulting increased awareness actually leads to more thorough examinations and sounder conclusions.

[.5] Assets—Unsafe or Unsound Practices
21.5% of a loan portfolio subject to adverse classification is an excessive and disproportionate quantity of low quality assets when the average for a comparable bank is only 10%.

[.6] Capital—Adequacy—Unsafe or Unsound Practices
A bank whose adversely classified assets are approximately two times that of unimpaired capital and reserves is engaged in an unsafe or unsound banking practice because its capital provision is inadequate.

[.7] Definitions—Covered Transaction
A covered transaction means "the acceptance of securities issued by the affiliate as collateral security for a loan or extension of credit to any person or company."

[.8] Federal Reserve Act §23A—Transactions with Affilliates—Affilliates Stock as Collateral
The use of stock of an affiliate to collateralize a loan clearly is one type of transaction limited by the Federal Reserve Act to prevent a bank from risking too large an amount in an affiliated enterprise and to assure that extensions of credit to affiliates will be repaid.

[.9] Federal Reserve Act §23A—Covered Persons—Control
A covered person is presumed to have control of a company if the person is an executive officer or director of the company and has power to vote more than 10% of any class of voting securities.

[.10] Regulation O—General Prohibitions—Approval by Board of Directors
All extensions of credit to executive officers, directors, principal shareholders, and their related interests must receive prior approval by a disinterested majority of the board of directors.

[.11] Cease and Desist Orders—FDIC Authority to Issue

When a bank has engaged in unsafe or unsound practices and has committed numerous violations of laws and regulations, the FDIC has broad discretion to exercise its expertise in fashioning an appropriate remedy to stop the practices and violations, to prevent future such abuses, and to correct the effects of the practices or violations.

[.12] Deposits—Brokered—Reports to FDIC
Requiring a bank to give written notice to the FDIC when its brokered deposits fund equals 5% or more of the bank's total deposits is a method of off-site monitoring of a bank designed to gain regulatory attention in the event the bank does turn extensively to brokered deposits, and is appropriate.

[.13] Cease and Desist Orders—Affirmative Remedies—Lending Authority Restricted
When a bank director had primary responsibility for 22 loans subject to adverse classification and when a board of directors failed to supervise the director's lending activities, the FDIC may remove the director's lending and investment authority and require the bank to retain a qualified chief loan officer who understands the importance of loan portfolio diversity and who will devote full time and attention to the responsibilities of that position.

[.14] Civil Money Penalties—Amount of Penalty—Statutory Standard
In determining the amount of a civil money penalty, the FDIC must consider the financial resources and good faith of the bank or person, the gravity of the violations, the history of previous violations, and such other matters as justice requires.

In the Matter of * * * BANK and * * *,
individually.
In the Matter of * * * individually and in
their capacities as executive officers,
directors or principal shareholders of * * *
BANK, (INSURED STATE
NONMEMBER BANK)

FDIC-84-23b
FDIC-84-67k
(Consolidated Action)
DECISION

I. INTRODUCTION

This proceeding is a consolidation of two separate actions brought by the Federal Deposit Insurance Corporation ("FDIC"), a cease and desist action against * * * Bank, * * * ("Bank"), and its principal shareholder and president, * * *, pursuant to section 8(b)(1) ("section 8(b)") of the Federal Deposit Insurance Act ("FDI Act"), 12 U.S.C. § 1818(b)(1), and a civil money penalty proceeding against the directors of the Bank (the Bank, the directors, and Mr. * * * are collectively referred to as "Respondents"), pursuant to section 18(j) of the FDI Act, 12 U.S.C. § 1828(j), for violations of section 22(h) ("section 22(h)") or "Reg. O"[1]) and section 23A ("section 23A") of the Federal Reserve Act, 12 U.S.C. §§ 375(b)(1) and 371c, and pursuant to section 106(b)(2) ("section 106") of the Bank Holding Company Act of 1956 as amended ("BHCA") (12 U.S.C. § 1972(2)). The FDIC alleged that the Respondents had engaged in certain unsafe or unsound banking practices and had violated the aforementioned statutes and regulation. The FDIC sought a cease and desist order designed to terminate and correct the adverse effects of the unsafe or unsound practices and violations of law. The FDIC also proposed that civil money penalties ranging from $1,000 to $100,000 be assessed against the Bank's directors.
The Board of Directors ("Board") has reviewed the record, the parties' briefs, and the Recommended Decision and Order of the Administrative Law Judge ("ALJ"). With certain exceptions that are discussed herein, *infra*, including his discussion and conclusions with regard to the propriety of

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[1] Reg. O, 12 C.F.R. Part 215, implements section 22(h) of the Federal Reserve Act.

a limitation on Mr. * * * lending authority and the appropriate amount of civil money penalties to be assessed, the Board agrees with the ALJ's Recommended Decision and proposed Order. The record contains substantial evidence supporting the ALJ's findings and conclusions that the Respondents have engaged in unsafe or unsound banking practices, relating principally to the extension of an excessive

volume of poor quality loans, and have violated sections 23A and 22(h) of the Federal Reserve Act and section 106 of the BHCA. The Board, therefore, finds that an appropriate cease and desist order requiring the Respondents to discontinue the unsafe or unsound practices and the violations of laws and regulation, and to correct the adverse effects of such practices and violations should be adopted. The Board also agrees with the ALJ that imposition of civil money penalties is warranted in this case. There is substantial evidence in the record to support numerous violations of laws and regulation in this instance. However, the Board disagrees with the ALJ as to the amounts to be assessed and, finds that the civil money penalty assessments should be as follows:

* * *	$50,000
* * *	$1,000
* * *	$1,000
* * *	$1,000
* * *	$1,000
* * *	$1,000

Finally, the Board declines to exercise its discretion under section 308.17 of the FDIC's Rules and Regulations and denies Respondents' request for oral argument.

II. STATEMENT OF THE CASE

On August 22, 1983, the FDIC commenced an examination of * * *.[2] The August 22, 1983 examination found that the Bank's condition had seriously deteriorated since the prior FDIC examination. Adversely classified assets totaled $7.6 million, of which $6.9 million consisted of loans. Approximately $6.7 million of the loans were adversely classified as "Substandard" and $200,000 as "Loss". This was a dramatic increase from the 1981 examination.[3] The ratio of adversely classified loans to total loans increased from 3.59 percent in 1981 to 28.72 percent in 1983 and the Bank's delinquency ratio[4] had increased from 3.2 percent to 9.7 percent. The $6.9 million in loans were adversely classified in large part because: (1) the loans had been extended (or renewed) without the normal complement of documentation, such as the borrowers' financial statements or structured repayment plans, and (2) the loans were primarily made either to the Bank's majority shareholder, * * *, Sr., and his family and business interests (* * * line") or to Mr. * * * business associate, * * *, and his family and business interests (* * * line"). In addition to the large volume of loans subject to adverse classifications, the Report of Examination expressed concern over the Bank's capital position and about the inadequacy of the Bank's loan valuation reserve ("loan loss reserve") in relation to the quantity of its poor quality assets, the lack of substantive, detailed lending, collection or investment policies, poor liquidity management and inadequate supervision by the board of directors over the affairs of the Bank. The Bank was also cited for various violations of law, including loans in excess of the lending limits prescribed by section 23A of the Federal Reserve Act and Reg. O. As a result, the Bank was assigned a composite CAMEL rating of "four". On February 8, 1984, the FDIC issued a Notice of Charges and of Hearing ("First Notice") to * * * pursuant to section 8(b)(1) of the FDI Act, 12 U.S.C. § 1818(b)(1). Mr. * * *, in addition to being the principal shareholder of the Bank,[5] is the President and a member of the Bank's board of directors. As President, he functions as the chief lending officer and is primarily responsible for many of

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[2] The FDIC had not conducted an examination of the Bank since April of 1981. The State of * * *, however, had examined the Bank on December 4, 1981, October 27, 1982, and March 18, 1984.

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[3] The 1981 examination had classified only $900,000 of the Bank's assets adversely, of which $700,000 had been loans. The breakdown of the adverse loan classification was:

Substandard	$500,000
Doubtful	100,000
Loss	100,000
Total	$700,000.

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[4] The delinquency ratio is the measure of overdue loans to total loans.

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[5] Mr. * * * owned 52.28% of all outstanding common stock in the Bank. (Tr. Vol. II, Exh. 10).

{{4-1-90 p.A-708}}the adversely classified loans. (Tr. Vol. I, Att. C)

The First Notice charged that the Bank had engaged in certain unsafe or unsound banking practices[6] and had violated various applicable laws and regulations.[7] A proposed cease and desist order was issued along with the First Notice. The proposed order required the Bank to terminate the unsafe or unsound banking practices, to correct the violations of law and to take affirmative action to rectify the conditions resulting from the practices or violations, including removal of Mr. * * * lending authority and providing management acceptable to the FDIC. The Bank and Mr. * * * contested the FDIC's allegations and a hearing before an administrative law judge was scheduled in the matter.

On April 11, 1984, prior to commencement of the hearing on the First Notice, the FDIC issued, pursuant to section 18(j)(3) of the FDI Act, 12 U.S.C. § 1828(j)(3), and section 106(b)(2) of the BHCA, 12 U.S.C. § 1972(2), a Notice of Assessment of Civil Money Penalties ("Notice of Assessment") against the directors of * * * and the directors of the Bank of * * *, another State nonmember bank in which Mr. * * * is both a director and a principal shareholder. By an order dated June 18, 1984, the ALJ severed the action on civil money penalties against the directors of Bank of * * * from that concerning the directors of * * * and consolidated the latter with the pending section 8(b) action against * * *.

On December 10–19, 1984 and January 24, 1985, a hearing on the consolidated actions was held in * * *. The FDIC and Respondents filed initial briefs containing proposed findings of fact, conclusions of law and proposed orders on May 3, 1985 and on May 6, 1985, respectively, and reply briefs on May 22, 1985. The ALJ issued his Recommended Decision and Order on October 8, 1985. Each party filed Exceptions to the ALJ's Recommended Decision and Order on November 22, 1985. In addition, counsel for Respondents requested oral argument pursuant to section 308.17 of the FDIC's Rules and Regulations, 12 C.F.R. § 308.17.

III. THE ALJ'S RECOMMENDED DECISION

Although the ALJ rejected some of the adverse loan classifications assigned by the FDIC, he concluded that the Bank had engaged in the following unsafe or unsound banking practices: hazardous lending and lax collection practices, disproportionate quantity of poor quality loans, inadequate capital and reserves, inadequate supervision of lending activities by the Bank's board of directors, and inadequate liquidity. He determined, however, that the Bank's loan loss reserve was adequate, finding that the FDIC's evidence on the issue was not persuasive. Although he did not uphold the FDIC on all alleged violations of law, he did find that the Bank had extended credit in violation of the lending limits of section 23A and Reg. O and the safety and soundness requirements of section 106.

As a result of his findings, the ALJ recommended that a cease and desist order be imposed upon * * *. He adopted most of the FDIC's proposed order, including the provisions that the Bank reduce loans classified "Substandard" to $2.0 million within 18 months, maintain a capital ratio of 7.5 percent, establish an independent audit committee composed of outside directors, provide prior board approval on all loans exceeding $50,000 and inform the FDIC of brokered deposit activity when such deposits exceed five percent of total deposits. He rejected the FDIC's request that all lending authority be removed from Mr. * * * on the ground that such a provision is tantamount to a removal under section 8(e) of the FDI Act, 12 U.S.C. § 1818(e). He reasoned that section 8(e) is the exclusive means by which the FDIC can seek to limit conduct of a bank officer and that the FDIC had not offered sufficient proof to justify

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[6] The First Notice alleged that the Respondent had engaged in seven unsafe or unsound banking practices: (1) hazardous lending and lax collection practices (including extending credit without first obtaining current financial information on the borrowers, adequate security, repayment plans or documenting the purpose of the loan); (2) disproportionately large volume of poor quality loans; (3) inadequate loan loss reserve; (4) inadequate levels of capital; (5) inadequate supervision by the Bank's board of directors over Mr. * * *'s lending activities; (6) inadequate liquidity; and (7) inadequate internal routines and controls. The FDIC offered little proof on the last allegation of inadequate internal routines and controls and did not propose any findings of fact or conclusions of law on this point in its post-hearing brief.

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[7] The Bank was charged with having violated the lending limits and collateral restrictions of section 23A and the lending limits contained in section 215.4(c) of Reg. O. Sections 22(h) and 23A of the Federal Reserve Act are made applicable to State nonmember banks by section 18(j)(1) of the FDI Act, 12 U.S.C. § 1828(j)(i).

{{4-1-90 p.A-709}}removal of Mr. * * * under section 8(e).[8] The ALJ also stated that the other provisions in his recommended order—reduction of adversely classified loans, maintenance of a 7.5 percent capital

ratio, the requirement for outside directors, review and revision of current loan, investment and liquidity policies—would provide adequate protection against abusive lending practices and negate the necessity of limiting Mr. * * *'s lending authority.

Because the record showed a pattern of violations of law and neglect of their fiduciary duties by the Bank's directors, the ALJ agreed with the FDIC that some penalty should be imposed but differed with the FDIC over the appropriate amounts of such penalties. The ALJ reduced FDIC's requested penalties by two-thirds on the grounds that the multiple violations of law arose from the same loans, were not the result of deliberate overreaching and had not caused the Bank to suffer any actual losses.

IV. THE PARTIES' EXCEPTIONS

The FDIC excepted to the ALJ's refusal to find several of the Bank's extensions of credit to be violative of section 23A, Reg. O and section 106. The FDIC also strongly objected to the recommendation that Mr. * * *'s lending authority not be restricted and to the two-thirds reductions in civil money penalties. The Respondents argued that the ALJ erred in failing to scrutinize more closely the August 1983 Report of Examination. They argued that the State of * * * March 1984 Report of Examination, in which a substantially lower volume of loans was subject to adverse classification, more accurately pictured the condition of the Bank and that, therefore, the Bank had not engaged in unsafe or unsound banking practices. They excepted to most of the ALJ's conclusions regarding section 23A violations on the ground that the FDIC had not proven that an alleged affiliate of the Bank was, in fact, an affiliate within the meaning of the statute. They objected to the brokered deposit provision, the provision requiring prior board approval for loans exceeding $50,000 and the requirement of outside directors. They also objected to the assessment of civil money penalties on the grounds that many of the alleged violations of law were not, in fact, violations and that those which did occur were inadvertent. The Respondents have also requested, pursuant to section 308.17 of the FDIC's Rules and Regulations, 12 C.F.R. § 308.17, that the FDIC's Board of Directors hear oral argument on the case prior to rendering a final decision in this matter.[9]

V. OPINION

The divergent views of each party on the facts at issue in this action and the conclusions to be drawn therefrom led to extended hearings and a lengthy Recommended Decision and Order by the ALJ. For ease of analysis, we have divided this section into four parts. In Part A, *infra*, we discuss and analyze the ALJ's findings concerning the allegations of unsafe or unsound banking practices by * * *, the parties' exceptions and our conclusions with regard to these issues. In Part B, *infra*, we discuss and analyze the alleged violations of law. Part C, *infra*, discusses the ALJ's Recommended Order to Cease and Desist. Finally, in Part D, *infra*, we discuss and analyze the ALJ's Order to Pay Civil Money Penalties and our conclusions with respect thereto.

A. *Unsafe and Unsound Banking Practices*

1. *The Parties' Positions*

The FDIC's allegations that the Bank had engaged in six categories of unsafe or unsound banking practices were hotly contested by the Respondents in this proceeding. The bases for these allegations are thirty-three extensions or renewals of credit, totaling over $5.9 million, which had been made without at least one type of documentation considered essential to prudent banking:

(1) Loan files on thirty of thirty-three loans did not contain current or suffi-

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[8] In January 1985, a section 8(e) removal action against Mr. * * * was brought by the FDIC. That action is now in the post-hearing briefing stage.

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[9] Under section 308.17 of the Rules and Regulations, oral argument is purely discretionary. The Board has refused to exercise that discretion unless a party presents substantial reasons why argument is necessary and the Board concludes that argument will be a substantial aid in reaching its decisions. Here, Respondents have presented no basis for their request other than the conclusory statement that "fairness and justice" require that they be granted oral argument. In view of the lack of good cause set forth by Respondents and the extensive record in the proceeding, including lengthy briefs by both parties, the ALJ's thorough Recommended Decision, and the parties' Exceptions, the Board sees no need for oral argument.

ciently detailed financial information about the borrowers (PFF[10] 10–40);

(2) Eighteen of the thirty-three loans were not collateralized with adequate security when made (PFF 42–60);

(3) Twenty-five of the thirty-three loans lacked an adequate repayment program, including determinations as to the source of repayment (PFF 62–87); and

(4) Eighteen of the thirty-three loans were made with either no or erroneous documentation as to their purposes (PFF 89–109).

The FDIC also alleges that proceeds from some of the thirty-three loans were disbursed to persons or companies other than the named obligors, evidencing undocumented flow of funds among persons or companies associated with either Mr. * * * or Mr. * * *. The FDIC urges that failure to establish and maintain adequately documented loan files and the free flow of loan proceeds within the * * * and * * * "concentrations of credit" justified the assignment of adverse classifications to the thirty-three loans[11] in the August 1983 Report of Examination.

The thirty-three adversely classified loans, in turn, serve as the factual bases for the allegations of hazardous lending and lax collection practices, a disproportionate quantity of poor quality (i.e., adversely classified) loans in relation to total loans (28.7%), inadequate unimpaired capital (271%), inadequate loan loss reserves (1.5% of total loans after charge-off of assets classified "Loss") and negligent supervision by * * * board of directors which resulted in the allegedly poor condition of the Bank.[12]

At the hearing, the Respondents did not present any evidence that the loan files, in fact, had proper documentation. Instead, they argued that it is not unusual to find loan files lacking documentation and that the lending officers at the Bank, particularly Mr. * * *, had extensive knowledge about the character of the borrowers, their credit history, and the profitability of their businesses on the thirty-three contested extensions of credit. As such, the Respondents contended that the lack of documentation is not evidence that the loans had been made without sufficient information about the borrowers and that, in fact, the knowledge possessed by the lending officers more than compensates for the incomplete loan files.

The Respondents argued, therefore, that the extensive FDIC loan classifications are in error, relying heavily on the FDIC examination of the Bank in April 1981, and the state examination in March 1984. Respondents pointed out that ten loans, identified as part of the * * * line and adversely classified in the August 1983 Report of Examination, were on the Bank's books at the time of the April 1981 FDIC examination, but were not adversely classified.[13] The State examination was conducted nine months after the FDIC August 1983 examination, during which time there was no substantial change in the loans which were subject to adverse classification by the FDIC. (Tr. Vol. V-A, 34). The State, however, adversely classified only $1.9 million, or 8.7 percent, of the Bank's loans, excluding loans belonging in the * * * and * * * lines. The Respondents argued that, in view of the inconsistent treatment, the lack of documentation alone is not a sufficient basis for adversely classifying the * * * and * * * loan lines and that the FDIC failed to articulate any other reasons for adversely classifying the loans.

The Respondents also asserted that, to the extent that the FDIC's classifications were based on "concentration of credit" in the * * * and * * * lines, a determination of the existence of a concentration of credit is a matter of subjective judgment and not *per se* an unsafe or unsound banking practice. They further argue that the volume of loans assigned adverse classifications resulted from the particular bias and prejudice of the FDIC Examiner-in-Charge ("EIC") of the August 1983 examination. Prior to the commencement of the August 1983 examination, the EIC had spent eight months as part of the FDIC team assigned to investigate the collapse of the Penn

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[10] For purposes of this discussion, the ALJ's Recommended Decision will be cited as "R.D.", the ALJ's proposed cease and desist order as "R.O.", the FDIC's Proposed Findings of Fact as "PFF", the FDIC's Exceptions to the Recommended Decision as "FDIC Exc.", the Respondents' Exceptions to the Recommended Decision as "Resp. Exc.", the record or transcript of hearings as "Tr.", and evidentiary exhibits as "Exh.".

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[11] The FDIC offered no evidence at hearing beyond the August 1983 Report of Examination supporting the adverse classification of $900,000 in other loans and $700,000 in other assets.

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[12] The FDIC also alleged that the Bank's liquidity position was inadequate in that short term liabilities far exceeded the Bank's ability to service this debt out of maturing short term assets.

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[13] There was also a similar difference in the treatment of loans included in the * * * line.

{{4-1-90 p.A-711}}Square Bank, National Association, Oklahoma City, Oklahoma ("Pen Square"). One of the predicates to that bank's demise was the existence of large concentrations of credit to the energy industry, which, at the time, was experiencing severe economic difficulties. The Respondents suggest this experience led the EIC to conclude that concentrations of credit, *per se*, threaten banks' viability and, therefore, constitute an unsafe or unsound banking practice. In other words, they argued that the EIC's experience with the Penn Square investigation so colored her perspective that she was unable to distinguish a situation where concentration of credit was not an unsafe or unsound practice from one which posed real threat of harm to a bank.

2. *The ALJ's Decision*

a. *Findings of Fact*

The FDIC's evidence concerning lack of loan documentation, except in a few instances, was uncontested. The ALJ, therefore, adopted the FDIC's PFF 10–40, 42–46, 48–57, 59–60, 62–87 and 89–109. (R.D. App. A, Table II). He rejected PFF 47 (inadequate collateral documentation for a $50,000 loan to * * * and PFF 58 (inadequate collateral documentation for a $370,000 loan to * * *)[14] because he felt the security for these loans was sufficient. (R.D. 32; App. A, Table II; App. B., n.8.). From these findings of fact, the ALJ concluded that incomplete loan documentation justifies an assignment of adverse classifications. He, therefore, held that twenty-six of the thirty-three loans, totaling $5.0 million, should be subject to adverse classification because they were extended without two or more essential categories of documentation. (R.D. 31-2; App. A, Table I) The ALJ did accept the Respondents' argument that an occasional lapse in prudent banking procedures does not support an adverse classification and on that basis rejected classification of the remaining seven loans, totaling $1.0 million, which were shown to lack only a single category of documentation—adequate financial information about the borrowers or specific repayment plans. *Id*. He also rejected a finding of adverse classification on $900,000 of other loans because the FDIC had offered no proof supporting this action beyond the August 1983 Report of Examination. (R.D. 33; App. B, n.2.)

The ALJ did not address in detail the Respondent's allegations concerning bias and prejudice of the FDIC examiners or the weight to be accorded the State's examination of March 1984.[15] He merely stated that the State's determination that only $1.9 million, rather than $5.0 million, of loans should be subject to adverse classifications "fail**[**ed**]** to overcome the conclusion that the overwhelming preponderance of loan classification contained in the report of the August 1983 FDIC examination were accurate." (R.D. 6) He did not, however, provide any citations to the record to support this conclusion. While the ALJ disagreed with certain adverse classifications, he felt this, by itself, did not discredit either the EIC of the August 1983 examination or the Report of Examination. A showing that one examiner is more critical than another "is no justification for escaping the conclusions of that more critical examiner and is no invitation to ignore the results of duly performed bank examination." (R.D. 7)

The Board has reviewed the findings cataloged by the ALJ in Table II and the corresponding citations contained in the FDIC's proposed findings and agrees with the ALJ that the record contains substantial evidence concerning the lack of proper documentation for the thirty-three loans at issue. The Board, therefore, adopts and incorporates herein by reference the findings presented in the ALJ's Table II.[16] and the citations to the record contained in the FDIC's

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[14] In Appendix A, Table II, the ALJ mistakenly notes that PFF 58 is in reference to a loan to * * * Company. Since PFF 58 is discussed in footnote 8 as concerning * * * , it would appear the reference to * * * Company in Table II is an inadvertent error.

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[15] The ALJ does not appear to have given any weight to the FDIC examination of April 1981. We feel this treatment is correct since the EIC of the prior examination did not testify. Moreover, as evidenced by the August 1983 Report of Examination, there had been a material change in the condition of the Bank over the two year period.

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[16] The Board also agrees with the ALJ's rejection of PFF 47 and 58. The $50,000 loan to * * * , contrary to the FDIC's assertion that it was unsecured, was collateralized by Mr. * * * personal cross-pledge (Tr. Vol. II, Exh. 10) and that the $370,000 loan to * * * was fully guaranteed by individuals with a reported net worth of $4.7 million (Tr. Vol. V-A, 63) Even if the net worth of the guarantors is overstated and the guarantors are obligated on other loans, the evidence does not persuade us to ignore the guaranty in evaluating the value of the loan's collateral. (Tr. Vol. V-A, 69–70).

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{{4-1-90 p.A-712}}proposed findings upon which Table II is based.

[.1**]** Upon finding that the thirty-three loans lacked proper documentation, the ALJ examined the validity of assigning adverse loan classification. (R.D. App. A, Table I)[18] As the fact finder, the ALJ is properly entitled to review the factual predicates for the loan classifications. In this case, determination of the existence or nonexistence of loan documentation does not require expertise in either banking or bank examination practices. It is the view of this Board, however, that the decision to classify a loan is one which requires the specialized training, experience and expertise possessed by a bank examiner. Once it is shown that the facts support adverse classifications, the ALJ should defer to the training, experience and expertise of the examiners and the exercise of their judgment regarding the classification of individual loans. Therefore, we find that classifications assigned by the FDIC examiners are to be accorded deference unless it is shown they are without factual basis or are unreasonable in light of the factual basis.

The ALJ found, and we concur, that the thirty-three loans in question had been extended without the normal complement of documentation. In other words, sufficient facts were proven to support the assignment of adverse classifications to these loans. Since the FDIC examiner's conclusions concerning the loan classifications are supported by verifiable facts, they should be overruled only if they are shown to be unreasonable in light of those facts.

[.2**]** The Respondents present two arguments in support of their contention that the examiners' actions were unreasonable. The Board finds that neither argument is persuasive or sufficient to overturn the loan classifications of the August 1983 Report of Examination. First, the Respondents argue that incomplete loan file documentation is not unusual and bank examiners should rely upon unrecorded information known to the Bank's loan officers. From this argument, Respondents would have this Board conclude that the August 1983 loan classifications were unreasonable because the examiners failed to take into account this off-the-record knowledge. While there is some evidence in the record to support the Respondents' argument when incomplete loan files are isolated occurrences, the evidence also strongly supports the conclusion that "a pattern of credit extensions attended by few, if any, of the routine and normally expected safeguards" existed at the Bank. (R.D. 31) It would appear, therefore, that the failure to document loans was a pervasive practice at * * *. Documentation of loans is important to safe and sound banking because it guarantees that a complete credit analyses will be performed prior to approval of the loan. (Tr. Vol III, 69–73) If specific information is relied upon by loan officers in evaluating loans, prudent banking practice requires that the information be recorded in the loan file. (Tr. Vol. III, 71) Such a procedure will also ensure that banks' boards of directors will have sufficient information to fulfill their fiduciary duties to supervise and monitor the lending activities of the bank. Finally, written documentation is of critical importance for examination of the quality of a loan. (Tr. Vol. III, 67-8) Undocumented information possessed by a lending officer is a factor that may be considered before classifying a loan. (Tr. Vol. III, 88-9) On the other hand, the Board concludes that the existence of unrecorded information will not mitigate the threat posed to a bank by the lack of accepted and conventional banking practices where, as here, the absence of documentation is so pervasive. (Tr. Vol. V-A, 80).

[.3,.4**]** The Respondents' second argument is that the EIC's prior experience with the Penn Square investigation so prejudiced her view concerning concentration of credit that she was unable to perform an objective examination of * * *. Even assuming *arguendo* that the EIC was improperly influenced by the Penn Square experience, the lack of loan file documentation still provides a sufficient objective, factual basis for the adverse loan classifications. Moreover, we find that the record supports the ALJ's conclusion that the examination should not be discounted on the ground of prejudice or bias because the Respondents did not provide any evidence that the alleged bias was directed specifically at * * * , Mr. * * * or any of its other shareholders, directors or officers. The courts have held, and this Board agrees, that a highly discretionary governmental activity, *e.g.*, the conduct of

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[17] Attached to this decision, as Appendix A, are the FDIC's proposed findings of facts and conclusions of law and, as Appendix B, Table II from the ALJ's Recommended Decision.

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[18] Attached to this decision, as Appendix C, is Table I.

{{4-1-90 p.A-713}}an FDIC bank examination, will not be overturned due to bias of the government agent unless it is shown that the bias is directed specifically at the person who alleges the harm by the activity. *United Steel workers of American AFL-CIO-CLC, etc. v. Marshall*, 647 F.2d 1189 (D.C.Cir. 1980), *cert. denied sub nom. Lead Industries Ass'n, Inc., etc. v. Donovan*, 453 U.S. 913 (1981); *Roberts v. Morton*, 549 F.2d 158 (10th Cir. 1976), *cert. denied sub nom. Roberts v. Andrus*, 434 U.S. 834 (1977). Moreover,

as the EIC testified, her Penn Square experience sharpened her skills and made her more aware of the problems which could arise when a bank fails to diversify its loan portfolio. (Tr. Vol. V-A, 17-8). Prior involvement in examinations which increase an examiner's expertise does not create a legal bias. To the contrary, this experience and the resulting increased awareness actually leads to more thorough examinations and sounder conclusions. *United Steel workers*, 647 F.2d at 1209. Consequently, the Board rejects Respondents' arguments and finds that there is no evidence of any improper bias or prejudice on the part of any examiner.

The Board must also reject the ALJ's refusal to uphold the adverse classification of those loans whose credit files lacked only one type of documentation or for which the FDIC offered no proof in support of the classification beyond the August 1983 Report of Examination. The ALJ excluded the first group of loans from adverse classification on the ground that lack of one type of documentation represented an "isolated lapse" of prudent banking practices. The Board finds that the ALJ erred in this conclusion because there is no evidence in the record which indicates that the failure to provide complete loan documentation for these extensions was the result of anything other than the "casual and indifferent regard towards accepted and conventional banking practices." (R.D. 32) In fact, EIC testified that her critical approach to examining * * * lending practices was the result of the pervasiveness of the failure to document its extensions of credit. (Tr. Vol. V-A, 80)[19]

As to the second group of loans excluded from classification by the ALJ, the Board finds the ALJ erred in rejecting the loan classifications on the ground that the August 1983 Report of Examination is not sufficient proof. The Board finds that the facts set forth in the Report of Examination were sufficient to establish a *prima facie* basis for the adverse classifications. Absent evidence offered by the Respondents to challenge the factual basis of these classifications the ALJ should not have overturned the examiners' conclusions.

b. *Conclusions of Law*

Upon finding that loans totaling $5.0 million, out of $24.3 million in total loans, had been extended without proper documentation and were subject to adverse classifications, the ALJ concluded that the Bank's lending and collection practices were unsafe or unsound banking practices. (R.D. 31-2) Although the Recommended Decision does not identify specific facts from the record supporting this conclusion of law, it appears that the ALJ implicitly accepted the FDIC's PFF 7–9, 41, 61 and 88 as the underlying factual basis for this holding.[20]

[.5,.6**]** The ALJ also held that, with 21.5 percent ($5.0 million out of $24.3 million) of a loan portfolio subject to adverse classification, the Bank had maintained an excessive and disproportionate quantity of low quality assets because the average for a comparable bank was only ten percent. (R.D. 33-4) As he did with his conclusion concerning the bank's lending practices, the ALJ failed to provide any citations to the record in support of his conclusion on this issue, but appears implicitly to have adopted PFF 109. (R.D. 27) He also held that the Bank's capital provision was inadequate,

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[19] In addition, the Board notes that uncontroverted evidence in the record establishes that there are other facts which justify adversely classifying each of these loans. (Tr. Vol. II, Exh. 10, at pp. 30–45).

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[20] PFF 7–9, in general, state that a bank cannot evaluate the credit worthiness of prospective borrowers without accurate and detailed financial information and that prudent banking practice requires complete documentation on borrowers for all loans. (R.D. 9 —citing parts of the record cited by FDIC to support PFF 7–9) PFF 41 states that unsecured or undersecured lending is an unsafe or unsound practice when a bank lacks adequate financial information to perform a proper credit evaluation. (R.D. 15—citing parts of the record cited by FDIC to support PFF 41) PFF 61 states that normal lending practices include determination of the source of repayment and the establishment and enforcement of repayment plans. (R.D. 19—citing parts of the record cited by FDIC to support PFF 61). Lastly, PFF 88 states the risk of extending credit cannot be evaluated unless a bank can determine the purposes of the loans. (R.D. 23—citing parts of the record cited by FDIC to support PFF 88)

{{4-1-90 p.A-714}}and, therefore, an unsafe or unsound banking practice because adversely classified assets were approximately two times that of unimpaired capital and reserves. (R.D. 29; 35-6; PFF 112) The ALJ also concluded that the Bank's viability was threatened by its liquidity practices in that the Bank did not have sufficient short term assets to service short term liabilities, thereby creating the possibility of premature asset liquidation at a loss or borrowing at increased rates. (R.D. 28, 35; PFF 111) Finally, the ALJ held that "the web of * * * related borrowings required exercise of caution and control by a prudent board of directors" (R.D. 36) and that the board of directors had failed in their duty to supervise the

activities of the Bank, especially the lending practices of Mr. * * *, and that this negligence resulted in the pattern of unsafe and unsound banking practices which he found to exist at the Bank. (R.D. 30, 36; PFF 113)

The ALJ determined that, contrary to the FDIC's allegation, the bank's loan loss reserve ($308,000 or 1.5% of total loans) was adequate and, therefore, did not represent an unsafe or unsound practice. (R.D. 34) He noted that the EIC of the August 1983 examination of * * * had testified a reserve of ten to thirty percent of adversely classified loans ($690,000 to $2,070,000) was necessary, despite a previous recommendation that one percent of total loans ($247,000) would be sufficient. (Tr. Vol. IV, Exh. R) An expert witness for the Respondents concurred with the EIC's earlier recommendation of one percent of total loans. (R.D. 34 with summary of citations to record) The ALJ did not feel either witness was overly persuasive and concluded that, since the reserve was in excess of one percent of total loans, it was not maintained at an unsafe or unsound level.

The ALJ, therefore, found that the Bank had engaged in five of the six unsafe or unsound practices with which the Respondents had been charged, despite rejecting $1.9 million of the FDIC's adverse loan classifications. A review of the record supports the ALJ's conclusions concerning these issues. The Board's conclusion that the $6.9 million in adverse loan classifications in the August 1983 Report of Examination should be upheld provides even further evidence upon which to base a conclusion that the Bank has engaged in unsafe and unsound banking practices. Consequently, the Board agrees with the ALJ and adopts and incorporates herein by reference his conclusions of law as set forth above. The ALJ concluded that the Bank's loan valuation reserve of 1.5 percent of total loans did not represent an unsafe or unsound banking practice because it was in line with its peer group average and was greater than what the Respondents' expert witness testified would "normally" satisfy regulators. (R.D. 34 with appropriate citations to record) The Board finds that the record does not support the conclusion reached by the ALJ in that regard and that the ALJ, therefore, erred.

A comparison to a peer group average is not particularly relevant in a case such as this where a determination has been made that the Bank had a disproportionate quantity of poor quality loans. Moreover, the Bank did not take a particularly prudent approach to valuing the reserve for possible loan losses, as evidenced by the fact that the Bank experienced only nominal recovery on loans previously charged-off. (Tr. Vol. V-B, 148; Vol. II, Exh. 10, p. 10; Vol. IV, Exh. E). Lastly, the EIC of the March 1984 state examination felt a loan valuation reserve of 1.25 to 1.5 percent of total loans would be adequate given the level of loans that had been classified by the State. (Tr. Vol. XI, 26). The State had classified only $1.9 million loans, an amount far below that which the ALJ upheld and which this Board has determined is substantiated by the record.

While the vast majority of the adverse classifications were in the "Substandard" category and there is no definitive policy for determining an adequate loan loss reserve for "Substandard" assets (Tr. Vol. IV, 157-9), principles of prudent banking demand that the loan loss reserve take into account all adversely classified loans, including those designated as "Substandard". This is especially important in a case such as this where the unimpaired capital and reserves are woefully inadequate and where the Bank has a history of inability to recover charged-off loans. While the Board cannot fix or identify a definite amount for the loan loss reserve, it can and does find that, in view of the Bank's impaired financial condition, a reserve amounting to only 1.5 percent of the Bank's total loans is not

adequate and represents an unsafe or unsound banking practice.[21]

B. *Violations of Law*

1. *The Violations Alleged*

a. *Section 23A of the Federal Reserve Act*

The FDIC alleged that thirty-six loans by the Bank violated various statutes and regulations. Twenty-eight loans were charged with being violations of section 23A(a)(1) of the Federal Reserve Act, which restricts the extent to which banks can engage in "covered transactions" with an affiliate. The FDIC argued that these loans involve a "covered transaction"[22] in that they were secured by stock of * * *, an affiliate of the Bank and that the aggregate value of the loans exceed the lending limits of section 23A. The Respondents countered with two alternative arguments: (1) that * * * was not an "affiliate" of the Bank as that term is defined by the statute, and (2), alternatively, that even if * * * was an affiliate for purposes of section 23A, the loans in question were not "extensions of credit" within the meaning of statute because they were renewals of loans originating prior to the effective date of the applicable provision.

b. *Section 106 of the BHCA*

Eight loans made to persons associated with the Bank's correspondent bank, * * * Bank * * *, or to business interests of those persons, were alleged to be in violation of section 106(b) of the BHCA. This statutory provision prohibits loans to executive officers or directors of * * * or the directors' interests unless they are on substantially the same terms as those prevailing at the time for comparable transactions and do not involve more than the normal risk of repayment or present other unfavorable features. The Respondents argued that five of the loans were made to persons or companies which do not fall within the meaning of "executive officers" or "related interests" of executive officers as defined in section 106(b) and that the remaining three are on the same terms as comparable transactions and do not present any unusual risk of nonrepayment.

c. *Reg. O*

The FDIC contended that the eight loans which allegedly violated section 106(b) also violated the lending limits of section 215.4(a) of Reg. O, 12 C.F.R. § 215.4(a). which prohibits loans to the Bank's executive officers, directors, principal shareholders or their related interests unless they are on substantially the same terms as those prevailing at the time for comparable transactions, do not involve more than the normal risk of repayment, or present other unfavorable features. Under Reg. O, a loan to a third party is treated as a loan to a covered person if the proceeds are used for the tangible benefit of, or are transferred to, a covered person. The FDIC alleged that the loans to persons associated with * * * were, in effect, made to Mr. * * * because, during the period of time the eight loans were outstanding, Mr. * * * and his related interests had preferential loans from * * * of approximately $1.9 million. The Respondents again denied that the loans were of poor quality or that Mr. * * * line of credit at * * * was a *quid pro quo* for the favorable terms allegedly given by the Bank on the loans to * * * executive officers.

Twenty of the twenty-eight loans that allegedly violated section 23A had been made to * * *, a director of the Bank, and to * * *, a related interest of * * *, a director of the Bank. These, in addition to the eight loans discussed in reference to section 106, allegedly violated section 215.4(b) of Reg. O, 12 C.F.R. § 215.4(b), which prohibits extensions of credit to executive officers, directors, principal shareholders or their related interests in excess of a specified limit.[23] unless approved in advance by a disinterested majority of a bank's board of directors. The Respondents did not contest that a disinterested majority of the Bank's board

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[21] In a memorandum dated October 11, 1983, the EIC had indicated, contrary to her testimony at hearing, that a loan loss reserve of one percent of total loans would be sufficient. (Tr. Vol. IV, Exh. R). The record does not contain any substantive examination of this seemingly inconsistent prior statement. One percent is a frequently utilized benchmark for a loan loss reserve for banks in sound financial condition. It is clearly not adequate for banks in an impaired condition, as here.

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[22] Section 23A defines "covered transaction" as:
the acceptance of securities issued by an affiliate as collateral security for a loan or extension of credit to any person or company...
12 U.S.C. §371c(b)(7)(D).

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[23] The limit is fixed as the higher of $25,000 or 5% of bank's capital and unimpaired surplus or $500,000 (where 5% of the capital and unimpaired surplus exceeds $500,000).

{{4-1-90 p.A-716}}of directors had not given prior approval to these loans and did not present any rebuttal evidence on the twenty extensions of credit to * * * and * * *. As to the eight loans to persons and companies associated with * * *, Respondents argued that section 215.4(b) was not applicable because the proceeds did not inure to the benefit of a covered party.

Finally, the FDIC alleged that some of the twenty-eight loans secured by * * * stock violated the lending limits of section 215.4(c) of Reg. O, which restricts the extent to which a bank can extend credit to its executive officers, principal shareholders or their related interests.[24] Although the loans were not made directly to covered persons, the FDIC contended that they were used for the benefit of, or were transferred to * * *, a related interest of Mr. * * *, because some of the proceeds of each loan were used to purchase stock of * * *.

The Respondents acknowledged that the proceeds of some of these loans were used to purchase * * * stock, but argued that it is the purchaser of the stock who benefits from such a transaction and not the issuer of the stock. Since Mr. * * * derived no direct benefit from the loans, the Respondents argued that there were no violations of section 215.4(c).

2. *The ALJ's Decision*

a. *Background*

As a preliminary matter the Board notes that the FDIC and the Respondents stipulated to the following:
[1] * * *...and * * * are and have been at all relevant time "related interests" of * * * within the meaning of section 22(h) of the Federal Reserve Act, 12 U.S.C. § 375b, and Regulation O, 12 C.F.R. Part 215, thereunder and [* * * is an] "affiliate" of * * * within the meaning of section 23A of the Federal Reserve Act, 12 U.S.C. § 371c, by virtue of * * * ownership, control, or voting power. At all relevant times * * * exercised a controlling influence over * * *. * * * and * * * are and have been at all relevant times related interests of * * *.
[2] At all relevant times * * * has maintained a "correspondent account" at * * * Bank within the meaning of section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. § 1972(2)). At all relevant times * * * and * * * were "executive officers" of * * * within the meaning of section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. § 1972(2)) and at all such times * * * and * * * were also "directors" of * * * within the meaning of section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. § 1972(2)).
[3] (a) As of August 22, 1983, * * * had extended and still carried on its books extensions of credit secured by stock in * * * to the following obligors:

* * *	$190,000
* * *	36,000
* * *	225,000
* * *	214,000
* * *	329,000
* * *	310,000
* * *	300,000
* * *	$1,604,000

(b) Of these extensions of credit, at least $600,000 was transferred to * * * to purchase stock.
(c) Of these extensions of credit, $200,000 in the name of * * *, $100,000 in the name of * * *, and $100,000 in the name of * * * was outstanding prior to October 19, 1982. This was in excess of ten percent of the capital stock and surplus of * * *. The extensions of credit referenced in paragraph [3](c) were made in violation of section 23A.

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[24] The loans alleged to violate section 215.4(c) were made to * * *. It is not entirely clear from the record, however, specifically which loans to these individuals violated section 215.4(c), other than "at least $600,000 was transferred to * * * to purchase stock." (Tr. Vol. I., Att. C) It appears, however, that portions of the following loans balances make up the $600,000 referred to in the record:

Borrowers	Total Outstanding Balance 8/22/83	Amount Used to Purchase Stock
* * *	310,000	200,000
* * *	329,000	100,000
* * *	214,000	100,000
* * *	300,000	200,000

(Tr. Vol. II, Exh. 10)

[d] That 10 of the extensions noted in [3](a) were approved after the fact by * * * board of directors. (Tr. Vol. I, Att. c)

b. *Section 23A of the Federal Reserve Act*

Despite Stipulation [1] above, much time during the hearings, large portions of the parties' briefs, and the ALJ's Recommended Decision were spent on the issue of whether or not * * * is an "affiliate" of the Bank within the meaning of section 23A. The Board finds that the stipulation of the parties set forth above is conclusive and dispositive as to the fact that * * * is an affiliate of * * * for purposes of section 23A. The Board, therefore, concurs with the ALJ's conclusion to that effect, but concludes that his analysis apart

from the stipulation was not necessary.

The ALJ then held that twenty-four of the twenty-eight loans at issue violated section 23A because the * * * stock used to collateralize the loans had been purchased with proceeds from those loans. He did not view the remaining four loans as violations of section 23A, although secured by stock of * * * because he concluded that the stock had not been purchased with the proceeds from the loans. The basis for the ALJ's decision was his interpretation of section 23(A)(a)(2)[25], from which he concluded that "a suspect transaction would seemingly require a factual predicate linking the "issuance" of the securities directly to the `loan...to any person.'" (R.D. App. B, n.25) Thus, he reasoned that "absent an indicia of a purchase money security interest taken in connection with the same transaction," no benefit is derived by the affiliate from the loan.

[.7,.8**]** We note that portions of proceeds of three of the loans[26] the ALJ deemed not to violate section 23A were, in fact, used to purchase stock in * * * , which, in turn, collateralized the loans. (Tr. Vol. II. Exh. 10). The Board finds, however, that the ALJ erred in his interpretation of section 23A(a)(2). Section 23A is quite clear that a covered transaction means "the acceptance of securities issued by the affiliate as collateral security for a loan or extension of credit to any person or company." 12 U.S.C. § 371c(b)(7)(D). The statute does not limit this type of covered transaction only to loans whose proceeds are used to purchase the offending collateral. Moreover, the ALJ's emphasis on what he viewed to be the underlying purpose of section 23A is misplaced. (R.D., App. B, n.25) Section 23A(a)(2) applies to those situations which facially do not appear to be covered transactions, but which the statute deems to be within the purview of section 23A. Paragraph (a)(2), therefore, permits bank regulatory agencies to look beyond the form to the substance of transactions in order to reach all extensions of credit which are effectively transactions between banks and their affiliates. Since the transactions alleged here to violate section 23A fall within the literal definition of "covered transactions", the provision cited by the ALJ in support of his contrary conclusion is not applicable. The purpose of section 23A is to "prevent a bank from risking too large an amount in affiliated enterprise and to assure that extensions of credit to affiliates will be repaid." 12 C.F.R. § 250.240. The use of stock of an affiliate to collateralize a loan clearly is one type of transaction section 23A is designed to limit, regardless of when or how the borrower obtained funds to purchase the collateral.

The Board, therefore, adopts PFF 114 and finds that the twenty-eight extensions of credit listed therein, secured by stock of * * * , are in violation of the lending limits of section 23A.

c. *Section 106(b) of the BHCA*

The ALJ upheld the FDIC's position on two of the eight extensions of credit alleged to be in violation of section 106(b) of the BHCA, rejected it on five loans and made conflicting statements with regard to the final loan.[27] As set forth below, the Board

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[25] Section 23A(a)(2) states:
For the purpose of this section, any transaction by a member bank with any person shall be deemed to be transaction with an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that affiliate.
12 U.S.C. § 371c(a)(2).

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[26] $400,000 to * * * (2/2/83); $200,000 to * * * (5/28/83); $200,000 renewal of 5/28/83 to * * * (11/28/83). A renewal of a loan constitutes a violation of section 23A separate from that which arises from the "original" loan. *Cf.* 12 C.F.R. § 215.3(a)

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[27] In the text of his decision, the ALJ stated that a 1983 renewal of a 1978 loan to an executive officer * * * of * * * violated section 106 because it was made at a rate lower than the prevailing rate for comparable transactions. (R.D. 45)
(Continued)

finds that four of the eight loans violated section 106(b).

The Board agrees with the ALJ's conclusion that the two loans to * * * violated section 106 because they were extended to an executive officer (* * *) of * * * at eight percent when the prevailing rate was twelve percent for comparable transactions (R.D. 44-5) We, therefore, incorporate by reference PFF 3. (PFF 3; Paragraph 15(a) of the Stipulation, Tr. Vol. I. Att. C)

The ALJ rejected three of the alleged violations of section 106 because the loans were not made to "executive officers" of * * *. (R.D. 44). Our review of the record indicates that the obligors on these loans

were not involved in "major policymaking" roles at * * *. (12 C.F.R. § 215.2(d)— which defines "executive officer" as used in section 106(b)) The Board, therefore, agrees with the ALJ as to those loans to * * * and * * *.

[.9**]** The ALJ rejected the FDIC's contentions that a loan to * * * Company * * * and a loan to * * * * * * violated section 106 because he determined that the two companies are not "related interests" of Mr. * * * , an officer of * * *. He appears to have relied upon an admission by Respondents that Mr. * * * owned twenty percent of * * * and ten percent of * * *. Since the tests for "related interests," *i.e.*, a showing of 25% ownership or control over election of majority of the board or management, were not satisfied, the ALJ concluded that the two loans did not violate section 106. The ALJ erred, however, by failing to apply the presumptions of control (R.D. App. B, n.29) set forth in section 215.2(b)(2) of Reg. O. (*See* 41 *Fed. Reg.* 67,973 (1979)) Section 215.2(b)(2) states that a covered person is presumed to have control of a company if the person is an executive officer or director of the company and has power to vote more than ten percent of any class of voting securities. 12 C.F.R. § 215.2(b)(2)(i) To overcome the presumption, a person must present written evidence which demonstrates an absence of control. 12 C.F.R. § 215.2(b)(4) The Respondents admitted that Mr. * * * owned a twenty percent general partnership interest in * * *. (R.D. 45) Ownership of a general partnership is analogous to ownership of voting securities and the function of a general partner is similar to that of a director and executive officer of a corporation. 1981–1982 Fed. Banking L. Rep. (CCH)F ¶85,247. Therefore, the Respondents have admitted that Mr. * * * had the power to vote more than ten percent of * * * "voting shares" and occupied a position *vis-a-vis* * * * that was effectively the same as that of an executive officer and director of a corporation. Moreover, the Respondents have submitted no written evidence to overcome the presumption that Mr. * * * controls * * *.

The Board, therefore, finds that the $200,000 loan to * * * violated section 106(b) of BHCA because it was made to a related interest of an executive officer of * * * correspondent bank and it involved more than the normal risk of nonrepayment.[28] The Board further finds that the ALJ was correct as to the loan to * * * since the record does establish that Mr. * * * neither owned 25 percent of its stock nor met the presumption of control tests under section 215.2(b)(2) of Reg. O.

d. *Reg. O*

The ALJ rejected the FDIC's argument that the eight loans which were discussed above in relation to section 106 violated section 215.4(a). The FDIC contended that these loans were, in effect, made to Mr. * * * because * * * had extended credit on a reciprocal basis to Mr. * * * and his related interests in the amount of approximately $1.9 million on preferential terms. The ALJ found that the FDIC had failed to tender any evidence which showed that the eight loans extended by the Bank are a *quid pro quo* for Mr. * * * line of credit from * * *. (R.D. 47) Although the record supports the FDIC's allegations that some of the loans made by * * * to Mr. * * * and his related interests were either on preferential terms or presented more than normal risk (Exh. JJ), there is no evidence which leads to the conclusion that loans made by * * * to officers of * * * or their related interests inured to the benefit of Mr. * * *. The Board, therefore, agrees with the ALJ's conclusion that the Bank did not violate section 215.4(a) of Reg. O when it extended

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27 Continued: However, the ALJ failed to include this violation in Table III. (R.D. App. A, Table III) It would appear that this omission was inadvertent since the record supports a conclusion that Mr. * * * loan violated section 106. (PFF 3; Paragraph 15(d) of the Stipulation, Tr. Vol. I, Att. C)

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28 In Part B above, we upheld the adverse classification that had been assigned to the * * * loan. This determination supports our conclusion that this loan involves more than the normal risk of repayment.

{{4-1-90 p.A-719}}credit to executive officers of its correspondent bank.

[.10**]** Section 215.4(b) of Reg. O establishes minimum lending limits, above which all extensions of credit to executive officers, directors, principal shareholders, and their related interests must receive prior approval by a disinterested majority of the board of directors. Twenty loans which are alleged to violate this requirement were extended to * * * , a director of the Bank, and * * * , a related interest of Mr. * * *. The record contains substantial evidence supporting the ALJ's conclusions that these loans were made to covered persons, that their aggregate amount exceeded the minimum, and that the Bank's board failed to give approval prior to the disbursement of the proceeds. (Tr. Vol. I, Att. C; Vol. VII, 94-6) Similarly, the record supports the ALJ's conclusion that the eight loans extended to officers of * * * and their related interests did not violate section 215.4(b) because the evidence does not establish that a benefit inured to

a "covered party."

The ALJ found that the $600,000 the Bank had extended to purchase stock in * * * inured to the benefit of Mr. * * * because Mr. * * * related interest benefited by the infusion of capital. Since the aggregate amount is in excess of the lending limits set forth in section 215.4(c), he found that these loans violated that provision of Reg. O. The Respondents argued that it was the purchasers of stock that received the benefit from the transaction. This argument, however, does not refute the fact that the issuer of the stock also derived a benefit. Moreover, loans do not violate section 215.4(c) only when the benefit which inures to covered persons is an intended one. Nothing in section 215.4(c) requires that the loans be part of a scheme designed to benefit covered persons. As long as covered persons benefit from a loan, it is subject to the lending limits of section 215.4(c). The Board, therefore, agrees with the ALJ's conclusion that the borrowers used the proceeds of the loans in question for the benefit of a related interest of Mr. * * * in violation of the lending limits of section 215.4(c) of Reg. O.

C. *Order to Cease and Desist*

1. *The ALJ's Recommended Order and the Parties' Exceptions*

The ALJ recommended that an Order to Cease and Desist be issued (hereinafter referred to as "Recommended Order"). The Recommended Order, with a few exceptions discussed below, adopted the provisions proposed by the FDIC.[29] The Respondents did not contest the ALJ's conclusion that an order should be imposed on the Bank. However, the Respondents took exception to numerous parts of the ALJ's Recommended Order, including the following provisions:[30]

> 1. ¶2 (requiring additions to loan loss reserves to cover assets classified loss and maintenance of an adequate reserve, R.D. 55) because the ALJ found the Bank's loan valuation reserve to be adequate.
> 2. ¶5 (requiring correction of all violations of sections 22(h) and 23A and Reg. O, R.D. 59) because there had been no violations of sections 22(h) and 23A of the Federal Reserve Act.
> 3. ¶7 (requiring prior approval by the Bank's board for all loans over $50,000, R.D. 59) because the $50,000 floor on prior approval represents a substantial portion of the Bank's loans.
> 4. ¶8 (requiring a majority of outside directors, R.D. 59) because no law requires such a provision and there was no

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[29] ¶9 (prohibiting transfer of an adversely classified asset to another bank without full disclosure of its status to that bank in writing) (R.O. 59) was not proposed by the FDIC in its post-hearing brief, but is a provision of a stipulated consent order under which the Bank is currently operating. The ALJ determined that the record supported its inclusion on the ground that acquisition of an adversely classified loan is an unsafe or unsound banking practice. (Tr. Vol XI, 35) The Board agrees.

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[30] The Respondents argue that those provisions in the ALJ's Recommended Order with which they contend the Bank is currently in compliance (¶¶1(a), 2, 3, 5, 6, 7, 10 and 11 of the Recommended Order, R.D. 55–60) should not be included therein. We find that these provisions are appropriate even if the Respondents are currently in substantial compliance. As discussed more fully below, the findings of unsafe or unsound banking practices and violations of law more than adequately support inclusion of these provisions in the cease and desist order. Moreover, as noted by the ALJ, "there is no reason to suppose that the cures would have occurred absent the goad of regulatory enforcement." (R.D. 49) These provisions, therefore, will ensure future compliance and provide the FDIC with timely means of enforcement should the Bank act in ways contrary to the cease and desist order. (*See* section 8(i)(1) of the FDI Act, 12 U.S.C. § 1818(i)(1))

> showing that an insider directorship is an unsafe or unsound banking practice.
> 5. ¶12 (requiring notice to FDIC when brokered deposits exceed five percent of total deposits, R.D. 60) because there was no showing that use of brokered deposits are an unsafe or unsound banking practice or that the Bank had or was about to use them.

The Respondents further objected to the ALJ's observations (R.D. 49) that the unsafe or unsound banking practices would have continued unchecked absent the intervening regulatory enforcement actions. On the other hand, the FDIC does not object to any provisions in the Recommended Order but strongly argues that the ALJ erred by not recommending that Mr. * * * lending and investment authority

be curtailed.

2. *Analysis*

[.11**]** The Board notes at the outset that where, as here, it has found that a bank had engaged in unsafe or unsound practices and has committed numerous violations of laws and regulations, it has, under established court precedent, broad discretion to exercise its expertise in fashioning an appropriate remedy to stop the practices and violations, to prevent future such abuses and to correct the effects of the practices or violations. *First National Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674, 680 (5th Cir. 1983); *del Junco v. Conover*, 682 F.2d 1338, 1340 (9th Cir. 1982), *cert. denied*, 459 U.S. 1146 (1983); *Gross National Bank v. Comptroller of the Currency*, 573 F.2d 889, 897 (5th Cir. 1978). In view of our findings of fact and conclusions set forth above, the Board agrees with the ALJ that the issuance of a cease and desist order to the Bank is both appropriate and necessary. There only remains a determination of whether the ALJ's Recommended Order is an appropriate remedy. In general, we find that the provisions adopted by the ALJ are a proper response to the unsafe or unsound practices and violations found in this proceeding. Therefore, the Board adopts paragraphs 1 through 14 of the ALJ's Recommended Order.

The Board's conclusion that the Bank and Mr. * * * have committed numerous violations of sections 22(h) and 23A and Reg. O is more than adequate justification for a requirement that Respondents correct those violations. Similarly, the findings that the Bank has engaged in unsafe or unsound practices justifies a provision requiring the Respondents not to engage in such practices in the future.[31] Despite the Respondents' objections, the Board concludes that there is ample evidence in the record to support a view that any corrective efforts by the Respondents are a direct result of the initiation of the enforcement action by the FDIC. Thus, this type of injunctive relief is clearly warranted to ensure not only that the Respondents carry through with proper corrective action, but that such abuses do not occur in the future.

The Respondents objected to the ALJ's recommendation that all credit extensions in excess of $50,000 receive prior approval of the Bank's board of directors on the ground that the Bank's current policy which requires prior approval on loans greater than $100,000 is satisfactory to the FDIC. The record in this proceeding does not show that the FDIC has approved the Bank's current loan policy and, in fact, shows that only the State of * * * has approved the policy. (Tr. Vol. V, 84, 86-7; VIII, 62) Indeed, the record establishes a total lack of supervision over the lending activity of the Bank's officers, especially Mr. * * * , by the Bank's board of directors. This evidence justifies stringent measures, including requiring prior approval by the Bank's board of all loans over $50,000.

The Respondent also took exception to paragraph 8 of the Recommended Order, arguing that a board of directors comprised of insiders is not necessarily an unsafe or unsound banking practice and that outside directors are not required by federal law or regulation. Wholly apart from the Respondents' argument that an inside board is not a *per se* unsafe or unsound practice, the record is replete with testimony that the current board of the Bank exercised little if any judgment independent from that of Mr. * * * and did not fulfill its duties and responsibilities. Therefore, requiring a majority of outside directors and an independent audit committee for the Bank are, in this Board's view, both justified and necessary to ensure that the board of directors of the

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[31] In our review of the Recommended Order, we note that the ALJ ordered the Respondents to cease and desist from operating with an inadequate reserve for loan losses." This requirement would appear to be inconsistent with his findings. However, in view of the Board's conclusion that the Bank's loan loss reserve was inadequate, we determine that such a requirement is necessary and is directly related to an unsafe or unsound banking practice.

Bank will exercise independent judgment and more careful evaluation of its lending decisions.

The Respondents excepted to the ALJ's inclusion of paragraph 12 in his Recommended Order requiring the Bank to give written notice to the FDIC whenever five percent or more of its total deposits are funded by brokered deposits. That paragraph specified that the notice shall indicate how such deposits are to be used and the effect of such deposits on the Bank's funds position and its asset/liability matching, and that the FDIC's Regional Director shall have the right to object to the planned use for such funds. The bases of the Respondents' exception to this provision are essentially twofold: (1) that the evidence showed the Bank had neither previously used brokered deposits nor was likely to do so in the future; and (2) that section 8(b) requires specific proof that a bank has engaged or is about to engage in an unsafe or unsound practice as a predicate for relief and that FDIC offered no proof with respect to brokered deposits.

[.12**]** Experience over the past several years has indicated that brokered deposits are utilized more frequently and more extensively by banks with financial problems than banks in sound condition. The Bank has been found to be in a weakened financial condition resulting from unsafe or unsound practices. Should its condition continue to deteriorate, there is the potential danger that it would turn to highly volatile brokered deposits to overcome liquidity difficulties. Thus, past history and present intentions are not particularly useful guides. The reporting requirement is in actuality a method of off-site monitoring of the Bank designed to gain regulatory attention in the event the Bank does turn extensively to brokered deposits. If, as Respondents appear to imply, the Bank continues its present course and does not utilize brokered deposits, the reporting requirement does not create any burden on the Bank.

Furthermore, while Respondents' statement that section 8(b) requires proof of unsafe or unsound practices (or violations of laws, rules, regulations or outstanding orders) as a predicate for issuance of a cease and desist order is correct, the Board does not agree with the narrow interpretation of the statute that Respondents' argument implies—that each provision of a cease and desist order must be *directly* related to a *specific* unsafe or unsound practice. As the courts have held, once unsafe or unsound practices have been established, the bank regulatory agencies have broad discretion to fashion proper remedies not only to halt and correct current or former practices but also to prevent future abuses that could result in further deterioration of a bank's financial condition. Even assuming *arguendo* that Respondents' argument has some merit (an assumption with which the Board disagrees), the ALJ's finding, with which the Board agrees, that the Bank had inadequate liquidity (an unsafe or unsound practice) justifies the requirement. The use of brokered deposits could in the Board's view seriously aggravate the Bank's asset/liability matching problems, creating even greater liquidity problems. Therefore, the Board concludes that there is more than sufficient justification for the inclusion of paragraph 12.

The ALJ declined to adopt a provision requiring the Bank to remove Mr. * * * lending and investment authority and to retain a new qualified chief lending and investment officer. The ALJ concluded that such a restriction was unnecessary because other provisions of the Recommended Order—mandating reduction of adversely classified loans, restoring and maintaining a 7.5 percent capital ratio, requiring outside directors and an audit committee comprised only of outside directors, adopting written loan, investment, and liquidity policies and submitting compliance reports to the FDIC—would check the "pervasive influence" of Mr. * * * eliminating the need for what he characterized as "Draconian" relief. (R.D. 52) He also determined that the proposed provision "is tantamount" to removal from office, "a result not authorized in this proceeding **[***i.e.*, one brought under section 8(b) of the FDI Act**]** but only in an appropriate case **[**under section 8(e) of the FDI Act**]**." (R.D. 52) The ALJ reasoned that "there is precious little left to do for the controlling shareholder and principal operating official of this Bank if he is not to participate in credit extensions and investment decisions." (R.D. 52).

[.13**]** The Board agrees that other provisions in the Recommended Order may accomplish much to prevent continuance of
{{4-1-90 p.A-722}}the unsafe or unsound practices and violations of law and to correct their effects. This, however, does not address the question of the appropriateness of a provision which limits Mr. * * *'s role in the lending and investment activities of * * *. The Respondents have stipulated that Mr. * * * had primary responsibility for twenty-two of the loans subject to adverse classifications. (Tr. Vol. I, Att. C; Vol. II, Exh. 10) The Board found that many of those loans for which Mr. * * * had primary responsibility resulted in violations of sections 23A and 106 and Reg. O. We have also found the Bank's board of directors failed to supervise Mr. * * *'s lending activities to the point where the board exercised no prior approval on any loans. This failure permitted a large portion of the Bank's loan portfolio to be concentrated in loans to Mr. * * * , his family and related interests and to Mr. * * * , his family and related interests. These facts led the Board to the inevitable conclusion that the Bank's directors failed to live up to their responsibilities. Lastly, the record contains substantial evidence to support the ALJ's observation that the outside "entrepreneurial activity on the part of * * *...distract**[**ed**]** from his responsibilities concerning the Bank...." (R.D. 50) Thus, removing Mr. * * *'s lending and investment authority and requiring the Bank to retain a qualified chief loan officer who understands the importance of loan portfolio diversity and who will devote full time and attention to the responsibilities of that position are methods to deal with the Bank's excessive number of classified loans and to prevent a future recurrence of such problems. This Board believes that such a remedy is clearly "reasonably related" to the unsafe or unsound banking practices and violations of law in this case. Therefore, the Board finds that the cease and desist order in this proceeding should include these requirements.

The Board also finds that the ALJ was incorrect in concluding that removal of Mr. * * *'s lending and investment authority is "tantamount" to a section 8(e) removal. The restriction is more limited than that imposed under section 8(e). In a section 8(e) removal, an officer or director is prohibited from participating in *any* manner in the conduct of the bank with which he is currently associated *and* from

participating in any manner in the conduct of *any other* FDIC insured bank. 12 U.S.C. § 1818(e)(1), (j)(2). As such, a section 8(e) removal would not only eliminate Mr. * * *'s lending authority, but would also remove him as an officer and member of the board, and prevent him from exercising his controlling interest in the Bank and any other FDIC insured bank. Therefore, it is clear that the ALJ was incorrect in equating FDIC's proposed relief with that afforded under section 8(e) of the FDI Act.

The order will have no effect on Mr. * * *'s other duties as president—bank operations, public relations, employment, personnel management, etc. More importantly, Mr. * * * will be permitted to continue to serve on the Bank's board of directors and to exercise his right to be heard on and to vote on all matters before the Bank's board. Mr. * * * will be an active participant in the development, implementation and monitoring of the loan, loan collection, capital, investment and liquidity policies required by the order. Contrary to the ALJ's assertion, this limitation does not deny Mr. * * * "meaningful participation in restoring the Bank to an appropriate level of regulatory confidence." Furthermore, this provision will not be a particular hardship on Mr. * * * in view of his other banking interests, as well as his "many" outside business interests. (R.D. 52) For the foregoing reasons, we adopt the FDIC's proposed provision to limit Mr. * * *'s lending and investment authority.

D. *Order to Pay Civil Money Penalties*

The FDIC seeks assessments of civil money penalties of $75,000 against Mr. * * * , $10,000 against his son, * * *, and $1,000 against each of the remaining individual Respondents. The Respondents argue that the assessments should be $1,000, $100, and $100 each, respectively, on the ground that substantially fewer violations of law occurred than, in fact, have been established by the record.

The ALJ noted that, although the violations of law were not the result of "deliberate overreaching" (R.D. 63), they were, nonetheless, not "inadvertent." (R.D. 64) On the other hand, he observed that the multiple statutory violations arose from the same set of loans, several violations were not, in his view, proven and the Bank had not suffered any actual loss from the offending loans. (R.D. 64) Moreover, he stated that no "yardstick" had been provided against which to measure the FDIC's re- {{4-1-90 p.A-723}}quested relief in order to produce "a result consistent with precedent, if any, or with prevailing legislative and regulatory sentiment." (R.D. 63) In the end, the ALJ reduced the FDIC's proposed penalties by two-thirds, thereby recommending that Mr. * * * be assessed a civil money penalty of $25,000, his son be assessed a $3,333 penalty and each of the remaining individual Respondents be assessed a $333 penalty. The method by which the ALJ arrived at the reduction, however, is not at all clear. Indeed, the ALJ may have been influenced by the modest size of prior penalties paid. The Board does not find prior assessments to be a particularly useful guide against which to judge the penalties in this case without a thorough review of the facts and violations upon which the prior penalties were predicated.

[.14**]** The Board has undertaken an independent review of the civil money penalties in light of the discrepancy between the penalties assessed by the FDIC in the Notice of Assessment and those recommended by the ALJ. In determining whether to assess civil money penalties and the amount of such penalties, the Board is guided by the statutes, 12 U.S.C. §§ 1828(j) and 1972(2)(F), the Regulations, 12 C.F.R. § 308.64-.72, and the September 30, 1980 Interagency Policy Statement Regarding the Assessment of Civil Money Penalties by the Federal Financial Institutions Regulatory Agencies ("Policy Statement"). The statutes and regulations require the FDIC to consider the financial resources and good faith of the Respondents, the gravity of the violations, the history of previous violations and other such matters as justice requires in assessing civil money penalties. The Policy Statement lists thirteen factors the federal banking agencies have deemed relevant in determining whether the violations are of sufficient gravity to assess penalties. These factors are:

1. Evidence that the violation or pattern of violations was intentional or committed with a disregard of the law or the consequences to the institution;
2. The frequency or recurrence of violations and the length of time the violation has been outstanding.
3. Continuation of the violation after the respondent becomes aware of it, or its immediate cessation and correction;
4. Failure to cooperate with the agency in effecting early resolution of the problem;
5. Existence of concealment of the violation, or its voluntary disclosure;
6. Any threat of or actual loss or other harm to the institution, including harm to public confidence in the institution, and the degree of any such harm;
7. Evidence that participants or their associates received financial gain or other gain or benefit or preferential treatment as a result of or from the violation;
8. Existence of any restitution by the participants in the violation;
9. History of prior violations, particularly where similarities exist between those and the violations under consideration;

10. Previous criticism of the institution for similar violations;
11. Presence or absence of a compliance program and its effectiveness;
12. Tendency to create unsafe or unsound banking practices or breach of fiduciary duty; and
13. The existence of agreements, commitments or orders intended to prevent the subject violation.

45 *Fed. Reg.* 59,423 (1980).

Although it does not appear from the record in this case that the violations of law were deliberate or intentional, we concur with the ALJ's assessment that they were not inadvertent. (Factor 1) The FDIC has proven that thirty-two extensions of credit made between October 1982 and August 1983 resulted in at least fifty-two separate violations of applicable statutes and regulations.[32] (Factor 2) The Respondents claimed that the section 23A violations were corrected once they become aware of them, but the evidence is not persuasive that this, in fact, did occur or that they took any steps to correct the section 106 or Reg. O violations. (Factor 3) While the Bank had not suffered any losses from the violations as of the date of the hearings, there is a threat of future loss since many of the offending loans are adversely classified. For the loans collateralized by stock of * * *

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[32] The fact that one loan gave rise to findings of multiple violations is not a conclusive factor in our assessment of civil money penalties.

(twenty-eight of the thirty-two loans in question), this threat is particularly acute since the company had a prior history of poor financial performance which continued up to the time of the hearings. (Tr. Vol. III, 20–32; Vol. II, Ex. 1) (Factor 6) The record shows that some of the violations inured to the benefit of * * * , thereby benefiting those individual Respondents who owned stock in that company.[33] (Factor 7) The Respondents have stipulated to a history of prior violations of section 23A, section 106 and Reg. O and prior criticism of loan concentrations by the FDIC. (Factors 9 and 10) The record also shows that, although a compliance committee was appointed in response to FDIC criticisms, it never functioned and the chairman of that committee was not even aware that he was its chairman. (Tr. Vol. VII, 51-2; Vol. II. Exh. 6) (Factor 11) Lastly, the Board has determined that the Respondents' failure to supervise the lending activity of the Bank resulted in unsafe or unsound banking practices. (Factor 12)

On the other hand, the record shows that several mitigating factors exist. The Respondents did not fail to cooperate with the FDIC in an attempt informally to resolve the problem. (Factor 4) There is also no evidence of any attempt by them to conceal the violations. (Factor 5) Not every Respondent personally benefited from these extensions of credit and those who did received only indirect gain. (Factor 7) On the basis of the foregoing discussion, and in light of the statutory mandate, the Board agrees with the ALJ's conclusion that the violations of law present an appropriate case for assessing civil money penalties.

The issue which must then be addressed is the amount of penalties to be assessed against each individual Respondent. The maximum penalty that may be assessed under sections 18(j) of the FDI Act and 106 of the BHCA is $1,000 per day for each violation. It would appear, therefore, that the penalties assessed in the Notice of Assessment and requested by the FDIC at hearing are substantially lower than what the FDIC is empowered to assess. Nonetheless, the Board agrees with the ALJ and has determined that the penalties assessed here should not exceed those which were assessed by the Notice of Assessment: $75,000 against * * * , $10,000 against his son, and $1,000 against each of the remaining Respondents. In order to establish the level of penalties that will accomplish the statutory goals, the statutes require that the FDIC weigh the seriousness of the violations against the financial resources and good faith of the Respondents. The thirteen factors set forth in the Policy Statement provide a useful guide for evaluating the responsibility of each individual Respondent for the violations.

With respect to the amount of the penalty to be assessed against * * * , the record in this proceeding establishes that he is the controlling shareholder, the chief executive officer, the chief lending officer and overall the dominant influence over the Bank. As such, he had direct or indirect responsibility for all of the violations. Mr. * * * has been a banker for over twenty years and he must have, or should have, knowledge of the statutory and regulatory limitations under sections 22(h), 23A and 106 and Reg. O. Furthermore, there is a prior history of similar violations and criticism by FDIC of concentrations of credit with no resulting action on the part of Mr. * * * to prevent the recurrence of such violations. It is true that there is no evidence that Mr. * * * attempted to conceal the violations, failed to cooperate with the FDIC examiners or tried to impede their investigation, or that the Bank had suffered any actual losses resulting from the violations (although the potential for future losses remains a serious consideration). Nevertheless, these types of violations of law, for which Mr. * * * had primary responsibility, involve insider abuses and are considered to be extremely serious.

Although the statutes establish criteria to be considered in determining the amount of a civil money penalty, they do not provide a precise method by which those criteria may be measured in order to arrive

at a dollar amount for a penalty. Thus, it is clear that setting the amount of a civil money penalty is a function left by the Congress to the discretion, expertise and judgment of the bank regulatory agencies, consistent with the statutory scheme. In the Board's judgment, the $25,000 penalty recommended by the ALJ does not adequately reflect the seriousness of the violations in this proceeding and Mr. * * * culpability for them. In view of the facts in this case, it is the

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[33] * * * and * * * (indirect ownership). (Tr. Vol. II. Exh. 10)

{{4-1-90 p.A-725}}Board's judgment that a civil money penalty of $50,000 for Mr. * * * is appropriate in light of the serious nature of the violations, his responsibility for them and the other factors discussed above.[34]

The penalty proposed by the FDIC for * * * and that recommended by the ALJ, while substantially different, were in each instance higher than those proposed or recommended for the remaining directors of the Bank. From our review of the record, we have difficulty distinguishing between the roles of Mr. * * * , Jr., and the remaining members of the board. The record does establish that Mr. * * * , Jr., was the recipient of several loans that violated section 23A and Reg. O and indirectly benefited from those loans whose proceeds were used to purchase shares of * * *. These facts do not in the Board's view justify a penalty ten times larger than those assessed against the other directors. Nevertheless, Mr. * * * , Jr., was a director of the Bank and as such had responsibility for its activities. Similarly, the remaining directors had little actual involvement in the violations and only one received any benefit (* * * through her indirect ownership of stock in * * *). Nevertheless, their lack of attention to the affairs of the Bank was, in part, responsible for the violations. Therefore, the Board assesses civil money penalties of $1,000 each against * * * , as directors of the Bank.

IV. CONCLUSION

For the reason set forth in footnote 9, the Board adopts and issues the accompanying Order Denying Request for Oral Argument.

The Board, having found that the Bank and * * * , Sr. engaged in unsafe or unsound practices as set forth herein at pages 14–26 and violations of sections 23A and 106 and Reg. O as set forth herein at pages 30–39, adopts and issues, pursuant to section 8(b) of the FDI Act, 12 U.S.C. § 1818(b), the accompanying Order to Cease and Desist. Furthermore, for the reasons set forth herein at pages 48–55, the Board also adopts and issues the accompanying Order to Pay Civil Money Penalties.

By direction of the Board of Directors.

Dated at Washington, D.C., this 19th day of February 1986.

/s/ Hoyle L. Robinson

Executive Secretary

I. SUMMARY OF PROCEEDINGS

A hearing in these consolidated cases was held in * * * , on December 10–19, 1984 and January 24, 1985. The record consists of a transcript[1] and 137 exhibits, numbered 1 through 32, 34 through 77, and 79 through 106 for the FDIC, lettered B, D, E, J, and L through MM for the respondents, and Judge's Ex. 1.

II. PROPOSED FINDINGS OF FACT

A. *Introduction*

The parties in this proceeding have entered into a Stipulation of certain matters of fact and law attached to volume I of the transcript of this proceedings as Attachment C ("Stipulation"). These proposed findings specifically refer to the Stipulation in logical sequence. The FDIC also requests that the court make the additional findings of fact set forth below in detail.

B. *History and Background*

1. See Stipulation ¶1.
2. See Stipulation ¶2. * * * has been a related interest of * * * at all relevant times. (Tr. II 62–63 - * * * , Sr.; Tr. II 27–30 - * * *).
3. See Stipulation ¶3.
4. See Stipulation ¶4.
5. See Stipulation ¶5. Exs. 3–9. The * * * Bank (* * * "Bank") promised to establish a regulatory compliance committee. (Ex. 6, at 2.) The Bank's promise was not kept; the committee never functioned.

(Tr. VII 61- * * *) The letter containing this promise was false in stating that Respondent * * * had no relationship with the principal stockholders of the Bank. (Ex. 6, at 2; Tr. VII 62 - * * *.) The letter (Ex. 6) was signed by * * *, Sr. Although the minutes of the Bank's board of directors reflect consideration of communications from * * * , Commissioner of Banking, no such consid-

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[34] Mr. * * * net worth, as of July 1983, exceeded $6.5 million and his projected income for that year approached $500,000. (Tr. Vol. I, Exh. 43) In these circumstances and in light of the above discussion, a $50,000 penalty is reasonable.

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[1] Contrary to the court's instructions, each volume of the transcript is separately paginated, with some volumes bearing arabic numerals and some bearing roman numerals. For convenience, this brief refers to volumes by roman numerals. The volumes as submitted by the reporter were number 1, 2, III, IV, 5-A, 5-B, 6, VII, VIII, and 11. Volume 11 was renumbered IX by the court's March 27, 1985, Order on Transcript Corrections.

{{4-1-90 p.A-726}}eration of the FDIC's reports of examination (Exhibits 3, 4, and 7) is reflected. (Ex. 82.)

6. See Stipulation ¶6.

c. *Lending Practices*

i. *Extending credit without adequate financial information*

7. Bank credit files normally contain current and historical financial statements of the borrower; credit comments stating the purpose, amount, terms, conditions, collateral, and the source and schedule of repayment of the loan; borrowing resolutions; security agreement or mortgage; title opinion; appraisals; and financing statements. (Tr. I 82–84 - * * * , Tr. III 69–72 - * * *.) Banks ask for both profit and loss statements and balance sheets. (Tr. I 116 -* * *.) Normally, such financial information is obtained before the credit is extended. (Tr. I 116 - * * *) To evaluate credit- worthiness of prospective borrowers, banks analyze profit and loss statements and balance sheets. (Tr. I 114-15 - * * *.)

8. In reviewing a guarantor's financial statement, the value of the investment in the firm whose debt is guaranteed is deducted from the assets (and therefore from the net worth) of the guarantor. (Tr. III 71 -* * *; Tr. V A 67 - * * *.)

9. It is an unsafe or unsound banking practice to extend credit (unless the credit is secured by readily marketable collateral) without first obtaining adequate financial information on all obligors. Without such information it is not possible to evaluate the obligor's financial capability. (Tr. III 69–73 - * * *.) The extensions of credit in ¶¶10–39, *infra* involved this unsafe or unsound banking practice. (Tr. III 73 - * * *.)

10. * * * ($160,000). Of the total line at the Bank, $70,000 was added subsequent to the previous examination (Ex. 7). The most recent financial information was dated May 31, 1981. (Tr. III 73 - * * *.)

11. * * * ($115,000). * * * financial statement omitted assets he reportedly owned. (Tr. III 74 - * * *.)

12. * * * ($300,000). The financial statement on file at the bank dated February 28, 1983, was not detailed, i.e., $345,000 was carried in accounts receivable and notes receivable and $45,000 was carried as accrued interest, but the obligors were not identified. Terms relating to escrow funds of $37,900 were not described. There was no income statement and only an incomplete cash flow statement. Notes payable of $500,000 were not detailed. (Tr. III 74 -* * *)

13. * * * ($125,000). The financial statement dated September 11, 1980, on which the borrowing was predicated, was not in sufficient detail. The statement carried accounts receivable of $310,000, but did not identify the obligor. The values listed as investments in * * * Corporation ($100,000) and * * * ($100,000) were not supported. * * * and partnership office building values of $150,000 and $100,000 respectively, did not describe how the values were determined. (Tr. III 74–75 -* * *.)

14. * * * ($225,000). The financial statement dated September 30, 1982, was not detailed. Real estate and personal property were valued at $478,000 without stating how the values were determined. * * * stock was valued at $1,401,700, but the bid price obtained during the examination of $2.00 per share resulted in a value of only $350,000. At the previous examination, the value was $2.50 per share. There was no support for the determination of * * * value. The statement showed $337,000 in listed (NYSE) stocks, but did not identify the stocks. A bank loan did not identify the lender. There was no detailed description of the sources of income. There was no evidence of verification of the assets or of a credit check. The statement did not address the possibility of contingent liabilities. (Tr. III 76–78 - * * *; *see also* Tr. V B 160–61, 163 - * * *)

15. * * * ($125,000). The value listed for the * * *s residence and condominium ($1,500,000) was not supported. The value listed for * * * Company ($7,357,700) was not supported by a fully completed financial statement of * * * Company. There was no evidence that the Bank verified * * * borrowing or

credit ratings at other institutions. (Tr. III 78 - * * *.)

16. * * * ($214,000). No financial information was available for the borrower (Mrs. * * *). (Tr. III 78–79 - * * *.)

17. * * * ($135,000). The financial statement listed accounts receivable at $14,000, but did not provide detail. The value (at February 28, 1983) placed on real estate ($836,000) was not supported by the appraised value dated April 5, 1982, of $810,000 by * * *. The mortgage payable {{4-1-90 p.A-727}}was not further detailed. There was no income statement. The cash flow statement was incomplete. (Tr. III 79 - * * *.)

18. * * * ($233,000). The financial statements were not sufficiently detailed. The income information was not of the same date as the balance sheet. (Tr. III 79 -* * *.)

19. * * * ($50,000). The financial information was not detailed. The balance sheet dated February 27, 1983 did not itemize accounts receivable, notes receivable, "future benefit of retained employees," accounts payable, checks outstanding, and current and long term notes payable. There was no income statement to coincide with the February 27, 1983 balance sheet. (Tr. III 79–80 - * * *.)

20. * * * ($270,000). The financial statement dated December 31, 1982, was not sufficiently detailed. The * * * stock was valued at $9.35 per share ($2,836,400) although its bid price had been $2.00 per share (or $606,700) for an extended period of time. See the discussion of the * * * credit, *supra* Proposed Findings of Fact ("PFF") ¶14. The * * * stock listed as an asset on the balance sheet was not owned by the corporation. * * * partnership, * * *, and * * *, were all closely held investments and had no supporting documentation for those values. The values of real estate holdings ($1,420,000) were also not supported. Bank loans were not itemized. There was no evidence in the files that the Bank's management verified liabilities or checked the obligor's credit rating at other institutions. (Tr. III 80–81 - * * *.)

21. * * * ($218,000). * * * September 6, 1980, financial statement listed net worth at $124,000. The most recent December 31, 1982, statement was signed by * * * personally, rather than in his corporate capacity. This statement (Ex. 71) did not accurately reflect the company's liabilities. The statement listed total liabilities of $164,200 on December 31, 1982, when the company had borrowings of at least $217,900. No income statement was provided and the cash flow statement was incomplete. (Tr. III 81–82 - * * *.)

22. * * * ($324,000). No income statements or cash flow statements were available. The April 30, 1983, financial statement (Ex. 75) was signed by * * * personally and not in a representative capacity. The total liabilities ($500,000) omitted at least $47,000 in liabilities. (Exs. 73–75; Tr. III 82 - * * *.)

23. * * * ($184,000). No income or cash flow statements were available. The balance sheet did not itemize accounts receivable ($275,000), which included a receivable from * * * in the amount of $251,500 (Tr. II 65–66 - * * *, Sr.; Ex. 77), or have supporting documentation for real estate values on the October 30, 1982, statement. Notes payable were not itemized. There was no statement pertaining to contingent liabilities. The August 30, 1983 financial statement (Ex. 57) received during the examination omitted $110,000 in liabilities to * * *. (Tr. II 145 - * * *, Sr.) These liabilities were guaranteed by * * *, whose financial statements (Exs. 41–43) were also false in that they omitted guaranties in the amount of as much as $1,282,984 (as of July 29, 1983, * * *: $110,000 for * * * and $250,000 for * * *: $257,984 for * * * and $665,000 for * * *) and overstated the value of stock held in * * * (Exs. 40–43, 53–55, 61, 62; Tr. II 140-45 - * * *, Sr.; and Tr. III 82–83 - * * *.)

24. * * * Jr. ($329,000). The borrower's August 19, 1982, statement reflected a $175,000 investment in * * * * * *, whose loans had been assumed by * * *, because of an inability to repay. There was no support for the $175,000 investment. There was no income information on the August 19, 1982, and August 31, 1983 (Ex. 19) statements. The borrower omitted a liability for a promissory note dated December 20, 1980, ($85,000) payable to * * *. There was no statement pertaining to contingent liabilities on the August 19, 1982, statement. (Tr. III 83 - * * *.)

25. * * * ($36,000). Financial statements dated August 30, 1982 (Ex. 33), and August 31, 1983 (Ex. 34), were not sufficiently itemized with respect to accounts receivable or notes receivable, * * *, Contract 3, and * * *. There were no income or cash flow statements. (Tr. III 84 - * * *.) The financial statement dated August 31, 1983 (Ex. 34) omitted liabilities of at least $35,600. (Tr. II 131-34 - * * *) This financial statement was signed in a representative capacity by * * *. (Ex. 34.)

26. * * * ($237,000). Financial statements dated July 27, 1982, and August 31, 1983 (Ex. 68), were not sufficiently detailed {{4-1-90 p.A-728}}as to notes receivable, which included a receivable from * * * in the amount of $50,000; stocks and bonds; investment in partnership; and notes payable. There was no income information. (Tr. II 63–64, 146 -* * *.; Tr. III 84 - * * *.)

27. * * * ($299,000). There was no personal financial information. (Tr. III 84 -* * *.)

28. * * * ($6,000). There was no current financial information. (Tr. III 87 - * * *.)

29. * * * ($3,000). The note was dated January 12, 1985, the last financial information on file was dated April 1, 1981. (Tr. III 87 - * * *.)

30. * * * ($40,000). The loan was made on May 14, 1982, with no current financial information on file. (Tr. III 87 - * * *.)
31. * * * ($130,000). There was no current financial information including income and cash flow statements. (Tr. III 87 -* * *.)
32. * * * ($195,000). There was no financial information available on the company. (Tr. III 87 - * * *.)
33. * * * ($370,000). No current financial information was available for guarantor * * *. Guarantor statements overvalued the * * * investment based on that company's financial statement. (Tr. III 87 - * * *.)
34. * * * & * * *, d/b/a * * * ($75,000). No financial information had been obtained on the business or individuals prior to the examination. (Tr. III 87–88 -* * *).
35. * * * and * * * ($105,000). The Bank extended additional credit in March and September of 1982 without obtaining current financial information. (Tr. III 88 -* * *.)
36. * * * and * * * ($28,000). The bank did not have current financial information on the borrowers when $28,000 was extended on April 16, 1982. Management was aware of the problems of * * *, a company in which * * * was a principal. (Tr. III 88 - * * *.)
37. * * * ($267,000). The most current statement on file when the loan dated September 24, 1982, was made was dated March 31, 1980, and reflected negative net worth of $16,200. (Tr. III 88 - * * *.)
38. * * * and * * * ($152,000). The bank extended additional credit in 1982 and 1983 without obtaining current financial information. The latest information on file was dated November 23, 1979. (Tr. III 88–89 - * * *.)
39. * * * and * * * ($136,000). When bank management extended $89,000 on May 20, 1983 and $1,900 on May 20, 1983, the borrowers' most current statement was dated May 28, 1982. Bank management did not obtain sufficient financial information to verify the borrowers' ability to service this debt. (Tr. III 89 - * * *.)
40. The total of the loans listed in ¶¶10–39, *supra*, as lacking financial information was $5,086,000. (Tr. III 194 - * * *) This represented 73.7 percent of the Bank's total adversely classified loans of $6,903,000.

ii. *Extending credit without adequate security*

41. If a bank has received and analyzed adequate financial information, performed a credit check, and established a favorable credit history, it may be prudent to extend unsecured credit. (Tr. III 89 - * * *.) In other cases, the extension of credit without adequate security is an unsafe or unsound practice. (Tr. IV 90 - * * *; Tr. IX 28 -* * *.) The extensions of credit in ¶¶42–59, *infra*, involved this unsafe or unsound banking practice. (Tr. III 90 - * * *.)
42. * * * ($115,000). The loan was unsecured. The obligor's financial statement, which listed total assets of $278,100; total liabilities of $37,000; and net worth of $241,100 on August 1, 1980, did not support unsecured credit of $130,000. Major assets consisted of real estate and personal property of $205,200 and $45,000 investment in closely held * * *. (Tr. III 90–91 -* * *.) See also PFF ¶11, *supra*.
43. * * * ($125,000). The loan was unsecured. The obligor's financial statement was not detailed. There was no evidence of a credit check or verification of assets, and there was no income information. Total unsecured debt of $300,000 was excessive in comparison to $984,800 listed net worth. (Tr. III 91 - * * *.) See also PFF ¶13, *supra*.
44. * * * ($225,000). The loan was unsecured. The obligor's financial statement lacked detail, and the * * * investment was significantly overstated. See discussion of * * * financial statement *supra*, PFF ¶14. With the * * * investment adjusted to $2.00 per share, the obligor's net worth would be $1,214,300, rather than $2,266,100. (Tr. III 91 - * * *.)
45. * * * ($214,000). This extension of credit was secured only by restricted * * * {{4-1-90 p.A-729}}stock. (Tr. III 92 - * * *.) See also PFF ¶16, *supra*, and ¶115, *infra*.
46. * * * ($135,000). The security was a junior lien on a shopping center in * * *. There was no final title search, recorded mortgage, or insurance. The appraisal was performed, not by an independent party, but rather by * * *. A letter in the file dated February 5, 1982, from a first mortgagor to * * *, in care of * * * indicated a possible first lien balance of $575,000 * * *. Appraised value was stated to be $810,000 and the loan was $135,000. An assignment of rents was taken but without corresponding loan terms or provisions concerning the receipt of rents. Funds were disbursed December 3, 1981 but a mortgage security agreement was not taken until March 16, 1983. (Ex. 10, at 34; Tr. III 93 -* * *.) See also PFF ¶17, *supra*.
47. * * * ($50,000). The financial statement (total liabilities of $6,682,800, net worth of $2,006,700 with fixed assets of $6,443,400) did not support unsecured borrowings. (Tr. III 93 - * * *.) See also PFF ¶19, *supra*.
48. * * * ($270,000). The loan was unsecured. The obligor's financial capacity did not support unsecured borrowings. Some assets listed on this corporation's statement were not owned by the company. (Tr. III 93–94 - * * *.) See also PFF ¶20, *supra*.

49. * * * ($218,000). The loan was unsecured. The obligor's financial statement did not support the unsecured credit. (Tr. III 94 - * * *.) See also PFF ¶21, *supra*.

50. * * * ($300,000). The loan was unsecured. When the bank advanced $500,000 on January 28, 1982, the corporation's latest financial statements dated September 30, 1980, listed total assets of $2,399,000, total liabilities of $2,229,000, and net worth of $170,000. The obligor's net loss for the year of 1982 was $752,000. Net loss for 1981 was $402,000. (Tr. III 94 - * * *.)

51. * * * ($324,000). Five hundred thousand dollars of the line was secured by a vendee's interest in a contract deed on a commercial building in * * *. There was no final title search. A November 9, 1983, letter from * * * reflected a first lien in the amount of $469,000. An appraisal dated April 8, 1982, by * * * valued the property at $1,400,000. Approximately $40,000 was unsecured. (Tr. 94–95 - * * *.) See also PFF ¶22, *supra*.

52. * * * ($184,000). The loan was unsecured. The obligor's financial statement adjusted for * * * debt would show total liabilities of $901,000 and net worth of $356,000 rather than total liabilities of $791,000 and net worth of $565,000. The financial statement did not support unsecured credit. (Tr. III 95 - * * *.) See also PFF ¶23, *supra*.

53. * * *, Jr. ($329,000). This loan was secured by 72,727 shares of restricted * * * stock owned by * * *, Sr. and a 1983 automobile. (Tr. III 95 - * * *.) The borrower's financial statement (Ex. 19) was false in that the stock was owned by his father. (Exs. 41 and 42.) See also PFF ¶24, *supra*, and ¶115, *infra*.

54. * * * ($36,000). This loan was secured only by 20,000 shares of restricted * * * stock. (Tr. III 95 - * * *.) See also PFF ¶25, *supra*, and ¶115, *infra*.

55. * * * ($237,000). This amount of the obligor's liabilities to the Bank was unsecured. Her financial statement (Ex. 68) was questionable and did not support unsecured credit. (Tr. III 95–96 - * * *.) See also PFF ¶26, *supra*.

56. * * * ($299,000). This credit was secured by 10,000 shares of * * *, closely held by the * * * family. The financial information obtained on this company was not sufficiently detailed. (Tr. III 96 - * * *.) See also PFF ¶27, *supra*.

57. * * * ($40,000). The obligor's equity in his home did not provide for sufficient security. Its appraised value was only $47,500. A lien of approximately $20,000 was prior to the Bank's. (Tr. III 96 - * * *.) See also PFF ¶30, *supra*.

58. * * * ($370,000). The loan was unsecured. Financial statement dated February 28, 1983 listed the company's total assets at $783,400, total liabilities $743,800, and net worth of $39,600, with a year end net loss before taxes of $180,500. This information did not support unsecured borrowings of $585,000 on June 28, 1983. (Tr. III 97 -* * *.) See also PFF ¶33, *supra*.

59. * * * and * * * ($136,000). The line had an insufficient collateral margin. (Tr. III 97 - * * *.) See also PFF ¶36, *supra*.

60. The total of the loans listed in ¶¶42–59, *supra*, as lacking adequate security was {{4-1-90 p.A-730}}$3,607,000. (Tr. III 194 - * * *.) This represented 52.3 percent of the Bank's total adversely classified loans of $6,903,000. In each case the inadequate security was accompanied by inadequate financial information.

iii. *Failing to establish and enforce realistic programs for repayment or to determine the source of repayment.*

61. Most banks determine the source of repayment of loans before extending credit and then establish a program for the loans' repayment. (Tr. I 84–85 - * * *; Tr. III 100 - * * *.) Determining the source of repayment is important to determine how the loan will be repaid. (Tr. I 85 - * * *; Tr. III 101-02 - * * *.) Extending credit without determining the source of repayment and without establishing plans for repayment involves unsafe or unsound banking practices. (Tr. III 100–102 - * * *, Tr. V A 79–80 - * * *.) The extensions of credit in ¶¶62–86, *infra*, involved this unsafe or unsound banking practice. (Tr. III 102 -* * *.)

62. * * * (115,000). There was no specific repayment program and all payments to the date of the examination had been made by individuals other than * * *. When the loan was renewed on March 18, 1983, interest was paid from a * * * and * * * money market deposit account. Proceeds of the loan had paid * * *, debts of $30,000, $30,000, and $70,000 on September 18, 1980. A $15,000 principal repayment had been made by * * * d/b/a * * * on September 20, 1982. (Tr. III 102 - * * *.)

63. * * * ($300,000). No definite repayment program existed for this line of credit. The December 10, 1981, credit file comments state that amortization of the note would begin as the business dictated. On March 29, 1983, interest of $35,000 was paid from a * * * and * * * money market deposit account. (Tr. III 103 - * * *.)

64. * * * ($125,000). No definite amortization program existed. Proceeds of the loan paid * * *'s loans at * * *. Payments were made by * * * d/b/a * * * and by a * * * and * * * money market deposit account. (Tr.

III 103 - * * *.)

65. * * * ($225,000). Proceeds of the $225,000 credit originating on October 26, 1982, were for the benefit of * * *. As of the examination date, no principal payments had been made. President * * * told the examiners the loan would be paid out the week of September 19, 1983. It was not. On February 3, 1984 the loan was paid by * * * d/b/a * * *. The borrower never made any payments. (Tr. III 103-04 -* * *.)

66. * * * ($125,000). Since June 29, 1981, there had been no repayment program for this credit. Interest payments of $20,300 were made from the proceeds of * * * loan PFF ¶50, *supra*. (Tr. III 104 -* * *.)

67. * * * ($214,000). No repayment program existed for this line. (Tr. III 104 -* * *.)

68. * * * ($135,000). No repayment program had been in effect since the loan's inception on December 3, 1981, when the borrower's demand account was credited to cover an overdraft created by a check payable to * * * for $107,000. (Tr. III 104-05 -* * *.)

69. * * * ($233,000). Notes for $100,000 and $30,000 had no specific repayment schedule. The $100,000 note originated on November 19, 1982, to cover partially an overdraft in * * *'s demand account. A principal and interest payment of $107,800 was made on September 18, 1982, by * * * d/b/a * * *. (Tr. III 105 - * * *.)

70. * * * ($50,000). This line had been stagnant since 1979. (Tr. III 105 - * * *.)

71. * * * ($270,000). This line had been stagnant since November 26, 1980. (Tr. III 105 - * * *.)

72. * * * ($218,000). This line originated November 19, 1982, to cover an overdraft in * * * demand account. No repayment program was in effect. (Tr. III 105-06 -* * *.)

73. * * * ($300,000). No repayment program was in effect. The proceeds primarily went to individuals or businesses other than the borrower (PFF ¶66, *supra*), and were not for real estate improvements, contrary to statements in a letter from * * * dated January 17, 1982. (Tr. III 106 - * * *.)

74. * * * ($324,000). Bank management had not requested any amortization for one and one-half to two years. Proceeds of the loan were not used to upgrade the real estate as stated in the credit file. Instead, * * * loans at the * * *, * * *, * * * (" * * *") and * * * Bank, * * *, * * *, (" * * * Bank ") were paid, * * *, debt ($63,940.32 to * * * Bank) was paid, and $23,200 was placed in a money order {{4-1-90 p.A-731}}and endorsed over to * * *. (Judge's Ex. 1, at 6; Tr. III 106 - * * *.)

75. * * * ($184,000). A portion of this line had been extended since February, November, or December of 1982 and no scheduled repayment program was in effect. (Tr. III 107 - * * *.)

76. * * * ($329,000). Proceeds from the various loans benefited * * *, * * *, and * * *. Notes originating in May of 1981, June 1982, August 1982, and October 1982 had no definite repayment plan. Under an agreement dated December 23, 1981, * * *, agreed to pay all interest on business and student loans of * * *, until December 31, 1983. (Tr. III 107 - * * *.)

77. * * * ($237,000). Portions of the line originated June 19, 1980, and in 1982, for which no repayment program had been instituted. Of the proceeds, $128,600 went to * * * and $96,400 went to * * *. A June 1983 interest payment on the $225,000 loan was made by * * * d/b/a * * * and by * * *. Of the $38,000 loan, $13,000 benefited * * *. No payments had been made by the borrower. (Tr. III 107-08 - * * *.)

78. * * * ($299,0000). No scheduled repayment program had been instituted for this line, which commenced in 1974. All proceeds benefited * * *. Interest payments have been made by * * *. (Tr. III 108 - * * *.)

79. * * * ($40,000). On May 14, 1982, this note was extended on a demand basis with no scheduled repayment program. (Tr. III 108 - * * *.)

80. * * * ($130,000). This note was dated December 13, 1982, due on demand. No definite repayment plan was specified although credit file notes indicated that monies would be applied to the loan as lot in the developments were sold. The Bank requested a $22,000 principal reduction on December 13, 1981, but extended payment to December 13, 1982, and even then did not get full principal payment. (Tr. III 108-09 - * * *.)

81. * * * ($370,000). The Bank's credit files indicated that only interest was requested to be paid on the $585,000 note dated June 28, 1983 due February 28, 1984. No other terms for principal repayment were specified. (Tr. III 109 - * * *.)

82. * * * and * * * ($339,000). No repayment program was specified for this cash crop farming and logging line of credit, consisting of three demand notes that date back to December 1982. (Tr. III 109 -* * *.)

83. * * * and * * * ($105,000). All four loans, totaling $102,500, were on a demand basis. The remaining balance consisted of an * * * check (drawing account) and an overdraft. One loan for $50,000 dated to February 4, 1981. (Tr. III 111 - * * *.)

84. * * * ($204,000). This line was adversely classified at the 1981 examination, when the notes were on a demand basis. The line increased approximately $20,000 between examinations with all notes remaining on a demand basis. Although a 30 per cent dairy assignment was received, it was not sufficient to reduce principal. (Tr. III 111 - * * *.)

85. * * * ($136,000). Although the Bank renewed the loans at a 10 per cent interest rate, the borrowers as of the examination date were three months delinquent on $89,000. Even at the reduced interest rate, the repayment program may be unrealistic. (Tr. III 111-12 - * * *.)

86. * * * ($152,000). Most of the borrowers' notes were on a demand basis rather than being amortized on a specific program. (Tr. III 112 - * * *.)

87. The total of the loans listed in ¶¶62–86, *supra*, as lacking adequate repayment plans was $5,159,000. (Tr. III 194 - * * *.) This represented 74.8 percent of the Bank's total adversely classified loans of $6,903,000.

iv. Extending credit without determining its purpose

88. Banks normally determine the purpose of a loan before extending credit. (Tr. I 84 - * * *; Tr. III 118 - * * *.) The failure to do so is an unsafe or unsound practice because without such information the lending officer cannot evaluate the risk of the loan or its compliance with loan policy. (Tr. III 119 - * * *.) The extensions of credit in ¶¶89–106, *infra*, involved this unsafe or unsound banking practice. (Ex. 84; Tr. III 124 - * * *.)

89. * * * ($115,000). * * *'s loan paid * * * debt of $130,000 on September 18, 1980. (Tr. III 124-26, 164 - * * *.) The ultimate purpose was to "correct" a reported violation of Regulation O. (Ex. 4, at 4–5; Ex. 84; Ex. 85, at 2.)

90. * * * ($300,000). Approximately $200,000 of the $300,000 loan paid * * *'s (* * *'s related interest) debt at the Bank. (Ex. 84; Tr. III 126, 164 - * * *.)

91. * * * ($125,000). The $300,000 loan was at the Bank due to Mr. * * *'s purchase of * * * units. Proceeds paid * * *'s debt at * * *. (Tr. III 127 - * * *.) The credit file lacked information concerning the purpose of the credit. (Ex. 84; ;Tr. III 126-27, 164 - * * *.)

92. * * * ($225,000). The Bank's credit files lacked purpose statements. (Tr. III 173 - * * *.) President * * * contacted the borrower during the examination as to the use of the $225,000. The $225,000 had been wired to the account of * * * (wholly-owned by * * *) and the $200,000 was used to pay * * *'s debt (wholly-owned by * * *) at * * *, (`* * *'). (Tr. III 168 -* * *.)

93. * * * ($125,000). The Bank's credit file lacked a purpose statement. (Tr. III 164 - * * *.)

94. * * * ($214,000). The Bank's credit file lacked a purpose statement. (Tr. III 164 - * * *.) President * * * had only a separate memorandum (not in the file) indicating that Mrs. * * * purchased $100,000 of * * * stock on June 1, 1982. On May 6 and 7, 1980, $160,000 was disbursed. Proceeds were disbursed by a $100,000 bank money order #91991 to * * * and $60,000 made two $30,000 principal payments on an unidentified loan. (Tr. III 143-45 - * * *.)

95. * * * ($135,000). The Bank's credit file lacked a purpose statement. The $135,000 covered an overdraft in the borrower's demand account due to a check drawn on the account payable to * * * (Tr. III 143, 164 - * * *.)

96. * * * ($233,000). The Bank's credit file lacked purpose comments. Of the total, $100,000 was used to cover part of an overdraft in * * *'s demand account arising from a check drawn on that account payable to * * * for $332,345.89. (Ex. 84; Tr. III 142-43, 164 - * * *.)

97. * * * ($50,000). The Bank's credit file lacked purpose comments. (Ex. 84; Tr III 164 - * * *.)

98. * * * ($270,000). The Bank's credit file lacked purpose comments. President * * *, admitted to examiners that he was not certain of the purpose of the extension. (Ex. 84; Tr. III 138-39, 164 - * * *.)

99. * * * ($218,000). The Bank's credit file lacked purpose comments. Proceeds of the loan were used to cover an overdraft in * * *'s demand account arising from a check drawn on the account and made payable to * * *. (Ex. 84; Tr. III 140, 164 -* * *.)

100. * * * ($300,000). Notes in the Bank's credit files stated that proceeds were for construction financing of roads, sewer, and water in the * * * outlet (* * *) and preliminary planning of drainage, sewer, and water in the 7th Addition in * * *. (Ex. 10, at 36.) A trace of the proceeds indicated a different use of the funds. Of the $500,000 note, $13,100 was used to pay interest on * * * of * * * notes; $500 was used to make an interest payment on * * *; $20,300 was used to make a payment on * * *'s $225,000 note; $56,800 was wired to * * * to pay * * * interest; $4,600 went to affiliated * * * for * * *; $11,300 went to * * *, with notation "interest as of December 31, 1981;" $210,000 was deposited in * * *'s account #135-829; $47,600 was made payable to * * *, $100,000 was credited to the Bank's account for the account of * * *; $4,200 was wired to * * * Bank, * * *, * * * ("* * *") for * * * and $31,800 was wired to * * * for the account of * * * with the notation " * * *, * * *." The $100,000 note was used to pay * * *'s debt ($96,000) at * * *. The remaining funds were placed in a money order for * * *. (Ex. 84; Tr. III 127-33, 164 - * * *.)

101. * * * ($324,000). Notes in the Bank's credit file indicated $500,000 was used for leasehold improvements and expansion of the parking area and loading docks of the present building. A memorandum found in the file from Assistant Cashier * * * to * * * indicated that the $500,000 was used

for a transfer of ownership (* * *), and to pay * * * $117,800 (of which $63,900 paid debts at * * * Bank). Of the remaining $129,900, $23,200 was used for a money order payable to * * *, and subsequently endorsed over to * * *. (Ex. 84; Tr. III 139, 164 - * * *.)

102. * * * ($184,000). The Bank's credit File lacked purpose statements. (Ex. 84; Tr. III 150, 164 - * * *.)

103. * * * ($36,000). The Bank's credit file lacked purpose statements. (Ex. 84; Tr. III 150, 164 - * * *.)

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104. * * * ($299,000). The Bank's credit file lacked purpose statements. The funds went to * * *. (Ex. 84; Tr. III 147-48, 164 -* * *.)

105. * * * ($329,000). The Bank's credit file lacked purpose statements. A separate memorandum maintained by President * * * indicated that * * * purchased $100,000 of * * * stock on June 1, 1982. Of an original $150,000 in proceeds, $72,000 was deposited into * * * * * * demand account and $78,000 was wired to * * * Bank, for * * *. (Ex. 84; Tr. III 145-46, 164 - * * *.)

106. * * * ($237,000). The Bank's credit file lacked purpose statements. Of the total, $225,000 was used to pay debts of * * *, and * * *, $13,000 of the original $38,000 was used to pay a * * * (* * * related interest) loan and $49,000 was used for a transaction between Merrill Lynch * * * and * * *. (Tr. III 148-50, 164 - * * *.)

107. The total of the loans listed in ¶¶89–106, *supra*, as lacking statement of purpose was $3,179,000. (Tr. III 195 - * * *.) This represented 46.2 percent of this Bank's total adversely classified loans of $6,903,000.

108. See Stipulation ¶8.

D. *Condition Resulting From Unsafe or Unsound Lending Practices*

109. A substandard asset is one that is inadequately protected by current sound worth or the paying capacity of the obligor. (Tr. III 63 - * * *.) Such credit weaknesses may jeopardize the liquidation of the loan and cause the Bank to sustain loss. (Tr. VA 35 - * * *.) Loans adversely classified as of August 22, 1983, were $6,721,000 "substandard," and $182,000 "loss." (Ex. 10, at 8, -6; Tr. VA 37 - * * *) A loan may be classified because it is undersecured, there is insufficient cash flow, or there is not a normal amortization program, among other things. (Tr. I 109 - * * *.) A condition resulting from the * * * hazardous lending and lax collection practices was an excessive and disproportionately large volume of poor quality loans in relation to * * * total loans. (Tr. III 192 - * * *.) The Bank's adversely classified loans represented 28.7 percent of its total loans. (Ex. 10, at 8; Tr. III 186-87 - * * *.) An average bank of the same size would have not more than ten percent of its loans adversely classified. (Tr. VB 142 - * * *.) As of October 31, 1983, the Bank had ceased accruing interest on $988,000 of its loans. (Ex. E, at 3.)

E. *Accounting Practice*

110. * * * had engaged in an unsafe or unsound banking practice in that it failed to make adequate provisions for its reserve for possible loans losses ("loan valuation reserve"). The Bank has waited until assets are almost uncollectible before charging them off. (Tr. VB 148 - * * *.) As of August 22, 1983, the loan valuation reserve of * * * totaled $308,000, while the total of all loans subject to adverse classification was $6,903,000. (Ex. 10, at 8–9; Tr. III 196 -* * *.) An adequate reserve would have been $690,000 or more. (Tr. III 196-97 -* * *.) *See also* Part IV B ii-iii of this Brief, *infra*, at 50–53. As a result, the financial statements prepared by * * * have overstated its earnings and equity capital. (Tr. III 199–200 - * * *.)

F. *Liquidity Practice*

111. * * * has engaged in an unsafe or unsound banking practice in that it has operated with inadequate liquidity. (Tr. III 200-12 - * * *.) During a period beginning on January 1, 1983, and ending on August 22, 1983, * * * had borrowed for 70 days at an average borrowing of $419,000 and a maximum borrowing of $925,000. (Tr. III 207 - * * *.) This is substantially more than normal. (Tr. III 210 - * * *.) As of August 22, 1983, only $65,000 of * * * investment portfolio of $10,777,000 was scheduled to mature within one year. (Tr. III 204 - * * *.)

G. *Capital Practice*

112. * * * has engaged in unsafe or unsound banking practice in that it has operated with an inadequate level of capital for the kind and quality of assets it held. (Tr. III 212-15 - * * *.) As of August 22, 1983, the total of $7,407,000 in adversely classified assets not considered in computing * * * adjusted capital and reserves was 271 percent of * * * adjusted equity capital and reserves.[2] (Tr. III 214 - * * *.)

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2 The ratio of a bank's adjusted capital and reserves to Net equity capital and reserves is calculated by subtracting the rest of the adversely classified assets. For August 22, 1983, the calculation was as follows:
(Continued)

H. *Supervision by Directors*

113. * * * board of directors has failed to provide adequate supervision over * * * and other active officers of * * *. (Tr. III 215 - * * *; Tr. VII 48–63 - * * *.) Abusive practices regarding loans to insiders and associates of insiders of * * * have been of concern to the FDIC for about five years. These concerns have been expressed to the board of directors of * * * repeatedly by letters and in reports of examination, as more fully set forth in PFF ¶5, *supra*.

I. *Violations*

114. See Stipulation ¶13.
115. * * * was and is a highly speculative stock. (Ex. 1, at 2; Tr. III 20 - * * *.) The company had not been profitable at the time the loans were made and had not become profitable even a year later. (Ex. 1, at 5, 25; Tr. III 20 - * * *.) The company was financially strapped even a year following the cash infusion represented by the loans. (Ex. 1, at 10; Tr. III 23 - * * *.) The stock continued to be risky even up to the time of the hearing. (Tr. III 32 - * * *.) In addition, the stock was restricted stock, making it not readily marketable. See the Securities and Exchange Commission's Rule 144, 17 C.F.R. § 230.144. *See also*, Lehr, *Some Securities Law Issues in Lending on Pledged Stock*, 38 Bus. Law. 91 (1982).
116. The $100,000 extension of credit in the name of * * * reflected in paragraph 13(a) of the Stipulation was actually an undisclosed accommodation loan to * * * to buy stock in * * *. (Ex. 1, at 18, 32, 38; Exs. 41–42, 79–80, 88–106; Tr. II 87–95 -* * *, Sr.; Tr. III 66 - * * *.) In connection with this transaction, * * *, falsely warranted that he owned the stock. (Tr. II 197 - * * *; Ex. 83; Ex. II, at 4.) Other loans purportedly made to * * * actually benefited his father or * * *. (Tr. III 145-46 - * * *.)
117. See Stipulation ¶14.
118. See Stipulation ¶15. The Bank generally charged interest rates of 12 percent or more on its loans. (Tr. III 220 - * * *; Ex. 67; Tr. IV 10–11 - * * *.) See also Stipulation ¶5(d).
119. See Stipulation ¶16(a).
120. The extension of credit was made without first obtaining current written financial information about * * *. Repayment of the extension of credit was dependent upon the income received from * * *, whose credit was of more than normal risk. (Tr. III 182-84 - * * *.)
121. See Stipulation ¶17(a).
122. The extension of credit was unsecured. The company was having financial difficulty and had written off some inventory and receivables. (Tr. III 174-76 - * * *.) * * * had operated at a loss in its most recent fiscal year. (Ex. 10, at 42.) There was only a limited guaranty (Tr. III 177 -* * *.)
123. See Stipulation ¶17(c).
124. By virtue of the transactions set forth in ¶117 *supra*, the extensions of credit described in ¶¶118-23 presented a conflict of interest of * * *.
125. See Stipulation ¶18.

* * *

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2 Continued:

Common stock	$250,000
Surplus	1,600,000
Undivided profits	541,000
Contingency reserves	100,000
	____________
Equity capital	2,491,000
Valuation reserves	308,000
	____________
Equity capital	2,491,000
Total equity capital and reserves	2,799,000
Less assets classified "loss"	184,000
	____________
Adjusted equity capital and reserves	2,615,000

Less assets classified "substandard"	7,407,000
Net equity capital and reserves	($4,792,000)

Its adjusted gross assets provides an indication of the amount of protection which a bank's capital accounts provide for its depositors. This ratio also reflects the extent to which asset loss or depreciation can be absorbed by the bank's capital accounts before its depositors' funds are impaired. In this regard, capital consists of equity capital (defined to include common stock, perpetual preferred stock, capital surplus, undivided profits, contingency reserves, other capital reserves, mandatory convertible instruments, and reserves for loan losses) less assets classified loss and one-half of assets classified doubtful. FDIC Statement of Policy on Capital Adequacy, 46 Fed. Reg. 62,694 (1981).

This statement of policy has been superseded by the FDIC's regulation, Capital Maintenance, 50 Fed. Reg. 11,128 (1985) (to be codified at 12 C.F.R. Part 325) and by the FDIC's Statement of Policy on Capital, 50 Fed. Reg. 11,138 (1985).

To the extent any requested finding of fact may be deemed a conclusion of law, or vice versa, the FDIC requests that it be so regarded.

* * *

III. PROPOSED CONCLUSIONS OF LAW

The parties in this proceeding have entered into a Stipulation of certain matters of fact and law attached to volume I of the transcript of this proceeding as Attachment C ("Stipulation"). The FDIC requests that the court make the additional conclusions of law set forth below.

A. *Jurisdiction*

1. The FDIC has jurisdiction over the Bank and the subject matter of this proceeding. See Stipulation ¶1.

B. *Unsafe or Unsound Practices*

2. The Bank and * * * have engaged in the following unsafe or unsound banking practices within the meaning of section 8(b) of the Federal Deposit Insurance Act:

(a) The Bank extended credit without first obtaining adequate financial information on all obligors. PFF ¶¶7–40.

(b) The Bank extended credit without adequate security. PFF ¶¶41–60.

(c) The Bank failed to establish and enforce realistic programs for repayment or failed to determine the source of repayment. PFF ¶¶61–87.

(d) The Bank extended credit without determining the purpose of the credit. PFF ¶¶:88–107.

(e) The Bank operated with an inadequate reserve for loan losses. PFF ¶110.

(f) The Bank operated with inadequate liquidity. PFF ¶111.

(g) The Bank operated with inadequate capital. PFF ¶112.

(h) The Bank operated with inadequate supervision by its board of directors. PFF ¶¶5, 113.

C. *Violations*

3. As of August 22, 1983, the Bank had granted extensions of credit in the amount of at least $600,000 secured by stock of * * *, an "affiliate" of the Bank within the meaning of section 23A of the Federal Reserve Act (12 U.S.C. § 371c), in violation of the lending limit and security restrictions of such section. PFF ¶114.

4. The extensions of credit in paragraph 3 inured to the tangible benefit of, or were transferred to * * *, a related interest of * * *. They were made in amounts in excess of the lending limit of section 215.2(f) of Regulation O (12 C.F.R. § 215.2(f)), in violation of section 215.4(c) of Regulation O (12 C.F.R. §215.4(c)) and section 22(h)(1) of the Federal Reserve Act (12 U.S.C. § 375b(1)). PFF ¶114.

5. On or about February 10, 1983, * * * extended credit in the amount of $5,000 to * * *. This extension of credit was not made on substantially the same terms as those prevailing at the time for comparable transactions with other persons. This extension of credit presented other unfavorable features by virtue of a conflict of interest of * * *, arising from his controlling influence over * * * and his seeking funds for himself and his related interests from * * *, in violation of section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. § 1972(2)). PFF ¶118; Answer ¶6.

6. On or about February 14, 1983, * * * extended credit in the amount of $45,000 to * * *. This extension of credit was not made on substantially the same terms as those prevailing at the time for comparable transactions with other persons. This extension of credit presented other unfavorable features by virtue of a conflict of interest of * * *, arising from his controlling influence over * * * and his seeking funds for himself and his related interests from * * *, in violation of section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. § 1972(2)). Further, * * * was * * *'s lending officer with respect to extensions of credit to * * *. PFF ¶118; Answer ¶7.

7. On or about February 11, 1983, * * * extended credit in the amount of $3,000 to * * *. This extension of credit was not made on substantially the same terms as those prevailing at the time for comparable transactions with other persons. This extension of credit presented other unfavorable features by virtue of a conflict of interest of * * *, arising from his controlling influence over * * * and his seeking funds for himself and his related interests from * * *, in violation of section 106(b)(2) of the Bank Holding Company Act Amend- {{4-1-90 p.A-736}}ments of 1970 (12 U.S.C. § 1972(2)). PFF ¶118; Answer ¶8.

8. On or about April 11, 1983, * * * extended credit in the amount of $5,000 to * * *. This extension of credit was not made on substantially the same terms as those prevailing at the time for comparable transactions with other persons. This extension of credit presented other unfavorable features by virtue of a conflict of interest of * * *, arising from his controlling influence over * * * and his seeking funds for himself and his related interests from * * *, in violation of section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. § 1972(2)). PFF ¶11; Answer ¶9.

9. On or about May 12, 1983, * * * extended credit in the amount of $30,000 to * * *. This extension of credit was not made on substantially the same terms as those prevailing at the time for comparable transactions with other persons. This extension of credit presented other unfavorable features by virtue of a conflict of interest of * * * arising from his controlling influence over * * * and his seeking funds for himself and his related interests from * * *, in violation of section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. § 1972(2)). PFF ¶118; Answer ¶10.

10. On or about June 13, 1983, * * * extended credit in the amount of $200,000 to * * * and to his related interest, * * * by extending credit in the amount of $400,000 and at the same time selling a participation in the amount of $200,000 to * * *. This extension of credit was made in violation of section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. § 1972(2)) in that it involved more than the normal risk of repayment or presented one or more of the following unfavorable features:

(a) The extension of credit was made without first obtaining current written financial information about * * *;

(b) The extension of credit presented a conflict of interest of * * *; and

(c) Repayment of the extension of credit was dependent upon the income received from * * *, whose credit was of more than normal risk within the meaning of section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. § 1972(2)). PFF ¶¶119-20, 124; Answer ¶11.

11. On or about June 28, 1983, * * * extended credit in the amount of $585,000 to * * * and to his related interest, * * *. This extension of credit was made in violation of section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. § 1972(2)) in that it involved more than the normal risk of repayment or presented one or more of the following unfavorable features:

(a) * * * had operated at a loss in its most recent fiscal year;

(b) The extension of credit presented a conflict of interest of * * *; and

(c) The extension of credit was not fully secured. PFF ¶¶121-24; Answer ¶13.

12. On or about July 15, 1983, * * * extended credit in the amount of $48,513.93 to * * *. This extension of credit was not made on substantially the same terms as those prevailing at the time for comparable transactions with other persons. This extension of credit presented other unfavorable features in the form of a conflict of interest of * * *, arising from his controlling influence over * * * and his seeking funds for himself and his related interests from * * *, in violation of section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. § 1972(2)). PFF ¶121-24; Answer ¶13.

13. The extensions of credit described in paragraphs 5 through 12 of the Proposed Conclusions of Law ("PCL"), *supra*, inured as well to the tangible economic benefit of * * *, and his related interests within the meaning of section 215.3(f) of Regulation O (12 C.F.R. § 215.3(f)). As a result, each of the extensions of credit described in paragraphs 5 through 12 was also made in violation of section 22(h)(3) of the Federal Reserve Act (12 U.S.C. § 375b(3)) and section 215.4(a) of Regulation O (12 C.F.R. § 215.4(a)). PFF ¶114.

14. On or about October 19, 1982, * * * extended credit in the amount of $105,000 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶17.

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15. On or about November 5, 1982, * * * extended credit in the amount of $2,000 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. §371c(a)(1)(A)). PFF ¶114; Answer ¶18.

16. On or about November 19, 1982, * * * extended credit in the amount of $1,500 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. §371c(a)(1)(A)). PFF ¶114; Answer ¶19.

17. On or about December 1, 1982, * * * extended credit in the amount of $100,000 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶20.

18. On or about December 1, 1982, * * * extended credit in the amount of $100,000 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶21.

19. On or about February 2, 1983, * * * extended credit in the amount of $400,000 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶22.

20. On or about February 8, 1983, * * * extended credit in the amount of $114,219.87 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. §371c(a)(1)(A)). PFF ¶114; Answer ¶24.

21. On or about February 11, 1983, * * * extended credit in the amount of $72,000 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶25.

22. On or about February 18, 1983, * * * extended credit in the amount of $2,500 to * * *, secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶26.

23. On or about March 9, 1983, * * * extended credit in the amount of $110,000 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶27.

24. On or about March 18, 1983, * * * extended credit in the amount of $7,000 to * * * secured by stock in * * * at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶29.

25. On or about March 22, 1983, * * * extended credit in the amount of $4,600 to * * * secured by stock in * * * at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Fed- {{4-1-90 p.A-738}}eral Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶30.

26. On or about March 23, 1983, * * * extended credit in the amount of $2,500 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶31.

27. On or about April 4, 1983, * * * extended credit in the amount of $19,000 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶32.

28. On or about April 18, 1983, * * * extended credit in the amount of $105,000 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶33.

29. On or about May 19, 1983, * * * extended credit in the amount of $1,500 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by

such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶35.

30. On or about May 20, 1983, * * * extended credit in the amount of $9,250 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶36.

31. On or about May 28, 1983, * * * extended credit in the amount of $200,000 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶37.

32. On or about June 1, 1983, * * * extended credit in the amount of $5,500 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶38.

33. On or about July 28, 1983, * * * extended credit in the amount of $5,600 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶40.

34. On or about August 3, 1983, * * * extended credit in the amount of $1,000 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶42.

35. On or about August 5, 1983, * * * extended credit in the amount of $1,200 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶43.

36. On or about August 10, 1983, * * * extended credit in the amount of $5,000 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶44.

37. On or about August 31, 1983, * * * extended credit in the amount of $2,500 to {{4-1-90 p.A-739}}* * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶46.

38. On or about September 8, 1983, * * * extended credit in the amount of $1,500 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. § 371c(a)(1)(A)). PFF ¶114; Answer ¶47.

39. On or about September 28, 1983, * * * extended credit in the amount of $80,000 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. §371c(a)(1)(A)). PFF ¶114; Answer ¶48.

40. On or about November 28, 1983, * * * extended credit in the amount of $200,000 to * * * secured by stock in * * *, at a time when, taken together with the amount of credit then outstanding on its books secured by such stock, the amount extended exceeded ten percent of capital and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. §371c(a)(1)(A)). PFF ¶114; Answer ¶52.

41. Each of the extensions of credit described in PCL ¶¶5–12, 13–16, 18, 21, 24–30, and 32–39, *supra*, was made without the prior approval required by section 337.3(b) of the FDIC's Rules and Regulations, 12 C.F.R. § 337.3(b), section 215.4(b) of Regulation O, 12 C.F.R. §215.4(b), and section 22(h)(2) of the Federal Reserve Act, 12 U.S.C. §375b(2), in violation of such sections.

42. Each of the respondents has violated sections 22(h) and 23A of the Federal Reserve Act (12 U.S.C. §§ 375b and 371c), Regulation O (12 C.F.R. Part 215) promulgated under section 22(h) of the Federal Reserve Act, and section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. § 1972(2)). PFF ¶114; Answer ¶¶29–32, 38, 40, 44, 46, and 47.

{{4-1-90 p.A-740}}

TABLE I

S = Substandard
D = Doubtful

L = Loss

PFF	CLASSIFICATION CONCLUSION (dollar amount in thousands) S	D	L	Conceded by Respondents	FDIC Proposed Findings Upheld	Other (See Footnotes to Table I)
(10)	160					1/
(11, 42, 62, 89)	115				X	
(12, 63, 90)	300				X	
(13, 43, 64, 91)	125				X	
(14, 44, 65, 92)	225				X	
(15, 66, 93)	125				X	
(16)	214			X	X	
(17, 46, 68, 95)	135				X	
(18, 69, 96)	233				X	
(19, 47, 70, 97)	50				X	
(20, 48, 71, 98)	270				X	
(21, 49, 99)	218				X	
(22, 51, 74, 101)	324				X	
(23, 52, 75, 102)	184			X	X	
(24, 53, 76, 105)	329			X	X	
(25, 54, 103)	36			X	X	
(26, 55, 77, 106)	237				X	
(27, 56, 78, 104)	299				X	
(28)		6			X	
(29)	3					2/
(30, 57, 79)		20	20		X	
(31, 80)	130				X	
(32)	195					3/
(33, 58, 81)	370				X	
(34)	75					4/
(35, 83)	105				X	
(36)	28					5/
(37)	150		117		X	
(38, 86)	152				X	
39, 59, 85)	136				X	
(50, 73, 100)	300				X	
(82)	339					6/
(84)	204					7/

KEY TO TABLE II (Ed. note: Table II precedes Table I in official material.)

1(a) Extending credit without obtaining adequate financial information.
1(b) Extending credit without obtaining adequate security.
1(c) Failure to establish and enforce a realistic program for repayment or to determine the source of repayment.
1(d) Extending credit without determining its purpose.

FOOTNOTES TO TABLE I (see following page)

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[1] * * * ($160,000). The only hazardous lending or lax practice alleged and proved pertains to the Bank's extending credit without adequate financial information. Under the rationale set forth in the Initial Decision at Section II-C-1, the classification is not upheld.

[2] * * * ($3,000). The only hazardous lending or lax collection practice alleged and proved pertains to the Bank's extending credit without adequate financial information. Under the rationale

set forth in the Initial Decision at Section II-C-1, the classification is not upheld.

[3] * * * ($195,000). The only hazardous lending or lax collection practice alleged and proved pertains to the Bank's extending credit without adequate financial information. Under the rationale set forth in the Initial Decision at Section II-C-1, the classification is not upheld.

[4] * * * & * * * d/b/a * * * ($75,000). The only hazardous lending or lax collection practice alleged and proved pertains to the Bank's extending credit without adequate financial information. Under the rationale set forth in the Initial Decision at Section II-C-1, the classification is not upheld.

[5] * * * & * * * ($28,000). The only hazardous lending or lax collection practice alleged and proved pertains to the Bank's extending credit without adequate financial information. Under the rationale set forth in the Initial Decision at Section II-C-1, the classification is not upheld.

[6] * * * & * * * ($339,000). The only hazardous lending or lax collection practice alleged and proved pertains to the failure of the Bank to establish and enforce a realistic repayment program or to determine the source of repayment. Under the rationale set forth in the Initial Decision at Section II-C-1, the classification is not upheld.

[7] * * * ($204,000). The only hazardous lending or lax collection practice alleged and proved pertains to the failure of the Bank to establish and enforce a realistic repayment program or to determine the source of repayment. Under the rationale set forth in the Initial Decision at Section II-C-1, the classification is not upheld.

TABLE II

[Determinations, Section II-C-1: Hazardous Lending and Lax Collection Practices]

S = Substandard
D = Doubtful
L = Loss

Alleged Hazardous Lending and Lax Collection Practice	Classification Conclusion (From Table I)				FDIC Proposed Findings Upheld by Category				FDIC Findings Not Upheld (See Key to Table II)
PFF	None	S	D	L	1(a)	1(b)	1(c)	1(d)	
(10)	X				X				
(11, 42, 62, 89)		X			X	X	X	X	
(12, 63, 90)		X			X		X	X	
(13, 43, 64, 91)		X			X	X	X	X	
(14, 44, 65, 92)		X			X	X	X	X	
(15, 66, 93)		X			X		X	X	
(16)		X			X	X	X	X	
(17, 46, 68, 95)		X			X	X	X	X	
(18, 69, 96)		X			X		X	X	
(19, 47, 70, 97)		X			X		X	X	1(b)
(20, 48, 71, 98)		X			X	X	X	X	
(21, 49, 99)		X			X	X		X	
(22, 51, 74, 101)		X			X	X	X	X	
(23, 52, 75, 102)		X			X	X	X	X	
(24, 53, 76, 105)		X			X	X	X	X	
(25, 54, 103)		X			X	X		X	
(26, 55, 77, 106)		X			X	X	X	X	
(27, 56, 78, 104)		X			X	X	X	X	
(28)				X	X				
(29)	X				X				
(30, 57, 79)		X		X	X	X	X		
(31, 80)		X			X		X		
(32)	X				X				1(b)
(33, 58, 81)		X			X		X		
(34)	X				X				
(35, 83)		X			X		X		

(36)	X				X			
(37)								
		X		X	X			
(38, 86)		X			X		X	
(39, 59, 85)		X			X	X	X	
(50, 73, 100)		X				X	X	X
(82)	X						X	
(84)	X						X	

{{4-1-90 p.A-743}}

FDIC-84-23b ORDER TO CEASE AND DESIST

IT IS ORDERED, that * * * Bank, ("Bank"), its directors, officers, employees, agents, assigns, and other persons participating in the conduct of the affairs of the Bank, and * * *, Sr., individually, CEASE AND DESIST, directly or indirectly, from the following unsafe or unsound banking practices and violations of law and regulation:

(a) Operating with an inadequate reserve for loan losses;
(b) Engaging in hazardous lending and lax collection practices;
(c) Operating with an inadequate level of capital;
(d) Operating with inadequate liquidity; and
(e) Violating sections 22(h) and 23A of the Federal Reserve Act (12 U.S.C. §§ 375b and 371c) and Regulation O (12 C.F.R. Part 215), promulgated under section 22(h) of the Federal Reserve Act.

IT IS FURTHER ORDERED, that:

1. (a) Upon the effective date of this ORDER, the Bank shall, to the extent it has not previously done so, eliminate from its books, by charge-off or collection or other suitable means, all assets or portions of assets classified "Loss" by the FDIC as a result of its examination of the Bank as of August 22, 1983. Reduction of these assets through proceeds of other loans made by the Bank is not considered "collection" for the purpose of this paragraph 1(a).

(b) Within eighteen months from the effective date of this ORDER, the Bank shall reduce the total of loans classified "Substandard" as of August 22, 1983, to not more than $2,000,000. As used in this paragraph, "reduce" means (i) to sell without recourse or to collect, (ii) to charge off, or (iii) to improve the quality of adversely classified assets sufficiently to warrant FDIC's removing any adverse classification in succeeding examinations.

2. (a) Within ten days from the effective date of this ORDER, the Bank shall replenish its reserve for loan losses by charges against current operating income in an amount equal to those loans required to be charged-off under paragraph 1(a) of this ORDER.

(b) In Reports of Condition and Income filed by the Bank with the FDIC or the Commissioner of Banking for the State of * * * ("Commissioner") prior to the effective date of this ORDER and subsequent to August 22, 1983, the Bank shall reflect a provision for loan losses which is adequate in light of the condition of the Bank's loan portfolio and which, at a minimum, equals the adjustments required by paragraph 2(a) of this ORDER. If necessary to comply with this ORDER, the Bank shall file amended Reports of Condition and Income.

(c) Prior to submission or publication of any Report of Income or Report of Condition requested by the FDIC or the Commissioner after the effective date of this ORDER, the board of directors of the Bank shall review the adequacy of the Bank's reserve for loan losses and make any provisions necessary to maintain the adequacy thereof. The minutes of the meeting of the board of directors of the Bank and of its audit committee at which such reviews are undertaken shall indicate the results of the review, the amount of increase in the reserve recommended, if any, and the basis for determination of the amount of reserve provided.

3. (a) Within 90 days from the effective date of this ORDER, the Bank shall review its current written loan policies and procedures in light of the deficiencies noted by the FDIC as of August 22, 1983, and develop any changes thereto that are necessary or appropriate in the opinion of the Bank's board of directors. Within four months from the effective date of this ORDER, the board of directors of the Bank shall, (i) direct the loan officers of the Bank to implement the written loan policies and procedures and any amendments thereto, and (ii) establish procedures to monitor loan officer compliance with the written loan policies and procedures.

(b) Areas to be addressed in the Bank's lending policy shall include without limitation the following:

(i) General fields of lending in which the Bank will engage and the kinds or types of loans within each general field.

(ii) The lending authority of each loan officer.

{{4-1-90 p.A-744}}
(iii) Responsibility of the board of directors in reviewing, ratifying, or approving loans.
(iv) Guidelines under which unsecured credit will be granted.
(v) Guidelines for rates of interest and the terms of repayment for secured and unsecured credit.
(vi) Limitations on the amount advanced in relation to the value of the collateral securing the credit and the documentation required by the Bank for each type of secured credit.
(vii) The maintenance and review of complete and current credit files on each obligor.
(viii) The collection procedures of the Bank including without limitation what actions are to be taken against borrowers who fail to make timely payments.
(ix) Limitations on the extension of credit through overdrafts.
4. Within 30 days from the effective date of this ORDER, and monthly, thereafter, the board of directors of the Bank shall require a progress report from the Bank's lending officers on all adversely classified loans in excess of $50,000.
5. Within 60 days from the effective date of this ORDER, the Bank shall correct, by collection or by sale without recourse, all violations of sections 22(h) and 23A of the Federal Reserve Act (12 U.S.C. §§ 375b and 371c) and of Regulation O (12 C.F.R. Part 215), promulgated under section 22(h) of the Federal Reserve Act, existing as of August 22, 1983, and shall institute procedures to ensure future compliance with all applicable laws, rules and regulations.
6. (a) Within 30 days of the effective date of this ORDER, the Bank shall achieve equity capital and reserves at a level equal to or exceeding 7.5 percent of the Bank's average assets for the last complete month prior to such effective date. Thereafter, for the duration of this ORDER, the Bank shall maintain equity capital and reserves at a level equal to or exceeding 7.5 percent of its average total assets for each month of June and December. Equity capital and reserves and total asset amounts utilized in the average shall be calculated in accordance with prevailing instructions for the preparation of Reports of Condition. If such ratio is less than 7.5 percent as of June 30 or December 31 of any calendar year, the Bank shall, within 30 days thereafter, present to the Regional Director of the FDIC's * * * Regional Office ("Regional Director") having supervisory jurisdiction over the Bank and to the Commissioner a plan for the augmentation of the capital accounts of the Bank or other measures to bring the ratio to 7.5 percent. If such ratio is less than 7.5 percent as of June 30 or December 31, respectively, of each calendar year, the Bank shall, by the following July 31 or January 31, respectively, present to the Regional Director and the Commissioner a plan for the augmentation of the capital accounts of the Bank or other measures to bring the ratio to 7.5 percent. Within 60 days after the plan is reviewed and no exception is taken by the Regional Director and the Commissioner, restoration of the capital ratio to 7.5 percent shall be completed.
(b) The formal semiannual capital ratio analysis in June and December of each year provided for in paragraph 6(a) shall not be construed to negate the responsibility of the Bank and its board of directors to maintain, throughout the year, an adequate level of capital protection for the kind, quality, and degree of market depreciation of assets held by the Bank.
(c) Any increase in equity capital and eserves necessary to meet the requirements of paragraph 6(a) may be accomplished by the following:
(i) Sale of common stock; or
(ii) Sale of perpetual or convertible preferred stock; or
(iii) Sale of subordinated debt mandatorily convertible into common or perpetually preferred stock; or
(iv) Direct contribution of cash by the shareholders or directors of the Bank; or
(v) Sale or collection of assets previously charged off; or
(vi) Reduction of all or part of the "Loss" assets specified in paragraph 1(a) of this ORDER without loss or liability to the Bank; or
(vii) Any combination of the above means; or
(viii) Any other means acceptable to the FDIC.
(d) If all or part of the increase in total equity capital and reserves necessary to meet the requirements of paragraph 6(a) of this ORDER is accomplished by the sale of new securities, the board or directors of the
{{4-1-90 p.A-745}}Bank shall forthwith take all steps necessary to adopt and implement a plan for the sale of such additional securities, including soliciting proxies and voting any shares or proxies owed 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 the Federal securities laws. Prior to the sale of the securities and, in any event, not less than thirty 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 at Washington, D.C. for its 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 equity is provided by the sale of preferred stock or subordinated debt, then all terms and conditions relative to interest rate and other convertibility factor, shall be presented to the Regional Director for prior approval.

(e) In complying with the provisions of this paragraph 6, the Bank shall, during the distribution, provide to any subscriber or purchaser of the Bank's securities, written notice of any planned or existing development or other change which is materially different from the information reflected in any offering material used in connection with the sale of the Bank's securities. The written notice required by this paragraph 6(e) shall be furnished within the ten days from the date such material development or change was planned or occurred, whichever is earlier, and shall be furnished to every purchaser or subscriber who received or was tendered the information contained in the Bank's original offering materials.

7. Upon the effective date of this ORDER, the Bank shall *cease* and *desist* from extending credit in any amount that alone or when aggregated with any outstanding credit would exceed $50,000 with respect to any obligor without the prior approval of the Bank's board of directors.

8. (a) Upon the effective date of this ORDER, the Bank shall remove all lending and investment authority from * * * , Sr. For purposes of this paragraph, "lending authority" is defined to include the direct or indirect authorization of loans, either individually or as a member of any Bank committee, except as a member of the full board of directors.

(b) Within 90 days from the effective date of this ORDER, the Bank shall provide and thereafter retain a qualified chief lending and investment officer, other than * * * , Sr., who shall be given stated written authority by the Bank's board of directors. The selection criteria and reasons therefor shall be reduced to writing and shall be submitted to the FDIC for its review.

9. (a) Within 60 days from the effective date of this ORDER, the board of directors of the Bank shall prepare a plan for submission to the shareholders of the Bank to reconstitute the Bank's board of directors to provide that a majority of the directors are outside directors. The plan shall be submitted to the shareholders at a meeting which must take place within 30 days after the plan is developed. The Bank shall, through its counsel, provide to all of its directors information as to the duties, responsibilities and liabilities of bank directors.

(b) Within 90 days from the effective date of this ORDER, the Bank shall establish an audit committee composed solely of outside directors.

(c) "Outside director" means an individual (i) not in the employ of the Bank, and (ii) whose total outstanding direct and indirect indebtedness to the Bank, including the indebtedness of any related interest of the individual, does not exceed $100,000.

10. While this ORDER is in effect, with respect to any adversely classified asset of the Bank, except for adverse classifications rejected in any administrative or judicial proceeding, the Bank shall not by sale or otherwise transfer same in whole or in part unless the Bank makes to the prospective transferee full and complete written disclosure of any such adverse classification bearing in any way upon the credit quality or collectibility of the asset and the legal sufficiency of the documentation relating to it.

11. Within 90 days from the effective date of this ORDER, to the extent it has not {{4-1-90 p.A-746}}already done so, the Bank shall develop a written investment policy which, at a minimum, shall address standards for selection of securities investments considering quality, maturity, marketability and the Bank's liquidity, diversification, and income. The Bank shall review this policy annually and revise it, as necessary, to meet the Bank's investment objectives. Once adopted, such written investment policy shall be tendered to the Regional Director and shall not be amended without prior written approval of the Regional Director.

12. Within 60 days from the effective date of this ORDER, to the extent it has not already done so, the Bank shall review its liquidity position and develop a written liquidity policy which takes into consideration the volume of volatile purchased certificates of deposit in relation to the Bank's asset base. The policy should provide for the Bank's anticipated and contingent future needs and establish specific guidelines including, without limitation:

(a) A limit on loans as a percentage of assets;

(b) Limits on the Bank's reliance on a particular liability category (e.g. large out-of-area certificates of deposit); and

(c) Limits on the rate-sensitivity position of the Bank's assets and liabilities.

Once adopted, such written liquidity policy shall be tendered to the Regional Director and shall not be amended without the prior written approval of the Regional Director.

13. While this ORDER is in effect, the Bank shall give written notice to the Regional Director at such time as five percent of the Bank's total deposits are funded by third party agents or nominees for

depositors, including deposits managed by a trustee or custodian when each individual beneficial interest is entitled to or asserts a right to Federal deposit insurance ("brokered deposits"). The notification should indicate how the brokered deposits are to be used with specific reference to credit quality of investments or loans and the effect on the Bank's funds position and asset/liability matching. The Regional Director shall have the right to object to the Bank's plans for using brokered deposits. So long as the level of brokered deposits equals or exceeds five percent of the Bank's total deposits, the Bank shall provide on the first Monday of each month a written report to the Regional Director detailing the level, source and use of brokered deposits.

14. At intervals of 90 days from the effective date of this ORDER, the Bank shall furnish accurate written progress reports to the Regional Director and the Commissioner detailing the form and manner of any action taken to secure compliance with this ORDER and the results of those actions. The reports shall include certified copies of resolutions of the Bank's board of directors and the audit committee thereof adopting such reports. Such reports may be discontinued when the corrections required by this ORDER have been accomplished or the Regional Director and the Commissioner have in writing released the Bank from making further reports. The Bank shall preserve evidence of its compliance with this ORDER until this ORDER is terminated.

15. For the purposes of this ORDER, the terms "extension of credit," "credit," "loan," and "related interest" shall be defined as those terms are defined in Regulation O of the Board of Governors of the Federal Reserve System (12 C.F.R. Part 215). In addition, the term "loan participation" shall be defined to include any loan purchased or sold in its entirety or in part by a financial institution, person, or other entity.

The provisions of this ORDER shall be binding upon the Bank and its directors, officers, employees, agents, successors, assigns, and other persons participating in the conduct of the affairs of the Bank.

The provisions of this ORDER shall become effective 30 days after its issuance, except as provided according to its terms, and shall remain effective and enforceable except to the extent that, and until such time as, any provision of this ORDER shall have been modified, terminated, suspended, or set aside by the FDIC.

By direction of the Board of Directors.

Dated at Washington, D.C., this 19th day of February, 1986.

/s/ Hoyle L. Robinson

Executive Secretary

ORDER TO PAY CIVIL MONEY PENALTIES FDIC 84-67k

After taking into account the appropriateness of the penalty with respect to the financial resources and good faith of * * *, and * * *, the gravity of the viola-
{{4-1-90 p.A-747}}tions, and other matters as justice may require, it is:

ORDERED, that a penalty of $1,000 be, and hereby is, assessed against * * * pursuant to section 18(j) of the Federal Deposit Insurance Act ("Act") and section 106(b)(2) of the Bank Holding Company Act of 1956, as amended ("BHCA");

ORDERED, that a penalty of $1,000 be, and hereby is, assessed against * * * , pursuant to section 18(j) of the Act and section 106(b)(2) of the BHCA;

ORDERED, that a penalty of $1,000 be, and hereby is, assessed against * * * pursuant to section 18(j) of the Act and section 106(b)(2) of the BHCA;

ORDERED, that a penalty of $1,000 be, and hereby is, assessed against * * * pursuant to section 18(j) of the Act and section 106(b)(2) of the BHCA;

ORDERED, that a penalty of $1,000 be, and hereby is, assessed against * * * pursuant to section 18(j) of the Act and section 106(b)(2) of the BHCA; and

ORDERED, that a penalty of $50,000 be, and hereby is, assessed against * * * , Sr. pursuant to section 18(j) of the Act and section 106(b)(2) of the BHCA.

IT IS FURTHER ORDERED, that the civil money penalties assessed herein shall not be paid directly or indirectly by * * * Bank, * * * , but shall be paid by each of the individual Respondents within sixty days after the issuance of this ORDER.

By direction of the Board of Directors.

Dated at Washington, D.C., this 19th day of February, 1986.

/s/ Hoyle L. Robinson

Executive Secretary

FDIC-84-23b FDIC-84-67k (Consolidated Action)

ORDER DENYING REQUEST FOR ORAL ARGUMENT

On November 22, 1985, * * * Bank, * * *, and * * * ("Respondents") requested, pursuant to section 308.17 of the Rules and Regulations, 12 C.F.R. § 308.17, permission to present oral argument to the Board of Directors of the Federal Deposit Insurance Corporation ("Board") with respect to the Board's deliberation on the above-captioned consolidated action.

After considering the Respondents' request and the allegations and arguments presented in the parties' briefs, the Board finds that (1) the factual and legal arguments are fully set forth in the parties' briefs, and the Recommended Decision of the administrative law judge, (2) no benefit will be derived by the Board from oral argument, (3) Respondents have set forth in their request no reason that would justify exercise of the Board's discretion to grant oral argument, and (4) Respondents will not be prejudiced by lack of oral argument because of the complete record in the proceeding. Therefore, the Respondent's Request for Oral Argument is DENIED.

By direction of the Board of Directors.

Dated at Washington, D.C., this 19th day of February, 1986.

/s/ Hoyle L. Robinson

Executive Secretary

RECOMMENDED DECISION

FDIC-84-23b FDIC-84-67k

APPEARANCES: * * * For the FDIC

*** * *, Esq. For Respondents**

BEFORE: Marvin H. Morse, Administrative Law Judge

(Ed. note: Footnotes to this decision appear after the text.)

INITIAL DECISION

I. *Statement of the Case*

On February 8, 1984, the Federal Deposit Insurance Corporation ("FDIC") instituted Docket FDIC-84-23b by issuing a Notice of Charges and of Hearing against * * * Bank, * * * ("Bank"), and * * * , individually ("* * *, Sr.") to determine whether an appropriate order should issue pursuant to Section 8(b)(1) of the Federal Deposit Insurance Act ("Act"), 12 USC § 1818(b)(1), and Part 308 of the FDIC's Rules of Practice and Procedure, 12 CFR §§ 308.01, *et seq*. The Notice alleged, and respondents' February 23, 1984 answer acknowledged, that, at all pertinent times, the Bank was an insured * * * State nonmember bank subject to the Act, FDIC rules and regulations and the laws of * * * , and that the individual respondent was at all such times the president, a director and a major shareholder of the Bank over whom the FDIC had jurisdiction. Admitting certain financial data alleged in the Notice, respondents {{4-1-90 p.A-748}}asked for a hearing, denied all the remaining allegations in the Notice, and put FDIC to its proof, including its allegations *inter alia*, that:

- * * * , Sr., exercised "a controlling influence over the management policies, and conduct" of the Bank's affairs;

-the Bank engaged in unsafe or unsound banking practices by engaging in "hazardous lending and lax collection practices which," as of August 22, 1983, occasioned "an excessive and disproportionately large volume of poor quality loans in relation to the Bank's total loans";

-the Bank engaged in unsafe or unsound banking practices by failing, as of August 22, 1983, to provide for an adequate reserve for possible loan losses ("loan valuation reserve") resulting in financial statements which overstated the Bank's earnings and equity capital;

-the Bank engaged in unsafe or unsound banking practices by operating with inadequate liquidity;

-the Bank engaged in unsafe or unsound banking practices by operating "with an inadequate level of capital protection for the kind and quality of assets held by it";

-the Bank engaged in unsafe or unsound banking practices by operating "with inadequate internal routines and controls";

-the Bank violated the lending limit and security restrictions of Section 23A of the Federal Reserve Act ("Act"), 12 USC § 371c, by extensions of credit of at least $600,000 secured by stock of an "affiliate" (* * *.), which extensions of credit "inured to the tangible benefit of, or were transferred to * * * , a related interest of" * * * , Sr., in amounts in excess of the lending limit of Section 215.2(f) of Regulation O, 12 CFR § 215.2(f), (of the Board of Governors of the Federal Reserve System promulgated under Section 22(h) of the Federal Reserve Act), in violation of Section 215.4(c) of Regulation O, 12 CFR § 215.4(c), and of Section 22(h)(1) of the Federal Reserve Act, 12 U.S.C. § 375b(1);[1]

-* * * , Sr., bore primary responsibility for extensions of credit which, as of August 22, 1983, resulted in adversely classified loans aggregating $6,903,000, representing 28.7% of total loans outstanding;[2]

-the board of directors failed to adequately supervise the Bank's officers to prevent the alleged unsafe or unsound banking practices and violations of law (including regulation).

The FDIC also issued a proposed cease and desist order.

Pursuant to request by FDIC to the Office of Personnel Management ("OPM") under 5 USC § 3344 to

obtain an administrative law judge to preside in the proceeding, I was so selected by OPM on March 7, 1984.

On April 11, 1984, the FDIC instituted Docket FDIC-84-67k by issuing a Notice of Assessment of Civil Money Penalties against * * *, Sr., and other named individuals as officers, directors or principal shareholders of the Bank and of another insured * * * State nonmember bank, the Bank of * * *. The Notice alleged violations of Sections 22(h) and 23A of the Federal Reserve Act and Regulation O, and of Section 106(b)(2) of the Bank Holding Company Act Amendments of 1970, 12 USC § 1972(2). Civil money penalties were assessed at $100,000 against * * *, Sr., $10,000 against respondent * * *, and $1,000 each against the other individual respondents. More specifically, * * *, Sr., was charged with violation of Sections 22(h), 23A(a) of the Federal Reserve Act ("FRA"), and Sections 215.4 and 337.3(b) of the FDIC's Rules and Regulations, in connection with credit extensions cited in paragraphs 6-53 of the Notice of Assessment. Each of the respondents was charged with violation of Sections 22(h) and 23A, FRA, Section 215.4 of Regulation O, and Section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 ("BHCA"). Various of the extensions listed at paragraphs 6-52 are alleged to have been made without prior approval required by Sections 337.3(b) and 215.4(b) of FDIC's Rules and Regulations, and Section 22(h)(2), FRA, in violation of such sections. The substance of the charges is more fully discussed at Section III of this Initial Decision, *infra*.

The Notice failed to distinguish the penalties sought from * * *, Sr., as between his roles in each of the two banks.

I was selected by OPM to preside in Docket FDIC-84-67k on April 22, 1984, having been previously so selected for Docket FDIC-84-43b (the Bank of * * * 8(b) proceeding). On the same date, respondents requested a hearing and suggested the difficulty of adequately answering the civil {{4-1-90 p.A-749}}money penalty notice absent a separation between the two banks and the individual respondents associated with one or the other. (Only * * * , Sr., was involved in both banks.) Following motion practice, by Order issued June 18, 1984, I consolidated the causes of action in each cease and desist docket, FDIC-84-23b * * * and FDIC-84-43b * * * respectively, each to be tried only with the pertinent allegations set forth in the notice in Docket FDIC-84-67k as pertained respectively to the Bank and to * * *, effectively severing the civil money penalty docket into two cases each to be tried with the issues raised in the associated cease and desist case involving, respectively, the Bank and * * *.

By Order issued June 21, 1984, reflecting that the parties had elected to first try the * * * cases (Docket FDIC-84-23b and associated aspects of Docket FDIC-84-67k), initial prehearing procedures were limited to the * * * dockets. At the * * * pretrial in * * *, on August 6, 1984, it appeared reasonable, to assist the parties to achieve an agreed disposition initially of * * * and, if successful, of the Bank dockets, to encourage the parties to seek an allocation as between the two banks by the FDIC's Board of Directors of the $100,000 civil money penalty sought of * * *, Sr. A pretrial schedule in Dockets FDIC-84-23b and associated aspects of FDIC-84-67k to meet time frames consistent with exploration by the parties of an agreed disposition was established by my Order of September 4, 1984.

Pursuant to that Order, the Bank's case and the associated issues were tried for nine days, December 10-14, 17-19, in * * *, with an additional trial date held in the same location on January 24, 1985. Due to singular delay in obtaining trial transcripts and assembled exhibits, post-hearing briefing procedures extended into June 1985.

The January 24 resumption of the hearing resulted from accommodation by * * * State banking officials to subpoena practice initiated by respondents to obtain evidence, including a witness subject to examination, arising out of the State's examination of the Bank at approximately the same point in time as the FDIC's August 1983 examination. The substantially contemporaneous State examination, although premised on standards of bank conduct similar to the Federal standards, produced significantly fewer loan classifications than did the FDIC examination. However, on the basis of my observation of the witnesses, evaluation of the documentary evidence and study of the pleadings and briefs, I conclude that the fact of the reduced level of classified loans as determined by the * * * State banking officials fails to overcome the conclusion that the overwhelming preponderance of loan classifications contained in the report of the August 1983 FDIC examination were accurate.

The record does not warrant the conclusion that the FDIC examination is clouded by bias, prejudice or other overreaching by the FDIC examiners and their supervisors who approved the 1983 examination report. The chief FDIC examiner, although verging in some instances on the hypercritical was in no way impeached. The credibility and propriety of the examination survived extensive inquiry at the hearing. It is generally agreed that ranking the stability of bank assets is judgmental, not a precise science.[3] Nevertheless, classification decisions by trained and experienced personnel, whose objectivity and conformance to normative examination principles and procedures is not discredited, will not lightly be discarded. While risk assessment conclusions by bank examiners in the form of classification of loans is entitled to respect it is not, however, immune from adjustment upon de novo review in the hearing

process.

Adjustment of any particular classification decision does not impeach the examination. That one bank examiner maybe more critical than another is no justification for escaping the conclusions of that more critical examiner and is no invitation to ignore the results of a duly performed bank examination. To the extent that one or another team of examiners is not shown to have a venal purpose, bias, prejudice or handicap other than commitment and zeal in writing up a bank, it simply is not persuasive that a different team of examiners might have reached different risk evaluations.

In an environment of general deregulation accompanied by more strenuous enforcement, acknowledging also the economic realities of the depressed economy in the market served by the Bank, and providing ample opportunity to the respondents to rebut the case presented by FDIC at hearing, {{4-1-90 p.A-750}}I sustain the overwhelming portion of the loan classifications and the inferences as to unsafe or unsound practices and violations drawn from them by FDIC.

II. *Unsafe or Unsound Banking Practices*

A. *Charges*

By Notice dated February 8, 1984, FDIC charged the Bank with having engaged in "unsafe or unsound banking practices in that it has engaged in hazardous lending and lax collection practices..." *Id.* at 2. Such practices were alleged to have included credit extensions without first obtaining adequate financial information on all obligors; extending credit without first determining the purpose of the credit; failure to establish and enforce programs for the repayment of loans and to determine the sources of repayment; and extending credit without obtaining adequate security.

B. *Positions of the Parties Contrasted*

In its Proposed Findings of Fact, Conclusions of Law, Recommended Order to Pay, Recommended Order to Cease and Desist, and Brief, dated May 3, 1985, FDIC arrays six categories of unsafe or unsound banking practices, listing specific instances in which respondents allegedly failed to observe safe and sound practices in operating the Bank.

In its Proposed Findings of Fact, Conclusions of Law and Order for Judgment, and Brief in Support, dated May 6, 1985, respondents offer substantially contrasting findings. Following discussion of the respective positions of the parties, the analysis below incorporates three tables to assist in summarizing the findings reached: Table I, Classification Conclusions, and Table II, Findings by Category of Hazardous Lending and Lax Collection Practices, summarize and reflect analysis of the unsafe or unsound banking practice evidence.[4] Because the FDIC rules provide for concurrent post-hearing briefs and concurrent proposed findings and conclusions, 12 CFR § 308.13(a), in any broad-ranging, multi-issue case such as this, a great deal of delay and confusion results from the lost opportunity for the parties to file consecutive pleadings which can more sharply join issue. For example, in its brief, respondents understandably address the provisions of the cease and desist initially served and not the subsequent version contained in the posthearing FDIC brief. For convenience of analysis, I have adopted the FDIC's enumeration when referring to its Proposed Findings in the Initial Decision and accompanying Tables.

1. *Hazardous Lending and Lax Collection Practices*

a. *Did the Bank extend credit without adequate financial information*?[5]

FDIC's Legal Theory:

Bank credit files normally contain current and historical financial statements of the borrower; credit comments stating the purpose, amount, terms, conditions, collateral, and the source and schedule of repayment of the loan; borrowing resolutions; security agreement or mortgage; title opinion; appraisals; and financing statements (Tr. Vol. I 82-84; vol. III 69–72). Banks ask for both profit and loss statements and balance sheets (Tr. Vol. I 116). Normally, such financial information is obtained before the credit is extended (Tr. Vol. I 116). To evaluate creditworthiness of prospective borrowers, banks analyze profit and loss statements and balance sheets (Tr. Vol. I 114-15).

In reviewing a guarantor's financial statement, the value of the investment in the firm whose debt is guaranteed is deducted from the assets (and therefore from the net worth) of the guarantor (Tr. Vol. III; V-A 67).

It is an unsafe or unsound banking practice to extend credit (unless the credit is secured by readily marketable collateral) without first obtaining adequate financial information on all obligors. Without such information it is not possible to evaluate the obligor's financial capability (Tr. Vol. III 69-73). The extensions of credit, *infra*, involved this unsafe or unsound banking practice (Tr. Vol. III 73).

FDIC's proposed facts in support of a finding of unsafe or unsound banking practices regarding (a):

10. * * * *($160,000)*. Of the total line at the Bank, $70,000 was added subsequent to the previous examination (Ex. 7). The most recent financial information was dated May 31, 1983 (Tr. Vol. III 73).

11. * * * *($115,000)*. * * * s financial statement omitted assets he reportedly owned. (Tr. Vol. III 74).

12. * * * *($300,000)*. The financial statement on file at the bank dated February 28, 1983, was not

detailed, *i.e.*, $345,000 was carried in accounts receivable and notes receivable and $45,000 was carried as ac-
{{4-1-90 p.A-751}}crued interest, but the obligors were not identified. Terms relating to escrow funds of $37,900 were not described. There was no income statement and only an incomplete cash flow statement. Notes payable of $500,000 were not detailed (Tr. Vol. III 74).

13. * * * *($125,000)*. The financial statement dated September 11, 1980, on which the borrowing was predicated, was not in sufficient detail. The statement carried accounts receivable of $310,000, but did not identify the obligor. The values listed as investments in * * * Corporation ($100,000) and * * * ($100,000) were not supported. * * * and partnership office building values of $150,000, each, respectively, did not describe how the values were determined (Tr. Vol. III 74–75).

14. * * * *($225,000)*. The financial statement dated September 30, 1982, was not detailed. Real estate and personal property were valued at $478,000 without stating how the values were determined. * * * stock was valued at $1,401,700, but the bid price obtained during the examination of $2.00 per share resulted in a value of only $350,000. At the previous examination, the value was $2.50 per share. There was no support for the determination of * * * 's value. The statement showed $337,000 in listed (NYSE) stocks, but did not identify the stocks. A bank loan did not identify the lender. There was no detailed description of the sources of income. There was no evidence of verification of the assets or of a credit check. The statement did not address the possibility of contingent liabilities (Tr. Vol. III 76–78; V-B 160-61; 163).

15. * * * *($125,000)*. The value listed for the * * * residence and condominium ($1,500,000) was not supported. The value listed for * * * Company ($7,357,700) was not supported by a fully completed financial statement of * * * Company. There was no evidence that the Bank verified * * * borrowing or credit ratings at other institutions (Tr. Vol. III 78).

16. * * * (*$214,000*). No financial information was available for the borrower (Mrs. * * *) (Tr. Vol III 78–79).

17. * * * *($135,000)*. The financial statement listed accounts receivable at $14,000, but did not provide detail. The value (at February 28, 1983) placed on real estate ($836,000) was not supported by the appraised value dated April 5, 1982, of $810,000 by * * *. The mortgage payable was not further detailed. There was no income statement. The cash flow statement was incomplete (Tr. Vol. III 79).

18. * * * *($233,000)*. The financial statements were not sufficiently detailed. The income information was not of the same date as the balance sheet (Tr. Vol. III 79).

19. * * * *($50,000)*. The financial information was not detailed. The balance sheet dated February 27, 1983 did not itemize accounts receivable, notes receivable, "future benefit of retained employees," accounts payable, checks outstanding, and current and long term notes payable. There was no income statement to coincide with the February 27, 1983 balance sheet (Tr. Vol. III 79–80).

20. * * * *($270,000)*. The financial statement dated December 31, 1982, was not sufficiently detailed. The * * * , stock was valued at $9.35 per share ($2,836,400) although its bid price had been $2.00 per share (or $606,700) for an extended period of time. See the discussion of the * * * credit, *supra*. The * * * stock listed as an asset on the balance sheet was not owned by the corporation. * * * partnership, * * * and * * * , were all closely held investments and had no supporting documentation for those values. The values of real estate holdings ($1,420,000) were also not supported. Bank loans were not itemized. There was no evidence in the files that the Bank's management verified liabilities or checked the obligor's credit rating at other institutions (Tr. Vol. III 80–81).

21. * * * *($218,000)*. * * * September 6, 1980, financial statement listed net worth at $124,000. The most recent December 31, 1982, statement was signed by * * * personally, rather than in his corporate capacity. This statement (Ex. 71) did not accurately reflect the company's liabilities. The statement listed total liabilities of $164,200 on December 31, 1982, when the company had borrowings of at least $217,900. No income statement was provided and the case flow statement was incomplete. (Tr. Vol. III 81–82).

22. * * * *($324,000)*. No income statements or cash flow statements were available. The April 30, 1983, financial statement (Ex. 75) was signed by * * * , personally and not in a representative capacity. The total liabilities ($500,000) omitted at
{{4-1-90 p.A-752}}least $47,000 in liabilities (Exs. 73-75; Tr. Vol. III 82).

23. * * * *($184,000)*. No income or cash flow statements were available. The balance sheet did not itemize accounts receivable ($275,000), which included a receivable from * * * , Sr. in the amount of $251,500 (Tr. Vol. II 65-66; Ex. 77) or have supporting documentation for real estate values on the October 30, 1982 statement. Notes payable were not itemized. There was no statement pertaining to contingent liabilities. The August 30, 1983 financial statement (Ex. 57) received during the examination omitted $110,000 in liabilities to * * * Bank, * * * (Tr. Vol. II 145). These liabilities were guaranteed by * * * , whose financial statements (Exs. 41–43) were also false in that they omitted guaranties in the amount of

as much as $1,282,984 (as of July 29, 1983, * * * , $110,000 for * * * and $250,000 for * * * , $257,984 for * * * and $665,000 for * * *) and overstated the value of stock held in * * * (Exs. 40–43; 53–55; 61–62; Tr. Vol. II 140-45; III 82–83).

24. * * * *($329,000)*. The borrower's August 19, 1982, statement reflected a $175,000 investment in * * * Inventory, whose loans had been assumed by * * * , because of an inability to repay. There was no support for the $175,000 investment. There was no income information on the August 19, 1982, and August 31, 1983 (Ex. 19) statements. The borrower omitted a liability for a promissory note dated December 20, 1980, ($85,000) payable to * * *. There was no statement pertaining to contingent liabilities on the August 19, 1982 statement (Tr. Vol. III 83).

25. * * * *($36,000)*. Financial statements dated August 30, 1982 and August 31, 1983 (Ex. 34) were not sufficiently itemized with respect to accounts receivable or notes receivable, * * * Partnership, Contract #3, and * * *. There were no income or cash flow statements (Tr. Vol. III 84). The financial statement dated August 31, 1983 (Ex. 34) omitted liabilities of at least $35,600 (Tr. Vol. II 131-34). This financial statement was signed in a representative capacity by * * * , Sr. (Ex. 34).

26. * * * *($237,000)*. Financial statements dated July 27, 1982, and August 31, 1983 (Ex. 68) were not sufficiently detailed as to notes receivable, which included a receivable from * * * , Sr. in the amount of $50,000; stocks and bonds; investment in partnership; and notes payable. There was no income information (Tr. Vol. II 63–64, 146; III 84).

27. * * * *($299,000)*. There was no personal financial information (Tr. Vol. III 84).

28. * * * *($6,000)*. There was no current financial information (Tr. Vol. III 87).

29. * * * *($3,000)*. The note was dated January 12, 1983; the last financial information on file was dated April 1, 1981 (Tr. Vol. III 87).

30. * * * *($40,000)*. The loan was made on May 14, 1982, with no current financial information on file (Tr. Vol. III 87).

31. * * * *($130,000)*. There was no current financial information including income and cash flow statements (Tr. Vol. III 87).

32. * * * *($195,000)*. There was no financial information available on the company (Tr. Vol. III 87).

33. * * * *($370,000)*. No current financial information was available for guarantor * * *. Guarantor statements overvalued the * * * investment based on the company's financial statement. (Tr. Vol. III 87).

34. * * * , *d/b/a/* * * * *($75,000)*. No financial information had been obtained on the business or individuals prior to the examination (Tr. Vol. III 87-88).

35. * * * *and* * * * *($105,000)*. The Bank extended additional credit in March and September of 1982 without obtaining current financial information (Tr. Vol. III 88).

36. * * * *and* * * * *($28,000)*. The bank did not have current financial information on the borrowers when $28,000 was amended on April 16, 1982. Management was aware of the problems of * * * a company in which * * * was a principal (Tr. Vol. III 88).

37. * * * *($267,000)*. The most current statement on file when the loan dated September 24, 1982, was made was dated March 31, 1980, and reflected negative net worth of $16,200 (Tr. Vol. III 88).

38. * * * *and* * * * *($152,000)*. The bank extended additional credit in 1982 and 1983 without obtaining current financial information. The latest information on file was dated November 23, 1979 (Tr. Vol. III 88–89).

{{4-1-90 p.A-753}}

39. * * * *and* * * * *($136,000)*. When bank management extended $89,000 on May 20, 1983 and $1,900 on May 20, 1983, the borrowers' most current statement was dated May 28, 1982. Bank management did not obtain sufficient financial information to verify the borrowers' ability to service this debt (Tr. Vol. III 89).

Respondents' rebuttal:

Respondents' legal theory and proposed facts in support of a finding that unsafe or unsound banking practices did not occur regarding (a):

The * * * credit lines have been in the Bank since the mid-1970's. * * * possesses extensive knowledge as to Mr. * * * 's character, his businesses, and his credit repayment history at the Bank.

In analyzing the prudency of an extension of credit, as well as a guarantee supporting a credit extension, it is important to consider the character of a potential borrower (Tr. Vol. V-A 75).

In analyzing the prudency of an extension of credit, as well as a guarantee supporting a credit extension, it is important to consider a potential borrower's previous credit history with a Bank (Tr. Vol. V-A 75).

In analyzing the prudency of an extension of credit, as well as a guarantee supporting a credit extension, it is important to consider the degree of knowledge possessed by a lending officer regarding a potential borrower's character and his/her business (Tr. Vol. V-A 75).

The lack of complete loan documentation is not necessarily an unsound banking practice (Tr. Vol. V-A 74).

It is not unusual to find a lack of loan documentation in a bank's files (Tr. Vol. V-A 75).

The FDIC has alleged that the credit extensions to * * * and * * * involved more than the normal risk of repayment at the time credit was extended.

Prior to the August 22, 1983 examination, the Bank extended credit in the amount of $195,000 to * * * and * * *. An additional $200,000 in credit was extended to * * * by * * * by way of participation with the Bank (Tr. Vol. V-A 53).

The FDIC has alleged that the * * * loan was not fully secured, and that such loan presented a conflict of interest to * * *.

The * * * loan was secured by a $400,000 guaranty (Tr. Vol. V-A 54–55).

The $400,000 guaranty was signed by four individuals, whose total net worth was approximately $4.7 million (Tr. Vol. V-A 55).

Ms. * * * did not consider the terms of the notes in the possession of the Bank and in the loan file, the comments of the lending officers concerning their knowledge of the purpose of the loan, the repayment history as to principal and interest and the history of reduction on the part of the borrower; all of which she knew to exist, when she classified loans in the Bank for lack of documentation, a repayment plan, or a purpose statement. *Parenthetically, Ms. * * * 's testimony concerning the fact that an examiner should look outside of the loan file* and consider the knowledge of officers as to the borrower's purpose for the loan and consider performance on the loan as evidence of a repayment plan notwithstanding the condition of the written documentation is supported by the testimony of Mr. * * * (Tr. Vol XI 29) and Mr. * * * (Tr. Vol. IV 12-930). Mr. * * * and Ms. * * * also agree that in analyzing the prudency of an extension of credit, as well as a guarantee supporting a credit extension, a person's reputation, business success and the profitability of his business should impact upon the classification decision (Tr. Vol. IV 155; V-A 75) (emphasis added).

b. *Did the Bank extend credit without obtaining adequate security?*

FDIC's legal theory:

If a bank has received and analyzed adequate financial information, performed a credit check, and established a favorable credit history, it may be prudent to extend unsecured credit (Tr. Vol. III 89). In other cases, the extension of credit without adequate security is an unsafe or unsound practice (Tr. Vol. IV 90; IX 28).

The extensions of credit *infra*, involved this unsafe or unsound banking practice (Tr. Vol. III 90).

FDIC's proposed facts in support of a finding that unsafe or unsound banking practices occurred regarding (b):

42. * * * *($115,000)*. The loan was unsecured. The obligor's financial statement, which listed total assets of $278,100; total liabilities of $37,000; and net worth of {{4-1-90 p.A-754}}$241,100 on August 1, 1980, did not support unsecured credit of $130,000. Major assets consisted of real estate and personal property of $205,200 and $45,000 investment in closely held * * * (Tr. Vol. III 90-91).

43. * * * *($125,000)*. The loan was unsecured. The obligor's financial statement was not detailed. There was no evidence of a credit check or verification of assets, and there was no income information. Total unsecured debt of $300,000 was excessive in comparison to $984,000 listed net worth (Tr. Vol. III 91).

44. * * * *($225,000)*. The loan was unsecured. The obligor's financial statement lacked detail, and the * * * investment was significantly overstated. See discussion of * * * financial statement *supra*. With the * * * investment adjusted to $2.00 per share, the obligor's net worth would be $1,214,300, rather than $2,266,100 (Tr. Vol. III 91).

45. * * * *($214,000)*. This extension of credit was secured only by restricted * * * stock (Tr. Vol. III 92).

46. * * * *($135,000)*. The security was a junior lien on a shopping center in * * *. There was no final title search, recorded mortgage, or insurance. The appraisal was performed, not by an independent party, but rather by * * *. A letter in the file dated February 5, 1982, from a first mortgagor to * * * , in care of * * * indicated a possible first lien balance of $575,000 (* * *). Appraised value was stated to be $810,000 and the loan was $135,000. An assignment of rents was taken but without corresponding loan terms or provisions concerning the receipt of rents. Funds were disbursed December 3, 1981 but a mortgage security agreement was not taken until March 16, 1983 (Ex. 10 at 34; Tr. Vol. III 93).

47. * * * *($50,000)*. The financial statement (total liabilities of $6,682,800, net worth of $2,006,700 with fixed assets of $6,443,400) did not support unsecured borrowings (Tr. Vol. III 93).

48. * * * *($270,000)*. The loan was unsecured. The obligor's financial capacity did not support unsecured borrowings. Some assets listed on this corporation's statement were not owned by the company (Tr. Vol. III 93-94).

49. * * * *($218,000)*. The loan was unsecured. The obligor's financial statement did not support the unsecured credit (Tr. Vol. III 94).

50. * * * *($300,000)*. The loan was unsecured. When the bank advanced $500,000 on January 28,

1982, the corporation's latest financial statements, dated September 30, 1980, listed total assets of $2,399,000, total liabilities of $2,229,000, and net worth of $170,000. The obligor's net loss for the year of 1982 was $752,000. Net loss for 1981 was $402,000 (Tr. Vol. III 94).

51. * * * *($324,000).* Five hundred thousand dollars of the line was secured by a vendee's interest in a contract deed on a commercial building in * * *. There was no final title search. A November 9, 1983, letter from * * * reflected a first lien in the amount of $469,000. An appraisal dated April 8, 1982, by * * * valued the property at $1,400,000. Approximately $40,000 was unsecured (Tr. Vol. II 94–95).

52. * * * *($184,000).* The loan was unsecured. The obligor's financial statement adjusted for * * * debt would show total liabilities of $901,000 and net worth of $356,000 rather than total liabilities of $791,000 and net worth of $565,000. The financial statement did not support unsecured credit (Tr. Vol. III 95).

53. * * * *($329,000).* This loan was secured by 72,727 shares of restricted * * * stock owned by * * * , Sr. and a 1983 automobile (Tr. Vol. III 95). The borrower's financial statement was false in that the stock was owned by his father (Exs. 41–42).

54. * * * *($36,000).* This loan was secured only by 20,000 shares of restricted * * * stock (Tr. Vol. III 95).

55. * * * *($237,000).* This amount of the obligor's liabilities to the Bank was unsecured. Her financial statement (Ex. 68) was questionable and did not support unsecured credit (Tr. Vol. III 95–96).

56. * * * *($299,000).* This credit was secured by 10,000 shares of * * * , closely held by the * * * family. The financial information obtained on this company was not sufficiently detailed (Tr. Vol. III 96).

57. * * * *($40,000).* The obligor's equity in his home did not provide for sufficient security. Its appraised value was only $47,500. A lien of approximately $20,000 was prior to the Bank's (Tr. Vol. III 96).

58. * * * *($370,000).* The loan was unsecured. Financial statement dated February 28, 1983 listed the company's total assets at
{{4-1-90 p.A-755}}$783,400, total liabilities $743,800, and net worth of $39,600, with a year end net loss before taxes of $180,500. This information did not support unsecured borrowings of $585,000 on June 28, 1983 (Tr. Vol. III 97).

59. * * * *($146,000).* The line had an insufficient collateral margin (Tr. Vol. III 97).

Respondents' rebuttal:

Respondents' legal theory and proposed facts in support of a finding that unsafe or unsound banking practice did not occur regarding (b):

The extension of unsecured credit is not a per se unsound banking practice (Tr. Vol. V-A 52).

Ms. * * * did not consider the terms of the notes in the possession of the Bank and in the loan file, the comments of the lending officers *concerning their knowledge of the purpose of the loan*, the repayment history as to principal and interest and history of reduction on the part of the borrower; all of which she knew to exist, when she classified loans in the Bank for lack of documentation, a repayment plan, or a purpose statement. Parenthetically, Ms. * * * 's testimony concerning the fact that an examiner should look outside of the loan file and consider the knowledge of officers as to the borrower's purpose for the loan and consider performance on the loan as evidence of a repayment plan notwithstanding the condition of the written documentation is supported by the testimony of Mr. * * * (Tr. Vol. XI 29) and Mr. * * * (Tr. Vol. IV 129-30). Mr. * * * and Ms. * * * also agree that in analyzing the prudency of an extension of credit, *as well as a guarantee supporting a credit extension*, a person's reputation, business success and the profitability of his business should impact upon the classification decision (Tr. Vol. IV 155; V-A 75). (Emphasis added).

c. *Did the Bank fail to establish and enforce realistic programs for repayment or to determine the source of repayment?*

FDIC's legal theory:

Most banks determine the source of repayment of loans before extending credit and then establish a program for the loans' repayment (Tr. Vol. I 84–85; III 100). Determining the source of repayment is important to determine how the loan will be repaid (Tr. Vol. 185; III 101-02). Extending credit without determining the source of repayment and without establishing plans for repayment involves unsafe or unsound banking practices (Tr. Vol. III 100-02; V-A 79–80). The extensions of credit *infra*, involved this unsafe or unsound banking practice.

FDIC's proposed facts in support of a finding that unsafe or unsound banking practices occurred regarding (c):

62. * * * *($115,000).* There was no specific repayment program and all payments to the date of the examination had been made by individuals other than * * *. When the loan was renewed on March 18, 1983, interest was paid from a * * * and * * * money market deposit account. Proceeds of the loan had paid * * * , debts of $30,000, $30,000 and $70,000 on September 18, 1980. A $15,000 principal repayment had been made by * * * d/b/a * * * on September 20, 1982 (Tr. Vol. III 102).

63. * * * *($300,000).* No definite repayment program existed for this line of credit. The December 10, 1981, credit file comments state that amortization of the note would begin as the business dictated. On

March 29, 1983, interest of $35,800 was paid from a * * * and * * * money market deposit account (Tr. Vol. 103).

64. * * * *($125,000)*. No definite amortization program existed. Proceeds of the loan paid * * * loans at * * *. Payments were made by * * * d/b/a * * * , and by a * * * and * * * money market deposit account (Tr. Vol. III 103).

65. * * * *($225,000)*. Proceeds of the $225,000 credit originating on October 26, 1982, were for the benefit of * * *. As of the examination date, no principal payments had been made. President * * * told the examiners the loan would be paid out the week of September 19, 1983. It was not. On February 3, 1984 the loan was paid by * * * d/b/a * * *. The borrower never made any payments (Tr. Vol. III 103-04).

66. * * * *($125,000)*. Since June 29, 1981, there had been no repayment program for this credit. Interest payments of $20,300 were made from the proceeds of * * * loan *supra* (Tr. Vol. III 104).

67. * * * *($214,000)*. No repayment existed for this line (Tr. Vol. III 104).

68. * * * *($135,000)*. No repayment program had been in effect since the loan's {{4-1-90 p.A-756}}inception on December 3, 1981, when the borrower's demand account was credit to cover an overdraft created by a check payable to * * *, for $107,700 (Tr. Vol. III 104-05).

69. * * * *($233,000)*. Notes for $100,000 and $30,000 had no specific repayment schedule. The $100,000 note originated on November 19, 1982, to cover partially an overdraft in * * * demand account. A principal and interest payment of $107,800 was made on September 18, 1982, by * * * d/b/a/ * * * (Tr. Vol. III 105).

70. * * * *($50,000)*. This line had been stagnant since 1979 (Tr. Vol. III 105).

71. * * * *($218,000)*. This line had been stagnant since November 26, 1980 (Tr. Vol. III 105).

72. * * * *($218,000)*. This line originated November 19, 1982, to cover an overdraft in * * * demand account. No repayment program was in effect (Tr. Vol. III 105-06).

73. * * * *($300,000)*. No repayment program was in effect. The proceeds primarily went to individuals or businesses other than the borrower and were not for real estate improvements, contrary to statements in a letter from * * * dated January 17, 1982 (Tr. Vol. III 106).

74. * * * *($324,000)*. Bank management had not requested any amortization for one and one-half to two years. Proceeds of the loan were not used to upgrade the real estate as stated in the credit file. Instead, * * * loans at the Bank of * * *, * * * and * * * Bank, * * * ("Bank") were paid, * * *, debt ($63,940.32 to * * * Bank) was paid, and $23,200 was placed in a money order and endorsed over to * * * (Judge's Ex. 1 at 6; Tr. Vol. III 106).

75. * * * *($184,000)*. A portion of this line had been extended since February, November, or December of 1982 and no scheduled repayment program was in effect (Tr. Vol. III 107).

76. * * * *($329,000)*. Proceeds from the various loans benefited * * *. Notes originating in May of 1981, June 1982, August 1982, and October 1982 had no definite repayment plan. Under an agreement dated December 23, 1981, * * *, agreed to pay all interest on business and student loans of * * * until December 31, 1983 (Tr. Vol. III 107).

77. * * * *($237,000)*. Portions of the line originated June 19, 1980, and in 1982, for which no repayment program had been instituted. Of the proceeds, $128,600 went to * * * and $96,400 went to * * *. A June 1983 interest payment on the $225,000 loan was made by * * * d/b/a/ * * * and by * * *. Of the $38,000 loan, $13,000 benefited * * *. No payments had been made by the borrower (Tr. Vol. III 107-08).

78. * * * *($299,000)*. No scheduled payment program had been instituted for this line, which commenced in 1974. All proceeds benefited * * *. Interest payments have been made by * * *, Sr. (Tr. Vol. III 108).

79. * * * *($40,000)*. On May 14, 1982, this note was extended on a demand basis with no scheduled repayment program (Tr. Vol. III 108).

80. * * * *($130,000)*. This note was dated December 13, 1982, due on demand. No definite repayment plan was specified although credit file notes indicated that monies would be applied to the loan as lots in the developments were sold. The Bank requested a $22,000 principal reduction on December 13, 1981, but extended payment to December 13, 1982, and even then did not get full principal payment (Tr. Vol. 108-09).

81. * * * *($370,000)*. The Bank's credit files indicated that only interest was requested to be paid on the $585,000 note dated June 28, 1983 due February 28, 1984. No other terms for principal repayment were specified (Tr. Vol. III 109).

82. * * * *($339,000)*. No repayment program was specified for this cash crop farming and logging line of credit, consisting of three demand notes that date back to December, 1982 (Tr. Vol. III 109).

83. * * * *($105,000)*. All four loans, totaling $102,500, were on a demand basis. The remaining balance consisted of an * * * check (drawing account) and an overdraft. One loan for $50,000 dated to February 4, 1981 (Tr. Vol. III 111).

84. * * * *($204,000)*. This line was adversely classified at the 1981 examination, when the notes were

on a demand basis. The line increased approximately $20,000 between examinations with all notes remaining on a demand basis. Although a 30 per cent dairy assignment was received, it was not sufficient to reduce principal (Tr. Vol. III 111).

85. * * * *($136,000).* Although the Bank renewed the loans at a 10 percent interest {{4-1-90 p.A-757}}rate, the borrowers as of the examination date were three months delinquent on $89,000. Even at the reduced interest rate, the repayment program may be unrealistic (Tr. Vol. III 111-12).

86. * * * *($152,000).* Most of the borrowers' notes were on a demand basis rather than being amortized on a specific program (Tr. Vol. III 112).

Respondent's rebuttal:

Respondents' legal theory and proposed facts in support of a finding that unsafe or unsound banking practices did not occur regarding (c):

It is not unusual to find a lack of a specific repayment plan in a bank's loan files (Tr. Vol. V-A 75).

The lack of a specific expressed repayment program is not a per se unsound banking practice (Tr. Vol. V-A 76).

The classification of loans on the basis of stock or lack of loan documentation, specific repayment agreements or purpose statements is not a general examination practice (Tr. Vol. IV 162; XI 29-30).

Respondents' proposed facts in support of a finding that unsafe or unsound banking practices occurred regarding (c):

* * * lines of credit have always been current on interest and principal, and have never caused the Bank to sustain a loss (Tr. Vol. VIII 30).

"* * *" lines of credit have always been current on interest and principal, and have never caused the Bank to sustain a loss (Tr. Vol. VIII 133).

Ms. * * * did not consider the terms of the notes in the possession of the Bank and in the loan file, the comments of the lending officers concerning their knowledge of the purpose of the loan, the repayment history as to principal and interest and the history of reduction on the part of the borrower; all of which she knew to exist, when she classified loans in the Bank for lack of documentation, *a repayment plan*, or a purpose statement. Parenthetically, Ms. * * *'s testimony concerning the fact that an examiner should look outside of the loan file and consider the knowledge of officers as to the borrower's purpose for the loan and consider performance on the loan as evidence of a repayment plan notwithstanding the condition of the written documentation is supported by the testimony of Mr. * * * (Tr. Vol. XI 129) and Mr. * * * (Tr. Vol. IV 129-30). Mr. * * * and Ms. * * * also agree that in analyzing the prudency of an extension of credit, as well as a guarantee supporting a credit extension, a person's reputation, business success and the profitability of his business should impact upon the classification decision (Tr. Vol. IV 155; V-A 75). (Emphasis added.)

d. *Did the Bank extend credit without determining its purpose?*

Banks normally determine the purpose of a loan before extending credit (Tr. Vol. I 84; III 118). The failure to do so is an unsafe or unsound practice because without such information the lending office cannot evaluate the risk of the loan or its compliance with loan policy (Tr. Vol. III 119). The extensions of credit involved this unsafe or unsound banking practice (Tr. Vol. III 124; Ex. 84).

FDIC's proposed facts in support of a finding that unsafe or unsound banking practices occurred regarding (d):

89. * * * *($115,000).* * * *'s loan paid * * * debt of $130,000 on September 18, 1980. The ultimate purpose was to "correct" a reported violation of Regulation O (Ex. 4 at 4-5; Ex. 84; Ex. 85 at 2).

90. * * * *($300,000).* Approximately $200,000 of the $300,000 loan paid * * *'s (* * *'s related interest) debt at the Bank (Ex. 84; Tr. Vol. III 126, 164).

91. * * * *($125,000).* The $300,000 loan was at the Bank due to Mr. * * *'s purchase of * * * units. Proceeds paid * * *'s debt at * * * (Tr. Vol. III 127). The credit file lacked information concerning the purpose of the credit (Ex. 84; Tr. Vol. III 126-27, 164).

92. * * * *($225,000).* The Bank's credit files lacked purpose statements (Tr. Vol. III 173). President * * * contacted the borrower during the examination as to the use of the $225,000. The $225,000 had been wired to the account of * * * (wholly- owned by * * *) and the $200,000 was used to pay * * *'s debt (wholly-owned by * * *) at * * * (Tr. Vol. III 168).

93. * * * *($125,000).* The Bank's credit file lacked a purpose statement (Tr. Vol. III 164).

94. * * * *($214,000).* The Bank's credit file lacked a purpose statement (Tr. Vol. III 164). President * * * had only a separate {{4-1-90 p.A-758}}memorandum (not in the file) indicating that Mrs. * * * purchased ($100,000 of * * *) stock on June 1, 1982. On May 6 and 7, 1980, $160,000 was disbursed. Proceeds were disbursed by a $100,000 bank money order #91991 to * * *, and $60,000 made two $30,000 principal payments on an unidentified loan (Tr. Vol. III 143-45).

95. * * * *($135,000).* The Bank's credit file lacked a purpose statement. The $135,000 covered an overdraft in the borrower's demand account due to a check drawn on the account payable to (Tr. Vol. III

143, 164).

96. * * * *($233,000)*. The Bank's credit file lacked purpose comments. Of the total, $100,000 was used to cover part of an overdraft in * * *'s demand account arising from a check drawn on that account payable to * * * for $332,345.89 (Ex. 84; Tr. Vol. III 142-43, 164).

97. * * * *($50,000)*. The Bank's credit file lacked purpose comments (Ex. 84; Tr. Vol. III 164).

98. * * * *($270,000)*. The Bank's credit file lacked purpose comments. President * * * admitted to examiners that he was not certain of the purpose of the extension (Ex. 84; Tr. Vol. III 138-39, 164).

99. * * * *($218,000)*. The Bank's credit file lacked purchase comments. Proceeds of the loan were used to cover an overdraft in * * *'s demand account arising from a check drawn on the account and made payable to * * *. (Ex. 84; Tr. Vol. III 140, 164).

100. * * * *($300,000)*. Notes in the Bank's credit files stated that proceeds were for construction financing of roads, sewer, and water in the * * * outlet (* * *) and preliminary planning of drainage, sewer, and water in the 7th Addition in * * * (* * *,) (Ex. 10, at 36). A trace of the proceeds indicated a different use of the funds. Of the $500,000 note, $13,000 was used to pay interest on * * * notes; $500 was used to make an interest payment on * * *; $20,300 was used to make a payment on * * *'s $225,000 note; $56,800 was wired to * * * to pay * * * interest; $4,600 went to affiliated * * * for * * *; $11,300 went to * * * with notation "interest as of December 31, 1981"; $210,000 was deposited in * * *'s account #135-829, $47,600 was made payable to * * *, $100,000 was credited to the Bank's * * *, account for the account of * * *; $4,200 was wired to * * *, * * *, [sic] for * * * and $31,800 was wired to * * * for the account of * * * with the notation " * * *". The $100,000 note was used to pay * * *'s debt ($96,000) at * * *. The remaining funds were placed in a money order for * * * (Ex. 84; Tr. Vol. III 127-33, 164).

101. * * * *($324,000)*. Notes in the Bank's credit file indicated $500,000 was used for leasehold improvements and expansion of the parking area and loading docks of the present building. A memorandum found in the file from Assistant Cashier * * * to * * * indicated that the $500,000 was used for a transfer of ownership (* * *), and to pay * * * $117,800 (of which $63,900 paid debts at * * *). Of the remaining $129,900, $23,200 was used for a money order payable to * * * and subsequently endorsed over to * * * (Ex. 84; Tr. Vol. III 139, 164).

102. * * * *($184,000)*. The Bank's credit file lacked purpose statements (Ex. 84; Tr. Vol. III 150, 164).

103. * * * *($36,000)*. The Bank's credit file lacked purpose statements (Ex. 84; Tr. Vol. III 150, 164).

104. * * * *($299,000)*. The Bank's credit file lacked purpose statements. The funds went to * * *, Sr. (Ex. 84; Tr. Vol. III 147-48, 164).

105. * * * *($329,000)*. The Bank's credit file lacked purpose statements. A separate memorandum maintained by President * * * indicated that * * * purchased $100,000 of * * * stock on June 1, 1982. Of an original $150,000 in proceeds, $72,000 was deposited into * * * * * *'s demand account and $78,000 was wired to * * * for * * * (Ex. 84; Tr. Vol. III 145-46, 164).

106. * * * *($237,000)*. The Bank's credit file lacked purpose statements. Of the total, $225,000 was used to pay debts of * * * and * * * $13,000 of the original $38,000 was used to pay a * * * (* * *'s related interest) loan and $49,000 was used for a transaction between * * * of * * * and * * * (Tr. Vol. III 148-50, 164).

Respondents' rebuttal:

Respondents' legal theory and proposed facts in support of a finding that unsafe or unsound banking practices did not occur regarding (d):

{{4-1-90 p.A-759}}

*Ms. * * * did not consider the terms of the notes in the possession of the Bank and in the loan file, the comments of the lending officers concerning their knowledge of the purpose of the loan*, the repayment history as to principal and interest and the history of reduction on the part of the borrower; *all of which she knew to exist*, when she classified loans in the Bank for lack of documentation, a repayment plan, or a purpose statement. Parenthetically, Ms. * * *'s testimony concerning the fact the bank examiner should look outside of the loan file and consider the knowledge of officers as to the borrower's purpose for the loan and consider performance on the loan as evidence of a repayment plan notwithstanding the condition of the written documentation is supported by the testimony of Mr. * * * (Tr. Vol. XI 29) and Mr. * * * (Tr. Vol. IV 129-30). Mr. * * * and Ms. * * * also agree that in analyzing the prudency of an extension of credit, as well as a guarantee supporting a credit extension, a person's reputation, business success and the profitability of his business should impact upon the classification decision (Tr. Vol. IV 155; V-A 75). (Emphasis added.)

2. *Did a condition of disproportionate quantity of poor quality loans arise from the Bank's lending and collection practices?*

FDIC's legal theory and proposed facts in support of a find that unsafe and unsound banking practices occurred regarding (2):

A substandard asset is one that is inadequately protected by current sound worth or the paying

capacity of the obligor (Tr. Vol. III 63). Such credit weaknesses may jeopardize the liquidation of the loan and cause the Bank to sustain loss (Tr. Vol. V-A 35). Loans adversely classified as of August 22, 1983, were $6,721,000 "substandard" and $182,000 "loss." A loan may be classified because it is undersecured, there is insufficient cash flow, or there is not a normal amortization program, among other things (Tr. Vol. I 109). A condition resulting from the * * * hazardous lending and lax collection practices was an excessive and disproportionately large volume of poor quality loans in relation to * * *'s total loans (Tr. Vol. III 192). The Bank's adversely classified loans represented 28.7 percent of its total loans (Ex. 10 at 8; Tr. Vol. III 186-87). An average bank of the same size would not have more than ten percent of its loans adversely classified (Tr. V-B 142). As of October 31, 1983, the Bank had ceased accruing interest on $988,000 of its loans (Resp. Ex. E at 3).

[There was no rebuttal by respondents on this issue.]

3. *Did the Bank overstate its earnings and equity capital position in failing to make adequate provisions for its loan valuation reserve?*

FDIC's legal theory and proposed facts in support of a finding that unsafe or unsound banking practices occurred regarding (3):

* * * had engaged in an unsafe or unsound banking practice in that it failed to make adequate provisions for its reserve for possible loans losses ("loan valuation reserve"). The Bank has waited until assets are almost uncollectible before charging them off (Tr. Vol. V-B 148). As of August 22, 1983, the loan valuation reserve of * * * totaled $308,000, while the total of all loans subject to adverse classification was $6,903,000 (Ex. 10 at 8-9; Tr. Vol. III 196). An adequate reserve would have been $690,000 or more (Tr. Vol. III 196-97). As a result, the financial statements prepared by * * * have overstated its earnings and equity capital (Tr. Vol. III 199-200).

Respondents offered the following rebuttal:

Well, the whole problem with that issue of loan loss reserve is almost like a classification, it's a subjective type of decision. Presumably the assets are classified based on the examiner's assessment of the losses in the Bank. And certainly there can be an argument provided for the losses that would be charged off and providing for at least a significant portion, if not all of the doubtful classifications, but the issue of how much reserve should be for substandard classification is really subjective and no one —I don't think anyone can say and there are no written guidelines that I've ever seen of how much reserve should be in a loan loss reserve to cover potential losses in the substandard loans. Since no one has identified any losses and there is no impirical [sic] evidence to say how much of those are going to be losses, it varies all over the board how much reserves people keep.

And the FDIC and none of the other regulators really have fixed policy also on this even though it's becoming more and {{4-1-90 p.A-760}}more of an accepted type of—I don't know. I don't even want to say it's a standard. You know, if you have one percent of your loans as a reserve, normally the regulators are satisfied. But I know an awful lot of banks that have less than that.

(Respondents' witness * * *, Tr. Vol. VI 157-58.)

4. *Did the Bank operate with inadequate liquidity?*

FDIC's legal theory and proposed facts is support of a finding that unsafe or unsound banking practices occurred regarding (4):

* * * has engaged in an unsafe or unsound banking practice in that it has operated with inadequate liquidity (Tr. Vol. III 200-12). During a period beginning on January 1, 1983, and ending on August 22, 1983, * * * had borrowed for 70 days at an average borrowing of $419,000 and a maximum borrowing of $925,000 (Tr. Vol. III 207). This is substantially more than normal (Tr. Vol. III 210). As of August 22, 1983, only $65,000 of * * *'s investment portfolio of $10,777,000 was scheduled to mature within one year (Tr. Vol. III 204).

[There was no rebuttal by respondents on this issue.]

5. *Did the Bank operate with an inadequate level of capital for the kind and quantity of its assets?*

FDIC's legal theory and proposed facts in support of a finding that unsafe or unsound banking practice occurred regarding (5):

* * * has engaged in an unsafe or unsound banking practice in that it has operated with an inadequate level of capital for the kind and quality of assets it held (Tr. Vol. III 212-15). As of August 22, 1983, the total of $7,407,000 in adversely classified assets excluded from computation of * * *'s adjusted capital and reserves was 271 percent of * * *'s adjusted equity capital and reserves ($2,615,000)[6] (Tr. Vol. III 214).

(The ratio of a bank's adjusted capital and reserves to Net equity capital and reserves is calculated by subtracting the rest of the adversely classified assets. For August 22, 1983, the calculation was as follows:

Common stock	$250,000
Surplus	1,600,000

Undivided profits	541,000
Contingency reserves	100,000
Equity capital	2,491,000
Valuation reserves	308,000
Total equity capital and reserves	2,799,000
Less assets classified "loss"	184,000
Adjusted equity capital and reserves	2,615,000
Less assets classified "substandard"	7,407,000
Net equity capital and reserves	(4,792,000)

Its adjusted gross assets provides an indication of the amount of protection which a bank's capital accounts provide for its depositors. This ratio also reflects the extent to which asset loss or depreciation can be absorbed by the bank's capital accounts before its depositors' funds are impaired. In this regard, capital consists of equity capital (defined to include common stock, perpetual preferred stock, capital surplus, undivided profits, contingency reserves, other capital reserves, mandatory convertible instruments, and reserves for loan losses) less assets classified loss and one-half of assets classified doubtful. FDIC Statement of Policy on Capital Adequacy, 46 Fed Reg. 62,694 (1981) (FDIC Proposed Finding of Fact 112).

[There was no rebuttal by respondents on this issue.]

6. *Did the Bank's board of directors fail to adequately supervise* * * *, *et al.?*

FDIC's legal theory and proposed facts in support of a finding that unsafe or unsound banking practice occurred regarding (6):

* * *'s board of directors has failed to provide adequate supervision over * * * and other active officers of * * * (Tr. Vol. III 215; VII 48–63). Abusive practices regarding loans to insiders and associates of insiders of * * * have been of concern to the FDIC for about five years. These concerns have been expressed to the board of directors of * * * repeatedly by letters and in reports of examination, as more fully set forth *supra*.

The respondents offered the following rebuttal:

Ms. * * *'s definition of "insider" for purposes of both her concentrations of credit and lending limit violations is substantially broader than anything which has been legally recognized.... Although there is some margin for subjective judgment even {{4-1-90 p.A-761}}in this definition, it was intended to be a relatively narrow one by Congress and to afford individuals and companies potentially impacted by the Regulation's [Regulation O] restrictions some notice of the standard of responsibility and performance they would be held to. There is no room in this statute for aggregation on the basis of personal relationships, common business interests per se, association, or even the recognized relationships of husband and wife or father and son per se. Yet all of these previously mentioned relationships were used by Ms. * * * to draw connections between individuals and companies for the purpose not only of determining concentrations of credit but also, apparently, for classifying those credit extensions.

Resp. Br. at 15–16.

c. *Unsafe or Unsound Banking Practices: Findings and Conclusions*

The term "unsafe or unsound banking practice" lacks statutory definition, although its meaning has been recognized in banking parlance and by bank regulators, and interpretations have been adopted by the courts.[7] The following quotation, taken from a memorandum prepared for congressional hearings on amendment to Section 8 of the Act, by then Chairman of the Federal Home Loan Bank Board John E. Horne, has been cited frequently for the "definition" of an unsafe or unsound banking practice:

> Generally speaking, an "unsafe or unsound practice" embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.

See Financial Institutions Supervisory and Insurance Act of 1966: Hearings on S. 3158 Before the House Committee on Banking and Currency, 89th Cong., 2d Sess., at 49-50 (1966).

Findings and conclusions as to six categories or unsafe or unsound banking practices alleged by FDIC in this proceeding are discussed below, at 1 through 6, and are incorporated and summarized in Tables I and II of Appendix A.

1. *Hazardous lending and lax collection practices*

FDIC alleges that the Bank has committed "unsafe or unsound banking practices" by engaging in hazardous lending and lax collection practices, which, in the instant case, have consisted of extending credit without obtaining and maintaining assurance of various safeguards for repayment, *e.g.*, obtaining financial information on the borrowers; obtaining adequate security for the loan; establishing and maintaining realistic programs for repayment; and determining the purpose of the loan before extending credit.

Upon review of the FDIC's proposed findings, considering respondents' rebuttal, where applicable, in light of the record evidence, I find a pattern of credit extensions attended by few, if any, of the routine and normally expected lending safeguards. Accordingly, I have upheld the FDIC's proposed findings regarding hazardous lending and lax collection practices, except in those instances noted in Table II. The instances in which classifications are not upheld, in Table I, are those where the "hazardous lending practice" alleged comprised a single rather than an aggregation of departures from the lending safeguards described above.[8]

The pattern of lending and collection practices proven on this record, and conveniently summarized by FDIC's proposed findings except in the limited situations which are explicitly rejected, reflects such a casual and indifferent regard to accepted and conventional banking practices as to warrant the conclusion of a breach of fiduciary duty, and I so find.

In applying the rationale above, I accepted respondents' promise that a substandard classification should not be predicated upon an isolated lapse attending the documentation of a credit transaction, where loss has not occurred nor its likelihood proven.[9]

It is absolutely clear that, on the one hand, the examiner, in exercising broad discretion, frequently assigned an adverse classification on what may be characterized as a totality-of-the-circumstances theory. On the other hand, exercising no less a judgmental evaluation, the examiner classified substandard certain credit extensions which were unique to one or another single category of unsafe or unsound conduct which, taken together, comprise hazardous lending and lax collection practices.

The credit extensions excluded here in the total sum of $1,004,000 do not rise to the level of unsafe or unsound banking practice. Without condoning such inattention to preferred and accepted norms, I confess to having reached the conclusion that the record is amply made, without more. Considering that the Bank, its officers and directors so far departed from the norm in respect of lending and collection practices as to warrant the finding that they engaged in hazardous lending and lax collection practices, as is found in this Initial Decision, little is lost to the enforcement effort by exercising equity, rejecting the isolated substandard classifications.

It is noted that where a particular credit extension was alleged in more than one category, doubt whether the adverse classification stands up to close scrutiny as to any one such category is not sufficient to prompt rejection so long as the other categories appear reasonably to support the classification. For example, the * * * loan, at FDIC proposed findings 19, 47, 70 and 97, constituted a $50,000 extension, which, as to the inadequate security allegation (proposed finding 47) clearly should escape classification no matter that the collateral is substantially written down in view of the relatively small credit compared to the size of the collateral even when written down. Accordingly, while I reject proposed finding 47, I uphold findings which otherwise suffice to support the adverse classification.

2. *Disproportionate Volume of Poor Quality Loans as a Condition Resulting from Hazardous Lending Practices*

FDIC has alleged that a bank similar in size to the respondent would not operate with more than 10% of its loans adversely classified. The parties have stipulated that the report of examination indicates the Bank's loans adversely classified in the Report of Examination (Ex. 10) represent 28.7% of its total loans outstanding.[10] After adjusting the total of adversely classified loans by subtracting those where the adverse classification is rejected in this decision, 21.5% of the Bank's total loans ($23,420,000) remain classified.

Recapitulation:

Total classified	$6,903,000
less classifications not established at hearing	867,000
less isolated classifications	1,004,000
	$5,032,000

See footnote 2, *supra*.

Mere recitation of adverse classifications in the Report of Examination (Ex. 10) is insufficient, where the respondents as here, have put the FDIC to its proof, no testimony or evidence was introduced beyond the report itself, the FDIC having made proposed findings as to other classified loans has abandoned these

on brief (except insofar as they are included in the total of classified assets set out by FDIC at proposed finding #112), and can hardly expect me to comb Exhibit 10 to find and uphold them.

Respondents argue that because the amount of classified loans representing "loss" is small relative to the preponderance of "substandard" classifications; that because none of the classifications involving the alleged * * * and * * * concentrations[11] has resulted in loss; that because the single largest loss occurred at the * * * * * * Bank branch; and that because the Bank's loan loss history has run consistently less that its peer average of .59%, the effect of the classifications, with respect to a finding of an unsafe or unsound banking practice, is substantially mitigated.

The occurrence of "loss" is clearly an important factor in determining whether a practice has threatened the interest of the depositors, and, therefore, an important predicate for a finding of an unsafe or unsound banking practice. Although respondents have demonstrated that loss has not yet attended the alleged concentrations of credit, the most recent loss experience is still .78% of total loans, well above the loss ratio experienced in prior examinations. Satisfied that this loss ratio is excessive in light of the Bank's own prior and the peer history, and that the total classification of 21.5% is likewise disproportionate, I conclude that the condition resulting from the volume of poor quality loans constitutes an unsafe or unsound banking practice in the instant case.

3. *Accounting Practices*

FDIC alleges that the Bank has engaged in an unsafe or unsound banking practice in failing to make adequate provisions for possible loan losses ("loan valuation reserve"). FDIC alleges that an adequate reserve would have been an amount equal to at least 10% of the total of all loans subject to adverse classification, which FDIC con- {{4-1-90 p.A-763}}tends would amount to $690,000 or more (Tr. Vol. III 196-97). The record establishes that the loan valuation reserve as of August 22, 1983 was $308,000 (Ex. 10).

Although I am in full agreement with FDIC in its assertion of the importance of such reserve as recited in the legislative history of Section 8(b) of the Act (12 USC § 1818(b)) and case law indicating "the singular importance to financial institutions of the allowance for possible loan losses,"[12] I do not find that the Bank engaged in an unsafe or unsound banking practice in maintaining a loan valuation reserve of only $308,000 for the following reasons.

In her memorandum to FDIC (Ex. R), Examiner * * * recommended as adequate a loan loss reserve of approximately 1% of unadjusted total loans ($237,000/ $23,728,000) (Ex. 10 at 8; Ex. R), at a time when the peer average percentage was .99%. She testified, however, that an amount equal to 10-30% of adversely classified loans was the proper measure for adequacy of the reserve (Tr. Vol. III 196-97). By comparison, respondents' expert witness * * * testified that "normally the regulators are satisfied" with a loan valuation of 1% of total loans (Tr. Vol. VI 157-58).

The record supports a calculation of loan valuation reserve based on either the percentage-of-total loans or percentage-of-adversely-classified loans method. Consequently, a finding of unsafe or unsound practice, in this category, appears to turn on the method of calculation employed. Because the Bank's loan valuation reserve as of the date of the Report of Examination was $308,000, a figure in excess of 1% of total loans, and in line with its peer group average for the relevant period (.99%), I do not find the Bank's provision for the loan valuation reserve to have been unsafe or unsound, for the relevant period.

4. *Liquidity Practice*

FDIC alleges that the Bank has engaged in an unsafe or unsound banking practice in that it has operated with inadequate liquidity. Specifically, FDIC cites the Bank's borrowing and investment portfolio management practices, *i.e.*, that the Bank was unduly reliant on short term liabilities to fund its earning assets, and was unable to maintain necessary "secondary" reserves in the event of an unanticipated withdrawal of funds (Tr. Vol. III, 200-12).

FDIC urges that the effect of such illiquidity may ultimately force the Bank to either dispose of assets at a loss or procure new funds at added expense (*Id.*; FDIC Br. at 26–27; 53) and asserts that the Bank's "volatile liability dependency ratio" (a measure of dependence on short term liabilities) varied from positive 7.91 to 13.46 during a period when the peer average was negative 12.68 (Ex. 10 at 12).

Keeping in mind the reason underlying curtailing unsafe or unsound banking practices—protection of the depositors[13]—and the deference to be accorded bank examiners in assessing the quality of assets comprising the investment portfolio (FDIC Br. at 53), I find that the potential consequences of the liquidity practices complained of, *i.e.*, premature asset liquidation at a loss, or the need to procure more expensive replacement funds, pose a sufficient threat to the depositors' interest to sustain a finding that the Bank has engaged in an unsafe or unsound banking practice in its liquidity practice by failing to maintain necessary reserves.

5. *Capital Practice*

FDIC alleges that the respondent Bank has engaged in an unsafe or unsound banking practice in operating with an inadequate level of capital for the kind and quality of assets it holds. Specifically, FDIC

contends that the ratio of the Bank's assets classified "substandard" to its adjusted equity capital and reserves is 271% ($7,407,000/ $2,615,000), and, further, that experience demonstrates that a ratio of 100% or above connotes the presence of a "problem bank." (Tr. Vol. III, 213-215).

Respondents offered no rebuttal on this issue.

The adjusted ratio of classified assets to total equity and reserves, after deducting the classifications rejected, is 192% ($5,032,000), not 271% as FDIC alleges. I must agree with FDIC, however, in finding that a ratio of 100% or more is excessive and threatening to the depositors in the event of unanticipated withdrawals. I find, therefore, that the Bank has engaged in an unsafe or unsound banking practice within the meaning of Section 8(b)(1) of the Act in its capital practice, by failing to maintain an adequate level of capital for the kind and quality of assets it holds.

6. *Supervision by Directors*

FDIC alleges that the respondent Bank's Board of Directors has engaged in an unsafe or unsound banking practice in failing to adequately supervise * * *, and other active officers of the Bank.

In support of its allegations that the Bank engaged in continual abusive practices regarding insider loans, FDIC cites the repeated warnings issued to the Board subsequent to the 1979 and 1980 FDIC examinations. Concern was expressed over "concentrations or credit" arising from a continuing pattern of loans extended to insiders and associates of insiders, and the Bank's "continued refusal to abide by statutes and federal regulations..." (Stip. Paragraph 5 at page 4, citing the June 10, 1980 letter from Examiner * * * to the Board). FDIC cites also * * *'s July 8, 1980 reply letter (Ex. 6) in which * * * expressed the Bank's immediate intention to establish a regulatory compliance committee whose members would be "unrelated" to either "significant borrowers" or "principal shareholders." As claimed by FDIC, the "chairman" of the committee, Bank Director * * *, was in fact "related" to the "principal shareholders" of the Bank by virtue of his concurrent directorship in * * *, of which * * *, uncle of * * *, was president (Tr. Vol. III, 40). The FDIC alleges also that the committee never functioned (Tr. Vol. VII, 61-62). As asserted by respondents, family relationships and concentrations of credit are not per se indicia of banking improprieties; FDIC witnesses did not disagree. However, the web of * * * -related borrowings required exercise of caution and control by a prudent board of directors, an exercise demonstrably not borne by the Bank's directors.

I have upheld the adverse classifications involving the so-called " * * * * " and "* * *" "concentrations of credit." This, coupled with the forebearance demonstrated by the FDIC in prior examinations[14], ostensibly to enable the Bank to come into regulatory compliance of its own accord, and the subsequent failure of the Bank's committee to review its loan portfolios in light of new regulatory requirements, compel me to find that the Bank engaged in an unsafe or unsound banking practice in failing to supervise * * *, and its operating officers from engaging in abusive insider lending practices.[15]

III. *Violations of Law*

A. *Violation of Law Respecting Section 23A of the Federal Reserve Act*

The FDIC has alleged violations of law by respondents of Section 23A(a)(1)(A) of the Federal Reserve Act (12 USC § 371c(a)(1)(A)) in twenty-eight instances. Respondents, for their part, have stipulated to three violations of Section 23A, but offer by way of defense several legal theories, discussed *infra*, to which FDIC has taken exception on reply brief.

Respondents concede that if * * *, and the Bank are found to have been affiliated under subsection (a)(1)(A), the 10% rule of Section 23A was violated.[16] The issue presented is whether the Bank and * * * are affiliated. The test for affiliation to support liability under subsection (a)(1)(A) is determined by application to the case at hand of the definitions of control contained in subsection (b)(1)(A). In turn, the test for control required by (b)(1)(A) is made in accord with subsection (b)(3)(A).

The parties have argued the question of affiliation under (b)(3)(A)(i). However, subsection (b)(3)(A) of Section 23A contains three elements for determining the presence of a potential affiliation, not one element alone. The parties have not addressed (ii) or (iii). The question of affiliation, based on an examination of the entire record in light of each subelement of (b)(3)(A), is discussed below.

It is undisputed that Section 23A applies to insured State nonmember banks protected by FDIC, pursuant to Section 18(j) of the Act (12 USC § 1828(j)).[17]

1. *Relevance of the Amendment of Section 23A to these proceedings*

Section 23A of the Federal Reserve Act was amended on October 15, 1982, as part of the Banking Affiliates Act of 1982 overtaking the prior Act of June 16, 1933 (48 Stat. 183), as previously amended, recognizing, however, certain exceptions to the effect of the new Act.

With regard to the statutory revision which introduced the twenty-five percent ceiling on control where the previous test of affiliation had been 50%, the Bank concedes that while it was affiliated with * * *, within the meaning of Section 23A subsequent to the October 1982 amendment in certain instances, it

was not within the proscription of (a)(1)(A) contemplated by revisions to the "stock ownership test" {{4-1-90 p.A-765}}set forth at (b)(1)(A) and (b)(3)(A)(i) (Resp. Br. at 51–52).

As authority for their interpretation of the statute, respondents rely on the "Editor's Note," (Sec. 410(c) of Title IV of the Act of October 15, 1982), as exempting from the meaning of the statute:

> ...transactions which are the subject of a binding written contract or commitment entered into on or before July 28, 1982, and except that any renewal of a participation in a loan to such an affiliate as a result of the enactment of this statute, or any participation in a loan to such an affiliate emanating from the renewal of a binding written contract or communication outstanding on July 28, 1982, shall not be subject to the collateral requirements of this Act.

Resp. Br. at 53.

Thus, respondents argue that certain credit extensions [18] made prior to July 28, 1982 were "permissible loans" within the meaning of Section 23A as amended, and that inferably, without aggregation of these loans, no additional violations of Section 23A would occur (Resp. Br. at 54–55).

Additionally, respondents argue that several loans [19] should be excluded from those upon which the civil money penalty was assessed because they involved "original credit extensions or renewals of credit extensions prior to agency publication of the amendments." Coupled with their assertion that the general collateral pledge agreement, given to secure the above transactions with * * *, stock on all subsequent credit extensions, created "inadvertent" violations of Section 23A, respondents contend evidence of lack of "intent to violate the law" is manifested (Resp. Br. 55-56).

FDIC, however, challenges the respondents' construction of the "Editor's Note," *supra*, pertaining to transactions exempted from the amendment of Section 23A as restricted to those "[subject to] a binding written contract or commitment entered into on or before July 28," and that respondents "offered no evidence of a pre-July 28, 1982 binding commitment to renew these loans. Therefore, the Bank was contractually able to comply with section 23A's prohibitions..." (FDIC Reply Br. at 6).

FDIC argues also that respondents' attempt to mitigate the violation of Section 23A by citing its "inadvertence" would improperly relieve the respondents from the "duty of compliance" by shifting such to FDIC (*id.* at 7).

Accordingly, FDIC contends that culpability for "renewal" for aggregation purposes is appropriate as "each renewal... constitutes a separate violation" of Section 23A(a)(1)(A)'s ten (10) percent limitation. *Id.*

2. *Application of Section 23A to the transactions in question*

The legislative history accompanying the amendment of Section 23A, effective October 15, 1982, as part of the Depository Institutions Act of 1982 provides as follows:

> The bill accomplishes three major objectives. First, it liberalizes certain unduly restrictive provisions in the existing statute while still protecting a bank from adverse transactions with affiliates. Second, several potentially dangerous loop- holes are closed. Finally, it reorganizes and clarifies the statute to facilitate compliance and enforcement.

S. Rep. No. 536, 97th Cong., 2d Sess. 1982, *reprinted in* U.S. Code Cong. & Ad. News 3054, 3085.

The legislative history of the revised Act does not specifically address the intended construction to be placed on the revised text, nor does it contrast the amended elements of "affiliation" with the prior statute.

Under the prior statute at Section 23A(e)(2)(b)(1)-(4), *supra*, affiliation between a member bank and another company or corporation would be found if *any one* of four criteria, several of which alluded to a "50% stock ownership test," was met. The prior statute generally provided that affiliation between the member bank and the other company would be found if (1) the member bank directly or indirectly controlled the majority or 50% of the voting stock of the other company; or (2) if a shareholder of the member bank held a 50% or larger share in the other company as set forth under (1); or (3) if there was an inter-locking directorate between the member bank and the other company; or (4) if the other company held a 50% or larger share in the member bank equivalent to that set forth in (1).

The general definition of an affiliate as set forth in current (b)(1)(A) provides that {{4-1-90 p.A-766}}an affiliate of a member bank is "any company that controls the member bank and any other company that is controlled by the company that controls the member bank ...." The definition of control is set forth in (b)(3)(A), the elements of which are the same as those of the prior statute except as to the change in the percentage requirements noted above.

The legislative history does not inform whether the criteria set forth under (i)-(iii) must be satisfied collectively or individually in order to establish the presence of control, apart from the use of the disjunctive following clause (ii). However, the purpose underlying the statutory revision was said to be an intent to facilitate compliance through clarification. The current text, consistent with this purpose, condenses the elements of the prior statute into a test predicated upon "control." This "clarification" of the

statutory language does not suggest, however, that the drafters intended that the elements of the test for control under (i)-(iii) be applied differently from the disjunctive treatment applied in (b)(1)-(4) of the prior Act. Stated differently, each element, standing alone, if proven, supports a finding of control for purposes of determining whether there has been a violation of Section 23A.

Accordingly, the elements of "control" set forth under Section 23A(b)(3)(A)(i)-(iii) of the current statute are understood to be that each element individually, where proven, establishes a level of "control" which may form the basis for a finding of affiliation under (b)(1)(A).

3. *Findings and Conclusions*

In their Answer dated March 6, 1984, respondents admitted that * * *, was "at all times pertinent to this proceeding, the President, a director, and a major shareholder of respondent Bank," holding 1,307 (52.3%) of 2,500 outstanding common shares, the largest block, according to his financial statement dated July 29, 1983 (Ex. 43). During the same period, he was also president, chairman, and a director of * * *, as well as its largest shareholder, with an apparent 545,703 out of 2,079,903 outstanding common shares,[20] according to the Company's prospectus dated June 15, 1983 (Ex. 1; Tr. Vol. II 61, 81)[21]. Respondents, however, contended that the prospectus erred by including as shares of * * *, shares actually held by his son, reducing this amount to 472,976 and, thereby, below the 25% limit. Although the testimony to support the "mistake" in the prospectus did not unerringly persuade, it stood up sufficiently on cross examination and is not so inherently incredible absent rebuttal evidence as to warrant a conclusion that the witnesses were lying.

Whatever doubts I may have as to whether the respondents' evidence as to * * *'s "holdings" was real or concocted, I am compelled to sustain respondents because there is no evidence to the contrary and no basis for concluding that the respondents' evidence is less than it appears to be. The disregard for accuracy in counting his shares by * * *, and by counsel for * * * (Ex. 1) demonstrates a casual attitude towards public stock offerings and careful business practices expected of lawyers and bankers. Nevertheless, I am constrained to believe unimpeached testimony. I accept the correction of the SEC filing as consistent with a later realization of error in the prospectus. Accordingly, I find that the shares which ostensibly were held by * * *, were in fact his shares and are not to be included in his father's account. Even at the reduced shareholding level, * * * was the largest shareholder of * * *; the remaining shares were not concentrated (Ex. 1).

Based on the foregoing, the control test is satisfied, if at all, only on the basis of section (b)(3)(A)(ii) of (iii) since the 25% rule of subsection (b)(3)(A)(i) is not satisfied.

Under Section 23A subsection (b)(1)(A), *supra*, an affiliate with respect to a member bank is deemed to include "any company that controls the member bank...". "Control" is established pursuant to subsections (b)(3)(A)(ii)-(iii) where:

> "(ii) such company or shareholder controls in any manner the election of a majority of the directors...of the other company, or (iii) [if] such company or shareholder, directly or indirectly, exercises a controlling influence over the management or policies of the other company..."

In *Gottesman v General Motors Corporation*, 279 F. Supp. 361 (D.C. S.D.N.Y. 1967), *aff'd.*, 436 F.2d 1205, *cert. denied*, 403 U.S. 911 (1971), the court stated as follows (at 367-68):

> Corporate control is an inexact concept. [*] Certainly it carries with it *power* {{4-1-90 p.A-767}}to direct corporate policy and considerable patronage. [*] According to a noted corporate scholar, "`control' may be defined as the capacity to choose directors. As a corollary, it carries capacity to influence the board of directors and possibly to dominate it." Berle, "Control" in Corporate Law, 58 Colum. L. Rev. 1212 (1958).
>
> Power to control through the election of directors may exist where a large block of shares, even though a minority, is owned by one group and the remaining shares are widely scattered. This is called practical or working control.

(Footnotes omitted.)

Based upon the testimony, Stipulation, documentary evidence and case law, it is fair to conclude that through his "ownership, control, or voting power," * * *, is affiliated with the Bank and * * * within the meaning of Section 23A, and, further, that he "exercised a controlling influence" over * * *, * * *,[22] "[which have been] at all relevant times [his] related interests." (Stip. at paragraph 2, p. 2), and * * * by virtue of his 80% ownership interest therein (Ex. 10). Pursuant to subsection (b)(1)(A), by virtue of having satisfied the evidentiary test both of (b)(3)(A)(ii) and (iii), the six concerns are affiliated for the purpose of the prohibitions of (a)(1)(A) and (B), at all times relevant to this proceeding.

Under Section 23A(a)(2), *supra*, a "covered transaction" is "a transaction with an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that affiliate...." Under (a)

(1)(A) and (b), *supra*, such covered transactions are prohibited to the extent that the aggregate amount of such transactions exceed 10%, in the case of a single affiliate, or 20%, in the case of all affiliates, of the member bank's capital stock and surplus.[23]

As discussed above, * * *, Sr., and the five listed concerns are found to be affiliates of the Bank and their transactions with the Bank are deemed "covered." As set forth in the Stipulation, *supra*, respondents concede to having made covered transactions aggregating $600,000, and in violation of (a)(1)(A) and (B) because these extensions, used to purchase stock in * * *, were to the "benefit" of that affiliate under (a)(2), and further, exceeded 20% ($523,000/ $2,615,000) of the Bank's capital stock and surplus. Because these extensions remained undiminished during the relevant period, each further transaction, if "covered," necessarily results in a violation of (a)(1)(B).

I find, therefore, and Table III so reflects, that each transaction between the Bank and six identified affiliates—* * * and * * *— as well as every transaction between the Bank and "any person" in which the proceeds of the transaction were "used for the benefit of, or transferred to" any of the six concerns, results in violation of Section 23A(a)(1)(B); with respect to any transaction in which the proceeds were transferred to, or benefited * * *, additional violations of (a)(1)(A) and (B) result, because such extensions aggregate in excess of 20% of the Bank's capital stock and surplus.

The above rationale thus provides the basis for the conclusions expressed in Table III as to individual transactions. All transactions involving the Bank and any of the six identified concerns were scrutinized under a two-prong test (the results of which are depicted on Table II): first, were the proceeds of the transaction transferred to, or used for the benefit of, the affiliate? Second, did the amount of the transaction, properly aggregated, exceed the limitations set forth under (a)(1)(A) or (B)?

It should be noted that of 28 instances of violation of (a)(1)(A) alleged, 24 are upheld,[24] but not for the reasons urged by the FDIC in its Proposed Findings. This is so because I find that "collateralizing" an extension of credit with stock in * * *, absent indicia of a purchase money security interest taken in connection with the same transaction, fails to satisfy the statutory test, *i.e.*, collateralization as proven on this record is not shown to "benefit" the affiliate as contemplated by (b)(7)(D)[25]. Rather, the majority of these charges are upheld because the proceeds, so far as the record makes clear, benefited or were transferred to one of the Bank's six identified affiliates in an amount exceeding the limitations expressed under (a)(1)(A), (B), or both.[26]

B. *Violations of Law Respecting Section 106(b)(2) of the Bank Holding Company Act Amendments of 1970: Findings and Conclusions*

FDIC alleges that respondents have violated Section 106(b)(2) of the Bank Holding {{4-1-90 p.A-768}}Company Act ("BHCA") (12 USC § 1972(2)) by extending credit to Messrs. * * *, as well as * * *, and * * *, because such loans were not made on substantially the same terms as those governing comparable transactions with other persons not covered by the statute, and were instead made on preferential terms. In six instances, FDIC alleges that the interest rate charged by the Bank violated the statute. Regarding loans to * * * and * * *, there is dispute as to whether FDIC has alleged that "other unfavorable features" were present, including abnormal risk of repayment at the time credit was extended.[27]

Respondents have conceded by stipulation that Messrs. * * * and * * * were, at all times pertinent, "executive officers" of correspondent * * * Bank within the meaning of Section 106(b)(2) (Stipulation at paragraph 3, p. 2). Respondents do not agree, however, that Messrs. * * * and * * *, as Assistant Vice President and Vice President of * * * Bank, respectively, come within the meaning of "executive officers" under the statute. In addition, respondents challenge the applicability of Section 106 to the 1983 renewal of a loan made to * * * in November 1978, at a time prior to the effective date of the statute.

As indicated in Table III, I have upheld FDIC's charges of violation of Section 106(b)(2) with respect to the two February 1983 loans to * * *, an "executive officer" within the meaning of the statute, in the amount of $5,000 and $45,000, each made at 8% when the prevailing rate was 12% for those not covered by the statute. I have upheld also the charge of violation pertaining to the 1983 renewal of a November 1978 loan to * * * made at 8% when the prevailing rate was 12% for those not covered by the statute, because a renewal of a loan is to be given the same effect as a new extension of credit.

Because I find that their respective functions do not rise to those of "executive officers" of * * * Bank, I do not consider the subject loans involving Messrs. * * * and * * * within the prohibitions of Section 106(b)(2), and I do not uphold FDIC's charges of violation regarding the same. The function of these two officers do not appear to include policy-making responsibilities; it is notorious that position titles of bank officials are inflated in comparison to corporate entities generally. (*See* for an apt analogy, footnote 1, 12 CFR § 215.2(d) definition of executive officer for purposes of Regulation O.)

I do not uphold FDIC's charges of violation of Section 106(b)(2) regarding the loans to Mr. * * * or * * * for several reasons. Although * * *, concededly an "executive officer" of correspondent * * * Bank (Stipulation, *supra*), and a general partner of * * * (Tr. Vol. 1, pp. 117-118)[28] arguably "controls" * * *

pursuant to Section 22(h) of the Federal Reserve Act (12 USC § 375b(5)), his ownership interest in * * * is only 20% (Resp. Br. at 49); on the face of the statute Mr. * * * cannot be said to "control" * * * pursuant to the 25% ownership test of Section 22(h) of the Federal Reserve Act (12 USC § 375b(5)(A) incorporated into 12 USC § 1972(2)). Alternatively, the level of "electoral" or "managerial" control required in 12 USC § 375(5)(B) or (C) cannot be imputed to a 20% participant absent other evidence of control; here none was offered or proven.[29]

The testimony cited above is that as to the January 1983 loan of $585,000 to * * *, Mr. * * * holds no more than a minority block of voting shares in * * *. Although he has held, at various times, officer and director positions in * * *, no evidence was offered or proven that he held sufficient voting shares or managerial influence over * * * to bring the transaction within the proscription of Section 22(h), FRA (12 USC § 375b(5)(B) incorporated into 12 USC § 1972(2)), which requires a finding that the individual "controls" in any manner the election of a majority of the directors of the company).[30]

c. *Violations of Law Respecting Sections 22(h)(1)-(3) of the Federal Reserve Act, 215.4(a)-(c) of Regulation O and FDIC Regulation 337.3(b): Findings and Conclusions*.

[Because of their interrelationship, charges of violation concerning these sections are discussed together.]

FDIC alleges that the respondents have violated Sections 22(h)(1), FRA (12 USC § 375b(1)-(3)), Section 215.4(a)-(c) of Regulation O (12 CFR § 215.4(a)-(c)), and FDIC Regulation 337.3(b) (12 CFR § 337.3(b)) in connection with extensions of credit discussed in this decision at Section III-B, *supra:*

(1) *$600,000 in loans outstanding as of August 22, 1983 secured by stock in* * * * {{4-1-90 p.A-769}}"transferred to" * * * in excess of the limitation of 12 CRF § 215.2(f), and violative of Section 215.4(c) of Regulation O and Section 22(h)(1), FRA.

(2) *Extensions of credit set forth in the Initial Decision Section III-B, supra*.

—that the extensions cited above "inured to the benefit of * * *, Sr. or his related interests" within the meaning of Section 215.3(f) of Regulation O, and violative of Section 22(h)(3), FRA, and Section 215.4(a) of Regulation O.

(3) *Extensions of credit set forth in the Initial Decision Section III-B, supra, and the aggregate of extensions to * * * Jr. and * * **

—that the extensions of these credits are in violation of FDIC Regulation 337.3(b), Section 215.4(b) of Regulation O and Section 22(h)(2), FRA, because they exceeded the "unimpaired capital and surplus" tests set forth therein, and were made without the prior approval of the Bank's directorate. Alternatively, FDIC urges that those extensions made with prior approval are nonetheless violative of Section 215.4(c) of Regulation O and Section 22(h)(1), FRA.

As reflected in Table III, I uphold FDIC's charges of violation of Sections 215.4(c) of Regulation O and 22(h)(1), FRA, respecting the $600,000 in extensions collateralized by stock in * * *, but not for the reasons urged by FDIC. As already discussed in this decision at Section III-A, *supra*, the $600,000 in loans secured by stock in * * * Inc., "benefited" that company not because of the use of its stock as collateral, but, rather, because these funds, as conceded in the Stipulation, were used to purchase stock in * * *.

I find that this amount ($600,000) is in excess of the "15% unimpaired capital and surplus" test ($392,250/$2,615,000) set forth in Section 215.2(f) of Regulation O and in violation of Section 215.4(c) of Regulation O and Section 22(h)(1), FRA, because such amount was extended to "benefit" "a related interest" of * * *, Sr. under Section 215.2(k), this is so because the proceeds of the loans were used to purchase stock in * * *, and because Mr. * * * is a "director who is also an executive officer or principal shareholder" of the Bank within the scope of Section 215.4(c).

As reflected in Table III, I do not uphold FDIC's charge of violation of Sections 22(h)(3), FRA, and 215.4(a) of Regulation O regarding the transactions set forth in Section III-B, *supra*, for substantially the reasons urged by respondents (Resp. Br. at 49), *i.e.*, that FDIC tendered no evidence that the borrowings involving Messrs. * * * or * * * and * * * "inured to the benefit of" * * *, Sr., or his "related interests." I also do not uphold the charges of violation of FDIC Regulation 337.3(b), Section 215.4(b) of Regulation O, or Section 22(h)(2), FRA, with respect to the same individuals or concerns, as I do not find them to be "related interests" of an "executive officer" of the Bank.

On this question the FDIC Reply Brief takes strong issue with respondents' claim of nonliability and urges that I recognize the pattern of practice by which the individual respondent, * * *, Sr., engaged in a borrowing relationship with * * * Bank * * *, among others. I am entirely sympathetic to the proposition that the several banking statutes must be viewed comprehensively, acknowledging "the common purpose of prohibiting abusive practices by bank insiders." However, no amount of concern for the banking system and the public served by it can overcome a failure of proof.

I am not persuaded by FDIC's argument (FDIC Reply Br. at 15) that the pattern of borrowing between individuals associated with the two institutions overcomes the distinction to be given the meaning of

"executive officers" at respondent bank * * * and correspondent * * * Bank for the purpose of Regulation O in this proceeding. Accordingly, because * * * and * * * are "executive officer(s)" of * * *, and not * * *, I find that the loans for $30,000 and $50,000, respectively, cannot be used for the purpose of aggregation under Section 215.4(b); I find further that the transactions involving * * *'s alleged "related interests," * * * and * * *, do not come within Regulation O, and can not be aggregated. As the trier of fact, I simply do not find that the third party extensions of credit collateralized by * * * stock satisfy the test of Regulation O, absent a credible basis on which to find "related interests."

On the basis, already found, of the Bank's affiliation with * * * and * * *, I uphold {{4-1-90 p.A-770}}FDIC's charges of violation of the percentage limitation and prior approval requirements of FDIC Regulation 337.3(b), Section 215.4(b) of Regulation O and Section 22(h)(2) FRA with respect to all of the extensions regarding the above concerns, or extensions to others where the proceeds benefited or were transferred to any of the affiliates, because the aggregate amounts extended them was $4,740,900, and in excess of the 15% test ($392,250/$2,615,000) pursuant to Section 22(h)(2), and, a *a fortiori*, the 5% test ($130,750/$2,615,000) of Section 215.4(b) and FDIC Regulation 337.3(b), and, in the instances cited in Table III, made without "prior approval" of the Bank's directors (Stip. paragraph 13(e), p. 10)[31].

I uphold also FDIC's charges of violation of the above regulations regarding extensions made to * * * because, as stipulated, the substantial portion of the $329,000 extended was used to purchase stock in affiliate * * *, or was transferred to * * *, Sr., and the extensions, therefore, come within the meaning of the regulations.

As reflected in Table III, those extensions to * * * and * * * made with prior approval of the Bank's directors are found in violation of Section 22(h)(1), FRA, and Section 215.4(c) of Regulation O to the extent that they exceed the aggregate dollar limitations described above.

IV. *Remedies*

A. *Cease and Desist Order*

1. *Discussion*

The record amply demonstrates that the Bank engaged in unsafe and unsound banking practices and the persons responsible for management of the Bank committed violations of law and regulation. There is no question of authority to issue a cease and desist order in such circumstances. *See* Section 8(b)(1) of the Act. 12 USC § 1818 (b); indeed, respondents do not dispute that a cease and desist is in order, but issue is joined as to what is appropriate in such an order.[32] Without addressing each element of the proposed cease and desist, or the parties' entire discussions on brief, it is sufficient to note only certain critical elements in dispute, and the conclusion that I find the record supports the provisions set out below in the proposed order.

As to prior bank practices either cured before or during pendency of this proceeding, there is no reason to suppose that the cures would have occurred absent the goad of regulatory enforcement given the proven record of breach of fiduciary responsibilities by the Bank's officers and directors. Although there is a dearth of cases involving Section 8(b) of the Act, the Court of Appeals for the Fifth Circuit has instructed us that a cease and desist may issue "when a Bank is, has or is about to engage in an unsafe and unsound practice or, when a bank, is or is about to violate a law, rule or regulation," *First National Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674, 681 (5th Cir. 1983). The findings on this record satisfy the *Bellaire* tests.

It is well established that issuance of a cease and desist, once power exists, is a discretionary matter, the appropriateness of which turns on the facts of each case. Absent precedent under the banking statutes, cease and desist orders of the Federal Trade Commission are reasonable proxies. FTC orders have produced a judicial consensus; they will be upheld where the remedy selected has a "reasonable relation to the unlawful practices found to exist," *FTC v. Colgate-Palmolive Co.*, 380 U.S. 374, 394-395 (1965); *FTC v. National Lead Co.*, 352 U.S. 419, 429 (1957); *FTC v. Ruberoid Co.*, 343 U.S. 470, 473 (1952). It follows, for example, that brokered deposits, the limitation on which respondents accurately contend is not explicitly contemplated by statute, is not for that reason beyond reach in an appropriate cease and desist. Given the broad pattern of conduct demonstrated on this record, it is not unreasonable that the Bank be required to notify FDIC whenever 5 per cent of total deposits are funded by third party agents or nominees for depositors pursuant to which notice the Regional Director may object to the Bank's plan for use of such deposits. Given the generally casual attitude toward Bank managerial responsibilities demonstrated on this record, such remedial provision is reasonably calculated to protect the insurance fund and is reasonably enough relevant to the case at hand even though there is no proof of misuse of brokered deposits.

FDIC agrees on brief that no inference of past abusive practice is to be drawn from this limitation. I do not share respondents' understanding of the congressional attitude reflected in the report of an unidentified subcommittee [presumably of the U.S. House of Representatives] discussed in the excerpt of Volume 44 of *Washington Finan-*

{{4-1-90 p.A-771}}*cial Reports* appended to respondent's Reply Brief. The excerpt discusses legislative and regulatory initiatives to limit use of brokered deposits. The subcommittee, rejecting "harsh new regulations or legislation" confirmed its "earlier judgment . . . that the regulators can control excessive brokered funding growth by problem institutions through supervisory means alone."

The intrusive impact of the proposed order which accompanied the initial Notice was modified in several respects in the order urged by FDIC on post-hearing brief. The modifications presumably reflect FDIC trial staff's judgments in light of the record evidence. Review of the record and of the arguments by the parties compels the conclusion that the cease and desist which issues here does so on a record which reflects entrepreneurial activity on the part of * * * , to such an extent as to distract from his responsibilities concerning the Bank, coupled with the failure of the Bank's board of directors and officers to provide an adequate substitute for his inattention. But nothing in the record serves to suggest that his attention has not now been drawn to the need to attend to the Bank's affairs.

The substantial differences between the parties turn on the time to be provided for reduction of the adversely classified loan inventory and limitation on lending and investment authority on the part of * * *.

FDIC initially proposed reduction of loans classified substandard as of August 22, 1983 to $1,500,000 within six months of the effective date of the cease and desist; this provision would now be eased to reduction to $2,000,000 within 18 months of such date. Testimony and exhibits suggest that six months would not only be unusual but of dubious success. In my judgment, acknowledging the passage of time from the initial Notice to date, easing the amount of the limitation by one-third to a level of $2,000,000 in lieu of $1,500,000, and extending the period for compliance to 18 months, the formula proposed is a reasonable accommodation to the realities necessary to restore regulatory confidence in the viability of the Bank. Balancing the economic environment in the market served by the Bank against a record rather barren of urgency and intensity in past efforts to improve the portfolio, my best judgment is that the 18 month/$2,000,000 provision is reasonable both as to level and duration.

Another question, but not one on which the 18 month/$2,000,000 determination rests, is that the $2,000,000 is to be reached from an adjusted substandard classification aggregate of $6,903,000 (based upon the Report of Examination), reduced by $1,004,000 and $867,000, representing adversely classified loans previously held in this decision to be unproven and rejected, respectively.

In commenting on brief on the original form of the reduction requirement, respondents remind us that the temporary cease and desist (Ex. P), in effect *pendente lite*, prohibits the Bank from participating classified assets to another lending institution without informing the latter that the asset is classified, thereby reducing options available to the Bank to reduce its classified asset inventory. The FDIC did not propose retention of the prohibition. However, there is no reason on this record not to retain it. The testimony adduced by respondents from banking regulators, state and federal, and from its own expert, informed the record that financial institutions do not welcome the purchase of classified assets. It requires no expertise to suppose that the knowing acquisition by a banking institution of an adversely classified asset is an unsafe or unsound banking practice, a supposition confirmed by the opinion of the * * * witness (Tr. Vol. XI 35).

I cannot suppose that the banking system and the public are served by permitting the unchecked sale of loans, classified substandard by one regulatory financing institution, to another. Accordingly, the recommended order at paragraph 9 contains a prohibition against such participation.

Proposed paragraph 7 would require the Bank's board of directors to remove lending and investment authority from * * * , excluding him from authorizing any loans either individually or as a member of any committee except that he would be permitted to continue to vote as a member of the full board of directors. [The initial proposal had not limited investment participation, but was susceptible of an inference that participation as a board member on loan matters would be prohibited.] Respondents, focusing on the initial proposal, contend that the intended prohibitions are tant-
{{4-1-90 p.A-772}}amount to removal under Section 8(e) of the Act. Absent explicit charges and proof pursuant to that section, I agree.

Of course, as participants in this proceeding are aware, action to remove * * * , Sr., pursuant to Section 8(e) was initiated in January 1985 and is now in the post-hearing briefing stage in Docket FDIC-84-24e.

Given the provisions of the recommended cease and desist incorporated in this direction—mandating reduction of adversely classified loans, restoration and maintenance of a 7.5 percent equity capital and reserves ratio, requirement for outside directors and an audit committee comprised only of outside directors, review of current loan policy to include specified loan provisions, adoption of written investment and liquidity policies and the requirement for compliance reports—the pervasive influence of * * * , Sr., on lending practices, so evident in the transactions disclosed by the Report of Examination, cannot reasonably be expected to recur. On its merits, therefore, there is no need for the Draconian remedy proposed.

But I reject paragraph 7 also for the additional and elementary reason that, in the circumstances, it is

tantamount to removal from office, a result not authorized in this proceeding but only in an appropriate 8(e) case. This is so because there is precious little left to do for the controlling shareholder and principal operating official of this Bank if he is not to participate in credit extensions and investment decisions. Indeed, it might be thought that the better result would be to encourage him to take the lead in compliance with the cease and desist instead of denying him meaningful participation in restoring the Bank to an appropriate level of regulatory confidence. The loan portfolio comprised 62 percent of the assets of the Bank as of the date of the Report of Examination; total investments were $38,252,000. Obviously, lending and investment decision-making are significant aspects of the Bank's operations. It can not be doubted that * * * , Sr.'s position is an essential one in lending and investment operations. The best assurance of an opportunity for this Bank to improve the adverse classification position is for its controlling shareholder and chief operating official to be charged with the responsibility for effecting that result.

The foregoing reasons distinguish the result reached here from the rationale for limitations on lending authority imposed by the FDIC Board of Directors in * * * , Docket FDIC-83-132b, *supra*.

The legislative history of the Financial Institutions Supervisory Act of 1966, which amended the Act by adding, *inter alia*, Section 8(e), noted that each of the new enforcement powers conferred by that statute was granted "within carefully guarded limits," S. Rep. No. 1482, 89th Cong. 2d Sess., 1966, *reprinted in* U.S. Code Cong. and Ad. News, 3532, 3538. Moreover, Section 8(e) at subsection (4) contemplates that a Bank officer is to be prohibited in an appropriate case "from further participation in any manner in the conduct of the affairs of the Bank," 12 USC § 1818(e)(4). This provision suggests that Section 8(e) is the exclusive authority for prohibiting an official from participating in "the affairs of the bank." Participation in lending and investment decision-making is participation in the principal affairs of the Bank. Removal of that participatory role is beyond the reach of Section 8(b).

On the record lawfully permitted to be made in this case, considering the statutory scheme as a whole, considering also the comprehensive sweep of the cease and desist provisions recommended and incorporated herein, this decision recommends sufficient and lawful affirmative action to correct conditions resulting from unsafe or unsound banking practices and violations, without more. The provisions recommended to aid in restoring the Bank to a sound financial condition are sufficient for that purpose, without eliminating the role of * * * , Sr., in lending and investment decision-making (other than as a member of the full board of directors). The frustration of regulators confronted with the proven array of unsafe or unsound banking practices and violations is understandable. So are the limits of statutory authority.

The FDIC advocates that outside directors (and their related interests) should not be in debt to the Bank for as much as $100,000 or one per cent of the Bank's total capital and reserves, whichever is the lesser. Respondents suggest, correctly I think, that one per cent would be a stringent limiting factor. To place a ceiling on borrowing by outside directors at approximately $25,000 would appear to reduce substantially the universe from which qualified individuals
could be drawn. Although compromise is an obvious solution—$50,000 perhaps—I would judge that a ceiling of $100,000 is not improvident given the other constraints imposed by the cease and desist. Paragraph 8(c) below so reflects.

2. *Recommended Cease and Desist Order*

Accordingly, it is found and concluded that the respondents have engaged in certain unsafe or unsound banking practices and violations of law and regulation, and that a cease and desist from certain practices, including affirmative conditions requiring certain corrective steps, should issue. I recommend that the Board of Directors of the FDIC issue the following:

CEASE AND DESIST ORDER

The Federal Deposit Insurance Corporation ("FDIC") on February 8, 1984, issued to the * * * Bank, * * * ("Bank"), and * * * , Sr., a notice of charges and of hearing ("Notice") under Section 8(b)(1) of the Federal Deposit Insurance Act, 12 USC § 1818(b)(1). The Notice charged the Bank and * * * , Sr. with having engaged in unsafe or unsound banking practices and having violated certain specified laws and regulations.

As the result of the administrative proceeding held pursuant to the statutory opportunity for hearing provided to the respondents,

IT IS ORDERED, that the Bank, its directors, officers, employees, agents, assigns, and other persons participating in the conduct of the affairs of the Bank, and * * * , Sr., individually, CEASE and DESIST, directly or indirectly, from the following:

(a) Operating with an inadequate reserve for loan losses;
(b) Engaging in hazardous lending and lax collection practices;
(c) Operating with an inadequate level of capital;
(d) Operating with inadequate liquidity; and

(e) Violating Sections 22(h) and 23A of the Federal Reserve Act (12 USC §§ 375b and 371c) and Regulation O (12 CFR Part 215), promulgated under Section 22(h) of the Federal Reserve Act.

IT IS FURTHER ORDERED,

1. (a) Upon the effective date of this ORDER, the Bank shall, to the extent it has not previously done so, eliminate from its books, by charge-off or collection, all assets or portions of assets classified "Loss" by the FDIC as a result of its examination of the Bank as of August 22, 1983. Reduction of these assets through proceeds of other loans made by the Bank are not considered "collection" for the purpose of this paragraph 1(a).

(b) Within eighteen months from the effective date of this ORDER, the Bank shall reduce the total of loans classified "Substandard" as of August 22, 1983, to not more than $2,000,000. As used in this paragraph, "reduce" means (i) to sell without recourse or to collect, (ii) to charge off, or (iii) to improve the quality of adversely classified assets sufficiently to warrant removing any adverse classification by the FDIC in succeeding examinations.

2. (a) Within ten days from the effective date of this ORDER, the Bank shall replenish its reserve for loan losses by charges against current operating income in an amount equal to those loans required to be charged off under paragraph 1(a) of this ORDER.

(b) In Reports of Condition and Income requested by the FDIC or the Commissioner of Banking for the State of * * * ("Commissioner") and filed by the Bank prior to the effective date of this ORDER and subsequent to August 22, 1983, the Bank shall reflect a provision for loan losses which is adequate in light of the condition of the Bank's loan portfolio and which, at a minimum, equals the adjustments required by paragraph 2(a) of this ORDER. If necessary to comply with this ORDER, the Bank shall file amended Reports of Condition and Income.

(c) Prior to submission or publication of any Report of Income or Report of Condition requested by the FDIC or the Commissioner after the effective date of this ORDER, the board of directors of the Bank shall review the adequacy of the Bank's reserve for loan losses and make any provision necessary to maintain the adequacy thereof. The minutes of the meeting of the board of directors of the Bank and of its audit committee at which {{4-1-90 p.A-774}}such reviews are undertaken shall indicate the results of the review, the amount of increase in the reserve recommended, if any, and the basis for determination of the amount of reserve provided.

3. (a) Within three months from the effective date of this ORDER, the Bank shall review its current written loan policies and procedures in light of the deficiencies noted by the FDIC as of August 22, 1983, and develop any changes thereto that are necessary or appropriate in the opinion of the Bank's board of directors. Within four months from the effective date of this ORDER, the board of directors of the Bank shall, (i) direct the loan officers of the Bank to implement the written loan policies and procedures and any amendments thereto, and (ii) establish procedures to monitor loan officer compliance with the written loan policies and procedures.

(b) Areas to be addressed in the Bank's lending policy shall include without limitation the following:

(i) General files of lending in which the Bank will engage and the kinds or types of loans within each general field.

(ii) The lending authority of each loan officer.

(iii) Responsibility of the board of directors in reviewing, ratifying, or approving loans.

(iv) Guidelines under which unsecured credit will be granted.

(v) Guidelines for rates of interest and the term of repayment for secured and unsecured credit.

(vi) Limitations on the amount advanced in relation to the value of the collateral securing the credit and the documentation required by the Bank for each type of secured credit.

(vii) The maintenance and review of complete and current credit files on each obligor.

(viii) The collection procedures of the Bank including without limitation what actions are to be taken against borrowers who fail to make timely payments.

(ix) Limitations on the extension of credit through overdrafts.

4. Within one month from the effective date of this ORDER, and monthly, thereafter, the board of directors of the Bank shall require a progress report from the Bank's lending officers on all adversely classified loans in excess of $50,000.

5. Within two months from the effective date of this ORDER, the Bank shall correct, by collection or by

sale without recourse, all violations as found and determined in the administrative proceeding in Dockets FDIC-84-23b and 84-67k of Sections 22(h) and 23A of the Federal Reserve Act (12 USC §§375b and 371c) and of Regulation O (12 CFR Part 215), promulgated under Section 22(h) of the Federal Reserve Act, existing as of August 22, 1983, and shall institute procedures to ensure future compliance with all applicable laws, rules and regulations.

6. (a) Within 30 days of the effective date of this ORDER, the Bank shall achieve equity capital and reserves at a level equal to or exceeding 7.5 percent of the Bank's average assets for the last complete month prior to such effective date. Thereafter, for the duration of this ORDER, the Bank shall maintain equity capital and reserves at a level equal to or exceeding 7.5 percent of its average total assets for each month of June and December. Equity capital and reserves and total asset amounts utilized in the average shall be calculated in accordance with prevailing instructions for the preparation of Reports of Condition. If such ratio is less than 7.5 percent as of June 30 of December 31 or any calendar year, the Bank shall, within 30 days thereafter, present to the Regional Director of the FDIC having supervisory jurisdiction over the Bank and to the Commissioner a plan for the augmentation of the capital accounts of the Bank or other measures to bring the ratio to 7.5 percent. If such ratio is less than 7.5 percent as of June 30 or December 31, respectively, of each calendar year, the Bank shall, by the following July 31 or January 31, respectively, present to the Regional Director and the Commissioner a plan for the augmentation of the capital accounts of the Bank or other measures to bring the ratio to 7.5 percent. Within 60 days after the plan is reviewed and no exception is taken by the Regional Director and the Commissioner, restoration of the capital ratio to 7.5 percent shall be completed.

(b) The formal semiannual capital ratio analysis in June and December of each year provided for in paragraph 6(a) shall not be construed to negate the responsibility of the Bank and its board of directors to maintain, throughout the
{{4-1-90 p.A-775}}year, an adequate level of capital protection for the kind, quality, and degree of market depreciation of assets held by the Bank.

(c) Any increase in equity capital and reserves necessary to meet the requirements of paragraph 6(a) may be accomplished by the following:

(i) Sale of common stock; or
(ii) Sale of perpetual or convertible preferred stock; or
(iii) Sale of subordinated debt mandatorily convertible into common or perpetually preferred stock; or
(iv) Direct contribution of cash by the shareholders or directors of the Bank; or
(v) Sale of collection of assets previously charged off; or
(vi) Reduction of all or part of the "Loss" assets specified in paragraph 1(a) of this ORDER without loss or liability to the Bank; or
(vii) Any combination of the above means; or
(viii) Any other means acceptable to the FDIC.

(d) If all or part of the increase in total equity capital and reserves necessary to meet the requirements of paragraph 6(a) of this ORDER is accomplished by the sale of new securities, the board of directors of the Bank shall forthwith take all steps necessary to adopt and implement a plan for the sale of such additional securities, including soliciting proxies and voting any shares or proxies owned 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 the Federal securities laws. Prior to the sale of the securities and, in any event, not less than thirty 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 at Washington, D.C. for its 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 equity is provided by the sale of preferred stock or subordinated debt, then all terms and conditions relative to interest rate and any convertibility factor, shall be presented to the Regional Director for prior approval.

(e) In complying with the provisions of this paragraph 6, the Bank shall, during the distribution, provide to any subscriber or purchaser of the Bank's securities, written notice of any planned or existing development or other change which is materially different from the information reflected in any offering material used in connection with the sale of the Bank's securities. The written notice required by this paragraph 6(e) shall be furnished within the ten days from the date such material development or change was planned or occurred, whichever is earlier, and shall be furnished to

every purchaser or subscriber who received or was tendered the information contained in the Bank's original offering materials.

7. Upon the effective date of this ORDER, the Bank shall cease and desist from extending credit in any amount that alone or when aggregated with any outstanding credit would exceed $50,000 with respect to any obligor without the prior approval of the Bank's board of directors.

8. (a) Within 60 days from the effective date of this ORDER, the board of directors of the Bank shall prepare a plan for submission to the shareholders of the Bank to reconstitute the Bank's board of directors to provide that a majority of the directors are outside directors. The plan shall be submitted to the shareholders at a meeting which must take place within 30 days after the plan is developed. The Bank shall, through its counsel, provide to all of its directors information as to the responsibilities and liabilities of bank directors.

(b) Within three months from the effective date of this ORDER, the Bank shall establish an audit committee composed solely of outside directors.

(c) "Outside director" means an individual (i) not in the employee of the Bank, and (ii) whose total outstanding direct and indirect indebtedness to the Bank, including the indebtedness of any {{4-1-90 p.A-776}}related interest of the individual, does not exceed $100,000.

9. While this ORDER is in effect, with respect to any adversely classified asset of the Bank, except for adverse classifications rejected in any administrative or judicial proceeding, the Bank shall not by sale or otherwise transfer same in whole or in part unless the Bank makes to the prospective transferee full and complete written disclosure of any such adverse classification bearing in any way upon the credit quality or collectibility of the asset and the legal sufficiency of the documentation relating to it.

10. Within three months from the effective date of this ORDER, to the extent it has not already done so, the Bank shall develop a written investment policy which, at a minimum, shall address standards for selection of securities investments considering quality, maturity, marketability and the Bank's liquidity, diversification, and income. The Bank shall review this policy annually and revise it, as necessary, to meet the Bank's investment objectives. Once adopted, such written investment policy shall be tendered to the Regional Director and shall not be amended without prior written approval of the Regional Director.

11. Within two months from the effective date of this ORDER, to the extent it has not already done so, the Bank shall review its liquidity position and develop a written liquidity policy which takes into consideration the volume of volatile purchased certificates of deposit in relation to the Bank's asset base. The policy should provide for the Bank's anticipated and contingent future needs and establish specific guidelines including, without limitation:

(a) A limit on loans as a percentage of assets;

(b) Limits on the Bank's reliance on a particular liability category (e.g. large out-of-area certificates of deposits); and

(c) Limits on the rate-sensitivity position of the Bank's assets and liabilities.

Once adopted, such written liquidity policy shall be tendered to the Regional Director and shall not be amended without the prior written approval of the Regional Director.

12. While this ORDER is in effect, the Bank shall give written notice to the Regional Director at such time as five percent of the Bank's total deposits are funded by third party agents or nominees for depositors, including deposits managed by a trustee or custodian when each individual beneficial interest is entitled to or asserts a right to Federal deposit insurance ("brokered deposits"). The notification should indicate how the brokered deposits are to be used with specific reference to credit quality of investments or loans and the effect on the Bank's funds position and asset/liability matching. The Regional Director shall have the right to object to the Bank's plans for using brokered deposits. So long as the level of brokered deposits equals or exceeds five percent of the Bank's total deposits, the Bank shall provide on the first Monday of each month a written report to the Regional Director detailing the level, source and use of brokered deposits.

13. At intervals of three months from the effective date of this ORDER, the Bank shall furnish accurate 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 of those actions. The reports shall include certified copies of resolutions of the Bank's board of directors and the audit committee thereof adopting such reports. Such reports may be discontinued when the corrections required by this ORDER have been accomplished or the Regional Director and the Commissioner have in writing released the Bank from making further reports. The Bank shall preserve evidence of its compliance with this ORDER until this ORDER is terminated.

14. For the purposes of this ORDER, the terms "extension of credit," "credit," "loan," and "related interest" shall be defined as those terms are defined in Regulation O of the Board of Governors of the Federal Reserve System (12 CFR Part 215). In addition, the term "loan participation" shall be defined to include any loan purchased or sold in its entirety or in part by a financial institution, person, or other entity.

The provisions of this ORDER shall be binding upon the Bank and its directors, officers, employees, agents, successors, assigns, and other persons participating in the conduct of the affairs of the Bank.

The provisions of this ORDER shall become effective ten days after its issuance, except as provided according to its terms, and shall remain effective and enforceable except to the extent that, and until such time as, any provision of this ORDER shall
{{4-1-90 p.A-777}}have been modified, terminated, suspended, or set aside by the FDIC.

B. *Civil Money Penalties*

1. *Discussion*

The maximum penalty at issue is not the statutory amount which FDIC is authorized to seek under Section 18(j)(3) of the Act, 12 USC §§ 1828(j)(3), and 106(b)(2) of the Bank Holding Act Amendments of 1970, 12 USC § 1972(2), but is the limitation provided by the April 11, 1984 Notice of Assessment in Docket FDIC-84-67k. The Order to Pay contained in the Notice assesses several named respondents only one of whom, * * * , Sr., is involved in the two banks whose conduct of affairs is at issue. The amount assessed against him aggregates $100,000.

At the August 6, 1984 prehearing in * * * , counsel agreed to seek from the FDIC Board of Directors an allocation of the $100,000 as between the two banks. It has since been reported to me, most recently in colloquy among counsel and the Bench during hearing in * * * , that counsel would submit a written representation of such allocation previously agreed to (and for which a post-hearing exhibit designation in * * * was reserved). Instead, by letter in the * * * dockets dated September 4, 1985, FDIC trial counsel recites, asserting concurrence of counsel for respondents (being the same counsel in the * * * dockets), that although the matter of allocation had never reached the Board, the premise on which they had tried the cases is that the penalty split allocates $25,000 to the * * * dockets, $75,000 to the * * * dockets. At hearing, FDIC counsel agreed the maximum in this case is $75,000 (Tr. Vol. VI 55). FDIC on post-hearing brief urges a penalty of $75,000 against * * * , Sr.

In view of the foregoing, I find that the maximum allowable penalty against * * * , Sr., in Docket FDIC-84-67k is $75,000.

FDIC on post-trial brief urges the amounts assessed in the initial Order to Pay against the other individual respondents, *i.e.*, $10,000 against * * * , Jr., and $1,000 each against * * * and * * *.

The parties are agreed that imposition of civil penalties does not require proof of willfulness. However, respondents support the effort for drastic reduction in any penalties by arguing, *inter alia*, that violations were inadvertent, immediately corrected upon receipt of notice, lacking intent to conceal and without financial damage to the Bank. Respondents fit their recitation (Resp. Br. 58-65) essentially into the categories set forth as "considerations in the assessment of civil money penalties" contained in the interagency policy statement regarding the assessment of civil money penalties adopted by the FDIC as a Statement of Policy, an extract of which is appended to respondents' reply brief, of which official notice is taken. However, it is not my understanding that the guidelines are, in any case, jurisdictional. Moreover, respondents misperceive the literal text of the guidelines when they interpret away the initial factor, *i.e.*, evidence that a violation or pattern of violations was committed "with a disregard of the law or the consequence to the institution."

The fact is that $2,837,900 in prohibited insider transactions were identified as of the date of the Report of Examination, as found above. Clearly, the individual respondents neglected their fiduciary responsibilities as directors and several of them and their associates obtained financial gain, benefit and preferential treatment. On balance, to the extent that the guidelines are taken into account, on a retrospective reckoning in light of the record compiled at hearing, they support, rather than deny, the threshold enforcement determination to proceed with an Order to Pay.

Cutting the other way, respondents are correct that certain of the guidelines are not satisfied on this record.

The respondents are more persuasive on the issue of the amount than on the fact of civil money penalties. Having rejected certain of the allegations concerning violations, I find less predicate for holding respondents responsible than appears on the face of the charges. Although the Bank has been managed with a casual flair which in my judgment breaches the fiduciary duty owed to its depositors, I am satisfied from observation, particularly of * * * , Sr., on the witness stand, that his conduct was more a matter of inattention than deliberate overreaching. In this respect, considering also his financial resources, it is difficult to gauge what assessment would deter further misconduct. Exhibit EE, although only marginally useful and lacking significant probative value, informs us that the range of civil money penalties listed is

substantially short of the maximum sought here. Indeed, no penalty exceeds $19,000 among those {{4-1-90 p.A-778}}which have been paid; the largest amount pending other than in Docket FDIC-84-67k is $32,000.

Regrettably, no yardstick has been provided to me as trier of fact on which to measure the violations found against the penalties sought so as to produce with confidence a result consistent with precedent, if any, or with prevailing legislative and regulatory sentiment.

In this essentially discretionary aspect of administrative adjudication, the entire circumstances may be taken into account, including the rejection for purposes of this proceeding of certain of the adverse classifications found in the Report of Examination (Ex. 10). I do not find that any violations were inadvertent. However, it is a mitigating factor that the legal rationale concerning certain of the violations is not viewed in the same way by counsel and the trial judge; if the lawyers and the judge are not agreed as to which subtleties of the law are transgressed, can bankers be more certain? A critical consideration is that despite liability for multiple violations, the underlying events which gave factual content to those violations were often the same.

As previously discussed in this decision concerning violations, certain of the allegations of credit extensions involved in the web of * * * , Sr.'s related interests were not proven. Finally, the Bank has not suffered any loss to date from the events which comprise the violations nor does the evidence entitle us to anticipate loss.

For all the foregoing reasons, and my judgmental response to the demeanor of the witnesses, both for the FDIC and respondents, it is unfair to mulct the respondents with all that is sought. The discussion concerning * * *, Sr., pertains, although in a proportionately more modest way, to the other individual respondents.

2. *Recommended Order to Pay*

On the basis of the entire record, having observed the witnesses, received the evidence and taken into account the pleadings, including briefs, it is my judgment that appropriate civil money penalties are found and determined in amounts which are one-third of those asserted. Accordingly, I recommend that the Board of Directors of the FDIC issue the following:

ORDER TO PAY

After taking into account the appropriateness of the penalty with respect to the financial resources and good faith of the respondents, the gravity of the violations, and such other matters as justice may require, it is:

ORDERED, that a penalty of $333 be, and hereby is, assessed against * * * pursuant to Section 18(j) of the Act and Section 106(b)(2) of the Bank Holding Company Act Amendments of 1970;

ORDERED, that a penalty of $3,333 be, and hereby is, assessed against * * *, Jr., pursuant to Section 18(j) of the Act and Section 106(b)(2) of the Bank Holding Company Act Amendments of 1970;

ORDERED, that a penalty of $333 be, and hereby is, assessed against * * * pursuant to Section 18(j) of the Act and Section 106(b)(2) of the Bank Holding Company Act Amendments of 1970;

ORDERED, that a penalty of $333 be, and hereby is, assessed against * * * pursuant to Section 18(j) of the Act and Section 106(b)(2) of the Bank Holding Company Act Amendments of 1970;

ORDERED, that a penalty of $333 be, and hereby is assessed against * * * pursuant to Section 18(j) of the Act and Section 106(b)(2) of the Bank Holding Company Act Amendments of 1970;

ORDERED, that a penalty of $25,000 be, and hereby is, assessed against * * * pursuant to Section 18(j) of the Act and Section 106(b)(2) of the Bank Holding Company Act Amendments of 1970;

FURTHER ORDERED, that the civil money penalties assessed by this Order shall not be paid directly or indirectly by the Bank, but shall be paid by the respondents.

V. *Conclusion*

The foregoing decision, containing findings of fact and conclusion of law, a recommended Cease and Desist Order and a recommended Order to Pay, include and incorporate also the three tables, previously mentioned, set forth below. In addition, footnotes to the text are attached following signature but are incorporated as fully as if set out above. This decision constitutes the full findings, conclusions and recommendations by me based upon the entire record, including evidence, pleadings and briefs.

Dated at Washington, D.C. this 7th day of October, 1985.

/s/ Marvin H. Morse

Administrative Law Judge

{{4-1-90 p.A-779}}

TABLE I

S = Substandard

D = Doubtful

L = Loss

PFF	CLASSIFICATION CONCLUSION (dollar amount in thousands) S	D	L	Conceded by Respondents	FDIC Proposed Findings Upheld	Other (See Footnotes to Table I)
(10)	160					1/
(11, 42, 62, 89)	115				X	
(12, 63, 90)	300				X	
(13, 43, 64, 91)	125				X	
(14, 44, 65, 92)	225				X	
(15, 66, 93)	125				X	
(16)	214			X	X	
(17, 46, 68, 95)	135				X	
(18, 69, 96)	233				X	
(19, 47, 70, 97)	50				X	
(20, 48, 71, 98)	270				X	
(21, 49, 99)	218				X	
(22, 51, 74, 101)	324				X	
(23, 52, 75, 102)	184			X	X	
(24, 53, 76, 105)	329			X	X	
(25, 54, 103)	36			X	X	
(26, 55, 77, 106)	237				X	
(27, 56, 78, 104)	299				X	
(28)			6		X	
(29)	3					2/
(30, 57, 79)	20		20		X	
(31, 80)	130				X	
(32)	195					3/
(33, 58, 81)	370				X	
(34)	75					4/
(35, 83)	105				X	
(36)	28					5/
(37)	150		117		X	
(38, 86)	152				X	
(39, 59, 85)	136				X	
(50, 73, 100)	300				X	
(82)	339					6/
(84)	204					7/

{{4-1-90 p.A-780}}

FOOTNOTES TO TABLE I

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[1] * * * ($160,000). The only hazardous lending or lax collection practice alleged and proved pertains to the Bank's extending credit without adequate financial information. Under the rationale set forth in the Initial Decision at Section II-C-1, the classification is not upheld.

[2] * * * ($3,000). The only hazardous lending or lax collection practice alleged and proved pertains to the Bank's extending credit without adequate financial information. Under the rationale set forth in the Initial Decision at Section II-C-1, the classification is not upheld.

[3] * * * ($195,000). The only hazardous lending or lax collection practice alleged and proved pertains to the Bank's extending credit without adequate financial information. Under the rationale set forth in the Initial Decision at Section II-C-1, the classification is not upheld.

[4] * * * d/b/a/ * * * ($75,000). The only hazardous lending or lax collection practice alleged and proved pertains to the Bank's extending credit without adequate financial information. Under the rationale set forth in the Initial Decision at Section II-C-1, the classification is not upheld.

[5] * * * ($28,000). The only hazardous lending or lax collection practice alleged and proved pertains to the Bank's extending credit without adequate financial information. Under the rationale set forth in the Initial

Decision at Section II-C-I, the classification is not upheld.

[6] * * * ($339,000). The only hazardous lending or lax collection practice alleged and proved pertains to the failure of the Bank to establish and enforce a realistic repayment program or to determine the source of repayment. Under the rationale set forth in the Initial Decision at Section II-C-1, the classification is not upheld.

[7] * * * ($204,000). The only hazardous lending or lax collection practice alleged and proved pertains to the failure of the Bank to establish and enforce a realistic repayment program or to determine the source of repayment. Under the rationale set forth in the Initial Decision at Section II-C-1, the classification is not upheld.

{{4-1-90 p.A-781}}

TABLE II

(Determinations, Section II-C-1: Hazardous Lending and Lax Collection Practices)
S = Substandard
D = Doubtful
L = Loss

Alleged Hazardous Lending and Lax Collection Practice	Classification Conclusion (From Table I				FDIC Proposed Findings Upheld by Category				FDIC Findings Not Up-held (See Key to Table II
PFF	None	S	D	L	1(a)	1(b)	1(c)	1(d)	
(10)	X				X				
(11, 42, 62, 89)		X			X	X	X	X	
(12, 63, 90)		X			X		X	X	
(13, 43, 64, 91)		X			X	X	X	X	
(14, 44, 65, 92)		X			X	X	X	X	
(15, 66, 93)		X			X		X	X	
(16)		X			X	X	X	X	X
(17, 46, 68, 95)		X			X	X	X	X	
(18, 69, 96)		X			X		X	X	
(19, 47, 70, 97)		X			X		X	X	1(b)
(20, 48, 71, 98)		X			X	X	X	X	
(21, 49, 99)		X			X	X		X	
(22, 51, 74, 101)		X			X	X	X	X	
(23, 52, 75, 102)		X			X	X	X	X	
(24, 53, 76, 105)		X			X	X	X	X	
(25, 54, 103)		X			X	X		X	
(26, 55, 77, 106)		X			X	X	X	X	
(27, 56, 78, 104)		X			X	X	X	X	
(28)				X	X				
(29)	X				X				
(30, 57, 79)		X		X	X	X	X		
(31, 80)		X			X		X		
(32)	X				X				1b
(33, 58, 81)		X			X		X		
(34)	X				X				
(35, 83)		X			X		X		
(36)	X				X				
(37)		X		X	X				
(38, 86)		X		X		X			
(39, 59, 85)		X			X	X	X		

(50, 73, 100)		X				X	X	X
(82)	X						X	
(84)	X							

{{4-1-90 p.A-782}}

KEY TO TABLE II

1(a) Extending credit without obtaining adequate financial information.

1(b) Extending credit without obtaining adequate security.

1(c) Failure to establish and enforce a realistic program for repayment or to determine the source of repayment.

1(d) Extending credit without determining its purpose.

{{4-1-90 p.A-783}}

TABLE III

Loan Identification	Date of Loan or Refinancing	Amount of transaction	VIOLATION ALLEGED					Charges Upheld				Other (See Footnotes to Table III)
			(1)	(2)	(3)	(4)	(5)					
	10-19-82	$105,000	X	X	X		X					
	11-5-82	2000	X	X	X		X	(1)	(2)	(3)	(5)	f/
	11-19-82	1,500	X	X	X		X	(1)	(2)	(3)		f/
	12-1-82	100,000		X				(2)				a/, f/
	12-1-82	100,000	X	X	X		X	(1)	(2)	(3)	(5)	f/
*	2-2-83	400,000		X								f/
	2-8-83	114,200		X				(2)				f/
	2-11-83	72,000	X	X	X		X	(1)	(2)	(3)	(5)	f/
	2-18-83	2,500	X	X	X		X	(1)	(2)	(3)	(5)	f/
	3-9-83	110,000		X								f/
	3-18-83	7,000	X	X	X		X	(1)	(2)	(3)	(5)	b/
*	3-22-83	4,600	X	X	X		X	(1)	(2)	(3)	(5)	b/
	3-23-83	2,500	X	X	X		X	(1)	(2)	(3)	(5)	f/
	4-4-83	19,000	X	X	X		X	(1)	(2)	(3)	(5)	b/
	4-18-83	105,000	X	X	X		X	(1)	(2)	(3)	(5)	b/, f/
	5-19-83	1,500	X	X	X		X	(1)	(2)	(3)	(5)	b/, f/
*	5-20-83	9,250	X	X	X		X	(1)	(2)	(3)	(5)	b/, f/
	5-28-83	200,000		X								a/, b/
	6-1-83	5,500	X	X	X		X	(1)	(2)	(3)	(5)	b/, f/
	7-28-83	5,600	X	X	X		X	(1)	(2)	(3)	(5)	f/
	8-3-83	1,000	X	X	X		X	(1)		(3)	(5)	
*	8-5-83	1,200	X	X	X		X	(1)	(2)	(3)	(5)	f/
	8-10-83	5,000	X	X	X		X	(1)	(2)	(3)	(5)	f/
	8-31-83	2,500	X	X	X		X	(1)	(2)	(3)	(5)	b/, f/
	9-8-83	1,500	X	X	X		X	(1)	(2)	(3)	(5)	b/, f/
	9-28-83	1,000	X	X	X		X	(1)	(2)	(3)	(5)	
*	9-28-83	80,000	X	X	X		X	(1)	(2)	(3)	(5)	b/, f/
	11-28-83	200,000		X								f/
	1-10-83	84,000										c/
	1-13-83	715,000										c/
	1-19-83	330,000										c/
	1-24-83	20,000										c/, e/
	2-9-83	139,984										c/, e/

KEY TO VIOLATIONS

(1) 12 CFR $337.3(b)

(2) 12 USC $371c (a) (1) (A), (B) (23A)

(3) 12 USC $375b (1), (2), (3) (Section 22(h) FRA)

(4) 12 USC $1972 (2) (Section 106(b) BHCA)

(5) 12 CFR $215.4(a), (b), (c) (Regulation O)

{{4-1-90 p.A-784}}

TABLE III

Loan	Date of Loan	Amount of	VIOLATION ALLEGED					Charges Upheld	Other (See Foot-
Identification	or Refinancing	transaction	(1)	(2)	(3)	(4)	(5)		notes to Table III
	2-28-83	$100,000							c/,e/
	3-15-83	4,000							c/,e/
	4-11-83	84,000							e/
*	4-13-83	715,000							c/
	4-25-83	20,000							c/
*	5-31-83	100,000							c/
	6-13-83	4,000							c/,e/
	7-11-83	84,000							c/
*	7-13-83	690,000							c/
	7-19-83	330,000							c/
7-25-83	20,000								d/
	2-10-83	5,000	X		X	X	X	(4)	d/
	2-14-83	45,000	X		X	X	X	(4)	d/
*	2-11-83	3,000	X		X	X	X		d/
	4-11-83	5,000	X		X	X	X		d/
	5-12-83	30,000	X		X	X	X		d/
	7-15-83	48,500	X		X	X	X		d/
*	6-12-83	200,000	X		X	X	X		b/
	6-28-83	585,000	X		X	X	X		b/

KEY TO VIOLATIONS

(1) 12 CFR $337.3(b)
(2) 12 USC $371c (a) (1) (A), (B) (23A)
(3) 12 USC $375b (1), (2), (3) (Section 22(h) FRA)
(4) 12 USC $1972 (2) (Section 106 (b) (2) BHCA)
(5) 12 CFR $215.4(a), (b), (c) (Regulation O)

FOOTNOTES TO TABLE III

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[a] = Stipulated violation of 23A.

[b] = Loan approved after the fact by Directorate.

[c] = Renewals on which * * *, Sr. was personally obligated.

[d] = Loans extended at 8% during which period the prevailing rate was in excess of such rate.

[e] = Prior to October 15, 1982, extension of credit secured by stock in * * *.

[f] = Subsequent to October 15, 1982, extension of credit secured by stock in * * *.

FOOTNOTES TO TEXT

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[1] "Regulation O," promulgated pursuant to Section 22(h) of the FRA, and Section 22(h) itself, although similar in many respects, have different elements, and do not each involve identical covered parties.

[2] FDIC alleges that the amount subject to adverse classification is $6,903,000, and the parties have stipulated that the Report of Examination as of August 22, 1983 (Ex. 10) so indicates.
However, FDIC has proffered no argument in support of upholding adverse classifications respecting the following credit extensions: * * * ($107,000); * * * ($218,000); * * * ($88,000); * * * ($31,000); * * * ($26,000); * * * ($10,000); * * * ($101,000); * * * ($6,000); * * * ($23,000); * * * ($82,000); * * * ($2,000); * * * ($86,000); * * * ($58,000); * * * ($8,000); and * * * ($21,000). Preliminarily, in light of the attention focused on other credit extensions, I have deducted the aggregate amount of these extensions, $867,000, from my findings of unsafe or unsound banking practices.

[3] Senior FDIC regional officials concur: determination of what constitutes an unsound banking practice is subjective (* * *, Tr. Vol. VI 42); classification of assets is judgemental (* * *, Tr. Vol. IV 135-36).

[4] Table III, Findings of Violations of Law, is discussed in the Initial Decision at Section III, *infra*.

[5] This, and subsequent portions of the analysis of banking practices pertaining to hazardous lending and lax collection practices, as reflected in Table II, are identified by category, *e.g.*, this is Category I(a).

[6] Throughout this Initial Decision, in calculating ratios with reference to the Bank's "equity," I have adopted the adjusted equity capital and reserves amount ($2,615,000) as opposed to total equity ($2,799,000) (Stipulation at paragraph 6), because the former amount better reflects the Bank's true

equity position.

[7] *Accord, First National Bank of Eden v. Department of the Treasury*, 568 F.2d 610 (8th Cir. 1978); *First National Bank of Lamargue v. Smith*, 610 F.2d 1258, 1265 (5th Cir. 1980); *First National Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674, 685 (5th Cir. 1983); *In the Matter of First State Bank of Wayne County (Formerly City and County Bank of Wayne County), Monticello, Kentucky*, FDIC 83-132b (June 18, 1984); *see also Independent Bankers Association v. Heimann*, 613 F.2d 1164, 1169 (D.C. Cir. 1979), where the court held that the regulator's discretionary authority to define and eliminate "unsafe and unsound" conduct is to be liberally construed.

(The phrase "unsafe or unsound" appears to be treated the same as the phrase "unsafe and unsound.") [8] This premise formed the basis of the respondents' defense to allegations of unsafe and unsound banking practices, and, as mentioned above, I have accepted it in making classification conclusions and determinations. The classifications rejected, because they were based upon the absence of only a single safeguard, include * * * ($160,000); * * * ($3,000); * * * ($75,000); * * * ($28,000); * * * ($339,000); * * * ($204,000); and * * * ($195,000), for a total of $1,004,000.

I do not uphold FDIC's proposed finding as to the adequacy of the security for the $370,000 extension to * * * (Category 1 (b)) because it appears in fact that the guarantee was sufficient. Nevertheless, because other safeguards were absent, *i.e.*, adequate financial information and a realistic repayment schedule, I uphold the adverse classification.

With regard to the * * * and * * * lines, respondents urge that no finding of unsafe or unsound banking practice should be upheld because, they assert, those lines have "always been current on principal and {{4-1-90 p.A-786}}terest, and have never caused the Bank to sustain a loss." (Resp. Proposed Findings at 7.) I find that the record indicates otherwise, and establishes, as FDIC alleges, that those lines have remained "stagnant" for a number of years, during which time no principal reduction was made. The fact that loss has not occurred is not dispositive of safe and sound banking practice, but, in this instance, may be fortuitous.

[9] Sections 8(c) and (e) of the Federal Deposit Insurance Act (12 USC § 1818 (c), (e)), for example, list among the bases for cease and desist orders and subsequent removal actions against culpable bank directors or officers any "unsafe or unsound" practices which threaten "financial loss or other damage to the depositors."

[10] The parties have stipulated that the adversely classified loans ($6,903,000) represent 28.7% of the Bank's total loans (net of $23,728,000 less $308,000 valuation reserve for loan loss equals $23,420,000) (Stipulation at paragraphs 6, 8; Ex. 10 at 8-9). In deriving the stipulated amount, the parties appear to have excluded the "loss" component of the loans adversely classified. I have included both "loss" and "substandard" classifications in my calculation.

[11] Although convenient as a tool of reference, the term "concentration of credit" appears to lack probative significance.

[12] *See* the quotation in FDIC's post-hearing brief from *In re Utica Bankshares Corp.*, Exchange Act Release No. 20, 702 Fed. Sec. L. Rep. (CCH) Para. 73,424 at 63,098 (Feb. 29, 1984).

[13] *See* footnote 9, *supra*.

[14] The purpose of the Act (12 USC §§ 1811 *et seq.*) is to "stabilize or promote the stability of banks"; the purpose of FDIC bank examinations is to "prevent losses that would result in claims against the insurance fund," in order to safeguard the system of bank insurance, not to create a cause of action against FDIC by an insured bank obliging the agency to notify the bank of an unlawful banking practice by bank officials. *First State Bank of Hudson County v. U.S.*, 599 F.2d 558, 562 (3d Cir. 1979) *cert. denied*, 444 US 1013 (1979).

[15] Respondents contend that Regulation O should be limited to the "true" insiders of the Bank, to whom extensions totaled only $750,000: * * * (director); * * * (through * * *); * * *; and * * *, Jr. (director).

With respect to persons and transactions covered, I have found Regulation O to be much broader than counsel for respondents urges; consequently, I cannot avoid the inference of a pattern of insider lending practices arising therefrom. *See* Initial Decision at Section III-C, *infra*.

[16] In the Stipulation (Tr. Vol. I, Att. C, received December 10, 1984) respondents concede that, as of August 22, 1983, extensions of credit aggregating $1.6 million were secured by stock in * * *, of which at least $600,000 was used to purchase stock in the Company. Six hundred thousand dollars exceeds the ceiling on credit extensions to affiliates set forth in Section 23A(a)(1)(A) and (B), by exceeding permissible borrowings by affiliates limited by prescribed percentages (10-20% [$261, 500-$523,000]) of capital stock and surplus ($2,615,000) of the member bank.

The amendment of 23A, effective October 15, 1982, though argued by respondents to have altered the legal definition of "affiliation" between * * *, and the Bank—by lowering the floor which defined covered

transactions from control over 50% of any class of voting stock to control over 25% of such stock—is immaterial to a determination of affiliation. Moreover, in light of my holding under Section 23A(a)(1)(B)(1), *infra*, finding affiliation without regard to the percentage of control, the effective date of the current statute is irrelevant.

[17] Pursuant to Section 3(b) FDIA (12 USC § 1813(b)), "the term `state nonmember bank' means any state bank which is not a member of the Federal Reserve System." References made to "member" bank, therefore, include insured nonmember banks, including the * * * Bank of * * *.

[18] Respondents cite the following extensions: * * * (12-1-82) ($100,000); * * * (12-1-82) ($100,000); * * * (5-28-83) ($200,000) and (11-28-83) ($200,000).

[19] Respondents cite the extensions listed in footnote 12, *supra*, and * * *, Jr. (10-19-82) ($105,000); (11-5-82) ($2,000); (11-19-82) ($1,500); (2-11-83) ($72,000); (2-18-83) ($2,500); (4-18-83) ($105,000); (7-28-83) ($5,600); (8-3-83) ($1,000); (8-5-83) ($1,200); (8-31-83) ($2,500); * * * (2-2-83) ($300,000); and * * * (2-8-83) ($114,000).

[20] There is dispute as to whether * * * held this precise number of shares during the entire relevant period, as his financial statement dated June 11, 1982 reflects own- {{4-1-90 p.A-787}}ership of 432,976 shares. As discussed in the text of this decision, the 72,727 shares imputed as belonging to * * *, Sr., as to which there was extensive inquiry, witnesses and documentary evidence, were actually held by * * *. Nevertheless, based on the listing of shareholders provided in the subsequent prospectus, either number (545,703 or 432,976) is the single largest share of the Company's stock at all times relevant to this proceeding. *See* footnote 21, *infra*.

[21] Under the Stipulation, *supra*, respondents concede that * * *, Sr., and the Bank are "affiliates" within the meaning of 23A by virtue of his "ownership, control, or voting power" over the Bank and * * *. Respondents also concede that at all relevant times * * *, Sr., exercised a controlling influence over * * *, and * * *, and such concerns are "related interests" of * * *, Sr.

[22] Exhibit 10 indicates that * * *, Sr., owned 12.5% of * * *, which in turn held * * *, a now defunct concern. Nothing in the record warrants not finding * * * and * * * to have been affiliated during the relevant period. *See* footnotes 26 and 31, *infra*.

[23] For purposes of this decision I have construed the term "unimpaired capital" as referring to the Bank's adjusted equity. *See* footnote 6, *supra*.

[24] As Table III reflects, I reject the charges of violation of 23A concerning the following extensions or renewals: * * * (2-2-83) ($400,000); and * * * (3-9-83) ($110,000); (5-28-83) ($200,000); (9-28-83) ($200,000). These extensions were collateralized by stock in * * * but there was no showing that the proceeds benefited or were transferred to * * *, Sr., or an affiliate.

[25] (b)(7)(D) provides that a "covered transaction" with respect to a member bank and affiliate includes "the acceptance of securities issued by the affiliate as collateral security for a loan or extension of credit to any person...." Because the rationale underlying any restriction on "covered" transactions looks to ostensible benefit accruing to the affiliate, applying the above definition to a suspect transaction would seemingly require a factual predicate linking the "issuance" of the securities directly to the "loan...to any person." A purchase money security interest taken by a member bank in securities issued by the affiliate might provide such a predicate because of the real concern that, in that instance, the stock was issued solely to enable another in obtaining a loan, with the possible inference that the transaction was actually an arrangement to provide a market for the affiliate's securities, and thus a "benefit" to it under (a)(2).

I am not persuaded that the issuance of stock by * * * was sufficiently connected with its subsequent use as collateral to bring such within (b)(7) as a "covered transaction."

[26] Apart from a broad reference by FDIC at paragraph 42 of its Proposed Conclusions of Law, contending that "each of the respondents has violated Sections 22(h) and 23A of the Federal Reserve Act," no specific charges of violation of Section 23A were made regarding the following extensions: * * * ($115,000) (proceeds benefited * * *); * * * ($125,000) (proceeds benefited * * *); * * * ($237,000) ($128,000 benefited * * *); * * * ($299,000) (proceeds benefited * * *, Sr.); * * * ($300,000) ($56,800 benefited * * *); * * * ($324,000) ($140,000 benefited * * *); * * * ($715,000) (1-13-83 and subsequent renewals); or * * *, Sr. ($84,000) (1-10-83 and subsequent renewals), *inter alia*.

To the contrary, FDIC's application of 23A to the instant case appears to rest on the presumption that the Bank is affiliated, through * * *, Sr., with * * * alone (and that use of * * * stock as collateral is, on its face, sufficient to bring a transaction within the meaning of (b)(7)(D)(3), without a showing that such stock was issued for the singular purpose of providing collateral to another in a manner that benefits the affiliate).

[27] Although FDIC challenges the respondents' proposed finding that specific "unfavorable features," including inadequate security, formed the basis for the charges of violation, the issue need not be

addressed because I am satisfied that the assurances obtained ($400,000 and $585,000 guaranties regarding the loans to * * * and * * *, respectively)(Tr. Vol. V-A, 54–55), in view of the apparent resources of the guarantors ($4.7 million) (*Id.* at 60, 62), were ample, notwithstanding FDIC's contention that the value of the above-referenced collateral was not absolutely estab- {{4-1-90 p.A-788}}lished. I agree with respondents' contention that the reason these extensions were classified could only have been because Examiner * * * accorded * * *'s guarantee no weight at all, which, in spite of lack of independent support for the values reflected on his financial statement, I find to be hypercritical in light of the fact that the selfreported worth of * * * ($3.3 million), concededly subject to some downward adjustment, is almost nine times in excess of the amount guaranteed ($370,000).

[28] In this connection it is interesting to note that no violation of Section 22(g)(5)(12 USC § 375a(5)) was alleged, inferably because the statutory language contemplates an ownership interest equivalent to a majority, or controlling share.

[29] Section 106(b)(2)(H)(iii) BHCA provides that the terms "company" and "control of a company" have the same meaning as provided in Section 22(h), FRA (12 USC §375b). No reference is made in 106(b) or 22(h) to the definition of "control" set forth in Regulation O, under which a different result might obtain.

[30] Congress has failed to draw the nexus between member banks and its correspondents that counsel for FDIC urges. If the facts were otherwise, Section 22(g)(4)-(5), FRA, might apply.

[31] This amount ($4,740,900) reflects the aggregate extensions (including renewals), as of the date of the Report of Examination, which benefited or were transferred by the Bank to any of the six affiliates (* * *, Sr., * * * and comprised the following transactions: * * * (3-18-83) ($7,000); (3-22-83) ($4,600); (4-4-83) ($19,000); (8-10-83) ($5,000); (9-28-83) ($80,000); Alan * * * (1-10-83) ($84,000); (1-19-83) ($330,000); (4-11-83) ($84,000); (7-11-83) ($84,000); (7-19-83) ($330,000); * * * (1-13-83) ($715,000); (4-13-83) ($715,000); (7-13-83) ($690,000); * * * ($115,000)(proceeds paid debts of * * *); ($125,000)(proceeds of loan paid debts of * * *); * * * ($324,000) ($140,000 paid debts or was transferred to * * * ($237,000) ($128,600 was transferred to * * *; $13,000 benefited * * * ($299,-000)(proceeds benefited * * *, Sr.); * * * ($214,000) ($100,000 transferred to * * *); and * * * ($300,000) ($56,800 paid * * * debts; $11,300 was transferred to ; $4,600 was transferred to * * * Company).

[NOTE: Exclusive of renewals the above amount is $2,837,900.]

[32] Respondents tendered a draft cease and desist order as Exhibit A to the proposed findings of fact and conclusions of law [and, as Attachment to their brief in support].