

{{4-30-93 p.A-1656.3}}

[¶5164] **In the Matter of Bank of Salem, Salem, Arkansas, Docket No. FDIC-89-229b (2-28-91).**

Bank ordered to cease and desist from numerous unsafe and unsound practices. Board declined to use its discretion to delay publication of the cease and desist order because the Bank had not shown "exceptional circumstances" under which publication would threaten its safety or soundness. (*This order was terminated by order of the FDIC dated 2-25-93; see ¶9013.*)

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[.1] Evidence — Expert Opinion — Former Examiners

Administrative deference accorded to bank examiners does not extend to former FDIC examiners who serve as expert witnesses for banks in enforcement proceedings.

[.2] Cease and Desist Orders — Defenses — Improved Condition

Bank's unsubstantiated evidence of improvement in its condition after examination by FDIC personnel is not a defense to the issuance of a corrective order based on that examination; it may be considered in modifying or terminating such an order.

[.3] Directors and Officers — Unauthorized Compensation — Fiduciary Duty

Bank's Board of Directors must approve in advance any compensation to Chairman of the Board in the form of "fees" paid by borrowers as a precondition to a loan. Failure to obtain approval constitutes a breach of Chairman's fiduciary duty (even though Chairman is the majority shareholder), and is an unsafe and unsound banking practice.

[.4] Cease and Desist Orders — Publication — Exceptional Circumstances

Public policy favors publication of all enforcement orders, but the FDIC may delay publication under "exceptional circumstances" which would seriously threaten the safety or soundness of the Bank. Unsubstantiated effect of adverse publicity is not such an exceptional circumstance.

[.5] Evidence — Arising after Issuance of Notice

Bank's evidence of improvement in its condition does not rebut the examination findings. Until accuracy of the post-examination data can be objectively verified, it is not material and probative to the remedy. It may be taken into account in determining compliance with the cease and desist order.

[.6] Cease and Desist Orders — Termination

Proof of substantial compliance with the cease and desist order is to be determined by the FDIC, not by the Bank.

In the Matter of

**BANK OF SALEM
SALEM, ARKANSAS
(Insured State Nonmember
Bank)
DECISION**

I. BACKGROUND

This proceeding is brought pursuant to section 8(b)(1) of the Federal Deposit Insurance Act ("FDI ACT"), 12 U.S.C. § 1818(b)(1), for an order requiring Bank of Salem, Salem, Arkansas ("Insured Institution" or Respondent"), and its board of directors to cease and desist from certain unsafe and unsound banking practices and to correct the conditions resulting therefrom. After an examination of the Insured Institution by the Federal Deposit Insurance Corporation ("FDIC") as of May 26, 1989, the FDIC concluded that the Insured Institution is operating: 1) with inadequate capital and reserves; 2) with an excessive volume of poor quality assets and inadequate provisions for liquidity; 3) with management whose policies and practices are detrimental to the Insured Institution and jeopardize the safety of its

deposits; and 4) in violation of certain laws and regulations.

The Board of Directors ("Board") of the FDIC has reviewed the record, the parties' briefs, the Recommended Decision and Order of the Administrative Law Judge ("ALJ") and the parties' exceptions to the ALJ's Recommended Decision ("R.D.").¹

¹ Citations in this Decision shall be as follows:

Recommended Decision — "R.D. at _____."

Transcripts — "Tr. at _____."

Exhibits — "FDIC Ex. _____" or "Resp. Ex. _____."

{{5-31-91 p.A-1658}}The Board agrees with the majority of the ALJ's findings and adopts the ALJ's Recommended Decision and Proposed Order with certain modification discussed herein. The Board denies Respondent's request to delay submission of the record in this proceeding until the completion of the examination currently being undertaken² and declines to exercise its discretion under 12 C.F.R. § 308.43 of the FDIC's Rules and Regulations to permit oral argument.³

II. STATEMENT OF THE CASE

On May 23, 1989, the FDIC's Memphis Regional Office ("Regional Office") began an examination of Bank of Salem and found that the Insured Institution's condition had seriously deteriorated since the prior FDIC examination of November 1, 1985.⁴ Adversely classified assets totaled \$7,913,000, of which \$7,379,000 were loans. Approximately \$6,939,000 of the loans were classified as "Substandard," \$236,000 as "Doubtful," and \$204,000 as "Loss." This was a dramatic increase from the 1985 examination.⁵ The ratio of adversely classified loans increased from 9.3 percent to 22.2 percent. The change in adversely classified loans consisted of \$3,838,000 in newly extended credits and \$2,359,000 in loans not previously classified. In addition to the large volume of loans adversely classified, the Report of Examination expressed concern as to the Insured Institution's capital position, the adequacy of its loan loss reserve, its excessive concentration of credit, its poor liquidity management and the inadequate supervision of its officers. The Insured Institution was cited for violations of section 22(h) of the Federal Reserve Act and sections 215.4 and 215.7 of Regulation O.

In addition, the Insured Institution's ratio of primary capital to Part 325 total assets was found to be 6.17 percent.⁶ (FDIC Ex. 1 at 1-a-2). This was down from 8.43 percent as of the previous FDIC examination of November, 1985. The adversely classified assets equaled 249.38 percent of adjusted primary capital. The dollar amount of the Insured Institution's assets other than loans that were adversely classified as "Substandard," "Loss," and "Doubtful" as of May 26, 1989, totaled \$418,000, \$8,000 and \$108,000 respectively. The Insured Institution's loan loss reserve was only \$423,000 (Tr. at 112), only a little over five percent of the adversely classified assets. As a result of the examination findings, the Insured Institution was assigned a composite rating of four, which indicates severe problems threatening the viability of the Insured Institution.

On December 11, 1989, the FDIC Regional Director of the Memphis Regional Office ("Regional Director"), pursuant to delegated authority, initiated this action by issuing a Notice of Charges and of Hearing ("Notice") against Bank of Salem under section 8(b)(1) of the FDI Act, 12 U.S.C. § 1818(b)(1), and Part 308 of the FDIC Rules of Practice and Procedures, 12 C.F.R. Part 308. The Notice charged that, based upon the FDIC examination as of May 26, 1989, the Insured Institution had engaged in unsafe and unsound banking practices and violations of law and FDIC Rules and Regulations. The Respondent, through its counsel, filed an answer to the Notice on January 2, 1990, and an amended answer on January 3, 1990.

A hearing was held before Administrative Law Judge Paul S. Cross in Memphis, Tennessee, from May 21–25, 1990, and after an adjournment at the Insured Institution's request, resumed and concluded on July 2, 1990. Proposed findings of fact, conclusions of law, proposed orders and posthearing briefs were filed by the Insured Institution and FDIC Enforcement Counsel. On October 30, 1990, the ALJ issued his Recommended Decision that a Cease and

² The Board denies this request because, given the serious deterioration in the Insured Institution's condition found in the 1989 examination, the program of correction is needed. The Regional Director has the authority to modify the Cease and Desist Order if and when conditions at the institution so warrant. See *infra* at 16–19.

³ The Board denies this request because the parties have been given ample opportunity to present their

cases, the record is complete, and argument will not aid the Board in reaching its decision.

⁴ The FDIC had not conducted an examination of the Insured Institution since November of 1985. The State of Arkansas had examined the Insured Institution in 1986 and 1988. However, the FDIC's examination and FDIC Enforcement Counsel in this proceeding do not rely upon the findings of the state examination.

⁵ The 1985 examination had classified only \$3,080,000 of the Insured Institution's assets. The breakdown of adverse classifications was:

Substandard	\$2,867,000	Doubtful	98,000	Loss	115,000
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⁶ The Insured Institution had primary adjusted capital of \$2,999,000 and adjusted Part 325 total assets of \$48,658,000 (FDIC Ex. 1 at 2-a).

{{5-31-91 p.A-1659}}Desist Order be issued against the Insured Institution. The Insured Institution filed extensive exceptions to the Recommended Decision and Order and FDIC Enforcement Counsel filed four exceptions to terms of the Order.

III. THE ALJ'S RECOMMENDED DECISION AND PROPOSED ORDER AND THE PARTIES' EXCEPTIONS

The ALJ concluded that all of the adverse loan classifications made by the FDIC examiner were supported by the facts in evidence and further concluded that the Insured Institution had engaged in the following unsafe and unsound banking practices: hazardous lending and lax collection practices, disproportionate quantity of poor quality loans, inadequate capital and reserves, inadequate loan loss reserves, inadequate supervision of lending activities by the Insured Institution's board of directors, and inadequate liquidity. The ALJ also found that the chairman of the board of directors, Richard T. Smith, breached his fiduciary duties by conditioning the approval of loans or extensions of credit on his receipt of a part of the proceeds.

Further, the ALJ upheld the FDIC on all of the alleged violations of law, finding that the Insured Institution extended credit to a director that involved more than the normal risk of repayment, paid overdrafts to executive officers and directors without preapproved credit lines or prior written authorization for the transfer of funds from another account, and failed to identify a related interest of a member of the board of directors, all in violation of section 22(h) of the Federal Reserve Act and Regulation O.

Based on his findings, the ALJ recommended that a Cease and Desist Order be issued against Bank of Salem.

The Bank of Salem filed exceptions to most of the ALJ's findings of unsafe and unsound banking practices: 1) the FDIC examiner's opinion on the adverse classifications on loans and other assets were not entitled to deference; 2) the Insured Institution did not have an excessive volume of poor- quality loans in relation to its total assets and its equity capital and reserves; 3) the Insured Institution's primary capital was sufficient; 4) the Insured Institution's loan loss reserves were adequate; and 5) the diversion to Chairman Smith, or his related interests, of proceeds from loans or extensions of credit made by the Insured Institution to third parties did not constitute an unsafe or unsound practice. The Insured Institution filed exceptions to the ALJ's findings on three violations of law under section 22(h) of the Federal Reserve Act and Regulation O.

The Insured Institution also filed three exceptions to the Proposed Order. The Insured Institution excepted to the Cease and Desist Order on the grounds of overbreadth and the Insured Institution's alleged compliance with its terms. Finally, the Insured Institution asserted that publication of the Order as required by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), Pub. L. No. 101-73, 103 Stat. 183 (August 9, 1989), would be detrimental to the institution and its depositors.

FDIC Enforcement Counsel filed no exceptions to the Recommended Decision, but filed four exceptions to the Proposed Order objecting to: 1) the ALJ's failure to require the institution to infuse additional capital immediately; 2) the time period for the Insured Institution to reduce its classified assets; 3) the ALJ's failure to determine whether the Order should be published as required by FIRREA; and 4) the provision that the Order would terminate once the Insured Institution determined that it was in substantial compliance.

IV. DISCUSSION

A. THE BOARD'S MODIFICATIONS TO THE ALJ'S RECOMMENDED

DECISION.

The Board has carefully reviewed the entire record of this proceeding, including the Recommended Decision, the briefs of the parties, and the exceptions. The Board concludes that most of the Insured Institution's exceptions reargue matters previously raised before the ALJ and which were adequately addressed by the ALJ. For the reasons set forth below, the Board finds the Insured Institution's other exceptions unpersuasive. The Board therefore adopts the ALJ's Recommended Decision except as modified herein.

1. The Insured Institution's Deteriorated Condition and Alleged Improvements.

The low capital-to-asset ratio and high level of classified assets are indicative of the Insured Institution's deteriorated condition. Since the 1985 examination, the volume of [{{5-31-91 p.A-1660}}](#) assets subject to classification, primarily lending related, had increased significantly. This large percentage of adversely classified loans⁷ served as the factual basis for the charges of hazardous lending and lax collection practices, a disproportionate quantity of poor quality loans in relation to total loans (16.2 percent), inadequate unimpaired capital, inadequate loan loss reserves and negligent supervision by the board of directors, resulting in the poor condition of the Insured Institution.

[1] Based upon the 1989 examination, FDIC Enforcement Counsel alleged that twenty-three loans were subject to adverse classifications based upon the following credit weaknesses:

- (1) 14 loans were not, according to the files, collateralized with adequate security;
- (2) 12 loans had unsatisfactory performance;
- (3) 12 loans indicated a questionable ability of the borrower to service the debt;
- (4) 7 loan files did not contain current or sufficiently detailed financial information about the borrowers.⁸

The Board agrees with the ALJ's conclusion that there is ample factual support in the record to find that the twenty-three loans at issue were appropriately subject to adverse classification. The Board finds that the twenty-three loans were extended without one or more types of documentation essential to prudent banking, and modifies the Recommended Decision (R.D. at 40, line 18) to include that specific finding.

In addition, the Insured Institution's liquidity position is further evidence of the Insured Institution's generally poor condition. The examiner found that the Insured Institution's liquidity ratio was 24.92 percent, a level adequate in the event of a moderate withdrawal of funds. However, what is more significant is that total loans to total deposits had increased to 74.24 percent as of the examination. (FDIC Ex. 1 at 5). A potential liquidity problem exists if the total volume of loans continues to increase and short term investments decrease.

[2] It is clear that the Insured Institution's condition need not deteriorate to the point that it is on the verge of insolvency before it may be found to have engaged in unsafe or unsound banking practices. The Insured Institution, on the other hand, alleges that there has been substantial improvement in its financial condition since the 1989 examination and offered some evidence showing that adversely classified loans had improved. This alleged improvement is, however, unsubstantiated. For example, even giving the Insured Institution the benefit of the doubt as to that evidence which it presented on classified assets as they substantiate the improvements in the institution's capital position, it is at best a limited view as to the current condition of the Insured Institution. It does not provide an objective view of the current condition of the Insured Institution's remaining assets. Often, a bank focuses its energy entirely upon correcting problem assets and it fails to give adequate attention to preserving its remaining assets, which suffer as a result. The Board has heard this argument numerous times in the past in enforcement proceedings. The Board finds it equally unpersuasive in this case. Generally, such evidence goes to a bank's compliance with a corrective order, not the need for such an order. The same is true here—if improvement has occurred and it is substantiated in an objective manner by FDIC supervisory personnel, it could lead to modification of the Cease and Desist Order by the Regional Office or even to a sooner termination of the Order. Therefore, the Board declines to adopt the ALJ's finding (R.D. at

⁷ The following summary of asset classifications for the two most recent FDIC examinations reflects significant deterioration in the loan portfolio:

Date	Substandard	Doubtful	Loss	Total
5/26/89	7,357,000	244,000	312,000	7,913,000
11/1/89	2,897,000	98,000	115,000	3,080,000

⁸ The Board notes that, although the Respondent's experts are former FDIC examiners, their knowledge of the practices and policies of the regulatory agencies during their tenure at the FDIC should not be confused with the weight of their opinion. Although the ALJ applies the correct standard under *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (11th Cir. 1986), *reh'g denied* 792 F.2d 1126 (11th Cir. 1986), the statement in the Recommended Decision (at 29) that he "must choose between the opinions of the experts" is inconsistent with the ruling in *Sunshine* that the examiner's classifications are to be accorded deference unless they are arbitrary, capricious, or not supported by substantial evidence. No finding that the examiner's classifications lacked a sufficient factual foundation based upon objective, verifiable facts was made in this case.

{5-31-91 p.A-1661}61–63) that the Insured Institution's overall condition, and specifically, its capital position, has improved since the 1989 examination, absent a complete assessment of the Insured Institution's condition.

[.3] 2. *Diversion of Loan Proceeds to
Chairman Smith or Related Interests.*

The ALJ found that Chairman Smith's practice of conditioning the approval of loans or extensions of credit upon a fixed payment to Smith, or related interests by the borrower as a "fee" constituted a breach of fiduciary duty. (R.D. at 55). The Insured Institution objects to the ALJ's determination that this practice constituted an unsafe and unsound banking practice.

The Board finds it particularly reprehensible for the Insured Institution and Chairman Smith to contend that the receipt of a payment from the proceeds of loans made to third parties was "incentive compensation." As the Insured Institution and Chairman Smith both should be aware, any such compensation must be approved in advance by the board of directors of the Insured Institution. There is no evidence in the record of any such approval.

The Board also rejects the alternative argument raised by Chairman Smith that, because he and his brother Guy Smith own 75 percent and 25 percent of the stock, respectively, of Smith Associated Banking Company ("SABCO"), a holding company that owns 84 percent of the Insured Institution's stock, the shareholders of the Bank of Salem were not prejudiced by these transactions and consequently suffered minimal, if any, loss. Specifically, Smith asserted that there was no motivation for him to do anything improper or to divert funds to himself because he could increase his salary at any time. However, frequently such arrangements are a secret means for enhancing a director's or officer's compensation which is unknown to other officials of the bank and often is undiscovered by examiners. The use of such an incentive compensation scheme without approval from the Insured Institution's board of directors clearly constitutes a breach of fiduciary duty, as the ALJ found citing *Hoffman v. FDIC*, 912 F.2d 1172 (11th Cir. 1990).

B. *THE BOARD'S MODIFICATIONS TO
THE ALJ'S RECOMMENDED ORDER
TO CEASE AND DESIST.*

Both the Insured Institution and FDIC Enforcement Counsel filed exceptions to the ALJ's failure to decide the issue of publication of the Cease and Desist Order. The Insured Institution also challenged the Order as overbroad and the ALJ's failure to find that all of the alleged violations had been corrected before the Notice was issued.

FDIC Enforcement Counsel also raised three exceptions to the ALJ's Proposed Order: 1) the time period for decreasing the institution's classified assets, 2) termination of the Cease and Desist Order, and 3) the immediate infusion of additional capital into the institution.

1. *Publication of the Cease and Desist
Order.*

The Insured Institution has requested that publication of any Cease and Desist Order be delayed on the ground that it will be unfairly prejudiced by disclosure. The ALJ, having concluded that the Respondent engaged in unsafe and unsound banking practices and committed violations of law and regulations warranting the issuance of a Cease and Desist Order, nevertheless declined to make recommendations as to whether the Insured Institution and its customers would be damaged by the publication of the Order as required under section 1818(u) of the FDI Act, 12 U.S.C. § 1818(u). Accordingly, the Board must review the Insured Institution's request for delayed publication of a Cease and Desist Order *de novo*.

a. *Legislative History of Section 1818(u).*

Section 1818(u)(1) provides, in pertinent part, that "the [FDIC] shall publish and make available to the public any final order issued with respect to any administrative enforcement proceeding..."⁹ 12 U.S.C. § 1818(u)(1)(A). This provision was added to the statute in response to congressional concern that bank regulatory agencies have traditionally kept enforcement actions secret which, in the opinion of Congress, does not deter financial institutions from misconduct. This concern was specifically ad-

⁹ This provision was added to the FDI Act by section 913 of FIRREA.

{{5-31-91 p.A-1662}}dressed by the Committee on Banking, Finance and Urban Affairs:

Section 913: The bank regulatory agencies, with infrequent exceptions, do not disclose civil enforcement actions. (They are the only Federal regulatory agencies which do not do so.) *** One of the problems in the financial industry...has been the excessive secrecy of agency supervisory actions. Such secrecy does little to deter misconduct, but does serve to ultimately worsen the problems of financial institutions....

H.R. Report No. 101-54, 101st Cong., 1st Sess., pt. 1 at 470 (1989).

The legislative history further reveals that the financial institutions regulatory agencies' policy of nondisclosure of enforcement actions has been harshly criticized in congressional reports and congressional hearings. This criticism prompted Congress to propose several bills recommending, among other things, disclosure of the enforcement actions of the bank regulatory agencies.¹⁰

The House Committee on Government Operations addressed the need for broader disclosure of banking agencies' enforcement actions in two Committee reports.¹¹ The Committee asserted that the banking agencies' refusal to consider disclosure of enforcement actions was unreasonable. *Id.*¹² More recently, Congress passed the [Omnibus] Crime Control Act of 1990, Pub. L. No. 101-647, § 2547, 104 Stat. 4789 (1990), which requires that all phases of banking enforcement actions routinely be made public. *Id.* at 4886.

Therefore, it is clear that Congress has decreed that, except in unusual circumstances, public policy now favors publication of all enforcement orders.¹³

[.4] b. *No "Exceptional Circumstances"*
Exist to Delay Publication of the Cease
and Desist Order.

Section 1818(u) of the FDI Act, 12 U.S.C. § 1818(u), directs the FDIC to publicly disclose final agency enforcement orders, but provides discretion to delay such publication under "exceptional circumstances" which would seriously threaten the safety or soundness of the insured depository institution. The Insured Institution has asserted that possible adverse publicity incurred by the Insured Institution, its directors and officers, and the twenty-one customers whose loans were classified creates an "exceptional circumstance" that warrants delay in publication. The Board disagrees. In this situation, the unsubstantiated assertion that adverse publicity would harm the Insured Institution and its customers does not warrant the delay of publication. To hold otherwise would undermine the disclosure policy and render the statutory requirement a nullity. The Board finds no evidence that would lead it to conclude that publication of the proposed Order would cause harm to the Insured Institution. Moreover, the Board has weighed the possible negative effects of publication against the interests of other customers and depositors of the Insured Institution and has determined that these customers have the right to disclosure of insider misconduct. Finally, the concerns for the customers whose loans were adversely classified can be adequately addressed by deleting their names and identifying information from the Decision and Order which is routinely done to protect such individuals.

¹⁰ See H.R. 3929 (Section 117 - "Availability of Redacted Civil Enforcement Orders"); H.R. 5094 (Title VI of the Depository Institutions Act of 1988); and H.R. 32. While these bills did not become laws, the concept of disclosure and pertinent language from those bills, with slight modifications, was ultimately incorporated into Title IX of FIRREA.

¹¹ See House Committee on Government Operations, "Federal Response to Criminal Misconduct and Insider Abuse in the Nation's Financial Institutions," H.R. Report 98-1137, 100th Cong., 2d Sess., October 4, 1984, and "Combating Fraud, Abuse and Misconduct in the Nation's Financial Institutions:

¹² The Committee, in H.R. Report No. 100–1088, questioned the banking agencies' rationale for refusing to routinely disclose enforcement actions and stated that the argument that "adverse publicity could significantly damage an institution is questionable" and does not hold up to scrutiny in most cases, "unless the order requires taking immediate action to prevent insolvency." H.R. Report 100–1088 at 17.

¹³ The Insured Institution also suggests that publication may violate provisions of the Right to Financial Privacy Act of 1978 ("RFPA"), 12 U.S.C. § 3401, *et seq.*, which restricts access of federal government agencies to financial information derived from customers' bank records, unless the customer, including borrowers and depositors, is notified of the disclosure. Publication of the proposed order, in the instant case, is a statutory mandate. It also is well established that banking regulatory agencies exercising their supervisory authority within the meaning of the RFPA are exempt from the notice requirements of the RFPA. *See Adams v. Board of Governors of Federal Reserve Bd.*, 855 F.2d 1336 (8th Cir. 1988); *FDIC v. Kansas Bankers Sur. Co.*, 732 F. Supp. 103 (W.D. Okla. 1990).

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The Board has examined the record in light of the Insured Institution's exceptions and the ALJ's recommendation and finds no reason to delay the publication of the Cease and Desist Order in this action.

2. The Effect of the Institution's Current Financial Condition on the Cease and Desist Order.

Section 308(a)(3) gives the ALJ discretion, in evaluating the evidence underlying the Notice, to take into account, in appropriate circumstances, a financial institution's present condition when ordering a remedy, if the ALJ makes a specific finding of fact that the evidence is material and probative to the fashioned remedy. In the Recommended Decision, the ALJ notes the significant improvements in the Insured Institution's condition since the 1989 examination. Specifically, the ALJ noted that, as of April 30, 1990, Bank of Salem's capital to assets ratio was 7.72 percent, its capital-to-average adjusted assets ratio was 6.95 percent, its loan loss reserve had increased to \$778,000, and substandard loans have been reduced substantially. (R.D. at 61). These conclusion were based upon evidence submitted by the Insured Institution regarding improvements as to its capital position and the condition of 23 of the loans adversely classified in the 1989 examination.

Based upon the ALJ's view of the Insured Institution's improved condition, the proposed Order requires the Insured Institution to establish within 120 days of the effective date and thereafter maintain, its primary capital at or greater than 7.5 percent of its adjusted Part 325 assets, but not to immediately increase its capital by an additional \$600,000. The proposed Order also provides that the Cease and Desist Order will terminate upon proof by the Insured Institution of substantial compliance. The FDIC excepted to the Order on both grounds — infusion of additional capital and termination of the Order. The Board finds that these exceptions are meritorious and modifies the Order accordingly.

The FDIC's Notice alleged that the Insured Institution was operating with an inadequate level of capital protection for the kind and quality of its assets. In particular, the Notice charges that the Insured Institution's adjusted primary capital equaled 6.17 percent of its total assets of \$48,570,000.

[.5] The Notice is based upon the state of affairs at the Insured Institution as of the May 23, 1989 examination and the unsubstantiated information on the institution's alleged improvements in its capital position and on the 23 classified assets that were provided by the Insured Institution at the hearing. The 1989 examination documents the Insured Institution's overall condition as of the date of examination. Subsequent events or information relating to the Insured Institution's condition is neither inconsistent with nor does it rebut the examination findings. Until the accuracy of the Insured Institution's post-examination data can be objectively verified and a determination made as to the remainder of the Insured Institution's financial condition (usually at the completion of the next full-scale examination), the data upon which the Respondent has computed the institution's alleged improvements, especially the Insured Institution's capital percentages, cannot be relied upon as conclusive.

The Board finds, therefore, that the ALJ's finding that the Insured Institution's condition has improved is unsubstantiated and the Board, therefore, declines to adopt the ALJ's opinion to the extent that he concludes that the evidence of the Insured Institution's current financial condition is material and probative to the remedy. To the extent that it is objectively determined that the Insured Institution's condition has improved, the Cease and Desist Order can be modified or even terminated by the Regional Director, if circumstances warrant. Thus, the evidence of improvement in the Insured Institution's

condition can be taken into account in determining its compliance with the relief ordered herein.

In this case, a critical component of the institution, its capital, was shown during the examination to be in a weakened position. The figures relied upon by the ALJ to indicate an improvement in the institution's capital and lack of need for an immediate infusion of capital, are not only unsubstantiated, but also were submitted by the same management whose policies and action allowed the Insured Institution to reach such a deteriorated condition, making those figures suspect.

Furthermore, although the Order requires [{{5-31-91 p.A-1664}}](#) that the institution have primary capital of 7.5 percent of adjusted assets, the average ratio for Bank of Salem's Peer Group, without significant loan or other problems, is 9.28 percent. (FDIC Ex. 1 at 3). Therefore, the Board finds that the ALJ erred to the extent that the proposed Order finds the institution in compliance with the primary capital requirement due to the institution's alleged improved financial condition. Accordingly, the Board modifies the proposed Order to require the Insured Institution to immediately infuse additional capital of \$600,000. To the extent that the Insured Institution can establish to the Regional Director's satisfaction that a lesser infusion of capital is now appropriate based upon objective and complete financial information, the Regional Director has the authority to modify the Order accordingly.

[.6] Finally, as to termination of the Cease and Desist Order, the determination of whether the Insured Institution is in compliance with the Order and in sound financial condition is for the FDIC, not the institution, to determine. It is significant that this is not a cease in which the Insured Institution voluntarily ceased the complained of practices. Post-examination evidence that either these violations have been corrected or that the institution's condition has improved presents an unsubstantiated and incomplete picture of the Insured Institution's condition. The FDIC examiners assess an institution's complete financial condition based upon data obtained through the full scope examination process. In this case, there is justified basis to conclude that any corrective efforts by the Insured Institution are a direct result of the initiation of this enforcement action. Therefore, any cessation of unlawful practices and change in activities was directly in response to the FDIC's examination and the initiation of this action. Without a review of the Insured Institution's financial condition and practices in the verifiable and documented manner that the examination process yields, the FDIC has "no valid assurances that if the Insured Institution were free of the FDIC's restraint it would not continue its former course." *Bank of Dixie v. FDIC*, 766 F.2d 175, 178 (5th Cir. 1985); see also *Zale Corp. v. FTC*, 473 F.2d 1317, 1320 (5th Cir. 1973); and *First National Bank of Bellaire v. Comptroller*, 697 F.2d 674, 683 (5th Cir. 1983). Accordingly, the Board declines to adopt the provision of the Cease and Desist Order providing that the Order will terminate upon proof by the Insured Institution of substantial compliance. The Board therefore modifies the proposed Order (ALJ's Recommended Order at 19) by inserting the words "by the FDIC" at the end of the last sentence of the final substantive paragraph.

V. CONCLUSION

Having determined that the Respondent has engaged in numerous violations of unsafe and unsound banking practices and violations of law as set forth in the ALJ's Recommended Decision as modified, the Board finds that the issuance of a Cease and Desist Order is supported by substantial evidence and is in the best interests of the Insured Institution, its depositors, and the deposit insurance fund.

By direction of the Board of Directors.

Dated at Washington, D.C., this 28th day of February, 1991.

ORDER TO CEASE AND DESIST

The Board of Directors ("Board") of the Federal Deposit Insurance Corporation ("FDIC"), having considered the record and the applicable law finds and concludes that the Bank of Salem, Salem, Arkansas ("Insured Institution"), as set forth in this Decision, has engaged in unsafe and unsound banking practices and has committed violations of law and regulations, within the meaning of section 8(b)(1) of the Federal Deposit Insurance Act ("Act"), 12 U.S.C. § 1818(b)(1):

Accordingly, IT IS HEREBY ORDERED, that the Insured Institution, its directors, officers, employees, agents, successors, assigns, and other institution-affiliated parties cease and desist from the following unsafe and unsound banking practices and violations:

- (a) engaging in hazardous lending and lax collection practices;
- (b) operating with inadequate primary capital;
- (c) operating with a large volume of poor quality loans;
- (d) operating with an inadequate loan valuation reserve;
- (e) operating with inadequate provisions for liquidity;
- (f) operating with inadequate routine sions controls policies;

(g) operating in such a manner as to produce low earnings;

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(h) operating in violation of section 23B of the Federal Reserve Act, 12 U.S.C. § 371c-1, made applicable to state nonmember banks by section 18(j)(1) of the Federal Deposit Insurance Act, 12 U.S.C. § 1828(j)(1), and sections 215.4(a)(2), 215.4(d), and 215.7 of Regulation O of the Board of Governors of the Federal Reserve System, 12 C.F.R. §§ 215.4(a)(2), 215.4(d), and 215.7, made applicable to state nonmember banks by section 18(j)(2) of the Federal Deposit Insurance Act, 12 U.S.C. § 1828(j)(2); section 304.4(a) of the FDIC's Rules and Regulations, 12 C.F.R. § 304.4(a); and sections XV(8)(c) and XV(9)(d) of the Arkansas State Bank Department Rules and Regulations;

(i) operating with management whose policies and practices are detrimental to the Insured Institution and jeopardize the safety of its deposits; and

(j) operating with a board of directors which has failed to provide adequate supervision over and direction to the active management of the Insured Institution.

IT IS FURTHER ORDERED, that the Insured Institution take affirmative action as follows:

1. (a) During the life of this ORDER, the Insured Institution shall have management qualified to restore the Insured Institution to a safe and sound condition. Such management shall include a chief executive officer and an experienced senior lending officer responsible for supervising the Insured Institution's overall lending function. The chief executive officer may be the same individual.

(b) Present management shall be assessed on its ability to:

(i) comply with the requirements of this ORDER;

(ii) improve and thereafter maintain the Insured Institution in a safe and sound condition, including asset quality and capital adequacy; and

(iii) comply with all applicable State and Federal laws and regulations.

(c) (i) During the life of this ORDER, the Insured Institution shall notify the Regional Director of the Memphis Regional Office ("Regional Director") and the Bank Commissioner for the State of Arkansas ("Commissioner") in writing of any resignations and/or terminations from its board of directors and senior executive officers.

(ii) The Insured Institution shall comply with 12 U.S.C. § 1842, which includes a requirement that the Insured Institution shall notify the Regional Director and the Commissioner in writing of any additions to its board of directors and senior executive officers. The notification must include the identity, personal history, business background, and experience, including the individual's business activities and affiliations during the past five (5) years, and a description of any material pending legal (State or Federal Court) or administrative proceedings to which the individual is a party. The notification shall be provided at least 30 days prior to the individual assuming the new position, and the Insured Institution may not add such individual if the Regional Director issues a notice of disapproval of such addition before the end of the 30 day period beginning on the date the Regional Director receives notice of the proposed action.

(d) For purposes of this ORDER the term "senior executive officers" shall mean the chairman and vice-chairman of the board of directors, the president, each vice president, and the senior lending officer of the Insured Institution. The term shall also include any persons who have the functions, duties, or responsibilities normally associated with those titles but are not specifically so named.

(e) To ensure both compliance with this ORDER and qualified management for the Insured Institution, the board of directors, within 60 days of the effective date of this ORDER shall develop a written policy ("Management Policy") which shall incorporate an analysis of the Insured Institution's management and staffing requirements and shall, at a minimum, address (i) both the number and type of position needed to properly manage the Insured Institution, (ii) a clear and concise description of the needed experience and pay for each job, (iii) an evaluation of present management, (iv) a plan to recruit, hire, or replace personnel with requisite ability and experience, (v) a periodic evaluation of each individual's job performance, and

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(vi) the establishment of procedures to periodically review and update the Management Policy.

The Management Policy and any subsequent modification thereto shall be submitted to the Regional Director and the Commissioner for review and comment. Within 30 days of receipt of any comment, and after consideration of such comment, the board of directors shall approve the Management Policy which approval shall be recorded in the minutes of the meeting of the board of directors. Thereafter, the Insured Institution and its directors, officers, and employees shall implement and follow the Management Policy and any modifications thereto.

(f) Within 30 days of the effective date of this ORDER, the board of directors shall establish a committee of the board of directors with the responsibility to ensure that the Insured Institution complies with the provisions of this ORDER. At least two-thirds of the members of such committee shall be independent, outside directors as defined herein. The committee shall report monthly to the entire board of directors, and a copy of the report and any discussion relating to the report or the ORDER shall be included in the minutes of the board of directors. Nothing contained herein shall diminish the responsibility of the entire board of directors to ensure compliance with the provisions of this ORDER.

(g) For the purposes of this ORDER, an "outside director" shall be an individual:

- (i) who shall not be employed, in any capacity, by the Insured Institution or its affiliated other than as a director of the Insured Institution of an affiliate;
- (ii) who shall not own or control more than 5 percent of the voting stock of the Insured Institution or its holding company;
- (iii) who shall not be indebted to the Insured Institution or any of its affiliates in an amount greater than 5 percent of the Insured Institution's primary capital;
- (iv) who shall not have an extension of credit from the Insured Institution that is adversely classified in any Report of Examination and/or Visitation;
- (v) who shall not be related to any directors or principal shareholders of the Insured Institution or affiliated of the Insured Institution; and
- (iv) who shall be a resident of, or engage in business in, the Insured Institution's trade area.

2. (a) Within 120 days of the effective date of this ORDER, the Insured Institution shall increase its primary capital by no less than \$600,000. Within 120 days of the effective date of this ORDER, and during the life of this ORDER, the Insured Institution shall maintain adjusted primary capital equal to or greater than seven and one-half (7.5) percent of the Insured Institution's adjusted Part 325 total assets.

(b) Any increase in primary capital necessary to meet the requirements of Paragraph 2(a) of this ORDER may be accomplished by the following:

- (i) the sale of new securities in the form of common stock or perpetual preferred stock; or
- (ii) the direct contribution of cash by the directors, shareholders, or parent bank holding company of the Insured Institution; or
- (iii) the collection in cash of assets classified "Loss" without loss or liability to the Insured Institution; or
- (iv) the collection of assets previously charged-off; or
- (v) any other method acceptable to the FDIC.

(c) If all or part of the increase in primary capital required by Paragraph 2(a) of this ORDER is accomplished by the sale of new securities of any kind or should there be a plan involving a public distribution of the Insured Institution's securities (including a distribution limited only to the Insured Institution's existing shareholders), the Insured Institution shall prepare offering materials fully describing the securities being offered, including an accurate description of the financial condition of the Insured Institution and the circumstances giving rise to the offering, and any other material disclosure necessary to comply with Federal securities laws. Prior to the implementation of the plan and, in any event not less than 20 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 [5-31-91 p.A-1667](#) FDIC, Registration and Disclosure Section, Washington, D.C. 20429. Any changes requested to be made in the plan or materials by the FDIC shall be made prior to their dissemination.

(d) In complying with the provisions of Paragraph 2 of the ORDER, the Insured Institution shall provide to any subscriber and/or purchaser of the Insured Institution's securities written notice of any planned or existing development or other changes which are materially different from the information reflected in any offering materials used in connection with the sale of Insured Institution Securities. The written notice required by this paragraph shall be furnished within 10 days from the date such material development or change was planned or occurred, whichever is earlier, and shall be furnished to every subscriber and/or purchaser of Insured Institution's Securities who received or was tendered the information contained in

the Insured Institution's original offering materials.

(e) For purposes of this ORDER the terms "primary capital," "total capital," and "Part 325 total assets" shall have the meanings ascribed to them in Part 325 of the FDIC's Rules and Regulations, respectively, subsections 325.2(h), 325.2(1), and 325.2(k), 12 C.F.R. § 325.2(h), (1), (k). The "Analysis of Capital" schedule on page 3 of the FDIC's Report of Examination provides the method for determining the ratio of adjusted primary capital to adjusted Part 325 total assets as required by this ORDER.

3. (a) Within 10 days of the effective date of this ORDER, the Insured Institution shall eliminate from its books, by chargeoff or collection, all assets classified "Loss" and one-half of the assets classified "Doubtful" as of May 26, 1989, that have not been previously collected or charged-off. Reduction of these assets through proceeds of other loans made by the Insured Institution is not considered collection for the purpose of this paragraph.

(b) Within 120 days of the effective date of this ORDER, the Insured Institution shall have reduced the assets classified "Substandard" as of May 26, 1989, and those assets classified "Doubtful" that have not previously been charged-off pursuant to this ORDER to not more than \$5,000,000.

(c) Within 240 days of the effective date of this ORDER, the Insured Institution shall have reduced the assets classified "Substandard" as of May 26, 1989, and those assets classified "Doubtful" that have not previously been charged-off pursuant to this ORDER to not more than \$4,000,000.

(d) Within 360 days of the effective date of this ORDER, the Insured Institution shall have reduced the assets classified "Substandard" as of May 26, 1989, and those assets classified "Doubtful" that have not previously been charged-off pursuant to this ORDER to not more than \$4,000,000 and to not more than \$3,000,000 within 18 months of the effective date of this ORDER.

(e) The requirements of paragraph 3(a), (b), (c), and (d) are not to be construed as standards for future operations and, in addition to the foregoing, the Insured Institution shall eventually reduce the total of all adversely classified assets. As used in this paragraph and/or paragraphs 3(b), (c), and (d), the word "reduce" means (1) to collect, (2) to charge-off, or (3) to sufficiently improve the quality of assets adversely classified to warrant removing any adverse classification, as determined by the FDIC.

4. (a) Beginning with the effective date of this ORDER, the Insured Institution shall not extend, directly or indirectly, any additional credit to, or for the benefit of, any borrower who has a loan or other extension of credit with the Insured Institution that has been charged-off or classified, in whole or in part, "Loss" or "Doubtful" and is uncollected. The requirements of this paragraph shall prohibit the Insured Institution from renewing (after collection in cash of interest due from the borrower) any credit already extended to any borrower.

(b) Beginning with the effective date of this ORDER, the Insured Institution shall not renew any loan without the full collection of interest due. The issuance of separate notes, to the borrowing customer or a third party, the proceeds of which pay interest due, shall not satisfy the requirements of this paragraph unless these separate notes receive the prior approval by [\[5-31-91 p.A-1668\]](#) the board of directors after the board's affirmative determination, as reflected in the minutes of the meeting, that the extension of credit is necessary to protect the Insured Institution's interest or is adequately secured, that credit analysis has determined the customer to be credit worthy, that all necessary loan documentation is on file, including satisfactory appraisal, title and lien documents, and that the extension complies with the Insured Institution's loan policy and applicable rates and regulations.

5. (a) Beginning with the effective date of this ORDER, the Insured Institution shall review and strengthen its collection policies and procedures and adopt and implement a written loan interest nonaccrual policy which conforms with requirements contained in Instructions for Preparation of Reports of Condition and Income published by the Federal Financial Institutions Examination Council.

(b) Beginning with the effective date of this ORDER, the Insured Institution shall initiate and implement a program to strengthen its credit files and correct the technical exceptions as detailed on pages 2-f, 2-f-1, 2-f-2, 2-f-3, and 2-f-4 of the May 26, 1989 Report of Examination. In all future operations, the Insured Institution shall ascertain that all documents or evidence thereof, properly completed, are obtained before credit is extended.

(c) Within 60 days of the effective date of this ORDER, the Insured Institution shall establish and implement internal control procedures which shall provide the Insured Institution with a document audit trail which demonstrates as to each funded loan to whom loan proceeds are being disbursed.

(d) Within 30 days of the effective date of this ORDER, the Insured Institution shall establish and implement internal control procedures to secure and limit access to the Insured Institution's stock of blank cashiers checks.

6. (a) Within 30 days of the effective date of this ORDER, the board shall strengthen its internal loan review and grading system ("System") to periodically review the Insured Institution's loan portfolio and identify and categorize problem credits. At a minimum the System shall provide for:

- (i) identifying the overall quality of the loan portfolio;

- (ii) the identification and amount of each delinquent loan;
- (iii) an identification or grouping of loans that warrant the special attention of management;
- (iv) for each loan identified, a statement of the amount and an indication of the reason(s) why the particular loan merits special attention;
- (v) credit and collateral documentation exceptions;
- (vi) the identification and status of each violation of law, rule, or regulation;
- (vii) loans not in conformance with the Insured Institution's lending policy and exceptions to the Insured Institution lending policy;
- (viii) insider loan transactions; and
- (ix) a mechanism for reporting periodically to the board of directors on the status of each loan identified and the action(s) taken by management.

(b) A copy of the reports submitted to the board, as well as documentation of the action taken by the Insured Institution to collect or strengthen assets identified as problem credits, shall be kept with the minutes of the board of directors.

(c) Within 60 days of the effective date of the ORDER, the Insured Institution's board of directors shall establish and appoint a loan committee to review and approve in advance all extensions of credit and/or renewals that, when aggregated with all other extensions of credit to that borrower, either, directly or indirectly, exceed or would exceed \$50,000. The review should include financial, income, and cash flow information, collateral values and lien information, repayment terms, past performance by the borrower, the purpose of the extension, and whether the extension complies with the Insured Institution's loan policy and applicable rates and regulations. The loan committee shall meet at least twice monthly and shall maintain written minutes which document its review, conclusions, approvals, denials, and recommendations. At least two-thirds of the members of the loan committee shall be independent, outside directors as defined in Paragraph 1(g) of this ORDER.

7. Within 180 days of the effective date of ~~{{5-31-92 p.A-1669}}~~ this ORDER (unless within 60 days an alternative timetable or proposal is submitted by the Insured Institution and approved in writing by the Regional Director and the Commissioner), the Insured Institution shall reduce each loan concentration as of May 23, 1989 to an amount which shall be less than 25 percent of the Insured Institution's total equity capital and reserves for each individual concentration. In addition, the Insured Institution shall not make any new extensions of credit, directly or indirectly, to any borrower whose loans in the aggregate equal 25 percent or more of the Insured Institution's total equity capital and reserve.

8. Within 30 days of the effective date of this ORDER, the Insured Institution shall establish and thereafter maintain an adequate reserve for loan losses. Such reserve shall be established by charges to current operating income, together with collection of assets previously charged-off. In complying with the provisions of this paragraph, the board of directors of the Insured Institution shall review the adequacy of the Insured Institution's reserve for loan losses prior to the end of each quarter. The minutes of the board meeting at which such review is undertaken shall indicate the results of the review, the amount of any increase in the reserve, and the basis for determination of the amount of the reserve provided.

9. Within 60 days of the effective date of this ORDER, the Insured Institution shall eliminate and/or correct all violations of law which are set out on pages 6-b, 6-b-1, and 6-b-2 of the Report of Examination of the Insured Institution as of May 26, 1989. In addition, the Insured Institution shall henceforth comply with all applicable laws and regulations.

10. Within 60 days of the effective date of this ORDER, the Insured Institution shall formulate and adopt a written liquidity and funds management policy. Such policy shall include the establishment of acceptable ranges of ratios in the following areas: volatile liability dependence, total loans to total deposits, and temporary investments to volatile liabilities. In addition, the liquidity policy shall incorporate a funds management program which designates acceptable levels for: volatile liabilities, including borrowings; asset mix, including temporary funds and investments, long term investment securities and classes of obligors, and loans to deposits; and rate-sensitive assets as a percent of rate-sensitive liabilities. The written liquidity and funds management policy shall be submitted to the Regional Director and the Commissioner for review and comment.

11. (a) Within 30 days of the effective date of this ORDER, the Insured Institution shall review all Consolidated Reports of Condition and Income filed with the FDIC on and after May 26, 1989, and shall amend and file with the FDIC amended Consolidated Reports of Condition and Income which accurately reflect the financial condition of the Insured Institution as of the date of each such Report. At a minimum each such Report shall be amended to reflect elimination of all assets classified "Loss" and one-half of the assets classified "Doubtful" as required by Paragraph 3(a) of this ORDER and shall incorporate an adequate reserve for loan losses accurately reflecting the Insured Institution's loan portfolio as of May 26, 1989, as required by Paragraph 8.

(b) In addition to the above, and during the life of this ORDER, the Insured Institution shall file with the FDIC Consolidated Reports of Condition and Income which accurately reflect the financial condition of the Insured Institution as of the reporting period. In particular such Reports shall include any adjustment in the Insured Institution's books made necessary or appropriate as a consequence of any State of FDIC examination of the Insured Institution during that reporting period.

12. While this ORDER is in effect, the Insured Institution shall not declare or pay any cash dividends on its capital stock without the prior written approval of the Regional Director and the Commissioner.

13. (a) Within 60 days of the effective date of this ORDER, and thereafter on an annual basis, the Insured Institution shall review the total compensation (both current and deferred) being paid to Insured Institution directors to determine whether the compensation received by each such person is reasonable in relation to the services provided to the Insured Institution. The minutes of the board meeting at which such review is undertaken shall indicate the results of the review and the basis for determination of the reasonableness of the compensation. For the purpose of this paragraph, "compensation" refers to any and

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all salaries, bonuses, and other benefits of every kind and nature whatsoever, whether paid directly or indirectly.

(b) During the life of this ORDER, the Insured Institution shall not pay any bonuses to any of its directors, officers, or employees if subsequent to the payment of such bonuses the ratio of the Insured Institution's adjusted primary capital to its adjusted Part 325 total assets would equal less than seven and one-half (7.5) percent.

14. During the life of this ORDER, the board of directors of the Insured Institution shall, prior to the disbursement of any funds derived from the sale of credit life and other insurance, either approve or disapprove the proposed transaction. The board's action shall be stated in the minutes of the meeting.

15. Within 60 days of the effective date of this ORDER, the Insured Institution shall adopt and implement a written policy on real estate appraisal that conforms to the Interagency Appraisal Guidelines as set forth in Bank Letter 40-87, dated December 14, 1987, and in Bank Letter 29-88, dated September 8, 1988.

16. Following the effective date of this ORDER, the Insured Institution shall send to its shareholders or otherwise furnish a description of this ORDER, (i) in conjunction with the Insured Institution's next shareholder communication, and also (ii) in conjunction with its notice or proxy statement preceding the Insured Institution's next shareholder meeting. The description shall fully describe the ORDER in all material respects. The description and any accompanying communication, statement, or notice shall be sent to the FDIC, Registration and Disclosure Section, Washington, D.C. 20429, for review at least 20 days prior to dissemination to shareholders. Any changes requested to be made by the FDIC shall be made prior to dissemination of the description, communication, notice, or statement.

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

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

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

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

By direction of the Board of Directors.

Dated at Washington, D.C., this 28th day of February, 1991.

/s/ Hoyle L. Robinson
Executive Secretary

RECOMMENDED DECISION

**In the Matter of
Bank of Salem
Salem, Arkansas
(Insured State Nonmember Bank)
Paul S. Cross, Administrative Law Judge:**

I. SUMMARY OF PROCEEDINGS

On December 11, 1989, the Federal Deposit Insurance Corporation ("FDIC"), through the Memphis Regional Director acting under delegated authority from the FDIC's Board of Directors, issued a Notice of Charges and of Hearing ("Notice") against Bank of Salem, Salem, AR ("Bank") pursuant to the provisions of section 8(b)(1) of the Federal Deposit Insurance Act ("Act"), 12 U.S.C. § 1818(b)(1), and Part 308 of the FDIC Rules of Practice and Procedures, 12 C.F.R. Part 308. Based upon the results of the FDIC examination conducted as of the close of business May 26, 1989, the Notice charged that the Bank engaged in unsafe or unsound practices and violations of law and regulation as prohibited by section 8(b)(1) of the Act.

The Bank, through counsel, filed an answer to the Notice dated January 2, 1990, admitting certain allegations in the Notice and denying others. An amended answer was filed on January 3, 1990.

Robert E. Feldman, FDIC Deputy Executive Secretary, by letter dated January 8, 1990, pursuant to an assignment by the [{{5-31-91 p.A-1671}}](#) United States Office of Personnel Management informed me of my appointment to decide this matter and transmitted the record. The hearing was to commence on or about February 13, 1990, in Little Rock, AR. By notice dated January 29, 1990, I postponed the hearing and scheduled a prehearing conference for March 14, 1990. At the prehearing conference, I set May 21, 1990 as the date to commence the hearing and both parties consented to Memphis, TN as the site. Counsel for the Bank and the FDIC entered into stipulations regarding certain facts and use of documents.

The hearing of the Action was convened in Memphis on May 21, 1990 before me and continued from day-to-day until May 25, 1990 whereupon the hearing was adjourned, at the request of the Bank, until July 2, 1990. The hearing was resumed on July 2, 1990 and concluded the same day. The hearing record consists of ten volumes of transcript of the hearing ("TR") totalling 1063 pages, 112 documentary exhibits: 52 offered by the FDIC ("FDIC Ex. # _____"), 60 offered by the Respondents ("RESP. Ex.# _____"). Proposed findings of fact, proposed conclusions of law, proposed orders and opening briefs were filed by the FDIC and Respondent. The FDIC also filed a reply brief dated September 28, 1990. Respondent elected not to file a reply brief.

II. FINDINGS OF FACT

In General

1. The Bank, a corporation existing and doing business under the laws of the State of Arkansas and having its principal place of business at Salem is and was, at all times pertinent to this proceeding, an insured state nonmember bank. The Bank is subject to the Act, 12 U.S.C. §§ 1811-1831k, the FDIC Rules and Regulations, 12 C.F.R. Chapter III, and the laws of the State of Arkansas. The FDIC has jurisdiction over the bank, persons participating in the conduct of the affairs of the Bank, and the subject matter of the proceeding. (Admitted in Answer)

2. At all times pertinent, Richard T. Smith was and is the chairman of the Bank's board of directors and Frank B. Burge, L.R. Cochran, and C. Dwayne Plumlee were members of the Bank's board of directors. Marvin Newton was elected to the Bank's board of directors on April 13, 1989. (Admitted in Answer)

3. Smith Associates Banking Corporation is a related interest of Richard T. Smith and is the holding company of the Bank and Stephens Security Bank, Stephens ("Stephens"). (Stipulated)

4. As of May 26, 1989:

- (a) the Bank's total equity capital and reserves equaled \$3,646,000;
- (b) the Bank's total deposits equaled \$44,730,000;
- (c) the Bank's total loans equaled \$33,207,000; and
- (d) the Bank's gross loans equaled \$33,596,000.

(Admitted in Answer)

* * * *Transaction*

5. As of March 15, 1983, the Bank had listed on its books as other real estate owned ("ORE") property know as the *** property with a loan balance of \$175,000. (Stipulated; TR 37)
6. The Bank wrote down the property from \$175,000 to \$90,000 by July 30, 1985, charging \$85,000 to loss. (Stipulated; TR 38)
7. On July 30, 1985, Stephens made a loan of \$110,000 to one *** to purchase the *** ORE from the Bank. (TR 38–39, 44; FDIC Ex. # 2, 4, 15)
8. The Bank recorded the transaction as a sale to *** with \$90,000 applied to reduce the *** ORE account to zero with the additional \$20,000 as a recovery of a previously charged off loss. (TR 38)
9. The Bank's records, as of April 23, 1986, indicate that the Bank sold the *** property to a *** for \$100,000, even though it had previously indicated on its books the *** transaction in paragraph 8. (TR 39; FDIC Ex. #5, 13–14)
10. The Bank received net proceeds of \$94,076.89, after payment of closing costs, and then charged its General Ledger Cost of Collections Account \$5,923.11, for a total of \$100,000 which it sent to Stephens for credit to the \$110,000 loan of ***. (TR 39–40; FDIC Ex. #5–7, 9)
11. On July 31, 1986, the Bank made *** a loan of \$18,600 which was wired to Stephens for payment of the balance of the loan *** had remaining from the sale of the [{{5-31-91 p.A-1672}}](#) *** property to the ***. (Tr. 40, 47; FDIC Ex. #10–12, 17)
12. The July 31, 1986 loan to *** was carried on the Bank's books until August 18, 1987, whereupon it was charged off, including accrued interest of \$1,600 which had been credited to the Bank's earnings. (TR 40–41, 268; FDIC Ex. #8)
13. The Bank's records failed to disclose that the loan to *** for the purchase of the *** ORE was a nonrecourse loan. (TR 41–42, 729–30)
14. The transaction, as recorded, caused the Bank to file false and misleading Reports of Condition and Income and distorted the Bank's earnings. (TR 57, 276–77, 280, 753)

**** Transaction*

15. As of May 23, 1985, the Bank had on its books an ORE known as the *** Property with a loan balance of \$79,000. Between May 23, 1985 and May 27, 1986 the Bank charged-off \$12,300 of that amount as a loss, leaving a balance of \$66,700. (Stipulated)
16. The Bank transferred the *** ORE to *** on June 4, 1986, which in turn transferred the property on the same day to ***. (TR 51–52; FDIC Ex. #19)
17. The Bank made *** a loan of \$130,000 for the purchase of *** ORE from ***. The Bank applied \$66,700 of the proceeds to the pay off the balance of the *** ORE loan on the Bank's books. The remaining proceeds from the *** loan, \$63,300, were applied to the loan of ***, which at all times pertinent to this proceeding was solely owned by ***. The remaining balance of the *** \$95,500, was charged off on July 1, 1986. (TR 51–52; FDIC Ex. #20–21, 29)
18. The Bank's note for the *** loan was executed by *** as attorney-in-fact, but no power of attorney was executed or recorded. (TR 50, 733; FDIC Ex. #20)
19. The Bank made a payment to *** of \$11,000 for the use of a nonexistent hunting club. The \$11,000 was used to pay the interest on the *** loan. (TR 55–56; FDIC Ex. #23–25)
20. On September 17, 1987, a \$1,000 payment of interest was made on the *** loan from a loan to one ***. (TR 53–54; FDIC Ex. #22)
21. On September 14, 1988, the Bank made a loan in the amount of \$257,620 to *** for the benefit of *. (TR 54)
22. The sum of \$50,000 from the *** loan was paid to *** on September 14, 1988. The check was endorsed by *** and "LaNora Herbert for Richard Smith" and then exchanged for a \$50,000 cashier's check drawn on Worthen Bank & Trust, Little Rock, Arkansas, which was in turn applied to the loan of **, leaving a balance on the *** loan of \$79,000. (TR 54–55; FDIC Ex. #25–28)
23. The *** ORE was subsequently sold for \$39,243 and this amount was applied to the outstanding balance of the *** loan, leaving a balance of \$39,757, which was charged off by the Bank on January 9, 1989. (TR 56–57; FDIC Ex. #30–32)
24. The Bank's records did not disclose that the loan to *** was nonrecourse. (TR 57, 67, 729–31, 270)
25. The transaction, as reported, caused the Bank to file false and misleading Reports of Condition and Income and distorted the Bank's earnings. (TR 57, 276–77, 280, 753)

Unsafe and Unsound Practices

26. The Bank engaged in unsafe or unsound banking practices as evidenced by the following:

(a) The Bank extended loans in violation of its written loan policy as evidenced by the loan to ** * in that there was insufficient collateral; the loan to ** * in that it was based on guarantees; the loan to ** * in that there was no appraisal of the collateral; the loan to ** * in that the purpose of the loan is not stated and is in excess of the 80% of loan to value for real estate loans; the loans to ** * and ** * in that there was capitalization of interest without approval being noted in the minutes of the Bank. (TR 82–94; FDIC Ex. #1, 34)

(b) The Bank extended loans which do not evidence adequate sources of repayment. This is evidenced by the loans to ** * and ** *. (TR 82, FDIC Ex. #1)

(c) The Bank extended loans that were secured by insufficient collateral. This is evidenced by the loans to ** * (loan in excess of 100% of the real estate collateral), ** * (loan in excess of 100% of the real estate collateral), ** * (loan in greatly in excess of value of collateral), and ** *

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(loan in excess of value of collateral). (TR 82–89; FDIC Ex. #1.)

(d) The Bank extended loans that were not adequately documented. This is evidenced by the loans to ** * (purpose not stated and insufficient valuation of collateral), ** * (unable to determine the collateral), ** * (balance of prior lien and amount owed on assigned note not in evidence), ** * (outdated appraisals and inadequate income information). (TR 82–89; FDIC Ex. #1)

(e) The Bank extended loans without adequate credit analysis. This is evidenced by the loans to ** *. (TR 81–89; FDIC Ex. #1)

(f) The Bank capitalized the interest on existing loans into new extensions of credit. This is evidenced by the loans to ** *. (TR 91; FDIC Ex. #1)

(g) The Bank has extended loans without adequate repayment agreements and/ or failed to enforce repayment agreements. This is evidenced by the loans to ** *. (TR 40–57, 81–84; FDIC Ex. #1)

28. The Bank has engaged in unsafe or unsound banking practices in that, without prior written authorization of the board of directors, portions of the proceeds of extensions of credit made by the Bank to third parties were diverted to Chairman of the Board, Richard T. Smith, his wife, and/or his related interests, as follows:

(a) An extension of credit to ** * in the amount of \$350,000 on August 8, 1988 resulted in \$1,500 of the proceeds being diverted to Chairman Smith without knowledge or prior written authorization of the board of directors. (TR 91–96, 488, 508-09; FDIC Ex. #35–38)

(b) An extension of credit to ** * on October 11, 1988 in the amount of \$270,000 resulted in a diversion of \$2,200 of the proceeds to Chairman Smith which was without the knowledge or authorization of the board of directors. (TR 101–103, 488, 508-09; FDIC Ex. #39–41)

(c) An extension of credit to ** * Properties on March 13, 1989 in the amount of \$355,000 resulted in a diversion of \$3,479 of the proceeds to Chairman Smith without the knowledge or authorization of the board of directors. (TR 97–97, 103–104, 488, 508-09; FDIC Ex. #42)

(d) An extension of credit to ** * on August 15, 1988 in the amount of \$100,000 resulted in a diversion of \$9,000 of the proceeds to Chairman Smith without the prior written authorization of the board of directors or their knowledge or their consent. (TR 104–106, 108–109, 488, 508; FDIC Ex. #43–44)

29. The Bank had an excessive volume of poor quality loans and other assets in relation to its total assets and in relation to its equity capital and reserves, as evidenced by the following:

(a) The bank had an excessive volume of adversely classified loans. As of May 26, 1989, adversely classified loans totaling \$7,379,000 were 16.20 percent of total loans and 202.39 percent of total equity capital and reserves. (TR 109; FDIC Ex. #1)

(b) In addition to the classified loans, other assets adversely classified as of May 26, 1989 totaled \$418,000 "Substandard", \$8,000 "Doubtful", and \$108,000 "Loss". As of May 26, 1989, the total of adversely classified assets was \$7,913,000 which equaled 217.03 percent of total equity capital and reserves. (TR 111, 482; FDIC Ex. #1)

30. The Bank has engaged in unsafe or unsound banking practices in that the Bank is being operated with insufficient primary capital in relation to the kind and quality of assets held by the Bank. As of May 26, 1989, adjusted primary capital of \$2,999,000 equaled 6.17 percent of adjusted Part 325 total assets of \$48,570,000. The adversely classified assets not considered in computing adjusted primary capital totaled \$7,479,000. These adversely classified assets equaled 249.38 percent of adjusted primary capital. (TR 111, 481; FDIC Ex. #1)

31. The Bank has engaged in unsafe or unsound banking practices in that the Bank has operated with an inadequate loan valuation reserve. As of May 26, 1989, the loan valuation reserve was \$423,000. As of the same date, loans classified "Loss" and one-half of the loans classified "Doubtful" (which are considered nonbankable assets) totaled \$322,000, which left only \$101,000 for future losses for loans classified "Substandard" and unclassified loans. (TR 112; FDIC Ex. #1)

32. The Bank has engaged in unsafe and unsound banking practices in that the Bank [{{5-31-91 p.A-1674}}](#) had an excessive amount of concentrations of credit in its loan portfolio, as evidenced by the fact that the Bank has made extensions of credit to * * * and a letter of credit for the Benefit of * * *, which are all dependent on the performance of * * * for repayment and constitute 30.03 percent of the Bank's total equity capital and reserves. Extensions of credit to * * * and his related interests constitute 31.29 percent of the Bank's total equity capital and reserves. The above concentrations of credit represent 61.32 percent of the Bank's total equity capital and reserves. (TR 113–114, FDIC Ex. #1, 49)

Violations of Law or Regulation

33. The Bank violated section 22(h) of the Federal Reserve Act, 12 U.S.C. § 375b, and section 215.4(a)(2) of Regulation O of the Board of Governors of the Federal Reserve System, 12 C.F.R. § 215.4(a)(2), made applicable to the state nonmember banks by section 18(j)(2) of the Act, 12 U.S.C. § 1828(j)(2), in that the Bank extended and/or renewed credit to Director C. Dwayne Plumlee subsequent to November 1, 1985, which involved more than the normal risk of repayment and/or other unfavorable features as demonstrated, in part, by the "Substandard" classification which his line of credit received at the November 1, 1985 FDIC Report of Examination of the Bank. (TR 116, 118–119; FDIC Ex. #1)

34. The bank violated section 22(h) of the Federal Reserve Act, 12 U.S.C. § 375b, and section 215.4(d) of Regulation O of the Board of Governors of the Federal Reserve System, 12 C.F.R. § 215.4(d), made applicable to state nonmember banks by section 18(j)(2) of the Act, 12 U.S.C. § 1828(j)(2), in that the Bank paid overdrafts in excess of \$1,000 on the individual accounts of one of its directors and four of its executive officers without a written, preauthorized transfer of funds from another account of the holder at the Bank, as follows:

NAME	DATE	AMOUNT
L.C. Cochran (Director)	12-22-87	\$1,028.20
	12-23-87	1,847.47
	12-24-87	2,123.67
	12-28-87	2,737.71
	01-21-88	15,401.78
	01-28-88	1,531.65
	01-29-88	1,544.58
	02-01-88	1,758.59
	02-02-88	1,824.16
	10-03-88	1,127.13
	03-20-89	1,720.23
Frances Atkins (Vice President)	10-14-88	1,456.12
Brenda Barnes (Vice President)	05-03-88	7,450.13
Don Keesee (Vice President)	03-28-99	6,341.03
	03-29-89	6,391.14
	03-31-89	5,586.59
	04-03-89	5,485.38
Mark Montgomery (Vice President)	04-25-88	11,903.21
	06-10-88	2,496.91
	09-02-88	1,662.41
	09-06-88	1,762.41
	09-16-88	1,770.29
	10-31-88	2,600.33
	11-04-88	1,094.48
	02-23-89	8,580.29
	02-24-89	8,689.54

(Stipulated; TR 119–121, 474, 734; FDIC Ex. #1, 48)

35. The Bank violated section 215.4(d) of Regulation O of the Board of Governors of the Federal Reserve System, 12 C.F.R. § 215.4(d), in that the Bank paid overdrafts of one of its directors and one of its executive officers that each aggregated less than \$1,000 but were overdrawn for more than five days, as follows:

NAME	DATE ENTERED OVER- DRAFT	DATE CLEARED OVER- DRAFT
L.C. Cochran (Director)	01-25-88	02-11-88
Brenda Barnes (Vice President)	10-18-88	10-31-88

(TR 119–120; FDIC Ex. #1)

36. The Bank violated section 22(h) of the Federal Reserve Act, 12 U.S.C. § 375b, and section 215.7 of Regulation O of the Board of Governors of the Federal Reserve System, 12 C.F.R. § 215.7, made applicable to state nonmember banks by section 18(j)(2) of the Act, 12 U.S.C. § 1828(j)(2), in that the Bank failed to maintain records that identified Flying Star, Inc., with which the Bank had entered into a lease on September 1, 1988, as a related interest of Richard T. Smith, an executive officer and chairman of the board of directors of the Bank. (TR 122–123, 735; FDIC Ex. #1, 50)

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37. By reason of the practices and violations set forth above, the Bank has operated with policies and practices which are detrimental to the Bank and jeopardize the safety of its deposits. (TR 123–126, 514–15; FDIC Ex. #1)

38. The Bank's board of directors has engaged in unsafe or unsound banking practices in that it has failed to provide adequate supervision over and direction of the active officers of the Bank to prevent the practices and violations described above. (TR 123–126, 484; FDIC Ex. #1)

III. CONCLUSIONS OF LAW

1. The FDIC has jurisdiction over the Bank and the subject matter of this proceeding and has the authority to issue an order to cease-and-desist against the Bank pursuant to section 8(b) of the Act. (Admitted)

2. The following practices constitute unsafe or unsound banking practices within the meaning of section 8(b) of the Act:

(a) The Bank extended loans in violation of its written loan policy. (TR 82, 87–91, 949; FDIC Ex. #1, 34)

(b) The Bank extended loans which do not evidence adequate sources of repayment. (TR 82, 950; FDIC Ex. #1)

(c) The Bank extended loans that secured by insufficient collateral. (TR 82–86, 88–89, 950; FDIC Ex. #1)

(d) The Bank extended loans that were not adequately documented. (TR 81–83, 85–86, 88–91, 950; FDIC Ex. #1)

(e) The Bank extended loans without adequate credit analysis. (TR 81–83, 85–86, 89, 950; FDIC Ex. #1)

(f) The Bank capitalized the interest on existing loans into new extensions of credit. (TR 81–84, 91, 950; FDIC Ex. #1)

(g) The Bank extended loans without adequate repayment agreements and/or failed to enforce repayment agreements. (TR 40–57, 81, 84; FDIC Ex. #1)

(h) Portions of the proceeds of extensions of credit made by the Bank to third parties were diverted to Chairman of the Board, Richard T. Smith. (TR 96–97, 103–109; FDIC Ex. #42–44)

3. As a result of these practices, the Bank had an excessive volume of poor quality loans and other assets in relation to its total assets and in relation to its equity capital and reserves. (TR 111; FDIC Ex. #1)

4. The Bank has engaged in unsafe or unsound banking practices in that:

(a) The Bank is being operated with insufficient primary capital in relation to the kind and quality of assets held by the Bank. (TR 111; FDIC Ex. #1)

(b) The Bank has been operated with an inadequate loan valuation reserve. (TR 112; FDIC Ex. #1)

(c) The Bank had an excessive amount of concentrations of credit. (TR 113–114; FDIC Ex. #1, 49)

(d) The Bank has operated with policies and practices which are detrimental to the Bank and jeopardize the safety of its deposits. (TR 123–126; FDIC Ex. #1)

5. The Bank's board of directors has failed to provide adequate supervision over and direction of the active officers of the Bank to prevent the practices and violations described above. (TR 123–126; FDIC Ex. #1)

6. The Bank violated section 22(h) of the Federal Reserve Act, 12 U.S.C. § 375b, and section 215.4(a)(2) of Regulation O of the Board of Governors of the Federal Reserve System, 12 C.F.R. § 215.4(a)(2), made applicable to the state nonmember banks by section 18(j)(2) of the Act, 12 U.S.C. § 1828(j)(2), in that the Bank extended and/ or renewed credit to Director C. Dwayne Plumlee subsequent to November 1, 1985, which involved more than the normal risk of repayment and/or other unfavorable features. (TR 116–118, 119; FDIC Ex. #1)

7. The bank violated section 22(h) of the Federal Reserve Act, 12 U.S.C. § 375b, and section 215.4(d) of Regulation O of the Board of Governors of the Federal Reserve System, 12 C.F.R. § 215.4(d), made applicable to state nonmember banks by section 18(j)(2) of the Act, 12 U.S.C. § 1828(j)(2), in that the Bank paid overdrafts in excess of \$1,000 on the individual accounts of one of its directors and four of its executive officers without a written, preauthorized transfer of funds from another account of the holder at the Bank. (TR 119–120; FDIC Ex. #1)

8. The Bank violated section 22(h) of the Federal Reserve Act, 12 U.S.C. § 375b, and section 215.7 of Regulation O of the Board of Governors of the Federal Reserve System, 12 C.F.R. § 215.7, made applicable to [{{5-31-91 p.A-1676}}](#) state nonmember banks by section 18(j)(2) of the Act, 12 U.S.C. § 1828(j)(2), in that the Bank failed to maintain records that identified Flying Star, Inc., with which the Bank had entered into a lease on September 1, 1988, as a related interest of Richard T. Smith, an executive officer and chairman of the board of directors of the Bank. (TR 122–123; FDIC Ex. #1, 50)

IV. DISCUSSION AND CONCLUSIONS

A. Congress Granted The FDIC Broad Power and Discretion in Issuing Orders to Cease and Desist

Congress has empowered the FDIC with board discretionary authority under section 8(b) of the Act to initiate a wide range of cease-and-desist actions and to fashion appropriate remedies. The FDIC authority includes the power to require affirmative actions be taken to correct the conditions resulting from unsafe or unsound practices. Further, reviewing courts have extended substantial deference to the expertise of administrative agencies in fashioning appropriate remedies.

The authority of the FDIC to fashion a remedy in a cease and desist action is provided in section 8(b) of the Act:

Such order may, by provisions which may be mandatory or otherwise, require the depository institution or its institutional affiliated parties *to cease and desist from the same and, further, to take affirmative action to correct the conditions resulting from any such violation or practice.* (Emphasis added).

Once the FDIC establishes that an unsafe or unsound practice or violation of law existed at any time, it has authority to issue an order that will ensure that the practice or violation is corrected or, if already corrected, that it remain corrected during the life of the order.

In *J.P. Stevens & Co. v. NLRB*, 417 F.2d 533 (5th Cir. 1969), the court upheld a cease and desist order issued to stop anti-union activities. Nothing that "the reviewing court must pay an unusually high degree of respect to the Board's conclusion", *id.* at 537, the court followed the decision of *Virginia Electric & Power Co. v. NLRB*, 319 U.S. 533 (1943), in holding that:

[The order] should stand unless it can be shown that the order is a patent attempt to achieve ends other than those which can fairly said to effectuate the policies of the Act. *Id.* at 540

In *Warner-Lambert Co. v. FTC*, 562 F.2d 749 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 950 (1978), the

FTC issued a broad cease and desist order requiring affirmative corrective advertising. After noting that "the Commission has the power to shape remedies which go beyond the simple cease and desist order", the court affirmed the corrective action requirement, quoting *Jacob Seigel Co. v. FTC*, 327 U.S. 608 (1946):

The commission is the *expert body to determine what remedy is necessary* to eliminate the unfair or deceptive trade practices which have been disclosed. It has *wide latitude for judgment* and the courts will not interfere *except where the remedy selected has no reasonable relation to the unlawful practices* found to exist. *Id.* at 762 (emphasis added.)

In *Pan American World Airways, Inc. v. United States*, 371 U.S. 296 (1963), the Supreme Court noted that: "[t]he authority to mold administrative decrees is indeed like the authority of courts to frame injunctive decrees". *Id.* at 312 n. 17. The power of administrative agencies to require affirmative action is therefore very broad, limited only by Congress' intent in enacting the authorizing legislation.

The first judicial construction of section 8(b) occurred in *First National Bank of Eden v. Department of the Treasury*, 568 F.2d 610 (8th Cir. 1978), which held that a cease and desist order of the Comptroller of the Currency "can only be disturbed if it is shown to be arbitrary and capricious". *Id.* at 611. A similar result was reached in *Groos National Bank v. Comptroller of the Currency*, 573 F.2d 889 (5th Cir. 1978), where the court held:

[O]nce the Comptroller finds a violation, he may, within his allowable discretion, fashion relief in such a form as to prevent future abuses. *Id.* at 897

The Ninth Circuit in *del Junco v. Conover*, 682 F.2d 1338 (9th Cir. 1982), *cert. denied*, 103 S. Ct. 786 (1983), upheld a cease and desist order issued by the Comptroller requiring directors of a national bank to indemnify the bank for lost principal and interest on loans which exceeded the bank's legal lending limit, as well as for the bank's collection costs and attorney's fees paid by the bank for the directors' defense. Citing *del Junco*, the court held that the Comptrol-er has "broad discretion to sure the effect of a violation." *Id.* at 1340. Accordingly, it is not a function of the judiciary to second guess the supervisory need for, or the practical implications of, the prohibitions and requirements in an order and the legislative purpose and intent of the statute that enabled the agency to issue the order. *Southern Steamship Co. v. NLRB*, 316 U.S. 31 (1942).

B. Unsafe or Unsound Banking Practices

Section 8(b) of does not define "unsafe or unsound practices". However, the term "unsafe or unsound practice" has been in section 8(a) of the Act, 12 U.S.C. § 1818(a), since it was first enacted as part of the Banking Act of 1935, ch. 614, § 101(l), 49 Stat. 684, 690. In 1966, Congress enacted the Financial Institutions Supervisory Act of 1966, Pub. L. No. 89-695, § 202, 80 Stat. 1028, which amended section 8 of the Act by adding, among other things, subsection (b), under which these proceedings are brought. The legislative history of this Act shows that Congress carefully considered the phrase "unsafe or unsound". By retaining that phrase in the final legislation, Congress concluded that the term "unsafe or unsound" was sufficiently clear and definite so as to be understood by those subject to its proscription. Both the Senate and House quoted with approval from a memorandum introduced by the chairman of the Federal Home Loan Bank Board, John E. Horne, which explained the meaning of the term "unsafe or unsound" as it is used in the context of the regulation of the nation's financial institutions. (112 Cong. Rec. 24022 (bounded. Oct. 4, 1966) (House); 112 Cong. Rec. 25416 (bounded. Oct. 13, 1966) (Senate). The concept of "unsafe or unsound banking practices" was described by Chairman Horne as follows:

At the outset, it should be noted that the term "unsafe or unsound," as used in the cease and desist provisions of S. 3158, is not a novel term in banking or savings and loan parlance. The words "unsafe" or "unsound" as a basis for supervisory action appear in the banking or savings and loan laws of 38 States. For more than 30 years, "unsafe or unsound practices" have been grounds for removal under section 30 of the Banking Act of 1933, of a director or officer of a member bank of the Federal Reserve System. See 12 U.S.C. § 77. It has been grounds since 1935 for the termination of insurance of a bank insured by the Federal Deposit Insurance Corporation.

However, despite the fact that the term "unsafe or unsound practices" has been used in the statutes governing financial institutions for many years, the Board is not aware of any statute, either Federal or State, which attempt to enumerate all the specific acts which could constitute such practices. *The concept of "unsafe or unsound practices" is one of general application which touches upon the entire field of the operations of a financial institution.* For this reason, it would be

virtually impossible to attempt to catalog within a single all-inclusive or rigid definition the broad spectrum of activities which are embraced by the term. The formulation of such a definition, even though they might be highly injurious to an institution under a given set of facts or circumstances or a scheme developed by unscrupulous operators to avoid the reach of the law. Contributing to the difficulty of framing a comprehensive definition is the fact that a particular activity is not necessarily unsafe or unsound in every instance may be so when considered in the light of all relevant facts. Thus, what may be an acceptable practice for an institution with a strong reserve position, such as concentration in higher risk lending, may well be unsafe or unsound for a marginal operation. Like many other generic terms widely used in the law, such as "fraud," "negligence," "probable cause," or "good faith," the term "unsafe or unsound practices" has a central meaning which can and must be applied to constantly changing factual circumstances. 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 of loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.

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

The courts have construed this phrase, "unsafe or unsound practices", to encompass all practices contrary to accepted standards of prudent banking operation that might result in abnormal risk or loss to a bank. In *First National Bank of Eden v. Department of the Treasury*, 568 F.2d 610 (8th Cir. 1978), an action to cease and desist brought under section 8(b) of the Act, the U.S. Court of Appeals for the Eighth Circuit expressed its approval of the definition given to the phrase "unsafe or unsound" by the Comptroller of the Currency, stating: "Congress did not define unsafe and unsound banking practices in § 1818(b). However, the Comptroller suggests that these terms encompass what may be generally viewed as conduct deemed contrary to accepted standards of banking operations which might result in abnormal risk or loss to a banking institution or shareholder." *Id.* at 611.

The court in *Eden* also expressed deference to the expertise of the Comptroller of the Currency in defining what constitutes an unsafe or unsound practice. It stated that the courts could only overturn an agency's determination based on a showing of arbitrary or capricious judgment. If substantial evidence supported the agency, its determination would stand. *Id.* See also, *In re Franklin National Bank Securities Litigation*, 478 F. Supp. 210 (E.D. N.Y. 1979).

In *First National Bank of LaMarque v. Smith*, 610 F.2d 1258 (5th Cir. 1980), the Fifth Circuit Court of Appeals adopted the Comptroller's definition of "unsafe or unsound" practices affirmed by the Eighth Circuit Court of Appeals in *Eden*, *supra*. Based on deference to the Comptroller of the Currency, the court in *LaMarque*, held that payment of credit life insurance commissions to bank insiders constituted an "unsafe or unsound" banking practice. *Id.* at 1265.

In a similar case, *Independent Banker's Association of America v. Heiman*, 613 F.2d 1164 (D.C. Cir. 1979), *reh'g denied* (1980), the District of Columbia Court of Appeals considered whether the Comptroller could statutorily define a particular "unsafe or unsound" practice. In upholding the regulation, the court stated that the agencies' discretionary authority to define and eliminate "unsafe or unsound" practices is to be "liberally construed." *Id.* at 1169.

In *Groos National Bank v. Comptroller of the Currency*, 573 F.2d 889 (5th Cir. 1978), the Fifth Circuit Court of Appeals noted: "the phrase unsafe or unsound banking practice is widely used in the regulatory statutes and in case law, and one of the purposes of the banking acts is clearly to commit the progressive definition of such practices to the expertise of the appropriate agencies." *Id.* at 879. In the present case, the FDIC has determined that the practices of the Bank are unsafe and unsound, and one of the Bank's own experts agrees. (TR 1052-3).

The actions or activities that have been held to represent unsafe or unsound banking practices include:

- (i) a pattern of loans made with inadequate security (See: *Bank of Dixie v. FDIC*, 766 F.2d at 176);
- (ii) inordinate concentration of extensions of credit to one borrower and the borrower's related interests [See *id.* (extensions of credit aggregating 47 percent of bank's total equity capital); *Groos Nat'l Bank*, 573 F.2d at 896-97];
- (iii) excessive volume of low quality assets in relation to total equity capital, due to hazardous lending and lax collection practices (See *Bank of Dixie*, 766 F.2d at 176);
- (iv) excessive volume of overdue loans in relation to gross loans, due to hazardous lending and lax collection practices (See *id.* at 177);
- (v) inadequate loan policies [See *First State Bank of Wayne County v. FDIC*, 770 F.2d 81 (6th Cir. 1985)];

(vi) accumulation of an inordinate amount of unsafe assets, in relation to gross capital [See *First Nat. Bank of Eden*, 568 F.2d at 611 n. 1 (unsafe assets representing 37 percent of gross capital funds)];

(vii) failure to implement adequate internal controls and auditing procedures (See *id.*).

C. Deference to Expert Opinion

FDIC Examiners are experts for purposes of evaluating the safety and soundness of a bank. FDIC examiners receive extensive training and go through a lengthy apprenticeship. Courts have held that an FDIC examiner's unique experience leads to the conclusion that their determinations are entitled to deference and cannot be overturned unless shown to be arbitrary and capricious or outside a "zone of reasonableness". *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (11th Cir. 1986). The Court in *Sunshine* {{5-31-91 p.A-1679}} adopted, in whole, a statement by the FDIC Board of Directors on the deference that must be given to Examiners. The opinion stated:

Although there are no court opinions addressing the weight to be given examiners' loan classification, the Board's inquiry on this point is guided by several decisions addressing agency function which require similar exercises of expert judgment and informed discretion. The courts have uniformly recognized that certain types of agency judgments are not susceptible to strict "proof" because they involve the exercise of discretion, technical expertise and informed prediction about the likely course of future events. One court's explanation of the deference accorded such judgments is equally applicable to the judgments made by FDIC commissioned bank examiners in assigning loan classifications:

[T]he Commission's projection of carrier economic conditions three years into the future is a kind of agency function that the Supreme Court has recognized *to be primarily a question of probabilities, and thus peculiarly subject to the expert experience, discretion, and judgment of the Commission*. In making a predictive judgment, the expertise of the Commission supplements, and may supplant, the projections placed in the record by the parties.... *To hold otherwise would paralyze agencies merely because the future is not subject to proof*. While an agency cannot make a projection that is without any reasonable basis, the role of substantial evidence is greatly diminished.

Missouri-Kansas-Texas Railroad Co. v. United States, 632 F.2d 392, 406 (5th Cir. 1980) (emphasis added) (citations omitted). The United States Supreme Court has also consistently recognized the deference which should be afforded to judgments and predictions made by an agency within its area of special expertise. See, e.g., *Baltimore Gas & Electric Co. v. Natural Resources Defense Council, Inc.*, 462 U.S. 87, 103 S. Ct. 2046, 2256, 76 L.Ed. 2d 437 (1983); *Federal Communications Commission v. National Citizens Committee for Broadcasting*, 436 U.S. 775, 813-14, 98 S. Ct. 2096, 2121, 56 L.Ed.2d 697 (1978).

Congress has instructed this Board to "appoint examiners", and has provided that (*)[e]ach examiner shall have power to make a thorough examination of all of the affairs of the bank and its affiliates, and shall make a full and detailed report of the condition of the bank to the Corporation." 12 U.S.C. § 1820(b). After extensive training, lengthy apprenticeship and careful evaluation, FDIC examiners are appointed as "commissioned examiners", and thereby vested with authority to make informed predictions about the risk inherent in a bank's assets. This exercise of informed judgment on the part of commissioned examiners is entitled to deference, and should not be disregarded in the absence of compelling evidence that it is without rational basis. The Board does not, of course, mean to suggest that the examiners' conclusions are unreviewable. Despite their extensive training and experience, commissioned examiners are by no means infallible, and it is both necessary and appropriate that their classifications be subject to some degree of scrutiny. However, the appropriate degree of scrutiny will vary depending upon whether the ALJ is reviewing strict factual findings or discretionary decisions requiring the exercise of informed judgment.

Asset classifications are based upon objectively verifiable facts. For example, an examiner might find that a loan has been delinquent for six months; that collateral for the loan is a certain parcel of land; and that the borrower's annual salary is \$30,000. Because each of these conclusions consists of objectively verifiable facts requiring no particular training or expertise, the ALJ as fact finder is entitled to reach his own de novo conclusions as to the correctness of these underlying factual findings.

After ascertaining the relevant facts, the examiner then applies his expertise and training to those facts to reach certain conclusions about the likelihood of a particular loan being repaid. It is with respect to this second step, where certain expert inferences and judgments are made, that the

ALJ is required to defer to the examiner's expertise in reviewing the examiners' classification conclusions. The ALJ may not substitute his own subjective judgment for that of the examiner, but may set aside the

{{5-31-91 p.A-1680}}

classification if it is without objective factual basis or is shown to be arbitrary and capricious. The Board finds that in many cases the ALJ failed to meet either of these tests.

From the foregoing, it would appear that unless the Bank can clearly demonstrate that the expert opinions of the FDIC Examiners testifying at hearing are arbitrary and capricious or outside a "zone of reasonableness", then these determinations should be upheld. Here, however, the Bank submits opinions of other experts with experience and training at least equal to that of the involved FDIC examiners. Thus, I must weigh the conflicting expert testimony and make findings concerning the conclusions of the FDIC examiners especially concerning loan classifications. Stated differently, I must choose between the opinions of the experts.

D. The Banks Capital is Inadequate

The Bank has argued that because its capital level is at a level above the minimum specified in the FDIC Regulations it is adequate. 12 C.F.R. § 325.3(b) states that a minimum capital requirement for a bank "shall consist of a ratio of total capital to total assets of not less than 6 percent and a ratio of primary capital to total assets of not less than 5.5 percent." However, this is for "banks whose overall financial condition is fundamentally sound, which are well managed and which have no material or significant financial weaknesses." 12 C.F.R. § 325.3(a). The FDIC has demonstrated to the contrary, that the Bank does not meet these criteria, and a higher capital ratio is required to insure the safety of the FDIC insurance fund.

First National Bank of Scotia v. United States, 659 F.2d 1059 (2nd Cir. 1981), *cert. denied* 454 U.S. 1031 (1981) (Scotia I) concerned a cease and desist order that, *inter alia*, ordered a bank to affirmatively alter its capital position. In denying the bank's appeal, the court's unpublished opinion¹ implicitly accepted maintaining inadequate capital as an unsound practice. The court stated that the agency's discretion will only be disturbed if it is arbitrary or capricious.

The Comptroller later modified the cease and desist order in *Scotia I* decreasing the capital requirements. The Comptroller ordered the Bank to adhere to an equity capital to total asset ratio of 8 percent.

Subsequently, the bank appealed the Comptroller's modification in *First National Bank of Scotia v. United States*, 688 F.2d 815 (2nd Cir. 1981), *cert. denied* 51 U.S.L.W. 3226 (1982) ("Scotia II").

The Bank argued that similar banks had a ratio of 7.62 percent. Further, the bank stated that the Comptroller's guidelines called for a ratio of 7 percent in a well managed bank. In a second unpublished opinion, the court found that the order's 8 percent ratio "is well within the comptroller's broad authority to remedy undercapitalization resulting from unsafe and unsound bank practices."

E. The Authority of The FDIC to Issue an Order to Cease and Desist in Not Affected by a Showing the Practices Upon Which the Action was Based Have Been Discontinued or Corrected

The courts have held that the discontinuance of illicit practices or violation of law is not necessarily a defense against the issuance of a cease and desist order. This was articulated more than 20 years ago in *Clinton Watch Company v. FTC*, 291 F.2d 838 (7th Cir. 1961) *cert. denied*, 368 U.S. 952 (1962):

Voluntary *discontinuance* of an unfair trade practice *does not necessarily preclude issuance of and cease and desist order*. The order to desist from an abandoned unlawful practice is in the nature of a safeguard for the future. (Emphasis added)

In *Zale Corporation and Corrigan-Republic, Inc. v. FTC*, 473 F.2d 1317 (5th Cir. 1973), the defendant contended that it had stopped all illegal practices before issuance of a cease and desist order, thereby extinguishing the need for such order. The court, in dismissing a motion to enjoin the issuance of the order, stated:

Whether or not such practices have actually been abandoned can only be determined through

subsequent enforcement procedures. Hence, ...there is no valid assurance that if Zale were free of the Commission's restraint it would not continue its former course. *id.* at 1320.

The *Zale* court clearly recognized that an administrative cease and desist order is not only designed as a tool to stop abusive or

¹ Information on *Scotia I* and *Scotia II* is in Barnett, "Judicial Review of Agencies' Cease and Desist Orders: The Gains and Losses from Financial Institutions", 100 *Banking L.J.* 18 (1983).

[\[5-31-91 p.A-1681\]](#)unlawful practices, but also serves to deter and prevent future abuses. This concept was recognized by the court in *Montgomery Ward & Co. v. FTC*, 379 F.2d 666 (7th Cir. 1967), when it stated that "Voluntary discontinuance of a practice does not prohibit issuance of a cease and desist order, which operates prospectively." *Id.* at 672. Decisions interpreting the cease and desist powers of the National Labor Relations Board are similar in result. In *Lakeland Bus Lines, Inc. v. NLR Board*, 278 F.2d 888 (3rd Cir. 1960), the NLRB concluded that unfair labor practices were being committed by Lakeland and sought to issue a cease and desist order. Lakeland argued that since it had discontinued the practices as issue, there was no longer a basis for the issuance of an order. The *Lakeland* court dismissed the argument, stating:

Authority thoroughly establishes that *Compliance itself is not sufficient to deprive the Board of its right to secure enforcement to make sure that repetition of the unfair labor practice does not occur in the future.* (*Id.* at 891-91; emphasis added).

In *NLRB v. Globe-Wernicke Systems Company*, 336 F.2d 589 (6th Cir. 1964), Globe-Wernicke argued that a cease and desist order could not be issued since the company had abandoned the labor practices in question and that the need for an order was mooted. The court disagreed:

...[I]t is well settled that *compliance with an order of the Board is no defense to the entry of an order of enforcement. Abandonment of an unfair labor practice does not cause the controversy to become moot.* *Id.* at 590; emphasis added.)

In a deceptive advertising case, *Beneficial Corp. v. FTC*, 542 F.2d 611 (3rd Cir. 1976), *cert. denied*, 430 U.S. 983 (1977), the court affirmed the power of the Federal Trade Commission to issue a cease and desist order notwithstanding discontinuance that occurred *prior* to agency action:

It [petitioner] contends, however, that because the early text was soon abandoned with no prompting from the Commission, the finding cannot support a cease and desist order. But *this and other courts have held that at least practice may be the subject of a cease and desist order.* *Id.* at 612 (emphasis added).

The issue was considered by the U.S. Court of Appeals for the Fifth Circuit in *Bank of Dixie v. FDIC*, 776 F.2d 175 (5th Cir. 1985). In that case the Bank of Dixie appealed the issuance of a final order to cease and desist issued by the FDIC on the grounds, *inter alia*, that the FDIC failed to consider evidence of improvements made by that bank in its operating procedures. The Court rejected that contention and, citing the *Zale* case, rules that a cease and desist order is necessary to assure the FDIC that the bank will not resume the unsafe or unsound banking practices established. *Id.* at 8. See also, *First State Bank of Wayne County v. FDIC*, 770 F.2d 81 (6th Cir. 1985); *Diener's, Inc v. FTC*, 494 F.2d 1132 (D.C. Cir. 1974).

In other cases, the FDIC Board of Directors has determined that mere cessation of wrongdoing by itself will not bar the issuance of an order addressing future misconduct. In FDIC-84-100b, 1 P-H FDIC Enf. Dec. 6281 (1985), the Board noted that: "Even if the Bank could establish that the unsafe or unsound practices cited in the notice had ceased, the FDIC would still be justified in issuing a cease and desist order based on unsafe or unsound practices that existed at the time of the examination. Such an order is an appropriate instrument to deter and prevent future abuses...." *Id.* at 6293.

The FDIC Board of Directors reaffirmed the principle in FDIC-85-42b, 2 P-H FDIC Enf. Dec. 6593 (1986): "the case law... uniformly states that correction of deficiencies is not a defense to a Cease and Desist Order". *Id.* at 6603.

Similarly, the Bank has argued in this proceeding that it has ceased the practices and violations cited in the May 26, 1989 FDIC Examination and, thus, there is no need for a corrective order. The corrective program, was undertaken partially as a result of the issuance of the Notice and there is inadequate assurance that the corrective program will continue. The FDIC has no way of sufficiently verifying the corrective action, except through another examination of the Bank. In fact, the Bank's own witness, Larry Michael Hillyard, from the Arkansas State Banking Department testifies that as of June 18, 1990 the

Bank's asset quality is still alarming despite the corrective program. (TR 1052-3).

The Respondent has argued that because it was taking corrective action at the time of [{{5-31-91 p.A-1682}}](#) the issuance of the Notice and continues to make corrections, an order to cease and desist should not be issued. It points to regulation 308.38, 12 C.F.R. § 308.38, and the language in (a)(3) which states that "evidence concerning any act or event occurring after the date of the Notice may be admitted only for the express and limited purpose of assisting the administrative law judge in fashioning an order" as supporting its argument. As noted, the cessation of unsafe or unsound practices or violations does not mean necessarily that an order will not issue. Indeed, the cited regulation only addresses the remedy and states that the administrative law judge may consider post Notice evidence is relevant to whether an Order should issue. The ALJ therefore, must first determine that an Order is likely or potentially should be issued before consideration can be given to the question of admissibility of post Notice evidence. Once a determination has been made that a cease and desist Order is in the offing and may well be issued, post Notice evidence then may be admitted. However, the evidence may be used only for the purpose of fashioning the Order.

The comments and discussion which accompanied the December 22, 1988 revision of 12 C.F.R. Part 308 clearly support the proposition that evidence is to be admitted up to the date of the Notice for the purpose of determining whether there is a Bank violation or unsafe practice; and that evidence arising subsequent to the Notice is to be admitted for the express limited purpose of fashioning a remedy:

First, by limiting the admissibility of evidence to prove the fact of a Violation or Practice to evidence which occurred up to the date of the Notice, the modified rule will provide a time frame for the demarcation of facts relevant to proving the Violation or the Practice. Second, by requiring that the administrative law judge make a specific finding that evidence subsequent to the date of the Notice is necessary to fashion a remedy, the regulation will prevent the record from being cluttered with immaterial and irrelevant evidence concerning the fact of the Violation or Practice.

Thus, except for the terms of a remedial cease and desist Order, the scope of this proceeding is the condition of the Bank as of the December 11, 1989 date of the Notice with particular focus upon the FDIC's examination of the Bank as of May 26, 1989. In this regard, the Notice cites circumstances extant solely as of this latter date. The FDIC itself is bound basically to the scope of the Notice except as it may seek to rebut evidence of the Bank. The Bank in turn may submit evidence "up to the date of the Notice" relative to "the fact of a Violation". Thereafter, evidence is limited to that "necessary to fashion a remedy."

Section 8(b)(1) provides, in part, that:

If, in the opinion of the appropriate Federal banking agency (in this case, the FDIC), any insured depository institution, ...is engaging *or has engaged*, ... in an unsafe or unsound practice in conducting the business of such depository institution, or is violating *or has violated*, ...a law, rule or regulation, ...the agency may issue and serve upon the depository institution...a notice of charges in respect thereof. (Emphasis added.)

Section 8(b) also provides that:

...if upon the record made at any such hearing, the agency shall find that any violation or unsafe or unsound practice specified in the notice of charges has been established, the agency may issue and serve upon the depository institution... an order to cease and desist from such violation or practice. Such order may, by provisions which may be mandatory or otherwise require the depository institution...to cease and desist from the same, and, further, to take affirmative action to correct the conditions resulting from any such violation or practice. (Emphasis added.)

The statutory language of section 8(b)(1) alternatively is worded in the *past perfect* tense and does not require proof of ongoing practices or conditions. Section 8(b)(1) expressly encompasses unsafe or unsound practices and violations of law which have previously occurred. Consequently, there need not be an unsafe or unsound practice or violation occurring at the time of issuance of a Notice of Charges and of Hearing by the FDIC, nor at the time of the administrative hearing. The FDIC has the burden of establishing unsafe or unsound practices and violations as specified in the Notice or Charges. In this regard, the basic scope of the FDIC "case-in-chief is determined by the contents of the Notice, and evidence relating to conditions or events occurring after the date of Notice are not at issue except in [{{5-31-91 p.A-1683}}](#) fashioning an Order. Since the statute provides that the Order may require the bank to cease and desist from such violations and practices and take affirmative action to correct the conditions resulting therefrom, the mere fact that these practices or violations have been discontinued or that conditions have improved subsequent to the examination or the Notice should not preclude the issuance of the Order.

In summary, this proceeding is concerned essentially with an assessment of the Bank's condition resulting from an examination conducted by a team of FDIC examiners who were in the Bank, examined its records, and discussed their findings with its management and personnel during the period of the examination. The Bank participated in the examination process and received a written report of that examination at its conclusion. There can be no claim of unfairness or surprise as to any matters encompassed by such examination. See FDIC-85-42b, 2 P-H FDIC Enf. Dec 6593, p. 6603 (1986). Nonetheless, it is clear that the Bank had difficulties prior to the emergence several years ago of current management. Therefore, in assessing current management, it is important in crafting an Order to know whether under that management there has been a continual remedial trend at the Bank.

F. THE LOAN CLASSIFICATION CONTENTIONS OF RESPONDENT

Respondent files twelve proposed findings of fact. Proposed Finding of Fact #1, which is some 26 pages in length, states that the Bank of Salem's classified assets are less than \$2,453,000.

Respondent states that the examiners who prepared the May 26, 1989 Report of Examination negligently or willfully failed to determine and/or document sources of repayment, negligently or willfully failed to determine managements intentions, and "frequently" failed to estimate collateral coverage. The basis for these statements essentially is the expert testimony of former FDIC examiners Joel McLemore and Edwin Burr. These former examiners are indeed experts. At the same time, Joel McLemore is a law clerk for the law firm defending the Respondent and an employee of the Bank consulting firm owned by the same principal as the law firm (TR 857). Mr. McLemore last was a FDIC examiner in 1986. (TR 858).

Mr. Edwin Burr, a former high-ranking FDIC official, testifies that the last time he examined a bank as an Examiner-in-Charge was 1972. (TR 951). Mr. Burr did not review the Bank's files in order to provide his assessment of the examination report. (TR 937-942). His testimony is based upon FDIC examination reports and underlying notes and Respondent's Exhibit 59 prepared by Mr. McLemore. (TR 934-938). Mr. Burr has no knowledge of what is in the Bank's files and he has no fully independent basis to testify that there were errors or omissions in the Examiner-in-Charge's write-up of the classified loans.

Respondent states that David Larry Bowen, Senior Examination Specialist for the FDIC, discussed the nature of the errors at length. (Page 3 of Respondent's *Proposed Findings of Fact*). Mr. Bowen was asked a series of hypothetical questions concerning his opinion of whether certain items could be material. Mr. Bowen does not testify that there were material errors in the Report of Examination. Mr. Bowen testifies that the loan classifications were adequately supported, and that he concurs in the findings of the Report and this his only concern is a high probability of future deterioration in the Bank's loans. (TR 1042).

Respondent attempts to show that a number of loans were improperly classified and states that the errors by the examiners were outside a "zone of reasonableness" and that the classifications were without factual basis or were arbitrary or capricious and thus could be set aside under *Sunshine* case. *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (11th Cir. 1986). The Respondent, however, fails to show a basis for setting aside the classifications in the Report of Examination.

Respondent, in its post-hearing brief, states that Mr. Court reveals his "arrogation of authority" at transcript pages 150 through 153, where the examiner "advised the hearing that the FDIC Memphis Regional Office has overruled the FDIC Washington policies". (p. 7 of Respondent's Post-Hearing Brief). This is not correct. What Mr. Court stated is that the Memphis Regional Office could shortcut some of the procedures for writing-up the loan classification. (TR 150-153).

Respondent, also, states in its Post-Hearing Brief that there is the examiner clas- [{{5-31-91 p.A-1684}}](#)sified a loan Substandard, he is injuring the bank customer by branding him as less than credit worthy. This is not the case. The Report of Examination is confidential and not open to public inspection.

Respondent attacks 23 credits classified by the FDIC. The basis for the Respondent's position is contained in Respondent's Exhibit 59, a chart by Mr. McLemore helped prepare and on which Mr. Burr based his testimony without consulting the Bank's files (TR 937-942). Mr. McLemore, who is employed by Respondent's counsel as a law clerk and consultant, examined the Bank's files some five months after the date of the Report of Examination (TR 905). He testified that he had incomplete knowledge as to how the FDIC's review was conducted. (TR 905).

The loans Respondent contends should not be classified as are follows:

1) ***—Respondent states that the *** loan was misclassified because the examiner failed to account for liquidity in the borrowers' financial statement and erroneously analyzed borrowers' income stream. The basis for this statement is cited as RESP. Ex. 49, the examiners line sheet on the *** credit, and the borrowers' nonsalary sources of income" which were omitted for "expediency".

The record reveals that the borrowers January 31, 1989 financial statement is in the loan write-up and that it was not typed out *line by line* for expediency. [TR 164, FDIC Ex. 1 (p. 2-b-19)]. A large part of ***s

past income was attributable to his employment and at the time of the examination he was unemployed. [TR 163–164; FDIC Ex. 1 (p.2-b-19)]. The examiner did consider ***'s nonsalary sources of income. (TR. 166). The classification of the *** loan is documented by the facts in the write-up contained in the FDIC Report of Examination

2) ***—Respondent claims the *** loan should not have been classified since the examiner failed to identify and analyze the source of repayment of the credit. The Report of Examination reveals that the loan was overdue, the value of the collateral was unsubstantiated, a lack of liquidity was demonstrated in the borrower's financial statement, and there was lack of financial information on the borrower's company in the Bank's file. [FDIC Ex. 1 (p.2-b-25)]. All of the foregoing are sufficient reasons to classify the loan. Respondent's own witness, Frank Burge, testified that the borrower had run into problems finishing the building and was receiving no lease payments. (TR 635). Mr. Court testified that the only financial information available at the time of the examination on *** was a financial statement dated June 15, 1988 (TR 183). Further, Respondent misstates that FDIC review personnel concede that the financial condition of the tenant was a material omission. What Mr. Bowen stated was that it could be a pertinent factor, but he did not state there was an omission. (TR 1028).

3) ***—Respondent alleges the examiner's classification conceals the nature of the borrower's assets. The basis for this statement is the fact that the examiner did not indicate a value of the closely held bank stock owned by the borrower in his writeup. Mr Bowen testified that information was available on "larger financial institutions" (TR 1029), not that the examiner should have obtained a value for the stock. The Report of Examination clearly states that the loan was classified because of prior performance and lack of adequate financial information. [FDIC Ex. 1 (p. 2-b-21)].

4) ***—It is alleged by Respondent that the collateral in the *** loan had a significantly higher value than the one reflected in the Report of Examination and that the examiner failed to analyze the borrower's financial condition. FDIC Exhibit 1 reveals that the real estate loan was classified because *** performance on the loan was unsatisfactory, it was a real estate loan representing a loan to value of 100% of the collateral and the borrower's ability to service his indebtedness was questionable. [(FDIC Ex. 1 (p. 2-b-17))].

5) ***—Respondent claims the *** loan was misclassified because the examiner "manufactured" deficiencies. What the report of Examination reveals is that because of a lack of interest on the part of businesses to establish locations in the *** and the questionable collateral value a Substandard classification is continued." [FDIC Ex. 1 (p. 2-b-26)]. Respondent's Exhibit 59 also reveals that the balance sheet and income statement now in file, an indication that such was not in the file at the time of the examination.

6) ***—The classification of the *** loan is attacked as being without a discussion of source of repayment and for failing to note the borrowers \$125,000 income. [{{5-31-91 p.A-1685}}](#) However, Mr. Court testified that there was no income information in the bank's files. (TR 203). The Report of Examination reveals that the loan was classified because: The borrower's personal statement was inaccurate, as well as being unsigned and containing questionable values, no income information was present to substantiate repayment, and funds had been advanced to pay interest. [FDIC Ex. 1 (p. 2-b-28)].

7) ***—Respondent states that the loan to *** was incorrectly classified because the examiner selectively misanalyzed the borrower's income statement and failed to estimate collateral value. Mr. Court testified that there was no appraisal of the collateral (TR. 208) and that the business was operating at a loss (TR 210).

Respondent's again misstates that Mr. Bowen acknowledged the "materiality of the omissions". Mr. Bowen stated that it would be material to know the borrowers income and management plan concerning the credit (TR 1035), not that there was a material omission.

8) ***—Issue is taken with the *** credit because allegedly the examiners failed to report cash flow of the business and failed to estimate collateral values. Mr. Court testified that the staff attempted to obtain collateral values. (TR 233). The loan was classified because performance on the extension of credit was regarded as less than satisfactory as indicated by the number of renewals and payment extensions, as well as the insolvent financial positions of the business, deteriorating financial trends and questionable ability to generate sufficient cash flow to service the increased amount of debt. [FDIC Ex. 1 (p. 2-b-20)]. These latter reasons for classifying the loans were never addressed by the Respondent.

9) ***—Respondent states that examiner failed to identify any distinct possibility that bank will sustain some loss as required in a loan classified Substandard. Substandard loans "are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected". (TR 140). The Report of Examination reveals that the performance on the credit was not in line with the dividend payment received by the borrower and that the value of the stock pledged to secure the debt was considerably less than the loan amount. The Report of Examination also notes the lack of marketability of

the unlisted stock. [FDIC Ex. 1 (p. 2-b-5)]. Mr. Court testified that the presence of the divided income was considered and for this reason a more severe classification was not assigned. (TR 226–227). Respondent claims that Mr. Court did not consider the adequacy of the dividend because he didn't calculate it. However, the write-up contains a per share dividend figure and the number of shares are duly noted. (TR 227).

10) ***—Respondent, in the case of the *** loan misstates the definition of a Substandard loan. The Report of Examination reveals that "a definite workout situation appears to exist" as evidenced by capitalization of interest, additional funds being advanced and questionable protection offered by stock having a value of \$292,000 pledged for gross debts of \$751,000. [FDIC Ex. 1 (p. 2-b-14)].

11) ***—The classification of *** loan is also challenged and once again the definition of a Substandard loan is misstated. Respondent also alleges bias on the part of the FDIC Examiners, but the record is void of showing of bias. The Report of Examination reveals that the loan was classified because of the assets were centered in unsupported real estate values, questionable performance, and lack of collateral protection. [FDIC Ex. 1 (p. 2-b-24)].

12) ***—The reason for the examiner's classifying this credit is inadequate performance, lack of proper documentation, questionable collateral protection and unwarranted unsecured lending. The examiner's write-up reveals that one of the loans 142.75% of appraised value. In another, the security was a second mortgage on real estate with the first lien being unknown.

The Respondent criticizes the assessment of the examiner by stating he did not cite and particular deficiency in the performance. The Report of Examination states that the line of credit was previously classified Substandard for static performance and an increase in unsecured lending. The amount classified represents the total of twelve notes the borrower had outstanding.

The Report of Examination reveals that \$26,078 represents the balance of \$32,500 note dated 02-12-87 and extended four times, that \$11,550 represents the balance of a renewal note to purchase an automobile, and that of seven secured notes totaling {{5-31-91 p.A-1686}}\$27,988 only two had slight reductions. [FDIC Ex. 1 (p. 2-b-23)].

Respondent alleges the examiner reveals "some bias" about the individual which clouded his analysis of the borrower's income capacity, but fails to support this statement with a reference to any document or testimony that demonstrates bias.

13) ***—Respondent alleges the writeup to support the Substandard classification of the *** loan in deficient on its face. The write-up states the loan is classified because of a lack of documentation and the condition of the principals' personal debt line [FDIC Ex. 1 (p. 2-b-24)].

14) ***—This loan classification is criticized because the examiner "failed to estimate collateral value and failed to document management's plans on the debt". The record demonstrates that management had no plans and that there was no indication of value of the pledged collateral in the Bank's file. (TR 246). The report of Examination reveals that the loan was classified because of pronounced weaknesses in the credit. These weaknesses included: Lack of profitability, the highly leveraged position of the business, the need of the Bank to reduce payments before maturity, extension of the amortization period, and the unproven ability of guarantors to adequately service the debt. [FDIC Ex. 1 (p. 2-b-16)].

15) ***—The loan write-up is criticized by the Respondent as having the same deficiencies as the *** loan, a failure to estimate collateral values and to document management's plan. The same reasons for classifying the *** loan also apply to *** loan.

16) ***—\$264,000 was classified as Substandard because it involved a renewal of a debt of questionable collectability, capitalization of interest, highly leveraged position of the borrowers, as well as the pledged collateral offering questionable protection. [FDIC Ex. 1 (p. 2-b-4)]. Respondent states the classification is unwarranted because of a failure to analyze the collateral and to ask management its plan but fails to show the collateral was improperly analyzed or that management had a plan as to the credit.

17) ***—Respondent also questions the Substandard classification of the loans to ***. The allegations are failure to determine source of repayment, and failure to ascertain management's plan as to the debt. FDIC Report of Examination documents the reason for the classifications. In the case of *** the extension of credit was for speculative real estate purposes and was handled in an unsatisfactory manner in regard to debt service and documentation. [FDIC Ex. 1 (p. 2-b-1)].

18) ***—This loan was classified because of questionable protection of the collateral, questionable ability of borrower to service debt, highly leveraged position of borrower, and the failure of the Bank to identify sources of repayment. [FDIC Ex. 1 (p. 2-b-18)].

19) ***—Respondent states that the *** loan should not have been classified because the examiner failed to note the borrower contributed \$500,000 in cash for the venture, failed to note the source of repayment, and did not ask what was management's plan as to the credit. Respondent cites a chart (Resp. Ex 59) as the basis that the line sheets reveal the borrower's cash equity. There is no firm

evidence that borrowers contributed \$500,000 in cash equity. The Report of Examination states that the partners' equity is \$781,200 [FDIC Ex. 1 (p. 2-b-13)], but this could result from factors other than a cash infusion. There is no testimony in the record that there was a source of repayment noted in the Bank's file or that management had a plan. Frank Burge, President of the Bank, admitted that there were write-offs in the *** loan. (TR 725).

20) ***—This loan had inadequate collateral, was overdue, and lacked financial information. [FDIC Ex. 1 (p. 2-b)].

21) ***—This credit classification is criticized by Respondent for failure to analyze the capacity to repay the debt, "probably" miscalculation of the consideration for the acquisition of the property, and failure to address the reasonableness of the appraisal. The Report of Examination reveals that the Bank's files contained an appraisal prepared for the borrower, not the bank, and the loan was 128.67% of the cost of the real estate. Also, one of the loans is a nominee loan for the benefit of an individual Chapter 7 bankruptcy. [FDIC Ex. 1 (pgs. 2-b-9, 2-b-10)].

22) ***—This loan classification is criticized for the failure of the examiner to analyze the financial statement of one of the guarantors. The write-up reveals that the weaknesses were numerous and entailed inadequate performance, lack of adequate tangible collateral, an unsuccessful business venture, and questionable ability of debtor and {{5-31-91 p.A-1687}} guarantors to service the debt. There also existed \$25,052 of uncollected income on the debt which was classified Loss. [FDIC Ex. 1 (p. 3-b-1)].

23) ***—Respondents criticizes this classification for failure of the examiner to analyze the collateral value and to ask management for its plan. The record reveals that the unsecured loan was classified for failure to have adequate financial documentation and failure to meet the repayment schedule. [FDIC Ex. 1 (p. 2-b-29)].

The Respondent has failed to demonstrate that the FDIC Examiners' expert determinations are erroneous. The classifications are sufficiently supported by the facts and the FDIC examiners' conclusions appear slightly better founded than those of the Bank's experts.

However, respondent does show that, as of May 1990, many of the classified loans were current.

Respondent shows as follows concerning 23 of FDIC classified loans:

1] ***—The line has been reduced by \$103,000, or approximately 64%, within the twelve [12] months preceding May, and the line is presently amortizing with a current financial statement in the file. (RESP. Ex. 58 and TR. 634.)

2] ***—The loan is monthly amortizing, all technical exceptions have been corrected, the customer has paid down at least 10% of the outstanding principal balance since May, 1989 and the loan is current. (RESP. Ex. 59 and TR. 638.)

3] ***—The loan is monthly amortizing, all technical exceptions have been corrected, the customer has paid down at least 10% of the outstanding principal balance since May, 1989 and the loan is current. (RESP. Ex. 59 and TR. 638.)

4] ***—The loan is current. Respondent Bank of Salem has added more collateral to the line, and has received a statement from the personnel department of ***'s employer showing that *** has an excess of \$400,000 in liquid funds presently in his pension account. (RESP. Ex. 59 and TR. 640.)

5] ***—the loan is current with interest paid monthly. Bank of Salem has obtained additional financial information, balance sheets, income statement, and other information. The borrower currently has in process an application for \$300,000 grant from the Farmer's Home Administration for the installation of new water and sewer line on the collateral property. (RESP. Ex. 59 and TR. 650.)

6] ***—The loan is current and monthly amortizing. (RESP. Ex. 59 and TR. 655.)

7] ***—The loan is current and monthly amortizing has never been delinquent. There is a third party appraisal on real property. (RESP. Ex. 59 and TR. 658.)

8] ***—The loan is current, monthly amortizing, and have never been delinquent. (RESP. Ex. 59 and TR. 660.)

9] ***—The loan is current and has been reduced by \$30,000. The bank has obtained 1989 income statement from the borrower showing total income of \$1,300,000. (RESP. Ex. 59 and TR. 662.)

10] ***—The loan is current and the debtor has reduced principal by 17%. (RESP. Ex. 59 and TR. 665.)

11] ***—The loan is current. The debtor made a very large reduction between May, 1989 and May, 1990 of approximately \$73,000, which is over 65% of the outstanding principal. Further, the debtor pays monthly on principal and interest. (RESP. Ex. 59 and TR. 667.)

12] ***—The loan has been paid in full except for \$3,000. (RESP. Ex. 59 TR. 669.)

13] ***—The loan has paid in full. (RESP. Ex. 59 and TR. 668.)

14] ***—The loan has been paid in full. (RESP. Ex. 59 and TR. 671.)

15] ***—The loan is current. Respondent has obtained an outside executive in the debtor's industry to provide a third party appraisal of the collateral property using various appraisal approaches. (RESP. Ex.

59 and TR 672.)

16] * * *—The Loan is current and monthly amortizing. (RESP. Ex. 59 and TR. 673.)

17] * * *—loan has been paid in full, the * * * loan is on current monthly payments, and the * * * loan is a current monthly payment basis. (RESP. Ex. 59 and TR. 675.)

18] * * *—Interest is current on the loan, and the borrower is in the process of moving his debt to another financial institution by obtaining take-out financing. (RESP. Ex. 59 and TR. 676–677.)

19] * * *—The line is current and has ~~{5-31-91 p.A-1688}~~ been reworked. (RESEP. Ex. 59 and TR. 682.)

20] * * *—The loan is current and has received a principal reduction of approximately \$100,000, or 66% of the outstanding balance. (RESP. Ex. 59 and TR. 683.)

21] * * *—The loan has been paid down by approximately 81%, to approximately \$53,000. New collateral has been received in the form of 5 acres of land and a grain storage facility. The collateral is insured, and the line is current. (RESP. Ex. 59 and TR. 684.)

22] * * *—The loan is current, guarantors are making annual principal reductions. (RESP. Ex. 59 and TR. 687.)

23] * * *—This line is paid in full. (RESP. Ex. 59 and TR. 688.)

The classification of a loan is not improper simply because it ultimately is paid in full and there is no default. The definition of Substandard, under which the above loans were classified, states in part, that "they are characterized by the distinct possibility that the bank *will sustain some loss if deficiencies are not corrected.*" A loan can be current and still be classified. *Bank of Dixie v. FDIC*, 776 F.2d 175 (5th Cir. 1985).

**G. CONTENTIONS OF RESPONDENT
RELATING TO CHAIRMAN RICHARD
SMITH'S COLLECTION OF FUNDS
FROM LOANS TO THIRD PARTIES FOR
HIS PERSONAL BENEFIT**

Respondent characterizes the payment of funds to Chairman Richard Smith as "incentive compensation". The record, however, is devoid of any testimony that such a plan was ever approved or that the board of directors were aware of such a plan.

The only creditable testimony on the diversion of funds from the * * * transactions came from Mr. Court, Examiner-in-Charge of the May 26, 1989 examination. None of the witnesses for the Respondent explained why the borrowers paid Mr. Smith the fees and not the Bank.

It is obvious that if the Chairman of a bank states that he will obtain a loan for a potential borrower but it will cost him a fee (TR 99), that this is a breach of his fiduciary duty. This is also an unsafe and unsound banking practice. Chairman Smith in his capacity as the Chief Executive Officer of the Bank, and through his control of Respondent, can influence the decision to grant an individual a loan. He did so in the four transactions enumerated and he did so for his own personal gain at the expense of the Bank. The "incentive compensation" should have been paid to the Bank, not Chairman Smith.

The recent decision in *Hoffman v. FDIC*, No. 89–20466, slip op. (11th Cir. 1990), points out that "[s]elf dealing has been identified as an unsafe or unsound practice because of the conflict it creates between the interests of the institution and the interests of the individual". *Id.* at 10230. The Court also cited *First National bank of Lamarque v. Smith*, 610 F.2d 1258, 1265 (5th Cir. 1980); *Independent Bankers Association of America v. Herimann*, 613 F.2d 1164, 1168 (D.C. Cir. 1979), *cert denied*, 449 U.S. 823 (1980), for the "principle that breaches of fiduciary duty by bank officials are inherently dangerous and cannot be considered safe". *Id.* at 10230-31.

**H. CONTENTIONS OF RESPONDENT
THAT ARE * * * AND * * *
TRANSACTIONS DID NOT RESULT IN
FALSE AND MISLEADING REPORTS OF
BANK CONDITION AND INCOME**

Respondent seeks to characterize these two transactions as fully documented and as well argues that they did not result in "material" misstatements of the Bank of Salem's condition. This is incorrect, even though the basic transactions were innocent in purpose. Mr. Court's testimony shows that the * * * and the * * * transactions concealed the true income of the Bank, and caused it to file false Reports of Income and Condition (TR. 57 & 92).

Respondents expert, Richard Muse testified that if the transactions had been properly reported the results would be as the FDIC Examiner-in-Charge, Jack Court, related in his testimony. (TR 915). In fact,

Mr. Muse admitted that the Respondent amended its Reports of Condition and Income to reflect Mr. Court's criticism of these transactions. (TR 913).

Mr. Frank Burge, President of the Bank of Salem, admitted that the * * * and * * * transactions were the only nonrecourse loans ever made by the bank; that the notes and mortgages were typical recourse instruments; and there was nothing in the records of the Bank to indicate the true nature of the transactions. (TR 730–731). Mr. Burge testified that, if one were to examine the records [{{5-31-91 p.A-1689}}](#) of the Bank, one would believe the transactions to be recourse in nature. (TR 731).

*I. RESPONDENT'S CONTENTIONS
THAT THE CONCENTRATIONS OF
CREDIT WERE NOT UNSAFE AND
UN SOUND BANKING PRACTICES*

Respondent attempts to mitigate the nature of the concentrations of credit to * * * and its related interest and to * * * and his related interests by pointing out that concentrations are not automatically a subject of criticism. However, in the present situation the concentrations were determined to be unsafe and unsound banking practices. The testimony of Mr. Court explains as follows:

Q. And why — Why are they unsafe and unsound?

A. When you have this much dollar volume of loans or related assets vested ...vested in assets that are highly dependent upon...* * * if something would go wrong with * * * we're saying that 30.03% of the Bank's capital account could be lost just based on these loans with * * *. And the same is true with loans to * * * Associates.

We've got loans on different projects with * * * but we've still got the same individual involved. And we've learned from numerous examinations that when an individual experiences problems in one project a lot of time it tends to flow over to other projects.

So loans to * * * and his related interests which equals 61.32% of the total equity capital and reserves has that possible exposure to the Bank's capital accounts. (TR 114).

*J. THE EXTENSIONS OF CREDIT TO
DIRECTOR PLUMLEE INVOLVED
MORE THAN A NORMAL RISK OF
REPAYMENT*

Respondent argues that the extensions of credit to Director Dwayne Plumlee did not involve more than a normal risk of repayment or other unfavorable features because they were placed on a long term FHA loan basis, he reduced it to \$70,000, and the loans were reviewed by the State of Arkansas in 1986 and 1988 and were not adversely classified.

Mr. Court, the Examiner-in-Charge, testified that in the May 26, 1989 examination of the Bank, Directors Plumlee's loans were Substandard because of inadequate performance, lack of proper documentation, questionable collateral protection, and the question of whether Director Plumlee was warranted unsecured lending. (TR 119). The Respondent has introduced insufficient evidence that Mr. Court's analysis was incorrect.

*K. RESPONDENT'S CONTENTIONS
THAT THE OVERDRAFTS TO
RESPONDENTS OFFICERS AND
DIRECTORS DO NOT CONSTITUTE
VIOLATIONS OF SECTION 215.4(D) OF
REGULATION O.*

Respondent correctly points out that the five directors and officers, Cochran, Atkins, Baines, Keesee and Montgomery, has preapproved lines of credit and that they eventually paid overdraft fees. Each of the overdrafts was in excess of \$1,000 and each constitutes a violation of Section 215.4(d) of Regulation O of the Board of Governors of the Federal Reserve System, 12 C.F.R. § 215.4(d), made applicable to State nonmember banks by Section 18(j)(2) of the Federal Deposit Insurance Act, 12 U.S.C. § 1828(j)(2). The fact that the Bank had preapproved lines of credit to its officers and directors, is not sufficient to avoid a violation of § 215.4(d) of Regulation O. The fact that the overdrafts occurred is the violation.

Section 215.4(d), 12 C.F.R. § 215.4(d), states, in part:

No member bank may pay an overdraft of an executive officer or director of the Bank on an account at the bank, unless the payment of funds is made in accordance with (1) a written,

preauthorized, interestbearing extension of credit plan that specifies a method of repayment or (2) a written, preauthorized transfer of funds from another account of the account holder at the Bank....

There was no showing by the Respondent that payments of the overdrafts were from a written, preauthorized, interest bearing extension of credit or was a written, preauthorized transfer of funds from another account of the officer or director. The Respondent merely states that the overdrafts were eventually paid. This is not sufficient to avoid a violation of section 214.5(d) of Regulation O.

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*L. RESPONDENT'S CONTENTION THAT
CHAIRMAN SMITH DID NOT FAIL TO
DISCLOSE HIS RELATED INTEREST IN
FLYING STAR, INC.*

Respondent presents the argument that Chairman Richard Smith's interest in Flying Star, Inc., a company which he wholly owned, was disclosed because there existed in the Bank's file a lease agreement between Flying Star, Inc. and the Bank. Respondent admits the lease was signed by an employee of Smith Associated Banking Corporation, another wholly owned corporation of Chairman Smith. (TR 123; FDIC Ex. 50).

Respondent fails to point out that the Bank had a disclosure form for related interests, that Chairman Smith had submitted one, and that the form did not list Flying Star, Inc. as a related interest. (TR 122-23). 12 C.F.R. § 215.7 requires that all executive officers, directors, and principal shareholders shall identify annually their related interests. Chairman Smith failed to do this and provided the Bank with a false statement.

*M. RESPONDENT'S CONTENTIONS
RELATIVE TO FUTURE EVENTS*

The Respondent makes the argument that because the FDIC Notice of Charges and of Hearing makes no mention of future violations, the FDIC has not determined that the Bank of Salem is likely to commit "such future alleged violations".

Section 8(b) of the Federal Deposit Insurance Act, 12 U.S.C. § 1818(b), states, in pertinent part:

"if, in the opinion of the appropriate banking agency, any insured depository institution which has unsecured deposits... *is engaging or has engaged*, or the agency had reasonable cause to believe that the depository institution...is about to engage, in an unsafe or unsound practice in conducting the business of such depository institution..."

The FDIC brought this action against the Bank because of the unsafe and unsound practices and violations of law enumerated in the "Notice." The statute provides that the basis for bringing an 8(b) action may be either past, present, or future unsafe and unsound practices or violations of law. The statute does not require allegations that the Bank is about to engage in unsafe or unsound practices or violations, when past and present unsafe or unsound practices and violations of law are substantiated.

Further, Respondent's corrective actions do not preclude the FDIC from obtaining an order to cease and desist. The *Bank of Dixie v. FDIC*, 776 F.2d 175 (5th Cir. 1985), the Bank argued that the Board of Directors of the FDIC erred in its decision by failing to consider evidence of improvements. The court disagreed and stated:

Determination of whether the offensive practices have actually been abandoned by the Bank is appropriately made through subsequent enforcement proceedings. *Zale Corp. v. F.T.C.*, 473 F.2d 1317, 1320 (5th Cir. 1973). Without its Cease and Desist Order, the FDIC has "no valid assurance that if [the Bank] were free of the [FDIC's] restraint it would not continue its former course". *Id.*, See also, *First National Bank v. Comptroller*, 697 F.2d 674, 683 (5th Cir. 1983). Comptroller has discretion to enter Cease and Desist Order even through under a subsequent amendment to the statute the same conduct will no longer be a violation). *Id.* at 178

*ENTRY OF A CEASE AND DESIST
ORDER*

The Bank establishes that there are improvements in its condition. The evidence, not rebutted by FDIC, shows several favorable circumstances concerning the Bank. For example, Bank of Salem's capital to

assets ratio equals or exceeds 7%. The Bank's capital account experiences some fluctuation based upon earnings, losses, and other events which have an impact in the institution. As of April 30, 1990, the Bank had \$3,914,000 in capital, which yielded a capital to assets ratio of 7.72%. (TR. 697.) As of July 2, 1990, the Bank had a capital to average adjusted assets ratio of 6.95%. (TR. 1052.) Finally, even though the Bank's loan loss reserve as of March 26, 1989 was \$423,000 (Joint Stipulation #14) as of April 30, the Bank's loan loss reserve was \$778,000.

The noted improvements in the Bank's condition are important.

The recent improvements establish that present management, having reduced the capital or equity of the Bank through dividends, finally is responsive to the requirements of the FDIC. The Order to be entered will have a dividend restriction. For this important reason and also because of the recent improvements in the Bank's condition, modifications of the "Cease and Desist" order proposed by the FDIC are vital. The basic [{{5-31-91 p.A-1691}}](#) needed change is that because Respondent is close to present compliance with FDIC requirements, the Cease and Desist Order to be entered herein should be terminated upon proof by Respondent of substantial compliance with FDIC requirements, not proof of over-compliance. In this regard, the FDIC seeks an infusion of \$600,000 into the Bank. However, all that is required, as also sought by the FDIC is adjusted primary capital of 7.5 percent or more which is within reach at this time. In addition, the FDIC seeks a reduction of substandard and other classified loans from \$7,000,000 (almost all of the classified loans are substandard (as opposed to "loss or doubtful"), to \$3,000,000 within 360 days of this decision's effective date. The substandard loans already may have been brought down to less than \$5,000,000 (See pages 51 through 54 hereof) and perhaps as low as \$2,500,000 (See page 39). However, in my opinion, the 360 day requirement proposed by the FDIC is not sustainable, if one accepts, as I do, the FDIC examiner's conclusions concerning the initial scope of the substandard loans. I would ameliorate the 360 day requirement in the light of Respondent's showing of improving conditions at the Bank.

Lastly, although the subject is scarcely discussed in the post-hearing briefs, there were intensive and repeated arguments during the course of the hearing by Respondent that the Bank and its customers would be damaged by *publication* of a *cease and desist* order as is now required of such an order pursuant to a recent enactment of Congress. Any resulting damage to the Bank (from publication) might be punitive and might serve to negate the remedial purposes of a cease and desist order. In the absence of adequate post-hearing arguments on this subject from either the Respondent or FDIC I am unable to resolve the dilemma and make no finding thereon other than that customers of the Bank must be protected from disclosure of their participation in classified loans.

Having considered the evidence presented and determined that the Depository Institution has engaged in unsafe or unsound banking practices and has committed violations of law and regulations, the following order is hereby recommended pursuant to 8(b)(1) of the Federal Deposit Insurance Act ("Act"), 12 U.S.C. 1818(b)(1):

ORDER TO CEASE AND DESIST

IT IS HEREBY ORDERED that the Depository Institution, its directors, officers, employees, agents, successors, assigns, and other institution-affiliated parties cease and desist from the following unsafe or unsound banking practices and violations:

- (a) operating with inadequate lending and collection practices;
- (b) operating with inadequate primary capital;
- (c) operating with large volume of poor quality loans;
- (d) operating with an inadequate loan valuation reserve;
- (e) operating with inadequate provisions for liquidity;
- (f) operating with inadequate routine and controls policies;
- (g) operating in such a manner as to produce low earnings;
- (h) operating in violation of section 23B of the Federal Reserve Act, 12 U.S.C. § 371c-1, made applicable to state nonmember banks by section 18(j)(1) of the Act, 12 U.S.C. § 1828(j)(1); section 22(h) of the Federal Reserve Act, 13 U.S.C. § 375b, and sections 215.4(a)(2), 215.4(d) and 215.7 of Regulation O of the Board of Governors of the Federal Reserve Systems, 12 C.F.R. §§ 215.4(a)(2), 215.4(d) and 215.7, made applicable to state nonmember banks by section 18(j)(2) of the Act, 12 U.S.C. § 1828(j)(2); section 304.4(a) of the FDIC Rules of Regulations, 12 C.F.R. § 304.4(a), and sections XV(8)(c) and XV(9)(d) of the Arkansas State Bank Department Rules and Regulations; and
- (i) operating with a board of directors and management which has failed to provide adequate supervision over and direction to the active management of the Depository Institution.

IT IS FURTHER ORDERED that the Depository Institution take affirmative action as follows:

1. (a) During the life of this ORDER, the Depository Institution shall have management qualified to restore the Depository Institution to a sound condition. Such management may be present management but shall include a chief executive officer and an experienced senior lending officer re- [{{5-31-91 p.A-1692}}](#) responsible for supervising the Depository Institution's overall lending function. The chief executive officer and the senior lending officer may be the same individual.

(b) Present management shall be assessed on its ability to:

(i) Comply with the requirements of this ORDER;

(ii) Improve and thereafter maintain the Depository Institution in a safe and sound condition, including asset quality, capital adequacy, liquidity adequacy, and earnings adequacy; and

(iii) Comply with all applicable State and Federal laws and regulations.

(c) (i) During the life of this ORDER, the Depository Institution shall notify the Regional Director of the Memphis Regional Office ("Regional Director") and the Bank of Commissioner") in writing of any resignations and/or terminations from its board of directors and senior executive officers.

(ii) The Depository Institution shall comply with 12 U.S.C. § 1842, which includes a requirement that the Depository Institution shall notify the Regional Director and the Commissioner in writing of any additions to its board of directors and senior executive officers. The notification must include the identity, personal history, business background and experience, including the individual's business activities and affiliations during the past five (5) years, and a description of any material pending legal or administrative proceedings in which individual is a party and any criminal indictment or conviction of such individual by a State or Federal court. The notification shall be provided at least 30 days prior to the individual assuming the new position and the Depository Institution may not add such individual if the Regional Director issues a notice of disapproval of such addition before the end of the 30 day period beginning on the date the Regional Director receives notice of the proposed action.

(d) For purposes of this ORDER the term "senior executive officers" shall mean the chairman and vice-chairman of the board of directors, the president, each vice president and the senior lending officer of the Depository Institution. The term shall also include any persons who have the functions, duties or responsibilities normally associated with those titles but are not specifically so named.

(e) To ensure both compliance with this ORDER and qualified management for the Depository Institution, the board of directors, within 60 days from the effective date of this ORDER shall develop a written policy ("Management Policy") which shall incorporate an analysis of the Depository Institution's management and staffing requirements and shall, at a minimum, address (i) both the number and type of position needed to properly manage the Depository Institution, (ii) a clear and concise description of the needed experience and pay for each job, (iii) an evaluation of present management, (iv) a plan to recruit, hire or replace personnel with requisite ability and experience, (v) a periodic evaluation of each individual's job performance, and (vi) the establishment of procedures to periodically review and update the Management Policy.

The Management Policy and any subsequent modification thereto shall be submitted to the Regional Director and the Commissioner for review and comment. Within 30 days from receipt of any comment, and after consideration of such comment, the board of directors shall approve the Management Policy which approval shall be recorded in the minutes of the meeting of the board of directors. Thereafter, the Depository Institution and its directors, officers and employees shall implement and follow the Management Policy and any modifications thereto.

(f) Within 30 days from the effective date of this ORDER, the board of directors shall establish a committee of the board of directors with the responsibility to ensure that the Depository Institution complies with the provisions of this ORDER. At least two-thirds of the members of such committee shall be independent, outside directors as defined herein. The committee shall report monthly to the entire board of directors, and a copy of the report and any discussion relating to the report or the ORDER shall be included in the minutes of the board of directors. Nothing contained herein shall diminish the responsibility of the entire board of directors to ensure compliance with the provisions of this ORDER.

[{{5-31-91 p.A-1693}}](#)

(g) For the purposes of this ORDER, an "outside director" shall be an individual:

(i) Who shall not be employed, in any capacity, by the Depository Institution or its affiliates other than as a director of the Depository Institution of an affiliate;

(ii) Who shall not own or control more than 5 percent of the voting stock of the Depository Institution or its holding company;

- (iii) Who shall not be indebted to the Depository Institution or any of its affiliates in an amount greater than 5 percent of the Depository Institution's primary capital;
- (iv) Who shall not have an extension of credit from the Depository Institution that is adversely classified in any Report of Examination and/or Visitation;
- (v) Who shall not be related to any directors, principal shareholders of the Depository Institution or affiliate of the Depository Institution; and
- (iv) Who shall be a resident of, or engage in business in, the Depository Institution's trade area.

2. (a) Within 120 days from the effective date of this ORDER, the Depository Institution shall establish and thereafter maintain its primary capital during the life of this ORDER adjusted primary capital equal to or greater than seven and one-half (7.5) percent of the Depository Institution's adjusted Part 325 total assets.

(b) Any increase in primary capital necessary to met the requirements of Paragraph 2(a) of this ORDER may be accomplished by the following:

- (i) The sale of new securities in the form of common stock or perpetual preferred stock; or
- (ii) The direct contribution of cash by the directors, shareholders, or parent bank holding company of the Depository Institution; or
- (iii) The collection in cash of assets classified "Loss" without loss or liability to the Depository Institution; or
- (iv) The collection of assets previously charged-off; or
- (v) Any other method acceptable to the FDIC.

(c) If all or part of the increase in primary capital required by Paragraph 2(a) of this ORDER is accomplished by the sale of new securities of any kind or should there be a plan involving a public distribution of the Depository Institution's securities (including a distribution limited only to the Depository Institution's existing shareholders), the Depository Institution shall prepare offering materials fully describing the securities being offered, including an accurate description of the financial condition of the Depository Institution and the circumstances giving rise to the offering, and any other material disclosures necessary to comply with the Federal securities laws. Prior to the implementation of the plan and, in any event, not less than 20 days prior to the dissemination of such materials, the plan and any materials used in the sale of the securities shall be submitted to the FDIC, Registration and Disclosure Unit, Washington, D.C. 20429. Any changes requested to be made in the plan or materials by the FDIC shall be made prior to their dissemination.

(d) In complying with the provisions of Paragraph 2 of this ORDER, the Depository Institution's securities written notice of any planned or existing development or other changes which are materially different from the information reflected in any offering materials used in connection with the sale of Depository Institution securities. The written notice required by this paragraph shall be furnished within 10 days from the date such material development or change was planned or occurred, whichever is earlier, and shall be furnished to every subscriber and/or purchaser of the Depository Institution's securities who received or was tendered the information contained in the Depository Institution's original offering materials.

(e) For purposes of this ORDER the term "primary capital", "total capital" and "Part 325 total assets" shall have the meanings ascribed to them in Part 325 of the FDIC's Rules and Regulations, respectively, subsections 325.2(h), 325.2(1) and 325.2(k), 12 C.F.R. 325.2(h), (1), (k). The "Analysis of Capital" schedule on page 3 of the FDIC Report of Examination [{{5-31-91 p.A-1694}}](#) provides the method for determining the ratio of adjusted primary capital to adjusted Part 325 total assets as required by this ORDER.

3. (a) Within 10 days from the effective date of this ORDER, the Depository Institution shall have eliminated from its books, by charge-off or collection, all assets classified "Loss" and one-half of the assets classified "Doubtful" as of May 26, 1989, that have not been previously collected or charged-off. Reduction of these assets through proceeds of other loans made by the Depository Institution is not considered collection for the purpose of this paragraph.

(b) Within 120 days from the effective date of this ORDER, the Depository Institution shall have reduced the assets classified "Substandard" as of May 26, 1989 and those assets classified "Doubtful" that have not previously been charged-off pursuant to this ORDER to not more than \$5,000,000.

(c) Within 240 days from the effective date of this ORDER, the Depository Institution shall have reduced the assets classified "Substandard" as of May 26, 1989 and those assets classified "Doubtful" that have not previously been charged-off pursuant to this ORDER to not more than \$4,500,000.

(d) Within 360 days from the effective date of this ORDER, the Depository Institution shall have reduced the assets classified "Substandard" as of May 26, 1989 and those assets classified "Doubtful" that have not previously been charged-off pursuant to this ORDER to not more than \$4,000,000, and to not more than \$3,000,000 within 18 months of the effective date of the Order.

(e) The requirements of Paragraph 3(a), 3(b), 3(c) and 3(d) are not to be constructed as standards for future operations and, in addition to the foregoing, the Depository Institution shall eventually reduce the total of all adversely classified assets. As used in Paragraphs 3(b), 3(c), 3(d) and 3(e) the word "reduce" means (1) to collect, (2) to charge-off, or (3) to sufficiently improve the quality of assets adversely classified to warrant removing any adverse classification, as determined by the FDIC.

4. (a) Beginning with the effective date of this ORDER, the Depository Institution shall not extend, directly or indirectly, and additional credit to, or for the benefit of, any borrower who has a loan or other extension of credit with the Depository Institution that has been charged-off or classified, in whole or in part, "Loss" or "Doubtful" and is uncollected. The requirements of this paragraph shall prohibit the Depository Institution from renewing (after collection in cash of interest due from the borrower) any credit already extended to any borrower.

(b) Beginning with the effective date of this ORDER, the Depository Institution shall not renew any loan without the full collection of interest due. The issuance of separate notes, to the borrowing customer or a third party, the proceeds of which pay interest due, shall not satisfy the requirements of this paragraph unless these separate notes receive the prior approval by the board of directors after the board's affirmative determination, as reflected in the minutes of the meeting, that the extension of credit is necessary to protect the Depository Institution's interest or is adequately secured, that credit analysis has determined the customer to be credit worthy, that all necessary loan documentation is on file, including satisfactory appraisal, title and lien documents, and that the extension complies with the Depository Institution's loan policy and applicable rates and regulations.

5. (a) Beginning with the effective date of this ORDER, the Depository Institution shall review and strengthen its collection policies and procedures and adopt and implement a written loan interest nonaccrual policy which conforms with requirements contained in Instructions for Preparation of Reports of Condition and Income published by the Federal Financial Institutions Examination Council.

(b) Beginning with the effective date of this ORDER, the Depository Institution shall initiate and implement a program to strengthen its credit files and correct the technical exceptions as detailed on pages 2-f, 2-f-1, 2-f-2, 2-f-3, and 2-f-4 of the May 26, 1989 Report of Examination. In all future operations, the Depository Institution shall ascertain that all documents or evidence thereof, properly completed, are obtained before credit is extended.

(c) Within 60 days of the effective date of this ORDER, the Depository Institution shall establish and implement internal control procedures which shall provide the Depository Institution with a document audit trail which demonstrates as to each funded loan to whom loan proceeds are being disbursed.

(d) Within 30 days of the effective date of this ORDER, the Depository Institution shall establish and implement internal control procedures to secure and limit access to the Depository Institution's stock of black cashiers checks.

6. (a) Within 30 days of the effective date of this ORDER, the board shall strengthen its internal loan review and grading system ("System") to periodically review the Depository Institution's loan portfolio and identify and categorize problem credits. At a minimum the System shall provide for:

- (i) Identifying the overall quality of the loan portfolio;
- (ii) The identification and amount of each delinquent loan;
- (iii) An identification or grouping of loans that warrant the special attention of management;
- (iv) For each loan identified, a statement of the amount and an indication of the reason(s) why the particular loan merits special attention;
- (v) Credit and collateral documentation exceptions;
- (vi) The identification and status of each violation of law, rule or regulation;
- (vii) Loans not in conformance with the Depository Institution's lending policy, and exceptions to the Depository Institution lending policy;
- (viii) Insider loan transactions; and
- (iv) A mechanism for reporting periodically to the board of directors on the status of each loan identified and the action(s) taken by management.

(b) A copy of the reports submitted to the board, as well as documentation of the action taken by the Depository Institution to collect or strengthen assets identified as problem credits, shall be kept with the minutes of the board of directors.

(c) Within 60 days from the effective date of this ORDER, the Depository Institution's board of directors shall establish and appoint a loan committee to review and approve in advance all extensions of credit, and/or renewals that when aggregated with all other extensions of credit to that borrower, either, directly or indirectly exceed or would exceed \$50,000. The review should include financial, income, and cash flow information, collateral values and lien information, repayment terms, past performance by the borrower, the purpose of the extension, and whether the extension complies with the Depository Institution's loan policy and application rates and regulations. The loan committee shall meet at least twice monthly and shall maintain written minutes which document its review, conclusions, approvals, denials and recommendations. At least two-thirds of the members of the loan committee shall be independent, outside directors as defined in Paragraph 1(g) of this ORDER.

7. Within 180 days from the effective date of this ORDER (unless within 60 days an alternative timetable or proposal is submitted by the Depository Institution and approved in writing by the Regional Director and the Commissioner), the Depository Institution's total equity capital and reserves for each individual concentration. In addition, the Depository Institution shall not make any new extensions of credit, directly or indirectly, to any borrower whose loans in the aggregate equal 25 percent or more of the Depository Institution's total equity capital and reserve.

8. Within 30 days from the effective date of this ORDER, the Depository Institution shall establish and thereafter maintain an adequate reserve for loan losses. Such reserve shall be established by charges to current operating income, together with collection of assets previously charged-off. In complying with the provisions of this paragraph, the board of directors of the Depository Institution shall review the adequacy of the Depository Institution's reserve for loan losses prior to the end of each quarter. The minutes of the board meeting at which such review is undertaken shall indicate the results of the review, the amount of any increase in the reserve, and the basis for determination of the amount of the reserve provided.

9. Within 60 days from the effective date of this ORDER, the Depository Institution [{{5-31-91 p.A-1696}}](#) shall eliminate and/or correct all violations of law which are set out on pages 6-b, 6b-1, and 6-b-2 of the Report of Examination of the Depository Institution as of May 26, 1989. In addition, the Depository Institution shall henceforth comply with all applicable laws and regulations.

10. Within 60 days from the effective date of this ORDER, the Depository Institution shall formulate and adopt a written liquidity and funds management policy. Such policy shall include the establishment of acceptable ranges of ratios in the following areas: volatile liability dependence, total loans to total deposits and temporary investments to volatile liabilities. In addition, the liquidity policy shall incorporate a funds management program which designates acceptable levels for: volatile liabilities, including borrowings; asset mix, including temporary funds and investments, long term investment securities and classes of obligors, and loans to deposits; and rate-sensitive assets as a percent of rate-sensitive liabilities. The written liquidity and funds management policy shall be submitted to the Regional Director and the Commissioner for review and comment.

11. (a) Within 30 days from the effective date of this ORDER, the Depository Institution shall review all Consolidated Reports of Condition and Income filed with the FDIC on and after May 26, 1989, and shall amend and file with the FDIC amended Consolidated Reports of Condition and Income which accurately reflect the financial condition of the Depository Institution as of the date of each such Report. At a minimum each such Report shall be amended to reflect elimination of all assets classified "Loss" and one-half of the assets classified "Doubtful" as required by Paragraph 3(a) of this Order and shall incorporate an adequate reserve for loan losses accurately reflecting the Depository Institution's loan portfolio as of May 26, 1989, as required by Paragraph 8.

(b) In addition to the above and during the life of this ORDER, the Depository Institution shall file with the FDIC Consolidated Reports of Condition and Income which accurately reflect the financial condition of the Depository Institution as of the reporting period. In particular such Reports shall include any adjustment in the Depository Institution's book made necessary or appropriate as a consequence of any State or FDIC examination of the Depository Institution during that reporting period.

12. While this ORDER is in effect, the Depository Institution shall not declare or pay any cash dividends on its capital stock without the prior written approval of the Regional Director and the Commissioner.

13. (a) Within 60 days from the effective date of this ORDER, and thereafter on an annual basis, the Depository Institution shall review the total compensation (both current and deferred) being paid to Depository Institution directors to determine whether the compensation received by each such person is reasonable in relation to the services provided to the Depository Institution. The minutes of the board meeting at which such review is undertaken shall indicate the results of the

review and the basis for determination of the reasonableness of the compensation. For the purpose of this paragraph, "compensation" refers to any and all salaries, bonuses, and other benefits of every kind and nature whatsoever, whether paid directly or indirectly.

(b) During the life of this ORDER, the Depository Institution shall not pay any bonuses to any of its directors, officers or employees of subsequent to the payment of such bonuses the ratio of the Depository Institution's adjusted primary capital to its adjusted Part 325 total assets would equal less than seven and one-half (7.5) percent.

14. During the life of this ORDER, the board of directors of the Depository Institution shall, prior to the disbursement of any funds derived from the sale of credit life and other insurance, either approve or disapprove the proposed transaction. The board's action shall be stated in the minutes of the meeting.

15. Within 60 days from the effective date of this ORDER, the Depository Institution shall adopt and implement a written policy on real estate appraisal that conforms to the Interagency Appraisal Guidelines as set forth in Bank Letter 40-87, dated December 15, 1987, and in Bank Letter 29-88, dated September 8, 1988.

16. Following the effective date of this ORDER, the Depository Institution shall send to its shareholders or otherwise furnish a description of this ORDER, (i) in conjunction ~~{{9-30-91 p.A-1697}}~~ with the Depository Institution's next shareholder communication, and also (ii) in conjunction with its notice or proxy statement preceding the Depository Institution's next shareholder meeting. The description shall fully describe the ORDER in all material respects. The description and any accompanying communication, statement, or notice shall be sent to the FDIC, Registration and Disclosure Unit, Washington, D.C. 24029, for review at least 20 days prior to dissemination to shareholders. Any changes requested to be made by the FDIC shall be made prior to dissemination of the description, communication, notice, or statement.

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

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

This ORDER shall become effective 10 days from the date of its adoption by the FDIC, except that the effective date may be extended according to the sole discretion of the FDIC.

This ORDER shall not be published until such time as it is effective as an order of the FDIC. Also, the DECISION which supports this order shall not be published unless the identities of all bank customers involved in classified loans are fully masked.

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

/s/ By Paul S. Cross,
Administrative Law Judge