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{{4-1-90 p.A-38}}

[¶5004] FDIC Docket No. FDIC-80-35K (undated).

Bank directors assessed civil money penalties for violating a cease and desist order by failing to implement a policy to prevent unauthorized extensions of credit in the form of overdrafts to several directors.

[.1] Directors—Duties and Responsibilities—Supervision

Basic principles of banking law dictate that board members play an active role in the activities of the bank, and passivity on the part of the directors will not excuse individual liability.

{{4-1-90 p.A-39}}

[.2] Civil Money Penalties—Parties

"Order to Pay" penalties that are directed to the "board of directors" of a bank but do not specifically name the members are sufficient to establish that those members of the board named in the opening paragraph of the "Notice" will be penalized.

[.3] Regulation O—Lending Limitations—Overdrafts

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, interest-bearing extension of credit plan specifying a method of repayment or (2) a written, preauthorized transfer of funds from another account of the account holder at the bank. This prohibition does not apply to payment of inadvertent overdrafts on an account in an aggregate amount of $1,000 or less if (1) the account is not overdrawn for more than 5 business days, and (2) the member bank charges the executive officer or director the same fee charged any other customer of the bank in similar circumstances.

[.4] Regulation O—Overdrafts—Inadvertent

To come within the so called "inadvertent" exception to the rule that banks may not pay overdrafts of officers or directors, payment of the overdraft must meet four tests: (1) it must be inadvertent, (2) the overdraft may not exceed $1,000, (3) the account may not be overdrawn for more than five business days, and (4) the overdrawer must be charged the same fee as any other customer of the bank in similar circumstances. For the exception to be invoked, all four tests must be satisfied.

[.5] Regulation O—Overdrafts—Inadvertent

Inadvertent carries the connotation of something being done (or not done) through oversight rather than done designedly, or in another sense something performed occasionally rather than something done on a continuing basis, or even frequently.

[.6] Regulation O—Overdrafts—Inadvertent

Overdrafts by a bank director on three separate dates (February 28, 29, and again on March 31) appear to be the result of a fairly consistent pattern which tends to ignore the balance level in the account, and cannot be considered as inadvertent.

[.7] Regulation O—Extension of Credit—Overdrafts

An advance by means of an overdraft is an extension of credit. An insider may be advanced monies which are owed him for services provided or expenses incurred in performance of duties, without having such payouts tagged as an extension of credit. Overdrafts, however, are specifically identified as "extensions of credit" and their payment is prohibited. Overdrafts cannot be excused or considered as an offset against accrued salary.

[.8] Directors—Duties and Responsibilities—Correction of Known Problems

When a board of directors of a bank was aware of a problem with overdrafts, but chose to do nothing to correct the problem, each director is held to have participated in allowing a climate to exist which countenanced violations of law.

[.9] Civil Money Penalties—Amount—Statutory Standard

In determining the amount of a civil money penalty the following factors shall be taken into account: the appropriateness of the sanction with respect to the size of the financial resources and good faith of the

bank or person; the gravity of the violation; the history of previous violations; and such other matters as justice may require.

{{4-1-90 p.A-40}}

In the Matter of * * * (INSURED STATE NONMEMBER BANK) and * * * as the Board of Directors of * * * and * * *, and * * * individually.

FINDINGS OF FACT AND CONCLUSIONS OF LAW AND FINAL ORDER TO PAY
FDIC-80-35K

Pursuant to its authority under Sections 8(i) and 18(j) of the Federal Deposit Insurance Act (12 U.S.C. §§ 1818(i) and 1828(j)), the Federal Deposit Insurance Corporation ("FDIC") on May 19, 1980, issued a "Notice of Assessment of Civil Penalty" ("Notice") against the members of the board of directors of * * * and against * * * and * * * individually. The Notice charged that the Bank, through its directors, had violated Regulation O (12 C.F.R. § 215) and had violated an FDIC Cease and Desist Order issued against the Bank on December 16, 1977. The Notice also charged that * * * and * * *, officers and directors of the Bank, had violated the FDIC Cease and Desist Order of December 16, 1977.

An administrative hearing on the Notice was held in * * * on July 16, 17 and 18, 1980, before Administrative Law Judge Richard A. White. On December 9, 1980, Judge White rendered a Recommended Decision with findings of fact, conclusions of law and a proposed order. On January 16, 1981, pursuant to FDIC regulations, this case was submitted to the Board of Directors for final decision. On January 29, 1981, an offer of settlement was made by the Bank to the FDIC. This offer was forwarded to the Board on February 9, 1981.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

[.1**]** The Board of Directors, having considered the entire record and applicable law, agrees with the findings and conclusions of the Administrative Law Judge.* The Board of Directors also agrees with the proposed order of the Administrative Law Judge to the extent that it: (1) imposes a penalty of $4,500 upon the individual members of the Bank's board of directors for violations of Regulation O; (2) imposes a $5,000 penalty upon * * *; and (3) imposes a $2,000 penalty upon * * *. The Board, however, rejects the Administrative Law Judge's recommendation that the $7,000 fine originally imposed upon the members of the board of directors for violations of the FDIC Order be eliminated. The record amply indicates that the board members violated the FDIC Order by not implementing an effective policy to prevent unauthorized extensions of credit. Each member of the board was responsible to make certain that such a policy was formulated and implemented. Basic principles of banking law dictate that board members of banking institutions play an active role in the activities of their institution and that passivity on their part will not excuse individual liability. In this light, the elimination of the $7,000 penalty is not warranted. It is reasonable, however, that, in consideration of the mitigating factors noted by the Administrative Law Judge, the fine be reduced. As a result, the Board of Directors has determined that a fine of $900 against the members of the Bank's board of directors for violation of the FDIC Cease and Desist Order of December 16, 1977 is appropriate.

The Bank offered a proposal of settlement in which * * * (who presently owns 90 percent of the Bank) will contribute $11,500 to the undivided profits account of the Bank in lieu of any fines. As an owner of the Bank, any contribution by Mr. * * * to the Bank's capital account will be an indirect benefit to himself. This would defeat the deterrent purpose of the civil penalty. As a consequence, the Board rejects the Bank's offer of settlement of January 29, 1981.

Therefore, except to the extent the preceding conclusions are contrary, the Board adopts the findings and conclusions of the Administrative Law Judge, which are attached hereto and incorporated herein by reference. In addition, the Board adopts the following as its Final Order to Pay:

FINAL ORDER TO PAY

ORDERED, a penalty of $4,500 is hereby assessed against the members of the Bank's

* The Administrative Law Judge, in his findings, determined that an account of * * * (account number 22-225-2) was inadvertently overdrawn over a period of five days or less, in a sum of less than $1,000, and that the Bank failed to charge the same fee on that account that it would charge on any other customer under similar circumstances. Under these circumstances, the overdraft represents a violation of Regulation O. In his conclusions, however, apparently through oversight, the judge does not list the overdraft in this account as a violation of Regulation O. The Board of Directors is of the opinion that account number 22-225-2 of * * * also was overdrawn in violation of Regulation O.

{{4-1-90 p.A-41}}board of directors, namely, * * *, for violations of the FDIC Cease and Desist Order of December 16, 1977;

ORDERED, a penalty of $5,000 is hereby assessed against * * * for violations of the FDIC Cease and Desist Order of December 16, 1977; and

ORDERED, a penalty of $2,000 is hereby assessed against * * * for violations of the FDIC Cease and Desist Order of December 16, 1977.

This Order shall become effective at the expiration of 10 days after the issuance of the Order and the civil penalties assessed are due within the 90-day period after issuance of the Order.

By Order of the Board of Directors, dated [undated], 1981.

/s/ Hoyle L. Robinson
Executive Secretary

RECOMMENDED DECISION

No. 80-35K

Decided: December 9 1980

Bank's payment of overdrafts of two officers and one director found to be contrary to 12 C.F.R. 215.4(d). Payment of overdrafts of another director found to be contrary to 12 C.F.R. 215.4(d) and not an advance against accrued salary as defined in 12 C.F.R. 215.3(b)(1). Bank's extension of credit to a customer found to be contrary to the terms of the Cease and Desist Order of December 16, 1977. Civil Penalties sought to be applied by FDIC found not justified. Reasonable civil penalties imposed and order to be paid.

* * *, * * * and * * * for Federal Deposit Insurance Corporation. * * * and * * * for respondents. * * * for respondent * * *.

By Richard A. White, Administrative Law Judge:

The Federal Deposit Insurance Corporation, sometimes referred to as FDIC, the Corporation or proponent, alleges by "Notice of Assessment of Civil Penalty" dated May 19, 1980, that (1) * * * hereinafter referred to as Bank paid checks during designated periods drawn by * * * on two accounts, by * * * on two accounts, by * * * on one account, and by * * * on one account which caused the accounts to be overdrawn in violation of Section 22(h) of the Federal Reserve Act (12 U.S.C. § 375b) and Regulation O (12 C.F.R. Part 215) and that because of the foregoing infractions the Bank's Board of Directors * * * and * * * were assessed and ordered to pay a civil penalty of $24,000; and (2) the Bank extended credit including credit in the form of overdrafts to * * * and his related business interests which exceeded guidelines required to be observed by a December 16, 1977 Order of the FDIC, the Bank's own statement of lending policies, certain State and Federal banking officials, and designated * * * Statutes; and that * * *, president and chairman of the Board of Directors and * * * vice president, approved payment of one or more of the checks drawn on three accounts of * * * or his related business interests which caused these accounts to be overdrawn, and that by reason of the foregoing violations the Bank's Board of Directors were assessed and ordered to pay a civil penalty of $7,000, * * * a penalty of $5,000, and * * *, a penalty of $5,000.

The "Notice" provided that the effective date would be staved for 10 days after issuance to permit the Board of Directors, * * * and * * * to request a hearing. Each opted for a hearing.

The proceeding was initially assigned for hearing July 15, 1980, but was subsequently postponed to the 16th. The matter was heard at * * *, before the undersigned on July 16, 17, and 18, 1980. Proponent and respondents were represented by counsel. Initial briefs were filed by both parties on October 6 and reply briefs on November 7, 1980. Included in the record are two late filed exhibits, one shows that the Corporation's "Notice of Assessment of Civil Penalty" was served on * * *, * * *, and the Board of Directors as a group on May 27, 1980; the other is a four month study of overdrawn checking accounts. Both documents are received in evidence.

On July 16, 1980, during the course of the hearing, respondents filed a motion seeking to have the Administrative Law Judge, or in the alternative, the Corporation dismiss the proceeding for failure to set the hearing within 30 days of receipt of the request from respondents for a hearing as required by 12 C.F.R. § 308.76. Counsel for the Corporation responded in a reply filed during the course of the hearing on July 17, {{4-1-90 p.A-42}}pointing out that 12 C.F.R. 308.7(b)(7) provides that the Administrative Law Judge may not rule on a motion which would terminate the proceeding. Subsequently on October 14, 1976, Counsel for the Corporation requested that the undersigned rule on the motion, or in the alternative, certify the motion to the Corporation for determination. On the same day respondents withdrew the motion for dismissal. Accordingly the motion for dismissal has become moot and no further consideration will be given the matter.

By a Stipulation of Facts filed during the course of the hearing the parties agreed concerning the general jurisdiction of the Corporation to raise the issues presented in the "Notice", that the nine named Board of Directors served during the period covered by the alleged infractions except that Director * * * resigned March 12, 1980, and that * * * was president of the Bank and Chairman of the Board and * * * vice president during the periods when the alleged infractions were said to have occurred.

Before discussing substantive issues a procedural or jurisdictional matter will be considered.

Both in its initial and reply briefs respondents contend that the FDIC seeks to penalize the Board of Directors as an entity by imposing fines of $24,000 for violations of Regulation O and $7,000 for infractions of the Cease and Desist Order, but the statutes upon which the Corporation relies do not permit penalties to be applied against the Board of Directors as an entity. The statute authorizing penalties for purported violation of Regulation O is 12 U.S.C. 1828(J)(3)(A) which provides in effect that any non-member insured bank which violates or any officer, director, employee, agent or other person participating in the conduct of the affairs of the non-member bank who violates any provision of section 22(h) of the Federal Reserve Act or a lawful regulation relating thereto shall pay a civil penalty of not more than $1,000 per day for each day the violation continues. The statute relating to penalties for violation of lawful orders is 12 U.S.C. 1818(i)(2)(i). Insofar as is here pertinent it, like the above, is directed to banks, officers, directors, employees, agents, or other persons participating in the conduct of the affairs of the bank, but not to Boards of Directors as entities.

Respondents argue that under both statutes FDIC is precluded from penalizing a Board of Directors as an entity, but yet this is what it proposes. In support respondents submit that the "style" of the proceeding shows that it is directed toward the Board as a group, the "order to pay" included in the Notice of Assessment of Civil Penalty, provides that a penalty of $24,000 shall be assessed "against the board of directors of the Bank" for the Regulation O violations and a penalty of $7,000 shall be assessed "against the board of directors of the Bank" for violations of the cease and desist order, that service of the "Notice of Assessment of Civil Penalty" was made on "the Board of Directors, * * *" as a group, and none of the directors except president * * * and vice president * * * were served individually.

There is no merit in respondents position. The "Notice of Assessment of Civil Penalty" is in effect the equivalent of a statement of charges and establishes the identity of the persons charged and the nature of the charges. The opening paragraph states:

The Board of Directors of the Federal Deposit Insurance Corporation (the "Corporation"), is of opinion that * * * in their capacities as directors of The * * * (the "Bank") have violated Section 22(h) of the Federal Reserve Act, as amended (12 U.S.C. §375b) and Regulation O of the Board of Governors of the Federal Reserve System (12 C.F.R. Part 215) ("Regulation O") promulgated thereunder and that * * * as directors of the Bank and * * *, * * * and * * * individually, have violated the Corporation's Order * * *.

The above language clearly is directed to each of the Board of Directors individually in their capacities as directors of * * *. The record is not clear as to what respondents mean by the "style" of the proceeding as indicative of FDIC's intent to proceed against the Board as an entity, but apparently they have reference to the title of the proceeding as set forth on page 1 of the "Notice of Assessment of Civil Penalty." The title reads:

{{4-1-90 p.A-43}}
NOTICE OF ASSESSMENT OF CIVIL PENALTY, FINDINGS OF FACT AND CONCLUSIONS OF LAW, AND ORDER TO PAY

But again there is no basis for concluding that the action is against the Board as a group. By naming each of the directors it is apparent that they are each put on notice that the proceeding is against them in their capacities as directors.

[.2**]** It is true that the "Order to Pay" penalties are directed to the "board of directors of the Bank" and

that the members are not identified, but naming the members individually is unnecessary. As stated above the persons charged are identified in the opening paragraph of the "Notice" and it is these persons either individually or in their collective capacity as the Board of directors who are penalized.

The fact that service of the "Notice of Assessment of Civil Penalty" was made on the "Board of Directors" as a group does not in the circumstances of this proceeding" indicate that FDIC was charging the Board as an entity. Again it must be emphasized that the cause of action was framed by the opening paragraph of the "Notice". Faulty service of process may have jurisdictional and due process implications but such issues are not raised by respondents at the hearing. The record shows that the directors named in the "Notice" were represented by Counsel and were aware of the hearing. In short the evidence establishes that FDIC's statement of charges is against the nine moved directors in their capacities as directors of The First State Bank.

Respondents defend against the charges on several levels. As relates to the Regulation O violations they seek to show that the overdrafts come within exceptions to the general rule that Banks may not pay overdrafts. This issue will be treated first. With respect to both the Regulation O infractions and the violations of the Cease and Desist Order respondents seek to establish that the Board of Directors with the possible exception of president * * * and vice president * * * had no knowledge of the purported unlawful activities. Also they contend that the proposed penalties were put forth without considering relevant criteria and are unfair when considered in the context of the minor character of the infractions. These issues will be treated for the most part following a recount of the facts relating to violations of the Cease and Desist Order.

[.3**]** Consideration will first be given whether payment of overdrafts was contrary to the Statute and governing regulations. Section 22(h)(4) of the Federal Reserve Act (12 U.S.C. § 357b(4)) provides in effect that a bank may not pay an overdraft of an executive officer or director. The prohibition is implemented by section 215.4(d) of Regulation O (12 C.F.R. § 215.4(d)) which states:

> Overdrafts. 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, interest-bearing 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. This prohibition does not apply to payment of inadvertent overdrafts on an account in an aggregate amount of $1,000 or less: Provided (1) the account is not overdrawn for more than 5 business days, and (2) the member bank charges the executive officer or director the same fee charged any other customer of the bank in similar circumstances.

Proponent charges that checks were paid which resulted in overdrafts in the accounts of president * * *, vice president * * *, executive vice president * * *, all of whom are also directors, and * * *, also a Director. The evidence concerning the overdrafts of Messrs. * * *, * * *, * * * differs from that pertaining to * * * and the matters will be discussed separately.

Proponent relying on monthly bank statements shows that between November 6, 1979 and February 6, 1980, at least 6 checks drawn on account 22-225-2 of president * * * were paid causing the account to be overdrawn on 5 days with $352 being the largest overdraft. Several explanations or defenses are offered by witness * * *. The bank statement shows as an overdraft of $177 on November 6 with a deposit on the following day of $500 which restored the account to a positive balance. Respondent submitted copy of a deposit slip with an inked in date of November 6 which indicates a deposit of $500 was made to the account. However the deposit was not post- {{4-1-90 p.A-44}}ed until November 7 the following day. Had the posting been made on the 6th there would have been no overdraft. Again the bank statement shows that on December 26, 1980, there was an overdraft of $158 with a large deposit shown as having been made on the 27th. Again respondent produced a deposit slip with an inked in date of December 26, but which was not posted until the 27th. Had the item been posted on the 26th there would have been no overdraft. In like manner the bank statement shows an overdraft of $72 on January 18, 1980, (Friday) and a deposit of $1,500 on the 21st (Monday), and an overdraft of $101 on January 21 and a deposit of $2,500 on the 22nd. Respondent furnished deposit slips whose inked in dates are January 18, and 21, but which were not posted until the 21st and the 22nd, respectively. It submits that had the deposits been promptly posted there would have been no overdrafts. Lastly, on February 6, 1980 an overdraft of $352 was incurred. The bank statement shows there was a $1,500 deposit on February 12 which brought the account into positive balance. Respondent refers to a deposit slip with a pen inserted date of February 11, but which was not posted until February 12. It argues that in this instance the overdraft was less than $1,000 and persisted for less than five days and comes within the exception to the prohibition against paying overdrafts.

Witness * * * has no exact knowledge as to the time of day the deposits referred to above were made

but assumes they were placed between 2 and 3 p.m. He concedes that if the deposits were made after the Bank's "proof machine" was closed for the day, they would not be posted to the books until the following day, but he insists it may not be assumed that they were made after the close of the "proof machine" for the day.

Between January 15, and March 10, 1980, three checks drawn on account 22-334-4 of president * * * were paid causing the account to be overdrawn on 13 days. On five of the days the overdraw was less than $200, while on the remaining eight days the overdraw was $1,374. Respondent testified that the five day period of the less than $200 overdraw could have been reduced to three days if the checks whose payment caused the negative balance had been treated as cash items. As to the $1,374 overdraw for each of 8 days, respondent stated that he was not personally aware of the status of the account. He further testified that vice president * * * twice told his (Mr. * * *) secretary of the overdraw, that she made deposits on two occasions to the wrong account —22-225-2. Finally on March 10, Mr. * * * again called the secretary's attention to the out-of-balance and the matter was corrected.

Between February 26, and March 31, 1980, 7 checks drawn on account 23-069-3 of vice president * * * were paid causing the account to be in overdraw status on 4 separate days with $254 the largest amount of overdraw. The longest period of overdraft was 2 business days. The bank statement shows a negative balance of $57 on February 26 which was corrected by a $200 deposit made on the 27th. Witness * * * shows that he transferred $200 from savings to the checking account on February 26, but the sum was not credited to the account until the following day.

On February 28 (Thursday) and 29 (Friday), 1980, 2 checks drawn on account 23-115-0 of director * * * were paid causing the account to be overdrawn on the two days. On each day the overdraft exceeded $1,000, but the positive balance was restored by a deposit on March 3, Monday. A deposit slip with an inked in date of February 29 was submitted by respondent.

During the periods of the alleged infractions there were no written agreements between the Bank and the account holders whereby overdrafts would be converted to interest bearing extension of credit arrangements or a transfer of funds from an account with a positive balance to the overdrafted account.

Proponent's witness * * * was told by personnel of the Bank's bookkeeping office that it was Bank policy to charge $5 for each check paid which caused or increased an overdraft or for each check returned because of insufficient funds. Proponent also submits that the Bank did not charge president * * *, vice president * * * or Director * * * the same fee charged other customers in similar circumstances. On May 30, 1980, the aforesaid persons paid interest on their overdrafts of $8.07, 23 cents and 93 cents, respectively for a total of $9.23. Had the $5 charge per check overdraft been applied the total charges would have been $45, $30, and $10, respectively, or a total of $85. Witness * * * concedes {{4-1-90 p.A-45}}that it is not unusual for a bank to waive penalty charges for a valued customer.

Respondents assert that the Bank has no fixed policy on applying penalties or charges to customers whose accounts become overdrawn. Whether the customer will be assessed the $5 service charge for an overdraft, whether the overdraft will be converted to a loan and interest applied at the prevailing rate, or whether interest will be computed on the amount of the overdraft and the customer advised of the amount owed, or whether none of the above options will be exercised depends on the value to the Bank of the customer's business. Respondents insist it is not unusual to charge interest on an overdrawn account rather than apply the $5 service charge, but the only persons who have been charged interest within the time frame of the proceeding (October 17, 1978 to March 31, 1980) were president * * *, vice president * * *, and Director * * *.

The parties made a joint study for November and December 1979 and January and February 1980 of all overdrawn accounts. Proponent then submitted a refinement which separated the insider and noninsider accounts and made computations of the number and percent of accounts in each category on which service charges were imposed. The compilation shows that service charges were not imposed on insider accounts on which checks were paid which caused or contributed to an overdraft. By way of contrast and looking at the average for the four months, almost 39 percent of the non-insider accounts were assessed a service charge on every check that caused or contributed to an overdraft. 26 percent of the non-insider accounts were subjected to service charges on one or more, but not all checks that caused or contributed to an overdraft, while 33 percent of the non-insider accounts were not subjected to any service charge for the payment of checks which caused or contributed to overdraft status.

Respondents submit that as a small Bank in a small community it depends heavily on the opinions of the Corporation's representatives who from time to time examine or review the Bank's operations. Respondents' witnesses * * * and * * * testified to a meeting with proponent's witness * * * during March or April 1980 while the later was at the Bank at which time witness * * * said that overdrafts under $1,000 for five or less working days are considered inadvertent.

President * * * has read Regulation O on several occasions and discussed it with other bankers. As of February 1980 he was of the opinion that an inadvertent overdraft of less than $1,000 and persisting for

less than 5 business days was not a violation. He refers to a recent meeting where he, witness * * *, and Counsel for proponent were in attendance. He raised the question whether a $57 overdraft for one day such as that reflected in account No. 23-069-3 of vice president * * * for February 26, 1980, was unlawful. Witness * * * expressed the view that this was not a violation of Regulation O, but counsel disagreed saying even a one cent overdraft was proscribed. Proponent's witness * * * denies stating that overdrafts of less than $1,000 could never constitute a violation of Regulation O. He does concede to a disagreement with proponent's counsel concerning the $57 overdraft of Mr. * * *, but on reflection and when section 215.4(d) is considered in its entirety he now believes the overdraft does not come within the exception.

Respondents' witness * * *, a professional banker, serving the Bank as a paid consultant and advisory director, contacted personnel in the * * * office of the Federal Reserve Bank and the Comptroller of the Currency as to the meaning of the term "inadvertent" as it appears in Regulation O and whether a $57 overdraft persisting for one day as was the case of vice president account 23-069-3 would be a violation. The record is not completely clear but in light of the testimony of the witness considered in its entirety it appears that the inquiry was made subsequent to service of the May 19 "Notice" on the Bank. The contacts reported that by using the word "inadvertent" the banking regulators had created a "monster" because no one knows the meaning and that as a practical matter overdrafts of less than $1,000 and lasting not more than five days are not considered to be violations of Regulation O. They also expressed the opinion that a $57 overdraft for one day is not contrary to the regulation. The witness concedes that FDIC is not bound by these opinions.

{{4-1-90 p.A-46}}

Proponent submits that the Board of Directors had knowledge of the overdrafts and in support refers to the Minutes of the Board of Directors meetings from about mid November 1979 through mid March 1980. Emphasis is directed to a comment in the November Minutes reading "Overdrafts for October and including November 14, 1979, in the amount of $13,472.92 were reviewed and discussed." There were similar comments in the subsequent Minutes varying only in time periods and amount of overdrafts. Proponent was not able to determine from the Minutes the extent of the Board's review of the overdrafts or the nature of the discussion, if any, concerning payment of the overdrafts.

Respondents show however that the actual practice at Board meetings, going back to a period prior to the time the Bank's present owners assumed control, was to furnish only a computer printout of the most current overdrafts outstanding as of the day of the Board meeting which in the above example would be November 13. As a result therefore the Board of Directors would have, or could be charged with, knowledge only of those overdrafts outstanding as of the day prior to the meeting. Most of the directors are business men with many interests it is not surprising that they would be unaware of the overdrafts considering the generally minimal amounts involved. President * * * and consultant * * * admit that this is not a sound or prudent procedure and that effective with the Board meeting of March 13, 1980, the practice is to bring to the meeting room printouts of all overdrafts which have occurred during the approximate 30 days preceding the meeting in progress.

On July 11, 1979, each of the directors (including president Hudson and vice president * * *) was sent a letter, by certified mail with return receipt requested, advising that designated accounts of * * * were overdrawn, that this was contrary to Regulation O and because of past abuses by management the violations were considered flagrant. The letter showed the number of days the overdraws occurred, the maximum amount of the overdraws, and the average amount. The letters were mailed to the Bank's Post Office Box at * * * and were accepted by "* * *, VP" on July 13. The Minutes of the Board's meeting of August 8, 1979, reflect that the Chairman of the Board (president * * *) read the letter and that it was "reviewed and discussed in depth." The minutes show that consultant * * * and all the Board members were present except * * *. A July 24, 1979, letter from the Bank's Counsel states that all the overdrafts have been paid.

Witness * * *, a professional banker, has served as a consultant to respondent for several years. On or about the time Regulation O became effective he informed the Board of Directors of the general tone of the then new provision. Despite his experience in the banking industry the witness does not hold himself out as an expert on the meaning of the Regulation. President * * * concedes that the Board was aware of Regulation O and had an opinion as to its thrust, but he insists that the Board members had no specific knowledge of the overdrafts which are the subject of this proceeding. He himself was not aware that his accounts were overdrawn nor did he have knowledge of vice president * * *'s situation. The Board of Directors were first aware of the * * * overdrafts and that they were a credit against accrued salary as a result of discussion held during the Board meeting in March 1980.

Beginning apparently with the Board meeting of March 1980 and continuing up to the time of hearing the Board of Directors has been studying the feasibility of authorizing each director and Officer a designated line of credit and that overdrafts would be applied to this account and interest charged.

However, the Board has taken no formal action to approve such a procedure.

It is not disputed that the accounts of president * * *, vice president * * *, and director * * * were overdrawn. The real dispute is whether the Bank in paying the checks which caused or contributed to the overdrafts acted contrary to section 215.4(d) or as it is sometimes called Regulation O. Resolution of this issue requires that the evidence be considered in light of the language which exempts certain overdrafts from the general proscription that banks may not pay overdrafts of executive officers or directors.

[.4**]** It is a well known rule of construction that an exception to a general all encompassing proscription is to be construed in a way that does not defeat the general thrust of the provision's dominant theme. It seems clear that the dominant theme of {{4-1-90 p.A-47}}section 215.4(d) is that bank's may not pay overdrafts of officers or directors. To come within the so called "inadvertent" exception, payment of the overdraft must meet four tests, to wit, it must be inadvertent, the overdraft may not exceed $1,000, the account may not be overdrawn more than five business days, and the overdrawer must be charged the same fee as any other customer of the bank in similar circumstances. For the exception to be invoked all four tests must be satisfied.

Looking at president * * *'s account 22-225-2 and taking into consideration deposits made but not credited, it is concluded that the account was not overdrawn except from February 6 to the 12th (really February 11 because a deposit was made though not credited). Proponent insists that the inked in dates appearing on the deposit slips are not the dates the Bank received the funds. The date of receipt is the date encoded on the deposit slips and in all instances the latter date is at least one business day subsequent to the inked in dates and therefore the account was overdrawn to the extent indicated in an earlier section of the Decision.

Proponent's evidence was based on monthly bank statements which reflect the date checks written on the account or deposits made to the account are posted. In the absence of evidence tending to indicate otherwise such a showing would be considered *prima facie* proof of an overdraw. Respondent * * * however has shown that in several instances sums were deposited to the account on the same day as, except for the deposit, the account would have been overdrawn. There is no indication in the record that the deposit slips were back dated. Proponent cities * * * Statutes Annotated, § 84-4-107 which provide in effect that a bank may fix a cutoff hour for the posting of items to its books, and any item received after the cut off time may be treated as received on the next banking day. Clearly this is a rule designed for banking convenience and its application is not mandated. There is no evidence, except for the actual posting practices as indicated on the monthly statements, that this Bank has opted to conform to section 84-4-107. The record as a whole tends to establish that an account holder who objected to a posting which was subsequent to the date of actual deposit would be satisfied. There is no reason to hold that the same practice should not be applied to Officers or directors. This of course does not address the prudence of an officer or director who comes this close to an overdraft. Officers and directors by reason of their position ought as a matter of image avoid "brinkmanship".

In any event it is concluded that the account was not overdrawn except with respect to the period from February 6 to 11. In this instance because the overdraw was in the amount of $352 and did not persist for more than 5 business days, two of the conditions precedent are satisfied. There is a question however as to whether this overdraw can be considered as inadvertent.

[.5**]** Section 215.4(d) does not define the meaning of this term so it must be accorded its ordinary meaning as used in the language. According to Webster's New Collegiate Dictionary (1956) inadvertent is "heedless, inattentive, unintentional, or not turning the mind to a matter." Inadvertent carries the connotation of something being done (or not done) through oversight rather than done designedly, or in another sense something performed occasionally rather than something done on continuing basis or even frequently. This construction will be observed in treatment of the issues raised in this proceeding.

Upon consideration of the evidence it is concluded that in this instance the overdraft was inadvertent. The history for the study period establishes that respondent * * * kept the account under close scrutiny. Thus on several previous occasions when the account was in danger of being overdrawn, respondent would immediately replenish the account and by a narrow margin avoid an overdraft. Here respondent departed from the pattern and apparently through oversight permitted the account to become overdrafted.

As to president * * * account 22-334-4, one overdraw period persisted for more than 5 days on an amount of almost $200, while the other overdraw interval lasted for 9 days on an amount of $1,374. These overdrafts were either for amounts of over $1,000 and/or persisted for more than 5 business days. Respondent's explanation that because there was little activity in the account and a failure to communicate the need to infuse the account to cover the {{4-1-90 p.A-48}}overdrafts does not excuse the infraction. The history of this account for the study period indicates a pattern of carelessness or inattention which precludes a finding that the overdrafts were inadvertent.

[.6**]** Vice president * * * account 23-069-3, after taking into account that a deposit was actually received and encoded by the Bank, though not posted, on February 26 and thus forestalling an overdraw that day, was overdrawn on February 28 and 29 and again on March 31. The overdrafts were all less than $1,000 and none persisted for more than 2 business days. However because there were overdraws on February 28 and 29 and again on March 31, they cannot be considered as inadvertent, but rather appear to be the result of a fairly consistent pattern which tended to ignore the balance level in the account.

As to director * * * account 23-115-0 and giving consideration to the deposit made on February 29 though not credited until the following business day, the account was in arrears for only one day in an amount exceeding $1,000. Payment of the overdraft in this situation meets the inadvertence and 5 day measures but not the amount.

The last of the four conditions which must be satisfied before payment of an insider overdraft can be excused is that the holder of the delinquent account be charged the same fee as any other customer of the Bank in similar circumstances.

Respondents concede that the so called $5 service charge was not applied against the aforesaid accounts but insist that this does not indicate a failure to satisfy the fourth measure for the reasons stated in an earlier section of the Decision. They submit that proponent's compilation derived from the joint exhibit which shows that no insiders paid service charges on overdrafts whereas only about 33 percent of non-insiders were not assessed fees, is an incomplete and inaccurate portrayal of the situation. Proponent's review treats all service charges as assessed because of overdrafts, but this is not so. Respondents point out that negative balances bearing the designation OD appear on pages 27, 28, and 29, for each of the four monthly studies, but the negative balances depicted are not the result of overdrafts, but rather were caused by imposing charges for checks presented to the Bank which were not honored. Respondents imply that there are other instances of this practice in the exhibit and therefore proponent's compilation which, on the average, shows that almost 39 percent of the non-insiders were assessed a service charge for every overdraft, and 28 percent were assessed a service charge for some but not all overdrafts, is seriously exaggerated while the figure shown in Column H of the compilation which ostensibly represent the total number of non-insider accounts on which checks were paid that caused or contributed to overdrafts are "greatly understated." Respondents also state that the joint exhibit and proponent's compilation does not take into account those instances where the Bank rescinded imposition of the service charge.

The Corporation as the proponent of the action proposed has the burden of proving that the overdrafts under consideration do not fall within the exception to the general proscription in Regulation O against the payment of insider overdrafts. The record is clear that the $5 service charge was not applied against the considered insider accounts. Respondent insists that this does not defeat application of the exception because the Bank has no set policy on imposing fees or service charges on overdrawn accounts. The late filed exhibit submitted by the parties was initiated at proponent's request. It reflects that while none of the insider accounts were assessed service charges, about two-thirds of the non-insider accounts were assessed a service charge for overdrafts. Respondents seek to cast doubt on the significance of proponent's compilation pointing out that in several instances the service charges were imposed not for overdrafts but for checks not paid and returned to the drawer. There is no merit in respondents' observation. When a check is presented to the Bank on an account which lacks sufficient funds, the Bank may pay the check thus causing the account to be overdrawn or it may return the check to the drawer. Of course in the latter event the account is not necessarily overdrafted though by reason of the service charge imposed for return of the check, the account may be overdrawn or show a negative balance. In any event it appears that no insider was assessed a service charge either because of an overdraft or because of the return of checks not paid. In contrast most of the non-insiders were subjected to a service charge either because the account was over- {{4-1-90 p.A-49}}drawn or checks were not paid and returned to the drawer. Proponent has shown by a preponderance of the evidence that in terms of service charges insiders are treated differently from non-insiders. Respondents in order to prevail must do more than merely cast doubt on the worth of proponent's showing. They ought to have come forward with evidence to the effect that the showing made by proponent was seriously flawed, but this they did not do.

Respondents second defense is that the three insiders paid service charges of $8.07 in the form of interest. Payment was made on May 30, 1980. Two factors prevent this from being a viable defense. First, payment was made subsequent to receipt of the "Notice" of May 19 and this after-the-fact compliance does not excuse the infraction. Second, assessment of overdraft fees in the form of interest is not shown to be a customary practice but rather one designed for special or preferred customers. Respondents argue that non-insiders are assessed service charges in the form of interest, but no specifics were provided.

Respondents suggest that the overdraft infractions are due in some part to confusion on their part as to the meaning of the exception in section 215.4(d). They seek to show that the same uncertainty exists in

bank regulatory circles and even in the FDIC. This does not excuse the infractions. The real thrust of section 215.4(d) is to prohibit overdrafts of insiders unless the account holder has an extension of credit plan, a transfer of funds arrangement, or the overdraft comes within the inadvertent clause of the provision. There may be some uncertainty as to the circumstances which justify referring to an overdraft as "inadvertent" but the same situation exists whenever regulators' attempt to fix or determine "intent." Whether an overdraft is inadvertent cannot always be determined with the same precision such as would be the case if a finite guide such as dollar amount or time period were used. But then the significance of the term "inadvertent" is that is measures not so much action but an attitude. Whether the overdraft is inadvertent is determined from all the known circumstances surrounding the transactions. President * * * and consultant * * * are experienced professionals. On July 11, 1979, officers and Directors were informed of overdraft violations and respondents' counsel subsequently informed FDIC that the overdrafts had been corrected. The record establishes that respondents overdraft infractions are not the result of confusion or uncertainty as to the meaning of Regulation O.

Respondents assert that under * * * law a check can be presented on a certain day and reflected on the customer's records for that day, yet it will not constitute a liability to the bank or an extension of credit until two banking days later. Proponent's witness * * * stated however that the Bank's practice is not to pay a check where the account has insufficient funds until 24 or on occasion 48 hours after the check was presented to the Bank. Posting to the account is apparently performed by the servicer at * * *. Thus it would appear that when a check is posted to an account with insufficient funds, it has already been in the possession of the Bank one or two days.

In summary, it is concluded that account 22-334-4 of president * * *, account 23-069-3 of vice president * * *, and account 23-115-0 of director * * * were overdrawn, that the overdrafts were not covered by an extension of credit plan, or an arrangement for a transfer of funds program, and that said overdrafts do not come within the exception to the general prohibition that overdrafts of executive officers or directors not be paid.

Because the overdrafts of executive vice president * * * involve a different defense his situation is treated separately and will be taken up now.

Proponent shows that between October 17, 1979 and March 19, 1980, account No. 23-414-1 of witness * * * was overdrawn on 53 days caused by the processing for payment of about 101 checks. Many of the overdrafts exceeded $1,000 and persisted for more than 5 business days. Between November 16, 1979, and March 19, 1980, approximately 63 checks drawn on account 23-413-0 were paid causing the account to be overdrawn on 35 different days. On no single day did an overdraft exceed $745, but several overdrafts persisted for more than 5 days.

Testimony offered by Mr. * * *, president * * * and vice president * * * establishes that the checks issued on the two aforesaid accounts were paid or negotiated with knowledge that the accounts would be {{4-1-90 p.A-50}}overdrawn and therefore the action was not inadvertent.

Respondents state that Mr. * * * has been in fact, if not in title, executive vice president of the Bank since January 1977. On January 12, 1977, * * *, a partnership of * * * and * * *, and the Bank agreed that the partners would furnish executive supervision of the Bank for which service they would receive not more than $10,000 monthly beginning January 1, 1977. Witness * * * testified that from January 1977 to September 1979 he was compensated for his Bank work through the aforesaid management contract.

About June 1979, Mr. * * * indicated a desire to dispose of his stock in the Bank retaining only enough shares to qualify as a director. Sometime about September 1, 1979, he entered into an agreement with vice president * * * and president * * * whereby Mr. * * * would purchase his stock in the Bank. At the same time they reached an understanding that Mr. * * * would become a salaried employee of the Bank and would be compensated at the rate of $2,000 per month and at the same time would cease to be a partner in the management company or entitled to earnings from the same. However, it was agreed that Mr. * * * would not receive compensation until there was an actual transfer of the Bank stock to vice president * * *. Mr. * * *'s interest in the partnership was assigned to vice president * * * January 12, 1980. Because of complications which are not disclosed but apparently not relevant to the issues in this proceeding, the transfer was not affected until April 2, 1980. Prior to that date apparently 19,900 shares of stock were jointly owned by president * * * and * * *. On April 2, 1980, 11,776 shares were transferred to president * * * and 8,124 shares to vice president * * *. Respondents have no knowledge whether the FDIC has been advised of the change in control.

The Bank's Board of Directors meet about the middle of each month. Witness * * * admits that the Board did not agree to the aforesaid remuneration understanding at its September meeting or at any subsequent meeting until March 13, 1980, when the following statement, taken from the Minutes, appears:

> * * * Board Consultant * * * then explained to the Board of Directors the overdraft of Executive Vice President, * * * in the amount of approximately $9,000.00. He explained to the Board that a

back salary was owed to Mr. * * * by the Bank since September of 1979. Since Mr. * * * liability to the Bank has created trouble with the FDIC, Mr. * * * explained to the Board that the back salary which was owed to Mr. * * * was enough to cover the overdraft.

Director * * * made a motion to pay Mr. * * * a salary of $2,000 and that he retain his position as executive vice president as he no longer has ownership in the Bank other than a qualifying 100 shares. The motion was seconded and approved. On the following day witness * * * received all the salary owed him.

President * * * insists that the majority of the Board knew of Mr. * * * employment and salary though no formal action was taken until March 1980. He discussed it with all but directors and * * *, and he believes that Mr. * * * mentioned the matter to director * * *.

President * * * concedes that the agreement to employ Mr. * * * is a matter that should have been taken up at the stockholders meeting in January, 1980 or at the Board of Directors meeting in September or October, 1979, but he has the feeling that had these matters been raised approval from the stockholders and the Board would have been forthcoming. Much bank business is discussed outside the Board meetings. Generally formal actions binding the Bank are made at regular Board meetings but not always. Furthermore, he is not certain that the matter was not discussed at Board meetings though clearly it does not appear in the Minutes until the March meeting. President * * * had no knowledge as to whether there are any Bank documents and records which would reflect the employment status of Mr. * * *. However he is listed as Executive Vice President in an advertising brochure which was released early in January 1950.

Payment of the overdrafts on the two accounts of Mr. * * * was approved by president * * * or vice president * * *. No service charges or interest was paid on the overdrafts. This action was approved by president * * *. The matter was never discussed with the Board at a formal meeting though the record suggests that president * * * discussed the matter with several directors outside the Board meeting {{4-1-90 p.A-51}}room. He insists that witness * * * owed no service charge fees or interest on overdrafts because he was owed unpaid salary. Failure to approve the overdrafts would have meant that Mr. * * * could come against the Bank for salary owed and interest. None of the purported overdrafts were significant in amount or duration and none adversely affected the Bank's financial condition and therefore do not warrant penalties in the amount imposed.

Respondents' exhibit 4 shows the amount of overdrafts by date during the period from October 17, 1979 through April 29, 1980, on the two accounts heretofore described. The overdrafts range from a low of $9.24 on November 16, 1979 to a high of $11,791 on January 9, 1980. During the period studied the accounts were in overdraft status on 72 separate dates but only on January 9 did the amount of the overdrafts exceed the amount owed from the Bank as salary. In addition Mr. * * * is still owed $12,400 from the Bank for services provided in 1977 as a partner in * * *.

Proponent submits that * * * did not become an employee of the Bank until about mid March 1980. It shows that had service charges been applied on the * * * overdrafts the total charge would have been $820.

Respondents contend that Regulation O does not prohibit payment of overdrafts if they constitute an advance against accrued salary or other accrued compensation citing section 215.3(b)(1) which provides that an advance against accrued salary is not considered to be an extension of credit.

Respondents argument lacks merit. The purpose of section 215 subparagraphs 1 through 10 is to provide the banking business with guidelines for granting extensions of credit to insiders.

[.7**]** Section 215.3 goes into considerable detail defining what is and is not an extension of credit within the purview of the Federal Reserve Act. Section 215.3(a)(2) provides that an advance by means of an overdraft is an extension of credit. Section 215.4 is headed "General Prohibitions," and subparagraphs (a), (b), and (c) relate the conditions and limits which are to guide the bank in extending credit to insiders. Subparagraph (d) involves overdrafts and provides that the Bank may not pay an overdraft except under designated conditions.

Section 215.3(b)(1) is a clear statement that an insider may be advanced monies which are owed him for services provided or expenses incurred in performance of duties, without having such payouts tagged as being an extension of credit. Overdrafts however are specifically identified as falling within the definition of "extension of credit" and their payment is prohibited.

There is another reason why the * * * overdrafts cannot be excused or considered as an offset against accrued salary. At the time the overdrafts occurred * * * was owed no accrued salary. In the very best light of the evidence he was promised a salary of $2,000 a month by president * * * in September 1979, but that action was not approved by the Board of Directors until the meeting of March 13, 1980. It was only as the result of that action that Mr. * * * came to be owed a salary by the Bank. Furthermore Mr. * * * was paid his accrued salary on March 14, 1980, yet the overdrafts persisted until March 19, 1980.

It is concluded that executive vice president * * * overdrafts are contrary to 12 C.F.R. 215.4(d) and are not an advance against accrued salary within the meaning of 12 C.F.R. 215.3(b)(1).

The second of the principal charges raised by the "Notice" of May 19, 1980, relates to purported violations of the FDIC Cease and Desist order. This matter will now be taken up.

On December 16, 1977, the Corporation issued an order requiring the Bank, its Directors, Officers, employees, and agents to cease and desist from certain enumerated practices and to take designated affirmative courses of action. One such requirement was that the Bank and its Board of Directors establish written policies and procedures relating to loans. On March 30 and April 2, 1978, the Bank and its Board of Directors agreed to abide by a document titled "Statement of Lending Policies and Procedures" of which paragraph (m) provided in part "* * *. In no event shall the total direct and indirect obligations of a single borrower and/or his or her related business interest exceed $100,000.00."

Proponent shows that from January 29 through February 13, 1980, and from February 19, through February 25, 1980, the Bank extended credit in the form of a loan and in the form of overdrafts to * * * and {{4-1-90 p.A-52}}his related business interest * * * in excess of $100,000.

Another of the affirmative requirements of the December 16 order was that the Bank shall not extend credit to any person or concern including any person related to such person or concern in excess of 20 percent of the total capital and reserves of the Bank without the prior written approval of the Director of the Corporation's * * * Regional Office and the * * * State Bank Commissioner (paragraph 11(a) of the Order).

Proponent shows that from January 30, through February 8, 1980, and from February 19, through the 22nd, the Bank extended credit in the form of a loan and through overdrafts to * * * and his related business interests in excess of 20 percent of the total capital and reserves of the Bank without obtaining the prior requisite approval.

Still another of the affirmative requirements of the aforesaid order was that the Bank take all necessary steps to assure compliance with all applicable laws, rules, and regulations. Applicable statutes imposed a general lending limit equal to 15 percent of the bank's paid in and unimpaired capital stock and unimpaired surplus funds.

Proponent shows that from January 30 through February 13, 1980, and from February 19 through the 25th the Bank extended credit in the form of a loan and through overdrafts to * * * and his related business interests in excess of the 15 limit imposed by section 9-1104 of the * * * Statutes Annotated.

The record establishes that vice president * * * was generally responsible for approving payment of checks which caused * * * personal account 22-882-6, * * * account 10-563-5, and * * * account 10-401-0 to be overdrawn. However, in connection with check of $100,000 on account 10-401-0, and checks of $40,000 and $76,760 on account 22-882-6, witness * * * intended to disapprove payment but referred these items to president * * *. The referrals were due to the large size of the checks and the relationship between * * * and his brother president * * *. On May 30, 1980, interest in the amount of $1,170 was paid on the * * * overdrafts and $462 on the * * * personal checking account overdrafts. Had the service charge of $5 per transaction been applied the total charge for all three accounts would have been about $690.

President * * * does not believe his action jeopardized the Bank because in the case of the $100,000 overdraft the check was paid to a construction company which was working on a building title on which was held by the Bank. The overdraft persisted for 4 days and exceeded $100,000. The same account was credited with a 3rd party check of $90,000 on February 11, 1980. On February 26, 1980, the check was returned by the Bank on which it was drawn and it was necessary to debit the * * * account by $90,000. The Bank at that time went against the drawer and the debit was covered on the 26th.

Certain background information must be considered in evaluating the Corporation's charges. Thus on May 1, 1979, the Director, Division of Bank Supervision, FDIC, and the State Banking Commission, State of * * *, advised the Board of Directors, by certified mail-return receipt requested, that for certain enumerated reasons developed through an examination of the Bank on December 22, 1978, the Regional Director would recommend that paragraph 14 of the Order of December 16, 1977, be invoked unless the Bank took remedial action to correct the matters set forth in the letter. Following this letter there was at least one meeting between most members of the Bank's Board of Directors and FDIC and correspondence from president * * * and the Bank's counsel concerning the May 1, 1979, letter.

At a special meeting of the Board of Directors held June 1, 1979, the Bank's officers and agents and Board of Directors approved certain resolutions including a reaffirmation of their commitment to paragraph 11(a) of the Order of December 16, and to conform to the heretofore described Statement of Lending Policies and Procedures. These resolutions were transmitted to the Regional Director by the Bank's counsel on June 13, 1979.

By letter of July 27, 1979, the Regional Director of the FDIC's * * * Office wrote the Bank's counsel that FDIC was now satisfied that the Bank will meet the conditions set out in the May 1, 1979 letter, and the

Regional Director has "decided to recommend that no legal action to enforce the December 16, 1977, Order be initiated. * * *"
{{4-1-90 p.A-53}}

Respondents argue that there is no evidence that the members of the Board except perhaps as pertains to president * * * and vice president * * * participated in the alleged infractions. As noted above the statutory basis for the penalties sought are 12 U.S.C. § 1818(i)(2)(i) and 1828(J)(3)(A) which as noted above authorize penalties for violation of Regulation O and FDIC orders. Both sections define violations as "includes without any limitation any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation." Respondents argue that there is no evidence that, with the possible exception of Messrs. * * * and * * *, the Board members caused, brought about, aided or abetted any of the purported violations. The Directors may not be found guilty through association. Respondents point out that FDIC concedes that it was unable to determine the actual participation of individual directors in the discussions at Board meeting concerning the purported violations of Regulation O and the Order.

The FDIC submits that each director participated in the violations by failing to promote effective policies and procedures relating to the violations despite being placed on notice that infractions were occurring. Respondents counter with the argument that FDIC is equating "participating in" with "successfully preventing", apparently implying that though the directors may have lacked success in preventing infractions they cannot be changed with participating in the infractions.

It has long been held that a bank's board of directors is responsible for the overall administration of the affairs of the institution. The day-to-day management of the affairs of the bank may be delegated to the officers and others, but the Board is responsible for what may be termed the general policy of the bank. The evidence shows that on July 11, 1979, each of the Board members was advised by FDIC personnel that the Bank had paid overdrafts on the accounts of president * * *, vice president * * *, and executive vice president * * * and that such payments were contrary to Regulation O. The Minutes of the Board meeting of August 8, 1979, disclose that president * * * in his capacity as Chairman read the FDIC letter and that it was reviewed and discussed in depth. All the Board except * * * were present including consultant * * *.

[.8**]** It is probably true that the individual members of the Board except of course those whose accounts were actually overdrawn were not aware of the overdrafts which are the subject of this proceeding. But by reason of the FDIC letter of July 11 and discussions at Board meetings with president * * * and consultant * * * they were aware of a general problem. Yet despite these warnings neither the Board as a collective body nor the individual members opted or proposed that the Bank adopt a policy that overdrafts not be paid unless the account holder had an extension of credit or a transfer of funds arrangement to cover the overdrafts. Thus it appears that despite warnings that all was not right, the Board chose to continue doing nothing. Thus neither the Board's passivity nor its lack of knowledge concerning particular overdrafts will excuse it from the reach of section 1828(J)(3)(A). Clearly by doing nothing the Board as a group and the individual members allowed a climate to exist which countenanced the violations and in this sense the directors all participated.

Respondents submitted a large volume of evidence to the effect that Regulation O was a new guideline, that there was some uncertainty in Federal regulatory circles about the meaning of the Regulation particularly the term "inadvertent," that the FDIC's witness and counsel were in disagreement concerning the meaning of the exception, and that respondent's consultant, with many years experience in the banking business did not consider himself an expert on Regulation O.

These contentions must be considered in the context that respondents' consultant who was also an advisory member of the Board has had many years experience in the banking business. The record shows that the consultant furnished copies of the Regulation to the Board. The Minutes of the Board's meeting of July 11, 1979, disclose that president * * * in his capacity as Chairman discussed Regulation O on "Insider overdrafts." The minutes indicate that all members were present except director * * *, including consultant * * *. The latter testified that he advised the Board of {{4-1-90 p.A-54}}

Directors that insiders should be charged for overdrafts.

Thus the evidence of record considered in its entirety establishes that the Board of Directors through contacts with president * * *, consultant * * *, and through personal contact with FDIC personnel in * * * were cognizant or most certainly should be charged with knowledge of the general thrust of Regulation O. It may be argued that in using the word "inadvertent" the framers of section 215.4(d) introduced an element of discretion in interpreting the application of the exception, but clearly there is no uncertainty about the general tone, the reach of, or the general purpose of the Regulation, namely banks may not pay insider overdrafts unless there is an arrangement with the account holder for an extension of credit or a transfer of funds arrangement to cover the overdraft.

Concerning the Board's responsibility for the section 1818(i)(2)(i) infractions of the Cease and Desist

Order, it is noted that by letter of May 1, 1979, FDIC personnel advised the Directors concerning infractions of the order of December 16, 1977, and of certain action under contemplation unless the Bank complied. As a result of the letter there was a meeting between FDIC personnel and the Bank's officials and Board of Directors in * * *, on June 4, 1979. Also as a result of the letter certain action was taken by the Bank at a special meeting held June 1, 1979. Resolutions III, V, and VI are of particular interest. Resolution III provides that the Officer's and agents of the Bank are prohibited from extending additional credit to the persons described in paragraph 11(a)(1) and (2) of the Order of December 16. Resolution VI requires that Officers and the individual members of the Board of Directors are directed to monitor adherence of the Bank and its Officers and agents to the Statement of Lending Policies and Procedures heretofore adopted by the Board on April 12, 1978.

Thus the record shows that the Board in effect told the Officers of the Bank to adhere to the provisions of paragraph 11(a) of the order of December 16, 1977. However by resolution VI the Board committed itself to monitor compliance with the earlier approved Statement of Lending Policies. Thus it clearly appears that the Board has ignored its responsibilities. In the face of clear warnings, and despite its promise to assume a more active role, the Board persisted in its passive conduct. Accordingly, the record as a whole establishes that the Board through inaction countenanced management's action and participated in the infractions of the Cease and Desist order.

[.9**]** Section 1828(J)(3)(B) relating to Regulation O violations and section 1818(J)(2)(ii) concerning violations of orders both require that in determining the amount of the penalty the FDIC shall take into account the appropriateness of the sanction with respect to the size of financial resources and good faith of the bank or person, the gravity of the violation, the history of previous violations, and such other matters as justice may require.

Proponent submits that the violations of the Cease and Desist Order were intentional, persistent, and massive, while the Regulation O infractions were frequent, preferential of insiders, and continued despite warnings to the Board of Directors. An effort was made to determine the actual participation of each director in the review or discussion of the overdrafts at the regular Board meetings but the record of the meetings as reflected in the Minutes are silent concerning any discussion which may have been held. Proponent submits that the fines are reasonable because both sections 1818(i)(2)(i) and 1828(J)(3)(A) permit imposition of fines of not more than $1,000 per day for each day the violations continue. During the period covered by the "Notice of Assessment of Civil Penalty" the Bank violated Regulation O on no less that 177 occasions and therefore a penalty of $177,000 could have been sought. Over the same period of time at least one paragraph of the Order of December 16, 1977 was violated over a period of 17 days for which a penalty of at least $17,000 could have been exacted.

Respondents contend that the penalties sought are excessive considering the nature of the infractions and surrounding circumstances. They argue that there are only a handful of purported overdrafts on the accounts of Messr. * * *, * * *, and * * * the * * * overdrafts did not exceed the sums owed him for accrued salary and other owed compensation; and the loans and credits to * * * existed over a relatively short period of time. The fines of $24,000 and $7,000 sought against the Board are said to be excessive. The $5,000 fine against vice president * * * is not justified because he had no involvement in the extension of {{4-1-90 p.A-55}}credit to * * *. Respondents submit that arguably the record may support a penalty against president * * * for approving the credits to * * *, but yet when due consideration is given to all the surrounding circumstances even here no penalty is warranted.

Respondents refers to their exhibit which compares the Bank's vital statistics as of December 16, 1977 (date Cease and Desist Order entered), as of the FDIC examinations on December 22, 1978 and December 31, 1979, and as of July 10, 1980. The study shows that total deposits have increased, loans have declined, overdrafts reduced, and the bad debt reserve has increased. In view of the steady improvement of the Bank's condition the proposed penalties are without purpose.

Respondents also submit that the penalties are improper because FDIC contrary to the governing statues has failed to introduce evidence as to the financial resources of any of the respondents. Proponent in reply points out that it routinely collects information concerning the resources of directors and executive officers as an incident to its bank examining responsibilities. Proponent's exhibit 19, a copy of the Report of Examination dated December 22, 1978, contains data on this subject, while exhibit 28 is a copy of a net worth statement dated January 1, 1980, submitted by * * * and * * *.

The statutes which respondents are accused of violating and the authority for imposition of the penalties are the result of passage of the Financial Institutions Regulatory and Interest Rate Control Act of 1978. It was enacted in November 10, 1978, and became effective March 10, 1979. Though certain of the practices which are the subject of this proceeding were looked upon with disfavor by regulatory officials and even were unlawful, the law which became effective March 10, 1979, armed regulatory officials with a new procedure for dealing with abuses in the banking industry. Accordingly it is not surprising that there were or might be problems in obtaining conformity to the new statute and its

associated regulations. The evidence establishes, as heretofore noted, that the Bank's Board of Directors including of course the officers were put on notice that overdrafts of insiders were contrary to Regulation O, and that despite being so advised neither the Board as a group nor any individual directors effectuated or attempt to effectuate measures which would forestall overdrafts, as contemplated by section 215.4(d). Respondents submit that the $24,000 fine for the Regulation O violation is grossly out of proportion to the number, amount, and duration of the periods for which the overdrafts existed. It is true that the overdrafts involved accounts of only three directors and that in the case of vice president * * * and Director * * * the infractions were not numerous, but overdrafts of Messrs. * * * and * * * were the subject of the FDIC letter of July 11, 1979.

Despite the above however and considering the record as a whole it is believed the $24,000 fine imposed for the Regulation O violations is excessive when considered in the context that the FDIC was administering a new statute, that the overdrafts appear to be on a downward trend, and that the non-officer directors each owned only 100 shares in the Bank. The non-officer directors had no prior banking experience before joining the Board. Their inexperience in banking matters and their relatively nominal ownership interest undoubtedly made them reluctant to exercise the control which one might normally expect. For all these reasons it is concluded that the $24,000 fine is not justified, but that a fine of $4,500 is reasonable and will be assessed against the nine named Directors of the Board.

For violations of the Cease and Desist Order FDIC is asking for a $7,000 penalty against the nine named Directors and $5,000 each of president * * * and vice president * * *. The order became effective December 16, 1977. An examination of the Bank undertaken about December 1978 disclosed that the Bank was not in compliance with the order. On May 1, 1979, FDIC advised the Bank and its Board of Directors that unless steps were taken to bring affairs into compliance with the Order certain relief would be recommended. The Bank and its Board of Directors passed certain Resolutions which in effect reaffirmed the commitment to comply with the Order. On the basis of this promise, FDIC elected to not recommend the affirmative action mentioned in the letter of May 1. Nevertheless as this record shows the Bank through its {{4-1-90 p.A-56}}president and vice president violated the Order in the matter of the * * * accounts.

Upon consideration of all the evidence of record it is concluded that the $7,000 fine against the nine named Board of Directors is not justified. It cannot be seriously disputed that the Board erred in not monitoring compliance with the order as it had resolved to do. However the evidence of record is consistent with a conclusion that the non-officer directors considering their limited ownership interest and the familial relationship between the Bank's president and his brother * * * were as a practical matter not in a position to monitor this matter. The record shows that the extensions of credit to * * * were not outstanding as of the Board of Directors meetings. Perhaps significant, there was no Board of Directors meeting in February 1980 when most of the infractions occurred.

FDIC seeks penalties of $5,000 each against president * * * and vice president * * *. The fine imposed on the former is clearly justified. Besides being chief executive of the Bank he is chairman of the Board of Directors. He assumed responsibility for payment of the largest overdrafts associated with accounts of his brother * * *. He of course was aware of the Order, the December 1978 Bank examination, the FDIC letter of May 1, 1979, and the subsequent negotiations which satisfied FDIC that the Bank would comply with the order. The circumstances which caused the largest of the * * * extensions of credit do not excuse his actions.

It is believed however that the $5,000 fine imposed on vice president * * * is somewhat excessive. However as vice president he had significant professional responsibilities concerning approval of certain of the * * * extensions of credit. Undoubtedly he was in a difficult position concerning this matter, but as an officer holding an important executive position he ought to have removed himself entirely from this matter. A penalty of $2,000 is believed to be proper.

For all the reasons heretofore set forth, it is ordered that:

(1) A penalty of $4,500 be assessed against * * * in their capacities as members of the Board of Directors of the * * * for actions contrary to 12 U.S.C. 1828(J)(3)(A);

(2) A penalty of $5,000 be assessed against * * * and $2,000 against * * * for actions contrary to 12 U.S.C. 1818(i)(2)(i); and

(3) In all other respects respondents be discharged of penalties set forth in the "Notice of Assessment of Civil Penalty" dated May 19, 1980.

At Washington, DC, by Richard A. White, Administrative Law Judge.

HOYLE L. ROBINSON
Executive Secretary