FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON, D.C.

In the Matter of LARRY B. FAIGIN and JOHN J. LANNAN Individually and as former institution-affiliated parties of FIRST BANK OF BEVERLY HILLS CALABASAS, CALIFORNIA (Insured State Nonmember Bank in receivership)	)	DECISION AND ORDER TO PROHIBIT FROM FURTHER PARTICIPATION AND ASSESSMENT OF CIVIL MONEY PENALTY FDIC 11-269e FDIC 11-270k FDIC 11-252e FDIC 11-254k

I. INTRODUCTION

This matter is before the Board of Directors ("Board") of the Federal Deposit Insurance Corporation ("FDIC") following the issuance on August 21, 2015, of a Recommended Decision ("Recommended Decision" or "RD") by Administrative Law Judge C. Richard Miserendino ("ALJ"). The ALJ recommended that Larry B. Faigin ("Respondent") be subject to an order of prohibition pursuant to section 8(e) of the Federal Deposit Insurance Act ("Act"), 12 U.S.C. § 1818(e). The ALJ also found that Respondent was subject to a civil money penalty ("CMP") assessment in the amount of $85,000 pursuant to 12 U.S.C. § 1818(i)(2). The ALJ's recommendation was based on findings that Respondent engaged in a series of unsafe and unsound banking practices and breached his fiduciary duty to the First Bank of Beverly Hills, Calabasas, California ("Bank").

For the reasons discussed following, the Board affirms the ALJ's findings and conclusions that the necessary elements are established in the record and warrant an order to prohibit under section 8(e), and be assessed a CMP pursuant to section 8(i) of the Act.

II. PROCEDURAL HISTORY

The FDIC initiated this action on September 21, 2011, when it issued against Respondent, individually and as institution-affiliated party of First Bank of Beverly Hills, Calabasas, California, a Notice of Intention to Prohibit from Further Participation; Notice of Assessment of Civil Money Penalties, Findings of Fact and Conclusions of Law; Orders to Pay; and Notice of Hearing ("Notice"). The FDIC amended the Notice on September 7, 2012 ("Amended Notice").[1] The Amended Notice included an Order to Pay a CMP in the amount of $85,000. Amended Notice ¶ 110; RD at 2.

The Amended Notice charged Respondent with unsafe and unsound conduct and breaching his fiduciary duty by imprudently engaging in risky lending. Specifically, the Amended Notice alleged that Respondent: (1) led the Bank to enter a new, riskier lending area—known as acquisition, development, and construction ("ADC") lending—without ensuring the Bank had the appropriate policies and staff in place to navigate this type of lending; (2) led the Bank to purchase $117.1 million in eight, complex ADC participation loans ("Participation Loans") absent proper underwriting; and (3) despite the Bank's increasing risk profile, allowed the Bank to originate four more large, complex ADC loans ("Origination Loans") without proper underwriting. Amended Notice ¶¶ 22-92; RD at 1-2. The Amended Notice also alleged that Respondent's conduct resulted in financial loss to the Bank, a substantial risk of additional losses, prejudiced the Bank's depositors and breached Respondent's fiduciary duty as an officer

[1] The Notice and Amended Notice also contained allegations against John J. Lannan who was, during the relevant period, a director at the Bank. RD at 1, n. 1. On January 16, 2013, the FDIC filed a notice of Dismissal of Charges and, thereby, terminated proceedings against Lannan. *Id.*

and director of the Bank. Amended Notice ¶ 100-103; RD at 2. Finally, the Notice alleged that the above-described conduct demonstrated a willful and continuing disregard for the safety and soundness of the Bank. Amended Notice ¶ 104; RD at 2.

On September 21, 2012, Respondent filed a timely First Amended Answer denying the material allegations in the Amended Notice. RD at 2. The ALJ conducted a hearing on this matter from January 28, 2013 to March 1, 2013 in Los Angeles, California and held one additional day of proceedings on May 1, 2013 in Washington, D.C. *Id.* During the hearing, the ALJ received sworn testimony from twenty-four witnesses, including Respondent. Following the hearing, both parties filed timely post-hearing and reply briefs. *Id.* at 3.

On August 21, 2015, the ALJ issued a 166-page Recommended Decision recommending that Respondent be prohibited from participation in the banking industry and be ordered to pay a CMP as assessed in the Amended Notice. Enforcement Counsel timely filed exceptions. Respondent did not file exceptions. On October 2, 2015, pursuant to 12 C.F.R. § 308.40(c)(2), the FDIC Assistant Executive Secretary transmitted the record in the case to the Board for final decision.

III. FACTUAL OVERVIEW

Because the ALJ provided a lengthy, detailed and well-reasoned opinion with extensive citations to the record in support of his conclusions, the Board finds it unnecessary to reiterate in full the contents of the Recommended Decision. The Board has determined that Respondent, while serving as the Bank's top officer, engaged in a series of unsafe and unsound practices that exposed the Bank to unacceptable risk and warranted his prohibition from the banking industry. More specifically, Respondent, during a period covering nearly three and a half years, led the Bank into a high risk, complex ADC lending practice without the proper infrastructure to support

the lending practice; authorized staff to perform a truncated review of the largest ADC loan deal the Bank had ever undertaken; presented eight ADC Participation Loans to the Bank's board with inaccurate information and inadequate analysis; permitted a director, with a financial interest in the loans, to review and approve the purchase of the Participation Loans; failed to identify the Participation Loans as exceptions under the Bank's Loan Policy; and allowed the Bank to originate four more large ADC loans without proper underwriting. The following discussion focuses on the facts surrounding the review and approval of the Participation Loans. This discussion, however, is merely illustrative as one pattern of Respondent's misconduct as alleged in the Amended Notice, corroborated by supporting testimonial and documentary evidence, and recounted in the lengthy and detailed Recommended Decision.[2] Notably, the Board finds ample evidence in the record establishing that Respondent's conduct with respect to the Origination Loans also warrants a prohibition order and CMP assessment.

A. Background

1. Bank's Transition into ADC Lending

Respondent first became involved with the Bank in June 1999 when he was appointed to the board of directors of the Bank's holding company. RD at 5. He served as chairman of the holding company's board from September 1999 to 2009. *Id.* In April 2001, Respondent became a member of the Bank's board of directors. *Id.* In December 2005, he became the Bank's Executive Vice President of Development and six months later was named CEO and President of the Bank. *Id.*

An attorney by training, Respondent's professional career spans more than forty years in business, real estate, land development and lending matters. He has extensive experience with

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[2] The ALJ's findings rest on far more facts than those discussed here. The facts section of the Recommend Decision spans nearly a hundred pages.

real estate development (largely on the developer's side) and has worked with both residential and commercial real estate developers. RD. at 3-4. However, he had little experience in supervising the underwriting of ADC loans. *Id.* at 4.

Respondent's appointment as a Bank officer coincided with the Bank's move into ADC lending. RD at 5. Before then, the Bank's target loan size was between $2 million and $5 million, with most of its loans near the lower end of that range. *Id.* The Bank did very little construction lending and the type of construction lending it did was mostly bridge financing or short term loans to upgrade existing, stabilized properties as opposed to loans for ground-up construction. *Id.*

Discussions about a change in the Bank's lending direction began in 2004 and work in earnest began in 2005, at which point Respondent was a board member, but not yet an officer. RD at 7. In late 2004 or early 2005, Respondent arranged a weekend retreat for several senior members of the Bank's management to discuss what needed to be done for the Bank to move into ADC lending.[3] *Id.* at 7-8. Following the retreat, Respondent outlined for the Bank's board the conclusions he and other officers present reached on ADC lending. The Bank's board, in turn, expressed an interest in pursuing ADC lending. Respondent began working on an ADC lending plan. On January 26, 2006, following numerous ADC-related meetings and presentations, the Bank's board adopted a business plan ("Plan") drafted by Respondent that stated that construction lending would be the Bank's primary new product.[4]

2. Bank's Staffing and ADC Experience

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[3] Facing increased competition in its traditional stabilized lending, the Bank's board was looking at alternative business lines within real estate lending. RD at 7.

[4] The Plan explained that ADC lending presented the opportunity to close loans with higher margins and generate fee income, but also acknowledged that ADC lending entailed new construction risks. RD at 8-9.

Respondent was involved in staffing discussions and decisions in connection with the Bank's move into ADC lending. RD at 9, 10, n.9. More specifically, his Plan designated certain individuals as "Point Persons" for various functions related to ADC lending. *Id.* at 8-9. Respondent was designated as Director Overview; Bruce Gumbiner ("Gumbiner") was Designated Underwriter; and, Annette Vecchio ("Vecchio") was designated point person for Oversight of Disbursements. *Id.* at 9. In addition to these designations, Respondent changed the Bank's underwriting process after becoming CEO. *Id.* at 6. Notably, he split the role of Chief Lending Officer ("CLO") and Chief Credit Officer ("CCO"). *Id.* at 6-7. Craig Kolasinski ("Kolasinski"), who had served as both the Bank's CLO and CCO, remained CLO and Respondent appointed Vecchio as CCO. *Id.*

These adjustments, however, did not address the shortage of ADC experience among Bank staff. Vecchio had a small amount of ADC experience from decades earlier, but little or no background in ADC underwriting and no ADC underwriting experience during her time at the Bank. RD at 9-10. In addition, neither Gumbiner, the Designated Underwriter, nor his staff had experience underwriting ADC loans. *Id.* at 10. In an effort to acquire the necessary underwriting expertise, the Bank hired three new employees between March 2006 and September 2006; only one of the three new hires, Janet Giles ("Giles"), was clearly an experienced underwriter familiar with ADC lending. *Id.* at 10-11.

The Bank also provided its staff with some training on ADC lending, but it was minimal. RD at 11. In the summer of 2006, underwriters had access for a few hours each week to a six week online class reviewing the basics of construction lending. *Id.* Gumbiner took the class, but it was unclear who else did. *Id.* Respondent testified that ADC training was provided to credit administration staff, but said nothing about whether it was provided to underwriters. *Id.*

3. Bank's ADC Lending Policies

On August 31, 2006, the Bank's board approved a Loan Department Policy Manual ("Loan Policy") that was supposed to contain policy changes necessary for the Bank's move into ADC lending. RD at 12. Section 1 of the Loan Policy contained the type of financing the Bank offered, but contained no provisions authorizing ADC lending. *Id.* Section 2 contained the Bank's policies specifically directed towards ADC lending. *Id.* That section stated that it was to serve as a guide for "general construction financing" which would include ADC loans and it was the Bank's intent to make ADC loans that would convert to "permanent loans" with the Bank after construction. *Id.* at 12-13. The revised Loan Policy provided that construction financing could be provided for the following property types: Commercial, Industrial, Residential and Multifamily. *Id.* at 13. This was a substantial change from the prior version of the Loan Policy which stated that the Bank does not provide financing for general construction, residential or multi-family projects and offers bridge construction loans on a limited basis only. *Id.*

Section 2 of the Loan Policy also contained additional relevant policies, among them, that all constructions loans were to be made in compliance with the Bank's lending policies and all applicable state and federal laws and regulations. RD at 13. Moreover, Section 2 stated that all loans not complying with Bank policy be treated as exceptions and approved accordingly. In addition, the Loan Policy required that appraisals be dated no earlier than 12 months prior to the date a loan was funded or within a shorter period of time if the market was volatile. *Id.*

Finally, the Loan Policy addressed loan participations. RD at 14. Loan participations were to be underwritten with the same care as loan originations; the Bank would rely on the lead bank for an assessment of risk; and the Bank would obtain a value estimate for each loan, which might include a new appraisal. *Id.* Significantly, the Loan Policy set forth that any waiver of

due diligence must be disclosed, documented, and approved by the appropriate approving authority. *Id.*

The record reflects that senior officers responsible for ADC lending were confused about the applicability of the Loan Policy to the transactions at issue in this matter. RD at 14. For example, Vecchio sometimes seemed uncertain about whether the Bank's general underwriting policies or its ADC policies applied to participation loans. *Id.* At other times, she testified that the Bank's participation policies should have applied to underwriting the Participation Loans in this case, but were not followed. *Id.* Meanwhile, Gumbiner testified that the Bank's Loan Policy did not apply because Bank personnel only reviewed documents received from the originating bank and did not underwrite the Participation Loans at issue. *Id.*

4. The Chinatrust Participation Loans

In the summer of 2006, the Bank's lending was not on pace to reach its year-end goals. RD at 15. Respondent informed lending personnel that they needed to produce $16 million in loans per month to reach the Bank's annual goal and that failure to do so would result in a re-evaluation of their positions. *Id.* In May or June 2006—months before the Bank adopted its new Loan Policy—John Lannan ("Lannan"), a Bank director, arranged a meeting between Bank personnel and representatives of Chinatrust Bank ("CTB") to discuss the possibility of the Bank purchasing from CTB participations in several ADC construction loans. *Id.* At the time he arranged the meeting, Lannan had an agreement with the Bank which awarded him a fee for any loans he referred to the Bank. *Id.*

Respondent, Vecchio, Lannan and other members of the Bank's ADC group attended the initial meeting with CTB. RD at 16. CTB presented ten loans for purchase. *Id.* Respondent

initially testified that he attended the beginning of the meeting and left his staff to review specific loans with CTB. *Id.* at 17. But on cross examination, when confronted with his earlier and contradictory sworn statement, Respondent testified that he stayed at the meeting and participated in the initial review of the loans. *Id.*

Following the initial meeting, Kolasinski and his subordinate handled the review of the CTB Loans. RD at 17. At some point, Respondent became annoyed with the pace of the review. *Id.* at 18.[5] He told Kolasinski that the review needed to be completed and a decision made. *Id.* He also contacted CTB staff to urge them to move more quickly to provide information and documents to the Bank. *Id.* By mid-July, Respondent sought additional help from Vecchio. *Id.* Although Kolasinski remained in charge of the review, lending personnel as well as Lannan were reviewing files received from CTB. *Id.*[6]

When the Bank continued to have difficulty obtaining documents from CTB, Respondent eventually put Vecchio in charge. RD at 19. Once in charge, Respondent asked Vecchio if she could complete her review of the Participation Loans in a week to ten days so that the loans could be presented to the Bank's board. *Id.* at 21. Vecchio responded that the Participation Loans could not be underwritten in that time and, at most, staff could examine the documents in CTB's files, compare them to CTB's credit memos, obtain updated absorption and inspection data on the projects and prepare an Executive Summary for the Bank's board. *Id.* Respondent decided he would use the CTB materials and the Bank's summary. *Id.* He would also inform the Bank's board about what was and was not being done. *Id.*

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[5] The delays were largely caused by the fact that CTB had no single point person for the transaction and relevant documents were stored at different locations. RD. at 18.

[6] Vecchio testified that she had never seen a director assist with document review and did not know why Lannan was involved. RD at 18.

Both Vecchio and Gumbiner testified that the review of the Participation Loans was not underwriting, but a review of documents. RD at 21. Specifically, Bank staff verified CTB's calculations and compared the data in CTB's credit memos to the documents in the files CTB provided. *Id.* at 22. They did not obtain updated financial documents and analyze them. *Id.* Gumbiner characterized it as a "lightweight review" of the Participation Loan documents where staff did not analyze the documents in CTB's files, but checked to see that they existed. *Id.* Similarly, Gumbiner's most experienced ADC underwriter and new hire, Giles, testified that the Bank relied on CTB's credit analysis and that she did not do any independent analysis. *Id.* She merely summarized what CTB had already done. *Id.* Giles also testified that she believed that the Bank's decision makers wanted to purchase the Participation Loans and the process was just a summary of CTB's analysis. *Id.*

The record evidence reflects that Respondent was an active participant in the review and understood the level of analysis that took place. RD at 22. He inspected several of the projects for the Bank and had several informal meetings about the Participation Loans during the review. *Id.* Respondent discussed the Participation Loans at a regular lunch meeting he held with his senior officers every Tuesday and attended other meetings where they were discussed. *Id.* at 22-23. Respondent reviewed the summaries that Bank staff prepared. *Id.* at 23. Respondent described the Bank's review of the Participation Loans as an "iterative process" where "all were fairly familiar with what was going on, where the loans were, [and] what was in the various documents." *Id.*

5. The Final Review

Between September 8 and September 25, 2006, Bank staff attempted to complete its review of the Participation Loans in order for Respondent to present them to the Bank's board on

September 25, 2006. RD at 23-32. The record establishes that Bank staff was still attempting to obtain updated information up until the meeting began. *Id.* at 24. As the Bank's Chief Appraiser was completing his review between September 8 and September 15, he recommended that the Bank obtain additional information on five of the projects including the projects' current conditions, sales and construction status, and projected costs. *Id.* at 24. As late as September 14, Kolasinski emailed CTB—and copied Respondent—requesting complete working files for each loan because the Bank had only partial files. *Id.* On September 19, a Bank employee forwarded an email he received from CTB to Respondent in which CTB explained it was still gathering information that Kolasinski had previously requested. *Id.* at 25.

On September 20, 2006, the Bank's Officer's Loan Committee ("OLC") met to consider and approve the Participation Loans. RD at 26. The packets for four loans were sent to the Bank's board the same day as the OLC meeting and packets for the remaining four loans were sent the next day ("board packets"). *Id.* Respondent received the board packets when everyone else did. *Id.* No changes were made to the board packets as a result of the OLC meeting. *Id.* Even after the OLC had approved the Participation Loans and sent out the board packets in anticipation of the September 25 board meeting, Bank staff continued to try to obtain information from CTB in order to complete its review. *Id.* at 28.

Notably, Respondent testified that he relied on his staff's assurances that the Participations Loans were properly reviewed during this time. The ALJ rejected this claim and pointed out Respondent's own testimony to the contrary. RD at 27. For example, Respondent testified that Vecchio told him she could only verify the data in the CTB credit memos in the time she had. *Id.* Further, Respondent testified that he was heavily involved with the

Participation Loan review. He should, therefore, have already known the depth and breadth of the review process being used by staff. *Id.*

On September 22, 2006, as the board meeting was rapidly approaching, an exchange of emails suggested serious flaws in the review. First, Gumbiner sent Vecchio an email informing her that the Bank's review would "not necessarily uncover all the underwriting flaws." RD at 28. Later, Gumbiner sent another email, this time inquiring whether the Bank was "going down the right path by primarily looking at documentation?" *Id.* at 29. He described the review of the Participation Loans as making sure the Bank had "complete files and that in a very cursory sense ... they make sense." *Id.*

Also on September 22, 2006, William King ("King") the Chairman of the Bank's board raised his own questions about the Participation Loans. RD at 29. He sent an email to Respondent, Vecchio and Kolasinski expressing that more work needed to be done on the Participation Loans. *Id.* The email raised general concerns, followed by questions specific to several loans. *Id.* at 29-30. The email concluded by stating that there was not enough information to make decisions on the loans. *Id.* After receiving the email, Respondent forwarded it to the Bank's board with a statement that King's questions would be answered at the September 25 board meeting. *Id.* at 31. The following day, Respondent sent King a response defending his staff's work based on his familiarity with their work and the feelings of other board members. *Id.* Respondent stated that he was angered by King's email and he intended to rebuke him with his response. *Id.* at 31-32. On Sunday, September 24, King emailed Respondent insisting that he was only trying to be constructive and helpful, not negative or contentious. *Id.* at 32. King clarified his earlier email. *Id.* Respondent again replied, promising

that all of King's emails would be addressed at the board meeting and written responses would be prepared either in the board minutes or in a separate memo. *Id.*

On September 23, just two days before the board meeting, Vecchio sent an email to Respondent and others. RD at 40. She informed them that the Bank's Allowance for Loan and Lease Losses ("ALLL")[7] would be under-reserved by almost $1 million if it purchased the Participation Loans prior to the end of September, when the current quarter closed. *Id.* She suggested that the Bank delay funding the Participation Loans until October so that the Bank would not be required to increase its ALLL to account for them until the following quarter. *Id.* Despite the rushed review, the unresolved issues, and Respondent's knowledge that the Bank needed to delay closing until October, Respondent still had staff present the Participation Loans and allowed the Bank's board to vote and approve them on the morning of September 25, 2006. *Id.*

6. The September 25 Board Meeting

An hour before the board meeting on September 25, 2006, Bank staff met to discuss King's questions. RD at 32-33. At 10 a.m., the Bank's board convened. An hour later the meeting ended. *Id.* at 33. The minutes of that one hour meeting reflected a brief presentation of eight Participation Loans followed by a motion and vote to approve each loan; a discussion of how disbursement would be monitored going forward; when the Participation Loans would fund; funding strategy for the Participation Loans; and a few other comments ("board minutes"). *Id.* at 33. The board minutes also reflected discussions of some issues raised in King's email and three additional questions posed by board members. *Id.* at 33-34. The record is unclear, however, as

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[7] ALLL is a calculated reserve a bank holds to reflect an estimate of uncollectible debts. It was formerly known as the reserve for bad debts. RD at 40.

to how seriously King's concerns and any other issues were considered. *Id.* at 33. The board minutes do not reflect any in-depth analysis and several issues King raised in the emails do not appear to be mentioned at all. *Id.*

Respondent's testimony regarding the substance of the board meeting changed repeatedly. Initially, Respondent testified that the discussions at the board meeting were far more involved than the board minutes show. RD at 36-37. He insisted that the Bank's board was engaged in the discussion; King's questions were addressed; and, each loan was discussed. *Id.* at 37. Later, when pressed for specifics, Respondent testified that not many questions were asked at the board meeting and recalled only compliments from the Bank's board about how well the information was presented. *Id.* Respondent reversed his testimony again when confronted with potentially troubling issues regarding several of the Participation Loans. *Id.* In each instance, and despite his earlier testimony, Respondent insisted that the specific issue was discussed and resolved at the board meeting. *Id.* He offered no specifics about these alleged discussions and no explanation as to why any of these discussions did not appear in the board minutes. *Id.* at 37-38.

Other witness testimony did not support Respondent's claim that numerous issues were discussed and resolved at the board meeting. RD at 38. Moreover, the board minutes belie Respondent's claim. *Id.* at 39. In light of the many topics already captured by the board minutes, the ALJ found it unlikely that numerous additional issues cited by Respondent were also discussed and resolved in the space of that same hour but not captured in the board minutes. *Id.*

7. Underwriting Issues with the Participation Loans

Apart from the expedited and truncated review process, the ALJ's review of the materials presented to the Bank's board highlights numerous issues with the Participation Loans that went beyond those identified in King's email. RD at 40. The ALJ examined a host of common underwriting issues in light of the Bank's policies, governing regulations, and industry practice including whether the Bank: (1) performed an independent analysis; (2) performed an appraisal review; (3) performed an assessment of the borrower's financials; (4) used outside consultants when needed; (5) purchased a majority interest in the Participation Loans; and (6) disclosed and documented any waiver of due diligence. *Id.* at 41-44. In addition, the ALJ set forth the details of each of the eight Participation Loans and the many discrepancies in each loan's Executive Summary and supporting materials.[8] *Id.* at 45-68. We discuss briefly each of the eight Participation Loans and highlight some of their irregularities as documented much more fully in the record.

a. SEP

The SEP loan was a $12 million loan with an 18 month term originated by CTB in August 2006. RD at 45. The borrower was a single purpose LLC with a managing member who guaranteed 100 percent of the loan. *Id.* The purpose of the loan was financing the construction of 31 condominiums in Sherman Oaks, California. *Id.* The SEP Executive Summary recommended purchase of the loan based on an excellent location, the experience and financial

[8] The Bank's board was provided with an Executive Summary for each Participation Loan and the original CTB credit memo. RD at 23. An Executive Summary template contained an introductory paragraph, with a table showing a summary of loan terms such as borrower, location, loan amount, percent disbursed, percent completed, maturity date and any extension options, interest rate, the Bank's participation and the Bank's fees. *Id.* The Bank's board also received a short memorandum summarizing the entire CTB transaction. *Id.* Vecchio knew this material was not consistent with the Bank's Loan Policy requiring that participations be underwritten like originations. *Id.*

strength of the sponsor/guarantor, market absorption and acceptable Loan-to-Cost ("LTC") and Loan-to-Value ("LTV") ratios. *Id.*

Among the many issues discussed with the SEP Loan (RD at 45-48), the SEP Executive Summary raised and failed to resolve an issue about the status of construction in comparison to loan disbursement. *Id.* at 47. The SEP Executive Summary stated in one section that 35 percent of the loan was disbursed as of July 2006 (a month before CTB originated the loan), but stated in another section that the loan balance dropped as of September 18, 2006 to $2.9 million—approximately 25 percent of the loan limit. *Id.* Nothing in the SEP Executive Summary reconciled this discrepancy or affirmed the status of construction despite the fact that Bank staff visited the site on August 18, 2006. *Id.* at 48. Thus, the Executive Summary left open why 35 percent of the loan was apparently disbursed a month before CTB originated the loan; how the loan balance dropped to $2.9 million (or approximately 25 percent) two months later; and, how the current status of the project compared to the amount of the loan disbursed. *Id.* Respondent stated that the absence of an explanation might have been a problem were it not for the discussion that took place at the board meeting. *Id.* There was no discussion of the issue according to the board minutes. Thus, the record does not support Respondent's testimony. *Id.*

b. MAG

The MAG loan was an $11.2 million loan due to mature in January 2007 with one six-month option to extend. RD at 48. It was 16.56 percent disbursed and 23 percent complete. *Id.* The borrower was a single purpose LLC with its managing member guaranteeing 100 percent of the loan. *Id.* The purpose of the loan was financing construction of a 63-unit condominium complex in Riverside, California. *Id.* The MAG Executive Summary recommended purchase of the loan subject to three conditions: (1) evidence of tentative tract map approval; (2) further

investigation of the potential impact of an ongoing litigation on the borrower's financials; and (3) an evaluation of the adequacy of the interest reserve in light of construction delays. *Id.* at 48-49.

At the time CTB originated the loan, construction was projected to be completed by June 2006—three months before the Bank purchased its participation. RD at 49. But construction was only 23 percent complete when it came before the Bank's board. *Id.* The MAG Executive Summary attributed this to delays in obtaining approval for the tentative tract map and stated that clearance was expected "soon." *Id.* Nothing in the MAG Executive Summary or the CTB documents in the board packet, however, explained the reason for the delay or why approval was expected "soon." *Id.* Although the Bank's Loan Policy expressly identified delays and additional costs caused by delays as important consideration in underwriting construction loans, the Executive Summary did not include any discussion of how the delays would affect the cost of completion or the adequacy of the interest reserve. *Id.*

c. VIN

The VIN loan was a $24 million loan set to mature in May 2007. RD at 50. As of September 14, 2006, approximately $17.3 million had been disbursed. *Id.* The borrower was an LLC and its two managing members each guaranteed 100 percent of the loan. *Id.* The purpose of the loan was to repay debt and fund construction of 94 duplexes and single family condominiums in Coachella, California. *Id.* The VIN Executive Summary recommended purchase of the loan based on a "good location, experience and financial strength of the borrower/guarantors, market absorption, acceptable LTC and LTV." *Id.*

As with the SEP Loan, the VIN Executive Summary also noted but did not resolve a discrepancy between the amount of disbursement and the status of construction. RD at 52. It

stated that the loan was 72 percent disbursed while the project was only 60 percent complete. *Id.* It contained no explanation for this disparity. *Id.* Contrary to Respondent's testimony, the evidence suggests that this variance was also not explained to the Bank's board. *Id.* at 52-53. Further, while the VIN Executive Summary identified the guarantors' financial strength as support for purchasing the loan, it did not explain that a significant portion of the guarantors' assets were in real estate or that they had significant negative cash flow in recent years. *Id.* at 53. Respondent explained that he would expect developers to have a significant amount of their net worth in other projects and that the guarantors' negative cash flows did not concern him. *Id.*

d. MSC

The MSC loan was a $9 million revolving line of credit set to mature in November 2006, with two options to extend for six months. RD at 53. By the time of the board meeting, the MSC loan was 98.6 percent disbursed. *Id.* The borrower was a closely held corporation whose owners guaranteed one-third of the loan, up to $3 million. *Id.* The purpose of the loan was to repay debt and provide working capital for a development in Santa Clarita, California. *Id.* The MSC Executive Summary recommended purchase of the loan based on "excellent location, experience and financial strength of the sponsor/guarantor, market absorption, and acceptable LTV." *Id.* at 54. The Bank purchased an $8 million or 89.5 percent participation interest in the loan. *Id.*

The materials related to this loan raised several problems. First, the Bank's board packet contained four different CTB credit memos—each bearing a different date. RD at 54. At least two of the CTB credit memos stated that the loan funds would be used to develop the subject property. *Id.* at 55. Meanwhile, each credit memo stated that the borrower had tentative plans for a mixed-use building and that the borrower was attempting to determine if a hotel had any

interest in building on the site. *Id.* at 54. If not, the borrower intended to build townhomes on the site. *Id.* Despite what was stated in the credit memos, the field inspection section of the MSC Executive Summary implied that there had been no development on the subject property with 98.6 percent of the loan disbursed. *Id.* at 55. Notably, the record showed that the funds for this loan had actually been used to develop other projects. *Id.* On cross-examination, Respondent testified that this loan was discussed at length during the board meeting and that staff answered all questions about it. *Id.* The board minutes contained no substantive discussion of this loan including the amount disbursed, the manner in which the funds were spent, the correct source of the guarantor's financial information, or the outdated appraisal. *Id.* at 54-55.

e. MPC

The MPC loan was a $44.4 million loan set to mature in March 2007 with one option to extend for twelve months. RD at 56. By the September 25 board meeting, the loan was 25 percent disbursed and 46 percent complete. *Id.* The borrower was the same entity that borrowed against the MSC loan and this time its owners guaranteed half of the loan up to $22 million. *Id.* The purpose of the loan was to fund "backbone" infrastructure for a development in Santa Clarita, California. *Id.* The MPC Executive Summary recommended purchase based on an "excellent location, experience and financial strength of the sponsor/guarantor, market absorption, and acceptable LTV." *Id.* The Bank purchased a $13 million or 29.2 percent participation interest in the loan. *Id.* at 57.

The MPC Executive Summary incorrectly stated that the guarantors were providing a 33 percent guaranty limited to $3 million dollars for the MPC loan. RD at 57. But this was the guaranty in connection with the MSC loan for which they were also guarantors. *Id.* In his email, King questioned whether the $3 million guaranty was sufficient for a $44 million loan. *Id.* Even

though King flagged the issue, neither Respondent, Bank staff, nor the Bank's board realized the mistake. Instead, the board minutes reflected a discussion of whether $3 million was a sufficient guaranty for the MPC loan and the Bank's board decided it was. *Id.*

f. OTR

The OTR Loan was a $24 million loan set to mature in May 2008, with two options to extend for six months. RD at 59. It was 55 percent disbursed and 0 percent completed. *Id.* The borrower was an LLC owned by two entities. The owners each guaranteed 100 percent of the loan. *Id.* The purpose of the loan was to fund construction of 48 single family residences. *Id.* At the time the Bank purchased the participation, only the land acquisition had been funded under the loan. *Id.* The OTR Executive Summary recommended purchase of the loan subject to the following conditions: "1) construction budget review; 2) approved permits; and 3) approved plans and specs." *Id.* The Bank purchased a $21.5 million, or 89 percent participation interest in the loan. *Id.*

The OTR Executive Summary failed to include key information about (1) the appraisal; (2) the property transfer between the borrower LLC and its owners in a non-arms-length transaction for more than the appraised value of the property; (3) the high end projected pricing for completed units, despite the fact that sales had slowed and prices had declined; and (4) the guarantors' financials, specifically the CTB cash flow analysis showing that one of the guarantors had significant negative cash flow in 2003 (-$20 million) and 2004 (-$38 million). RD at 61-62.

g. NEV

The NEV loan was a $19.7 million loan with a 24 month term and two six-month options to extend. RD at 62. The initial term had already expired and the first option had been exercised. *Id.* The maturity date under the first option was February 2007. *Id.* The loan was 64 percent disbursed and the project was 50 percent complete with 60 percent of Phase I completed and Phase II not yet started. *Id.* The borrower LLC was a single purpose entity whose managing member and owner guaranteed 100 percent of the loan. *Id.* The purpose of the loan was to finance the construction of a 63-unit condominium complex in Cypress, California. *Id.* The NEV Executive Summary recommended purchase of the loan subject to six conditions: (1) explanation for slow progress; (2) updated financials; (3) status of borrower's ongoing construction projects; (4) an explanation for excessive insurance expenditures; (5) an analysis of the adequacy of the interest reserve; and (6) status of pre-sale activity. *Id.* at 62-63. The Bank purchased a $10.8 million, or 55 percent participation interest, in the loan. *Id.* at 63.

The board minutes reflected some discussion of the conditions attached to the NEV loan purchase in response to questions raised by King. RD at 63. Respondent testified that this discussion resolved the issues. *Id.* He also testified that the loan would not be funded unless the conditions were satisfied and that the agreement with CTB was written in such a way that the Bank would withdraw if the conditions were not satisfied. *Id.* Contrary to Respondent's assertions, the participation agreement between the Bank and CTB for this loan did not provide for the Bank's withdrawal if the conditions in the NEV Executive Summary were not met. *Id.* at 63.

h. SCH

The SCH loan was a $24 million loan scheduled to mature in January 2008 with two options for three-month extensions. RD at 65. It was 11 percent disbursed and 3 percent

complete. *Id.* The borrower was an LLC and the loan was guaranteed by two families. *Id.* The purpose of the loan was financing the construction of three 2-story senior condo buildings, which were Phase III of a master-planned project in Chino, California. *Id.* The SCH Executive Summary recommended purchase of the loan based on "excellent location, experience and financial strength of the borrower/guarantor, market absorption, and acceptable LTC." *Id.*

The financial statements provided in the CTB credit memo demonstrated that both families' assets were primarily centered on real estate holdings, including the land that was collateral for the loan. RD at 68. Although their combined net worth was significant, it could not cover the full amount of the loan if necessary. *Id.* Respondent characterized the borrower's net worth as "significant," but neither the SCH Executive Summary nor the board minutes addressed the adequacy of the guaranty. *Id.*

8. Closing and Funding the Participation Loans

On September 29, 2006, Gumbiner sent Vecchio an email with a spreadsheet showing which material was still missing from the Bank's files and indicating what he thought was needed to close the Participation Loans. RD at 68. On October 5, 2006, Vecchio sent an email to Bank staff assigning various tasks related to closing the Participation Loans in the event that they closed before she returned from vacation on October 24, 2006. *Id.* at 68-69. The Participation Loans did not actually close until shortly after Vecchio returned from vacation. *Id.* at 69. On October 25, 2006, the participation agreements were executed and the following day Respondent approved a wire to fund the Bank's participation in the loans. *Id.* There is no evidence in the record of any efforts by Respondent to ensure that the conditions were satisfied prior to approving the wire to fund the Participation Loans on October 26, 2006. *Id.*

9. Lannan's Participation and Fee

As noted earlier, Lannan, a Bank director, had an agreement with the Bank under which he was paid a fee for all loans he referred to the Bank. RD at 69. In this case, Lannan assisted staff in the initial review of the documents and took part in the board meeting where the Participation Loans were approved. *Id.* at 69-70. Lannan moved for approval of three of the Participation Loans and seconded the motions on two others. *Id.* at 69. On November 30, 2006, the Bank's board voted to approve payment of a $75,000 fee to Lannan for referring the CTB Loans to the Bank. *Id.* at 70. Lannan did not attend this meeting. Respondent, however, had more than two weeks earlier, on November 14, 2006, directed that the $75,000 payment be made to Lannan. *Id.*

Respondent admitted that Lannan should not have been allowed to vote on the approval of the Participation Loans and that it was his responsibility to prevent it. RD at 70. Respondent also testified that he felt the fee amount was "horrendous" and he did not recall directing Lannan to be paid before the Bank's board approved it. *Id.* Later, however, when confronted with a document showing he had directed the fee be paid more than two weeks before the Bank's board approved it, Respondent rationalized the fee amount stating that Lannan's referral had created an "extraordinary result" and he believed the fee had been approved at the September 25, 2006 board meeting. *Id.* It had not. *Id.*

IV. ANALYSIS

A. Prohibition is Warranted

As noted in the Recommended Decision, to meet its burden in a prohibition action, Enforcement Counsel must show that Respondent engaged in prohibited conduct (misconduct), the effect of which was to cause the Bank to suffer financial loss or damage, to prejudice or potentially prejudice the Bank's depositors, or to provide financial gain or other benefit to the Respondent (effects). Enforcement Counsel must also demonstrate that such misconduct evidences personal dishonesty or a willful or continuing disregard for the safety and soundness of the Bank (culpability). 12 U.S.C. § 1818(e)(1); *see In the Matter of Ramon M. Candelaria*, 1997 WL 211341, *3 (FDIC Mar. 11, 1997) *aff'd. mem., Candelaria v. FDIC*, 134 F.3d 382, *5 (10th Cir. 1998) (unpublished decision); *In the Matter of James L. Leuthe*, 1998 WL 438323, *11 (FDIC Jun. 26, 1998), *aff'd mem., Leuthe v. FDIC*, 194 F.3d 174 (D.C. Cir. 1999). As discussed below, the Board finds that the activities of Respondent during the pertinent time period clearly satisfy the three standards necessary to impose a prohibition.

1. Misconduct

Misconduct under section 8(e) encompasses: (1) a violation of a law or regulation, (2) engaging or participating in any unsafe or unsound practice in connection with any insured depository institution, or (3) committing or engaging in any act, omission or practice which constitutes a breach of an institution-affiliated party's fiduciary duty. 12 U.S.C. § 1818(e)(1)(A). The record here clearly establishes that Respondent engaged in both unsafe and unsound practices and a breach of his fiduciary duties to the Bank.

a. Unsafe or unsound practices

An unsafe or unsound banking practice is one that is "contrary to generally accepted standards of prudent operation" whose consequences are an "abnormal risk of loss or harm" to a bank. *Michael v. FDIC*, 687 F.3d 337, 352 (7th Cir. 2012); *see also Seidman v. OTS*, 37 F.3d 911, 942 (3d Cir. 1994) (imprudent act posing an "abnormal risk of loss or damage to an institution, its shareholders, or the agencies administering the insurance funds" is unsafe and unsound practice).

While there is no set list of unsafe or unsound practices, certain types of conduct or practices have been found to fall into this category. For example, management's failure to ensure that an institution has the necessary expertise and information to evaluate the transactions they enter into has been found to be an unsafe and unsound practice. *See, e.g., Landry v. FDIC*, 204 F.3d 1125, 1138 (D.C. Cir. 2000) (upholding Board finding of unsafe and unsound practice where Landry entered into transactions "with minimal information and virtually no expertise."). Likewise, an institution extending credit without (1) adequate documentation, (2) adequate credit analysis, (3) in violation of its loan policy, or (4) with inadequate collateral has also been found unsafe and unsound. *In the Matter of Stephens Security Bank*, 1991 WL 789326 (FDIC Aug. 9, 1991); *In the Matter of First State Bank*, 2003 WL 21307613 (FDIC Apr. 25, 2003); and *Northwest Nat. Bank v. OCC*, 917 F.2d 1111 (8th Cir. 1990). In the ADC context, unsafe or unsound practices also include: (1) generating loans the institution lacks the capacity to underwrite adequately; (2) lending based on deficient or outdated appraisals; (3) lending without ensuring that the borrower will have sufficient funds to complete the project; and, (4) failing to perform sufficient analysis of the borrower and guarantors finances to verify their ability to repay a loan. *Alliance Federal Savings and Loan Assoc. v. Federal Home Loan Bank Bd.*, 782 F.2d

490, 494-95 (5th Cir. 1986). In this case, the record establishes that Respondent engaged in this type of conduct with respect to both the Participation and Origination Loans.

b. Breaches of fiduciary duties

Respondent's misconduct constituting unsafe and unsound practices were also breaches of his fiduciary duties to the Bank. Breaches of fiduciary duties arise from knowledge of the pertinent facts and can include a deliberate failure to investigate matters that fall within the officer's responsibilities. *Northwest* at 1115; *see also De la Fuente II*, 332 F.3d 1208, 1222 (9th Cir. 2003) ("[A] person can breach a fiduciary duty by failing to disclose material information, even if not asked . . . De La Fuente had a fiduciary duty to disclose everything he knew relating to the transaction."). Directors and officers of banks have fiduciary duties to act in the best interests of the institution. *See FDIC v. Appling*, 992 F.2d 1109, 1113 (10th Cir. 1993). Here, Respondent had a duty to the Bank to act diligently, prudently, honestly, and carefully in carrying out his role. His conduct as described below and with respect to the Origination Loans did not meet that standard.

Below are more specific examples of how Respondent engaged in unsafe or unsound conduct and breached his fiduciary duty to the Bank with respect to the Participation Loans.

i. Failure to ensure the Bank had proper ADC infrastructure

The evidence established that ADC lending is a complex and risky form of lending. RD at 108. Respondent's expert witnesses agreed that a bank and its management needs to exercise extra care when moving into a new line of lending, particularly when the bank considers the new business risky, bank staff is doing analysis it has not previously done, or the loans are larger and more complex than loans the bank handled in the past. *Id.* Even Respondent acknowledged that

he understood ADC lending to be a higher risk form of lending than the Bank had traditionally engaged in. *Id.* Yet, Respondent failed to exercise the requisite care.

Instead, Respondent led the Bank into ADC lending without putting in place an adequate infrastructure to handle the new lending program—specifically, the necessary personnel and policies needed to manage an ADC lending practice. RD at 109. The Bank had almost no ADC expertise when its move into ADC lending began. *Id.* at 109. Vecchio, the Chief Credit Officer, had very limited experience with ADC lending, and what experience she had was decades old and involved little, if any, underwriting. *Id.* Meanwhile, neither the lead underwriter for the ADC program, Gumbiner, nor any of his staff, had any experience underwriting ADC loans. *Id.* Gumbiner even testified that he doubted his own ability to underwrite large ADC loans. *Id.* at 111. Further, Respondent's new hires did little to correct the Bank's shortage of ADC expertise. *Id.* at 109. Notably, Respondent's own staff (Gumbiner and Giles) agreed that the Bank's staffing was inadequate. *Id.* at 110.

Respondent's expert witnesses, James Kleinfelter ("Kleinfelter") and Mark Olson ("Olson"), opined that the Bank's staff was adequate to underwrite the ADC loans. RD at 108, 110. However, neither witness pointed to anything specific in any staff member's background or work that demonstrated the relevant expertise. *Id.* at 110-11. Further, Olson never met with the staff in order to assess their qualifications and conceded that it was inappropriate to designate Gumbiner as the lead underwriter for the ADC program if Gumbiner doubted his ability to underwrite large ADC loans.[9] Thus, the Board agrees with the ALJ's findings that Bank staff was not equipped to handle the more complex form of lending. *Id.* at 111.

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[9] Both experts testified that the staff's qualifications were evidenced by their work on the ADC loans. As the ALJ pointed out, however, the numerous deficiencies in that work undercut such an opinion. RD at 111.

Respondent also failed to ensure that the Bank had an adequate Loan Policy in place before he launched the Bank's ADC lending practice. RD at 112. Instead of amending the Loan Policy ahead of the move, Respondent allowed the Bank to begin review of the Participation Loans—the largest loan package in the Bank's history—at the same time the Bank's Loan Policy was being amended to provide for ADC lending. *Id.* The final version of the revised Loan Policy was approved at the end of August 2006, well into the Participation Loan review. *Id.* In other words, Bank staff was reviewing the Participation Loans at the very same time Bank management and the Bank's board was revising the Bank policies that would authorize those loans and govern that ongoing review. *Id.* Vecchio's testimony revealed she was confused about whether and to what extent the Loan Policy applied to the Participation Loans. *Id.*

Also, as the ALJ correctly noted, the revised Loan Policy was flawed. RD at 112. The Loan Policy was inconsistent, contradictory, and lacked necessary provisions. More specifically, the general policies section, Section 1, stated that the Bank did not provide ADC loans. *Id.* Section 2, however, stated that the Bank would provide ADC lending, but that it would be aimed at loans that could convert into permanent stabilized loans at the Bank. *Id.* at 113. None of the Participation Loans and only one of the Origination Loans fell into this permitted category. *Id.* Further, nothing in the Loan Policy governed how the Bank would handle interest reserves—which were present in almost all of the ADC loans at issue. *Id.* at 112. Respondent's own expert testified that a Bank should have policies governing the use of interest reserves. *Id.* at 121.[10]

In short, Respondent failed to exercise the requisite care to manage the Bank's entry into ADC lending. He failed to ensure that experienced staff and adequate policies were in place

[10] The ALJ also found that Respondent's failure to disclose to the Bank's board that the Bank lacked loan policies governing the use of interest reserves and Respondent's failure to analyze the potential impact of interest reserves for each of the Participation Loans prior to ascertaining the Bank board's approval was an unsafe and unsound practice. RD at 121.

before the Bank entered into ADC lending. RD at 113. Doing so was an unsafe and unsound practice and breach of his fiduciary duty. *See, Landry, supra; Alliance Federal, supra.*

ii. Failure to adequately supervise the ADC loan review process

Respondent's oversight of the loan review was also unsafe and unsound. As the ALJ correctly points out, the Bank's Loan Policy—as well as industry practice—required the Bank to conduct a complete and independent analysis before purchasing the Participation Loans. RD at 118. Respondent, however, failed to ensure that the Bank performed any such analyses for the Participation Loans. Anxious to get the loans before the Bank's board, Respondent approved an expedited review and Bank staff complied. *Id.* at 117. As a result, staff performed a much less stringent review than the Bank's Loan Policy required and leaned heavily on earlier underwriting done by CTB. *Id.* Vecchio, Gumbiner, and Giles all testified that the Bank did not underwrite the Participation Loans as if they were originations. RD at 118. Vecchio and Gumbiner characterized their work as merely a review of documents from CTB. *Id.* Giles added that she summarized the work CTB had done, without performing any independent analysis. *Id.* Although Kleinfelter believed Bank staff performed an independent review of the Participation Loans, the ALJ rightly found his argument unpersuasive in light of testimony to the contrary by the staff that actually performed the work. RD at 119.

Thus, it is clear from the evidence presented that Respondent failed to ensure that the Bank performed a complete, independent analysis of the Participation Loans per Respondent's orders. RD at 119. This failure constitutes an unsafe and unsound practice and a breach of Respondent's fiduciary duty of care because it failed to provide the level of analysis required by the Bank's Loan Policy and reasonably prudent banking practices. *Id.*

iii. Failure to provide information and analysis necessary for the Bank board's loan review

Respondent also allowed the Bank's board to approve the Participation Loans without adequate information in some cases or necessary analysis in others. RD at 120. The ALJ provided detailed, loan-by-loan findings of Respondent's failure to provide the Bank's board with adequate information or analysis in the Recommended Decision. *Id.* 126-141. For example, Respondent failed to resolve serious discrepancies concerning several of the loans including the rate of disbursement versus construction and project status or viability for the SEP, MAG, VIN, MSC, and OTR Participation Loans. *Id.* at 127-128 (SEP); 129 (MAG); 131 (VIN); 132 (MSC); and 136-137 (OTR). Likewise, the ALJ noted at least three instances where Respondent failed to disclose or adequately resolve issues related to a Participation Loan's guarantors and their finances. *Id.* at 131 (VIN), 138-139 (OTR) and 141 (SCH).

Respondent offered various, but on balance, unpersuasive explanations for the many issues that arose in connection with the Participations Loans. At times, he insisted that the discrepancy simply did not matter. For example, when discussing the negative cash flow for the VIN guarantors, Respondent stated, without explanation, that it did not concern him. RD at 53, 131. At other times, he insisted that the underlying issue was thoroughly discussed and resolved at the meeting before the Bank's board voted to approve the loan. *Id.* at 37. Minutes from the board meeting, however, suggest this was simply not true. *See e.g., Id.* at 37, 47, 50 (finding Respondent's testimony that the disbursement discrepancies with the VIN and SEP loans, the status of construction on the MSC project, and issues with the MAG loan were not discussed and resolved at the board meeting). The ALJ found, and the Board agrees, that Respondent's claims about the content of the board meeting were a convenient default answer to questions that suggested Respondent failed to provide relevant information to the Bank's board. *Id.* at 40.

In short, the Participation Loans were replete with issues that, at a minimum, needed to be raised to the Bank's board and in some cases resolved by Bank staff or the Bank's board before the loans were approved. As the Bank's CEO and President and the Director Overview of ADC lending for the Bank, this responsibility fell to Respondent. Respondent failed to exercise the requisite care and in his urgency to ascertain the Bank board's approval allowed the Bank to purchase several poorly underwritten loans. Respondent's action and inaction was a breach of his fiduciary duty and an unsafe and unsound practice.

iv. Allowing an interested director to review and vote on loans

Finally, it is undisputed that Lannan had a financial interest in the Bank's purchase of the Participation Loans. RD at 141. Indeed, Respondent testified that there was internal pressure to do the Participation Loans and that CTB was aware of that internal pressure from Lannan. *Id.* at 142. Based on this testimony, the ALJ concluded that Respondent believed Lannan fed information to CTB to close a deal Lannan had an interest in. *Id.* Despite this belief, Respondent allowed Lannan to participate in the meeting, vote on the loans, move to approve three of the loans and second the motions for two other loans. *Id.* at 141-142. Respondent acknowledged it was improper for him to do so and conceded that it was his job to stop a director from violating policy. *Id.* at 142. Accordingly, there is no dispute that Respondent put Lannan in a position to advance his own interests at the expense of the Bank, and thereby breached his fiduciary duty to the Bank and engaged in an unsafe and unsound practice. *Id.* at 142.

In summary, the Board finds Respondent's conduct with respect to the Participation Loans, as discussed above—as well as to the Origination Loans detailed in the ALJ's Recommended Decision—were unsafe and unsound and a breach of his fiduciary duty. By failing to: (1) adequately staff the Bank; (2) properly manage the loan review; (3) present the

high-risk and complex loans to the Bank's board in accordance with Bank policy and regulation; and (4) recuse Lannan from participating in the review and approval of the Participation Loans, Respondent acted "contrary to generally accepted standards of prudent operation" resulting in an "abnormal risk of loss or harm" to the Bank.[11] These same actions and inactions directly threatened the Bank's financial stability.[12] Finally, Respondent's conduct with respect to both the Participation and Origination Loans breached Respondent's fiduciary duties to the Bank.[13]

2. Effects

Substantial evidence also supports the ALJ's finding on the effects prong. That standard is met if the Bank suffered loss as a result of Respondent's acts. *See* 12 U.S.C. § 1818(e) (effects standard met if "(i) such insured depository institution or business institution has suffered or will probably suffer financial loss or other damage"), *see, e.g., In the Matter of Steven D. Haynes*, 2011 WL 4899748, *4 (FDIC Aug. 2, 2011) (finding loan losses to the bank in excess of $2.6 million was enough to satisfy 12 U.S.C. § 1818(e)); *In the Matter of Tonya Denise Williams*, 2015 WL 3644010, *10 (FDIC Apr. 21, 2015) (finding loan losses to the bank in excess of $200,000 was sufficient to satisfy 12 U.S.C. § 1818(e)).

Respondent's failure to ensure that the Participation Loans were reviewed, underwritten and approved appropriately resulted in both potential and actual losses to the Bank. RD at 142. By failing to provide the Bank's board with information that might have called for further review or that might have caused the Bank's board to reject some of the loans, and by allowing Lannan to participate in the review and approval process, despite Lannan's personal interest in the outcome, Respondent increased the risk of loss for the Bank. *Id.* at 143. In several cases, the Bank experienced actual losses when the loans went into default. Indeed, the evidence shows

[11] *Michael*, 687 F.3d at 352; *see also Seidman*, 37 F.3d at 932.
[12] *See e.g., De La Fuente II*, 332 F.3d at 1222.
[13] *Id.*

that the Bank suffered actual losses in excess of $51 million as a result of its participation in the ADC loans at issue in this matter. *Id.* at 96. Accordingly, the ALJ correctly held that Respondent's misconduct in connection with the review and approval of the Participation Loans satisfied the effects standard of Section 8(e). *Id.*

3. Culpability

Culpability, for purposes of section 8(e), can be shown by "personal dishonesty", or a "willful or continuing disregard" for the safety and soundness of the financial institution. 12 U.S.C. § 1818(e)(1). Courts have held that "willful or continuing disregard" signifies, at least, "a mental state... akin to 'recklessness.'" *Kim v. OTS*, 40 F.3d 1050, 1054 (9th Cir. 1994) (quoting *Brickner v. FDIC*, 747 F.2d 1198, 1203 & n.6 (8th Cir. 1984)); *see also De La Fuente II*, 332 F.3d at 1223 ("willful disregard" refers to "deliberate conduct which exposed the bank to abnormal risk of loss or harm contrary to prudent banking practices"); *In the Matter of *** Bank *** Bank*, 1986 WL 379636, *18 (FDIC Jul. 17, 1986) ("continuing conduct" is that "conduct which is voluntarily engaged in over a period of time with heedless indifference to the prospective consequences"). An officer acts "willfully" when he is aware of his conduct; "willfulness" does not require a showing that Respondent was aware of the law. *In the Matter of Michael D. Landry*, 1998 WL 34083421 (FDIC Aug. 14, 1998).

The Board finds the record supports a finding of continuing disregard in connection with the Participation Loans. RD at 143. Respondent oversaw the review of the Participation Loans over many months. The record establishes that throughout this period, Respondent set his sights on completing the review in time for the board meeting rather than ensuring that it was thorough. When Vecchio expressly told Respondent that the loans could not be appropriately underwritten in the time he wanted, Respondent directed her to move ahead with a cursory review instead of

exercising caution. *Id.* at 144. Later, when Vecchio informed Respondent that the Participation Loans could not close until October because of issues with the Bank's ALLL, he again ignored the chance to slow down the hurried review. *Id.* Respondent's ongoing pressure to complete the review and missed opportunities to slow down and perform a more thorough review demonstrated his continuing disregard for the safety and soundness of the Bank. *Id.*

The Board finds that the same conduct demonstrates Respondent's willful disregard for the safety and soundness of the Bank. RD at 144. Respondent admitted that he understood the level of review Bank staff could provide in the time he gave them. *Id.* He nevertheless allowed the Bank's board to vote on the Participation Loans without giving it adequate information or analysis or disclosing that staff used a truncated review process less rigorous than the type required by the Bank's Loan Policy. Moreover, Respondent believed that Lannan may have been feeding information to CTB during the review process, but allowed him to participate in the review, participate in the Bank's board discussion, and vote on the purchase of the Participation Loans. Respondent's actions evince a willful disregard for the safety and soundness of the Bank.

B. The CMP Assessment is Appropriate

CMPs are imposed to "serve as deterrents to violations of laws, rules, regulations and orders of the agencies." *Long v. Board of Governors*, 117 F.3d 1145, 1154 (10th Cir. 1997); *In the Matter of Richard D. Donohoo*, 1995 WL 618673, *27 (FDIC Jul. 5, 1995) (CMPs authorized to "deprive the violators of any financial benefit derived as a result of the violations, provide a sufficient degree of punishment, and [establish] an adequate deterrent to the respondents and others from future violations of banking laws and regulations"). The ALJ recommended a second-tier CMP of $85,000, and the evidence in the record supports that penalty.

A second-tier CMP is appropriate where there has been (1) misconduct in the form of, *inter alia*, reckless engagement in an unsafe or unsound practice in conducting a financial institution's affairs, or a breach of a fiduciary duty, and (2) effects which include either a pattern of misconduct, or conduct which caused or was likely to cause more than minimal loss to the institution, or which resulted in a gain or benefit to the respondent. 12 U.S.C. § 1818(i)(2)(B); *see, e.g., Leuthe,* 1998 WL 438323 at *16-17. A second-tier CMP carries a penalty of up to $37,500 for each day the violation continues. 12 U.S.C. § 1818(i)(2)(B); 12 C.F.R. § 509.103.

The Board has already discussed Respondent's unsafe and unsound banking practices and breaches of fiduciary duty and the effects of those acts and need not repeat that discussion here. Section 8(i) requires, however, that any unsafe or unsound banking practice be conducted "reckless[ly]" for a second-tier CMP to be imposed. Recklessness is established by acts committed "in disregard of, and evidencing conscious indifference to a known or obvious risk of a substantial harm." *Cavallari v. OCC*, 57 F.3d 137, 142 (2d Cir. 1995); *see also Simpson v. OTS*, 29 F.3d 1418, 1425 (9th Cir. 1994) (similar definition of "recklessness"). Further, if Respondent's conduct met the standard for "willful or continuing disregard" under section 8(e), it was *a fortiori* reckless as well. *Dodge v. OCC*, 744 F.3d 148, 162 (D.C. Cir. 2014) ("recklessness" in section 8(i) is established by same showing as "willful or continuing disregard" under section 8(e)).

The Board finds that standard is met here. Respondent engineered and oversaw the Bank's ADC lending program from planning through implementation and until the Bank failed in April 2009. RD at 157. During this time, the Bank's ADC lending infrastructure and practices were continually deficient. Instead of ensuring that underwriting included adequate staff that performed careful analysis of large, complex loans, Respondent affirmatively ordered

Bank staff to short-cut its analysis. Also, despite concerns raised by staff about the time needed to complete the review and by a director regarding issues with the loans themselves or underlying projects supported by the loans, Respondent forged ahead to secure the Bank board's approval. All of this establishes the requisite recklessness on Respondent's part.

As for the amount of the CMP, Respondent is responsible for up to $37,500 for each day his violations persisted uncorrected. *United States v. Marine Shale Processors*, 81 F.3d 1329, 1357 (5th Cir. 1996). As Respondent's misconduct began in 2005 and continued until at least approval of the final loan at issue in 2007, and arguably as long as the loans remained on the Bank's books, a CMP could potentially greatly exceed the $85,000 penalty recommended by the ALJ. Other relevant considerations in setting the amount of a CMP include Respondent's financial resources and good faith, the gravity of the violation, and Respondent's history of previous violations. 12 U.S.C. § 1818(i)(2)(G).

The ALJ concluded that Respondent's financial resources demonstrate an ability to pay the CMP and that, although he cooperated with the FDIC's investigation after the Bank failed, Respondent did not demonstrate sufficient good faith to mitigate the CMP. RD at 158-160. The ALJ also found that although Respondent had no history of prior violations, his actions had grave consequences in this case—namely, large losses on several of the loans at issue. *Id.* at 160. Finally, the ALJ cited certain factors set forth in interagency guidance as relevant. *Id.* at 160-61; *See Interagency Policy Regarding the Assessment of Civil Money Penalties by the Federal Financial Institutions Regulatory Agencies*, 63 Fed. Reg. 30226-02. Specifically, the ALJ found that most factors identified in the interagency guidance weighed against mitigating the amount of the CMP against Respondent. Only 4 of the 13 factors weighed in favor of mitigation. *Id.* at 160-161.

After having reviewed the ALJ's analysis regarding the assessment and amount of a CMP in this matter, the Board adopts the ALJ's recommendation of an $85,000 CMP to be imposed on Respondent.

V. EXCEPTIONS

Section 308.39 of the FDIC Rules of Practice and Procedure and 12 C.F.R. § 308.39, provides that the parties may file exceptions to the Recommended Decision. While Enforcement Counsel raised a single exception to the Recommended Decision, Respondent did not file any. Respondent's failure to file exceptions must be deemed a waiver of any objections to the ALJ's Recommended Decision.[14] Further, Enforcement Counsel's single exception does not raise a legal or factual issue that requires this Board to render a decision different than the one reached by the ALJ.

Enforcement Counsel's exception challenges the factual and legal findings in the ALJ's Recommended Decision that stand for the tenet that absorption data can update an outdated appraisal and did so with respect to the project underlying the MAG Loan in this case. Enforcement Counsel argues that the ALJ's determination in his Recommended Decision rests on "factual flaws" on this issue. Having reviewed and considered Enforcement Counsel's exception, the Board has determined that it need not engage in further consideration of this issue. The ALJ's determination that Respondent engaged in unsafe and unsound conduct and breached his fiduciary duties was not limited to a single loan or a single act. Indeed, even when discussing the MAG Loan, the ALJ found two additional grounds on which to conclude that Respondent's conduct with respect to the loan review and approval was unsafe and unsound and a violation of

[14] *See In the Matter of Patricia A. Amador*, 2014 WL 4640801, *3 (FDIC Jul. 15, 2014); *In the Matter of Arlene Shih,* 2011 WL 2574393, *4 (FDIC May 10, 2011); *In the Matter of Alex P. Majka,* 2007 WL 4698593, *3 (FDIC Oct. 16, 2007); and *In the Matter of Leann Bennett,* 2004 WL 2185944, *3 (FDIC Aug. 16, 2004).

his fiduciary duty. The appraisal aside, Respondent failed to provide the Bank's board with adequate information about the status of the project and its delays or about a litigation involving the MAG borrower. RD at 129.

The ALJ conducted a careful review and thorough analysis of the record before finding that Respondent's conduct warrants prohibition from the practice of banking. The Board need not disturb that finding based on the dispute raised in Enforcement Counsel's exception. The record provides ample factual evidence supporting the Board's determination that Respondent acted in an unsafe and unsound manner and breached his fiduciary duty with respect to not only the MAG loan but all the Participation Loans and on additional bases not enumerated here. Accordingly, the Board adopts in full the ALJ's findings of fact and conclusions of law save those referring or relating to whether an aged appraisal was brought up to date by updating the absorption analysis contained in the appraisal for the MAG or any other loan discussed.

VI. CONCLUSION

After a thorough review of the record in this proceeding, the Board, for the reasons set forth above—except as noted with respect to the aged appraisal raised in Enforcement Counsel's exception—affirms the Recommended Decision and issues the following Orders implementing its decision. In this case, the record shows that Respondent, ignoring his responsibilities to the Bank and its depositors, put the Bank at risk by authorizing unexperienced Bank staff to do an expedited review of a large and complex loan deal, permitting the Bank's board to vote on whether to purchase those loans without necessary information or analysis, and permitting a Bank board member with a financial interest in the transaction to participate in the review and vote approving the Bank's purchase of the loans. The evidence also establishes that Respondent overlooked numerous discrepancies in the loan files in order to complete the purchase of the

Participation Loans. In view of Respondent's repeated transgressions and breaches of his fiduciary duties, the Board concludes that he should be permanently barred from the banking industry. In addition to Respondent's misconduct in connection with the Participation Loans, the record is clear that he engaged in many other instances of unsafe or unsound conduct that necessitate a permanent bar from the industry including his pattern of misconduct with respect to the four Origination Loans.

Finally, the Board agrees with the ALJ that a CMP is warranted and that the $85,000 assessment is reasonable under the statute based on the same conduct warranting prohibition—namely, that Respondent recklessly engaged in a pattern of unsafe or unsound practices that was likely to cause more than minimal loss to the Bank and breached his fiduciary duties to the Bank.

Based on the foregoing, the Board affirms the Recommended Decision of the ALJ and adopts the conclusions of law and findings of fact, except any expressly not adopted, and issues the following Order implementing its Decision.

ORDER TO PROHIBIT

The Board of the FDIC, having considered the entire record of this proceeding finds that Respondent Larry B. Faigin, individually and as an institution-affiliated party of First Bank of Beverly Hills, Calabasas, California ("Bank") engaged in unsafe or unsound banking practices and breaches of fiduciary duty that resulted in a financial loss to the Bank. Also, Respondent's unsafe and unsound conduct involved willful and continuing disregard for the safety and soundness of the Bank. The Board hereby ORDERS and DECREES that:

1. Larry B. Faigin shall not participate in any manner in the conduct of the affairs of any insured depository institution, agency, or organization enumerated in section 8(e)(7)(A) of the FDIA, 12 U.S.C. § 1818(e)(7)(A), without the prior written consent of the FDIC and the appropriate federal financial institutions regulatory agency, as that term is defined in section 8(e)(7)(D) of the FDIA, 12 U.S.C. § 1818(e)(7)(D); and
2. Larry B. Faigin shall not solicit, procure, transfer, attempt to transfer, vote or attempt to vote any proxy, consent, or authorization with respect to any voting rights in any financial institution, agency, or organization enumerated in section 8(e)(7)(A) of the FDIA, 12 U.S.C. § 1818(e)(7)(A), without the prior written consent of the FDIC and the appropriate federal financial institutions regulatory agency, as that term is defined in section 8(e)(7)(D) of the FDIA, 12 U.S.C. § 1818(e)(7)(D); and
3. Larry B. Faigin shall not violate any voting agreement with respect to any insured depository institution, agency, or organization enumerated in section 8(e)(7)(A) of the FDIA, 12 U.S.C. § 1818(e)(7)(A), without the prior written consent of the FDIC and

the appropriate federal financial institutions regulatory agency, as that term is defined in section 8(e)(7)(D) of the FDIA, 12 U.S.C. § 1818(e)(7)(D); and

4. Larry B. Faigin shall not vote for a director, or serve or act as an institution-affiliated party, as that term is defined in section 3(u) of the FDIA, 12 U.S.C. § 1813(u), of any insured depository institution, agency, or organization enumerated in section 8(e)(7)(A) of the FDIA, 12 U.S.C. § 1818(e)(7)(A), without the prior written consent of the FDIC and the appropriate federal financial institutions regulatory agency, as that term is defined in section 8(e)(7)(D) of the FDIA, 12 U.S.C. § 1818(e)(7)(D).
5. This ORDER shall be effective thirty (30) days from the date of its service upon Respondent.

ORDER TO PAY CIVIL MONEY PENALTY

The Board, having considered the entire record in this proceeding, and taking into account the appropriateness of the penalty with respect to the size of the financial resources and good faith of Respondent, the gravity of the violations and such other matters as justice may require, hereby ORDERS and DECREES that:

1. A civil money penalty is assessed against Larry B. Faigin in the amount of $85,000 pursuant to 12 U.S.C. § 1818(i).
2. This ORDER shall be effective and the penalty shall be final and payable thirty (30) days from the date of its issuance.

The provisions of these ORDERS will remain effective and in force except to the extent that, and until such time as, any provision of these ORDERS shall have been modified, terminated, suspended, or set aside by the FDIC.

IT IS FURTHER ORDERED that copies of this Decision and Order to Prohibit From Further Participation and Assessment of Civil Money Penalty shall be served on Counsel for Respondent Larry B. Faigin, Enforcement Counsel, the ALJ, and California's Department of Business Oversight, Division of Financial Institutions.

By direction of the Board of Directors.

Dated at Washington, D.C. this 15th day of December 2015.

/s/

Robert E. Feldman
Executive Secretary

(SEAL)

083109

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D.C.

In the Matter of		
LARRY B. FAIGIN and JOHN J. LANNAN, individually and as former institution-affiliated parties of	)	FDIC-11-269e FDIC 11-270k FDIC-11-252e FDIC-11-254k
FIRST BANK OF BEVERLY HILLS CALABASAS, CALIFORNIA	)	
(INSURED STATE NONMEMBER BANK in receivership)	)	

RECOMMENDED DECISION

Dated: August 21, 2015

C. Richard Miserendino
Administrative Law Judge

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D.C.

In the Matter of LARRY B. FAIGIN and JOHN J. LANNAN, individually and as former institution-affiliated parties of FIRST BANK OF BEVERLY HILLS CALABASAS, CALIFORNIA (INSURED STATE NONMEMBER BANK in receivership)	)	FDIC-11-269e FDIC 11-270k FDIC-11-252e FDIC-11-254k

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FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D.C.

In the Matter of LARRY B. FAIGIN and JOHN J. LANNAN, individually and as former institution-affiliated parties of FIRST BANK OF BEVERLY HILLS CALABASAS, CALIFORNIA (INSURED STATE NONMEMBER BANK) (in receivership)	)	FDIC-11-269e FDIC 11-270k FDIC-11-252e FDIC-11-254k

RECOMMENDED DECISION

I. Statement of the Case

C. RICHARD MISERENDINO, Administrative Law Judge. On September 7, 2012, the Federal Deposit Insurance Corporation ("FDIC") issued a First Amended Notice of Intention to Prohibit from Further Participation, First Amended Notice of Assessment of Civil Money Penalties, Findings of Fact, Conclusions of Law, Order to Pay, and Notice of Hearing ("Amended Notice") against Respondent, Larry B. Faigin ("Respondent" or "Faigin"), individually and as an institution-affiliated party ("IAP") of First Bank of Beverly Hills, Calabasas, California (In Receivership) ("Bank").[1]

The Amended Notice alleges, among other things, that Respondent led the Bank to make an aggressive entry into a new lending area, specifically acquisition, development and construction ("ADC") lending, which is more complex and risky than the Bank's prior lending

[1] The Notice also contained allegations against John J. Lannan, another IAP of the Bank. On January 16, 2013, the FDIC filed a Notice of Dismissal of Charges against John J. Lannan, and the proceedings against Mr. Lannan were terminated.

programs; that Respondent failed to ensure that the Bank had adequate policies and experienced personnel necessary to safely navigate the Bank's entry into ADC lending; that Respondent ignored or exacerbated existing problems at the Bank at the same time he was pushing it into riskier ADC lending; that Respondent led the Bank to purchase loan participations from Chinatrust Bank ("CTB") in eight large, complex ADC loans ("CTB Loans") without proper underwriting; that the Respondent allowed the Bank to make four more large, complex ADC loans without proper underwriting; and that by his conduct the Respondent has engaged in unsafe and unsound banking practices and breached his fiduciary duties to the Bank.

The Amended Notice further alleges that as a result of Respondent's actions, the Bank suffered actual losses; that the Bank faced substantial risk of additional losses and that the Bank's depositors have been prejudiced. Finally, the Amended Notice alleges that by his conduct, Respondent demonstrated a willful or continuing disregard for the safety and soundness of the Bank.

The FDIC therefore seeks an order pursuant to section 8(e)(7)(A) of the Federal Deposit Insurance Act ("FDIA" or "Act"), 12 U.S.C. § 1818(e)(7)(A), prohibiting Respondent from further participation in the affairs of the Bank or any other financial institution without appropriate written permission, and also an order pursuant to section 8(i)(2)(B) of the Act, 12 U.S.C. §1818(i)(2)(B), assessing Second Tier civil money penalties of $85,000 against Respondent.

Respondent timely filed a First Amended Answer denying the material allegations of the Amended Notice. A hearing on this matter was held on January 28, 2013 to March 1, 2013 in Los Angeles, California and on May 1, 2013 in Washington, D.C. The parties have been afforded a full opportunity to appear, present evidence, examine and cross-examine witnesses,

and file post-hearing and reply briefs.

On the entire record, including my credibility determinations based on the weight of the respective evidence, established or admitted facts, inherent probabilities, and reasonable inferences drawn from the record as a whole, and after considering the parties' post-hearing briefs and reply briefs, I make the following findings of fact, conclusions of law and recommended orders.

II. Jurisdiction

At all times pertinent to this proceeding, the Bank was an insured State nonmember bank subject to the Act, 12 U.S.C. § 1811-1831aa, and the Rules and Regulations of the FDIC, 12 C.F.R. Chapter III. (Jt. Stip. ¶ 2.) At all times pertinent to this proceeding, Respondent was a member of the Board of Directors of the Bank as well as an officer of the Bank. (Answer ¶ 2; Jt. Stip. ¶¶ 3, 6.) Accordingly, Respondent was an "institution-affiliated party," within the meaning of section 3(u)(1) of the Act, 12 U.S.C. § 1813(u)(1), and for purposes of sections 8(e) and 8(i) of the Act, 12 U.S.C. §§ 1818(e) and 1818(i).

I find that with respect to the Bank, the FDIC is the "appropriate Federal banking agency" within the meaning of section 3(q)(2) of the Act, 12 U.S.C. § 1813(q)(2). I further find that the FDIC has jurisdiction over the Bank, Respondent, and the subject matter of this proceeding. *See* 12 U.S.C. §§ 1818(e)(1) and 1818(i).

III. Facts

A. Larry B. Faigin

Larry B. Faigin by education and training is an attorney. His professional career spans more than forty years in business, real estate, land development and lending matters. (Tr. 3680-82.) He has worked with various real estate developers – both residential and commercial. (Tr.

3682-3709.) He also has some banking experience, primarily assisting in work-outs or restructuring problem real estate loans. (Tr. 3689-92, 3700-01.)

Faigin testified that, at various points in his career, he had been involved in supervising loan underwriting. (Tr. 3694, 3701.) He acknowledged, however, that most of his experience and expertise in lending was as a borrower, not a lender. (Tr. 3689, 3691.) While it is clear that he has extensive experience with real estate development, it is equally clear that the majority of that experience has been on the developer side and that he had little experience in supervising the underwriting of ADC loans until his association with the Bank.

B. First Bank of Beverly Hills

At all times relevant to this proceeding, the Bank was a California state-chartered bank and a wholly-owned subsidiary of Beverly Hills Bancorp, Inc. ("Holding Company"). (Jt. Stip. ¶ 5, 11, 12.) From 2001 to 2006, Joseph Kiley ("Kiley") served as the Bank's CEO. (Tr. 738.) When Kiley joined the Bank, it had an overall CAMELS rating of 3 or 4.[2] It also was designated a troubled institution, subject to various regulatory directives.[3] (Tr. 735.)

Kiley worked to improve the Bank's ratings and relationship with regulators. By the time he left the Bank in 2006, it had an overall CAMELS rating of "2" and was not subject to any regulatory directives. (Tr. 736.) The Bank, however, was consistently rated a "3" on liquidity because it used a funding structure that relied on wholesale funding over retail deposits.[4] (Tr.

[2] The "CAMELS" ratings system is the commonly-used colloquial term for the Uniform Financial Institutions Ratings System adopted by the Federal Financial Institutions Examination Council on November 13, 1979. The term "CAMELS" comes from the six components that are rated, which are: (C)apital Adequacy; (A)sset Quality; (M)anagement; (E)arnings; (L)iquidity; and (S)ensitivity to Market Risk. In addition to the component ratings, each institution is given a composite rating. The components and composite ratings are graded on a scale of 1 to 5, with ratings of 1 or 2 being satisfactory and ratings of 3 through 5 indicating varying degrees of weakness and the need for improvement. *See* 62 Fed. Reg. 752 (1997).
[3] The Bank originally was a federally-chartered thrift regulated by the Office of Thrift Supervision. The relationship was adversarial. (Tr. 738.) In November 2004, the Bank applied to convert to a California state-chartered bank. (Jt. Stip. ¶ 11.) The charter conversion became effective on September 1, 2005. (Jt. Stip. ¶ 12.)
[4] Retail or "core" deposits are deposits, such as transaction accounts and small CDs, from retail customers who tend to be loyal to their financial institution. Wholesale deposits, also sometimes referred to a brokered deposits or

742-43.) Kiley attempted to address this issue by trying to increase retail deposits at the Bank's existing Beverly Hills branch and by opening a second branch in Calabasas, where the Bank was headquartered. (Tr. 743.) He testified that the Bank's Board of Directors was resistant to his efforts because some Board members felt retail deposits drove overhead expenses and wholesale funding was more efficient. (Tr. 743.)

Prior to Faigin joining the Bank, the Bank had focused its lending efforts on stabilized, income producing properties, such as apartment buildings, retail facilities and industrial buildings that were already built, occupied and generating income. (Tr. 737, 2161.) The Bank's target loan size was between $2 million and $5 million, with most of its loans near the lower end of that range. (Tr. 742, 1644, 2161.) The Bank did very little construction lending, and the construction lending that it did do was mostly bridge financing – short term loans to upgrade existing, stabilized properties as opposed to loans for ground-up construction. (Tr. 737-38.)

C. Faigin Joins the Bank

Faigin's involvement with the Bank began as a member of the Boards of Directors of the Bank and the Holding Company. He was appointed to the Board of Directors of the Holding Company in June of 1999. (Jt. Stip. ¶ 4.) He served as chairman of the Holding Company's Board from September 1999 to 2009. (Jt. Stip. ¶ 4.) In April 2001, Faigin became a member of the Bank's Board of Directors. (Jt. Stip. ¶ 3.) In December 2005, he became the Bank's Executive Vice President of Development. (Jt. Stip. ¶ 6.) Six months later, in June 2006, Faigin became CEO and President of the Bank. (Jt. Stip. ¶6.)

Faigin's appointment as a Bank officer, and the departure of his predecessor, Kiley, appear to be connected with the Bank's move into ADC lending. In 2005, the Bank began

noncore deposits, are generally large deposits that are very rate sensitive. They are seen are more volatile and less reliable than retail deposits. (Tr. 318.)

preparing for the change in earnest. (Tr. 3713.) This change in lending direction was driven by Faigin, with the support of several members of the Bank's Board. (Tr. 739.) The Board was supportive of the change because ADC lending generated higher fees and margins than the Bank's traditional, stabilized lending. (Tr. 740-41, 745.) Kiley, on the other hand, was uncomfortable with the new lending direction, which he viewed as risky. (Tr. 744.) He shared his concerns with some members of the Bank Board. (Tr. 744-45.) Shortly thereafter, he was replaced by Faigin.

There is some inconsistency in Kiley's testimony about his departure. He testified that his departure was termed a resignation but that, in fact, the Board did not renew his contract when it expired in December 2005. (Tr. 735.) He then served on an interim basis until June 2006, when Faigin took over. (Tr. 735.) Kiley testified that he was offered an opportunity to stay on as the Bank's CFO, but declined because of the Bank's shift to ADC lending, which he felt unfamiliar with. (Tr. 736-37.) On cross-examination, however, he admitted that Faigin asked him to leave the Bank. (Tr. 757.) While this leaves the circumstances of Kiley's departure less than clear, what is relevant to this proceeding, and undisputed, is that by June 2006, Kiley was out and Faigin was in. Shortly thereafter, Kiley shared his concerns about the Bank's new lending direction, and its wholesale funding strategy, with the American Banker magazine, which published his statements in an article entitled, "Stock Sales Sign of Rift at Beverly Hills?" ("Article"). (FDIC Exh. 158.)

Soon after he became CEO, Faigin made certain changes to the Bank's underwriting process. Most notably, he split the function of Chief Lending Officer ("CLO") and Chief Credit Officer ("CCO"). Prior to Faigin taking over, Craig Kolasinski ("Kolasinski") had served as both CLO and CCO. Faigin separated the position, retaining Kolasinski as CLO and appointing

Annette Vecchio ("Vecchio") as CCO. Faigin testified that he made this change because he viewed it as a "best practice," as he was concerned that having the same person in both roles could create conflicts. He believed it was better to split the positions so the CLO could concentrate on bringing in loans and the independent CCO would have the authority to decline a proposed loan. (Tr. 3733-35.) Faigin also created a Credit Committee at the Bank, which was made up of the CLO, the CCO and Faigin. (Tr. 3757.) This committee started as an ad hoc effort to resolve issues related to specific loans and was later formalized. (Tr. 3757-58.)

D. The Bank Transitions to ADC Lending

The most significant change Faigin oversaw at the Bank was the shift away from its traditional lending focus on stabilized income properties and into ADC lending.[5] This change was significant not only because it was a new direction, but also because it is undisputed that ADC lending is a riskier form of lending than the stabilized income lending the Bank had traditionally done. (Tr. 2501, 4073, 5062-63.)

Faigin testified that discussions about a change in the Bank's lending direction began in 2004 and work in earnest began in 2005, at which point he was a Board member, but not yet an officer. (Tr. 3713.) At the time, the Bank was facing increased competition in its traditional stabilized lending, often from banks with looser underwriting standards and larger banks that could offer more attractive rates. (Tr. 741, 3714.) This motivated the Board to look at alternative business lines within real estate lending, which the Board felt was the Bank's core competency. (Tr. 3714-15.)

In late 2004 or early 2005, still before he was a member of the Bank's management team, Faigin arranged a weekend retreat for several senior members of Bank management to discuss

[5] As noted earlier, ADC stands for Acquisition, Development and Construction lending. It includes (A)cquisition of land, preparing the site for construction (referred to as (D)evelopment) and (C)onstruction on the site. (Tr. 776-77.) As one witness described it, it is the "soup to nuts of what is commonly known as construction lending." (Tr. 776.)

what needed to be done for the Bank to move into ADC lending. (Tr. 3715-16.) Faigin testified that he brought the following officers on this retreat: Kolasinski, Vecchio, Chief Compliance Officer Bryce Miller ("Miller"), and CFO Takeo Sasaki ("Sasaki"). (Tr. 3715.) Faigin made no mention of including Kiley, who at the time was the Bank's President and CEO. Faigin did testify that "we may have taken a few other people." (Tr. 3716.) It seems likely, however, that Faigin would have mentioned the Bank's President and CEO by name, as he did with several less senior managers, if he had been included. Kiley likewise made no mention of this retreat in his testimony. The reasonable inference from this omission is that Kiley was not included in those meetings about a major shift in the Bank's business model.

After the retreat, Faigin met with the Board and outlined the conclusions he and the officers present had reached. The Board indicated an interest in pursuing ADC lending, so Faigin began working on a plan. (Tr. 3717.) In late 2005, Faigin arranged numerous meetings and presentations for the Board related to ADC lending, including a Board retreat about the subject. (Tr. 3722-23.) The Board heard presentations from outside consultants as well as Bank officers, including Vecchio and Sasaki. Among other topics, the presentations covered control and monitoring of loan disbursements, ADC loan documentation, Bank governance, target markets, funding strategies for ADC lending, and staffing. (Tr. 3723-3732.) As a result of these efforts, Faigin, and others, drafted a business plan, which was adopted by the Bank Board on January 26, 2006 (the "Strategic Plan"). (Jt. Exh. 28; Tr. 3716.)

The Strategic Plan stated that the Bank's primary new product would be construction lending.[6] (Jt. Exh. 28 at 31.) The Strategic Plan also designated certain individuals as "Point

[6] Prior to the hearing on this matter, the parties marked numerous voluminous documents as potential exhibits and numbered the pages of these marked exhibits. When specific pages of these exhibits were referenced at the hearing, counsel and witnesses referred to them by the page numbers that had been placed on them pre-hearing. However, in several instances, counsel only moved for the admission of selected pages of exhibits as opposed to the entire exhibit

Persons" for various functions related to ADC lending. Faigin was designated as Director Overview; Bill Fischer was designated as the Designated Originator; Bruce Gumbiner ("Gumbiner") was the Designated Underwriter; and Vecchio was designated the point person for Oversight of Disbursements. (Jt. Exh. 28 at 31.) The Strategic Plan further stated that ADC lending presented the opportunity to close loans with higher margins and to generate fee income. However, it also stated that ADC lending did entail new construction risks. (Jt. Exh. 28 at 31.)

1. Staffing and Training

One of the key areas addressed in the planning for the move into ADC lending was appropriate staffing. Faigin testified that there was discussion of who at the Bank had ADC experience and what staff needed to be added so that the Bank would have the right people in place. (Tr. 3730.)

When it began its preparation, the Bank had very little in-house ADC underwriting experience. Vecchio, the CCO, had a small amount of ADC experience that was decades old. In the late 1970s, she had worked on closing, but not underwriting, ADC loans at two banks. (Tr. 1610; R. Exh. 37.) From 1983 to 1985, Vecchio worked for the Real Estate Department of E.F. Hutton Life Insurance Company, where loan underwriting was one of many responsibilities. It is unclear, however, how much, if any of this work involved ADC lending. (Tr. 1617-18; R. Exh. 37.) After leaving E.F. Hutton, Vecchio joined the Bank[7] as a portfolio manager, a position in which she remained until her promotion to CCO in 2006. (Tr. 1611; R. Exh. 37.) Between the time she left E.F. Hutton (1985) and her appointment as the Bank's CCO (2006), Vecchio did no

as marked. In the interest of clarity, references to page numbers in this Recommended Decision refer to the page numbers marked on the exhibits, which do not necessarily correspond to the placement of the pages in the exhibits as admitted. For example if the page that had been numbered 25 was the first page of the portion of an exhibit that was admitted, a reference to that page would still refer to it as page 25, not page 1.

[7] Vecchio actually joined Girard Savings Bank, which through a series of mergers became a part of the Bank. (Tr. 1610.)

ADC underwriting.[8] (Tr. 1618.) Thus, Vecchio's ADC experience was 20 to 30 years old and involved little, if any, underwriting. Similarly, Gumbiner, the person designated as the lead person for ADC underwriting in the Strategic Plan, testified that, prior to June 2006, he had no experience underwriting ADC loans. (Tr. 777-78.) Further, none of the Bank's underwriting staff had ADC expertise. (Tr. 780.)

In order to acquire the expertise necessary, the Bank attempted to hire underwriters who were familiar with ADC lending. (Tr. 1675-76, 3730, 3732.) Faigin testified that, although he would not normally do so, he interviewed, or at least met with, all ADC underwriter candidates because he viewed the position as so important.[9] (Tr. 3733; 4067-68.)

In March 2006, the Bank hired Pamela Bauer ("Bauer") as an underwriter. (R. Exh. 54.) Bauer not only had no ADC underwriting experience: she had no underwriting experience and was brought in as a trainee.[10] (Tr. 783, 1624, 1680.)

The next underwriter hired by the Bank was Janet Giles ("Giles"), who was hired in April 2006. (R. Exh. 54.) Giles had ADC experience at several banks going back to 1990. (Jt. Exh. 21.) Her experience included underwriting ADC loans, monitoring ADC loan disbursements and even developing the business plan and policies for a bank that was considering moving into ADC lending. (Jt. Exh. 21; Tr. 1377-81, 1458-59.) Giles had the most ADC underwriting experience at the Bank. (Tr. 800.)

In September 2006, the Bank hired another underwriter to work on ADC lending, Kathleen Gregory ("Gregory"). (R. Exh. 54.) Gregory had some ADC underwriting experience

[8] Vecchio testified that when she began at Girard, she did close some local ADC loans, but she was clear that she did not underwrite them. Additionally, as portfolio manager, she occasionally underwrote transactions involving the purchase of properties out of the Bank's REO (foreclosed property) portfolio. (Tr. 1618-19.)

[9] Faigin initially testified that he interviewed all ADC underwriting candidates because of the importance of the position. (Tr. 3733.) On cross-examination, he attempted to downplay his role, saying he "believed" he had met with all candidates. (Tr. 4069-70.)

[10] Bauer was Kolasinski's sister-in-law. Beyond that relationship, there is nothing in the record to explain why the Bank's first hire in connection with its new lending program had no underwriting experience. (Tr. 783, 1624.)

but less than Giles. (Tr. 799-800, 1398.) Her experience was primarily in single-family residences. (Tr. 800.)

The Bank also provided its staff with some training on ADC lending, but it was minimal. In the summer of 2006, an online class in construction lending, which consisted of six weeks spent reviewing the basics of construction lending for a few hours weekly, was made available to the underwriters. (Tr. 804.) Gumbiner took this class, but it is unclear who else did.[11] (Tr. 804, 1658.) For his part, Faigin testified that ADC training was provided to credit administration staff, but said nothing about the underwriters. (Tr. 3738.)

Taken as a whole the record demonstrates that as of the summer of 2006, FBBH had little institutional expertise with ADC underwriting. The two senior officers with direct supervision over underwriting were, for all intents and purposes, complete neophytes to ADC lending, as was the Bank's existing underwriting staff. Additionally, of the three underwriters hired in preparation for the move to ADC lending, only one appears to have had substantial experience. It is telling that Gumbiner, the designated underwriter for the ADC program, testified that he had concerns about his staff's ability to handle underwriting the CTB Loans and that they ultimately failed to do an adequate analysis because, among other reasons, they lacked the needed expertise. (Tr. 886.) Similarly, Giles, the underwriter with the most ADC experience, did not believe that the Bank had the infrastructure needed to make ADC loans. (Tr. 1400.)

2. Development of ADC Lending Policies

Another key component for the Bank's move into ADC lending was the development of ADC lending policies. Miller was tasked with putting together a manual for ADC lending. (Tr.

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[11] Gumbiner also testified that he and other Bank employees attended a construction lending seminar in October 2006. However, it focused on compliance requirements, not underwriting and was not useful for underwriting loans. (Tr. 801-03, 920-21.) Additionally, that seminar was after the Bank Board had already approved the purchase of the CTB Loans, which are discussed below and which form the basis for most of the charges against Faigin.

3745.) This effort resulted in a revised Loan Department Policy Manual, which was approved by the Board on August 31, 2006 ("Loan Policy"). (Jt. Exh. 31; Tr. 3746-47.) Revisions to the Bank's Loan Policy appear to have been made until shortly before its approval. A redline excerpt of the new Loan Policy showing changes in policies related to ADC lending was circulated to the Board on August 24, 2006. (R. Exh. 67; Tr. 1673.) The cover memo for this excerpt states that "[t]he revisions made herein provide current Construction lending activity." (R. Exh. 67 at 1.)

Section 1 of the Loan Policy contained the Bank's General Policies for lending. (Jt. Exh. 31 at 17-68.) Among other things, this section set forth the type of financing offered by the Bank. It stated that the Bank offered financing on income properties that fell into certain defined categories. (Jt. Exh. 31 at 17-18, § 1.1.4.) It went on to state that the Bank "does not offer other types of loans." (Jt. Exh. 31 at 17, § 1.1.4.) This section does not include any provision authorizing ADC lending. It also does not appear that this section was revised when the Bank adopted policies aimed at launching its ADC lending program. The pages of Section 1 reflect that it was last revised on April 19, 2006 and approved by the Board on April 29, 2006. (Jt. Exh. 31 at 17.) Additionally, the redlined version of the Loan Policy that was circulated in August does not include revisions to Section 1. (R. Exh. 67.) Accordingly, I find that Section 1 was not revised when the Bank entered into ADC lending. I further find this failure to harmonize the Bank's Loan Policy indicative of the rushed pace of the move into ADC lending.

Section 2 of the Loan Policy contained the Bank's policies specifically directed towards ADC lending. (Jt. Exh. 31 at 69-75.) The section stated that it was to serve as a guide for "general construction financing," which would include ADC loans, and that it was the Bank's intent to make ADC loans that would convert to "permanent loans" with the Bank after

construction. (Jt. Exh. 31 at 69, § 2.1.) A review of the redline version of the Loan Policy circulated in August 2006 shows that this was a substantial change in policy. The prior version of the Loan Policy had stated that the Bank "does not provide general construction financing," and that bridge construction loans of the type Kiley said the Bank had traditionally done were offered on a limited basis in Southern California. (R. Exh. 67 at 2.) The revised Loan Policy provided that construction financing could be provided for the following property types: Commercial, Industrial, Residential and Multifamily, whereas the prior version had limited bridge financing to Commercial and Industrial, and expressly stated that the Bank did not provide financing for Residential or Multifamily projects. (Jt. Exh. 31 at 69, § 2.1; R. Exh. 67 at 2, § 2.1.)

Section 2 of the Loan Policy also contains several policies relevant to this case.[12] Chief among them is the requirement that all construction loans be made in compliance with the Bank's lending policies and all applicable state and federal laws and regulations. (Jt. Exh. 31 at 69, § 2.1.) Section 2 of the Loan Policy contained numerous other requirements relevant to this case, including: that all loans not complying with Bank policy were to be treated as exceptions and approved accordingly (Jt. Exh. 31 at 69, § 2.1.1); that the Bank would generally not make loans on certain projects, including hotels, high-rises of 4 stories or more, and projects involving difficult topography, and would treat any such loans as exceptions (Jt. Exh. 31 at 70-71, § 2.1.3); and that the Bank would hire outside consultants to assist with pre-loan due diligence. (Jt. Exh. 31 at 74, § 2.3.1.) In addition, the Loan Policy required that appraisals be dated no earlier than 12 months prior to the date a loan was funded, or less if the market was volatile. (Jt. Exh. 31 at 104-05, § 5.3.3.1.)

[12] The citation to certain provisions of the Bank's Loan Policy does not suggest that those provisions are the only ones that were relevant to this case or that were binding on the Bank and Faigin.

In addition, several provisions of the Bank's Loan Policy regarding loan participations are relevant to this case.[13] They include, among others, that loan participations were to be underwritten with the same care as loan originations (Jt. Exh. 31 at 151, § 6.1.4); that the Bank would not rely on the lead bank for an assessment of risk (*Id.*); and that the Bank would obtain a value estimate for each loan, which might include a new appraisal. (Jt. Exh. 31 at 164, 171-72, §§ 6.2.2.15, 6.2.3.11.) Significantly, the Loan Policy provided that any waiver of due diligence must be disclosed, documented and approved by the appropriate approving authority. (Jt. Exh. 31 at 153, § 6.2.1.)

The record reveals that senior officers responsible for ADC lending were unclear about the applicability of the Loan Policy to the transactions at issue in this case. For example, Vecchio's testimony showed that she was unclear as to whether the Bank's general underwriting policies or its ADC policies applied to participation loans. (Tr. 1755-57, 1841, 1844.) This testimony is troubling not only because Vecchio was the Bank's CCO, but also because, at other times, she testified that Bank policy required participations to be underwritten with the same care as originations. (Tr. 1620.) Further, Vecchio testified that the Bank's participation policies should have applied to underwriting the CTB Loans, but were not followed. (Tr. 1844.) She seemed to justify this by saying that the Bank's lending policies were underwriting policies and the Bank was not underwriting the CTB Loans. (Tr. 1841.) Similarly, Gumbiner testified at numerous points that Bank personnel did not underwrite the CTB Loans, but only reviewed documents received from CTB, so the Bank's Loan Policy did not apply. (Tr. 939, 1031-32.)

Some of this confusion may have resulted from the newness of the policies. As discussed above, that the Loan Policy was not finalized and approved until August 31, 2006. Thus, the

[13] It appears that the Participation section of the Loan Policy, Section 6, was last revised on September 14, 2005 and approved by the Board on December 1, 2005. (Jt. Exh. 31 at 149.)

Bank's policies related to ADC lending were still a work in progress by the fall of 2006 – when Bank staff were already engaged in reviewing a very large package of ADC loans.

E. The Chinatrust Loan Participations

By the summer of 2006, the Bank's lending was not on pace to meet its year-end goals. Faigin informed the lending personnel that they had needed to produce $16 million in loans per month in order to reach the Bank's annual goals, and that, if they failed to do so, their positions would be reevaluated. (FDIC Exh. 110 at 3; Tr. 4255.) In May or June 2006, John Lannan ("Lannan"), one of the Bank's directors, arranged a meeting between Bank personnel and representatives of CTB to discuss the possibility of the Bank purchasing participations in several construction loans from CTB.[14] (Tr. 1684-85, 4260; Jt. Exh. 95 at 1.) At the time he arranged the meeting, Lannan had an arrangement with the Bank pursuant to which the Bank paid him a fee equal to 0.25% of the principal amount of any loans he referred to the Bank. (FDIC Exh. 20 at 59.)

The Bank had purchased participations in the past. (Tr. 746.) They had mostly been large pools of loans for single-family homes, as well as two loans from CTB that involved rehabbing existing properties. (Tr. 1666-67.) These prior participations had been handled entirely by Kolasinski and Eric Martz, a subordinate of Kolasinski, rather than the underwriters. Vecchio and Gumbiner had not been involved. (Tr. 813, 1667.) Kolasinski had decided what Bank staff reviewed participations. (Tr. 1668.) Vecchio does not know if Kolasinski assigned anyone to underwrite participations that did not go through her underwriters. (Tr. 1669.)

The evidence shows that the Bank's policy regarding participations had always been to

[14] A loan participation is a transaction wherein one bank decides that it does not want to retain an entire loan on its books, so it sells, or participates out, all or a portion of the loan to another bank. There are a variety of reasons a bank might participate out a loan, including lending limit restrictions and determinations about the level of risk the bank wants to retain. (Tr. 2472.) There is no allegation in this case that the practice of buying and selling loan participations is, in and of itself, improper or unusual.

underwrite participations with the same care as originations. (Tr. 748-49, 1620, 2172-73, 4543, 4664.) However, there was some variation as to what that meant in practice. Kiley, the Bank's former CEO and President, testified that the Bank was required to underwrite participations as if the Bank was going to make the loan itself, with the additional requirement that the Bank would verify that the selling bank was in financial and regulatory good standing. (Tr. 748-49.) On the other hand, William King ("King"), the former Chairman of the Bank's Board, testified that, while he agreed "buyer beware" applied to loan participations, it would be "totally appropriate" to evaluate the sufficiency and accuracy of the selling bank's credit memo because, "it's a confirmation process as opposed to an origination process." (Tr. 2173-74.) For his part, Faigin testified that both Bank policies and banking industry practice required that participations be subject to the same complete and independent credit assessment as originations. (Tr. 4542-43.) He went on to testify that he believed the summaries generated by the Bank, discussed below, provided the Board with this type of independent assessment. (Tr. 4543-44.) As discussed above, Vecchio expressed some confusion about what policies applied to participations, particularly those purchased from CTB.

1. First Meetings with CTB Personnel

The first meeting between the Bank and CTB was attended by Faigin, Vecchio, Gumbiner, Kolasinski and Lannan. (Tr. 3762.) Vecchio described this initial meeting as a general conversation of some ADC loans CTB was interested in selling and whether the Bank would be interested in buying them. CTB presented ten loans for purchase, and the Bank eventually purchased an interest in eight of them. The CTB Loans were substantially larger than loans the Bank had purchased in the past. (Tr. 1685.) The CTB Loans purchased were CTB loan numbers: 31377 ("SEP"), 31324 ("VIN"), 30907 ("MSC"), 31265 ("MPC"), 31334

("OTR"), 31098 ("MAG"), 30908 ("NEV"), and 31396 ("SCH").

Faigin initially testified that he attended only the beginning of the meeting and left his staff to review specific loans with CTB. (Tr. 3767.) However, on cross-examination, Faigin was confronted with his earlier sworn statement, wherein he testified that he stayed at the meeting and participated in the initial review of loans. At that point, Faigin admitted he had stayed at the first meeting longer than he had initially testified, stating, "I guess I did not get up and leave quite as soon as I wished. Then or now." (Tr. 4259-63.) This is one of several instances where Faigin's testimony shifted as he was presented with contradictory evidence. Several others are noted throughout this Recommended Decision. Taken in total, these changes and inconsistencies in Faigin's testimony, as well as the numerous instances when Faigin's testimony was inconsistent with the contemporaneous documentary evidence, leads me to the conclusion that, within the context of this case, Faigin had a tendency to be less than completely candid.

2. Initial Review Efforts

After the first meeting, the review of the CTB Loans was initially handled by Kolasinski and Martz. (Tr. 1685, 1692.) Faigin testified that he initially assumed Kolasinski and Vecchio had divided the task. He later realized that Kolasinski had taken on the responsibility of obtaining the necessary documents from CTB and the Bank was not getting them. (Tr. 3768.)

In July of 2006, Faigin realized that the Bank was not getting the needed materials from CTB, and he asked Vecchio to get an update.[15] (Tr. 1687, 3768-69.) Vecchio checked with Martz on more than one occasion. Each time, Martz informed her that they were waiting on

[15] There is some dispute in the testimony of Faigin and Vecchio. Faigin testified that he asked Vecchio to speak to Kolasinski. (Tr. 3768-69.) Vecchio, on the other hand, testified that he asked her to speak to Martz. (Tr. 1687.) Ultimately, this discrepancy is immaterial because there is no dispute that Faigin asked Vecchio to check on the progress of the loans; she did so; and she reported back to Faigin that Kolasinski and Martz were working on it. (Tr. 1687, 3769.)

materials from CTB, which Vecchio reported back to Faigin. (Tr. 1687.) The delays were largely caused by the fact that CTB had no single point person for the transaction and the relevant documents were stored at different locations. (Tr. 1688, 3769.) Vecchio also observed that Martz seemed disorganized.[16] (Tr. 1687.)

At some point, Faigin became fed up with the pace of review. He spoke to Kolasinski and told him that the CTB Loan review needed to be completed and a decision made. He also contacted an official at CTB to urge CTB to move more quickly to provide information and documents to the Bank. (Tr. 3769-70.)

A second meeting between representatives of the Bank and CTB was held on July 13, 2006 to discuss what information the Bank needed from CTB. (R. Exh. 2062; Tr. 1688.) Until that second meeting, Kolasinski and Martz had been the only Bank personnel involved in gathering and reviewing documents related to the CTB Loans. (Tr. 1692.) At that point, Faigin asked Vecchio to get involved in helping to get the review of the CTB Loans moving. (Tr. 1697-98, 3773.) Vecchio arranged a meeting between staff from the underwriting department and Kolasinski and Martz to plan for the review. (Tr. 1696-97; Jt. Exh. 78.) However, Kolasinski and Martz remained in charge of the review, and lending personnel assisted them with review of the files received from CTB. (Tr. 824, 1698-99.) Lannan also assisted with the review of documents. (Tr. 1715-16, 1720; Jt. Exh. 86; FDIC Exh. 77.) Vecchio had never seen a director assist with document review before and did not know why Lannan was involved. (Tr. 1716.)

Some of the delay in reviewing the CTB Loans may have been due to the fact that two of the key staff members involved, Gumbiner and Gary Dent ("Dent"), the Bank's Chief Appraiser, took extended vacations in August, and very little substantive work was done before they left.

[16] Similarly, Vecchio testified that it was "no secret" that Kolasinski was "an extremely disorganized person." (Tr. 1710.)

Gumbiner left for vacation on August 12th and did not return until August 25th. (Tr. 841-43, 1734-35; R. Exh. 2113; Jt. Exh. 89.) He testified that prior to the time he left on vacation, Bank staff's efforts were focused on ascertaining what documents were in CTB's files. It was only after he returned, around which time Vecchio was placed in charge, that Bank staff began to do some level of analysis of the files. (Tr. 1100-01.) Dent left for vacation on August 9th and did not return until August 28th. (Tr. 1721; FDIC Exh. 78.) He testified that he may not have done any of his write-ups related to the CTB Loans until he got back (Tr. 4671-73.)

3. Vecchio Is Put In Charge of CTB Loan Review

The Bank continued to have difficulty obtaining documents from CTB. (Tr. 827-28, 1698.) As a result of the continued delays, Faigin eventually put Vecchio in charge. (Tr. 1746, 3773-74.) However there is disagreement about exactly when this occurred. Faigin testified that he "probably" put Vecchio in charge in August. (Tr. 3773.) Vecchio, on the other hand, testified that Kolasinski remained in charge until September 6th or 7th. (Tr. 1685-86, 1746.)

Looking at the record, it appears that while Vecchio became involved and began assisting the review in July, Kolasinski remained in charge until late August or early September of 2006. Gumbiner testified that even after the lending department began assisting in July, Kolasinski remained in charge. (Tr. 822, 824-27.) He testified that Kolasinski was still in charge when he left for vacation on August 12th and Vecchio was put in charge around the time he returned a few weeks later. (Tr. 841-43; Jt. Exh. 89.) Additionally, documents from the time suggest Kolasinski was still in charge. For example, on August 4, 2006, Martz sent an email to Faigin advising him that the Bank had received full files on five of the CTB Loans, and that Lannan was working on reviewing them. (FDIC Exh. 77.) Then, on August 23, 2006, Carol Schardt ("Schardt"), the Board secretary, sent an email notifying the Board that the CTB Loans would

not be considered at an upcoming Board meeting because Kolasinski indicated the due diligence would not be done in time. (FDIC Exh. 80.) This suggests that Kolasinski was still in charge. Similarly, on September 5, 2006, Dent sent Vecchio an email discussing some work Kolasinski and Martz asked him to do relating to the CTB Loans. (Jt. Exh. 96.)

Further, the evidence shows Vecchio took a more assertive stance in directing the CTB Loan review in early September. On September 7, 2006, Vecchio sent an email to Kolasinski and Martz telling them Faigin wanted them to conclude the CTB transaction "ASAP" and asking them to meet immediately to go over it. (Jt. Exh. 97.) Later that day, Vecchio sent Dent an email pushing him to complete the appraisal reviews because Faigin wanted the CTB deal "wrapped up yesterday!" (Jt. Exh. 98.) Additionally, Vecchio circulated a template she intended staff to use for the write-ups on the CTB Loans on September 13, 2006. At the same time, Vecchio noted that she was waiting for Faigin's notes about his visits to various CTB projects. (FDIC Exh. 82.) Even Faigin admitted that circulating the template in early September was consistent with Vecchio's testimony that she was put in charge in September, not August. (Tr. 4281.) He also testified that if he had actually given Vecchio an August deadline to complete the CTB review, he would have gotten her his inspection reports in August. (Tr. 4289.) However, he admitted that two other emails, one from Carol Schardt (R. Exh. 2142) and one from him (R. Exh. 2147) show that he did not complete those inspections until September. (Tr. 4290.)

All of this suggests that responsibility for the CTB Loans was transferred to Vecchio at some time around the beginning of September. Examining the entire record, it appears that his insistence that Vecchio was in charge earlier was aimed at bolstering his argument that he was entitled to rely on the work of staff, and obscure the tight time constraints he placed on Vecchio and the staff. For the reasons stated above, I do not accept Faigin's testimony on this issue,

which I find less than convincing.

When the CTB review was transferred to Vecchio, Faigin asked her if the review could be completed in a week to ten days so that they could be presented to the Board. (Tr. 1746, 3773-74.) Vecchio informed him that the CTB Loans could not be underwritten in that time and the most that could be done was to examine the documents in CTB's files, compare them to CTB's credit memos, obtain updated absorption[17] and inspection data on the projects and prepare an Executive Summary for the Board.[18] (Tr. 1748, 3774.) Faigin decided that the Bank would use the CTB materials, together with a summary prepared by Bank staff and that he would inform the Board about what was and was not done in the review. (Tr. 3775.) Faigin testified that Vecchio told him that the CTB credit memos were "terrific," and that she would cover and "certify" all factual issues. (Tr. 3774-75.) On cross-examination, however, he stated that certification was a poor choice of words and that the statements he got from lending personnel were more to the effect that they thought they had done everything correctly and knew of nothing they had missed. (Tr. 4298.) For her part, Vecchio testified that when she described what could be accomplished in the timeframe Faigin demanded, he directed her to "do it" and "get the deal to the Board in a week." (Tr. 1749.) She testified, however, that she was never directed to ignore problems and that she felt she could recommend against approving the CTB Loans. (Tr. 1930, 2092.)

Both Vecchio and Gumbiner testified that the review of the CTB Loans was not underwriting, but only a review of documents. (Tr. 939-40, 1031-32, 1841, 1844.) Vecchio

[17] Absorption data is the rate at which real estate sells. It is used in estimating the value of a development project. (Tr. 4582-84.)

[18] Gumbiner testified that underwriting an ADC loan of "medium complexity" would generally take approximately a month. The CTB Loans were more complex and he was unable to estimate how long it would have taken to underwrite them as if they were originations. (Tr. 859, 1171.) Vecchio did not testify as to how long it would have taken to underwrite the CTB Loans as originations, although she did state that getting appraisals alone could take 45 days. (Tr. 1754.)

testified that the review was not similar to underwriting loans the Bank originated. Bank staff verified CTB's calculations and compared the data in CTB's credit memos to the documents in the files CTB provided. But they did not obtain updated financial documents and analyze them. (Tr. 1752-53.) When asked if this meant Bank staff were basically cross-checking CTB's figures and calculations, she responded "it's figures and it's all kind of information . . . But that's what I told [Faigin] I thought could be done in a week. I mean, you can't – our policy says we originate like a new loan. That was impossible. It would take 45 days just to get an appraisal." (Tr. 1753-54.) When asked if the Bank relied on CTB's conclusions, she said only that they "confirmed what was in there." (Tr. 1754.) Gumbiner characterized it as a "lightweight review" of the CTB's loan documents. (Tr. 1077.) He testified that Bank staff did not analyze those documents; they only checked to see that they existed in CTB's files. (Tr. 1138-39.) Giles also testified that the Bank relied on CTB's credit analysis. (Tr. 1437.) She did not do any independent analysis; she only summarized what CTB had done. (Tr. 1410.) Giles testified that she believed the Bank's decision makers wanted to purchase the CTB Loans and the process was just a summary of CTB's analysis. (Tr. 1454.)

The evidence reflects that Faigin was an active participant in the review of the CTB Loans and understood the level of analysis that took place. Most notably, he inspected several of the projects for the Bank.[19] (Tr. 3776; FDIC Exhs. 67 at 5; 56 at 76; Jt. Exhs. 61 at 3; 41 at 3; R. Exh. 1959 at 2.) Additionally, Faigin testified that, because the CTB Loans were so significant, he had several informal meetings about them as the review continued. (Tr. 3760, 3779.) They were also the subject of conversation at a regular lunch meeting he held with his senior officers

[19] Faigin inspected the following projects: VIN, SCH, OTR, MAG, and NEV. (FDIC Exh. 67 at 5; FDIC Exh. 56 at 76; Jt. Exh. 61 at 3; Jt. Exh. 41 at 3; R. Exh. 1959 at 2.)

every Tuesday, and Faigin attended pipeline meetings where they were discussed.[20] (Tr. 3760-61, 3778-79.) Faigin also reviewed summaries Bank staff prepared as they were working on them. (Tr. 3777, 3781-82.) Faigin described the review as "an iterative process," where, "we all were fairly familiar with what was going on, where the loans were, what was in various documents." (Tr. 3783.)

Vecchio developed a template for the Bank's Executive Summaries of the CTB Loans, which she circulated on September 13, 2006. (Tr. 1762; FDIC Exh. 82.) The template was a memorandum addressed to the Board from Credit Administration. It contained an introductory paragraph, and a table with a summary of loan terms such as, borrower, location, loan amount, percent disbursed, percent completed, maturity date and any extension options, interest rate, the Bank's participation and the Bank's fees. The template also included the following section headings: Absorption Data, Field Inspection, and Recommendation. (Jt. Exh. 68.) The Board was provided with an Executive Summary for each CTB Loan, together with the original CTB credit memorandum. (Jt. Exh. 103.) Additionally, the Board was sent a short memorandum summarizing the entire CTB transaction. (Jt. Exh. 95.) Vecchio knew that this material was not consistent with the Bank's Loan Policy requiring that participations be underwritten like originations. Such underwriting would have required more time. (Tr. 1755, 1757.) Similarly, Gumbiner testified that the Executive Summaries did not reflect a full, adequate or independent analysis of the credit risk of the CTB Loans because Bank staff did not have enough time, expertise or information to perform a proper analysis. (Tr. 886.)

4. The Final Review Countdown

On September 25, 2006, the CTB Loans were presented to the Bank Board and approved

[20] Faigin testified that he attended pipeline meetings whenever he wished because he felt that, as CEO, he could attend or not attend any meeting he chose. (Tr. 3760-61.)

at a Board meeting. (Jt. Exh. 115.) Preparation for that meeting required an intense effort by Bank staff, during which they were simultaneously trying to obtain information from CTB and complete their review of the CTB Loans - right up until the September 25, 2006 meeting began.

a. September 8, 2006

Between September 8th and 15th, as he completed the reviews of CTB's appraisals, Dent recommended that the Bank obtain additional information on at least five of the projects: VIN, MAG, OTR, SCH and MPC. (Tr. 4675-78, 4682-83; FDIC Exhs. 32; 54; 66; 84; Jt. Exh. 56.) Among other things, Dent recommended the Bank obtain updated information about the projects' current condition, sales and construction status and projected costs. (FDIC Exhs. 32; 54; 66; 84; Jt. Exh. 56.)

b. September 14, 2006

On Thursday, September 14, 2006, eleven days before the meeting, Kolasinski sent an email to CTB requesting additional information. (FDIC Exh 83.) In that email, Kolasinski informed CTB that the Bank needed CTB's complete working file for each loan, and noted that the Bank has thus far only received parts of the files. He also attached a spreadsheet detailing the information still being sought for each loan. Faigin was copied on this email. (FDIC Exh. 83.) The record is unclear as what information the Bank received in response.

c. September 15, 2006

On Friday, September 15, 2006, there was an early morning series of email exchanges between Vecchio, Dent and Martz relating to information needed about the CTB Loans, including information on balances and explanations of certain loans where costs were equal to or greater than the value of the projects. (FDIC Exh. 86.) This exchange ended with an email from Vecchio to Dent requesting updated absorption data for two projects and stating that their

"marching orders from [Faigin]" were to get the CTB Loans to the Board by the following Monday (September 18, 2006). (FDIC Exh. 86.) Dent responded later in the day that he was working on his last update and it would be done by the end of the day. (FDIC Exh. 87.) The same day, Vecchio and Faigin exchanged emails about the status of Faigin's write-ups from his inspections of project sites. (R. Exh. 2151.)

Near the end of the day on Friday, September 15, 2006, Vecchio sent an email to Martz and Gumbiner requesting an update on the review. (Jt. Exh. 101.) Early the following Monday, September 18, 2006, Gumbiner replied and informed Vecchio that Kolasinski had requested additional help in the review. Gumbiner went on to say that he had allocated the work among himself, Giles and Gregory and that the review would be finished on a staggered schedule, with 3 loans done that day, 3 on Tuesday and the remaining 2 on Wednesday. (FDIC Exh. 89.) By this time, the Bank's workforce was focused primarily on finishing the review of the CTB Loans. (Tr. 1343-45, 1489.)

d. September 19, 2006

On Tuesday, September 19, 2006, Martz forwarded an email that he had received from CTB to Vecchio and Kolasinski. (R. Exh. 2155.) This email demonstrated that CTB was still attempting to gather information that Kolasinski had requested in a telephone call on September 15, 2006. (R. Exh. 2155.) Asked whether this information was included in the Bank's final analysis of the CTB Loans, Vecchio testified that the Bank would not have been able to verify any information that was not in file. (Tr. 1785.)

Later on September 19, 2006, Vecchio sent an email to the Board informing them that they would be receiving information about four of the CTB Loans on Wednesday and the remaining four on Thursday. (Jt. Exh. 103.)

e. September 20, 2006

On Wednesday, September 20, 2006, the Bank's Officer's Loan Committee ("OLC") met to consider and approve the CTB Loans. (Tr. 1788; Jt. Exh. 50 at 9.) Faigin testified that at the OLC meeting, he asked Vecchio "a general question" if she had done what she said she would do, by which he meant confirm all issues raised in the CTB files and any that the Bank would have raised. (Tr. 3823-24.) He testified that because no one raised any issues, he thought it was fair to assume everything had been done. (Tr. 3787-88.) He further testified that he was never told that less than a full analysis had been done; that he relied on Vecchio's statement that she had done a full analysis; and that he assumed all the Bank's policies had been complied with. (Tr. 3824.) For her part, Vecchio testified that she does not recall telling Faigin that underwriters had done what they discussed, and that he received the Board packets when everyone else did. (Tr. 1924-25.) She did testify that Faigin expressed no dissatisfaction with the packets sent out to the Board. (Tr. 1787.) The Board packets for the first four loans went out to the Board that day. The remaining four were sent the next day, Thursday, September 21, 2006. (Jt. Exh. 103.) No changes were made to the Board packets as a result of the OLC meeting. (Tr. 4307.)

Faigin's testimony about his reliance on Bank staff was undermined by the weight of the evidence in the record – including his own contradictory testimony. His testimony that he was never told that less than a full analysis was done is simply incompatible with his earlier testimony that Vecchio told him that all the Bank could do within the timeline Faigin gave her was verify the data in the CTB credit memos. (Tr. 3774-75.) Further, Faigin testified that when Vecchio told him about the limitations of what could be done, he directed her to move forward with that review and decided he would tell the Board what it was getting and what it was not getting. (Tr. 3774-75.) Vecchio corroborated this testimony. (Tr. 1748-49.) Thus, Faigin was

aware of the scope of the review that was performed.

The conclusion that Faigin understood the review process being used to evaluate the CTB Loans is further bolstered by Faigin's testimony about his involvement in the CTB review process. Faigin testified that there were numerous informal meetings about the CTB Loans, and that he attended pipeline meetings. (Tr. 3760-61.) He also testified that he would "go down, see what was coming," while the CTB Loans were being reviewed. (Tr. 3781-82.) He described the CTB review as an "iterative process," and testified that everyone involved (including Faigin) was familiar with what was in the documents. (Tr. 3782-84.) Faigin testified that during the review, he would, to use his words, "break the chain of command," and speak to Dent about appraisal reviews. (Tr. 3778-80.) In an email to King, discussed below, Faigin even highlighted the fact that he took part in the review of the CTB Loans. (FDIC Exh. 91.)

Faigin's claim to have relied on the assurances of his subordinates is further undercut by his shifting admissions about what assurances he actually received. Faigin initially testified that Vecchio agreed to certify all factual issues related to the CTB Loans. (Tr. 3774-75.) He similarly testified that Miller attended the September 20, 2006 OLC meeting and certified that all Bank policies were followed during the review of the CTB Loans. (Tr. 4296.) When he was challenged about these "certifications," Faigin quickly backtracked, and stated that "certification," was not the right word. (Tr. 4297.) Instead, Faigin testified that he got what he termed as "assurances" from Miller. He explained this was not a formal attestation, but Faigin or the Board *might* have asked Miller questions if they had concerns and that, based on periodic conversations that Miller *might* have taken part in, he felt Miller could provide assurance that the CTB review complied with Bank policy. (Tr. 4297-98.)

Similarly, Faigin testified that "certification" was an inappropriate description of the

assurances he received from Vecchio, Gumbiner and Kolasinski. (Tr. 4298.) Instead, he testified that they gave assurances that were "more, 'we've done it, we believe we've done everything correctly.'" (Tr. 4298.) He testified that these assurances were verbal and that they *might* have come at an OLC meeting or at a lunch meeting. (Tr. 4299.) This testimony that various people may have, at some point, given Faigin some assurance that they thought they had performed an adequate review of the CTB Loans undercuts his contradictory testimony that staff certified that a full review had been performed in accordance with Bank policies. Additionally, it further undermines the credibility of Faigin's claims that he believed such a review had been done.

f. September 22, 2006

On Friday, September 22, 2006, the Bank's staff was still trying to obtain information from CTB and complete its review, despite the fact that the CTB Loans had already been approved by the OLC and the Board packets sent out in preparation for the September 25th Board meeting. That morning, Gumbiner sent Vecchio an email informing her that the Bank's staff was reviewing the CTB documents, but that it might take longer than expected. He also noted that their review would "not necessarily uncover all of the underwriting flaws." (FDIC Exh. 92.) Gumbiner testified that at the time he wrote this email, Bank staff was attempting review the documents in the CTB files and identify any needed documents. (Tr. 867.) He raised a concern about uncovering underwriting flaws because the Bank did not have all of the documentation from CTB. (Tr. 868.)

In the afternoon of September 22, 2006, Gumbiner sent Vecchio another email informing her that review of the CTB Loans would not be completed that day. (FDIC Exh. 94.) In response, Vecchio asked if anyone could come in over the weekend to finish the review before

Monday's meeting. (FDIC Exh. 97.) Gumbiner responded that the staff could be in on Sunday and should be able to get the reviews finished. (FDIC Exh. 97.) He went on to state that any remaining questions would have to be answered by CTB on Monday morning. (FDIC Exh. 97.) He finished his email by raising a question about whether the Bank's review had been sufficient, writing, "Strange to ask at this point, but are we going down the right path by primarily looking at documentation? What we are doing at this point is making sure we have complete files and that in a very cursory sense, that they make sense." (FIDIC Exh. 97.) Gumbiner testified that he raised this issue because the Bank was doing only a cursory review of documents, not an in-depth analysis. (Tr. 874-75.) Vecchio testified that that was what she had been instructed to do for this transaction, and that she did not respond because "everybody knew that was the way this transaction was being handled." (Tr. 1815-16.)

Shortly thereafter on September 22, 2006, Vecchio sent Gumbiner a follow-up email saying Martz should have given him a list of documents that the Bank still needed and asking Gumbiner to add anything else that he found was needed or required explanation. Gumbiner replied that he had received Martz's list, but it was a list for a standard commercial loan that left out a number of items related to construction. Gumbiner stated that he was using lists from an earlier group of construction loans to make sure the Bank had everything. (FDIC. Exh. 97.)

Also on Friday, September 22, 2006, King, the Chair of the Bank's Board, raised questions about the CTB Loans. As he was leaving for a vacation to Europe, King dictated his concerns to the Bank's corporate secretary Carol Schardt, who sent them via email to Faigin, Vecchio and Kolasinski. (FDIC Exh. 90.) The email stated that King thought more work needed to be done on the CTB Loans. It raised general issues, followed by questions about specific loans and concluded by stating that there was not enough information to make decisions on the

loans:

> As you know, Bill is leaving for France (boarding 30 min). Since he tried to reach you Annette, but was unable to get an answer, he called me with the following comments after reviewing the [CTB] docs. He wants you to know his tone is not negative, but just thinks more work needs to be done on these loans. Here are his comments:
>
> 1. Many have "subject to extension" and wants to make sure the Bank get the fees if they are extended.
> 2. People are guarantying 1/3, but not to exceed $3 million up to 100% on the loan. Wants to make sure to clarify the "source" of the guaranty.
> 3. Look at the construction status percentage of completion compared to money loaned.
>
> Examples of questions:
> #5 Cypress, CA – loan is recommended "subject to . . . . ". Way too many "subject to" to vote on a loan at this time.
> #8 Santa Clarita – Owned property since 2004 and nothing has happened. Why?
> #6 Approved, but no China Trust recommendation.
> #7 Trust guaranteed, but no trust behind it, based on what he sees.
> #1 Read it and actual deal is very hard to understand. Guaranty is 33-1/3% not exceed $3 million, when amount of loan is $44 million.
>
> Bill believes there are lots of questions to be answered and doesn't think anyone in Bank understands details based on paperwork . . . . . sales status vs construction status. Further, he thinks the knowledge base is not sufficient to make decision on a number of loans. (FDIC Exh. 90.) [21]

[21] During the hearing, King attempted to minimize the importance of this email by testifying that his intent was only to ascertain whether the Bank had performed adequate due diligence on the CTB Loans, and that he subsequently found out that it had. (Tr. 2194, 2198, 2200, 2208, 2212, 2220, 2262.) King also testified that the questions he raised did not call into question the advisability of purchasing the package of CTB Loans. (Tr. 2197, 2199.) Finally, King raised a question about the accuracy of Schardt's transcription of his concerns. (Tr. 2200-05.) However, the relevant documents, King's testimony at his sworn statement and his contradictory testimony at the hearing undercut all of these claims.

For example, King's testimony about the meaning of the initial email is contradicted by the language of the email itself, which expressly stated that King thought more work was needed before the Board voted. Further, the follow-up email King sent to Faigin expressly reiterated that he thought the Board should hold off voting. (Jt. Exh. 105). King testified that, when he sent his follow-up, he was standing by the concerns expressed in the initial email. (Tr. 2222-23.) King was also contradicted by testimony he gave at an earlier sworn statement, where he testified that he did not think adequate due diligence had been done; that it could not be done by the time of the meeting; and that he thought his concerns called the entire loan package into question. (Tr. 2192-94; 2198; 2214.) Finally, it is worth noting that King may have had reason to attempt to temper any criticism of the CTB Loan review. During the hearing, King testified that he has been named as a defendant in an action against the directors and officers of the Bank, which was brought in connection with the Bank's receivership. (Tr. 2195.) Further, King is represented in that action by the same attorneys who represent Faigin in this matter, and he has entered into a joint defense agreement with Faigin in that action. (Tr. 2196.) While these facts, on their own, do not establish that King's testimony was not credible, it must be taken into consideration when evaluating his testimony – especially in light of

After receiving the email, Faigin forwarded it to the Board with a statement that King's questions would be answered at the September 25, 2006 Board meeting. (Jt. Exh. 106.) He also asked Vecchio and Kolasinski to convene a conference call the next day, Saturday, September 23, 2006, to discuss King's concerns. (Jt. Exh. 107.) Vecchio told Faigin that she was available and the conference call apparently took place. (Jt. Exh. 107; Tr. 1807.)

g. September 23, 2006

On Saturday, September 23, 2006, Faigin sent King a response to his email. (FDIC Exh. 91.) Faigin testified that he was "pissed" by King's email. (Tr. 3809.) Faigin believed that King had impugned the Bank staff's work on the CTB Loans – a matter Faigin believes he could measure, but King could not. (Tr. 3809.) He believed that King had less of a basis to evaluate the staff's work than the other directors because he had less interaction with staff. (Tr. 4310-11.) In his response, Faigin defended the staff's work, based on his familiarity with it and the feelings of other Board members, stating:

> In general after my own review and speaking with other members of the Board there does not seem to be agreement with the position suggested by these notes either as to form or substance. . . . I must note that staff took their responsibility to underwrite these loans with great care and diligence and that all senior members of management took part in this transaction, including the undersigned. (FDIC Exh. 91.) (emphasis added).[22]

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the changes in his recollection or viewpoint between his sworn statement and the hearing.

In light of all of the above, I find that King's testimony that his initial email was not meant to express the opinion that the Bank had not performed adequate due diligence on the CTB Loans lacks credibility. Instead, in accordance with the plain language of the email and his earlier testimony, King's clear intent was to inform Faigin that he did not believe the Bank Board had been given adequate information to vote on the CTB Loans.

[22] Faigin's written representation to King, the Chair of the Bank Board, at a critical point in the approval process, that the staff took care to "underwrite these loans" was patently false. The evidence viewed as a whole shows that he knew it to be false at the time it was made, particularly since he was actively involved in the approval process as further stated in his "rebuke" to King. This evidence underscores that Faigin had a tendency to be less than candid. It also shows that he was much more actively involved in directing the CTB loan approval process than he subsequently would like one to believe. Finally, it supports a reasonable inference that after receiving King's email, Faigin solicited the support of the other Board members to vote for approval. While Faigin testified that he "may have" polled other Board members about the CTB Loans after he received King's email (Tr. 4309), the evidence establishes that he did so. It shows that Vecchio forwarded King's email to Sasaki on September 23, 2006, stating that "[Faigin] called this afternoon and said all of the other board members like the deal." (Jt. Exh. 106.) Vecchio

He went on to characterize King's comments as "neither fair nor accurate." (FDIC Exh. 91.) Faigin testified that he meant his response as a rebuke of King. (Tr. 3811.)

h. September 24, 2006

On Sunday, September 24, 2006, King sent an email back to Faigin. (Jt. Exh. 105.) In it, he stated that his earlier comments were not meant to be overly critical and his intent was to be constructive and helpful, not negative or contentious. (Jt. Exh. 105.) King also offered the following clarifications:

> 1. Several of the loans do not have current construction and sales information. My interest is that the borrower(s) not get too far ahead of the lender(s) – cash out versus construction completion.
> 2. The (5) questions under "examples of questions" are correctly stated by Carol's memo. As an example, loan #5, the bank internal write-up recommends approval "subject to" six items. In my opinion, this is too many unknowns at this time for the Board to approve the loan. Wait until all reasonable conditions are met prior to asking the Board to approve.
> 3. Loan #1- is a 3 Million guarantee adequate for a 44 Million loan?
> 4. One of the docs mentions requiring a guarantee from a trust as well as the borrower. Is this comment applicable to more of the loans? (Jt. Exh. 105.)

Faigin testified that, upon reading King's response, he believed King felt rebuked – as Faigin had intended. (Tr. 3811-12.) He sent an email to King in which he promised that all of King's emails would be addressed at the Board meeting and written responses would be prepared, either in the Board minutes or in a separate memo. (Jt. Exh. 105.) He then forwarded King's latest email to Vecchio and Kolasinski with the direction, "Please be prepared to respond to Bill's 5 questions at the Board Meeting. The Board minutes will serve as the response to Bill's questions LBF." (Jt. Exh. 105.)

5. Approval of the CTB Loans

Shortly before 6:00 a.m. on Monday, September, 25, 2006, Vecchio sent an email to

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also testified that, during their conference call earlier that day, Faigin informed her and Kolasinski that the other Board members indicated that they "liked" the deal. (Tr. 1807.)

Kolasinski, Martz, Gumbiner and Dent asking them to meet at 9:00 a.m. to discuss King's questions and certain other issues. (Jt. Exh. 109; Tr. 1804-06, 1810.) Vecchio believes that Gregory and Giles attended this meeting as well. (Tr. 1805, 1818.) She believes that King's questions were discussed, but did not specifically recall the discussions. (Tr. 1805-06.)

The Board meeting convened at 10 a.m. and ended one hour later. (Jt. Exh. 115 at 1, 4.) Faigin chaired the meeting. (Jt. Exh. 115 at 1; Answer, ¶ 60.) Vecchio, Gumbiner, Kolasinski, Martz, Dent, Giles, Gregory and Bauer were all present. (Jt. Exh. 115 at 1.) All of the directors, except King who was in Europe, attended by telephone. (Jt. Exh. 115 at 1.) Despite all of the activity that had gone on in the interim, the directors had not been provided any updates to the Board packets that were sent to them the week before. (Tr. 1808, 4307.)

The minutes of the September 25, 2006 Board meeting reflect that Bank staff provided some responses to King's concerns and other questions from Board members. (Jt. Exh. 115 at 1.) However, the record is unclear as to how seriously, King's concerns, or any other issues, were considered. The minutes themselves do not reflect any in-depth analysis of the CTB Loans or the issues raised by King, and several issues he raised do not appear to be mentioned at all. (Jt. Exh. 115.)

King had raised numerous issues, both general and specific to certain loans. (FDIC Exh. 90; Jt. Exh. 105.) Accounting for overlap between general and specific issues and his points of clarification, those issues were: (1) whether the Bank would receive fees on any loan extensions; (2) the status of construction versus loan disbursements, including the lack of information about construction and sales for some loans; (3) the number of conditions on the recommendations of NEV; (4) whether the guaranty on MPC was sufficient; (5) why there had been no development on MSC when the borrower had owned it since 2004; (6) that SEP did not appear to have a

recommendation from CTB; and (7) whether multiple loans would be guaranteed by trusts. (FDIC Exh. 90; Jt. Exh. 105.)

Of the seven issues raised by King, the Board minutes only record discussion of three: (1) the numerous conditions of the recommendation of NEV; (2) the guaranty on MPC; and (3) the status of construction versus disbursement. (Jt. Exh. 115 at 1-2.) Beyond these three issues, the only mention of King's concerns is the statement that the Board and management did not understand his question regarding SEP. (Jt. Exh. 115 at 2.) Further, the description of the issues that were discussed is cursory at best.

The discussion of the conditions on the recommendation of the NEV loan states that it "was submitted 'subject to' receipt of specific items, some of which were received prior to the meeting, including final approved plans." (Jt. Ext 115 at 1.) The minutes go on to say that the Bank had received satisfactory updated costing for the project and would receive an assessment of the adequacy of the remaining interest reserve from CTB. (Jt. Exh. 115 at 1.) This discussion did not address all of the conditions on the recommendation of the NEV loan. As noted by King, NEV was submitted subject to six conditions. (Jt. Exh. 105; R. Exh. 1959 at 2.) They were: (1) an explanation for slow progress; (2) updated financials; (3) status of Borrower's ongoing construction projects; (4) explanation for the excessive insurance expenditure; (5) an analysis of the adequacy of the interest reserve; and (6) status of pre-sale activity. (R. Exh. 1959 at 2.) The only one of these clearly addressed in the minutes was the adequacy of the interest reserve, and the minutes merely stated that CTB would provide an assessment in the future. (Jt. Exh. 115 at 1.) As to the other issues, the only statement was that "some" items have been received, including final approved plans, which were not listed in the conditions, and satisfactory costing. (Jt. Exh. 115 at 1.) While costing might address some of the conditions, it is not clear

that it did.

The discussion of the guaranty on MPC contained in the minutes raises significant questions about the seriousness of the discussion of King's questions. It stated that the guaranty structure was discussed and the Board felt that the $3 million guaranty was adequate for the risk. (Jt. Exh. 115 at 1.) However, the record makes clear that the guaranty discussed at the meeting, and described in the Bank executive summary for MPC, was not the guaranty connected to that loan. It was the guaranty for the MSC loan – the second CTB Loan to the Monteverde Development Company. (FDIC Exh. 46 at 54, 67-68; Jt. Exh. 50 at 3, 16; Tr. 2625-26.) The documents establish that MSC, a $9 million loan, was supported by a 33% guaranty, limited to $3 million. (Jt. Exh. 50 at 16.) MPC, on the other hand, was a $44 million loan that was supported by a 50% guaranty, with a $22 million limit. (FDIC Exh. 46 at 68.) The Bank's Executive Summaries for both Monteverde loans erroneously stated that they were each supported by a 33% guaranty limited to $3 million. (FDIC Exh. 46 at 54; Jt. Exh. 50 at 3.) Apparently relying on this mistake, King's messages questioned whether a $3 million dollar guaranty was sufficient support for MPC – a $44 million loan. (FDIC Exh. 90; Jt. Exh. 105.) It appears from the meeting minutes that the Board discussed precisely that issue – whether a $3 million guaranty was sufficient for the $44 million dollar MPC loan. (Jt. Exh. 115 at 1.) Despite the presence of Faigin and all of the staff involved in reviewing the CTB Loans, and all the work that was supposedly done to address King's concerns, it appears that no one realized that a different, and larger, guaranty actually supported the MPC loan. This raises questions about the depth and seriousness of the Board's consideration of King's concerns, and the CTB Loans in general.

Finally, the Board minutes reflect some discussion of the status of construction versus

disbursements on two loans, NEV and VIN. (Jt. Exh 115 at 2.) The minutes noted that these were the two loans where vertical construction had commenced, and that lending had received confirmation that there were adequate funds remaining on these two loans to complete construction. (Jt. Exh. 115 at 2.) There is no discussion, however, of the discrepancies between construction and disbursement on the remaining loans. The Executive Summaries reflect that the percent disbursed exceeded the percent completed on four loans: VIN, OTR, NEV and SCH (FDIC Exh. 67 at 4; 56 at 75; Jt. Exh. 61 at 2; R. Exh. 1959 at 1), and construction information was not provided for two others: SEP and MSC. (Jt. Exh. 68 at 2; Jt. Exh. 50 at 2.) Despite this, the Board appears to have limited discussion to two loans about which some confirmation of the adequacy of funds had been received. (Jt. Exh. 115 at 2.)

The Board minutes indicate a few other questions were asked by the Board members present. Director Amster apparently asked about the implication of a borrower's failure to timely complete construction and the beneficiary of the MPC loan. Director Glennon asked about the documentation related to a letter of credit connected to the MPC loan. (Jt. Exh. 115 at 2.) Additionally, Vecchio apparently informed the Board that Bank staff had reviewed all loan documents and found them to be standard construction loan documents. (Jt. Exh. 115 at 2.)

After the discussion of questions, Kolasinski presented the CTB Loans to the Board. (Tr. 1799-1800; Jt. Exh. 115 at 2.) After Kolasinski's presentations, each loan was unanimously approved by the Board. (Jt. Exh. 115 at 2-4.) The <u>one hour</u> meeting ended at 11:00 a.m. (Jt. Exh. 115 at 4.) Notably absent from the minutes and the testimony of those who attended, is any indication that the Board was aware of or discussed any of the common underwriting issues discussed below.

Faigin testified that the discussions at the Board meeting were far more involved than the

minutes show. He testified that the Board was engaged in the discussion; that all relevant staff were present; that King's questions were addressed; and that each loan was discussed. (Tr. 3813, 3822-23.) However, this testimony was ultimately not credible in light of the entire record.

Faigin's testimony that issues were discussed in depth during the Board meeting is undercut first by his own testimony on the issue, which seemed to shift as convenience dictated. As noted above, Faigin initially testified that there was a robust discussion of all the loans and related issues; however, when pressed for specifics, he could not recall anything beyond complements from the Board about how well the information was presented. (Tr. 3822-23.) He then testified that, in fact, not many questions were asked at the meeting.[23] (Tr. 3823.) After this, Faigin proceeded to again reverse his testimony by repeatedly testifying that numerous potentially troubling issues relating to the CTB Loans were discussed and resolved at the meeting, including: the apparent variance between construction and disbursement on the VIN and SEP loans (Tr. 3905, 4408); the correct amount of the mezzanine loan on the SEP loan (Tr. 4401); the litigation relating to the MAG loan (Tr. 4408); the transfer of OTR (Tr. 4520-21); and the status of construction on the MSC project. (Tr. 4540-41.) In each case, Faigin testified that there were discussions at the Board meeting that resolved the issue in question, but he did not describe the substance of those discussions.

The record does not support Faigin's claims that these Board discussions actually took place. Of the issues described above, only one, the variance between disbursements and construction at VIN, is mentioned in the minutes, which state that the Bank had verified that there were adequate funds to complete construction on that project.[24] The other issues Faigin

[23] When he gave this testimony, Faigin did add that he knew there had been "a lot of significant sidebar discussion amongst the directors" about the CTB Loans. (Tr. 3823.) It is not at all clear how unrecorded "sidebars," among the directors would in any way cure any deficiencies in the information provided to those directors.

[24] While the minutes reflect that Kolasinski informed the Board that the Bank had received confirmation that there

testified were resolved in discussion at the meeting simply do not appear anywhere in the minutes. (Jt. Exh. 115.)

Faigin did not explain why these discussions, if they occurred, were not in the minutes. While testifying about a different issue, Faigin did testify that verbal discussions often were not recorded in the minutes. (Tr. 4812.) However, this was contradicted by Faigin's repeated testimony, both at the hearing and at his sworn statement, that Schardt, the Board Secretary, was an excellent note-taker who was very precise in ensuring the minutes accurately reflected meetings and that, if anything, Schardt's minutes were over-inclusive. (Tr. 2406, 2426, 2428, 4761.) Additionally, the fact that the minutes do contain discussion of some issues related to the loans suggests that any other discussion of issues related to a specific loan would have been included as well. There is no reason to presume Schardt would include some of these discussions, but not others. Additionally, the minutes reflect discussions of more general questions, like the Bank's options if construction on one or more projects was not complete by a loan's maturity date. (Jt. Exh. 115 at 2.) Once again, there is no reason to include such generalized information but omit any mentions of substantive discussions of potential problems with specific loans being considered for approval.

Additionally, testimony of other witnesses present at the meeting does not support Faigin's claim that numerous issues were discussed and resolved. Vecchio did not remember if there were any questions beyond those raised by King. Both Vecchio and Gumbiner testified that they did not inform the Board that the Bank's loan policy had not been followed. (Tr. 1311-12, 1947.) Although Dent testified that he attended the meeting and believes he answered

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were adequate funds to complete construction on VIN and NEV (Jt. Exh. 115), other evidence raises some question about the accuracy and completeness of that information. Vecchio testified that as of the time of the Board meeting, the Bank was still waiting for an updated budget analysis on VIN. (Tr. 1994.) This raises further concern about whether the information given to the Board while it considered the CTB Loans was complete or accurate.

questions, he provided few specifics. (Tr. 4627-28.)

Further, there is the simple issue of time. The minutes show that the September 25, 2006 Board meeting began at 10:00 a.m. and concluded one hour later at 11:00 a.m. They show that in that time, there were cursory discussions of issues raised in King's emails; three additional questions posed by Board members; a brief presentation of each of the 8 CTB Loans followed by a motion and vote to approve each one; a discussion of how disbursements would be monitored going forward; when the CTB Loans would fund; the funding strategy for the CTB Loans; and a few other comments. (Jt. Exh. 115.) It seems highly unlikely that, in addition to these recorded items, numerous detailed discussions took place in the space of a single hour.

Finally, the credibility of Faigin's claims about his efforts to ensure that the Board was provided with adequate information was severely undermined by an episode during his testimony best described as bizarre. When first asked about his role in ensuring that the Board was provided with adequate information, Faigin testified that it was his responsibility to see that all Board members, "got in-depth information on every issue, and that it was complete, appropriate." (Tr. 4312-13.) He went on to testify that he could not control how Board members absorbed the information provided, and that it was his job to ensure that Board members had access to staff who could explain any issues to the Board and answer the Directors' questions. However, immediately after offering this testimony, and with no question pending, Faigin stated, "I withdraw." When Enforcement Counsel expressed some confusion, Faigin stated, "I withdraw any of that." (Tr. 4313.) While Faigin did not elaborate, and Enforcement Counsel did question him on what he meant, it appears Faigin was attempting to completely disavow testimony he found uncomfortable, as opposed to explaining it. This episode further reflects Faigin's tendency to be less than completely open and forthright in his testimony.

For all the reasons above, I find that discussions Faigin claims occurred during the September 25, 2006 Board meeting, but which are not reflected in the minutes, did not take place. Further, Faigin's claims to the contrary seem to have been a convenient default answer to questions that suggested that relevant information was not provided to the Board. This attempt is further indication of Faigin's tendency to be less than completely candid in his testimony.

6. Faigin Was Informed that the Loan Closing Should Be Delayed

Given the unresolved issues related to the CTB Loans, discussed more fully below, it is somewhat surprising that Faigin brought them to the Board for consideration at the September 25, 2006 meeting. This is even more surprising because, prior to that meeting, he was informed that the Bank could not close on the CTB Loans until October. On September 23, 2006, two days before the meeting, Vecchio sent an email to Faigin, Kolasinski and Sasaki, in which she informed them that the Bank's ALLL[25] would be under-reserved by almost $1 million if it purchased the CTB Loans prior to the end of September, when the current quarter closed. (Jt. Exh. 107.) She suggested that the Bank delay funding the CTB purchase until October so that the Bank would not be required to increase its ALLL to account for them until the following quarter. (Jt. Exh. 107; Tr. 1798-99.) Despite the rushed review, the unresolved issues and Faigin's knowledge that the Bank needed to delay closing until October, Faigin had staff present them and allowed the Board to vote to approve them.

7. Common Underwriting Issues

A review of the materials presented to the Board demonstrates numerous issues relating to the Bank's review of the CTB Loans that went beyond those identified by King.

[25] "ALLL" is a bank's Allowance for Loan and Lease Losses is a calculated reserve a bank holds to reflect an estimate of uncollectible debts. It was formerly known as the reserve for bad debts.

a. Failure to Conduct an Independent Analysis

It was the Bank's policy and practice to treat loan participations with the same care as loans the Bank originated. (Tr. 748-49, 1620, 2172-73, 4543, 4664; Answer, ¶ 44.) The Bank's Loan Policy expressly required this level of care in underwriting participations, stating that the Bank would not rely on the selling bank for an assessment of credit risk and that it would thoroughly analyze the credit quality of the borrower. (Jt. Exh. 31 at 151, § 6.1.4.). Finally, the relevant regulatory guidance set forth an expectation that an acquiring bank would perform an independent credit analysis prior to purchasing a loan participation. (FDIC Exh. 144 at 2; Jt. Exh. 121 at 1.) Despite this, the Bank's underwriting staff all testified that the CTB Loans were not reviewed with the same care as originations. (Tr. 939-40, 1031-32, 1437, 1841, 1844.) Additionally, Faigin admitted that he understood, and approved, the less thorough review that was done. (Tr. 3774-75.) He further testified that he decided that he would advise the Board about the underwriting process that had been used. (Tr. 3774-75.) The evidence, however, does not reflect that the Board was advised that the review of the CTB Loans deviated in any way from the Bank's Loan Policy. (Jt. Ext. 115.)

b. Appraisal Review

The Executive Summaries prepared by the Bank staff also did not include a section dedicated to review of the appraisals provided by CTB. Instead, it included a section related to absorption data, which was used to update the valuation of the project. Additionally, the LTV[26] derived from the CTB appraisal was often set forth in the Summary and/or Recommendation sections. (*See, e.g.,* FDIC Exh. 67.)

For his part, Faigin testified that he relied on Dent and Vecchio to identify and clear up

[26] LTV is an acronym for Loan-to-Value Ratio, which is the ratio of the amount of the loan to the value of the collateral. The definition of LTV and certain requirements relating to it are set forth in the applicable regulations. *See,* 12 C.F.R. Part 365, Subpt. A, App. A.

any issues related to appraisals. (Tr. 3823-24, 3906-07.) Additionally, the record establishes that Dent, and an outside reviewer, did obtain updated market data for all CTB Loans. (FDIC Exhs. 32; 51; 59; 66; 76; 84; R. Exhs. 446; 1868; 1870; 1972; 2121.)

c. Assessment of Borrower's Financials

The Bank's staff did not perform an independent analysis of the financials and cash flows of the borrowers and guarantors. They did not obtain updated financial information. (Tr. 1753.) Their review of financials was limited to ensuring the information presented in CTB's credit memo's matched the documents in CTB's loan files. (Tr. 1752, 1922-23.) As Vecchio explained, only CTB, as lead bank, would have been able to obtain updated financials. (Tr. 2138.) Vecchio also testified that they did not perform cash flow analysis on the borrowers as part of the review of the CTB Loans. (Tr. 1757.) She further testified that because the Bank was only using the same financials, appraisals and information, there was no benefit to an underwriter preparing a new credit memo that merely re-analyzed the same data. (Tr. 1930.)

Gumbiner believes he reviewed certain analyses of borrower and guarantor financial information and cash flows that were contained in CTB files. (Tr. 1230-35, 1300-01; R. Exhs. 312 at 13-14; 356; 422.) Giles testified that she did not perform a cash flow analysis because the Bank was relying on CTB's analysis. (Tr. 1440-42.) However, she also testified that it was not industry standard or her practice to perform global cash flow analysis. (Tr. 1480-81.) Faigin testified that the Bank did not do global cash flow analysis because it was not industry practice at the time. (Tr. 3880.) He also raised a question about the usefulness of cash flow analysis for real estate developers – testifying that because developers make money by selling completed projects, they generally have a "feast or famine" cash flow, where either a great deal of cash is coming in or none at all. (Tr. 3999.) He also asserted that it is common for a developer to have

a lot of its net worth tied up in illiquid real estate. (Tr. 3910, 3996-97.)

d. Failure to Employ Outside Consultants

The Bank's Loan Policy provides that the Bank "will employ a consultant to assist the Bank with loan identification and risk quantification, in connection with construction loans, by performing the following pre-loan due diligence, as may be appropriate to the specific loan request." (Jt. Exh. 31 at 74, § 2.3.1.) The list of due diligence activities that may require the retention of outside consultants includes the following: entitlement review, including adequacy and sufficiency of proposed documents, zoning and approval process, and availability of permits; Engineering Review regarding the buildable characteristics of the site; and the soundness of budget. (Jt. Exh. 31 at 74-75, § 2.3.1.) With the exception of outside appraisal reviewers, none of the Executive Summaries evidence the participation of third party experts in the underwriting process.

e. Purchase of Large Participation Percentage

There is no dispute that the Bank purchased a majority interest in seven of the CTB Loans, and purchased over 87% interest in six of them. (FDIC Exh. 56, 67; Jt. Exh. 41, 50, 61, 68; R. Exh. 1959.) The only CTB Loan that the Bank did not acquire a majority stake in was MPC, in which it purchased a 29% interest. (FDIC Exh. 46.) At the hearing, FDIC Field Supervisor Robert McGibbon criticized the Bank for purchasing such a large share of the CTB Loans without taking control of the administration. (Tr. 372-73, 375-76.) However, according to Kiley, this was consistent with the Bank's past practices. He testified that when the Bank had purchased participations in the past, they had generally been majority interests, up to the entire loan. (Tr. 747.) Kiley further testified that the originating bank usually retained servicing rights, as CTB did, but he did state that the Bank tried to obtain the right to step in and take over in the

event of default. (Tr. 747-48.) Faigin testified that he believes he could have secured the servicing rights for the Bank and would have done so if he thought the Bank was in a position to handle it. (Tr. 4266-68, 4270-71.) However, he believed it was safer to let CTB retain the responsibility for servicing the CTB Loans because the Bank was still ramping up its ADC program. (Tr. 4266-68.)

f. Failure to Identify Exceptions to Policy

The Bank's Loan Policy required that all construction loans be made in compliance with its policies and any loans that did not comply had to be dealt with as exceptions. (Jt. Exh. 31 at 69, §§ 2.1 & 2.1.1.) Similarly, the Bank's policy on participations required that any waiver of due diligence be disclosed and documented for approval. (Jt. Exh. 31 at 153, § 6.2.1.) This is consistent with the governing regulations, which require that a bank's lending policy include documentation, approval and reporting requirements to monitor compliance with its lending policies. 12 C.F.R. § 365.2(b)(2)(iv). The regulations also require the board of every bank to establish standards for review and approval of exception loans, which must include a written justification for approval and a report to the board of any exceptions of significant size. 12 C.F.R. § 365, Subpt. A., App. A. A bank's lending policy exception report is reviewed by examiners as part of their review of lending. 12 C.F.R. § 365, Subpt. A, App. A. Similarly, FDIC Case Manager Cornell-Pape testified that she would expect any exceptions to the Loan Policy to be noted so the Board was aware of it and that the documents should have discussed the factors that warrant the exception. (Tr. 2483-84.)

The evidence shows that none of the CTB Loans were identified as exceptions to the Bank's Loan Policy. None of the Executive Summaries stated the loans involved any exceptions to policy. (FDIC Exhs. 46; 56; 67; Jt. Exhs. 41; 50; 61; 68; R. Exh. 1959.) Similarly, the

summary memorandum describing the CTB transaction as a whole contained no mention of exceptions to the Loan Policy. (Jt. Exh. 95.) There is nothing in the minutes of the September 25, 2006 Board meeting to suggest that exceptions to the Loan Policy were discussed or even that the Board was made aware of any exceptions to the Loan Policy. (Jt. Exh. 115.) Finally, there is nothing in the record to suggest that the Bank created or maintained any report about exceptions to the Loan Policy relating to the CTB Loans. Accordingly, I find that none of the CTB Loans were approved and recorded as exceptions to the Loan Policy.

8. Individual CTB Loans

The review of each individual CTB Loan also presented unique underwriting issues.

a. SEP

The SEP loan, loan #31377, was a $12 million loan with an 18 month term that was originated by CTB in August 2006. As of September 18, 2006, approximately $2.9 million had been disbursed. The borrower was Sepulveda Blvd., 35, LLC, a single purpose entity. Adam Pasori, a developer with 17 years' experience, was the managing member and guaranteed 100% of the loan. (Jt. Exh. 65 at 2-3.) The purpose of the loan was financing the construction of 31 condominiums in Sherman Oaks, California. (Jt. Exh. 65 at 17.)

The SEP Executive Summary was prepared by Giles. It recommended purchase of the loan based on "excellent location, experience and financial strength of the sponsor/guarantor, market absorption, and acceptable LTC and LTV."[27] (Jt. Exh. 65 at 3.) As to location, the Executive Summary characterized the project as an "excellent 'in-fill' site in a well-established, highly desirable area." It described Mr. Pasori as having a net worth of $47 million, 17 years' experience as a developer, and five other projects with CTB with a total exposure of $32.9

[27] LTC is an acronym for a Loan-to-Cost ratio, which compares the amount of an ADC loan to the total cost to complete the project, including land, construction, permitting and all related expenses.

million. The Executive Summary did not actually state the LTV or LTC ratios. Instead, it described the expected price range for the units; states the project's aggregate retail value is $18.8 million and that the loan could be repaid with the sale of 22 units, which it estimated would take 5-6 months after completion. (Jt. Exh. 65 at 3.) The Bank purchased a 90%, or $10.8 million, participation interest in the loan. (Jt. Exhs. 65 at 2; 115 at 3.)

The documents regarding SEP that the Bank obtained from CTB, which were included in the Board packet, made inconsistent representations about additional financing involved. In the recommendation section of CTB's credit memorandum, it stated that the borrower contributed $1.45 million towards the acquisition of the land, and that the rest was funded with another loan in the amount of $1.56 million. (Jt. Exh. 65 at 19.) These figures made the borrowers equity in the project appear to be approximately 10%. (Jt. Exh. 65 at 19; Tr. 2635-37.) However, the promissory note for the additional loan stated that the loan was for $3.86 million. (Jt. Exh. 65 at 53.) This reduced the borrower's equity to 0.7%.[28] (Tr. 2636-37.) The Bank's Executive Summary did not raise this discrepancy in CTB's documents or contain anything to alert the Board that the borrower had made an equity contribution of less than 1% to the project. This issue was omitted despite the fact that Giles, the underwriter who prepared the Executive Summary, discovered the issue and knew how low the borrower's equity was. (Tr. 1421-24, 1525-26; FDIC Exh. 60 at 10, 12.)

Faigin testified that he was aware of the discrepancy regarding the additional financing. (Tr. 3878-79.) However, he gave conflicting testimony about its significance. Initially, he claimed that the additional debt did not encumber the property and went so far as to opine that

[28] As the numbers above demonstrate, the actual amount of the mezzanine financing is greater than the mezzanine amount and borrower's equity set forth in the CTB credit memo combined. This makes it appear that accounting for the correct mezzanine amount would completely wipe out the borrower's equity, and might even render it negative. However, FDIC Case Manager Cornell-Pape testified that while the correct mezzanine amount did reduce borrower equity to below 1%, the borrower did retain that small amount of equity when the financials were correctly calculated. (Tr. 2637.)

anyone who suggested this additional debt lowered the borrower's equity was demonstrating a lack of understanding of real estate finance. (Tr. 3878-79.) Then, on cross-examination, Faigin retreated from this position and admitted that the additional financing was secured by the same property as the SEP loan; that the discrepancy did lower the borrower's equity; and that he was aware of the issue before the OLC meeting where the loan was approved. (Tr. 4399-4401.) Faigin testified that he believed this issue had been shared with the Board. (Tr. 4401.) The record does not support this belief. As discussed above, no updated or additional materials were provided to the Board after the OLC meeting. (Tr. 4307.) Additionally, the Board minutes contain no indication this issue was discussed. (Jt. Exh. 115.)

Additionally, the Executive Summary had very limited discussion of the guarantor's financial strength. As noted above, it stated only that that he had a net worth of $47 million. (Jt. Exh. 65 at 3.) The CTB documents in the Board packet contain a personal financial statement, dated March 21, 2006, which supported the net worth reported in the Executive Summary. (Jt. Exh. 65 at 40.) However, it did not indicate how, or if, the figures in the financial statement were verified. (Jt. Exh. 65 at 40; Tr. 2641-42.) Additionally, it showed that the majority of Mr. Pasori's assets were concentrated in illiquid holdings – primarily real estate. The CTB documents also included an income statement purportedly drawn from Mr. Pasori's tax returns for the years 2002-2004. It showed net income of $436,571, $412,824 and $768,242, respectively. (Jt. Exh. 65 at 40.)

Finally, the SEP Executive Summary raised and failed to resolve an issue about the status of construction in comparison to loan disbursements. It stated that 35% of the loan was disbursed as of 7/06, but in another section it stated that, as of September 18, 2006, the loan balance was $2.9 million, which was approximately 25% of the loan limit. In the space provided

for percentage complete, it stated "No inspection report available—loan closed 8/06." (Jt. Exh. 65 at 2.) There was nothing in the Executive Summary to reconcile these statements. Even the Field Inspection section, which stated that Kolasinski visited the site on August 18, 2006, contained no mention of the status of construction. (Jt. Exh. 65 at 3.) Thus, it left open the question of why 35% of the loan was apparently disbursed a month *before* CTB originated it; how the loan balance dropped to $2.9 million, or approximately 25%, two months later; what the current status of the project was and how it compared to the loan disbursements. Faigin agreed that the lack of explanation of the status of construction as it compared to the disbursements would have presented a problem were it not for discussion of the issue that he claims occurred at the Board meeting. (Tr. 4408.) The record does not support Faigin. The only discussion of construction contained in the Board minutes is one statement that the vertical construction on two projects, NEV and VIN, had commenced. This notation was framed as a response to King's question about the status of construction versus disbursements on the CTB Loans. (Jt. Exh. 115 at 2.) It implies that any discussion of construction status of other loans would have been similarly recorded in the minutes, but was not included.

b. MAG

The MAG loan, loan #31098, was an $11.2 million loan due to mature in January 2007, with one six-month option to extend. It was 16.56% disbursed and 23% complete. The borrower was Magnolia, LLC, a single purpose entity. Adam Pasori was the managing member and guaranteed 100% of the loan. The purpose of the loan was financing the construction of a 63-unit condominium complex in Riverside, California. (Jt. Exh. 41 at 2-3.)

The MAG Executive Summary was prepared by Giles. It recommended purchase of the loan subject to three conditions: (1) evidence of tentative tract map approval; (2) further

investigation of the potential impact of ongoing litigation on the borrower's financials; and (3) an evaluation of the adequacy of the interest reserve in light of construction delays. (Jt. Exh. 41 at 3.) The Bank purchased a $10 million, or 89%, participation interest in the loan. (Jt. Exhs. 41 at 2; 115 at 4.)

When CTB originated the loan, construction was projected to be complete by June of 2006 – three months before the Bank purchased its participation. However, by the time it came before the Board, construction was only 23% complete. The Executive Summary attributed this to delays in obtaining approval for the tentative tract map and it stated that clearance was expected "soon." (Jt. Exh. 41 at 3.) However, nothing in the Executive Summary or the CTB documents in the Board packet explained the reason for the delay or why approval was expected "soon." (Tr. 2679-82.) There was no discussion of how the delays would affect the cost of completion or the adequacy of the interest reserve, despite the fact that the Bank's Loan Policy expressly identified delays and additional costs caused by delays as particularly important considerations in the underwriting of construction loans. (Tr. 2681-82; Jt. Exh. 31 at 70, § 2.1.2.) Similarly, the Executive Summary stated that the developer was in litigation with his former partner related to an earlier phase of the development but contained no analysis or updates other than the statement that the Judge had ruled in the borrower's favor on every issue, and resolution was once again expected "soon." (Jt. Exh. 41 at 3.) There was no discussion of how the litigation might affect the borrower's ability to complete the project or repay the loan. (Tr. 2684.)

For his part, Faigin testified that the litigation was "*de minimus*;" that "somebody" had looked at the construction budget and determined there were adequate funds to complete the project; and that Vecchio understood that funding was not to occur until the conditions had been

satisfied. (Tr. 3889-90.) He also testified that these issues were resolved in the verbal discussions at the Board meeting. (Tr. 4408.) The Board minutes reflect no such discussions. (Jt. Exh. 115.)

The appraisal for the subject property was dated as of June 5, 2005 – 15 months before the Board meeting. (Tr. 2682-83; Jt. Exh. 39.) The Bank's Loan Policy required that appraisals be no more than 12 month's old at loan funding and that valuations of collateral on all participations be updated. (Jt. Exh. 31 at 105, § 5.3.3.1, 164, § 6.2.2.15, 171-72, § 6.2.3.11.) Despite this, the Executive Summary does not contain any update on the property's valuation beyond updated absorption data. (Tr. 2683.) In addition to the age of the appraisal, it is relevant that the Executive Summary does not mention the property's value at all.

c. VIN

The VIN loan, loan #31324, was a $24 million loan set to mature in May 2007. As of September 14, 2006, approximately $17.3 million had been disbursed. The borrower was the Vineyards South, LLC. The managing members were Walter Luce and Robert Mayer, who each guaranteed 100% of the loan. (FDIC Exh. 67 at 4-5.) The purpose of the loan was to repay debt and fund construction of 94 duplexes and single family condominiums in Coachella, California. (FDIC Exhs. 63 at 25; 67 at 4.)

The VIN Executive Summary was prepared by Gregory. It recommended purchase of the loan based on "good location, experience and financial strength of the borrowers/guarantors, market absorption, acceptable LTC and LTV." (FDIC Exh. 67 at 5.) As to location, the Executive Summary stated the project "is entry level and has value enhancement due to its location." It described Messrs. Luce and Mayer as experienced developers who had a combined net worth that exceeded $303.7 million. The Executive Summary stated that total loan and

subordinated debt was "high at 80%; however, additional collateral was pledged which reduced overall LTV on this credit facility to 44%." It did not say what the additional pledged collateral was. (FDIC Exh. 67 at 5.) The Bank purchased an 89.5%, or $21.5 million, participation interest in the loan. (FDIC Exh. 67 at 4; Jt. Exh. 115 at 3.)

The Executive Summary included no discussion of the appraisal of the project. (FDIC Exh. 67.) While this is true of all the Executive Summaries, it is particularly relevant with regards to VIN because the appraisal raised a potential seismic issue related to the project's proximity to a fault line and suggested that it be investigated further. (Jt. Exh. 71 at 3, 16.) It is undisputed that this seismic issue became a significant problem and contributed to the ultimate failure of the VIN project. (Tr. 2553-55, 3908-09, 4434.)

Vecchio testified that the short review period for the CTB Loans prevented Bank staff from discovering this seismic issue because there was nothing in CTB's file about it. She testified that if the Bank had underwritten the loan like an origination, it would have obtained a new appraisal, which should have raised the issue. (Tr. 1855-56.) For his part, Dent did not recall saying anything about the seismic issue at the Board meeting and characterized the failure to raise it at the meeting or in the Board package a "glaring omission." (Tr. 4702, 4706-07.) Faigin testified that he relied upon staff for appraisal review and did not become aware of the seismic issue until after the loan closed. (Tr. 3906-09.) He admitted it was a significant issue.[29] (Tr. 4434.)

The Executive Summary left out other information about the appraisal of the project. For example, it stated an LTV for the project, but it didn't explain how the LTV was calculated. (FDIC Exh. 67; Tr. 2530-31.) The LTV presented in the Executive Summary was calculated

[29] This admission was a reversal of the position Faigin took in a sworn statement taken during the FDIC's investigation. At that time, he testified that the seismic issue was not a "red flag." (Tr. 4438.)

using the aggregate retail value of the project – the total amount the units would be projected to sell to individual retail buyers. (Tr. 2578; Jt. Exh. 71 at 3; FDIC Exh. 63 at 32.) The relevant regulatory guidance requires that LTV on projects of this type be calculated using bulk value – the price the developer could expect if it sold the entire project to one buyer. (Tr. 2578; FDIC Exh. 148 at 3; Jt. Exhs. 125 at 84; 126 at 117.) This is significant because the aggregate retail value used by the Bank is generally higher than the required bulk value, resulting in a more favorable LTV. (Tr. 2578.) Even using the higher aggregate retail value, the LTV calculated was 80%, which the Executive Summary stated was "high." The Executive Summary stated that this high LTV was mitigated by additional collateral that brought the LTV down to 44%. (FDIC Exh. 67 at 5.) Faigin testified that he would have been troubled by the high LTV if not for the additional collateral. However, he admitted that the Executive Summary did not say what the additional collateral was, and he did not know. (Tr. 4425.)

In addition to the appraisal issues, the VIN Executive Summary raised an issue about the status of construction and disbursement without resolving it. The Executive Summary stated the loan was 72% disbursed while the project was only 60% complete. It contained no explanation for the disparity. (FDIC Exh. 67 at 4.) Faigin testified that he recalled that an adequate explanation of this issue was presented to the Board. (Tr. 3905.) The record does not support this testimony. (Jt. Exh. 115.) Vecchio testified that, in order to determine why disbursements were running ahead of construction,[30] the Bank would have needed the most recent construction inspection. She further testified that the Bank was still waiting for several documents at the time of the Board meeting and the inspection may have been missing. (Tr. 1838-39.) The documents suggest that it was. Respondent's Exhibit 1402 was a construction budget analysis for the VIN

[30] Vecchio did testify that it is not unusual for disbursements to be ahead of completion because some disbursements go to things other than actual construction, such as engineering and entitlements. (Tr. 1994.)

addressed to CTB and dated September 25, 2006. (R. Exh. 1402.) Vecchio testified that she believes this was a document that the Bank was waiting for as of the Board meeting. (Tr. 1994.) Given the fact that this analysis was addressed to CTB and dated the same day as the Board meeting, and in light of the slow pace at which CTB got documents to the Bank, it is very unlikely that this document reached the Bank prior to the 10 am Board meeting. Accordingly, I find that the variance between disbursements and construction at VIN was not explained to the Board.

Finally, the Executive Summary contained very little information about the guarantors' financial strength. While that strength is touted in support of the recommendation to purchase the loan, the only comment about it is that the guarantors have a combined net worth over $303 million. (FDIC Exh. 67 at 5.) The documents in CTB's files showed that the guarantors held a significant portion of their assets in real estate. (FDIC Exh. 63 at 39-40, 42-43.) Faigin testified he would expect this of developers. (Tr. 3910.) The CTB documents also showed significant negative cash flow in recent years. (FDIC Exh. 63 at 41, 44.) However, the Executive Summary made no mention of this, focusing solely on their net worth. (FDIC Exh. 67 at 5.) Faigin testified that this did not concern him, but he did not explain why. (Tr. 3910-11.)

d. MSC

The MSC loan, loan #30907, was a $9 million revolving line of credit set to mature in November 2006, with two options to extend for six months. It was 98.6% disbursed. The borrower was the Monteverde Development Company, a closely held corporation owned by James and Joyce Rodgers, who guaranteed 1/3 of the loan, up to $3 million. (Jt. Exh. 50 at 2-3.) The purpose of the loan was to repay debt and provide working capital for a development in Santa Clarita, California. (Jt. Exh. 50 at 17.)

The Executive Summary was prepared by Gumbiner. It recommended purchase of the loan based on "excellent location, experience and financial strength of the sponsor/guarantor, market absorption, and acceptable LTV." (Jt. Exh. 50 at 3.) As to location, the Executive Summary stated, among other things, that, "the area is experiencing strong housing and population growth, subject can be developed with a variety of uses." It described Mr. Rodgers as having over 46 years of development experience and stated the Rodgers' net worth was $121.4 million. It stated that the "as is" value of the project was $17.6 million as of June 6, 2004 for an LTV of 51%. (Jt. Exh. 50 at 3.) The Executive Summary stated that the loans proceeds would be used to fund a reverse 1031 exchange[31] and to provide working capital to develop commercial lots. (Jt. Exh. 50 at 3.) The Bank purchased an $8 million, or 89.5%, participation interest in the loan. (Jt. Exhs. 50 at 2; 115 at 3.)

The Bank's Board packet for this loan contained four different CTB credit memos – each bearing a different date from 2004. (Jt. Exh. 50.) Faigin admitted that he did not know which iteration of the CTB credit memo he and the Board relied on when considering this loan. (Tr. 4531.) It does not appear from the minutes that this issue was raised or discussed during the Board meeting. (Jt. Exh. 115.) In fact, Faigin admitted that the minutes contain no substantive discussion of this loan at all. (Tr. 4547.)

The CTB credit memos reveal that the developer had not decided how to develop the property. Each one stated that, as of 2004, borrower had "tentative plans" for a mixed-use building and that the borrower was attempting to determine if Marriott had any interest in building a hotel on the site. If not, the borrower intended to build townhomes on the site. In 2004, the borrower was also pursuing approval of a planned development. (Jt. Exh. 50 at 17, 22,

[31] A reverse 1031 exchange is a tax deferral strategy involving the exchange of two properties. The technical details of how such exchanges are structured are not material to this case.

34, 39; Tr. 2592-93.) Faigin testified that the developer intended to sell the property to someone who would build on it. (Tr. 4535-38.)

The Executive Summary contained no information about the borrower's intentions or development activities despite the fact that the loan was 98.6% disbursed and set to mature in approximately 6 weeks. (Jt. Exh. 50.) The Field Inspection section of the Executive Summary implied that there has been no development. It was limited to a discussion of the attributes of the location and stated it, "can be developed with a variety of uses." (Jt. Exh. 50 at 3.)

Faigin testified that the status of construction was irrelevant because this loan was a revolving line of credit. He went so far as suggest anyone who thought the lack of an update on construction was problematic did not understand the credit, without explaining why. (Tr. 3942.) His testimony on the discussion of the loan by the Board was vague and contradictory. Initially, he testified he did not specifically recall discussion of it. (Tr. 3941.) Then, during cross-examination, he testified that this loan was discussed at length during the Board and that Kolasinski answered all questions asked about it. (Tr. 4540-41.) He went on to testify that staff was prepared to tell the Board how loan proceeds had been spent if they had asked; however, he stopped short of testifying that the Board was made aware of the status or how the loan proceeds were spent. (Tr. 4540-44.) In fact, it is undisputed that the loan funds were used to develop other projects. (Tr. 2607-08; 3157-60.) However, at least two of the CTB credit memos included in the Board packet stated that the funds would be used to develop the subject property. (Jt. Exh. 50 at 16-17, 22.)

The information about the borrower and guarantors' financials in the Executive Summary is apparently drawn from CTB documents related to a second loan to Monteverde. The Executive Summary only stated net worth figures. (Jt. Exh. 50 at 2-3.) However, it is worth

noting that the Executive Summary stated the guarantors' net worth as of September 30, 2005, while the financial statements in the CTB documents related to this loan are dated 2004 and cash flow statements are from 2001 and 2002. (Jt. Exh. 50 at 17-18, 28-30.). Faigin testified that the date in the Executive Summary led him to believe the financials were only 12 months old. (Tr. 3943.) Additionally, the CTB loan documents for a second loan to Monteverde, the MPC loan discussed below, do contain financial statements dated September 30, 2005.[32] (FDIC Exh. 46 at 93-94.) Thus, the figures stated in the Executive Summary may be accurate as of that date, but the documents provided in connection with this loan did not demonstrate so and there is no indication that the Board was made aware of where the supporting information was found.

The Executive Summary's discussion of the appraisal was also limited. It was only a statement of value, which it disclosed was from an appraisal dated June 6, 2004 – more than two years earlier. (Jt. Exh. 50 at 3.) There was no discussion at the Board meeting of whether a new appraisal was needed. (Jt. Exh. 115.)

e. MPC

The MPC loan, loan #31265, was a $44.4 million loan set to mature in March 2007, with one option to extend for twelve months. It was 25% disbursed and 46% completed. The borrower was the Monteverde Development Company and the Rodgers guaranteed 1/2 of the loan, up to $22 million. (FDIC 47 Exh. 46 at 53-55, 68.) The purpose of the loan was to fund "backbone" infrastructure for a development in Santa Clarita, California. (FDIC Exh. 46 at 54.)

The Executive Summary was prepared by Gumbiner. It recommended purchase of the loan based on "excellent location, experience and financial strength of the sponsor/guarantor, market absorption, and acceptable LTV." (FDIC Exh. 46 at 55.) As to location, the Executive

[32] This is not the only time that CTB's information related to one Monteverde loan flowed through to the Bank's discussion of the other. As discussed elsewhere, Bank personnel appear to have mistakenly stated that the terms of the guaranty related to this loan also applied to MPC.

Summary stated, among other things, that, "[t]his neighborhood is very desirable and is in a higher income area." Its description of the financials was precisely the same as that contained in the Executive Summary for MSC. It set forth two values for the project, an "as is" value of $57.4 million and a "finished lot" value of $88.9 million, which it used to calculate an LTV of 50%. (FDIC Exh. 46 at 54-55.) The Bank purchased a $13 million, or 29.2%, participation interest in the loan. (FDIC Exhs. 46 at 53; 115 at 2.)

The Executive Summary incorrectly stated that the Rodgers provided a 33% guaranty, limited to $3 million dollars, when in fact they provided a 50% guaranty with a $22 million limit. (FDIC Exh. 46 at 54, 68.) The statements in the Executive Summary were a description of the guaranty of the other Monteverde loan, MSC. (Jt. Exh. 50.) In his e-mail, King questioned whether a $3 million guaranty was sufficient for this $44 million loan. (FDIC Exh. 90.) Despite having the issue raised by King, and despite the work that purportedly went on to address his questions, it appears that no one on the Bank's staff or the Board realized that the information in the Executive Summary was incorrect. Instead, the minutes reflect that there was discussion of whether a $3 million guaranty was sufficient for this loan and that the Board decided it was. (Jt. Exh. 115 at 1.) Indeed, Faigin's testimony about this guaranty at the hearing focused on the appropriateness of the misstated $3 million as security for this loan, not how or why no one noticed that the description of the guaranty was not accurate. (Tr. 3935-36.) When directly asked about the mistake on cross-examination, Faigin stated he would "take [Enforcement Counsel's] word for being wrong." (Tr. 4529.) All of this leads to the conclusion that the mistake about the guaranty was not discovered, and the actual guaranty was not discussed, before the Board approved purchase of this loan.

The Executive Summary also contained very little discussion of the underlying project. It

stated that the loan was for "backbone infrastructure."[33] (FDIC Exh. 46 at 53.) It also stated that the loan was made in conjunction with a division of property between Monteverde and Shappell Industries, Inc., and that $19 million of the loan funds were for a standby letter of credit to insure completion. (FDIC Exh. 46 at 54.) It did not, however, give any details about the land division or the use of the letter of credit. In fact, the development and division of property was quite complex. At the time CTB made the loan, title to the property was held by a partnership made up of Monteverde and Shappell, which was formed to develop the land. In 2006, that partnership was dissolving and the partners were dividing the lots amongst themselves, with each doing the infrastructure development on its own lots. Additionally, each partner was required to obtain a standby letter of credit to ensure completion of its assigned lots. (FDIC Exh. 46 at 68-73.) It appears Faigin was familiar with this project. He testified he had prior knowledge of it from his time at Shappell, the other partner. (Tr. 3928-29.) Despite this, the Executive Summary and Board minutes did not indicate that the specifics of this project, including the reasons for the partnership dissolution and what effect it might have on the project, were ever explained to the Board. (Tr. 2702-05.)

The Executive Summary also contained limited information about the borrower's exit strategy for the project. It stated that two residential builders were "interested" in purchasing the finished lots, but it did not provide any information about the status of any negotiations or agreements with the builders. (FDIC Exh. 46 at 54-55.) The CTB documents in the Board packet show that the borrower had at least initially intended the sale of the lots to close in October or November of 2006 – no more than two months after the Bank purchased its participations. (FDIC Exh. 46 at 74.) Despite the imminent approach of the anticipated sale

[33] "Backbone infrastructure" development is development related to preparing lots for delivery of utilities, such as water, gas and electric. (Tr. 3928.)

date, there is nothing in the Board packet or the minutes indicating that the Board was provided any updates on the borrower's progress towards its exit strategy. (FDIC Exh. 46; Jt. Exh. 115.)

The financial information in the Executive Summary matched that provided in the MSC Executive Summary word-for-word. (FDIC 46 at 54; Jt. Exh. 50 at 2-3.) The net worth figures were based on financial statements dated September 30, 2005, and cash flow statements from 2002 to 2004. (FDIC Exh. 46 at 93.)

f. OTR

The OTR loan, loan #31334, was a $24 million loan set to mature in May 2008, with 2 options to extend for 6 months. It was 55% disbursed and 0% completed. The borrower was Otay Ranch JC R-7, LLC. The LLC was owned by two entities, which were both in turn owned by members of the Baldwin family. James Baldwin and another Baldwin-controlled LLC each guaranteed 100% of the loan. The purpose of the loan was to fund construction of 48 single family residences. As of the time of the Bank's purchase, only the acquisition of the land had been funded under the loan. (Jt. Exh. 60 at 2-3.)

The Executive Summary was prepared by Gumbiner. It recommended purchase of the loan subject to the following conditions: "1) construction budget review; 2) approved permits; and 3) approved plans and specs." (Jt. Exh. 60 at 4.) The Bank purchased a $21.5 million, or 89%, participation interest in the loan. (Jt. Exhs. 60 at 2; 115 at 2.)

Faigin testified that the conditions were typical post-closing items. (Tr. 3923.) He testified that he understood that someone who reported to Vecchio would take care of them prior to funding and that no one had ever informed him there was any problem doing so. (Tr. 3926.) The Loan Policy, however, identifies the possibility that there will not be sufficient funds to complete a project as the first primary risk of construction lending. (Tr. 2657-58; Jt. Exh. 31 at

69, §2.1.2.) Additionally, on cross-examination, Faigin admitted that budget, plans and likelihood of getting needed approvals were key components to assessing viability of a construction project. (Tr. 4226-29.) He further agreed that someone "could" draw the conclusion that the recommendation subject to these conditions was essentially a request that the Board approve the loan subject to a future assessment of the project's viability. (Tr. 4523.) He also admitted that the people who should have ensured the conditions were resolved prior to funding reported to him, and it was his responsibility to make sure they were resolved. (Tr. 4523-24.) Nothing in the Executive Summary suggested that the Bank could resolve these conditions prior to funding which CTB had apparently not been able to do in the months since it had closed the loan. (Tr. 2660-61.)

The Executive Summary failed to include key information about the appraisal. The Executive Summary stated that the appraisal indicated an "as is" value of $18.4 million and a "prospective market value" of $41.9 million. It used the "prospective market value" to arrive at an LTV of 57.7%. (Jt. Exh. 60 at 4.) The Loan Policy required the Bank to use an appraisal estimating the market value of the property in precisely the condition it is in on the effective date of the value, not an estimate of value with anticipated improvements. (Jt. Exh. 31 at 118, § 5.5.4.) From the face of the Executive Summary it is clear that the "prospective market value" is not an "as is" value. Additionally, the appraisal stated that the "prospective market value" is the estimated value after all assumed improvements. (Jt. Exh. 59 at 2-3.) The "as is" value that was provided assumed the lots were in "blue top" condition, meaning they had been graded. (Tr. 2667; Jt. Exh. 59 at 2-3.) However, the Executive Summary stated that grading was not scheduled to occur until November 2006. (Jt. Exh. 60 at 3; Tr. 2669.) Thus, there was no true "as is" value provided for the collateral. (Tr. 2666-68.)

The Executive Summary contained little information about the transfer of the property. It stated that the portion of the loan proceeds already disbursed had funded acquisition of the land. (Jt. Exh. 60 at 3.) It also stated that the subject site was acquired by the Baldwins, who controlled Otay Ranch and guaranteed the loan, in 1988. (Jt. Exh. 60 at 3.) It did not, however, provide any information about the transfer from the Baldwins to Otay Ranch. The parties agree that the transfer of the property to Otay Ranch was not an arms-length transaction. (Tr. 2659, 4519.) Faigin even acknowledged that the price paid exceeded the appraised value of the property. (Tr. 4519; Jt. Exh. 60 at 21.) Despite this, Faigin testified that internal transfers like this are not unusual in real estate, and that the transaction was explained in great depth to the Board at the meeting. However, he admitted the minutes contain no reference to any such discussion. (Tr. 4520-21; Jt. Exh. 115.)

The Executive Summary also contained little information about projected pricing. The CTB documents indicate that the projected pricing for the completed units was at the high end of the pricing spectrum. (Jt. Exh. 60 at 26.) This high price point was not mentioned in the Executive Summary. (Jt. Exh. 60 at 2-4.) The Executive Summary, however, did note that sales had slowed and prices had declined. (Jt. Exh. 60 at 2-3.) These changes tend to slow sales and decrease prices. (Tr. 2664-65.) Faigin testified that the slowing absorption reflected the fact that this was a mature development reaching the end of its development cycle. (Tr. 3918-19.) This maturity was key to Faigin's support for the loan. (Tr. 3917.) He viewed the project as an excellent site in a mature, successful development. (Tr. 3912.)

There was also little discussion of the guarantors' financials. The Executive Summary only set forth net worth figures for the two guarantors – Mr. Baldwin and an LLC he controlled. However, the CTB credit memo in the Board packet included a cash flow analysis, which

indicated that Mr. Baldwin had significant negative cash flow in 2003 (-$20 million) and 2004 (-$38 million). (Jt. Exh. 60 at 33.) The CTB credit memo also stated that Mr. Baldwin's tax returns were "very complex" and involved 75 different s-corporations, partnerships and LLCs that contributed income or losses to him. It attributed his negative cash flow to discretionary contributions to various development projects. It also stated that Mr. Baldwin used a combination of distributions and loans from his various entities to cover his living expenses. (Jt. Exh. 60 at 32.) Faigin testified that he viewed the information on the developer as very positive – focusing on the high net worth and the fact that they were long-time developers Faigin had done business with in the past. (Tr. 3919.)

g. NEV

The NEV loan, loan #30908, was a $19.7 million loan. It originally had a 24 month term and two six-month options to extend. However, the initial term had already expired and the first option had been exercised. The maturity date under that option was February of 2007. The loan was 64% disbursed and the project was 50% complete overall, with 60% of Phase I completed and Phase II not yet started. The borrower was Nevis Cypress, LLC, a single purpose entity. Jeff Ta-Jen Lee was the managing member and 100% owner of Nevis Cypress and guaranteed 100% of the loan. The purpose of the loan was financing the construction of a 63-unit condominium complex in Cypress, California. (FDIC Exh. 52 at 2-3.)

The Executive Summary was prepared by Giles. Among other facts, the Executive Summary stated that the loan's original 24 month term had expired, and the project was only 50% complete, but the loan was 64% disbursed. It went on to state that the interest reserve had been 58.38% utilized and might not be adequate. It also stated that the project's LTV was 82%, which it categorized as "high for a declining market." It recommended purchase of the loan

subject to six conditions: (1) explanation for slow progress; (2) updated financials; (3) status of the borrower's ongoing construction projects; (4) an explanation for excessive insurance expenditures; (5) an analysis of the adequacy of the interest reserve; and (6) status of pre-sale activity. (R. Exh. 1959 at 2.) The Bank purchased a $10.8 million, or 55%, participation interest in the loan. (R. Exh. 1959 at 2; Jt. Exh. 115 at 3.)

The minutes of the Board meeting reflect that there was some discussion of the conditions attached to the recommendations – apparently in response to the question raised by King. (Jt. Exh. 115 at 1.) However, the minutes are unclear about the resolution, stating that "some" items, including approved plans, were received prior to the meeting; that the Bank had received satisfactory updated costing; that CTB would be providing an assessment of the adequacy of the interest reserve; and that they had received confirmation from an architectural/engineer firm that there were adequate funds to complete construction. (Jt. Exh. 115 at 1-2; Tr. 3961.) Faigin testified that this resolved the issue of completing the project. (Tr. 3965.)

Faigin testified that the loan would not be funded unless the conditions were satisfied, and that the agreement with CTB would be written in such a way that the Bank could withdraw if the conditions were not satisfied. (Tr. 3958-59.) He then testified that Vecchio and Sasaki were responsible for making sure the conditions were met prior to funding. (Tr. 3959-60.) However, on cross he admitted that they reported to him, and it was his responsibility to make sure the conditions were satisfied. (Tr. 4523-24.) Additionally, the participation agreement between the Bank and CTB for this loan did not provide for the Bank's withdrawal if the conditions in the Executive Summary were not met. (R. Exh. 1957.) Quite the contrary, the agreement contains an acknowledgement that the Bank had already made the investigation and inquiries about the loan

it deemed necessary, and that execution of agreement constituted the Bank's approval of the form, content and sufficiency of the documents it had been provided, and contained an acknowledgement of what documents the Bank received from CTB. (R. Exh. 1957 at 8-9, § 9.1, 9.5.) It also made administration of the loan a matter within the discretion of CTB. (R. Exh. 1957 at 4-5, § 6.)

The appraisal on the subject property was from July of 2004, more than two years before the Board considered the loan. (R. Exh. 1959 at 16; Tr. 2730-31.) As noted above, the Bank's Loan Policy required appraisals to be no more than 12 months old at the time a loan funded. (Jt. Exh. 31 at 105, § 5.3.3.1.) Further, the LTV set forth in the Executive Summary from that appraisal was 82%, which the Executive Summary described as "high for a declining market." (R. Exh. 1959 at 2.) In fact, the LTV was above the limits in the Bank's Loan Policy and relevant regulatory guidance, both of which limited LTV on a project like this to 80%. (Jt. Exh. 31 at 73, § 2.2.4; 12 C.F.R. Pt. 365, Subpt. A, App. A, Supervisory Loan-to-Value Limits.) Despite this, the Bank did not update the value of the property and nothing in the Executive Summary or the minutes reflected that the age of the appraisal or the LTV were approved as exceptions to Bank policy. (Jt. Exh. 115; R. Exh. 1959.) Faigin admitted that the LTV was an issue and part of the calculation of the loan. He did not testify that the Board was made aware of the relevant policies. (Tr. 3968-69.)

Finally, there is some confusion regarding a land draw taken by the guarantor at the origination of this loan. The documents reflect that the borrower took a $2.5 million cash distribution for the land when CTB originated the loan –essentially purchasing the land from itself. (Tr. 2738-39; R. Exh. 1959 at 19.)

h. SCH

The SCH loan, loan #31396, was a $24 million loan scheduled to mature in January 2008 with 2 options for 3-month extensions. It was 11% disbursed and 3% complete. The borrower was Schaefer Property, LLC, a single purpose entity. The managing member was a corporation. The loan was guaranteed by two families, the O'Connells and the Chengs. The purpose of the loan was financing the construction of three 2-story senior condo buildings, which were Phase III of a master-planned project in Chino, California. (FDIC Exh. 56 at 75-76.)

The Executive Summary was prepared by Kathleen Gregory, the underwriter hired while the CTB review was already under way. It recommended purchase of the loan based on "excellent location, experience and financial strength of the borrower/guarantor, market absorption, and acceptable LTC." (FDIC Exh. 56 at 76.) As to location, the Executive Summary stated, that "[t]he area housing market is strong and demand is expected to continue to grow." It stated that the managing member of the borrower was a corporation whose principals were experienced developers and builders. It also stated that the guarantors had combined net worths of over $16 million. The Executive Summary did not contain an LTC, LTV or a value for the project. It stated that absorption in the county had dropped to a nine quarter low, but remained strong in the project's submarket. (FDIC Exh. 56 at 75-76.) The Bank purchased a $21.5 million, or 89.6%, participation interest in the loan. (FDIC Exh. 56 at 75; Jt. Exh. 115 at 3.)

The CTB documents in the Board packet for this loan contain inconsistent dates for the construction of the project. At one point, the CTB credit memo stated that construction had begun in May of 2006 and was expected to be completed in February of 2007. (FDIC Exh. 56 at 93.) Later in the same CTB memo, it stated that only the tentative tract map had been approved. It went on to state that the borrower expected final map approval and building permit by June 1,

2006 and expected to begin construction in June of 2006 with completion expected by the end of October 2007. (FDIC Exh. 56 at 95.) There is no reconciliation of these conflicting project timelines in the CTB credit memo. (Tr. 2717.)

The Bank's Executive Summary did not address the discrepancy between the timelines. Instead, the Absorption section stated that the original appraiser assumed the land would be ready for development in June of 2006 and the first homes would be complete by November of 2007 – effectively injecting a third potential timeline. (FDIC Exh. 56 at 76.) It went on to recommend that the Bank ascertain current construction status and projected infrastructure costs, further suggesting that the Bank did not know whether construction had begun or where it was. (FDIC Exh. 56 at 76.) The Field Inspection, which was performed by Faigin, did nothing to clarify this issue. It was limited to a discussion of the location and included nothing about the progress of construction. (FDIC Exh. 56 at 76.) The only reference to construction in the Executive Summary is the first page, which stated that the project was 3% complete and the loan was 11% disbursed. (FDIC Exh. 56 at 75.) There was nothing addressing this disparity. (Tr. 2719.)

The timeline for the project was further complicated by the fact that the CTB documents in the Board packet showed that the term of the loan had already been extended shortly after CTB originated it. The Board packet contained a second CTB credit memo, from June of 2006, that related to an extension of the loan's initial term from 12 to 18 months. (FDIC Exh. 56 at 117, 119.) There was no substantive explanation for the change in term mere weeks after the loan was originated. (Tr. 2720.)

Faigin testified that he was not concerned about delays in construction because they were common at the time. (Tr. 3953.) He also testified that the disparity between construction and

loan disbursement was due to the borrower using some of the money for pre-construction costs, such as design and permits. (Tr. 3950-51.) There is nothing in the Executive Summary or Board minutes that demonstrates that these explanations were relayed to the Board. (FDIC Exh. 56; Jt. Exh. 115.) Further, even if Faigin's testimony is believed, it does not resolve the fundamental issue of when the project was expected to be complete. Accordingly, I find that at the time this loan was approved, the Bank had not ascertained the expected completion date and thus had not provided it to the Board.

The final timeline complication related to this loan has to do with the time it was projected to take to sell the completed units. The Executive Summary stated that the absorption rate in the county was 1.35 units per week, and that the project's submarket had an absorption rate of 5.56 units per month, which equates to a slightly higher weekly absorption rate. (FDIC Exh. 56 at 75.) However, at either absorption rate, selling out the 107 unit development would take over 19 months. Thus, even if the developer had begun selling units immediately upon origination of the loan by CTB, before it even had building permits, the project would not have been sold out by the end of the original loan term. (Tr. 2721-24.) On the other hand, the Executive Summary stated that the appraiser estimated the project's absorption rate at 7.0 units per month. Similarly, the CTB credit memo projected that paying off the loan would require sale of 75.91 units, which it estimated would take 10.84 months. (FDIC Exh. 56 at 76, 116.) However, it did not state how this would be impacted by construction and the delays therein. Neither the Executive Summary nor the Board minutes contain any discussion or resolution of this issue. (FDIC Exh. 56; Jt. Exh. 115.)

The final issue related to this loan is the information regarding the guarantors' financials. The Executive Summary stated that the guarantors had combined net worths of over $16 million,

but said nothing further. (FDIC Exh. 56 at 76.) That appears to be based on financial statements in the CTB credit memo – one for the O'Connells, dated May 1, 2006, which showed a net worth of $5.325 million, and one for the Chengs, dated December 15, 2005, $11.565 million. These financial statements demonstrated that both families' assets were primarily centered on real estate holding, including the land that was collateral for the loan. (FDIC 56 at 113, 115.) Faigin characterized the net worth as "significant," but did not testify about any discussion of it with the Board. (Tr. 3948.) While a net worth of almost $17 million is certainly significant, it is impossible to overlook the fact that these individuals were guarantying a loan for $24 million dollars. Thus, on its face, the Executive Summary demonstrated that the guarantors could not be expected to cover the full amount of the loan if necessary. A deeper review of the CTB memo showed that the assets they had were primarily centered in real estate, and included the property that was the primary collateral for the loan, further decreasing the amount that could be expected from the guarantors. Despite this, there is nothing in the Executive Summary or the Board minutes addressing the adequacy of the guaranty. (FDIC Exh. 56; Jt. Exh. 115.)

9. Closing and Funding of the CTB Loans

After the CTB Loans were approved, the Bank staff turned to closing the transaction. On September 29, 2006, Gumbiner sent Vecchio an email with a spreadsheet showing what material was still missing from the Bank's files and indicating what he thought was needed to close. (Jt. Exh. 111; Tr. 1822-23.) On October 5, 2006, Vecchio sent an email to Bank staff assigning various tasks related to closing the CTB Loans. Gumbiner was put in charge of obtaining missing items and working with Eric Rosa, a CTB employee, to obtain CTB final approval for the transaction. (Jt. Exh. 113.) Vecchio sent this email immediately before she left on a vacation to Italy until October 24, 2006. (Jt. Exhs. 113, 114; Tr. 1823-24.)

The email was meant to assign relevant tasks to everyone in the event the CTB loans closed before Vecchio returned. (Tr. 1823-24.) In fact, the email suggested that CTB loans close the following week – while she was on vacation. (Jt. Exh. 113.) The CTB loans did not actually close until shortly after Vecchio returned. On October 25, 2006, the participation agreements were executed. (Answer, ¶ 75.) On October 26, 2006, Faigin approved a wire to fund the Bank's participations in the CTB Loans. (Jt. Exh. 77 at 3-4; Tr. 3826-29.) Faigin offered inconsistent testimony about this approval. Initially, he testified that he did not recall any specific conversations with Vecchio about funding the CTB Loans. (Tr. 3826-29.) He later testified that he and Vecchio had an understanding that the CTB Loans were not to be funded unless all conditions related to them were satisfied. (Tr. 3890.) Then, on cross-examination, he testified it was his responsibility to ensure that the conditions were satisfied prior to funding the CTB Loans. (Tr. 4523-24.) Vecchio's absence from the Bank during the time when any necessary follow up on the CTB Loans should have been occurring undercuts Faigin's claims that he was relying on Vecchio to make sure these matters were handled.[34] There is no evidence in the record of any efforts to ensure that the conditions were satisfied prior to approving the wire.

10. Lannan's Participation and His Fee

As noted earlier, at the time the CTB Loans were approved, Lannan had an agreement with the Bank under which he was paid a fee for all loans he referred to the Bank, including the CTB Loans. (FDIC Exh. 20 at 59.) Despite this, Lannan took part in the Board meeting where the CTB Loans were approved. He moved for the approval of three of the CTB Loans and seconded the motions on two others. (Jt. Exh. 115 at 2-4.) Additionally, Lannan assisted Bank

[34] Vecchio was not the only senior staff member absent between the approval and closing of the CTB Loans. Eric Martz, another Bank employee who was extensively involved in the pre-approval review of the CTB Loans, was also on vacation from September 29, 2006 to October 20, 2006. (Jt. Exh. 111).

staff in the initial review of the documents from CTB – something Vecchio had never seen a director do before. (Tr. 1715-17.) Faigin admitted that Lannan should not have been allowed to vote on the approval of the CTB Loans and that it was Faigin's responsibility to prevent it. As to why he allowed it, Faigin said only that it did not occur to him. (Tr. 3833.)

On November 30, 2006, the Board voted to approve payment of a $75,000 fee to Lannan for referring the CTB Loans to the Bank.[35] (FDIC Exh. 116 at 9.) However, Faigin had already directed Sasaki to make that $75,000 payment to Lannan on November 14, 2006 – more than two weeks *before* the Board approved it. (FDIC Exh. 127.)

Faigin's testimony about the payment to Lannan and his feelings about it shifted as he was confronted with the evidence. He initially testified that he thought the fee to Lannan was "horrendous," and that he did not recall directing Sasaki to pay the fee before the Board approved it. (Tr. 4385.) When he was shown evidence that he had done just that, Faigin testified that he considered bringing in the CTB Loans to be an extraordinary result because it was the Bank's first significant progress in moving into ADC lending. (Tr. 4386-87.) Faigin then testified that he directed the payment prior to its approval because he believed it had been approved at the September 25, 2006 Board meeting. (Tr. 4387.) It had not. (Jt. Exh. 115.) Faigin's contradictory testimony, which is not supported by the record, further demonstrates his tendency to be less than candid during his testimony.

While Faigin's motivations remain unclear, the following facts are established: Faigin knew Lannan had a financial interest in the CTB Loans; Faigin allowed Lannan to vote on the approval of the CTB Loans; and Faigin directed Bank staff to pay Lannan's fee before the payment was authorized by the Board.

[35] Lannan did not attend this meeting. (FDIC Exh. 116 at 1.)

F. Hiring of Eric Rosa as CLO

Eric Rosa ("Rosa") was CTB's Executive Vice President and Head of Real Estate. (Jt. Stip. ¶ 13.)[36] He was one of the Bank's key points of contact at CTB, and was still actively involved on behalf of CTB as late as October 25, 2006, while the parties were working out the final terms of the participation agreements. (Jt. Exh. 113; R. Exh. 2238.) Shortly after the CTB transaction closed, the Bank hired CTM employee, Eric Rosa ("Rosa"), as its new Chief Lending Officer. He executed an employment agreement with the Bank on October 31, 2006. His first day at the Bank was November 13, 2006

The negotiation related to Rosa's employment with the Bank began some time earlier. Faigin testified that Lannan initially suggested that the Bank attempt to hire Rosa. (Tr. 3830.) On August 31, 2006, the Boards of the Bank and the Holding Company authorized Faigin to enter into negotiations with Rosa to become the Bank's CLO. (FDIC Exh. 111; Tr. 4236.) Around this time, Faigin had discussions with Rosa about joining the Bank. (Tr. 3831, 4237.)

Faigin's testimony about the timing of his negotiations with Rosa was contradictory. After admitting to an initial meeting, Faigin testified that he believed he had told Rosa that they could not continue negotiations until the CTB transaction closed. (Tr. 4241.) However, when confronted with the fact that the transactions closed only a few days before Rosa signed his employment agreement with the Bank, Faigin conceded that it seemed unlikely that the negotiations took place in such a short time. (Tr. 4242.) He later admitted he was negotiating with Rosa in October, prior to the closing on the CTB Loans. (Tr. 4245.) This is another instance where Faigin's testimony is inconsistent and contradictory.

Other evidence shows that Faigin was negotiating with Rosa before the CTB transaction

[36] The parties' Joint Stipulations of Fact contain two paragraphs numbered 13. This is a reference to the second paragraph 13.

closed. Vecchio testified that Faigin told her that one of the reasons for the rush to close the CTB transaction was so that the Bank could hire Rosa. (Tr. 1746.) She believed the rush was attributable to Faigin's desire to hire Rosa, who Faigin believed could accelerate the Bank's move into ADC lending. (Tr. 1859.) Gumbiner likewise testified that the CTB timeline was driven in part by the desire to hire Rosa by year-end. (Tr. 843-44.)

After Rosa was hired, he was allowed to realign the staff to create an arrangement in which the underwriters were paired with specific loan officers. Under this system, Gumbiner and Dent still reported to Vecchio, but the other underwriters reported to Rosa. (Tr. 3736, 4247.) This was a partial reversal of the change Faigin had made when he became president of the Bank and split the CLO and CCO functions. Faigin admitted that the change represented "slippage" in underwriter independence. He testified he allowed the reorganization because he felt he had to give Rosa "some leeway" when he joined the Bank. (Tr. 3736, 4247.) Faigin testified that, while he would have preferred not to have made the change, he felt that with Vecchio and Gumbiner in place, the Bank still had appropriate controls. (Tr. 4247.) Vecchio and Gumbiner disagreed. Vecchio testified that she was uncomfortable with the arrangement and worried it would result in corners being cut. (Tr. 1661.) Gumbiner viewed it as a conflict of interest. (Tr. 918.) Vecchio reported these concerns to Faigin, but the realignment stayed in place until Rosa left the Bank. (Tr. 1661.)

Rosa was with the Bank for a little more than one year. He was terminated in January 2008. (Tr. 3832-33; Jt. Exh. 18 at 7, 45.) During his time at the Bank, Rosa repeatedly circumvented loan administration policies and procedures without management or Board approval. (Jt. Exh. 18 at 7.)

G. Sale of the Beverly Hills Branch

In November 2006, the Bank sold its Beverly Hills branch, which had been its main source of retail deposits. (Jt. Exh. 7 at 3.) Faigin testified that he did not see the economic justification for the Bank to maintain the branch. (Tr. 4825-26.) Kiley disagreed with the decision. He was concerned about its effect on the Bank's liquidity. (Tr. 755; FDIC Exh. 158.) In the September 12, 2006 Article, he was quoted as stating that he disagreed with the Bank's strategy of relying on wholesale funding because, "[c]ore deposits are just cheaper and more stable." (FDIC Exh. 158 at 2.)

The evidence shows that the decision to sell the Beverly Hills branch was actually driven by considerations of earnings, rather than liquidity. Faigin testified that a financial analysis by the Bank determined that the Beverly Hills branch was costing the Bank approximately $1 million per year. (Tr. 3837-38.) This analysis examined the overhead cost of maintaining the branch. It then deducted the increased cost of relying on wholesale funding versus core deposits, which Faigin testified was nominal. Additionally, Faigin testified that the Beverly Hills branch did not bring in any loans. (Tr. 3838-40.) He testified that the sale of the branch impacted the Bank in two ways. First, it resulted in $1 million of positive cash flow. Second, the Bank received $8 million for the branch. (Tr. 3841, 3867.) Faigin received a bonus of approximately $350,000.00 in connection with the sale of the branch. (Tr. 4831; FDIC Exh. 204.)

This focus on the earnings of the Beverly Hills branch came despite the undisputed fact that the ongoing regulatory concerns about the Bank related to its liquidity and funding, not earnings. The Bank had consistently received unsatisfactory ratings for liquidity. (Tr. 426-27, 742-43, 4827.) In the time leading up the Bank's entry into ADC lending through the date of its failure, the Bank was more reliant on wholesale funding than 97-98% of its peer banks. (Tr.

472-75, 4828-29; Jt. Exh. 4 at 2.) Faigin admitted that he was aware of the Bank's low reliance on core deposits and that this placed the Bank out of the mainstream of banking. (Tr. 4828-29.) This reliance on wholesale funding presented a severe risk to the Bank's funding in the event its capital rating fell below "well capitalized." If that were to happen, statutory restrictions would prevent the Bank from replacing or renewing its wholesale funding – essentially placing its operating liquidity at risk. (Tr. 677-79, 2773; Jt. Exh. 7 at 3.) When asked about the Bank's contingency plan for such an event, Faigin testified that the Bank's short-term plan was to significantly increase its wholesale borrowing as a capital problem approached, in an effort to secure sufficient cash to survive, until it could improve its capital position and resume borrowing. Faigin admitted that this was a short-term plan that did nothing to reduce the Bank's reliance on wholesale funding, and that the Bank had no long-term plan for dealing with liquidity problems. (Tr. 4829-30.)

Faigin downplayed any concerns about how the sale of the branch affected the Bank's funding or liquidity. He testified that he does not believe it had a material effect on the Bank's funding strategy. (Tr. 3841.) He further opined that few of the retail deposits at the Beverly Hills bank were what he termed "true core deposits" because the Bank's depositors were prone to moving their deposits when rates changed. (Tr. 3720-21.) Finally, he testified that he disclosed the plan to sell the branch to regulators one or two months before it closed, and no one raised any objection. (Tr. 3836-38.)

FDIC Field Supervisor McGibbon testified that he likely did receive notice of the impending branch sale, but did not think much of it because the FDIC had no authority to stop an institution with an overall two rating from selling a branch. (Tr. 581.) McGibbon opined, however, that in light of the historical liquidity concerns at the Bank and its shift into riskier

ADC lending, the sale was inconsistent with Faigin's duties to the Bank. (Tr. 581.)

H. The 2006 Examination of the Bank

1. Planning and Focus of 2006 Examination

On November 20, 2006, the FDIC commenced an examination of the Bank ("2006 Exam"), which examined its conditions as of September 30, 2006. The examiner in charge ("EIC") of the 2006 Exam was Bettine Levy ("Levy"). (Jt. Exh. 7 at 1.) The examination team included nine examiners, including Levy. The exam staff spent a total of 931.5 hours on the 2006 Exam. (R. Exh. 117; Tr. 2275-76.)

Prior to beginning the 2006 Exam, Levy prepared a pre-examination planning report ("PEP Report"), which is standard practice. (Jt. Exh 9; Tr. 2271.) On November 16, 2006, Levy met with Faigin as part of her pre-exam planning, another normal part of the process of planning an exam. (Jt. Exh. 9 at 2; Tr. 2271.) They discussed the Bank's new focus on ADC lending and the sale of the Beverly Hills branch. (Jt. Exh. 9 at 2.) Levy did not question Faigin about his ADC lending experience during that meeting. (Tr. 2357-60.) She did not recall whether Faigin specifically mentioned the CTB Loans during this meeting. (Tr. 2272.) Levy also reviewed the Article as part of her pre-exam preparation. (Tr. 2273.) According to the PEP Report, the 2006 Exam focused on, among other things, the Bank's new ADC lending, its funding strategy, the impact of the sale of the Beverly Hills branch and the change in management at the Bank. (Jt. Exh. 9 at 3.) Levy testified that the focus on ADC lending was at least in part the result of the concerns raised by Kiley in the Article. (Tr. 2309.)

Levy testified that one of the goals of the 2006 Exam was to determine if the Bank's staff had the requisite expertise to handle its new ADC lending program. (Tr. 2360-63.) Levy had conversations with Faigin about his ADC expertise and that of the Bank's staff. (Tr. 2360-63.)

However, she did not recall any conversation with Vecchio about the issue, and she did not interview Rosa. (Tr. 2360-63.) While she agreed it was likely that she spoke to some Bank staff about their ADC experience, she did not remember who. (Tr. 2364.)

2. Loan Review During the 2006 Examination

Loan review is a normal part of an examination. (Tr. 390.) Generally, 30-50% of the total time spent on an examination is spent on loan review. (Tr. 2276.) Examiners performing loan review go over the information in the loan file to assess the risk of the loan at the time of the exam. (Tr. 332, 388, 2276.) The PEP Report set forth the scope of loans to be reviewed during the 2006 Exam. According to the PEP Report, the goal was to examine all loans over $10 million dollars, all ADC loans over $3 million and all new loans originated after August 31, 2006. (Jt. Exh. 9 at 3.) This scope encompassed all of the CTB Loans. Levy testified that the examiners did not specifically target the CTB Loans, but they did target that type of loan. (Tr. 2309.)

At least seven of the eight CTB Loans were examined during the 2006 Exam. (R. Exh. 2 at 2; Tr. 396, 2324.) All seven loans were passed. (Tr. 2324; R. Exhs. 4-7.) According to the 2006 ROE, three of the CTB Loans (MAG, NEV and VIN) were found to be underwritten using improper valuations in contravention of FDIC rules and regulations. (Jt. Exh. 7 at 8; R. Exh. 8 at 3.) The 2006 ROE also stated that NEV had an LTV of 82% – above the 80% supervisory limit – a fact not appropriately documented and reported to the Board. (Jt. Exh. 7 at 8.)

It does not appear that the examiners discussed the CTB Loans or their underwriting with the Bank's staff during the 2006 Exam. Levy testified that she did not speak to any Bank employees or directors who had concerns about the CTB Loans. Nor did she recall any

conversations with Vecchio, Gumbiner or Giles.[37] (Tr. 2292-93.) She also testified that she did not see the e-mails Gumbiner sent to Vecchio where he raised concerns about the underwriting of the CTB Loans. (Tr. 2294.) She does not know if any examiners spoke to the underwriting staff. (Tr. 2352.) Vecchio testified that she does not recall telling examiners that the CTB Loans were not underwritten in accordance with Bank policy. (Tr. 1956, 2058.) Similarly, Gumbiner does not recall being interviewed about the CTB Loans or sharing his concerns about the CTB Loans or the ability of the Bank's staff to underwrite ADC loans with the examiners. He testified that he would recall if any such conversations had taken place. (Tr. 895-98.) Giles testified that she had no contact with the examiners and never expressed any concerns about the CTB Loans to examiners. (Tr. 1417.) Accordingly, I find that the examiners involved in the 2006 Exam were never informed that the CTB Loans were not underwritten in accordance with the Loan Policy.

3. Conclusions of the 2006 Examination

On December 14, 2006, at the conclusion of the 2006 Exam, Levy and McGibbon met with Faigin, Vecchio, Kolasinski, Rosa, Miller, Sasaki, Vice President Douglas Thomas and Vice President John Kardos to discuss the examiners' findings. (Jt. Exh. 7 at 6.) Levy's notes for this meeting contain a summary of her initial conclusions. (R. Exh. 8.)[38] Among other things, her notes show that the examiners continued to have concerns about the Bank's liquidity. They state that the Bank was dependent on wholesale deposits and borrowing for funding; that its core deposits decreased with the sale of the Beverly Hills Branch; and that its funding sources

[37] Examiners would not inquire about specific loans being reviewed as a matter of course, unless something in the loan files raised concerns. Levy testified that when examiners have questions, they seek information from appropriate bank personnel, but she did not testify that any particular questioning about underwriting was a normal part of an examination. She also testified that she did not know what Bank personnel examiners spoke to during the 2006 Exam. (Tr. 2351-52.)

[38] This exhibit is titled "First Bank of Beverly Hills, FDIC Examination, Board Meeting, December 14, 2006." (R. Exh. 8 at 1.) However, Levy testified it was her notes for her meeting with management. (Tr. 2295, 2324.)

could become unavailable if the Bank became uncreditworthy or its capital position weakened. According to Levy's notes, she recommended a rating of "3" for Liquidity. (R. Exh. 8 at 1.)

Levy's notes about asset review focused on ADC lending and describe the same concerns that were ultimately included in the 2006 ROE, and which are discussed in Section H.2, above. Notwithstanding those concerns, Levy recommended a rating of "1" for Asset Quality. (R. Exh. 8 at 3.)

After the 2006 Exam was completed, the draft of the 2006 ROE, and Levy's recommendations, were reviewed by senior FDIC officials, including Field Supervisor McGibbon. (Tr. 662, 2296; Jt. Exh. 7 at 21.) McGibbon testified that he spent approximately four hours reviewing the 2006 ROE before signing off on it. (Tr. 668-69.) During this review, the Bank's rating for Asset Quality was downgraded from the "1" recommended by Levy to a "2." (Tr. 2296.) This was a decline from the Bank's last exam, where its Asset Quality had been rated a "1." (Jt. Exh. 1 at 6.) The downgrade was due to the higher risk of the Bank's new ADC lending. (Tr. 359; Jt. Exh. 7 at 5, 21.) Otherwise, the Bank's ratings were consistent with Levy's recommendations. (Jt. Exh. 7; R. Exh. 8.)

In the final 2006 ROE, the Bank received a composite rating of "2," indicating an overall satisfactory condition. (Jt. Exh. 7 at 3.) It was rated as a "2" in every CAMELS component except Liquidity, where it received a "3." With the exception of the decline from a "1" to a "2" in Asset Quality, none of the Bank's ratings changed from its prior exam. (Jt. Exh. 7 at 3.)

The Liquidity section of the 2006 ROE discussed several concerns about the Bank's reliance on wholesale funding over core deposits and analyzed how far the Bank was from its peers in this regard. Even before selling the Beverly Hills branch, which had been its primary source of core deposits, the Bank's core deposits were only 13.24% of its total assets, well below

its peer average of 60.48%. Similarly, the 2006 ROE stated that the dependence on non-core funding was 79.65%, well above its peer average of 28.15%. (Jt. Exh. 7 at 3.) The 2006 ROE also noted that the Bank's brokered deposits had increased by 93.58% from the prior year. (Jt. Exh. 7 at 3.) The 2006 ROE raised concerns about the cost and stability of the Bank's funding strategy. It stated that the Bank's funding was generally more expensive than core deposits. It also raised the concern that the Bank's funding sources could become unavailable if the Bank's capital position declined and it became subject to regulatory restrictions. (Jt. Exh 7 at 3; Tr. 436.)

Although the 2006 ROE concluded that the Bank's overall Asset Quality was "still satisfactory," it set forth some concerns and concluded that Asset Quality had declined since the prior exam. (Jt. Exh. 7 at 4-5, 8.) The ROE's discussion of problems and violations relating to specific loans is described above in the discussion of the loan review during the 2006 Exam. Additionally, the 2006 ROE noted that the Bank had significant concentrations in commercial real estate lending and that it had moved into ADC lending – a higher risk area lending area. (Jt. Exh. 7 at 5.) The 2006 ROE identified these concerns as the reason for downgrading the Bank from the rating of "1" it had received as its last exam to a "2" in the 2006 Exam. (Jt. Exh. 7 at 5, 21.)

The 2006 ROE described the Bank's Capital as satisfactory; however, it questioned the amount of the dividends paid by the Bank. It noted that the Bank had agreed to pay quarterly dividends of $3 million to its holding company, and that those dividends consumed the majority of the Bank's net income. The 2006 ROE also stated that Faigin had informed regulators that he would recommend ending the dividends in 2007, in light of the Bank's growth plan, its projections that return on average assets would decline in 2007 and its required equity levels.

The 2006 ROE agreed that the concerns Faigin expressed, and the Bank's commercial real estate concentration levels, made ending the dividends prudent. (Jt. Exh. 7 at 5.)

I. The Bank's Other ADC Lending

Between December 16, 2006 and July 7, 2007, the Bank originated four more large ADC loans. (Jt. Stip. ¶¶ 14-17.)

1. LV215

The LV215 loan, loan #800365, was approved on December 19, 2006 as a $17.85 million loan. (Jt. Exh. 47.) It was an interest-only loan that had a term of two years, with one option to renew for 12 additional months. (Jt. Exh. 46 at 1.) It was secured by 10 acres outside Las Vegas, Nevada. (Jt. Exh. 47 at 1.) The borrowers were Las Vegas 215, LLC and Apache Dream, LLC, and the loan was guaranteed by the Koroghli Family Trust and Ray Koroghli. (Jt. Exh. 46 at 1.) Mr. Koroghli was the managing member of Las Vegas 215, LLC and the designated property manager for Apache Dream, LLC. (Jt. Exh. 46 at 7.)

The purpose of the loan was to refinance the purchase of the subject property and provide an interest reserve. (Jt. Exh. 46 at 7.) According to the Bank's credit memo, the property had been purchased in May of 2005 for $17.5 million, using two purchase assignments, which cost $3.5 million each, bringing the total cost of the land to $24.5 million. The property first went under contract in November 2004, prior to a zoning change. The credit memo went on to state that the zoning change had an immediate impact on the value of the land, raising it to $47.9 million. (Jt. Exh. 46 at 7.) The sale of the property was the primary anticipated source of repayment for the loan. (Jt. Exh. 46 at 10.) The credit memo stated that there was a verbal contract to sell the property to Whitehorse Hotel & Casino for $47 million, which intended to build a five-story hotel and casino on the property. (Jt. Exh. 46 at 7-8.) The guaranty was the

secondary source of repayment. (Jt. Exh. 46 at 10.) There is nothing in the credit memo regarding any plans for the borrower to develop the property.

The financial analysis done in connection with the loan raised several issues regarding the guarantor's finances. First, his assets were mostly illiquid real estate holdings. Second, the credit memo stated the guarantor had approximately $2 million in liquid assets, but does not describe what they were. (Tr. 2796; Jt. Exh. 46 at 7-8.) FDIC Case Manager Cornell-Pape testified that her review of the supporting documents revealed no evidence that the guarantor actually had $2 million in liquid assets. (Tr. 2798.) Additionally, the guarantor had negative cash flows in 2004 and 2005 and his assets were spread across 20 real estate entities. (Jt. Exh. 46 at 8.)

For his part, Faigin defended both the loan and the guarantor. He described the loan as a "classic land play," where prior development restrictions had limited the value of the subject land. He testified that once the restrictions were removed the land's value shot up. (Tr. 4001-02.) He also testified that the guarantor had a good history of buying land and securing zoning changes to increase its value, and that the Bank relied on that experience in approving the loan. (Tr. 3999-4000.) He later testified that while a further variance was necessary, he felt that the appropriate zoning was in place to justify the increased value of the land. (Tr. 4772.)

Faigin also defended the use of an interest reserve in connection with this loan. He pointed to the very low LTV on this loan, 39%, as evidence of the low risk that the Bank would not suffer any loss. He further testified that every land loan he had ever done involved an interest reserve, which he believed was appropriate. (Tr. 3994.) Similarly, while they did not agree that interest reserves were always appropriate on land loans, both Vecchio and Gumbiner testified that they concluded that the interest reserve on this loan was appropriate because of the

low risk of loss. (Tr. 1215, 2108-09.)

Finally, Faigin denied that the guarantor's financials raised concerns. He testified that all developers have their net worth tied up in multiple real estate projects. (Tr. 3996-97.) Further, he stated that the guarantor's negative cash flow was a balancing. He asserted that developers have irregular cash flow, which tends to be "feast or famine." (Tr. 3999.) He also stated that the negative cash flow might indicate the developer had limited cash, but it also showed he covered his debts. (Tr. 3998.) Faigin also pointed out that the guarantor had $2 million in liquid assets, although he did not explain what they were or contradict Cornell-Pape's testimony that there were no documents evidencing their existence in the Bank's files. (Tr. 3998.)

2. LV18

The LV18 loan, loan #800364, was approved on January 16, 2007 as a $29 million loan. (FDIC Exh. 119 at 1-2.) It was an interest-only loan that had a term of one year, with two options to renew for 12 additional months. (Jt. Exh. 49 at 10.) It was secured by 42 acres in Las Vegas. (FDIC Exh. 119 at 1; Jt. Exh. 49 at 21.) The borrower was Las Vegas Mobil 18, LLC, and the loan was guaranteed by the Koroghli Family Trust and Ray Koroghli. (Jt. Exh. 49 at 10.) Mr. Koroghli was the managing member of Las Vegas Mobil 18, LLC. (Jt. Exh. 49 at 20.) On February 22, 2007, Kolasinski submitted a memo to the Credit Committee recommending that the initial funding provided be increased from $23.13 million to $24.43 million. The memo explained that the increase was necessary because the Bank closed the loan later than initially anticipated. The borrower had obtained a short term loan to cover the period until the Bank closed the loan, and needed the additional disbursement to pay that loan. (Jt. Exh. 49 at 1.)

The purpose of the loan was to refinance the acquisition of the subject property and provide an interest reserve. (FDIC Exh. 119 at 1; Jt. Exh. 49 at 20.) The subject property was

purchased in 2005 for $32 million, and according to the credit memo, it had appreciated to $108 million because of a change in zoning. (Jt. Exh. 49 at 20.) The credit memo listed the primary anticipated source of repayment as a construction loan to develop the property. It listed sale of the property and the guarantees as the secondary and tertiary sources of repayment respectively. (Jt. Exh. 49 at 22.) However, the credit memo does not discuss any planned development or any potential sale of the property.

The subject property contained an operating mobile home park, but the Bank obtained an appraisal that estimated a hypothetical value for the property as vacant land. (Tr. 2807-08.) An appraisal review obtained by the Bank in January of 2007 listed several risks involved in relying on the hypothetical valuation, primarily relating to the potential difficulty in closing the mobile home park. (R. Exh. 550 at 6.) While the credit memo did reference the mobile home park, it did not state that the appraised value was a hypothetical value. (Tr. 2807-08; Jt. Exh. 49 at 21.)

In addition to being based on hypothetical assumptions, the appraised value of the property reflected a large increase in value in a short time. The property had been purchased in March 2005 for $32 million; however, the appraised value set forth in the credit memo was $108 million. (Jt. Exh. 49 at 20.) The only explanation offered for this large increase in value was the fact that the property had, like LV215, benefited from a zoning change. (Tr. 2810-11; Jt. Exh. 49 at 20.)

Additionally, the financial data presented in connection with this loan was the same information presented in support of LV215, the other Koroghli loan. (Tr. 2813.) However, when the closing of the loan was delayed, the developer got interim financing rather than pay his existing expenses himself, despite purportedly having $2 million in liquid assets. (Tr. 2813-17; Jt. Exh. 49 at 1, 30.)

Faigin's testimony about this loan was similar to his testimony concerning LV215. He testified that he voted to approve the loan because of the location and the financial strength of the guarantor. He specifically pointed to the very low LTV (27%) and the high demand for vacant land in Las Vegas. (Tr. 4012; Jt. Exh. 49 at 23.) He testified that the increase in value was an "amazing home run," but that similar increases had been occurring in Las Vegas for 7-8 years. (Tr. 4015-16.) With regard to zoning issues, Faigin testified that he thought that obtaining any needed approvals would be ministerial. (Tr. 4016.) He testified that he had brought in his own zoning expert to assure him that closure of the park would not be a problem, but he failed to identify that expert or introduce any supporting documentation. (Tr. 4788-89.) He also relied on the fact that the appraiser retained was a specialist in mobile home park conversions. (Tr. 4017-18.)

3. DOR

The DOR loan, loan #800392, was approved by the Directors' Loan Committee on May 29, 2007 as an $11.5 million loan. (Jt. Exh. 117.) It had a five-year term, with interest only payments for the first two years. (Jt. Exh. 35 at 5, 14.) It was secured by a five-story building at 30 Dore Street in San Francisco. (Jt. Exh. 35 at 14, 18.) The borrower was 30 Dore LLC, and the loan was guaranteed by George F. Hauser, who was the developer of the project. (Jt. Exh. 35 at 6, 14.)

The purpose of the loan was to refinance an existing construction loan being used to construct a 42-unit condominium project at the subject property and provide an interest reserve. (Jt. Exh. 35 at 14.) Upon completion, the borrower intended to operate the property as an apartment complex rather than sell it. (Jt. Exh. 35 at 14.) The credit memo stated that the loan would be repaid from cash flow from the property, sale of the units, liquidation of the collateral

and the guaranty. According to the credit memo, the sale of 34 of the 42 units would fully repay the loan. (Jt. Exh. 35 at 16.)

The credit memo disclosed that the project's Debt Service Coverage Ratio ("DSCR")[39] did not meet the requirements of the Bank's Loan Policy. (Jt. Exh. 35 at 15.) The Loan Policy required that multi-family properties, like this one, have a DSCR of 1.15:1 or higher. (Jt. Exh. 31 at 41, §1.4.3.1; Tr. 2830.) While the credit memo did state that the project's DSCR did not meet the Bank's policy (Jt. Exh. 35 at 15), it was less than clear about what was the actual DSCR. In the transaction summary, it stated that the maximum loan amount was based on a DSCR of 1.05:1 during the interest-only payment period. Later in the same section, it stated that the DSCR for principal and interest payments would drop to 0.92:1. (Jt. Exh. 35 at 14.) Still later, the credit memo disclosed that there would be a junior lien on the property, and the DSCR for the combined first and second liens would be 0.84:1.[40] (Jt. Exh 35 at 15.) Thus, any way the credit memo calculated DSCR, it was below the requirements of the Bank's Loan Policy, and if principal payments were taken into account, it was below the amount needed to service the project's debt. In its assessment of the strengths and weaknesses of the loan, the credit memo stated that the low DSCR, which it stated was 1.05:1, was a key risk factor. The credit memo stated that it was mitigated by the interest reserve, Mr. Hauser's personal liquidity and his ability to sell units in the project or other condos he owned. (Jt. Exh. 35 at 40.)

The credit memo also suggested that the borrower might obtain a more favorable DSCR in the future if it could refinance the loan at a lower rate, which it suggested might raise the DSCR to 1.24:1 if it was calculated on an interest only basis or 1.02:1 on an interest and

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[39] Debt Service Coverage Ratio is the ratio of cash flow available to meet debt obligations to the amount of those debt obligations. For example, if a property had $100 in available cash flow and debt obligations of $50, its DSCR would be 2:1. A DSCR under 1:1 indicates that available cash flow is insufficient to meet debt obligations.
[40] The credit memo stated that Mr. Hauser would be servicing the junior debt out-of-pocket, which seemed to imply that it was not necessary to include the junior debt when calculating the DSCR. (Jt. Exh. 35 at 15.)

principal basis. (Jt. Exh. 35 at 15.) But this hypothetical refinance, if available, would not be the loan at issue, but a loan that replaced it.

Despite the numerous DSCRs, and calculation methods, set forth in the credit memo, the only discussion of the DSCR in the minutes stated that the DSCR was 1.05:1, which it characterized as "light." (Jt. Exh. 117.) Nothing in the minutes expressly stated that this DSCR of 1.05:1 (the highest of all the credit memo's calculations) failed to meet the Bank's Loan Policy or that the loan was being approved as an exception to policy. (Jt. Exh. 117.)

The financial analysis in the credit memo indicated that Mr. Hauser, the developer and guarantor, had a negative cash flow of approximately $1 million in 2004 and approximately $2 million in 2005. (Jt. Exh. 35 at 39.) It also indicated that Hauser's rental properties operated at a loss in 2004 and 2005, and as of the date of the memo were "operating at or near breakeven." (Jt. Exh 35 at 39.) Hauser's negative cash flow, and his strategy of holding his properties as rentals, were listed in the credit memo as key risk factors related to this loan. (Jt. Exh. 35 at 40.) Despite his large negative cash flow, the credit memo stated that Mr. Hauser would make the payments on the junior debt personally. (Jt. Exh. 35 at 15; Tr. 2838.)

Faigin admitted that as an apartment building, this project would be "marginal" at paying off the loan; however, he testified that the units would ultimately be sold, and the sale of 34 units could pay off the loan. (Tr. 3983-84; Jt. Exh. 35 at 16.) He also pointed out that Hauser had $800,000 in liquidity and a $250,000 interest reserve that the Bank could draw on in the event of a shortfall. (Tr. 3987-89; Jt. Exh. 35 at 5.) Finally, Faigin testified that Hauser had other condo projects he could sell to pay the loan, but he admitted that the credit memo did not provide any information about the debt encumbering Hauser's other projects. (Tr. 3987-89, 4764.)

4. ACA

The ACA loan, loan #800408, was approved by the Board on July 20, 2007 as a $15 million loan. (Jt. Exh. 118.) It was a two-year, interest-only loan. (Jt. Exh. 42 at 147.) The loan was secured by 60.57 acres of vacant land in Carlsbad, California. (Jt. Exhs. 42 at 147; 118.) The borrower was Acacia Investors, LLC, and the loan was guaranteed by Stephen Taylor, who was one of the principal figures directing the project.[41] (Jt. Exh. 42 at 148.)

The purpose of the loan was to refinance the existing debt on the property, provide funds to obtain zoning changes, and provide an interest reserve. (Jt. Exhs. 118 at 1; 42 at 157.) The credit memo stated that the debt service would be provided by the interest reserve and that the loan would be repaid by the sale of the property after the zoning changes were secured. (Jt. Exh. 42 at 158.)

At the time the loan was approved, the zoning for the subject property allowed for the construction of 103 single-family residences. The borrower was seeking an amendment to allow for the development of 468-unit condominium units. According to the credit memo, the city was favorably disposed to the requested change and its approval was considered "very probable." (Jt. Exh. 42 at 158-59.) In exchange for the zoning change, the city was expected to require the borrower to construct a bridge to connect two sections of the property that were separated by a canyon. (Jt. Exh. 42 at 159.) The credit memo included a projected time table for various milestones in the zoning approval process. According to this time table, final approval of the property's tentative tract map was expected in the second quarter of 2009, with construction of

[41] Mr. Taylor's exact ownership interest and investment in the project is unclear. According to an organizational chart included in the credit memo, Acacia Investors, LLC, the borrower, is owned and managed by other entities, which each have their own ownership structure. It appears Mr. Taylor was affiliated with various entities that owned and/or managed Acacia. (Jt. Exh. 42 at 172.) Additionally, the credit memo listed other projects that it stated Mr. Taylor had developed. (Jt. Exh. 42 at 169-70.) The credit memo also stated that an unnamed corporation owned by Mr. Taylor and James Kubicka, another person listed an "integral part of the deal," had an option to purchase the property upon receipt of a tentative tract map. (Jt. Exh. 42 at 158.)

the bridge to begin thereafter and take approximately 12 months to complete. (Jt. Exh. 42 at 159.) Thus, according to the projections in the credit memo, the required bridge would not be completed until after the loan term expired. (Tr. 2858-59.) The credit memo listed getting the zoning changes and the length of time the borrower would need to carry the loan while doing so as key weaknesses in the credit. (Jt. Exh. 42 at 174-75.)

The credit memo also demonstrated a sharp rise in the appraised value of the subject property. The subject property was assembled by combining four parcels that the borrower purchased between 2004 and 2006 for a total price of approximately $14.8 million. (Jt. Exh. 42 at 157.) However, the credit memo stated that the appraised value of the property under its current zoning was $28.22 million and $50.93 million with the desired zoning change. (Jt. Exh. 42 at 162-65.) The appraiser arrived at these valuations by using what is known as a "land residual value" method. Under this method, the appraiser estimated the value of the land if it was improved to a certain condition (in this case, lots ready for construction) and deducted the developer's estimated costs to improve the land to that state. (Jt. Exh. 42 at 164-65; Tr. 2850-56.) While Faigin testified that the LTV of the land in its current condition was very strong at 53%, he did admit that the credit memo did not adequately explain how the valuation had been calculated. (Tr. 3972-73, 4792-93.) He testified that he was recovering from a heart attack at the time this loan was approved and admitted that he may not have paid as much attention as he should have to it. (Tr. 4794.)

The credit memo described the subject property as ranging "from level areas to rolling hilltop areas to sloping ravine-like areas." It also described a portion of the land as "undeveloped canyon/open space." (Jt. Exh. 42 at 158.) Similarly, the Board minutes reference the city's desire to have the developer build a bridge over the canyon to connect a roadway. (Jt.

Exh. 118.) However, neither the credit memo nor the minutes discuss the existence of sloping ravines and a canyon on the property as they related to the Loan Policy's prohibition on making loans for construction on, among other things, "[p]roperties with difficult topography (e.g., steep hillside or excessive, soil import)." (Jt. Exh. 31 at 70-71, §2.1.3.)

J. 2007 Examination of the Bank

In 2007, the California Department of Financial Institutions ("CDFI") conducted an examination of the Bank ("2007 Exam") using financial statements and information as of June 30, 2007, and loan information as of July 31, 2007. (Jt. Exh. 12 at 3.) The FDIC did not participate in the 2007 Exam. (Tr. 478.) It did, however, review the CDFI's Report of Examination ("2007 ROE"). (Tr. 428.)

The CDFI 2007 ROE gave the Bank the same CAMELS ratings it had received in the FDIC 2006 ROE. In other words, the Bank received an overall rating of "2" or satisfactory. (Jt. Exh. 12 at 3.) It likewise received a "2" in each CAMELS component with the exception of Liquidity, where it was rated a "3" or unsatisfactory. (Jt. Exh. 12 at 4-7.) The 2007 ROE stated that the Bank's wholesale funding was "considered inherently volatile," and that liquidity remained less than satisfactory. (Jt. Exh. 12 at 3-4.) The 2007 ROE also noted that while the Bank's Capital Adequacy was still viewed as satisfactory, its capital position had declined – largely due to cash dividends paid in 2006 and the first half of 2007 that consumed the majority of the Bank's net income. The 2007 ROE stated that capital was expected to decline further because the Bank intended to continue to pay $2.4 million in quarterly dividends. However, it did state that Faigin had indicated that the Board was receptive to the idea of reducing the dividend payment to augment the Bank's capital. (Jt. Exh. 12 at 4.)

During the 2007 Exam, the CDFI examiners reviewed six of the CTB Loans – VIN,

MAG, SEP, OTR and both Monteverde loans. (Tr. 410.) The VIN loan was adversely classified. (Jt. Exh. 12 at 4-5; Tr. 411-13.) Additionally, the MAG loan and the SEP loan were classified as special mention. (Jt. Exh. 12 at 5, 14; Tr. 407.) OTR and both Monteverde loans were passed by the CDFI examiners. (R. Exh. 11, 12; Tr. 407-09.) The CDFI examiners also reviewed and passed the LV215 and LV18 loans. (R. Exh. 13, 14; Tr. 410-11, 414-15.)

The CDFI also reviewed the fee paid to Lannan in connection with the CTB Loans. In the 2007 ROE's comments related to Management, it noted that the Board approved the payment of a $75,000 fee to a director (Lannan) for loan referrals (CTB). It stated that the Board needed to expand its conflict of interest policies to require directors to abstain from transactions in which they were interested; institute an approval process when directors request compensation for services; institute procedures for determining the reasonableness of fees paid to directors; and address conflicts of interest arising from transactions between the Bank and its directors. (Jt. Exh. 12 at 7.)

The Confidential Supervisory Section of the 2007 ROE discussed in greater detail the chain of events surrounding Lannan's fee and CDFI's concerns about it. It noted that in July of 2006, Faigin approved a request from Lannan for $29,000 for Lannan's efforts to secure loans for the Bank. This fee was disclosed in the Bank's July 21, 2006 SEC Form 8-K, which stated it was paid pursuant to an oral agreement and was limited to $29,000 in a six month period. However, in the Bank's October 4, 2006 Form 8-K, it disclosed that the oral agreement was amended to remove the $29,000 fee limit. Then, on November 30, 2006, the Board unanimously approved a payment of $75,000 to Lannan for his efforts in referring the CTB Loans to the Bank.[42] (Jt. Exh. 12 at 20-21; FDIC Exh. 116 at 9.) The Supervisory Section contained the same recommendations set forth in the Management section, discussed above. (Jt. Exh. 12 at 21.) It

[42] Lannan was absent from the meeting where his fee was approved. (FDIC Exh. 116 at 8.)

also suggested that the fee paid in connection with the VIN loan might be void or voidable because the loan may have been Substandard at the time the Bank purchased it. (Jt. Exh. 12 at 22.) It recommended that Lannan's fees be reviewed and that CDFI be notified of the findings. The 2007 ROE stated that Faigin agreed with these recommendations. (Jt. Exh. 12 at 22.)

K. Dividends

Throughout its foray into ADC lending, the Bank continued to pay dividends to its holding company. The record reflects that the Bank approved the following dividends in 2006:

- March 2, 2006, a $3 million dividend was approved (R. Exh. 81 at 3-4; Tr. 2151-52);
- May 25, 2006, a $3 million dividend was approved (Tr. 2154);
- August 31, 2006, a $3 million dividend was approved (R. Exh. 2122 at 4; Tr. 2153);
- November 30, 2006, a $2.4 million dividend was approved (FDIC Exh. 116 at 3; Tr. 2153);

The 2006 ROE stated that Faigin had indicated that he would be recommending that the Bank cease paying dividends in 2007, which the 2006 ROE agreed would be prudent. (Jt. Exh. 7 at 5.) Faigin testified that he recommended reducing dividends in 2007 in order to maintain good relations with the regulators, who wanted the Bank to retain more of its earnings. (Tr. 3844-46.)

Despite Faigin's statement that he would recommend reducing or ending dividend payments in 2007, dividends continued to be approved, and Faigin voted in favor of most of them. The following dividends were approved that year:

- On February 22, 2007, the Board approved a $2.4 million dividend. Faigin did

vote against this dividend. (FDIC Exh. 22 at 107.)

- On May 31, 2007, the Board approved a $2.4 million dividend. Faigin abstained from voting on this dividend. (FDIC Exh. 22 at 74.)
- On September 6, 2007, the Board approved a dividend of 12.5 cents per share. The minutes do not record Faigin's vote. (FDIC Exh. 22 at 50) Supervisory Examiner McGibbon opined that this indicates Faigin voted in favor of the dividend. (Tr. 485-87.)
- On November 29, 2007, the Board approved a $10 million special dividend.[43] Faigin made the motion for approval of this dividend and voted for its approval. (FDIC Exh. 22 at 10.)
- On December 13, 2007, the Board approved a $2.4 million dividend, and Faigin voted in favor of this dividend.[44] (FDIC Exh. 22 at 1.)

The 2007 ROE indicated that these continued dividend payments had consumed the majority of the Bank's net income and continued to weaken its already declining capital position. (Jt. Exh. 12 at 4.) Faigin informed regulators that the Bank's Board was receptive to reducing dividends going forward to augment capital. It was not until March 5, 2008, that the Board actually followed through and voted to defer all dividends to a future date. (Jt. Exh. 18 at 10.)

[43] A special dividend is a dividend payment that is separate from a company's normal, recurring dividend cycle. This special dividend was apparently issued to allow the Holding Company to pay off a trust preferred security. (Jt. Exh. 18 at 10.)

[44] Faigin offered confusing testimony suggesting he does not believe that he voted for this dividend. He initially testified that he opposed the dividend and voted against it at a meeting of the Holding Company board the same day. (Tr. 3863.) When asked about his vote at the meeting of the Bank Board, he testified that he intended to vote against the dividend "later;" however, he admitted that the minutes showed that he voted for it, which he testified "implies" that he did. He then testified that he could not contest what the minutes showed. (Tr. 3865-66.) Contrary to his testimony, the minutes go beyond implying that he voted for the dividend. They expressly state that approval was unanimous and that Faigin was present at the meeting. (FDIC Exh. 22 at 1.) The necessary conclusion is that he voted in favor. Accordingly, I find that the Faigin did vote in favor of it at the meeting of the Bank Board.

L. 2008 Examination of the Bank

On November 3, 2008, the FDIC and the CDFI commenced a joint examination of the Bank's conditions as of September 30, 2008. (Jt. Exh. 18 at 1.) The Report of Examination ("2008 ROE") issued at the end of this examination concluded that the Bank's condition had deteriorated significantly. (Jt. Exh. 18 at 3.) The Bank received a composite CAMELS rating of "5," as well as a "5" in each of its CAMELS components. (Jt. Exh. 18 at 3.) The summary of findings described the Bank as critically deficient. It attributed the Bank's elevated risk profile to inadequate management and the move into ADC lending. (Jt. Exh. 18 at 3.) More specifically, it stated that management had not provided for adequate capital to support the Bank's risk. (Jt. Exh 18 at 3-4.) The Bank's downgrade to a "5," in management was driven by, among other things, concerns about the Bank failing to accurately grade credits, making or renewing loans on stalled development projects and continuing to pay dividends as the economy worsened. (Tr. 452-54.)

The 2008 ROE determined that liquidity was deficient and stated that the contingent liquidity sources available to the Bank had decreased while its reliance on wholesale funding had increased. (Jt. Exh. 18 at 4.) It further stated that the Bank's lowered capital would restrict its use of wholesale funding. The 2008 ROE observed that this restriction would have a critical impact on the Bank because it relied on wholesale funding for its daily and contingent liquidity needs. (Jt. Exh. 18 at 4.) The 2008 ROE detailed the ways in which many of the Bank's sources of liquidity had been reduced or withdrawn entirely. (Jt. Exh. 18 at 4-5.) Finally, it stated that, without brokered deposits or other high cost deposits, it was unlikely that the Bank would be able to fund itself in 2009. (Jt. Exh. 18 at 5.)

The 2008 ROE determined that the Bank's asset quality as critically deficient. (Jt. Exh.

18 at 5.) Because of concerns about the Bank's asset quality, the exam team reviewed more loans than in previous exams. (Tr. 439; FDIC Exh. 2 at 5.) Several of the ADC loans at issue in this matter were reviewed and classified.

Four of the CTB Loans were adversely classified. The VIN loan was classified as partly substandard ($3.36 million) and partly loss ($15.19 million). (Jt. Exh. 18 at 7, 30-31.) The 2008 ROE pointed out that seismic issues had caused delays, and that the borrower had abandoned the project. (Jt. Exh. 18 at 31.) It stated that management agreed with the classification. (Jt. Exh. 18 at 31.) The SCH loan was classified as substandard. (Jt. Exh. 18 at 7, 29-30.) Among its problems, the 2008 ROE noted a high LTV, a lack of final sales and issues relating to the borrower's cash flow and ability to carry the loan. (Jt. Exh. 18 at 30.) Once again, management agreed with the classification. (Jt. Exh. 18 at 30.) The OTR and MPC loans were also classified as partially substandard and partially loss. (Jt. Exh. 18 at 7, 32.)

Three of the four later ADC loans that were originated by the Bank were also adversely classified. LV18 was classified as partially substandard ($5.17 million) and partially loss ($10.5 million). (Jt. Exh. 18 at 25-27.) Among other things, the 2008 ROE criticized the Bank's use of a hypothetical appraisal and the borrower's failure to take any actions to bring the hypothetical conditions of the appraisal to fruition. It also noted that the Bank had obtained a true "as is" appraisal in August of 2008, which set the property's value at $9.8 million – far below the $16.8 million loan amount and the two hypothetical appraisals, which set the value at $108 million and $73 million, respectively. (Jt. Exh. 18 at 26-27.) Although Management disagreed with this classification, it did not disagree that the loan should be adversely classified. Instead, management took the position that the entire loan should be classified substandard as opposed to loss. Additionally, Faigin contended that the $73 million hypothetical value was more realistic

than the $9.8 million "as is" value the Bank had recently received. (Jt. Exh. 18 at 27.)

The 2008 ROE also classified the LV215 and DOR loans as substandard. (Jt. Exh. 18 at 7, 24-25, 32.) It criticized the LV215 loan for being a loan on raw land, which it stated was the riskiest type of real estate, and for improperly using an interest reserve to keep the loan current. (Jt. Exh. 18 at 25.) Management agreed with this classification. (Jt. Exh. 18 at 25.)

M. The Bank's Losses and Its Failure

Beginning in 2008, the Bank took charge-offs on several of the loans at issue. On June 25, 2008, the Bank charged off $3.33 million of the SEP loan and waived the accrued interest.[45] (FDIC Exh. 61 at 5-6.) On December 17, 2008, the Bank took partial charge-offs on three more of the CTB Loans: VIN ($15.195 million), MPC ($704,000), and OTR ($7.27 million). (FDIC Exhs. 68 at 4; 48 at 8; 55 at 5.) On the same day, the Bank charged off over $5.87 million on the LV18 loan. On December 31, 2008, the Bank charged off another $4.63 million on LV18. (FDIC Exh. 40 at 5.) On February 26, 2009, CTB charged off $14.1 million of the SCH loan. (FDIC Exh. 58 at 3.) The Bank's loss on this charge-off was approximately $12.6 million, based on its 89% stake in the loan. (Tr. 2743.)

On April 24, 2009, the CDFI closed the Bank, and the FDIC was appointed receiver. (FDIC Exh. 139 at 2, 5; Jt. Stip. ¶ 1.) On July 12, 2010, a compromise charge-off in the amount $1.7 million was taken on the MAG loan.[46] (FDIC Exh. 35 at 1-2.)

[45] Faigin testified that SEP and MAG failed as a result of Mr. Pasori's death in a plane crash; however, this testimony was stricken on objection by Enforcement Counsel. (Tr. 3881-82.) Further, the record establishes that both loans were experiencing trouble before Mr. Pasori died on August 31, 2007. (Tr. 4418.) SEP was presented to the Bank's Internal Asset Review Committee on April 27, 2007, six months before Pasori's death, and Faigin believed at that time the loan was already in default. (FDIC Exh. 182 at 12.) Eventually, Faigin admitted that both loans had begun to experience trouble before Pasori died and that the problems leading to the failure of SEP included issues that FDIC Case Manager Cornell-Pape had highlighted in her criticism of the underwriting of the loan. (Tr. 4423-24.)

[46] Faigin's Counsel objected to this evidence on the basis of its post-receivership date and argued that the FDIC should provide information as to the loss on June 26, 2008, when the property was sold at foreclosure. His objection was overruled. (Tr. 2745-50.) Because Faigin did not introduce any evidence to dispute that the amount of the loss, I find the date the charge-off was taken to be irrelevant.

Accordingly, the evidence shows that the Bank suffered actual losses in excess of $51 million related to the ADC loans at issue in this matter.

IV. Analysis and Findings

A. The Burden of Proof

The burden of proof in an administrative enforcement proceeding, unless otherwise provided by statute, is on the administrative agency to establish its charges by the preponderance of the evidence. *See Steadman v. Sec. Exch. Comm'n,* 450 U.S. 91 (1981). The FDIA contains no provision to the contrary. Thus, the standard of proof in this proceeding is the preponderance of the evidence, which is just enough evidence to make it more likely than not that the fact the agency seeks to prove is true. *See In the Matter of First Bank of Jacksonville*, Docket No. FDIC-96-155b, 1998 WL 34083414, *24 (OFIA 1998), *adopted by Board, In the Matter of First Bank of Jacksonville,* FDIC Enf. Dec. ¶ 5248, A-2895 (1998).

In order to satisfy this standard, "[d]irect evidence of a fact is not required. Circumstantial evidence is not only sufficient, but may also be more certain, satisfying and persuasive than direct evidence." *Michalic v. Cleveland Tankers, Inc.,* 364 U.S. 325, 330 (1960). Circumstantial evidence is evidence of a fact from which a person may reasonably infer the existence or non-existence of another fact. *U.S. v. Henderson,* 693 F.2d 1028, 1031 (11th Cir. 1982).

B. Effect of 2006 and 2007 Exams on this Action

Faigin asserts that the allegations of misconduct in this action involve the same activities reviewed in the 2006 and 2007 examinations, which the examiners found to be "satisfactory." Relying on *Sunshine State Bank v. FDIC,* 783 F.2d 1580 (11th Cir. 1986), he argues that deference should be afforded the findings of those examiners and therefore the FDIC should be

precluded from proceeding with this case as a matter of law. The argument is unpersuasive for several reasons.

First, Faigin made a similar argument earlier in this proceeding in support of an estoppel defense, which was stricken by Order, dated January 6, 2012. At page 18 of his response in opposition to the FDIC's motion to strike, he argued that his "defense alleges that the FDIC has waived its right to bring these claims,[47] and is also estopped from asserting its claims, because the FDIC approved the practices which are the subject of its Notice of Charges," and that Faigin's "conduct and the operation of the Bank complied in all material respects with the regulatory guidance issued by the FDIC, including without limitation: (i) the Interagency Guidelines for Real Estate Lending Policies; (ii) the Joint Guidance on Commercial Real Estate Lending, Sound Risk Management Practices; and (iii) the Primer on the Use of Interest Reserves." The estoppel defense was stricken because Faigin failed to assert an affirmative misrepresentation or affirmative concealment of a material fact by the FDIC. *See Linkous v. United States,* 142 F.3d 271, 278 (5th Cir. 1998). To the extent that Faigin now seeks to renew or resurrect his estoppel defense, reconsideration of the prior Order is not warranted because the preponderance of the evidence viewed as a whole does not support the necessary elements of an estoppel defense. And even if the examiners had reviewed the same practices, but never reported any violations, an estoppel defense still would be unwarranted. *See de la Fuente II v. FDIC,* 332 F3d. 1208, 1220 (9th Cir. 2003).

Second, Faigin's *Sunshine State* argument fails because the underlying premise of the argument is wrong: i.e., that the 2006 and 2007 examinations focused on the same allegations of

[47] Faigin's waiver defense, which survived the FDIC's motion to strike, fails based on the evidence viewed as a whole. Waiver is the "intentional relinquishment or abandonment of a known right." *U.S. v. Olano,* 507 U.S. 725, 733 (1993), *quoting Johnson v. Zerbst,* 304 U.S. 458 (1938). There is no evidence showing that the FDIC by its acts, words, conduct or report of examination intentionally relinquished or abandoned its right to bring this action.

wrongdoing made in this case. The allegations in this case largely concern the ADC lending process undertaken by the Bank with Faigin's approval and at his direction. The Notices allege, among other things, that the CTB Loans were not underwritten as originations in accordance with Bank Loan Policy, but instead underwent a limited reviewed by Bank staff, who had no training, knowledge or experience in underwriting ADC loans; that the later ADC loans also failed to comply with the Bank Loan Policy and were handled by the same inadequate staff; that the information presented to the Bank Board to obtain approval of the ADC loans was limited, incomplete and inaccurate; and that although Faigin was aware of these shortcomings, he failed to inform the Bank Board. The allegations also concern the payment of a referral fee to a Bank director, who participated in a meeting, and voted to approve, the CTB Loans with Faigin's knowledge and consent. And in that context, the allegations here focus on various deficiencies in the ADC loans, which the FDIC attributes to the ADC lending process.

In contrast, the 2006 and 2007 examinations were focused on the condition of the Bank, the condition of the ADC loans and the overall operation of the Bank by Bank management at a given point in time. The determinations made by the examiners were based on the information that was provided by the Bank to the examiners for review. What is telling here is that the preponderance of the evidence viewed as a whole does not show that during the 2006 or 2007 examinations the examiners were told of the actual practices followed by the Bank in processing and approving the ADC loans. Nor does the evidence viewed as a whole show that the examiners in 2006 and 2007 were told at whose direction and with whose approval the actual practices occurred.

Specifically, the record evidence does not show that the examiners were told during the 2006 or 2007 examinations that all but one Bank staff member lacked the training, knowledge

and experience to underwrite ADC loans. There is no evidence showing that examiners were told that the Bank staff did not underwrite the CTB loans as originations in compliance with Bank Loan Policy, but instead performed a limited review of some, but not all of the loan documents because CTB had not provided all the loan documents by the time the Bank board approved the loans. Similarly, there is no evidence that examiners were told that the later ADC loans also deviated from the Bank Loan Policy.[48] In other words, the examiners did not know that the Bank did not "underwrite" the ADC Loans in a true sense of the word. There is no evidence showing that the examiners were told during the examinations that Board members were not informed by Faigin or anyone else that the ADC Loans were not underwritten in accordance with Bank policy, that loan summaries given to them to review in some instances were based on incomplete and outdated loan documents, and that Faigin had approved this ADC lending process. There is no evidence that EIC Levy was shown the email COB King sent to Faigin detailing numerous concerns that he had with the Executive Summaries distributed to the Board. (FDIC Exh. 90.) There is no evidence showing that EIC Levy was shown the email that Gumbiner sent to Vecchio four days after the CTB Loans were approved, with a spreadsheet detailing information the Bank still had not received from CTB, which divided those items between "important items we should require," and "not necessary/optional items." (Jt. Exh. 111.) And there is no evidence showing that the FDIC examiners were told during the 2006 Exam that Director Lannan participated in a meeting, and voted to approve, the CTB Loans despite a referral fee of $75,000 that was paid to him with Faigin's knowledge and consent. When the CDFI examiners became aware of Lannan's fee during the 2007 Exam, it was criticized in the 2007 ROE. (Jt. Exh. 12, at 20-22.)

[48] In this regard, it must also be noted that the later ADC loans were originated after the 2006 Exam and were not reviewed until the 2007 Exam. That examination was conducted by the California DFI, and the FDIC did not participate. (Tr. 478.) None of the examiners who actually took part in the 2007 Exam testified at the hearing. This is an additional basis for rejecting Faigin's argument to the extent he seeks to bar this FDIC enforcement action on the basis of conclusions made by state examiners during an examination the FDIC took no part in.

Thus, it can hardly be argued that the 2006 and 2007 examinations focused on the same allegations of wrongdoing made in this case, when there is no evidence showing that the examiners even knew about them, let alone considered them. While there may have been a rational basis for the examination findings based on the information provided to the examiners, there is no evidence here that the examiners were actually provided pertinent information surrounding the allegations of misconduct involved in this case, which may or may not have affected their assessment of the ADC loans. Hence, Faigin's attempt to pivot from an estoppel defense that the FDIC approved the practices which are the subject of its Notice of Charges to a *Sunshine State* deference argument on effectively the same basis must fail. For these reasons, and based on the preponderance of the evidence viewed as a whole, I decline to find that the FDIC is precluded from bringing this action.

C. Prohibition

1. Legal Standard for Prohibition

Pursuant to 12 U.S.C. § 1818(e)(1), the appropriate Federal banking agency may seek a final order prohibiting an IAP from further participating in the affairs of an insured depository institution when the agency determines that:

> (A) any IAP has, directly or indirectly –
> (i) violated—
> (I) any law or regulation;
> . . .
> (ii) engaged or participated in any unsafe or unsound practice in connection with any insured depository institution or business institution; or
> (iii) committed or engaged in any act, omission, or practice which constitutes a breach of such party's fiduciary duty;
>
> (B) by reason of the violation, practice, or breach described in any clause of subparagraph (A)—
> (i) such insured depository institution or business institution has suffered or will probably suffer financial loss or other damage;

> (ii) the interests of the insured depository institution's depositors have been or could be prejudiced; or
> (iii) such party has received financial gain or other benefit by reason of such violation, practice, or breach; and
>
> (C) such violation, practice or breach –
> (i) involves personal dishonesty on the part of such party; or
> (ii) demonstrates willful or continuing disregard by such party for the safety or soundness of such insured depository institution or business institution . . . .

In other words, the FDIC must "prove three things before it may lawfully impose a permanent Prohibition Order against an IAP: (1) 'misconduct' under § 1818(e)(1)(A); (2) 'effect' under § 1818(e)(1)(B); and (3) 'culpability' under § 1818(e)(1)(C)." *Kim v. OTS*, 40 F.3d 1050, 1054 (9th Cir. 1994).

a. Misconduct

The misconduct prong can be satisfied by proving any one of the following: a violation of a law or regulation, the participation in an unsafe or unsound banking practice, or the breach of a fiduciary duty. 12 U.S.C. § 1818(e)(1)(A). Because the FDIC has not based its claims on alleged violations of law or regulation in this case, it is unnecessary to discuss the standards governing such allegations.[49]

i. Unsafe or Unsound Practices

The phrase "unsafe or sound banking practice" is not specifically defined in the statute. *See generally* 12 U.S.C. § 1818(e). Because of this ambiguity, courts frequently look to the legislative history of the Act for clarification. *See, e.g.*, *Seidman v. OTS,* 37 F.3d 911, 926 (3d Cir. 1994) ("Because the statute itself does not define an unsafe or unsound practice, courts have sought help in the legislative history."); *Gulf Fed. Savings & Loan Ass'n v. Fed. Home Loan*

[49] While the undersigned will refrain from analyzing the existence of regulatory violations, it is worth noting that several of the loans at issue may have involved violations of underwriting regulations, including issues related to proper appraisal standards, appropriate LTVs and documentation of exceptions to policy.

Bank Bd., 651 F.2d 259, 264 (5th Cir. 1981) (explaining that "the authoritative definition of an unsafe or unsound practice, adopted in both houses, was a memorandum submitted by John Horne, then Chairman of the Bank Board"). In hearings before Congress prior to its adoption in the Financial Institutions Supervisory Act of 1966, John E. Horne, Chairman of the Federal Home Loan Bank Board (FHLBB), the predecessor to the OTS, testified: "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." *See* Financial Institutions Supervisory Act of 1966, Hearings on S. 3158 Before the House Committee on Banking and Currency, 89th Cong., 2d Sess. 49, 112 Cong. Rec. 26474 (1966) (memorandum submitted by John E. Horne, Chairman, FHLBB). Under this standard, unsafe and unsound practices is a "flexible concept which gives the administrative agency the ability to adapt to changing business problems and practices in the regulation of the banking industry. *In re Seidman*, 37 F.3d 911, 927 (3rd Cir. 1994).

While there is no set listing of what actions constitute unsafe or unsound practices, there are several examples of practices that have been found to be unsafe and unsound relevant to this case. Management's failure to ensure that an institution has the necessary expertise and information to evaluate the transactions they enter into has been found to be an unsafe and unsound practice. *See, e.g., Landry v. FDIC,* 204 F.3d 1125, 1138 (D.C. Cir. 2000) (upholding Board finding of unsafe and unsound practice where Landry entered into transactions "with minimal information and virtually no expertise.").

Some lending practices that have been found to be unsafe and unsound include: extending credit without adequate documentation, extending credit without adequate credit

analysis, capitalizing loan interest, extending credit in violation of the institution's loan policy and extending credit with inadequate collateral. *In re Stephens Security Bank,* FDIC-89-234b; 1991 WL 789326 (1991) (capitalizing interest, inadequate loan review and documentation, and violations of policy); *In re First State Bank,* FDIC-02-069b; 2003 WL 21307613 (2003) (inadequate review); *Northwest Nat. Bank v. OCC,* 917 F.2d 1111, 1115 (8th Cir. 1990) (finding unsafe and unsound practice where bank's loan portfolio had high level of exceptions and widespread inadequate documentation). In the context of ADC lending, unsafe and unsound practices include: generating loans the institution lacks the capacity to underwrite adequately, lending based on deficient or outdated appraisals, lending without ensuring that the borrower will have sufficient funds to complete the project and failing to perform sufficient analysis of the borrower and guarantors finances to the verify their ability to repay the loans. *Alliance Federal Savings and Loan Assoc. v. Federal Home Loan Bank Bd.,* 782 F.2d 490, 494-95 (5th Cir. 1986).

Failure to maintain adequate liquidity, including by being overly reliant on wholesale funding and failing to have a contingency funding plan have also been found to be unsafe and unsound practices. *Frontier State Bank Oklahoma City, Oklahoma v. FDIC,* 702 F.3d 588, 602-04 (10th Cir. 2012).

ii. Breach of Fiduciary Duty

As an officer and director of the Bank, Faigin also owed it a fiduciary duty. A "fiduciary duty" is generally defined as "the requirement that care be exercised 'which ordinary prudent and diligent men would exercise under similar circumstances.'" *In re Baker*, FDIC-92-86e, 1993 WL 853609, at * 7 (FDIC Apr. 8, 1993) (*quoting Briggs v. Spaulding*, 141 U.S. 132, 152 (1891)). Because of their unique position as safekeepers of depositors' money, directors or officers of depository institutions owe a greater duty to the bank than directors of other types of entities. *See*

Comeau v. Rupp, 810 F. Supp. 1127, 1148 (D. Kan. 1992) (explaining that officers and directors of a savings and loan institution are held to a heightened standard of conduct even among the general class of corporate officers). The fiduciary duty of bank officers and directors generally requires that they:

> act as prudent and diligent persons would act safeguarding the bank's property, complying with state and federal banking laws and regulations, and ensuring that the bank is operated properly. The duty is owed to the bank, and not to persons with controlling interests in the bank. It requires the proper supervision of subordinates, a knowledge of state and federal banking laws, and the constant concern for the safety and soundness of the bank. While the standard of care for bank directors and officers, like the standard of care in negligence cases, is expressed in constant terms, the nature of the duty varies according to the facts. The greater the authority of the director or officer, the broader the range of his duty; the more complex the transaction, the greater the duty to investigate, verify, clarify and explain. *In re* ***, FDIC-85-356e, 1988 WL 583064, at *9 (FDIC Mar. 1, 1988).

The fiduciary duty of bank officers and directors has multiple components: the duty of care, the duty of loyalty, and the duty of candor.

The duty of care is generally defined as "the requirement that care be exercised 'which ordinary prudent and diligent men would exercise under similar circumstances.'" *In re Baker, supra.* However, as explained above: "'The greater the authority of the director or officer, the broader the range of his duty; the more complex the transaction, the greater the duty to investigate, verify, clarify, and explain.'" *Id.* (finding that the respondent, who owned 94% of the bank, and whose relatives and employees controlled the bank's board, "owed the Bank the highest degree of fiduciary care"). The fiduciary duty of care also requires that bank directors "ensure their institution's compliance with state and Federal banking laws and regulations." *In the Matter of Jess T. Simpson*, OTS AP 92-123, at 22 (1992).

Fiduciaries also owe a duty of loyalty to the institutions they serve. *In the Matter of Neil M. Bush*, OTS AP 91-16, at 13 (1991). The FDIC Statement of Policy titled "Statement

Concerning the Responsibilities of Bank Directors and Officers," 2 FDIC Law, Regulations, Related Acts at 5369 (April 30, 1993), http://www.fdic.gov/regulations/laws/rules/5000-100.html, states:

> The duty of loyalty requires directors and officers to administer the affairs of the bank with candor, personal honesty and integrity. They are prohibited from advancing their own personal or business interests, or *those of others*, at the expense of the bank. (emphasis added)

A director may not participate in or vote on any matter in which he has a conflicting interest. *In re Brannan*, FDIC 91-37k, 1992 WL 812955 (1992) ("An officer or director breaches his or her fiduciary duty unless he or she abstains from participating in decisions on any loan transaction where they have a personal interest.").

Finally, fiduciaries have a duty of candor, which requires that fiduciaries disclose all material information relevant to corporate decisions. *Seidman,* 37 F.3d at 935 n. 34. A party can breach their fiduciary duty to an institution by failing to disclose relevant information to the institution's board of directors when it is considering a loan, even if the board does not ask. *De La Fuente II*, 332 F.3d at 1222.

b. Effect

To satisfy the "effect" element of § 8(e), the FDIC must demonstrate that, as a result of Faigin's actions, the Bank suffered or will probably suffer financial loss or other damage, the interests of the Bank or its depositors were or could have been prejudiced, or he received financial gain or other benefit by virtue of the alleged misconduct. *See* 12 U.S.C. § 1818(e)(1)(B). This element is clearly satisfied where Enforcement Counsel can demonstrate that the bank suffered a loss. *See Pharaon v. Bd. of Governors of the Fed. Reserve Sys.*, 135 F.3d 148, 157 (D.C. Cir. 1998). Further, the FDIC is not required to establish an actual loss; a potential loss will suffice. *De La Fuente II*, 332 F.3d at 1225. However, the risk of loss to the

Bank must have been "reasonably foreseeable" to one in Faigin's position, even if the precise sequence of events leading to the loss was not obvious. *See De La Fuente II*, 332 F.3d at 1223, *citing Kaplan v. OTS*, 104 F.3d 417, 421 (D.C. Cir. 1997) ("Any . . . risk must of course be reasonably foreseeable. That is not to say that the exact series of events that cause injury or loss to the institution must be perceived or even perceivable, but surely no director can be faulted for approving a management proposal that does not pose an increased risk of some kind to the financial institution.").

It has long been clear that there may be more than one cause of harm to a bank, and that an individual need not be the proximate cause of the harm in order to be held liable under Section 8(e). *See Landry v. FDIC*, 204 F.3d 1125, 1139 (D.C. Cir. 2000) (explaining that the fact that other IAPs may have been "more guilty" does not absolve respondent from responsibility for his actions); *In re Jeffrey Adams*, FDIC Enf. Dec. ¶ 5244, at A-2861 (1997) (recognizing that "multiple factors, and individuals, may contribute to a bank's losses," and that a respondent cannot escape liability simply because others have contributed to the bank's loss as well).

c. Culpability

With respect to culpability, the FDIC must show that Faigin's actions involved personal dishonesty or demonstrated willful or continuing disregard for the safety or soundness of the Bank; i.e., that he acted culpably. *See* 12 U.S.C. § 1818(e)(1)(C).

"The term 'personal dishonesty' has been held to mean 'a disposition to lie, cheat, defraud, misrepresent, or deceive. It also includes a lack of straightforwardness and a lack of integrity.'" *Michael v. FDIC,* 687 F.3d 337, 351 (7th Cir. 2012) (*quoting, In re Watts,* FDIC-98-046e, FDIC-98-044k, 2002 WL 31259465, *7 (FDIC Aug. 6, 2002)). Failing to disclose relevant

information to a bank's board has been held to demonstrate personal dishonesty for 8(e) purposes. *Dodge v. Comptroller of Currency,* 744 F.3d 148, 160 (D.C. Cir. 2014); *De La Fuente II*, 332 F.3d at 1223.

"Willful disregard" and "continuing disregard" present two separate bases for making the necessary showing of scienter. *Kim v. OTS,* 40 F.3d 1050, 1054 (9th Cir. 1994). "'Willful disregard' means 'deliberate conduct which exposed the bank to abnormal risk of loss or harm contrary to prudent banking practices." *De La Fuente II*, 332 F.3d at 1223 (*quoting Grubb v. FDIC*, 34 F.3d 956, 961-62 (10th Cir. 1994)). An IAP "cannot claim ignorance by turning a blind eye to obvious violations of his statutory and fiduciary duties." *Michael v. FDIC*, 687 F.3d 337, 352 (7th Cir. 2012). "There are 'many types of misconduct that, by their very nature, evidence willful disregard for a bank's safety and soundness.'" *De La Fuente II*, 332 F.3d at 1223 (*quoting Oberstar v. FDIC*, 987 F.2d 494, 502-03 (8th Cir. 1993)). "'Continuing disregard' means 'conduct which has been voluntarily engaged in over a period of time with heedless indifference to the prospective consequences.'" *De La Fuente II*, 332 F.3d at 1223 (*quoting Grubb v. FDIC*, 34 F.3d 956, 962 (10th Cir. 1994)). While "continuing disregard" does not require as high a degree of culpability as "willful disregard," it still requires a mental state akin to recklessness. *Kim*, 40 F.3d at 1054; *see also De La Fuente II*, 332 F.3d at 1223 (explaining that "'some scienter' is required to establish culpability under this standard"). Thus, regardless of whether the agency alleges that the IAP acted with willful or continuing disregard, it must "show a degree of culpability well beyond mere negligence, i.e., there must be a showing of scienter." *Kim,* 40 F.3d at 1054.

2. The Bank's Entry Into ADC Lending

a. Misconduct Related to the Bank's Entry Into ADC Lending

ADC lending has been recognized as being a complex and risky form of lending for years. *See,* FDIC Financial Institutions Letter, *Acquisition, Development and Construction Lending,* FIL-110-98 (October 8, 1998). Two FDIC witnesses, Case Manager Christina Cornell-Pape and Field Supervisor Robert McGibbon, both characterized ADC as a risky type of lending. (Tr. 641-643; 2500-02.) Faigin himself acknowledged that, at the time he led the Bank's move into ADC lending, he understood it to be a higher risk form of lending than the Bank had traditionally done. (Tr. 4073.)

James Kleinfelter, who offered expert testimony on ADC lending on Faigin's behalf, opined that that he would not necessarily characterize ADC lending as complex, but admitted it was "highly detailed." (Tr. 3318.) Kleinfelter also admitted that he was aware that the FDIC's examination manual describes ADC lending as being riskier than many other types of lending. (Tr. 3429.) Kleinfelter also agreed that a bank needed to exercise extra care when entering a new line of lending – particularly if that new lending was of a different complexity than its historical business and if the move involved a significant portion of the bank's capital. (Tr. 3658-59.)

Similarly, Mark Olson, another expert who testified on behalf of Faigin, agreed that moving into a new line of lending imposes a higher duty of care on a bank CEO, particularly if the bank considers the new business risky, the bank staff is doing analysis it has not previously done and the loans are larger and more complex than loans the bank has previously handled. (Tr. 4221-24.) Thus, the relevant guidance and testimony in this case establishes that ADC is a riskier form of lending that requires appropriate level of care.

i. The Bank Did Not Have an Adequate Infrastructure to Handle Large, Complex ADC Loans

The evidence viewed as a whole shows that Faigin engaged in an unsafe and unsound banking practice by leading the Bank into ADC lending without putting in place an adequate infrastructure to handle the new lending program. The Bank personnel, the training they were provided and the Bank's policies were all inadequate for the significant move into ADC lending that the Faigin spearheaded.

Faigin failed to ensure that the Bank's staff had the necessary expertise to handle the move into ADC lending. Even Faigin's expert, Kleinfelter, testified that it was Faigin's responsibility to hire competent staff and make sure their work was adequately reviewed to ensure it met prudential standards. (Tr. 3483.)

When the move into ADC lending began, the Bank had almost no ADC expertise. Vecchio, the Chief Credit Officer and someone on whom Faigin purported to place great reliance, had very limited experience with ADC lending, and what experience she had was decades old and involved little, if any, underwriting. (R. Exh. 37; Tr. 1610-11, 1617-18.) Worse yet, Gumbiner, who was designated as the lead underwriter for the ADC program, had essentially no experience underwriting ADC loans. (Tr. 777-78.) Similarly, none of the existing underwriting staff had ADC experience. (Tr. 780.)

The hiring that Faigin did as the Bank moved into ADC lending did not adequately address the lack of staff experience. The first underwriter hired was Pam Bauer, who not only had no experience underwriting ADC loans, she had no underwriting experience whatsoever. (Tr. 783, 1624, 1680.) It appears her only qualification to be the Bank's first hire - as it moved into a complex, risky new lending area - was that she was Kolasinski's sister-in-law. (Tr. 783, 1624.) After Bauer, the Bank hired Janet Giles, who did have experience underwriting and

monitoring ADC loans. (Jt. Exh. 21.) She had the most ADC underwriting expertise at the Bank. (Tr. 800.) The only other underwriter hired with any ADC experience was Kathleen Gregory. The record is unclear about the extent of Gregory's ADC expertise, but it is undisputed that she had less ADC experience than Giles and most of her underwriting experience involved single-family residential loans, not ADC. (Tr. 799-800.) What is more, Gregory was not hired until September of 2006 – by which time Bank staff was already in the thick of the review of the CTB Loans.

In summary, the underwriting team Faigin assembled in preparation for the Bank's aggressive entry in ADC lending consisted of: a Chief Credit Officer, who may have had limited experience with ADC underwriting decades earlier; a lead ADC underwriter with absolutely no ADC underwriting experience; one experienced staff-level ADC underwriter; and a late addition to the underwriting staff, whose experience included some amount of ADC underwriting. Not surprisingly, FDIC Case Manager Cornell-Pape opined that the Bank's staff was not adequate to handle large, complex ADC loans like the CTB Loans. (Tr. 2750-53.) Notably, both Gumbiner and Giles agreed. (Tr. 860-61, 886, 1400.)

While Faigin's experts, Robert Kleinfelter and Mark Olson, opined that the Bank's staff was adequate to underwrite the loans at issue (Tr. 3315-18, 4166-69), their testimony was unconvincing for several reasons. First, both witnesses provided limited and vague bases for their opinion. Kleinfelter somewhat opaquely stated that he concluded the staff was adequate based on "their backgrounds and the review of their work and files." (Tr. 3315.) However, when asked for specifics, he resorted to generalizations like characterizing various people's experience as "extensive" or their work as "seasoned," and praised their work on the files as the

best he had ever seen.[50] (Tr. 3316.) He did not, however, point to anything in any staff member's background or work that specifically demonstrated any relevant expertise.

Similarly, Olson testified that the manner in which staff reviewed and presented loans suggest they had the capacity to underwrite ADC loans. (Tr. 4167.) Faigin then proffered that Olson would offer testimony about staff qualifications that was similar to Kleinfelter's. (Tr. 4167.) Their unsupported opinions are not entitled to significant weight. *See, Davis v. Secretary of HHS,* 20 Cl. Ct. 168, 173 (1990) (conclusions of experts are only as good as evidence and reasons that support them). Olson further undercut his testimony when he admitted he had never met with any of the relevant staff despite his belief that it is necessary to meet with staff in order to properly assess their qualifications. (Tr. 4102, 4183.) He went on to testify that if Gumbiner doubted his ability to underwrite large ADC loans, it was inappropriate to designate him the lead underwriter for the ADC program.[51] (Tr. 4187-88.) Kleinfelter also acknowledged that, prior to the CTB Loans, Faigin had no opportunity to assess the staff's ability to handle ADC loans. (Tr. 3659.)

Finally, to the extent Faigin's witnesses purported to base their opinions on the staff's work, the numerous deficiencies in that work, which are detailed more fully below, undercut their opinions further. Accordingly, the opinions of Faigin's experts on this issue were not persuasive and are outweighed by the evidence viewed as a whole that the Bank's staff was not equipped to handle the Bank's entry into ADC lending.

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[50] When pressed for specific examples on cross examination, Kleinfelter testified only that he had seen various emails from staff requesting relevant documents, but he could not provide any examples. (Tr. 3404.)

[51] It must be noted that when this question was initially posed to Olson, he made what appeared to be a concerted effort to avoid answering it – stating that if he met with Gumbiner and discussed the staff, and Gumbiner's opinion of them, Olson believed he likely would have gained "a satisfaction." It was only after Enforcement Counsel expressly pointed out that Olson had not answered the question, and again asked if it was appropriate to name Gumbiner as lead ADC underwriter – when Gumbiner himself did not believe he was qualified – that Olson admitted it was not. (Tr. 4187-88.) Such attempts to avoid questions must be taken into account when assessing credibility.

Faigin also failed to ensure that the Bank had an adequate Loan Policy in place before he launched the Bank's aggressive entry into ADC lending. Rather than amend the Loan Policy to provide for ADC lending *before* the Bank moved into ADC, Faigin allowed the Bank to begin the review of the CTB Loans – the largest loan package in the Bank's history – at the same time the Bank's Loan Policy was being amended to provide for ADC lending. The final version of the revised Loan Policy was not approved until late August of 2006, well into the CTB Loan review. This revision of the Loan Policy marked the first time the Bank's Loan Policy had authorized any ADC lending that was not designed as a bridge to the type of long-term income lending the Bank had traditionally done. Put simply, Bank staff was reviewing the CTB Loans at the very same time Bank management and the Board were revising the Bank policies that would authorize those loans and govern that ongoing review.

Reviewing the CTB Loans at the same time that Loan Policy was being revised to authorize that review led to a certain amount of confusion. Vecchio's testimony revealed confusion about whether and to what extent the Loan Policy applied to the review of the CTB Loans. This is hardly surprising since the Loan Policy was not finalized until the review was well underway.

Additionally, the revised Loan Policy was flawed. The most obvious flaw was the failure to include any provision governing how the Bank would handle interest reserves – which were present in almost all of the loans at issue in this case. Even Faigin's expert Kleinfelter admitted that if a bank is providing interest reserves, its loan policy should contain provisions governing their use. (Tr. 3458.) Beyond this specific omission, the Loan Policy's authorization for ADC lending was inconsistent and contradictory. The general policies section, Section 1, stated that the Bank did not provide ADC loans. However, Section 2 of the Loan Policy stated that the

Bank would provide ADC lending, but it said that such lending was to be aimed at loans that could convert into permanent stabilized loans at the Bank. Of all the loans at issue in this case, only the DOR loan potentially falls into this permitted category. Thus, the Loan Policy omitted at least one critical component and did not clearly authorize the lending the Bank was already actively pursuing by the time the Loan Policy was amended. This evinces Faigin's failure to ensure that adequate policies were in place before the Bank entered into ADC lending.[52]

Faigin's failure to ensure that the Bank had appropriate staff and policies in place prior to making an aggressive entry into the complex field of ADC lending constituted an unsafe and unsound practice. *See, Landry, supra; Alliance Federal, supra.* His failure to adequately ensure and verify the Bank's readiness to enter this complex new lending area was also a breach of Faigin's fiduciary duty of care to the Bank. *See, In re Banker, supra.*

ii. Faigin Failed to Mitigate Other Risks While the Bank Entered ADC Lending.

Faigin failed to mitigate, and in fact increased, existing risks at the Bank at the same time he was pursuing the move into ADC lending. While the Bank was beginning its ADC lending, Faigin directed or acquiesced in moves that weakened the Bank's liquidity and capital.

It is undisputed that the Bank's liquidity had been a concern for regulators for some time. (Tr. 426.) The Bank's low liquidity was due to its reliance on wholesale funding as opposed to retail deposits. This funding strategy was more risky than 97-98% of the Bank's peers. (Jt. Exh. 4.) Faigin admitted that the Bank had no long-term plan for improving liquidity.

[52] Faigin attempted to rebut criticism of the Loan Policy by offering testimony of Kleinfelter, who opined that the Loan Policy was as thorough and complete as any he had ever seen and had no material omissions or deficiencies. (Tr. 3245.) This testimony is ultimately unpersuasive for several reasons. First, as with his testimony about staff expertise, Kleinfelter's opinion relied merely on the weight of his experience. He pointed to nothing specific about the policy that caused him to declare it the best ever. As to specifics, Kleinfelter admitted that the Loan Policy should have included provisions governing interest reserves but did not. Despite this seemingly significant omission, Kleinfelter reaffirmed his opinion that the Loan Policy was the best he had ever seen, once again without any explanation beyond his expert imprimatur. Finally, Kleinfelter did not testify about the timing of approval of the Loan Policy or how the fact that it was not approved until months into the CTB Loan review affected his opinions.

Faigin not only failed to take steps to improve the Bank's risky liquidity situation, he actually made it worse by leading the efforts to sell the Bank's Beverly Hills branch – its main source of retail deposits. Although Faigin attempted to defend the decision to sell the Beverly Hills branch, his arguments were misplaced. Faigin's reasons for selling the branch all went to increasing the Bank's earnings, an area that was already satisfactory. He seemingly ignored the impact on liquidity – the Bank's ongoing trouble spot.

Faigin also acquiesced in the Bank's ongoing payments of dividends throughout the period at issue in this case – even though he told regulators at both the 2006 and 2007 examinations that he would try to reduce or stop the payments in order to augment capital and address concerns at the Bank. These dividend payments consumed the majority of the Bank's net income; weakened the Bank's capital position; and reduced its ability to absorb any losses that it might incur as it shifted its lending into ADC. The evidence shows that Faigin supported the Bank's continued payment of dividends even though he knew, and understood, that the change in the Bank's lending profile was increasing its risk profile, which required him to mitigate other existing risks at the Bank. (Tr. 4846.)

Accordingly, I find that Faigin's failure to attempt to correct existing issues at the Bank while at the same time taking its lending business in new, riskier direction constituted an unsafe and unsound practice. *See, Frontier State, supra.* It was also a breach of his fiduciary duty of care because pursuing risky new lending while allowing the Bank's historical liquidity problem to persist and worsen, despite his admitted understanding that he had an obligation to deal with the Bank's liquidity problem, fell well short of the level of care "which ordinary prudent and diligent men would exercise under similar circumstances." *In re Baker, supra.*

b. Effect of Faigin's Misconduct

Faigin's failure to appropriately manage the Bank's entry into ADC lending resulted in both potential and actual losses to the Bank. *See,* 12 U.S.C. § 1818(e)(1)(B). As set forth in the Facts, and discussed more fully below, several large ADC loans were approved despite the existence of unresolved issues related to them. The failure to identify and resolve the issues related to these loans was directly related to Faigin's failure to ensure that the Bank had adequate staffing and policies in place to appropriately underwrite the loans at issue. Reviewing, approving and funding the loans at issue under these circumstances created potential losses for the Bank. Additionally, in several cases, the Bank experienced actual losses when the loans went into default, which satisfies the effects prong. *See, Pharaon, supra.*

Similarly, by failing to mitigate, and actually exacerbating, the existing risks related to the Bank's liquidity and capital, Faigin weakened the Bank's overall condition. This left the Bank less able to absorb any losses incurred in connection with its new ADC lending program. By reducing its ability to absorb losses that it might suffer in its new, risky lending, Faigin increased the possibility that the interests of the Bank or its depositors could be prejudiced. *See,* 12 U.S. C. § 1818(e)(1)(B).

Finally, Faigin received at least one readily identifiable personal benefit as a result of his misconduct. Faigin received a bonus of approximately $350,000 that was directly connected with the sale of the Beverly Hills branch. (Tr. 4831; FDIC Exh. 204.) As noted above, the sale of the Beverly Hills branch, which occurred at the same time Faigin was moving the Bank into ADC lending, was an unsafe and unsound practice and breach of his fiduciary duty of care because it worsened the Bank's historical liquidity problems by leaving it more reliant on wholesale funding than ever. Faigin's bonus was a benefit he received as a result of this unsafe

and unsound action.

Accordingly, and based on the evidence viewed as a whole, I find that Faigin's conduct in connection with the Bank's entry into ADC lending satisfied the "effect" prong of Section 8(e).

c. Faigin's Culpability

Faigin acted with willful and continuing disregard in connection with the Bank's preparation and entry into ADC lending. His continuing disregard is demonstrated by the long period of time Faigin spent planning for the Bank's entry into ADC lending without ensuring that an appropriate infrastructure was in place or that the existing risks at the Bank were mitigated to the extent possible. Faigin was the primary driving force behind the move into ADC lending. He testified that he began the discussions and planning for this transition in 2005. Despite this, Faigin did not ensure that the Bank had a proper infrastructure in place prior to beginning significant work on ADC lending. Instead, he led the Bank to move aggressively into ADC lending while attempting to assemble the right staff and promulgate appropriate policies at the same time. Additionally, while this *ad hoc* entry into ADC lending was ongoing, Faigin failed to take action to mitigate the other risks at the Bank. All of this demonstrates Faigin's continuing disregard.

The same conduct demonstrates Faigin's willful disregard for the safety and soundness of the Bank. His own testimony shows that he understood the importance of putting the proper ADC infrastructure in place. For example, Faigin testified about the numerous planning sessions, the efforts to revise the Loan Policy, and the importance of qualified staff. (Tr. 3729-30; 3738; 3745-49.) He also testified that he took part in all interviews for ADC underwriters because he viewed the position as so important to the Bank. (Tr. 3733.) Despite his recognition

about the importance of an adequate ADC infrastructure, Faigin moved the Bank into large, complex ADC lending before that infrastructure was in place. He relied on inexperienced staff and attempted to update the Bank's policies while CTB loan review was underway.

Faigin's willful disregard is further demonstrated by the aggressive manner in which he moved the Bank into ADC lending. He did not move into ADC slowly to test the Bank's staff and policies and identify areas of concern with small, discrete lending. Instead, he charged forward with a rushed review of 8 complex loans that together made up the largest loan package the Bank had ever considered. Finally, Faigin's willful disregard for the Bank is demonstrated by his willingness to pursue this aggressive strategy while failing to act to mitigate other dangerous conditions at the Bank or taking actions that made those conditions worse – despite warnings from regulators – and Faigin's own admitted understanding that the move into ADC lending was increasing the Bank's risk profile.

3. Review and Approval of the CTB Loans

a. Misconduct

i. Faigin Directed Bank Staff to Undertake an Abbreviated Review of the CTB Loans.

It is undisputed that the review of the CTB Loans did not comply with Bank's Loan Policy. Bank staff did not underwrite the CTB loans. Rather, they performed a much less stringent review than was required by the Loan Policy. (Jt. Exh. 31 at 151, § 6.1.4.) The Bank staff utilized an abbreviated process that leaned heavily on the earlier underwriting done by CTB. Further, Faigin was aware of the less stringent review applied to the CTB Loans. In fact, he testified that he was the one who decided to move forward on the CTB Loans using this expedited review. (Tr. 3775.) This was corroborated by Vecchio. (Tr. 1749.)

It is also undisputed that a bank must do an independent analysis prior to purchasing a

loan participation. FDIC Case Manager Cornell-Pape testified that safe and sound banking practices require a purchasing bank to underwrite a participation as if they were originating the loan itself. (Tr. 2473-74.) Faigin's expert Kleinfelter agreed. (Tr. 3410.) Even Faigin admitted that both the Loan Policy and industry practice required the Bank to do a complete and independent analysis before purchasing the CTB Loans. (Tr. 4543.)

Faigin failed to ensure that the Bank did a full, independent analysis of the CTB Loans. The three members of the Bank's underwriting staff who testified at the hearing, Vecchio, Gumbiner and Giles, all agreed that the Bank did not underwrite the CTB Loans as if they were originations. Vecchio and Gumbiner went so far as to distinguish the review process for the CTB Loans from underwriting entirely – characterizing it as merely a review of documents from CTB. (Tr. 939-40, 1031-32, 1841, 1844.) Similarly, Giles testified that she merely summarized the work CTB had done, without performing any independent analysis. (Tr. 1410.) This testimony is further corroborated by the contemporaneous documentary evidence admitted at the hearing – specifically multiple emails reflecting the rapid pace of the review, the inability to secure needed information from CTB and doubts about the adequacy of what was done.

That the loan reviews were less than adequate was also reflected by Faigin's own testimony about his own attitude toward the review, which was careless to say the least. For example, Faigin's testimony about the "certifications" he received from staff, aside from shifting during the hearing, demonstrated an attitude that it was acceptable to close his eyes to potential issues unless they were plainly obvious, rather than doing a careful investigation to make sure issues were resolved. Another example of this attitude was Faigin's testimony during his sworn statement about the investigation of the seismic issue related to the VIN loan. Faigin was asked what appraiser Dent should have done to investigate the seismic issue raised in the CTB

documents. He responded by stating that Dent did not need to do anything other than look for other discussion of it in the CTB file. If there was none, Faigin testified that he believed it would be acceptable to presume that meant that the issue was resolved and no follow-up was necessary. (Tr. 2413-17, 4439.) This willingness to "presume" issues were resolved rather than investigating them reflects an attitude that condoned the lack of a thorough, independent analysis.

On the whole, the record reflects not only a failure to conduct a thorough independent analysis, but what is best characterized as a mad dash to assemble the Executive Summaries in time to meet the deadline imposed by Faigin.

Although Kleinfelter testified that he believed Bank staff performed an independent review, his testimony on this point was unpersuasive. When asked to explain the basis for this opinion, he pointed to emails demonstrating efforts to collect documents. (Tr. 3408-10.) He testified that knowing what documents to ask for demonstrated that staff understood ADC lending and he inferred that staff would have reviewed documents. (Tr. 3408-10.) Accepting Kleinfelter's supposition would require rejecting the unequivocal testimony of the witnesses who were actually involved in the process and who testified that they did not analyze CTB's documents, as well as the contemporaneous documents corroborating their testimony. Further, Kleinfelter admitted that, in his words, the Bank's review "leaned" towards document collection over analysis. (Tr. 3409.) From all of this, it is clear that Faigin failed to ensure that the Bank performed a complete, independent analysis of the CTB credits. This failure constituted an unsafe and unsound practice and a breach of Faigin's fiduciary duty of care because it failed to provide the level of analysis required by reasonably prudent banking practices. *See, Landry, supra; Stephens Security Bank, supra.*

ii. Faigin Allowed the Board to Approve the CTB Loans Without Adequate Analysis

There were several relevant issues related to the CTB Loans that were not fully disclosed and resolved before the Board voted to approve the purchase.[53] In several cases, there is no evidence that the Board was made aware of important issues at all. In other cases, issues were mentioned but not adequately analyzed.

There were several issues that the FDIC alleges were significant, which were common to most or all of packages sent to the Board. These included: failure to apprise the Board that Bank staff did not independently analyze the credits; failure to thoroughly analyze the finances of the borrowers and guarantors; failure to analyze the appraisals; failure to hire outside consultants; allowing CTB to remain the lead bank while purchasing a large majority of most of the CTB Loans; and not noting the exceptions to the Loan Policy involved. Some of these issues affect all of the CTB Loans as a package. Others are only relevant to certain loans.

Faigin's failure to inform the Board that Bank staff did not independently analyze the CTB Loans and instead relied on the analysis done by CTB impacted all of the CTB Loans. As discussed above, the failure to perform an independent analysis was itself unsafe and unsound. It was also an issue the Board should have been made aware of if it was going to consider the CTB Loans despite the lack of independent analysis. *See, De La Fuente II, supra.* There is nothing in the record establishing that this issue was raised with the Board.

Similarly, Faigin failed to inform the Board about the exceptions to the Loan Policy involved in the CTB Loans. Any exceptions to the Loan Policy should have been noted so the

[53] It should be understood that the conclusions in this section, and the later section relating to the post-CTB loans at issue, relate to the adequacy of the analysis performed and the information provided to the Board. To the extent the parties have attempted to argue about whether certain loans ultimately should or should not have been approved or recommended, I decline to resolve that issue because it is not necessary to the decision in this matter. The relevant issue addressed herein is whether Faigin ensured that Bank staff performed an adequate review and analysis to provide the Board with the basis to make informed decisions. The undersigned will not engage in an attempt to redo the underwriting of these loans or make a legal decision about whether specific loans would or would not have been advisable if proper underwriting had been done.

Board was aware of it and the documents should have discussed the factors that warranted the exception. 12 C.F.R. § 365, Subpt. A., App. A. There were several exceptions specific to certain loans, and there were two that were common to most or all of the CTB Loans. First, they were not underwritten like new loans. This issue has now been referenced repeatedly, but must be raised again. Beyond the inherent unsafety and unsoundness of the review, and the fact that the Board should have been informed about it, they also should have been informed that the review was an exception to the Loan Policy, which expressly required participations to be underwritten with the same care as originations. (Jt. Exh. 31 at 151, § 6.1.4.) Thus, the failure to note the review process as an exception was yet another way in which it was unsafe and unsound. The second exception common to most of the CTB Loans was the presence of an interest reserve. Faigin's expert, Kleinfelter, testified that if a bank is using interest reserves, it should have policies governing their use. (Tr. 3458.) FDIC Case Manager Cornell-Pape noted the lack of a policy on interest reserves and characterized it as a weakness in the Bank's lending infrastructure.[54] (Tr. 2864.) Given the agreement that there should have been a policy in place governing and authorizing interest reserves, the Board should have been expressly advised that there was no such policy at the time it approved the CTB Loans.

The FDIC contends that another feature common to the CTB Loans constituted an exception to the Loan Policy – the fact that none of the CTB Loans were designed to convert into permanent loans with the Bank. According to the Loan Policy, the intent of ADC lending was to produce loans that would convert into permanent loans once construction was complete. (Jt. Exh. 31 at 69, § 2.1.) So, under the Loan Policy, ADC was not only a new, independent product;

[54] FDIC Case Manager Cornell-Pape also testified that one of the reasons exceptions to policy must be expressly noted is so that decisionmakers can assess whether changes to the policy are appropriate. As she put it, if every loan is an exception maybe the policy is too strict or maybe the bank is taking too much risk. (Tr. 2490-91.) Had Bank staff properly noted every interest reserve as an exception, it might have motivated a more careful review of the loans and the Loan Policy.

it was also to serve as a feeder for the Bank's traditional lending focus (stabilized income properties). Despite this stated intent, none of the CTB Loans were designed to convert after construction. Instead, they were designed to be paid off when the developers sold the completed housing units to retail buyers.[55]

In response, Faigin argues that the goal of converting to permanent loans only applied to the types of loans that could be paid off with permanent loans, and the CTB Loans simply could not. Reading the entire Loan Policy, I agree with Faigin on this point. The Loan Policy authorizes loans for residential construction. (Jt. Exh. 31 at 69, § 2.1) It also has provisions relating to lending for development of tract housing. (Jt. Exh. 31 at 72, § 2.1.4.3; 73, § 2.2.4.) As Faigin points out, such loans could not convert to permanent loans with the Bank by their nature. The exit plan for the CTB Loans – payoffs as the individuals units were sold to retail buyers – left the developer with no loan to convert. Once the units were sold, the commercial aspect of the project simply ended. Further, the Loan Policy expressly stated that the Bank did not make single-family loans. (Jt. Exh. 31 at 17, § 1.1.4.) Accordingly, even if retail buyers of the units had wished to obtain permanent financing from the Bank (which does not seem to be what the Loan Policy's statement of intention was aimed at), they would not have been able to do so. For these reasons, I credit Faigin's interpretation of the Loan Policy. To do otherwise would be to create an inconsistency because every residential construction loan, a category of loans that was expressly authorized by the Loan Policy, would violate the Loan Policy simply because of the nature of the loan. However, while I hold that this failure to convert does not constitute an exception to the Loan Policy, this latent inconsistency within the Loan Policy is yet more evidence of Faigin's rush to push the Bank into ADC lending without an adequate infrastructure.

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[55] For some reason, the FDIC has only raised this issue with regard to the VIN loan, but it is true of all of the CTB loans.

Similarly, I find that the FDIC has not met its burden of establishing the Bank's purchase of a large percentage of the CTB participations constituted an unsafe and unsound practice. FDIC Field Supervisor McGibbon criticized the Bank's purchase of large majority interests in most of the CTB participations, stating that it created a disincentive for CTB, as lead bank, to administer the loans diligently. (Tr. 372-73, 375-76.) However, he cited no guidance advising against majority participations. Instead, he characterized them as "unusual," and said he had only seen it in one other bank, which failed. (Tr. 375.) Significantly, he did not testify that the "unusual" majority participations caused or contributed to that failure.

On the other hand, Kiley testified that the Bank had historically purchased large majority portions of loans participations it acquired. (Tr. 747-48.) Additionally, Faigin testified that purchasing the majority percentage while leaving CTB to administer the loans was a conscious decision made because he believed leaving an experienced construction lender like CTB in charge of administration was safer while the Bank ramped up its ADC credit administration staff. (Tr. 4266-68.) Ultimately, there is room for disagreement on the wisdom of this point. However, viewing the evidence as a whole, it is reasonable to infer that the complaint about the large participation percentages had more to do with the careless review of the CTB Loans and the amount of the loan loss the Bank suffered than anything inherently unsafe about purchasing large shares of loan participations. Accordingly, I find that the FDIC has failed to establish that purchasing large participations was, in and of itself, unsafe or unsound.

Other issues must be analyzed in the context of the individual loans and cannot be ruled on across-the-board for all the CTB Loans. For example, the FDIC criticized the Bank's failure to include an in-depth analysis of the financial information relating the borrowers and guarantors. Its main argument regarding the analysis of borrower/guarantor financials is that Faigin did not

require Bank staff to perform a global cash flow analysis on the borrowers and guarantors.[56] FDIC Case Manager Cornell-Pape testified at length about the importance of performing a global cash flow analysis on borrowers, and opined that the failure to perform a global cash flow analysis prior to originating an ADC loan was unsafe and unsound. (Tr. 2514-18.) In essence, Cornell-Pape opined that cash flow analysis was more important than other financial analysis, such as net worth, because cash flow was the source of debt repayment. She summarized the basis for her opinion clearly with the following testimony, "having a good net worth is a wonderful thing, but net worth doesn't pay debt. . . Cash is king because that's what you have to rely on to pay your loan." (Tr. 2514.)

While Cornell-Pape's reasoning has a common-sense appeal, it is ultimately unpersuasive. Faigin offered a convincing counterpoint to this point. Faigin's expert, Kleinfelter, opined that cash flow is not meaningful in ADC lending because repayment of ADC loans is not intended to come from ongoing cash flow, as it would with a traditional mortgage loan. Instead, the intended source of repayment of an ADC loan is sale of the collateral after the project is complete. (Tr. 3120-22; 3362-63; 3443-44.) Thus, according to Kleinfelter, the bigger concerns in ADC lending are the feasibility of, and market for, the project. (Tr. 3362-63.) Additionally, both Kleinfelter and Faigin testified that global cash flow was less useful in analyzing ADC loans because real estate developers do not have regular cash flow. (Tr. 3120-22; 3999.) They either have no cash coming in (while they are developing) or a lot of cash coming in (when selling completed projects). Further, the record evidence establishes that, in 2006, it was not standard practice to perform global cash flow analysis when underwriting ADC loans. Giles, the most experienced ADC underwriter who testified, stated that it was neither

[56] A global cash flow analysis is an examination of the total cash flow from all related entities to attempt to arrive at a global view of the ultimate cash flow available to service obligations. (Tr. 2517.)

industry practice, nor her personal practice to perform global cash flow analysis on ADC loans. (Tr. 1480-81.) Faigin and Kleinfelter offered similar testimony. (Tr. 3120; 3880.) Cornell-Pape admitted that there was no written regulatory guidance requiring global cash flow analysis in 2006. (Tr. 5076.) Accordingly, in the absence of evidence showing that global cash flow analysis was a standard industry practice, I find that the failure to include a global cash flow analysis in the information provided to the Board with each CTB Loan was not an unsafe or unsound practice per se.

This is not to say that a global cash flow analysis is never necessary. Regardless of the fact that the CTB Loans were designed to be paid off using sale proceeds, the financials of the borrower, and in particular the guarantors, were relevant to Bank's ability to recover on guaranties in the event any of the projects were not successful. With respect to certain specific loans, the information provided to the Bank by CTB raised questions that called for a deeper review, possibly including a global cash flow analysis. Accordingly, to the extent it may have been necessary to provide the Board with a global cash flow analysis related to certain loans, that issue will be discussed below in the context of the specific loan at issue.

Similarly, the need for updated financial statements is discussed below on a case-by-case basis. While the FDIC criticized the age of the financial information provided in connection with several of the CTB Loans, there is no authoritative evidence of any governing standard. While Dennis Akenbrand, a retired FDIC employee, testified that the "rule of thumb" is that financial statements should be one year old or less, he acknowledged that there was "squishiness" to this rule and much older financials are sometimes used. (Tr. 78.) Kleinfelter testified that older financials are often relied upon, particularly for high net-worth individuals. (Tr. 3119, 3615.) In light of this testimony, and the absence of an authoritative standard, I will

consider the age of financials where it is appropriate. As with global cash flow, with some of the CTB Loans there was nothing to raise concern about the age of the financials involved. With others, the information the Bank received presented a reason to seek updated financial information. The issues of global cash flow and updates often overlap. Where there was a reason for concern about financials, it often called for both updates and a global analysis.

Other issues call for a similar loan-by-loan analysis. For example, the FDIC has taken the position that the lack of a specific discussion of the strengths and weaknesses of the appraisal of each property was, in all cases, a failure to provide the Board with adequate information and analysis. However, a review of the evidence shows that with some loans, there were issues regarding the appraisals that should have been raised, while in others there appear to have been no problems relating to the appraisal. The same holds true for the failure to note exceptions to policy beyond those discussed above. For these reasons, the adequacy of the information presented to the Board about these issues, and other issues unique to each loan, is best considered on a loan by loan basis.

(a) SEP

Faigin failed to ensure that the Board was provided adequate information and analysis to make an informed decision on the SEP loan. Specifically, the Board was not made aware of a discrepancy relating to additional financing and there were issues regarding the status of construction versus disbursements that were not adequately explored. The most egregious was additional financing. As explained above, there was additional debt encumbering the subject property. The CTB credit memos included in the Board's package understated the amount of this financing by more than two million dollars and overstated the borrower's equity in the project by over a million dollars. This made it appear that the borrower had approximately 10%

equity in the project when in fact its equity was less than 1%. Worse yet, the Executive Summary did not even mention this additional financing or the discrepancy about it. Similarly, there is no mention of this additional financing in the minutes of the September 25th Board meeting. Accordingly, the evidence establishes that Faigin allowed the Board to vote to approve this loan without apprising them of this additional financing, the discrepancy regarding its amount or the borrower's low equity – despite Faigin's admission that he was aware of these issues prior to the loan's approval. (Tr. 3878-79; 4399-4401.)

While Faigin's expert, Kleinfelter, attempted to testify that this issue was insignificant, his testimony was contradictory and unpersuasive. Kleinfelter initially testified that the additional financing was insignificant because it was junior to the Bank's debt and would be wiped out in the event of a default. (Tr. 3147-49; 3527.) However, he later testified that the borrower's equity in a project is an important consideration and that, because the directors received the CTB credit memo that misstated borrower equity, the matter should have been corrected in the Executive Summary. (Tr. 3415-18; 3532.) He also testified that the Board should have been aware of the $2 million discrepancy on the subordinate lien. (Tr. 3526-29.) This testimony, on balance, points to the need to have disclosed this issue to the Board.[57]

Faigin also failed to resolve an issue relating to the disbursements on the loan and how they compared to the status of construction. The Executive Summary stated that the loan had been 35% disbursed on July 6th – a month *before* CTB closed it; however, it also shows a balance of approximately 25% of the total loan amount as of September 18th. (Jt. Exh. 65 at 2.) Thus, it appeared from the Executive Summary that the borrower received 35% of the loan proceeds before the loan was closed and paid 10% back over the next two months. Further, the Executive

[57] During his testimony, Kleinfelter did surmise that this issue was probably brought to the Board's attention. (Tr. 3527-29.) However, as discussed above, the documentary evidence does not support this supposition and the undersigned does not accept Kleinfelter's speculation about it.

Summary stated that no inspection of the construction was available because the loan had recently closed. Also, Kolasinski had inspected the property – again without describing the progress of construction. (Jt. Exh. 65 at 2-3.) The inconsistent statements about loan disbursements, combined with the complete absence of information about construction raise an issue about the progress of this project and how the funds were being used. This issue of construction status versus disbursements was one raised by King. (FDIC Exh. 90.) Faigin's expert Kleinfelter testified, however, that the discrepancy was due to acquisition costs. (Tr. 3153-54.) While that may be the reason for the discrepancy, it does not reach the core issue, which is the failure to provide the relevant information to the Board before it approved the transaction. Faigin should have made sure the Board received an adequate analysis of the progress of construction before they voted to approve this loan. The record shows he failed to do so.

The FDIC also raised an issue about the financial information provided to the Board. The FDIC pointed out that the financial information about the borrower and guarantor was over two years old and that no global cash flow analysis was prepared. However, the FDIC did not point to any reason these issues were particular problems in relation to this loan. FDIC Case Manager Cornell-Pape pointed out that CTB had a relationship with the guarantor, Mr. Pasori, that she believed would have provided the information necessary to perform a cash flow analysis, but she did not identify any specific issues relating to his finances that necessitated such an analysis. As discussed above, I decline to rule that such analysis was required of every loan as a matter of course. Accordingly, I find that the evidence does not support a finding that the Board received inadequate financial information about the SEP loan.

(b) MAG

Faigin also failed to ensure that the Board was provided adequate information and analysis to make an informed decision on the MAG loan. Specifically, the Board was not given adequate information about the status of the project and its delays; litigation involving the borrower; or numerous issues relating to the appraisal. To the contrary, the information submitted to the Board raised substantial questions about the progress and viability of the project without resolving them. It demonstrated that it was already well behind schedule – it was originally scheduled to be completed months before the Bank purchased its participation, but it was only 23% complete by the time the Board approved the loan. The Executive Summary attributed the problem to a delay in getting approval of the project's tract map, but did nothing to explain why approval was delayed or any specificity about when it would be received. Instead, it merely said approval was expected "soon." Similarly, there was a reference to litigation involving the project, but no explanation of what it concerned or how it might impact the project. Instead, the Executive Summary merely stated that the litigation, like the tract map, was expected to be resolved, "soon." While Faigin attempted to dispute the importance of these matters, they were material to the viability of the project. That fact is amply demonstrated by the conditions on the staff recommendation, which called for further investigation of whether delay and litigation could undermine the viability of the project. The FDIC is correct that approval under these circumstances amounted to the Board approving the loan subject to the Bank staff later determining whether the project was viable. Allowing the vote while this central question remained unanswered constituted an unsafe and unsound practice and a violation of Faigin's fiduciary duties of candor and care. *See, Alliance Federal, supra; De La Fuente, supra.*

The FDIC also complained about the age of the appraisal; however, it has not met its

burden of demonstrating this was unsafe and unsound. The Bank's Loan Policy required that collateral valuations be updated on all participations. Here, the Bank obtained updated absorption data. Cornell-Pape testified that this raw data was insufficient to update the valuation. (Tr. 2511-13.) On the other hand, Kleinfelter testified it updated the valuation by verifying the appraised value. (Tr. 3375-76.) Additionally, FDIC Examiner Levy testified that absorption data brings an appraisal up to date. (Tr. 2318.) Accordingly, the FDIC has not met its burden of establishing that the collateral valuation was not adequately updated.

(c) VIN

The evidence shows that Faigin also failed to ensure that the Board was provided adequate information to make an informed decision on the VIN loan. Specifically, the Board was not given adequate information about the appraisal report, the status of the project, or the guarantors' finances. The appraisal revealed that further investigation of the seismic issue that ultimately caused the project to fail was needed. This was a significant issue that the Board should have been apprised of, but it was never raised. Faigin's attempt to argue that he is not responsible because he did not know about this issue fails. Faigin was responsible for overseeing the underwriting staff he assembled to enter the ADC arena, especially on their very first significant project. Faigin's argument is further undercut by his own testimony, discussed above, that he believed it was appropriate for Dent to presume this issue was resolved.

The Board also should have been made aware that the LTV set forth in the Executive Summary was calculated using retail value of the proposed units, instead of bulk value as required by governing regulations. Additionally, there should have been some explanation of the additional collateral that supposedly lowered the property's LTV to a very favorable 44%.

In addition, the Board should have been provided more information about the progress of

construction. At the time the Board approved the loan, disbursements were running ahead of construction. Despite the fact that King highlighted this very issue, there is no evidence that any explanation or analysis was provided to the Board. While Faigin testified the Board was provided with an explanation, he could not say what it was.

Finally, Faigin failed to provide the Board with an adequate analysis of the guarantors' finances. The most recent financial documents from CTB showed that the guarantors had suffered hundreds of thousands of dollars in negative cash flow. This fact was not so much as mentioned in the Executive Summary provided to the Board. Accordingly, there was no analysis of how this negative cash flow impacted the guarantors' ability to support the loan if necessary. Faigin's only response to this failure was to state, without explanation, that the negative cash flows did not concern him. This was insufficient. The negative cash flows and their effect on the guaranty should have been disclosed and analyzed.

By failing to raise these issues and adequately analyze them for the Board, Faigin committed an unsafe or unsound practice by allowing the Bank to originate the credit without adequate analysis. *See, Alliance Federal, supra.* By these failures, Faigin also breached his fiduciary duty of candor, which required Faigin to disclose this type of relevant information whether they asked for it or not, and his fiduciary duty of care, which required him to adequately investigate, verify and explain this loan. *See, De La Fuente II, supra; In re Baker, supra.*

(d) MSC

Faigin failed to ensure that the Board had adequate information about the developer's plans for the subject property or the use of the funds when the Board voted to approve this loan. The Executive Summary for this loan describes the purpose in simple terms – funding a property exchange and providing working capital for development. The underlying documents, however,

reveal a far more confused picture. Neither the four CTB credit memos in the file nor the Executive Summary spelled out what the developer actually planned to do with the loan funds or the property, something that was apparently unsettled. Further, despite the fact that the developer had not even settled on his final development plans, the loan was almost entirely disbursed. In hindsight the reason for this is obvious – the borrower used the proceeds to develop other properties. The parties disagree about the appropriateness of this occurrence. FDIC Case Manager Cornell-Pape thought it was improper and characterized it as diversion of funds. (Tr. 2607-08.) Kleinfelter, on the other hand, testified that the funds were not earmarked and could be used for any purpose. (Tr. 3159-60; 3577-78.) However, he later admitted that the CTB credit memo, which he would expect the Board to rely on, stated that the funds would be used to develop the subject property. (Tr. 3578-80; Jt. Exh. 50 at 16-17.) While it may be possible to argue about the propriety of using the loan funds to develop other properties, the Board should have been aware that the funds were being used for other projects and there were no concrete development plans for the subject property -- particularly in light of the statements in the CTB memos that the funds would be used for this project.

Further, the use of the loan proceeds for other projects makes the approval of an interest reserve even more troubling in this case than others. There was conflicting testimony about propriety of the interest reserve. Cornell-Pape opined that the use of an interest reserve was improper in this case because the loan was not improving the subject property and was not increasing its value. Accordingly, she testified that the borrower should have been paying down the loan, not increasing it by drawing against the interest reserve. (Tr. 2601-06.) In support of this position, the FDIC offered a primer on interest reserves that it published in 2008, which provided that interest reserves may be inappropriate when there is no immediate plan for

development. (Jt. Exh. 127, at 2.) However, it must be observed that this guidance was issued *after* the lending at issue in this case took place, and its language (providing that interest reserves "may" be inappropriate in the absence of development) is far more equivocal that Cornell-Pape's testimony.

In contrast, Kleinfelter testified the interest reserve was not problematic because the loan was fully secured.[58] (Tr. 3577-78.) While there may be some question about whether it was inappropriate per se to approve an interest reserve on this loan,[59] the issue should have been analyzed for the Board. By allowing the borrower to draw on the interest reserve without developing the land, the Bank effectively underwrote the borrower's speculation that the land would not only appreciate, but appreciate faster than interest would accrue. In light of the fact that the Loan Policy did not authorize or address the use of interest reserves at all, the Board should have discussed all interest reserves carefully. In light of the speculative nature of this interest reserve, discussion was even more critical in this case.

In his reply brief, Faigin argued that this was not an issue because the interest reserve was eliminated from this loan before the Bank purchased its participation, relying on one of the four CTB credit memos. (Jt. Exh. 50 at 37, 41.) The argument, however, is unconvincing. Faigin seems to rely on the fact that one of the four CTB memos in the Board packet did not list the interest reserve among the uses for the loan funds. This argument by Faigin ignores the fact that the interest reserve is listed in other CTB memos in the Board packet. (Jt. Exh. 50 at 33.) Even more damaging to Faigin's assertion, the CTB credit memo that Faigin purports to rely stated that repayment during the loan term was to be "Interest only from Interest Reserve." (Jt. Exh. 50

[58] For his part, Faigin testified that interest reserves were routine and had been a part of every land loan he had ever been involved in. (Tr. 3994.)

[59] Further complicating this question, Gumbiner testified, in relation to another loan, that generally it is inappropriate to have an interest reserve on an ADC loan when there is no development, but he defended the use of interest reserve in the absence of development if the LTV on the loan was very low. (Tr. 909-14.)

at 38.) Thus, this argument fails to resolve the issue related to the interest reserve. At best, it reinforces the potential for confusion created by including four different CTB credit memos in the Board package. At worst, it demonstrates a willingness by Faigin to advance arguments that are plainly contradicted by the very evidence he purports to rely on.

Faigin engaged in unsafe and unsound practices and violated his fiduciary duties of care and candor by allowing the Board to approve this loan without full disclosure of how the loan proceeds would be used and how this impacted the risk of the loan – particularly given that it included an interest reserve that would increase the debt without adding any value to the collateral. This was relevant information. Faigin had a duty to explain how the proceeds would be used and make sure that the Board understood the impact of its use.

The preponderance of the evidence shows that the financial information provided to the Board relating to the borrower was adequate. The Bank had the financial statements and cash flow statements. Although the documents in the packet related to the MSC loan were over a year old, the MPC loan packet, which was provided to the Board at the same time, contained more recent documents about the same parties.[60] Thus, the evidence reflects that there was sufficient financial information concerning this loan to enable an adequate review by the Board.[61] Contrary to the FDIC assertions, the evidence does not establish that the Faigin allowed the Board to rely on an outdated appraisal. As with MAG, the MSC valuation was updated with absorption data, and the evidence falls short of showing this was not adequate to comply with the Loan Policy.

[60] The financial documents contained in the MPC Board packet do show significant negative cash flow for the Monteverde Development Company in 2004, resulting from the dissolved partnership of Monteverde and Shappell and officer compensation. However, the other years reported showed positive cash flows. (FDIC Exh. 46 at 93.) Additionally, it shows that in the same year, the guarantors had positive cash flow in excess of the company's losses. The guarantors also had large positive cash flows in the two preceding years. (FDIC Exh. 46 at 94.) Accordingly, this did not present the unexplained losses present in connection with some other loans.
[61] The same holds true for MPC, which used the same financial data.

(e) MPC

The evidence shows that Faigin failed to make sure the Board had adequate information about the terms of the MPC loan and its underlying project before the Board voted to approve the participation. First, the Board was not provided with accurate information about the guaranty related to this loan. The guaranty described in the Executive Summary is the guaranty applicable to the MSC loan. No one caught this mistake at any point despite the fact that the guaranty was highlighted by King, who noted that it appeared extremely low compared to the amount of the loan. Although the actual guaranty was larger than represented, which arguably made the loan safer than it appeared, Faigin was required to provide accurate information to the Board. The failure to correct this error, despite the fact that King specifically flagged it, is indicative of the rushed, careless review Faigin presided over. Moreover, had this error been brought to the Board's attention, it might have prompted a more thorough review and analysis of this loan and all the CTB Loans.

The Board packet also failed to adequately explain this loan and the underlying project. As discussed above, this was a complex project, involving the dissolution of a joint venture with each co-venturer taking on certain responsibility, but missing was a concrete explanation of the borrower's strategy to exit the project in a way that allowed the loan to be paid. Once again, King highlighted the confusing nature of this transaction, but it was not clearly analyzed for the Board. In his attempt to downplay this complexity, Faigin's expert Kleinfelter actually reinforced how difficult it would have been for the Board to gain an adequate understanding of the loan. Kleinfelter testified that the details of the transaction were not clear from the written documents and needed to be supplemented. (Tr. 3169.) However, there is no evidence that Faigin provided that supplemental information or any analysis of it to the Board.

(f) OTR

The conditions on the recommendation in the OTR Executive Summary were essential components to underwriting the loan and determining whether the project was viable. (Tr. 2697-98.) By allowing the Board to approve this loan before these factors were analyzed, Faigin failed to ensure that the Board was presented with an analysis of key underwriting components of this loan. FDIC Case Manager Cornell-Pape testified that while it is common for banks to approve loans subject to conditions, those conditions are usually ancillary items. She also testified that the conditions in the Executive Summary were essential components to underwriting the loan and determining whether the project was viable. (Tr. 2697-98.) According to Cornell-Pape, budget review, final plans and approved permits are essential to an underwriter's ability to assess the cost and viability of a project and whether the funds available will be sufficient to complete the project. (Tr. 2657-58.) In addition, the Loan Policy identifies the possibility that there will not be sufficient funds to complete a project as the first primary risk of construction lending. (Jt. Exh. 31 at 69, §2.1.2.) Cornell-Pape also testified that the preliminary nature of the plans impacted the appraisal because changes to the plans could have a significant impact on the completed project's value.[62] (Tr. 2658-59.) Her credible testimony demonstrates the viability and risk of this loan had not actually been analyzed when the Board approved it.

Faigin's attempts to rebut this conclusion were unpersuasive. While he testified that the conditions were typical post-closing items (Tr. 3923), and that he understood that someone who reported to Vecchio would take care of them prior to funding (Tr. 3926), Faigin admitted on cross-examination that budget, plans and the likelihood of getting needed approvals were key

[62] The appraisal report supports this contention. It expressly states that it assumed all cost figures were correct and any change in them could affect the value conclusions. (Jt. Exh. 59 at 2, 9.)

components to assessing viability of a construction project. (Tr. 4226-29.) He further agreed that someone "could" draw the conclusion that the recommendation subject to these conditions was essentially a request that the Board approve the loan subject to a future assessment of the project's viability. (Tr. 4523.) Yet, there was nothing in the Executive Summary to suggest that the Bank could resolve these conditions prior to funding when CTB had apparently not been able to do in the months since it had closed the loan. (Tr. 2660-61.)

Faigin also failed to ensure that the Board was provided with key information about the appraisal. The Executive Summary stated that the appraisal indicated an "as is" value of $18.4 million and a "prospective market value" of $41.9 million. It used the "prospective market value" to arrive at an LTV of 57.7%. (Jt. Exh. 60 at 4.) The Loan Policy required the Bank to use an appraisal estimating the market value of the property in precisely the condition it is in on the effective date of the value, not an estimate of value with anticipated improvements. (Jt. Exh. 31 at 118, § 5.5.4.) From the face of the Executive Summary, it is clear that the "prospective market value" is not an "as is" value. Additionally, the appraisal stated that the "prospective market value" is the estimated value after all assumed improvements. (Jt. Exh. 59 at 2-3.) Even the "as is" value that was provided assumed that the lots were in "blue top" condition, meaning they had been graded. (Tr. 2667; Jt. Exh. 59 at 2-3.) The Executive Summary, however, stated that grading was not scheduled to occur until November 2006. (Jt. Exh. 60 at 3; Tr. 2669.) Thus, no true "as is" value was provided for the collateral. (Tr. 2666-68.)

Faigin further failed to ensure that the Board was provided with adequate information about the transfer of the property to Otay Ranch. The Executive Summary stated that in 1988 the site was acquired by the Baldwins, who controlled Otay Ranch and guaranteed the loan. (Jt. Exh. 60 at 3.) However, it did not provide any information about the transfer from the Baldwins

to Otay Ranch. There is no dispute that the transfer of the property to Otay Ranch was not an arms-length transaction and that the price paid exceeded the appraised value of the property. (Tr. 2659, 4519; Jt. Exh. 60 at 21.) Cornell-Pape testified that this transaction should have been analyzed and explained in greater detail. Specifically, she testified that the analysis should have described whether the money paid for the transfer was used to pay off existing debt on the land or was a cash-out transaction for the Baldwins. (Tr. 2659-60.) I agree with her testimony.[63] The minutes contain no reference to any such discussion. (Jt. Exh. 115.)

Faigin also failed to ensure that the Board was informed about the potential risk related to the projected pricing for the project. The CTB documents indicate that the projected pricing for the completed units was at the high end of the pricing spectrum, but that fact is not mentioned in the Executive Summary. (Jt. Exh. 60 at 2-4, 26.) The Executive Summary did note, however, that absorption had slowed and prices had declined. (Jt. Exh. 60 at 3-4.) These changes tend to slow sales and decrease prices. (Tr. 2664-65.)

Finally, this is a loan where there were specific reasons that the Board should have been presented with more information about the guarantors' financials. The Executive Summary only set forth net worth figures for the two guarantors – Mr. Baldwin and an LLC he controlled. However, the CTB credit memo in the Board packet included a cash flow analysis, which indicated that Mr. Baldwin had very significant negative cash flow in 2003 (-$20 million) and 2004 (-$38 million), which it attributed to discretionary contributions to various development projects. (Jt. Exh. 60 at 32-33.) The CTB credit memo also stated that Mr. Baldwin's tax returns were "very complex" and involved 75 different s-corporations, partnerships and LLCs that contributed income or losses to him, and that Mr. Baldwin used a combination of

[63] This testimony also adequately rebuts Faigin's argument that there is no evidence the transfer was in any way unusual.

distributions and loans from his various entities to cover his living expenses. (Jt. Exh. 60 at 32.) FDIC Case Manager Cornell-Pape opined that the summary of this structure left significant unknowns and demonstrated a need for a global cash flow analysis. Specifically, she testified that there was no way to know if the allegedly discretionary contributions Mr. Baldwin had made to other projects were truly discretionary or whether they would continue to drain his cash flow going forward. (Tr. 2662-63.) While I have declined to hold that the Bank was required to perform a global cash flow analysis of every borrower and guarantor, I find that the information the Bank had about Mr. Baldwin's finances raised concerns that should have prompted the Bank to perform a more thorough analysis of his global cash flow to determine if his involvement and guaranty would support the project or might drain money from it.

(g) NEV

Faigin failed to ensure that the Board was informed of a clear exception to the Loan Policy. The LTV was 82%, above the maximum (80%) in both the Loan Policy and the relevant guidance. The brief description of the LTV as "high for a declining market," was not sufficient to put the Board on notice that it was approving a loan as an exception to the Loan Policy. The Board should have been made expressly aware that this was outside of the Loan Policy and provided with mitigating circumstances that justified approval as an exception.

The analysis of the viability of this project was also inadequate. The conditions attached to the recommendation in the Executive Summary were key to assessing the viability of the project. (Tr. 2732-34.) The most significant question was the adequacy of the interest reserve, which the Executive Summary itself notes may not be sufficient to complete the project. (R. Exh. 1959 at 2.) Despite this, the Board minutes reflect that the adequacy was not analyzed for the Board. Instead, the Board was informed that the Bank was still waiting for an analysis of the

interest reserve from CTB. (Jt. Exh. 115.) This expressly demonstrates that Faigin allowed the Board to approve the loan without information critical to assessing the credit adequately. Faigin's testimony that this was not an issue because the participation agreement would allow the Bank to back out if the conditions were not satisfied is contradicted by the terms of the participation agreement.[64]

Additionally, the Board should have been provided more information about the land draw the borrower took at the origination of the loan. Cornell-Pape testified that she could not determine what these funds were used for. (Tr. 2739.) Paying itself $2.5 million from the initial disbursement seems inconsistent with the normal course of ADC lending where the borrower would put its own equity at risk before the Bank's. While there may have been a legitimate explanation for this draw, Faigin should have made sure the Board had it and understood it.

(h) SCH

Faigin also failed to ensure that the Board was provided with adequate information about the projected timeline for completion of this project – an essential factor in determining whether the project was viable and the loan would be repaid. The documents the Bank received from CTB suggested two very different timelines without reconciling them. Additionally, the Executive Summary made it appear that, even under the most optimistic assumptions, the borrower would not be able to sell enough units to pay the loan off within its original term. Faigin should have ensured that the Board had an accurate analysis of the project's schedule and an explanation of how and when the borrower would be able to repay the loan. Without this, the Board did not have a full analysis of this credit.

Faigin also failed to ensure that the Board was provided with an adequate analysis of the

[64] It should also be noted that the inclusion of this discussion in the minutes suggest that any and all such discussions that took place were included in the minutes. It further undercuts Faigin's repeated assertions that all issues were adequately discussed at the Board meeting whether the minutes reflect the discussions or not.

guarantors' finances. As explained above, the financial information about the guarantors showed that they had a combined net worth of approximately $17 million dollars, but they were guarantying a loan for $24 million. In addition, most of their assets were centered in real estate, which as Cornell-Pape testified, is often illiquid and subject to overvaluation. The net worth statements included the property that was the collateral for the loan – property, which would likely be seized by the Bank before it sought recovery under the guaranty. All of this raises substantial doubt that the guarantors would be able to perform on their guaranty if needed. These facts called for a more thorough analysis of the guarantors' financials.

(i) Summary

Faigin orchestrated a review process for the CTB Loans that repeatedly missed or failed to adequately analyze significant and troubling issues related to them. Additionally, important information that was known was often not shared with the Board. Faigin's attempt to avoid responsibility for these failings by claiming that he relied on the work of his staff falls short for two reasons. First, Faigin is the person who put in place the ADC infrastructure at the Bank. This made it incumbent on Faigin to oversee that infrastructure to ensure that it provided an adequate level of review. Second, Faigin approved of the truncated review that was performed on the CTB Loans and was well aware of that the review was shallow. Having put in place the Bank's infrastructure and authorized the staff to shortcut the CTB review, Faigin could not turn a blind eye to the multiple problems with that review. He was instead required to ensure that the review was adequate. His failure to do so satisfies the misconduct prong of section 8(e).

iii. Faigin Allowed Lannan to Participate in the Review and Approval of the CTB Loans.

It is undisputed that Lannan had a financial interest in the Bank's purchase of the CTB Loans. Despite this, he was allowed to participate in the meeting, vote on the loans, move for

approval of three of them and second the motions for two others. (JE 115 at 2-4.) Faigin admits that he allowed Lannan to vote on the CTB Loans; that he knew it was improper for Lannan to do so; and that it was his job to stop a director from violating policy. (Tr. 4380.) His failure to stop Lannan from voting is even more troubling in light of the fact that Faigin testified that there was pressure to do CTB loans; that he believes CTB was aware of that pressure; and that he believes was Lannan was the source of CTB's knowledge about the internal pressure at the Bank. (Tr. 4270.) While he did not elaborate further, this testimony supports a reasonable inference that Faigin believed that Lannan may have actually fed information to CTB to help it close this deal in which Lannan had an interest, and in which he took part in the document review. By allowing Lannan to participate under these circumstances, Faigin engaged in an unsafe or unsound practice because allowing Lannan to influence decisions that he stood to benefit from put Lannan in a position to advance his own interests at the expense of the Bank. Similarly, by allowing Lannan that opportunity Faigin breached his fiduciary duties of care and loyalty to the Bank.

b. Effect of Faigin's Misconduct

Faigin's failure to ensure that the CTB Loans were reviewed, underwritten and approved appropriately resulted in both potential and actual losses to the Bank. *See,* 12 U.S.C. § 1818(e)(1)(B). The CTB Loans were approved despite the Bank's failure to fully analyze important issues related to them. The failure to adequately analyze these loans was the direct result of Faigin's knowing decision to rush the underwriting despite the fact that he knew that the underwriting would not involve the same degree of care as new originations, as the Loan Policy required. In several instances, Faigin was aware of potentially troubling issues, but he failed to make sure the issues were raised with the Board and adequately resolved. In others, the rushed

review Faigin mandated missed significant issues entirely – even some that were flagged by King. Reviewing, approving and funding the loans at issue under these circumstances created potential losses for the Bank. Additionally, allowing Lannan to participate in the review and approval process for the CTB Loans, despite Lannan's direct financial interest increased the risk of loss. After all, Lannan had an incentive to push for approval regardless of whether the CTB Loans were prudent for the Bank, and Faigin's own testimony reflects that Faigin believed Lannan may have done just that.

This failure to provide the Board information that might have called for further review or resulted in rejection of loans and allowing Lannan to participate in the review and approval process all increased the risk of loss to the Bank. In several cases, the Bank experienced actual losses when the loans went into default. Faigin's argument that the Bank's losses were the unforeseeable result of the financial crisis is unpersuasive. As stated above, there can be multiple causes for a loss. *See, Landry, supra.* Even a potential loss satisfies the effect requirement of Section 8(e). 12 U.S.C. §1818(e)(1)(B). Thus, while it is likely true that the financial crisis contributed to the Bank's losses, that does not change the fact that Faigin's misconduct contributed to them, or made them more likely, as well. For all these reasons, I find based on the evidence viewed as a whole that Faigin's conduct in connection with the review and approval of the CTB Loans satisfied the effect prong of Section 8(e).

c. Faigin's Culpability

Faigin acted with willful and continuing disregard in connection with the review and purchase of the CTB Loans. His continuing disregard is demonstrated by the long period of time that Faigin oversaw the review of the CTB Loans. During this entire time, Faigin's focus was on completing the review, not ensuring it was thorough. When Vecchio expressly told him the CTB

Loans could not be appropriately underwritten within the time he wanted, Faigin directed her to move ahead with an unsafe and unsound review, instead of slowing down in the face of difficulties. When Vecchio informed Faigin that the CTB Loans could not close until October because of issues with the Bank's ALLL, he again ignored the chance to slow down the rushed review. Faigin's ongoing pressure to move the CTB review at an unsafe and unsound pace combined with the specific instances where he passed on obvious opportunities to slow down and perform a more appropriate review demonstrates his continuing disregard for the safety and the soundness of the Bank.

The same conduct demonstrates Faigin's willful disregard for the safety and soundness of the Bank. Faigin admitted that he understood the problems that the Bank encountered in getting information from CTB, and he understood what level of review Bank staff could provide in the time he gave them. Further, he took it upon himself to make sure the Board was aware that a review had been done and that it had adequate information to vote. He nevertheless allowed the Board to vote on the CTB Loans without giving it adequate information or analysis or making it aware that the review process itself had been far less rigorous than the type of review required by the Bank's Loan Policy.[65]

Faigin went even further when King attempted to raise questions about some irregularities with CTB Loans. Rather than carefully address King's issues and encourage discussion, Faigin sent a reply to King that Faigin admits he meant as a rebuke of King. (Tr. 3811-12.) Even his own expert, Olson, testified that this conduct was improper. (Tr. 4190-91.)

Faigin's willful disregard is further demonstrated by his failure to stop Lannan from participating in the review and approval of the CTB Loans. He was aware of Lannan's interest

[65] Although the FDIC has not alleged that Faigin acted with personal dishonesty, it should be noted that failure to disclose material information to a bank board has been held to constitute personal dishonesty under section 8(e). *See, Dodge, supra.*

and admitted he had a responsibility to keep Lannan from participating in the decision. Despite this, Faigin allowed Lannan to work on the review of the CTB Loans from its inception. Then, he allowed Lannan to participate in the Board discussions and to vote to approve the CTB Loans. All of this is even more troubling given Faigin's testimony that he believed Lannan may have been feeding information to CTB during the review process. Allowing Lannan to be involved demonstrates at the very least willful disregard – as well as extremely poor judgment.

4. The Other Bank-Originated ADC Loans

a. Misconduct – Faigin Allowed the Board to Approve Loans Without Adequate Analysis.

i. LV215

Faigin failed to ensure that this loan was adequately analyzed before it was brought to the Board for a vote. The most troubling issues relate to the rapid increase in appraised value and the use of an interest reserve on a loan that was essentially funding real estate speculation. FDIC Case Manager Cornell-Pape opined that the significant, rapid increase in the appraised value of the subject property was not sufficiently analyzed in the credit memo, which attributed the rapid increase to a zoning change. (Tr. 2781-83.) While she agreed a zoning change can significantly increase the value of a parcel, she questioned whether the change here was the type that would do so. (Tr. 2785-86.) Cornell-Pape testified that the property had not been granted any increased entitlements. It had only been placed in a zoning district, known as a Mixed-Use or "MUD" overlay, that allowed the owner to request approval to build in excess of the normal zoning restrictions. (Tr. 2784-85.) Faigin's expert Kleinfelter, on the other hand, opined that the increase was justified by several factors, including the change in zoning, comparable sales in the area and the fact that the former owner had prevailed in a lawsuit against the county to ease building restrictions on the property. (Tr. 3225-28.) While Kleinfelter's testimony may provide

some reason to believe that the appraised value was reasonable, it does not address the central issue regarding the appraisal – the failure to analyze the factors that pushed this substantial and rapid increase in value. Whether the value stated in the appraisal was ultimately appropriate or not, the Board should have been provided a more comprehensive analysis that informed them of the reasons for the increase and the risks related to it.

The Bank's approval of an interest reserve on this loan also raises questions. As Cornell-Pape pointed out, the loan was a speculative vehicle to hold the land, rather than a loan where development was adding value. (Tr. 2801-02.) In light of the loan's speculative nature, and the lack of any development, Cornell-Pape opined that it was inappropriate to include an interest reserve on the loan. (Tr. 2602-06, 2791.) Kleinfelter disagreed, testifying that the interest reserve was appropriate because it was for the acquisition of land, which is part of the Acquisition, Development and Construction or "ADC" process. (Tr. 3219.) However, he also admitted that there was no plan for development ("D") or construction ("C") on the property. (Tr. 3649.) Faigin also defended the interest reserve in light of the very low LTV on this loan. He further testified that every land loan he had ever done involved an interest reserve, which he believed was appropriate. (Tr. 3994.)

In the end, both the increased appraised value and the use of an interest reserve called for greater analysis to be provided to the Board. The combination of the large increase in value, the lack of any development plan and the use of the interest reserve meant that the Bank was completely financing the borrower's land speculation. The Bank provided financing, and a reserve to service the interest on that financing, while the borrower waited for buyers to agree to his increased valuation. Given this, the Board should have been provided with a careful analysis of the support for the increased value of the land and the reasoning for financing even the debt

service on holding the land. This conclusion is reinforced by the fact that, as discussed above, the Loan Policy provided no guidance on when the Bank would approve interest reserves. That lack of guidance was a failing of the Loan Policy and one that mandated careful consideration of using an interest reserve in a situation as speculative as the one presented.

The information regarding the guarantor's finances failed to demonstrate that the Bank's risk on this speculative loan would be protected by the guaranty. First, his assets were mostly illiquid real estate holdings. Second, the credit memo stated the guarantor had approximately $2 million in liquid assets, but did not describe what they were. (Tr. 2796; Jt. Exh. 46 at 7-8.) Cornell-Pape testified that her review of the supporting documents revealed no evidence that the guarantor actually had $2 million in liquid assets. (Tr. 2798.) Nothing evidencing this purported liquidity was introduced into evidence. Additionally, the guarantor had negative cash flows in 2004 and 2005, and his assets were spread across 20 real estate entities. As Cornell-Pape testified, these facts, combined with the fact that the loan required an interest reserve, made it appear that the guarantor was very illiquid and raised questions about whether he would be able to fulfill his guaranty. (Tr. 2798-99.) Faigin was not able to rebut this concern. While he testified that the guarantor's negative cash flow showed he paid his debts, he also admitted that it could indicate he had limited cash. (Tr. 3998.) Similarly, Kleinfelter testified that the negative cash flows were the result of discretionary investments, but he later admitted that the information in the loan file left it unclear whether the guarantor would be able to liquidate assets to pay on the guaranty if needed. (Tr. 3218; 3656-57.) These concerns about the guarantor's ability to come up with liquid assets should have been disclosed and analyzed for the Board – particularly in light of the speculative nature of the loan.

ii. LV18

The most obvious flaw in the analysis of this loan was the failure to point out to the Board that its appraisal did not comply with applicable standards. The relevant regulations require that property appraisals contain an estimate of a property's value in its current condition and subject to the zoning in effect on that date. *See,* FDIC, Financial Institution Letter, "Appraiser Independence," FIL 84-2003, 2003 WL 22434766, *6 (October 28, 2003). Similarly, the Bank's Loan Policy required that all appraisals prepared for the Bank "for all purposes" be on an "as is" basis, which the Loan Policy defined to mean, "an estimate of the market value of the subject property in the condition observed on the date of the inspection, and as it physically and legally exists without hypothetical condition, assumptions or qualifications, as of the date of the inspection." (Jt. Exh. 31 at 118, § 5.5.4.1.). The subject property was being used as a mobile home park, but it was appraised as vacant land.

Faigin's expert, Kleinfelter, attempted to justify the appraisal as vacant land on the basis that vacant, developable land was the highest and best use of the property. (Tr. 3246-47.) However, his testimony did not, and could not, change the fact that applicable regulations and the Loan Policy expressly required the Bank to obtain a valuation of property in its actual condition prior to approving the loan.[66]

Faigin also argued in his post-trial briefing that the relevant policies allowed the hypothetical appraisal. He first argued that the FDIC cannot rely on FIL 84-2003, cited above, because it was not introduced into evidence. This argument ignores the fact that Financial Institution Letters are public documents used to announce FDIC policy. As such, they are subject to judicial notice. 12 C.F.R. § 308.36(b); *see also, Hickman v. Wells Fargo N.A.,* 683

[66] When confronted with the governing regulations, Kleinfelter attempted to evade the issue by stating that the appraisal did not "in the strictest sense," contain a value for the property in its current condition. (Tr. 3636-39.) The evidence shows that the appraisal did not contain such a value in any sense, strict or otherwise.

F.Supp.2d 779, 784 (N.D. Ill. 2010). Thus, the FDIC may rely on it.

He also argued that the Loan Policy allowed hypothetical appraisals like this one, and cites the Loan Policy's definition of "Market Value 'As If Complete,'" which did allow an estimate of market value assuming all proposed construction, conversions, etc. . . are complete. (Jt. Exh. 31 at 120, § 5.5.4.3.) This argument, however, fails because while Faigin cites the Loan Policy's definition of "Market Value 'As If Complete,'" he completely ignores the Loan Policy's provisions about the use of such valuations. The Loan Policy provided that "Market Value 'As If Complete,'" valuations could be used if the property needed major repairs or remediation in order to make it marketable. (Jt. Exh. 31 at 119, § 5.5.4.2.) While Kleinfelter testified that vacant land was the property's highest and best use, there was no evidence it was not marketable in its current condition. Thus, the Loan Policy did not authorize a hypothetical valuation for this property. Moreover, even when a "Market Value 'As If Complete,'" is authorized, the Loan Policy requires that it be identified as "the Market Value 'As If Complete,'" and that it be reported as the secondary value only, with the primary value being the actual as-is value of the property. (Jt. Exh. 31 at 119, § 5.5.4.2.)

The relevant regulatory guidance and the Loan Policy further required an actual as-is valuation of the property in its current condition. If the loan was to be approved without such a valuation, it should at the very least have been expressly approved as an exception to policy. It was not, and there is no evidence that the Board was ever informed that the valuation method was inconsistent with all of these standards. Additionally, the Bank had obtained a review of the appraisal that warned that using this hypothetical value was risky.[67] Failing to inform the Board about the risks uncovered by an appraisal review defeats the entire purpose of such a review.

[67] Hindsight has made the magnitude of this risk more clear. In 2008, the Bank obtained a true "as is" appraisal of the property, which estimated its value at $9.8 million – almost $100 million less that the hypothetical value obtained a year earlier and well below the loan amount.

Allowing the Board to vote to approve the loan without adequate analysis of the appraisal was unsafe and unsound.

In addition to being outside of relevant policies and regulation, the hypothetical appraisal also is related to another issue – the speculative nature of the loan. Like the LV215 loan, the borrower had no concrete development plans for this loan. Instead, it intended to hold the land until it could be sold at a profit. Also like LV215, the appraised value of this property had seen a dramatic price increase. Indeed, in this case, even Faigin's expert Kleinfelter testified that the information in the credit memo alone was insufficient to allow him to understand the large increase in appraised value.[68] (Tr. 3635-36.) Nothing in the Board minutes reflects that any of this information was shared with the Board. The FDIC's criticism of the interest reserve related to this loan went a step further than it had with LV215. FDIC Case Manager Cornell-Pape opined that it was improper to underwrite this loan as an ADC loan at all because the property contained an operating business, the mobile home park. Instead, she thought it should have been underwritten as an income-producing property and opined that the Bank did not do so because the income from the mobile home park was insufficient to pay the interest on the loan, so the Bank treated it as an ADC loan in order to allow it to provide an interest reserve to cover the shortfall. (Tr. 2811-13.) While Cornell-Pape's supposition about motivation may or may not be correct, she was correct that classifying a stabilized, income-generating property (the Bank's traditional lending arena) as an ADC loan, and providing an interest reserve, based on the assumption that the business would be shut down and the land sold as vacant, certainly raised further questions about the loan. Faigin's testimony that he brought in an expert to resolve those

[68] The only explanation the credit memo offered for the increase in value was the fact that the property had, like Las Vegas 215, been placed in a MUD overlay district. (Jt. Exh. 49 at 20; Tr. 2810-11.) Once again, Cornell-Pape opined that in order to take advantage of the MUD overlay, a developer would still need to obtain approval for a zoning change to take advantage of the change. (Tr. 2810-11.)

questions is not credible in light of the complete lack of documentary support and his inability to identify the purported expert. His testimony is further undercut by his own admission that he knew mobile home parks can be difficult to close. Accordingly, the lack of a development plan, existence of the park, and the potential issues related to closing the park, should have been analyzed and presented to the Board, before it voted to approve the loan.

Finally, the financial data provided raised the same concerns that existed with LV215 – which is hardly surprising as both loans had the same guarantors. Thus, there were the same unanswered questions about the ability to actually perform on the guaranty. There were, however, two differences. First, the Bank's exposure to this guarantor was now greater. Second, the developer needed short-term financing when the loan closing was delayed, despite the guarantor's purported $2 million of liquid assets. This raised questions about the guarantor's actual liquidity. (Tr. 2817.) Both of these factors made a thorough analysis of the financial information even more important.

iii. DOR

It was unsafe and unsound to allow the Board to vote to approve this loan without a clear explanation of the fact that not only was the Debt Service Coverage Ratio ("DSCR") for the project below the requirements of the Loan Policy, but also that once principal repayment began, the DSCR would fall below the amount necessary to service the debt according to its terms. Instead of clearly explaining these facts, the credit memo's discussion of the DSCR was a confusing mish-mash. It began by reciting a DSCR of 1.05:1, based on interest only on the Bank's loan. Then, it stated that the DSCR would drop to 0.92:1 when principal payments began and to 0.84:1 if payments on additional debt on the property were included. Later, when the credit memo finally stated that the DSCR was below Bank policy, it constructed a hypothetical

scenario where the DSCR could be improved by refinancing – a transaction that would pay off the Bank's loan, not service it according to its terms. (Jt. Exh. 35, at 14-15.) Cornell-Pape testified that she had never in her career seen a loan presentation attempt to justify a low DSCR by theorizing about the potential to refinance in the future. (Tr. 2829-33.) The theoretical suggestion that another bank might offer better terms at some future date does not mitigate the risk presented by the inadequate DSCR on the loan the Bank actually made.

While the discussion of DSCR in the credit memo was confusing at best, the discussion reflected in the Board minutes is worse. Rather than unpack the issue and explain it to the directors, the minutes gloss over it. The only mention of the DSCR is the statement that it is 1.05:1 – the most favorable DSCR calculation available. Additionally, rather than expressly inform the directors that the DSCR was below the requirements of the Loan Policy, they were told only that it was "light." Finally, the fact that the staff's best solution to the DSCR problem came through refinancing the loan was not discussed. (Jt. Exh. 35, at 13.)

There was also insufficient information about the guarantor's financials. In this case, such information was crucial because the guarantor was supposed to be making payments on the property's subordinate debt from his own resources, and, as discussed above, the income from the project would be insufficient to service that additional debt. Despite the acknowledged need for the guarantor to service the subordinate debt, the financial information provided did not establish that he would be able to do so. Most notably, he had experienced millions of dollars in negative cash flows over the prior two years. Additionally, his other rental properties appeared to have a history of operating at a loss. All of this made it appear doubtful that he could meet the obligation to service the subordinate debt. Faigin should not have allowed this loan to be approved without more information and analysis to establish how the guarantor could meet his

obligations.

iv. ACA

The information provided to the Board did not adequately analyze the large increase in the value of the property. The value of the property had almost doubled in only a few years, yet there was no explanation as to why. Further, the valuation method used in the appraisal was one that used a hypothetical developed value and backed-out development costs, rather than just calculating the value the land could sell for in its current condition. This method leaves numerous issues unknown and is usually only used as a secondary valuation. (Tr. 2850-56.) It is at least questionable whether this truly provides an estimate of the land in its current condition. Most tellingly, Faigin himself admitted that the valuation of this property was not adequately explained to the Board. (Tr. 4792.) The undersigned agrees.

The information presented to the Board also failed to analyze whether the topography of the subject property comported with the Loan Policy's prohibition against lending on properties with difficult topography. On its face, the credit memo's description of the subject property as ranging "from level areas to rolling hilltop areas to sloping ravine-like areas," and including, "undeveloped canyon/open space," as well as the city's desire to have the developer build a bridge over the canyon to connect a roadway, seemed to indicate the type of difficult topography the Loan Policy prohibits lending on. (Jt. Exh. 42 at 158; *see also,* Jt. Exh. 31 at 70-71, §2.1.3.) Faigin argued that this portion of the Loan Policy did not apply to this loan because the borrower did not plan to build on it. However, he cited nothing in the Loan Policy limiting the prohibition against lending on properties with difficult topography to projects where actual construction was planned. Because the Bank underwrote this as an ADC loan, it should have followed the Loan Policy's provision relating to ADC loans. Accordingly, prior to approval of this loan, how the

subject topography related to the Loan Policy should have been analyzed. If it did not constitute difficult topography under the Loan Policy, the credit memo should have explained why. If it was the type of difficult topography the Loan Policy prohibited, the loan needed to be approved as an exception. Instead the issue was overlooked or ignored.

v. Summary

As the Bank's president and CEO, and the architect of the Bank's ADC lending program, Faigin was required to supervise the Bank's staff to ensure that the ADC lending was conducted in a safe and sound manner. Instead, Faigin failed to ensure that Bank staff adequately analyzed these loans prior to presenting them for approval and allowed important information to be omitted from the information presented to the Board. This failure to adequately supervise the ADC program he put into place constituted unsafe or unsound conduct and a breach of his fiduciary duties of care and candor which satisfy the misconduct prong of section 8(e).

b. Effect of Faigin's Misconduct

Faigin's failure to ensure that the post-CTB loans were adequately analyzed resulted in both potential and actual losses to the Bank. *See,* 12 U.S.C. § 1818(e)(1)(B). Those loans were approved despite the existence of unresolved issues related to them. Faigin allowed the Board to vote to approve the loans without providing adequate information and analysis to allow the Board to make an informed decision. Reviewing, approving and funding the loans at issue under these circumstances created potential losses for the Bank. This failure to provide the Board information that might have called for further review or resulted in rejection of loans increased the risk of loss to the Bank. Additionally, in at least one case, LV18, the Bank suffered an actual loss.[69] For all these reasons, Faigin's conduct in connection with the Bank's approval of the post-

[69] As with the CTB Loans, Faigin's argument that the financial crisis is the cause of the Bank's losses fails because Faigin's actions still contributed to the risk of loss and actual losses suffered. *See, Landry, supra.*

CTB loans satisfied the effect prong of Section 8(e).

c. Faigin's Culpability

The Faigin acted with continuing disregard in connection with the underwriting of these other loans. The underwriting of these loans was a continuation of the ADC underwriting regime Faigin established and maintained from the time the Bank entered into ADC lending until its failure. Despite the weaknesses in the system that should have been obvious, Faigin allowed large, complex ADC loans to be underwritten without adequately supervising the Bank staff or improving the ADC infrastructure he had built. One obvious example of this is the lack of any guidance about interest reserves. Faigin's own expert testified that if the Bank was going to offer interest reserves, the Loan Policy should have provided guidance on them, but it is undisputed that the Loan Policy had no such guidance. Despite this, Faigin not only allowed the Bank to continue to make large ADC loans that included interest reserves, he allowed it to make speculative loans that more aggressively pushed the boundaries of when interest reserves are appropriate. This conduct reflects Faigin's continuing disregard for the safety and soundness of the Bank.

The Faigin also acted with willful disregard for the Bank's safety and soundness. Despite the known issues related to the Bank's ADC underwriting infrastructure, Faigin took no steps to improve it. In fact, he further weakened it by hiring Eric Rosa. Rather than strengthen the role of underwriters, Faigin allowed Rosa to reorganize the lending department in a way Faigin admits he viewed as decreasing underwriter independence. By allowing this to occur, Faigin weakened an underwriting system that was already inadequate thereby demonstrating a willful disregard for the safety and soundness of the Bank.

D. Civil Money Penalty

1. Legal Standard for Civil Money Penalty

Section 8(i)(2) of the Act, 12 U.S.C. § 1818(i)(2), provides for the assessment of a civil money penalty ("CMP") if certain conditions are met. The purpose of a CMP is "to deter and sanction respondent, for the acts and practices alleged in the Amended Notice." *In the Matter of John R. Givens*, No. OCC-AA-MW-91-136, 1993 WL 13011388 (OFIA Feb. 8, 1993); *see also Long v. Bd. of Governors of the Fed. Reserve Sys.*, 117 F.3d 1145, 1154 (10th Cir. 1997) (explaining that Congress enacted the civil money penalty provisions to provide the federal banking agencies with the necessary flexibility to secure compliance with the relevant banking laws and to "serve as deterrents to violations of laws, rules, regulations and orders of the agencies").

Here, the FDIC seeks a Second Tier CMP in the amount of $85,000. A Second Tier CMP requires proof of two elements: "misconduct," *i.e.*, either a violation of any law or regulation or final order, or a breach of a fiduciary duty, or recklessly engaging in an unsafe or unsound practice in connection with the Bank, *see* 12 U.S.C. § 1818(i)(2)(B)(i); and "effects," *i.e.*, either a pattern of misconduct, or conduct which caused or was likely to cause more than minimal loss to the institution, or which resulted in a gain or benefit to the Faigin. *See* 12 U.S.C. § 1818(i)(2)(B)(ii). These elements largely mirror those the FDIC is required to prove to justify a prohibition, except that the engagement in unsafe or unsound banking practices must be shown to have been reckless. "[R]eckless disregard for the law, applicable regulations, or an agency order exists when: (1) the party acts with clear neglect for, or plain indifference to, the requirements of the law, applicable regulations or agency orders of which the party was, or with reasonable diligence should have been, aware; and (2) the risk of loss or harm or other damage

from the conduct is such that the party knows it, or is so obvious that the party should have been aware of it." *Simpson v. OTS,* 29 F.3d 1418, 1425 (9th Cir. 1994) (defining "reckless disregard" for purposes of 12 U.S.C. § 1818(b)(6)(A), which provides for restitution in connection with a cease & desist order). Conduct that demonstrates willful or continuing disregard under 8(e) has been held to demonstrate the requisite recklessness. *Dodge*, 744 F.3d at 162.

2. Appropriateness of a Civil Money Penalty

Based on the evidence, analysis and findings set forth above, Faigin's conduct in connection with the Bank's ADC lending constitutes "misconduct" warranting a CMP against the Faigin. As discussed above, Faigin engineered and oversaw the Bank's ADC lending program from planning, through implementation and until the Bank ultimately failed. Throughout this time, the Bank's ADC lending infrastructure and practices were deficient. Despite this, Faigin took no action to ensure underwriting that included adequate analysis, and in the case of the CTB Loans, affirmatively ordered Bank staff to short-cut the analysis of the loans in question. Additionally, throughout the Bank's foray into ADC lending, Faigin never took steps to correct or improve the Bank's flawed system. In fact, he allowed it to be weakened further when Rosa joined the Bank. All of this establishes the requisite recklessness on Faigin's part.

With respect to the "effects" of Faigin's misconduct, the record speaks for itself. Most obviously, the Bank suffered substantial losses that contributed to its eventual failure. Additionally, Faigin's ongoing close involvement with the ADC program, coupled with the lack of any attempt to improve the program and his active undercutting of safe and sound practices, establish a pattern or misconduct. *See, Rapp v. OTS,* 52 F.3d 1510, 1518 (10th Cir. 1995) (holding that repeated misconduct constitutes a pattern, even if not the same act).

For these reasons I find a Second Tier CMP appropriate in this matter.

3. Amount of the Civil Money Penalty

Having determined a Second Tier CMP is warranted, it is necessary to determine the appropriate amount of the penalty to be assessed. As noted above, the FDIC has requested a CMP in the amount of $85,000. Second Tier CMPs can be assessed in an amount not to exceed $37,500 for each day during which the violation, practice or breach continues. 12 U.S.C. § 1818(i)(2)(B); 12 C.F.R. § 308.132(c)(3)(i).[70] As the record above demonstrates, Faigin's conduct constituted a continuous pattern of misconduct that began with the planning of the Bank's entry into ADC lending in 2005 through at least the approval of the final loan at issue in 2007, and arguably as long as the loans remained on the Bank's books. Accordingly, based on the statutory penalty, the Second Tier CMP against Faigin, calculated at $37,500 per day, could total in the tens of millions of dollars. Thus, the amount requested is clearly authorized.

While the statute clearly authorizes the CMP requested, that is not the end of the inquiry. In determining the appropriate amount of a CMP, it is necessary to consider the mitigating factors set forth in 12 U.S.C. § 1818(i)(2)(G), namely: (1) the size of Faigin's financial resources; (2) the good faith of Faigin; (3) the gravity of the violations; (4) the history of previous violations; and (5) such other matters as justice may require. The 13-factor analysis found in the Interagency Policy Regarding the Assessment of Civil Money Penalties by the Federal Financial Institutions Regulatory Agencies, 63 Fed. Reg. 30,226 (May 28, 1998) ("Interagency Policy"), must also be considered.

a. Financial Resources

With regard to Faigin's financial resources, Faigin provided a financial statement dated

[70] The text of the Act states that Second Tier penalties may be assessed in an amount not to exceed $25,000 per day. 12 U.S.C § 18181(i)(2)(A). However, the Debt Collection Improvement Act directs the heads of all federal agencies to periodically adjust the civil money penalties under their jurisdiction for inflation. 28 U.S.C. § 2461, note. Pursuant to this authority, the FDIC Board of Directors has adjusted Second Tier CMPs to an amount not to exceed $37,500 per day. 12 C.F.R. § 308.132(c)(3)(i).

December 31, 2012. (ALJ Exh. 1.) Faigin also provided numerous tax filings and related documents. (ALJ Exhs. 2-6.) These exhibits were made a part of the record and placed under seal. (Tr. 4318-19.) As stated at the hearing, I find those documents accurately portray Faigin's finances in the several years leading up to the hearing in this matter. (Tr. 4318.)

The documents relating to Faigin's financial condition demonstrate that he has the financial resources to pay the requested CMP. Without going into detail, Faigin's financial statement shows that, as of December 31, 2012, Faigin had a net worth in the millions and in excess of $1 million in liquid assets.[71] (ALJ Exh. 1.) This is more than adequate to pay the requested CMP.

b. Good Faith

The good faith element looks to what Faigin did to prevent violations and what he did to rectify those violations once they were brought to his attention. *See, In re Haggard,* FDIC-09-545e, FDIC-09-547k, 2012 WL 3234237, *78 (FDIC 2012). As discussed above, Faigin did not act to prevent the unsafe and unsound practices at issue. In fact, he actively pushed the ADC lending program that they arose out of. Faigin also failed to take any steps to help regulators resolve their longstanding concerns about the Bank's liquidity and the payment of dividends. On the other hand, FDIC Field Supervisor McGibbon testified that he believed Faigin cooperated with the FDIC's investigation. (Tr. 2881.) Faigin also pushed for the adoption of an ethics policy after regulators raised concerns about Lannan's fee. (Tr. 2873-74.) Overall, I find that while Faigin addressed the issue of Lannan's fee and cooperated in the FDIC's investigation *after* the Bank failed, that does not demonstrate sufficient good faith to mitigate a CMP in light

[71] Faigin's current income is less clear. Faigin had a history of high earnings. (ALJ Exhs. 4-6.) Faigin did testify that he had not worked since September of 2011; however, he still received some income in the form of social security and unemployment benefits. (Tr. 4315; ALJ Exhs. 2-3.) Accordingly, while Faigin does not appear to have significant earnings, he has some income. This further reinforces the conclusion that his substantial assets and net worth are adequate to pay the requested CMP.

of his failure to take action to prevent violations before they occurred and while they were ongoing.

c. Gravity

Faigin's actions in this case had grave consequences. It is beyond dispute that the Bank suffered large losses on several of the loans at issue. Those losses certainly contributed to the ultimate failure of the Bank. Additionally, Faigin took other actions, such as those relating to liquidity and dividends, that further weakened the Bank. (Tr. 2881-82.) Accordingly, this factor does not mitigate the amount of the CMP.

d. History

Faigin's history of violations does provide some mitigation. The record reflects that Faigin had no history of similar conduct, or other violations or unsafe and unsound practices, and he had not been the subject of similar criticism in the past. (Tr. 2878-79.)

e. Other Matters Required by Justice

Neither party introduced any matters beyond the statutory factors and interagency factors that should be taken into account in determining the amount of the CMP.

f. Interagency Policy Factors

In accordance with the Interagency Policy, thirteen additional factors are identified as relevant to this inquiry:

1. evidence that the violations were intentional or committed with disregard of the law or consequences to the institution;
2. the duration and frequency of the misconduct;
3. the continuation of the misconduct after the Faigin was notified or, alternatively, its immediate cessation and correction;
4. the failure to cooperate with the agency in effecting early resolution of the problem;
5. concealment of the misconduct;
6. any threat of loss, actual loss, or other harm to the institution, including harm to the public confidence in the institution, and the degree of such harm;

7. the Faigin's financial gain or other benefit from the misconduct;
8. any restitution paid by the Faigin for the losses;
9. any history of previous misconduct, particularly where similar to the actions under consideration;
10. previous criticism of the institution or individual for similar actions;
11. presence or absence of a compliance program and its effectiveness;
12. tendency to engage in violations of law, unsafe or unsound practices or breaches; and
13. the existence of agreements, commitments, orders or conditions imposed in writing intended to prevent violations.

See Interagency Policy Regarding the Assessment of Civil Money Penalties by the Federal Financial Institutions Regulatory Agencies, 63 Fed. Reg. 30226-02 (June 3, 1998).

Based on the preponderance of the evidence viewed as a whole, and as fully explained above, factors (1), (2), (3), (4), (6), and (12) weigh against mitigating the amount of the CMP against the Faigin. Additionally, factor (11) weighs against mitigation because the Bank lacked sufficient policies and the policies it had were not adequately followed. (Tr. 2880.) Similarly, factor (8) weighs against mitigation because Faigin has paid no restitution. (Tr. 2878.) Factor (7) also weighs against mitigation because Faigin received one concrete financial benefit in the form of his bonus in connection with the sale of the Beverly Hills Branch. While I do not find that bonus to have significant weight in this case, it cannot be said to support mitigation. On the other hand, Factors (5), (9), (10) and (13) weigh in favor of mitigation. There is no evidence of concealment of the misconduct. (Tr. 2876.) Also, Faigin had no history of misconduct or criticism, and he was not subject to any written agreements with regulators. (Tr. 2878-80.)

Examining the record in its entirety, the amount of the penalty that the FDIC seeks to have assessed against Faigin is conservative considering the maximum amounts that could have been assessed as per the statute as a Second Tier CMP. Taking into consideration all of the factors discussed above, I find no reason to alter the assessment sought by the FDIC. Accordingly, I find that the total amount of $85,000 is an appropriate civil money penalty to be

assessed against Respondent, Larry B. Faigin.

V. Conclusions of Law

1. The Bank is subject to the provisions of the Federal Deposit Insurance Act set forth in 12 U.S.C. §§ 1811 through 1831aa and the FDIC's Rules and Regulations, 12 C.F.R. Chapter III.
2. Respondent, Larry B. Faigin is an institution-affiliated party of the Bank. 12 U.S.C. § 1813(u).
3. The FDIC is also the "appropriate Federal Banking agency" with respect to the Bank. 12 U.S.C. § 1813(q)(2).
4. The FDIC has jurisdiction over the Bank, Faigin, and the subject matter of this proceeding. 12 U.S.C. §§ 1818(e)(1) & (i).
5. As Chief Executive Officer and President of the Bank and as a director of the Bank, Respondent, Larry B. Faigin owed fiduciary duties to the Bank and its depositors.
6. By reason of the of Respondent, Larry B. Faigin's acts, omissions, and practices with respect to causing the Bank to shift its lending strategy to larger and riskier ADC loans, as fully described in the foregoing findings, Respondent, Larry B. Faigin engaged in or participated in unsafe or unsound practices in connection with the Bank. 12 U.S.C. § 1818(e)(1)(A)(ii).
7. By reason of the Respondent, Larry B. Faigin's acts, omissions, and practices with respect to causing the Bank to shift its lending to larger and riskier ADC loans, as fully described in the foregoing findings, Respondent, Larry B. Faigin breached his fiduciary duties to the Bank. 12 U.S.C. § 1818(e)(1)(A)(iii).

8. By reason of his unsafe or unsound practices and breach of fiduciary duties, Respondent, Larry B. Faigin caused risk of loss and an actual loss to the Bank. 12 U.S.C. § 1818(e)(1)(B)(i).

9. The Respondent, Larry B. Faigin's acts, omissions, and practices with respect to causing the Bank to shift its lending strategy to larger and riskier ADC loans, as fully described in the foregoing findings, demonstrate his willful or continuing disregard for the safety and soundness of the Bank. 12 U.S.C. § 1818(e)(1)(C)(ii).

10. Based on the foregoing findings, Respondent, Larry B. Faigin has engaged in conduct satisfying the requirements of 12 U.S.C. § 1818(e) and is subject to the imposition of an order prohibiting him from future participation in the affairs of a federally insured financial institution or organization listed in 12 U.S.C. § 1818(e)(7) without prior written approval of the FDIC and such other appropriate Federal banking depository institution regulatory agency.

11. By reason of Respondent, Larry B. Faigin's acts, omissions, and practices with respect to the Bank's approval of the purchases of participations in eight ADC loans, as fully described in the foregoing findings, Respondent, Larry B. Faigin engaged in or participated in unsafe or unsound practices in connection with the Bank. 12 U.S.C. § 1818(e)(1)(A)(ii).

12. By reason of the Respondent, Larry B. Faigin's acts, omissions, and practices with respect to the Bank's approval of those eight ADC loan participations and impermissibly allowing Director John Lannan to vote to approve those loans despite Lannan's known financial interest in them, as fully described in the foregoing findings, Respondent, Larry B. Faigin breached his fiduciaries duty to the Bank. 12 U.S.C. § 1818(e)(1)(A)(iii).

13. By reason of his unsafe and unsound practices and breach of fiduciary duties, Respondent, Larry B. Faigin caused risk of loss and an actual loss to the Bank. 12 U.S.C. § 1818(e)(1)(B)(i).

14. The Respondent, Larry B. Faigin's acts, omissions, and practices with respect to the Bank's approval of those eight ADC loan participations, as described in the foregoing findings, demonstrate his willful and continuing disregard for the safety and soundness of the Bank. 12 U.S.C. § 1818(e)(1)(C)(ii).

15. Based on the foregoing findings, Respondent, Larry B. Faigin has engaged in conduct satisfying the requirements of 12 U.S.C. § 1818(e) and is subject to the imposition of an order prohibiting him from future participation in the affairs of a federally insured financial institution or organization listed in 12 U.S.C. § 1818(e)(7) without prior written approval of the FDIC and such other appropriate Federal banking depository institution regulatory agency.

16. By reason of the of Respondent, Larry B. Faigin's acts, omissions, and practices with respect to the Bank's approval of four additional ADC loans, as fully described in the foregoing findings, Respondent, Larry B. Faigin engaged in or participated in unsafe or unsound practices in connection with the Bank. 12 U.S.C. § 1818(e)(1)(A)(ii).

17. By reason of the Faigin's acts, omissions, and practices with respect to the Bank's approval of four additional ADC loans, as fully described in the foregoing findings, Respondent, Larry B. Faigin breached his fiduciary duties to the Bank. 12 U.S.C. § 1818(e)(1)(A)(iii).

18. By reason of his unsafe or unsound practices and breach of fiduciary duties, Respondent, Larry B. Faigin caused risk of loss and an actual loss to the Bank. 12 U.S.C. § 1818(e)(1)(B)(i).

19. The Respondent, Larry B. Faigin's acts, omissions, and practices with respect to the Bank's approval of four additional ADC loans, as described in the foregoing findings, demonstrate his willful or continuing disregard for the safety and soundness of the Bank. 12 U.S.C. § 1818(e)(1)(C)(ii).

20. Based on the foregoing findings, Respondent, Larry B. Faigin has engaged in conduct satisfying the requirements of 12 U.S.C. § 1818(e) and is subject to the imposition of an order prohibiting him from future participation in the affairs of a federally insured financial institution or organization listed in 12 U.S.C. § 1818(e)(7) without prior written approval of the FDIC and such other appropriate Federal banking depository institution regulatory agency.

21. Based upon the foregoing findings, the Respondent, Larry B. Faigin has recklessly engaged in unsafe or unsound practices in conducting the affairs of the Bank. 12 U.S.C. § 1818(i)(2)(B)(i)(II).

22. Based upon the foregoing findings, the Respondent, Larry B. Faigin has breached his fiduciary duties to the Bank. 12 U.S.C. § 1818(i)(2)(B)(i)(III).

23. Based on the foregoing findings, the Respondent, Larry B. Faigin's breach and practices constitute a pattern of misconduct. 12 U.S.C. § 1818(i)(2)(B)(ii)(I).

24. Based on the foregoing findings, the Respondent, Larry B. Faigin's breach and practices resulted in more than minimal loss to the Bank. 12 U.S.C. § 1818(i)(2)(B)(ii)(II).

25. Based on the foregoing findings, Respondent, Larry B. Faigin has engaged in conduct satisfying the requirements of 12 U.S.C. § 1818(i)(2) and is subject to the imposition of an order assessing a civil money penalty. Upon consideration of mitigating factors, a civil

money penalty against Respondent, Larry B. Faigin in the amount of $85,000 is appropriate.

VI. Recommended Orders

Pursuant to the provisions of sections 8(e) and 8(i) of the Federal Deposit Insurance Act, 12 U.S.C. §§ 1818(e) & 1818(i), the undersigned recommends that the proposed orders attached hereto as Appendices "A" and "B" be issued (1) prohibiting Respondent, Larry B. Faigin, from future participation in the affairs of federally insured financial institutions, and (2) assessing against Respondent a civil money penalty in the amount of Eighty-Five Thousand Dollars ($85,000.00).

SO ORDERED.

Dated: August 21, 2015

/s/

C. Richard Miserendino
Administrative Law Judge

Appendix A

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D.C.

In the Matter of LARRY B. FAIGIN and JOHN J. LANNAN, individually and as former institution-affiliated parties of FIRST BANK OF BEVERLY HILLS CALABASAS, CALIFORNIA (INSURED STATE NONMEMBER BANK in receivership)	FDIC-11-269e FDIC 11-270k FDIC-11-252e FDIC-11-254k

PROPOSED ORDER OF PROHIBITION

On September 7, 2012, the Federal Deposit Insurance Corporation issued a First Amended Notice of Intention to Prohibit from Further Participation, First Amended Notice of Assessment of Civil Money Penalties, Findings of Fact, Conclusions of Law, Order to Pay, and Notice of Hearing against Respondent, Larry B. Faigin, individually and as an institution-affiliated party of First Bank of Beverly Hills, Calabasas, California (In Receivership). Respondent timely filed an answer to the Amended Notice.

A hearing on this matter was held on January 28, 2013 to March 1, 2013 in Los Angeles, California and on May 1, 2013 in Washington, D.C. to determine whether an order should issue permanently prohibiting the Respondent from further participation in the affairs of other insured depository institutions pursuant to Section 8(e) of the Federal Deposit Insurance Act ("FDIA"), 12 U.S.C. § 1818(e); and whether a civil money penalty should be assessed against the Respondent pursuant to Section 8(i)(2)(A) and (B) of the FDIA, 12 U.S.C. § 1818(i)(2)(A) and

(B). The Respondent appeared at the hearing, represented by counsel, and was given the opportunity to be heard, and evidence was taken.

Having considered the evidence presented at said hearing and the record as a whole, and the arguments of both parties, and the Recommended Decision issued by the presiding administrative law judge,

Pursuant to Section 8(e) of the FDIA, 12 U.S.C. § 1818(e):

1. Larry B. Faigin shall not participate in any manner in the conduct of the affairs of any insured depository institution, agency, or organization enumerated in Section 8(e)(7)(A) of the FDIA, 12 U.S.C. § 1818(e)(7)(A), without the prior written consent of the appropriate Federal financial institutions regulatory agency, as that term is defined in Section 8(e)(7)(D) of the FDIA, 12 U.S.C. § 1818(e)(7)(D); and

2. Larry B. Faigin shall not solicit, procure, transfer, attempt to transfer, vote or attempt to vote any proxy, consent, or authorization with respect to any voting rights in any institution described in Section 8(e)(7)(A) of the FDIA, 12 U.S.C. § 1818(e)(7)(A), without the prior written consent of the appropriate Federal financial institutions regulatory agency, as that term is defined in Section 8(e)(7)(D) of the FDIA, 12 U.S.C. § 1818(e)(7)(D); and

3. Larry B. Faigin shall not violate any voting agreement with respect to any insured depository institution, agency, or organization enumerated in Section 8(e)(7)(A) of the FDIA, 12 U.S.C. § 1818(e)(7)(A), without the prior written consent of the appropriate Federal financial institutions regulatory agency, as that term is defined in Section 8(e)(7)(D) of the FDIA, 12 U.S.C. § 1818(e)(7)(D); and

4. Larry B. Faigin shall not vote for a director, or serve or act as an institution-affiliated party, as that term is defined in Section 3(u) of the FDIA, 12 U.S.C. § 1813(u), of any insured

depository institution, agency, or organization enumerated in Section 8(e)(7)(A) of the FDIA, 12 U.S.C. § 1818(e)(7)(A), without the prior written consent of the appropriate Federal financial institutions regulatory agency, as that term is defined in Section 8(e)(7)(D) of the FDIA, 12 U.S.C. § 1818(e)(7)(D).

This ORDER will become effective thirty (30) days from the date of its issuance.

The provisions of this ORDER will remain effective and in force except in the event that, and until such time as, any provision of this ORDER shall have been modified, terminated, suspended, or set aside by the Federal Deposit Insurance Corporation.

IT IS SO ORDERED.

Dated at Washington, D.C., this ______ day of ___________________, 2015.

____
Board of Directors
Federal Deposit Insurance Corporation

Appendix B

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D.C.

In the Matter of LARRY B. FAIGIN and JOHN J. LANNAN, individually and as former institution-affiliated parties of FIRST BANK OF BEVERLY HILLS CALABASAS, CALIFORNIA (INSURED STATE NONMEMBER BANK in receivership)	FDIC-11-269e FDIC 11-270k FDIC-11-252e FDIC-11-254k

PROPOSED ORDER
ASSESSMENT OF A CIVIL MONEY PENALTY

On September 7, 2012, the Federal Deposit Insurance Corporation issued a First Amended Notice of Intention to Prohibit from Further Participation, First Amended Notice of Assessment of Civil Money Penalties, Findings of Fact, Conclusions of Law, Order to Pay, and Notice of Hearing against Respondent, Larry B. Faigin, individually and as an institution-affiliated party of First Bank of Beverly Hills, Calabasas, California (In Receivership). The Respondents timely filed an answer to the Amended Notice.

A hearing on this matter was held on January 28, 2013 to March 1, 2013 in Los Angeles, California and on May 1, 2013 in Washington, D.C. to determine whether an order should issue permanently prohibiting the Respondent from further participation in the affairs of other insured depository institutions pursuant to Section 8(e) of the Federal Deposit Insurance Act ("FDIA"), 12 U.S.C. § 1818(e); and whether a civil money penalty should be assessed against the Respondent pursuant to Section 8(i)(2)(A) and (B) of the FDIA, 12 U.S.C. § 1818(i)(2)(A) and

(B). The Respondent appeared at the hearing, represented by counsel, and was given the opportunity to be heard, and evidence was taken.

Having considered the evidence presented at said hearing and the record as a whole, and the arguments of both parties, and the Recommended Decision issued by the presiding administrative law judge,

Pursuant to Section 8(i) of the FDIA, 12 U.S.C. § 1818(i):

IT IS HEREBY ORDERED, that the Respondent, Larry B. Faigin, be assessed a civil money penalty in the amount of Eighty-Five Thousand Dollars ($85,000.00).

Remittance of the civil money penalty shall be payable to the Treasury of the United States and delivered to the Executive Secretary of the Federal Deposit Insurance Corporation, Washington, D.C.

IT IS FURTHER ORDERED that the Respondent is prohibited from seeking or accepting indemnification from any insured depository institution for the civil money penalty assessed and paid in this matter.

This ORDER will become effective thirty (30) days from the date of its issuance.

The provisions of this ORDER will remain effective and in force except in the event that, and until such time as, any provision of this ORDER shall have been modified, terminated, suspended, or set aside by the Federal Deposit Insurance Corporation.

IT IS SO ORDERED.

Dated at Washington, D.C., this ______ day of __________________, 2015.

____
Board of Directors
Federal Deposit Insurance Corporation