FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON, D.C.

In the Matter of: MICHAEL R. SAPP, Individually and as an Institution-Affiliated Party of TENNESSEE COMMERCE BANK, FRANKLIN, TENNESEE (Insured State Nonmember Bank)	DECISION AND ORDER TO PROHIBIT FROM FURTHER PARTICIPATION AND ASSESSMENT OF CIVIL MONEY PENALTY FDIC-13-477(e) FDIC-13-478(k)

I. INTRODUCTION

This matter is before the Board of Directors ("Board") of the Federal Deposit Insurance Corporation ("FDIC") following the issuance on May 14, 2019, of a Recommended Decision on Remand ("Recommended Decision" or "R.D.") by Administrative Law Judge Christopher B. McNeil ("ALJ"). The ALJ found that Respondent, Michael R. Sapp ("Respondent"), the President and Chief Executive Officer ("CEO") of Tennessee Commerce Bank ("Bank"), breached his fiduciary duties to the Bank and actively participated in the Bank's violation of federal law by engaging in multiple acts to conceal the Bank's losses on $16 million in commercial loans made to two related companies in 2006 and 2007, which were all guaranteed by the same husband and wife.

The ALJ recommended that the Respondent be subject to an order of prohibition pursuant to section 8(e) of the Federal Deposit Insurance Act ("FDI Act"), 12 U.S.C. § 1818(e), and be assessed a civil money penalty ("CMP") pursuant to section 8(i) of the FDI Act, 12 U.S.C. § 1818(i). For the following reasons, the Board affirms the Recommended Decision and issues against Respondent an Order of Prohibition and Order to Pay a CMP in the amount of $250,000.

II. PROCEDURAL HISTORY AND BACKGROUND

The FDIC initiated this action on April 11, 2014, when it issued against Respondent, individually, and as an institution-affiliated party of the Bank, a Notice of Intention to Prohibit From Further Participation, and Notice of Assessment of Civil Money Penalty, Findings of Fact and Conclusions of Law, Order to Pay, and Notice of Hearing ("Notice"). The charges in the Notice focused primarily on (a) the creation of a subsidiary shell company to house two non-performing loans that should have been charged off; (b) the extension of $16 million in credit to the shell company without any meaningful credit analysis or adequate collateral; (c) the purchase of a life insurance policy without regulatory approval that effectively wagered on the date a guarantor would die; (d) an attempt to avoid seeking regulatory approval by housing the life insurance policy in a subsidiary shell company; (e) the failure to investigate and consider the risks posed by acquiring the insurance policy and making the $16 million in loans; and (f) the failure to disclose material information to the Bank's Board or obtain approval from the Bank's Board prior to undertaking these actions. R.D. at 3; Notice ¶¶ 16-172.[1] The Notice charged that Respondent recklessly engaged in unsafe or unsound banking practices, breached his fiduciary duties, and violated 12 C.F.R. Part 362. Notice ¶¶ 173-82. The Notice also alleged that, as a result, the Bank suffered losses in excess of $4 million. *Id.* ¶¶ 183-87. The Notice further alleged that Respondent demonstrated personal dishonesty and a willful or continuing disregard for the safety or soundness of the Bank. *Id.*[2]

[1] The Board conducted an independent review of the record, including the underlying supporting evidentiary documents and transcripts. The Board cites to either the numbered pages in the R.D. or to the exhibits ("FDIC Exh." or "JT. Exh." (joint exhibits)) or transcripts ("Tr."). Respondent's Exceptions to the R.D. are cited, respectively, as "R. Exceptions" and exhibits, as "Resp. Exh."

[2] The Notice also charged Respondent with causing the filing of false Troubled Asset Relief Program ("TARP") applications and approving loans in violation of Section 23A. Notice ¶¶ 188-288. Although the record is less than clear, it appears that FDIC Enforcement Counsel presented evidence on the 23A

The FDIC sought to prohibit Respondent from further participation in the banking industry. R.D. at 3-4; Notice at 2-3. The FDIC also originally sought to impose a CMP of \$485,000 against Respondent pursuant to 12 U.S.C. § 1818(i). Notice at 45. That amount was subsequently reduced to \$250,000 at the hearing when the FDIC elected not to pursue two of the charges against Respondent. On May 30, 2014, Respondent filed a timely answer ("Answer") to the Notice denying or attempting to minimize many of the FDIC's material allegations and advancing multiple affirmative defenses.[3] R.D. at 1. For example, Respondent argued that he made reasonable efforts to inform the Bank's Board about the status of the loans and the proposed workout arrangements, that he was not completely aware of the wrongdoing of his subordinates, and that the Bank was authorized to purchase the life insurance policy under its Debt Previously Contracted ("DPC") authority.

Following extensive discovery, a six-day hearing was held in Memphis, Tennessee, between April 18 and 22, 2016, and August 1, 2016. R.D. at 2. At the hearing, the ALJ received sworn testimony from more than nine witnesses including Respondent and admitted over 200 exhibits into evidence.

On November 16, 2017, the ALJ who was originally assigned to this matter, C. Richard Miserendino, issued an 86-page Recommended Decision. In 2018, before the Board issued a final decision, the case was stayed pending the Supreme Court's decision in *Lucia v. Securities & Exchange Commission*, 138 S. Ct. 2044 (2018), which challenged the Securities and Exchange

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violation at the hearing but elected to abandon that claim post-hearing and did not present any evidence on the TARP application claim at the hearing. *See* Tr. 542-43 (statement from Enforcement Counsel on April 19, 2016 (day 2 of the hearing) indicating that 23A is still at issue in the case); FDIC's Reply Brief at 27, Nov. 22, 2016 (stating that FDIC Enforcement Counsel did not introduce proof of a 23A violation at trial and is not seeking a Prohibition or CMP based upon any 23A violation).

[3] Respondent's Answer states affirmative defenses in a numbered list (1) – (11). Citations to any of Respondent's affirmative defenses will use the same numbers.

Commission's ("SEC") reliance on ALJs who had not been appointed consistent with the Appointments Clause of the United States Constitution. After the Supreme Court held that the SEC's ALJs were "inferior officers" who required appointment under the Appointments Clause, 138 S. Ct. 2044, the FDIC Board adopted a Resolution appointing its ALJs and reassigned pending cases to newly appointed and different ALJs. *See* FDIC Resolution Seal No. 085172, Order in Pending Cases (July 19, 2018).

This case was reassigned to ALJ McNeil. *Id.* With the parties' consent, ALJ McNeil conducted a written hearing on remand and issued his Recommended Decision on May 14, 2019. Respondent filed timely exceptions on June 13, 2019. Pursuant to 12 C.F.R. § 308.40(c)(2), the Executive Secretary on June 27, 2019, transmitted the record in the case to the Board for final decision.

III. FACTS

The following discussion summarizes Respondent's misconduct as alleged in the Notice and corroborated by supporting testimonial and documentary evidence in the record.

A. General Background

Tennessee Commerce Bank, of Franklin, Tennessee, was a state-chartered financial institution whose primary financial regulator was the FDIC. It was chartered in January 2000 and failed on January 27, 2012. At the time of failure, it had assets of approximately $1.0 billion. During all relevant times, the Respondent was the President of the Bank. Jt. Stip. ¶ 7. Respondent also became CEO of the Bank on January 1, 2010. *Id.* ¶ 8. The Bank focused on commercial and industrial loans made to companies and individuals involved in the transportation industry, such as loans for the purchase of trucks and other commercial use vehicles. Notice ¶¶ 13-15.

B. Respondent's Lending Practices

1. The Wildwood Loans

In 2006 and 2007, the Bank made a series of loans to two companies that purportedly purchased manufacturing equipment and then leased the equipment to manufacturers. The two companies were Diversified Financial Resources, Inc. ("Diversified") and DDI Leasing, Inc. ("DDI"). For example, on December 15, 2006, the Bank loaned Diversified $931,423.40 to purchase a commercial grade furnace that was to be leased to Wildwood Industries ("Wildwood"). Notice ¶¶ 23, 25. The loan was secured by the furnace, a lease agreement between Diversified and Wildwood and the anticipated stream of lease payments from Wildwood to Diversified. The loans were guaranteed by Gary Wilder and Toni Wilder (collectively, the "Wilders"), husband and wife, and Wildwood's principals. All of the loans were structured in the same way and are hereafter referred to as the "Wildwood Loans." All told, the Bank made approximately $16 million in loans to Diversified and DDI guaranteed by the Wilders. The Bank then sold participation interests in several of the Wildwood Loans shortly after the loans were finalized, leaving the Bank with a total credit exposure of approximately $8.3 million.

FDIC Enforcement Counsel did not allege any wrongdoing with respect to the making of these loans. This case instead is about the Bank's attempts to avoid charging off the entire amount of the loans when it learned that the Wilders had engaged in fraud and that the purported collateral for the loans was non-existent. Respondent, as the Bank's President and CEO, substantially participated in these actions.

2. The Bank Learns of the Guarantors' Fraud and That There Is No Collateral Securing the Wildwood Loans.

By October 1, 2008, Wildwood had stopped making lease payments to DDI and Diversified. Without the stream of payments, DDI and Diversified soon stopped making payments to the Bank and the loans became past due. The Bank sent a default and demand letter to the borrowers and guarantors in January 2009 and placed the Wildwood Loans on nonaccrual status in March 2009. About the same time, Wildwood and the Wilders were forced into involuntary bankruptcy by their many creditors. By April 15, 2009, the bankruptcy trustee informed creditors of significant fraud at Wildwood, and the Bank's counsel informed the Bank it should consider itself unsecured.[4] After subtracting out participation interests, the Bank was owed approximately $8.3 million on the Wildwood Loans.

When attention turned to the Wilders as guarantors, it became evident based on their bankruptcy filings that little monetary support was anticipated, leaving the Bank significantly exposed as it had basically no source of repayment for $8.3 million in outstanding debt. At this point, the Bank charged off $3 million and increased the Allowance for Loan and Lease Losses ("ALLL") by $1.5 million in June 2009. The Bank did not, however, charge off the remainder of the debt even though no payments had been received since late 2008 and no collateral supported the loans.

3. The Bank Acquires a Life Insurance Policy on Wilder at a Bankruptcy Auction.

Early in the course of the bankruptcy it was revealed that Gary Wilder was the insured on five large life insurance policies totaling approximately $64 million and that the Trustee in the bankruptcy proceedings intended to auction off at least some of the policies. FDIC Exh. 292; Tr.

[4] Criminal proceedings revealed that the Wilders did not actually use the proceeds of the loans to purchase manufacturing equipment. They used them instead for their own personal purposes. The Wilders concealed the fraud by, among other things, obtaining false invoices from an equipment supplier, directing the preparation of false financial statements, and directing an employee to affix false serial number plates to machines already owned by the company so when creditors inspected collateral, it appeared the company had actually purchased new machinery. Their scheme involved over $100 million in fraudulently obtained loans from various entities. In 2010, the Wilders pleaded guilty to bank fraud and money laundering in federal court in Illinois. Gary Wilder was sentenced to fifteen years' incarceration and Toni Wilder received a seven-year sentence. Criminal Information, *United States v. Gary Wilder*, Case No. 1:10-cr-10065-MMM-JAG (C.D. Ill. July 14, 2010), Dkt. No. 1; FDIC Exh. 292.

737. It was also known that Wilder had cancer and that none of the Wildwood Loans were secured by the policies. *Id.*

Bank management focused the Bank's efforts on procuring one of those policies, a $24 million term life insurance policy ("Wilder Policy") that obligated the insurance company to make a $24 million payment if the policy was in effect at the time of Wilder's death. As early as May 2009, the Bank started making quarterly premium payments of $69,846.05 on the policy although the Bank did not have rights to the policy proceeds. FDIC Exh. 136 at 2; Jt. Stip. ¶ 115. Respondent approved the wired quarterly payments. Tr. 136-37, 144-45.

In the lead-up to the auction, the Bank received multiple life expectancy reports on Gary Wilder that estimated his life expectancy between 58 and 97 months and one actuarial report that said it could not provide an estimate because of the high potential for cure. *See* FDIC Exh. 178. Respondent acknowledged receiving the reports and testified that he understood Wilder's life expectancy was between 5 and 7 years. Tr. 174, 193, 217-20. These actuarial reports were never shared or discussed with the Bank's Board. Tr. 851, 853. Instead, the Bank's Board was informed that Wilder was at imminent risk of death. Tr. 853. A member of the Bank's Board testified that had the Bank's Board been presented with the actual life expectancy information, "this would have caused me to have serious doubt whether this was a proper approach" and that the information in the actuarial reports was not consistent with the information that management provided to the Bank's Board. Tr. 853, 857.

On September 26, 2009, Respondent authorized the Bank to bid approximately $2.5 million for the policy. Tr. 200; FDIC Exh. 307 at 2. Two days later, the Bank's legal counsel advised the Bank that FDIC regulations prohibited the Bank from purchasing the policy absent FDIC approval because investment in life insurance policies covering a terminally ill person not affiliated with the bank was not a permissible activity for a bank absent regulatory approval. Tr. 765-66; Jt. Stip. ¶¶ 120-21.

At no point was FDIC approval sought or received even though Bank management met with FDIC representatives on other matters seven days after the Bank received the legal opinion. Jt. Exh. 21 at 1. Instead, Bank management began formulating a plan to nominally house the policy in an entity outside the Bank but to do so in a manner so that the Bank maintained control of the policy. Resp. Exh. 26. At an October 22, 2009 meeting, the Bank's Board was informed that $3 million had been charged off, that "Mr. Wilder's life insurance policy appears to be a key part of the solution for creditors," and that the manager of Special Assets would have an update next month. FDIC Exh. 148 at 3. Respondent admitted the plan to bid on the policy was something the Bank's Board would have wanted to know about, and a Bank Board member responded "absolutely" when asked if that was something the Bank's Board would have wanted to know in advance. Tr. 213, 857-58. Respondent also admitted that it was not a prudent banking practice to wire money out of the Bank while management was still figuring out who the borrower would be on the associated loan. Tr. 215.

Respondent testified that the FDIC would have been happy with the Bank's plan to resolve the Wildwood Loans given the large number of classified assets in the 2009 examination report. Tr. 208-09. Yet Respondent did not share the Bank's plans with the FDIC even though the Bank was on the verge of being deemed a "troubled institution" by the FDIC based on a 2009 Report of Examination. Tr. 206.

On October 27, 2009, Respondent was informed by a subordinate that a "last minute bid for $3 million" had come in and that the Bank would have to raise its $2.5 million bid to secure the policy. FDIC Exh. 309. Respondent directed his subordinate to "Go win it!!" Tr. 227; FDIC Exh. 309. The Bank bid $3.5 million, which was the winning bid. After learning of the news, Respondent stated "Great Job!!!" FDIC Exh. 310. Neither the FDIC, nor the Bank's Board was informed of these developments nor was approval sought from either the FDIC or the Bank's Board.

4. The Bank Forms a Shell Company to Hold the Life Insurance Policy and House the Worthless Wildwood Loans, and It Lends the Shell Company $16.5 Million.

At or about the same time the Bank was acquiring the Wilder Policy, Respondent and his subordinates were searching for ways to transfer ownership of the policy to another entity so it would appear that the Bank was not holding the policy. They settled on a plan to house the Wilder Policy in a newly formed LLC, which the Bank named Landmark Consulting, LLC ("Landmark"). Under the plan as executed, the Bank owned 50 percent of Landmark and another individual, Bank customer James West, owned the other half and served as managing member. Jt. Exh. 51. Landmark had no other assets, no other operations, and no cash flow or financial statements. The LLC agreement prohibited a sale, assignment, or transfer of the policy without the Bank's consent. *Id.* West testified that the Wilder Policy was property of the Bank and that he was only responsible for making sure the premiums were paid. Tr. 944, 946; Jt. Exh. 57 at 7. In short, Landmark was a shell company formed to make it appear that the Bank did not own and control the Wilder Policy. Tr. 945; Jt. Stip. ¶ 124; Jt. Exhs. 55, 56, & 57 at 22. Respondent knew all of this. Tr. 238-43.

On November 13, 2009, the Bank assigned its rights to the Wilder Policy to Landmark and originated an $8 million loan to Landmark ("Landmark Loan 1"). Jt. Exhs. 58-60. Respondent approved Landmark Loan 1. FDIC Exh. 323 at 4-5. Landmark used $3.5 million of the $8 million authorized to purchase the Wilder Policy. FDIC Exhs. 182 at 60, 323 at 2-5; Jt. Exhs. 52, 53; Jt. Stip. ¶¶ 138-39; Tr. 960-63. The remainder of the loan was to be used to pay the yearly premiums on the Wilder Policy to the life insurance company and to pay interest on the loan to the Bank. Under the terms of the LLC agreement and the loan, West was paid $250,000 from the loan as compensation for serving as managing member and would be due another $250,000 upon Mr. Wilder's death. Jt. Exh. 58.

On December 23, 2009, the Bank made a second loan to Landmark of $8.5 million ("Landmark Loan 2"). Jt. Stip. ¶ 138; Jt. Exh. 60; FDIC Exh. 323. The purpose of this loan was to furnish Landmark the funds to pay the balance on the original Wildwood Loans that the Bank did not want to write off. *Id.* The remainder of the loan balance—$4.4 million—was to be used to pay interest to the Bank on the Wildwood Loans. As of the date of Landmark Loan 2, the outstanding non-charged off balance on the Wildwood Loans stood at approximately $4.1 million. Respondent also approved Landmark Loan 2. FDIC Exh. 323. Landmark Loan 2 and Landmark's take out of the Wildwood Loans were consummated just before the end of the year 2009 financial reporting deadline. *Id.* Thus, the unsecured non-performing Wildwood Loans appeared to be no longer on the Bank's books. In their place was the recently funded Landmark Loan 2, a performing loan. Respondent approved these transactions, including personally signing the Loan Request Form, the primary document in the Bank's loan approval process. FDIC Exhs. 323, 338 at 24; Tr. 238-40.

Although the Loan Request Form stated that the loans were consistent with the Loan Policy, the two Landmark Loans violated the Bank's lending policy in multiple respects. FDIC Exh. 323 at 3; Tr. 870. For example, the Bank's Loan Policy states the Bank will make loans to borrowers and/or guarantors with the financial strength and capacity to repay the loan, for which the collateral is both adequate and appropriate, and for which there are two or more sources of repayment. FDIC Exh. 338 at 10. The Loan Policy also states that the character of the borrower and/or the guarantor would be firmly established before loan approval and loan repayment would come from established cash flow. *Id.* Landmark did not have the financial strength to repay the loans nor did it have cash flow or any operations on which to base an underwriting assessment. The sole source of repayment was the Wildwood Loans, which themselves were not sound loans, and the Wilder Policy, a highly speculative proposition. Landmark's earnings, liquidity, and capitalization were non-existent, and there is no evidence that Respondent or anyone else even attempted to conduct an underwriting analysis. Instead, the Loan Request Form signed by Respondent stated that such information was "N/A." *Id.* at 323, at 3. The failure to gather financial and credit information about the borrower also violated the Loan Policy. FDIC Exh. 338 at 24.

On November 19, 2009, after Landmark Loan 1 was made but before Landmark Loan 2 was made, the Bank's Board was provided an inaccurate update on the status of the Wildwood Loans and the Bank's plans for Landmark. FDIC Exh. 182 at 60. Respondent did not deliver the presentation but was present at the meeting. Tr. 245. The Bank's Board was not informed that the Bank would have a 50 percent ownership stake in Landmark and would maintain ownership and control of the Wilder Policy. FDIC Exh. 182. The Bank's Board was told that Landmark Loan 1 would be in the amount of $6 million, not $8 million, and Landmark Loan 2 would be in the amount of $7 million, not $8.5 million. *Id.* at 60. Thus, the Bank's Board was told that the Landmark Loans together would total $13 million even though the Loans in fact would total $16.5 million—$3.5 million higher. The Bank's Board also was told that the loans to the Landmark shell company would be "fully secured" by the Wilder Policy, implying that there would be no risk of loss on the loans. FDIC Exh. 182 at 60; Tr. 865. Because Landmark was a shell company with no income, the only way it could repay the Landmark Loans was upon the death of Mr. Wilder or by reselling the Wilder Policy on a secondary market. The former possibility was highly speculative given the varying life expectancy estimates for Mr. Wilder and the fact that life insurance is usually treated as a contingent source of repayment. Tr. 504-05, 525-26. The presentation pegged Wilder's life expectancy between three and five years, even though Respondent testified that he understood Wilder's life expectancy to be between five and seven years. Tr. 174, 217-18, 220-21; FDIC Exhs. 178, 182 at 59.

Respondent also testified that the Wilder Policy could have been sold for $8 million on the secondary market. Jt. Exh. 74 at 55; Tr. 450-53, 455. Wilder made the same representation to FDIC examiners during a 2010 examination. *Id.* When FDIC examiners requested documentation of the $8 million offers or even an expression of interest from a potential buyer, no documentation could be provided, and Bank management did not explain how a policy purchased for $3.51 million in 2009 could have more than doubled in value by 2010, only one year later. Tr. 450-55. Even if Respondent's unsupported claims about the policy's value on the secondary market were correct, the Bank was still not adequately secured for the $16.5 million in credit it had extended to Landmark. Tr. 454-55, 467, 471-72.

The Bank's Board was also not informed that yearly premiums would increase from $263,570 per year to more than $4 million starting in December 2015. Tr. 223-24; FDIC Exhs. 137, 182. The following table reflects the annual premiums for the first 15 years of the policy:

Policy Year	Current Annual Life Insurance Premium	Maximum Annual Life Insurance Premium
1-10	$263,570.00	$263,570.00
11	$4,005,170.00	$4,554,290.00
12	$4,434,770.00	$5,080,370.00
13	$5,340,530.00	$5,644,850.00
14	$6,245,810.00	$6,245,810.00
15	$6,877,490.00	$6,877,490.00

FDIC Exh. 137 at 5-6. The Bank purchased the policy at the conclusion of year 4, meaning that beginning in December 2015, the premiums would have increased from $263,570 to over $4 million and would increase substantially each year thereafter. *Id.*; Tr. 449, 978-79. Respondent was present at the board meeting and was aware of the omissions and misstatements but did not correct them. Tr. 868, 872; FDIC Exh. 182 at 6. The Bank's Board approved the tentative plan for \$6 million and \$7 million loans and was not informed that a note for \$8 million had already been signed. Jt. Stip. ¶ 126; Jt. Exhs. 52, 54.

5. The Bank Sells the Life Insurance Policy at a Significant Loss and Writes Off the Remainder of the Loans to the Shell Company.

On August 2, 2010, the FDIC and the Tennessee Department of Financial Institutions ("TDFI") began a joint examination of the Bank. Jt. Exh. 74 at 3, 9. The final Report of Examination ("ROE") was highly critical of the Wildwood Loans and the Landmark transactions. Jt. Exh. 74 at 3, 9-10, 23, 25, 44-46. It concluded that the Wilder Policy was a speculative investment that required prior approval from the FDIC and that it had been made in violation of 12 C.F.R. Part 362. The ROE was sent to the Bank on March 17, 2011.

On May 24, 2011, the Bank entered into a Consent Order with the FDIC covering a variety of unsatisfactory conditions at the Bank. Among other things, the Consent Order required that all adversely classified assets—such as the Landmark Loans—be sold within 90 days. Tr. 1222, 1224, 1233; Jt. Exh. 74; Resp. Exh. 271. The Bank failed to sell the Landmark Loans within 90 days, and after belatedly asking for multiple extensions it finally sold the Wilder Policy for \$776,000 (nearly \$3 million less than it paid for it) on January 7, 2012. The \$776,000 in proceeds were applied to one of the outstanding Landmark Loans, and the remainder of the balance of both Landmark loans—approximately \$5 million—was charged off.

IV. ANALYSIS

A. A Prohibition Order is Warranted.

The Board may impose a prohibition order if a preponderance of the evidence shows 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); and that Respondent acted with personal dishonesty or a willful or continuing disregard for the safety and soundness of the Bank (culpability). 12 U.S.C. § 1818(e)(1); *Dodge v. Comptroller of Currency*, 744 F.3d 148, 152 (D.C. Cir. 2014) (citing *Proffitt v. FDIC*, 200 F.3d 855, 862 (D.C. Cir. 2000)). The Board finds that Respondent's actions during the relevant period satisfy each of these three elements and concludes that a prohibition order is warranted.

1. Misconduct

Misconduct under section 8(e) consists of (1) a violation of any law or regulation; (2) participation in any unsafe or unsound banking practice; or (3) breach of a fiduciary duty. 12 U.S.C. § 1818(e)(1)(A). Here, the evidence demonstrates Respondent violated a regulation (12 C.F.R. Part 362), participated in unsafe or unsound banking practices, and breached his fiduciary duties to the Bank.

a. Violation of Part 362

Section 24 of the FDI Act limits the activities and investments of state-chartered banks to those that are permissible for national banks, unless the FDIC has determined that the activity would pose no significant risk to the Deposit Insurance Fund and the bank is in compliance with applicable capital standards. 12 U.S.C. § 1831a(a)(1). Part 362 of the FDIC's Rules and Regulations ("Part 362"), implements Section 24. 12 C.F.R. pt. 362. Part 362 defines the phrase "activity permissible for a national bank" to include "any activity authorized for national banks under any statute including the National Bank Act, as well as activities recognized as permissible for a national bank in regulations, official circulars, bulletins, orders or written interpretations issued by the Office of the Comptroller of the Currency (OCC)." 12 C.F.R. § 362.1(a). Respondent contends that the Bank's purchase of the Wilder Policy was a permissible activity for a national bank based on previous regulatory guidance and that, even if the purchase violated Part 362, Respondent did not meaningfully participate in the Bank's decision to acquire the policy. *See* R. Exceptions ¶¶ C-F. We agree with the ALJ's conclusion that the Bank's decision to purchase the Wilder Policy was a violation of Part 362 and that Respondent participated in the violative conduct. *See* R.D. at 16-32.

(i) The Bank's Acquisition of The Wilder Policy Was Not a Permissible Activity

There are two primary regulatory documents cited by the parties that discuss a bank's ability to purchase life insurance: (1) an OCC Interpretive Letter from 1992 discussing under what circumstances a national bank may hold a term life insurance policy ("OCC Interp. Ltr. 592" or "OCC Interpretive Letter"), published June 18, 1992; and (2) a Financial Institution Letter ("FIL"), jointly issued by the federal banking agencies on December 7, 2004, titled *Bank-Owned Life Insurance, Interagency Statement on the Purchase and Risk Management of Life Insurance* (December 7, 2004), https://www.fdic.gov/news/news/financial/2004/fil12704.html ("FIL-127-2004").

Both the OCC Interpretive Letter and FIL-127-2004 clearly state that purchasing a life insurance policy for a speculative investment purpose is not a permissible banking activity. For example, FIL-127-2004, states:

> The purchase of life insurance on a borrower is not an appropriate mechanism for effecting a recovery on an obligation that has been charged off, or is expected to be charged off, for reasons other than the borrower's death. . . . In the case of a loan that the institution expects to charge off for reasons other than the borrower's

> death, the risk of loss is so pronounced that the purchase of life insurance by the institution at that time would be purely speculative and an unsafe and unsound banking practice.

FIL-127-2004, at 25-26. Similarly, the OCC Interpretive Letter states that banks are not permitted to purchase and hold life insurance as an investment and may not purchase "life insurance on a borrower whose loan has been or is expected to be charged-off." *See* OCC Interp. Ltr. 592 (citing OCC Banking Circular 249).

This should be the end of this inquiry. The Bank had already charged off half of the Wildwood Loans, and the remainder needed to be charged off as well for reasons having nothing to do with the life expectancy of the insured. The loans were effectively worthless because of the fraud committed by the Wilders, because the collateral was non-existent, and because the Bank had not received a single payment on the loans for over nine months. FDIC Exh. 176 at 3; Tr. 611, 647-49. The Bank's own head of indirect lending testified that when he learned of the fraud in April 2009, months before the Bank acquired the policy, he believed the Wildwood Loans were a total loss and should be charged-off. Tr. 733, 735. Moreover, the other banks that had purchased participations in the Wildwood Loans wrote off their participation interests in their entirety, Tr. 463-64, and the Bank's own outside counsel opined that investment in the Wilder Policy was not a permissible activity for a national bank because the Bank would be purchasing the policy for a speculative purpose. Jt. Stip. ¶¶ 120-21; R.D. at 16 (Finding of Fact ("FOF") No. 35). Outside counsel recommended that the Bank seek FDIC approval prior to making the purchase, which the regulations allow for, but the Bank declined to do so.

Instead of charging off the Wildwood Loans or seeking FDIC approval for the purchase, Bank management decided to house the Wilder Policy in Landmark. Resp. Exh. 26; FDIC Exh. 178. This was an effort to circumvent the clear bar on the Bank acquiring the policy. *Id.* Bank management's efforts to house the policy outside the Bank further evidence that Bank management knew the acquisition was impermissible for a bank.[5]

Structuring the transaction so that Landmark was the nominal owner of the policy does not render the acquisition permissible. A "subsidiary" of a bank cannot engage in any activity that would be impermissible for a bank; otherwise any bank that wanted to engage in an impermissible activity could simply form a subsidiary and conduct the activity through that subsidiary. 12 C.F.R. § 362.1(a). Any company "controlled" by a bank is a "subsidiary" for purposes of Part 362 and "control" is defined as the "ability to control . . . management and policies of a company." 12 C.F.R. § 362.2(e), (r). The evidence establishes that Landmark was under the Bank's full control. Tr. 945; Jt. Exh. 57. The LLC agreement prohibited Landmark from taking any action without the approval of the Bank, including selling or transferring rights in the policy. Jt. Exh. 57 at 7. The managing member installed to run Landmark testified that the Bank maintained ownership of the Wilder Policy while housing it in Landmark and that all of the appraisals and meaningful activity with respect to the purchase and sale of the Wilder Policy were conducted by the Bank. Tr. 238, 944-46.

(ii) Acquisition of The Wilder Policy Was Not a Proper Exercise of The Bank's DPC Authority

Respondent also argues that his actions were lawful because the Bank acquired the life insurance policy in connection with a debt previously contracted ("DPC"). R. Exceptions ¶¶ A, E, F. The purpose of DPC authority is to enable a bank to acquire assets that the bank otherwise would be prohibited from holding so that it can negotiate workouts or compromises of debts previously contracted. OCC Interp. Ltr. 592 at 2. FDIC examiners explained that DPC assets are generally assets a bank obtains through foreclosure on a bad loan. Tr. 1098-1101. FDIC

[5] As discussed below, Respondent was fully involved in all aspects of the Landmark transactions.

regulations state that Part 362 does not apply to "equity investments acquired in connection with [DPC] if the insured State bank does not hold the property for speculation and takes only such actions as would be permissible for a national bank's DPC." 12 C.F.R. § 362.1(b)(3). An FDIC regulated bank must obtain the FDIC's written consent prior to making any DPC equity investments that are speculative or have not been deemed permissible for national banks. 12 C.F.R. §§ 362.3(b)(2), 362.4(b)(1). In authorizing DPC transactions under appropriate and limited circumstances, Part 362 emphasizes that the FDIC's intent is to allow "insured state banks and their subsidiaries to undertake only safe and sound activities and investments that do not present significant risks to the Deposit Insurance Fund and that are consistent with the purposes of Federal deposit insurance and other applicable law." 12 C.F.R. § 362.3(d).

A bank's authority to engage in otherwise impermissible activities through DPC transactions is not without important limitations. First, although "[n]ational banks may make additional investments in a DPC asset after notification to the OCC, they may not make speculative investments in DPC assets." OCC Interp. Ltr. 592; FIL-127-2004, at 2-3 (banks may not purchase life insurance for speculation or hold life insurance in excess of their risk of loss or cost to be recovered); *see also Case 2: Appeal of Decision on Holding Insurance Policies*, 14 OCC Q.J. 25 (OCC 1995) ("The purchase of life insurance on a borrower is not an appropriate mechanism for effecting a recovery on obligations that have been (or are expected to be) charged off."). Second, the transaction must involve a compromise of the debt at issue. *See* OCC Interp. Ltr. 502 at 3 (a DPC transaction must involve some "significant concession to the borrower . . . such that the bank's acquisition of the property operates as a total or partial satisfaction of the borrower's contractual obligation."). Third, such transactions "must be compromises in good faith, and not mere cloaks or devices to cover unauthorized practices." *First Nat'l Bank of Charlotte v. Nat'l Exch. Bank of Baltimore*, 92 U.S. 122, 128 (1875).

None of these elements are present in the purchase of the Wilder Policy. As discussed previously, the purchase was speculative and the Bank unwittingly invested hundreds of thousands of dollars of its own funds in maintaining the policy through both the bidding process and the payment of premiums. The amount of the policy—$24 million—far exceeded the total amount of the loans—$16 million. Nor was there a compromise. The Bank purchased the Wilder Policy at an auction by wiring $3.5 million of its own money, it did so because it believed it would be a profitable investment, and it attempted to hold that investment for as long as it could. *Accord* OCC Interp. Ltr. 592 (valid DPC transaction where bank acquired assignment of life insurance policy as workout agreement where policy was exchanged for a full release of the borrower's obligation); FIL-127-2004 (bank acquires life insurance policy by DPC by exercising security interest, not by prevailing at an auction); OCC Interp. Ltr. 502 at 4 (transaction where a bank exchanged debt for stock was not a DPC transaction because the debt was not reduced or otherwise satisfied). Respondent's attempt to now cast the transaction as an exercise of the Bank's DPC authority is a cloak to cover the fact that the purchase was impermissible, as the Bank had been told prior to making the purchase.

Even assuming, *arguendo*, that the Wilder Policy had been acquired through a valid DPC transaction, the Bank still could not hold the asset for speculative purposes. *See* 12 C.F.R. § 362.1(b)(3). FIL-127-2004 states:

> Institutions may acquire ownership of life insurance policies for debts previously contracted (DPC) by invoking their security interest in a policy after a borrower defaults. Consistent with safety and soundness, institutions should use their best efforts to surrender or otherwise dispose of permanent life insurance acquired for DPC at the earliest reasonable opportunity. In the case of temporary insurance acquired for DPC, retention until the next renewal date or the next premium date, whichever comes first, will be considered reasonable.

FIL-127-2004, at 26. "The OCC has generally directed national banks to surrender or divest permanent life insurance acquired for DPC within 90 days of obtaining control of the policy."

Id. at n.15.[6] Premiums on the Wilder Policy were due quarterly thus rendering the issue of whether the policy was "temporary" versus "permanent" irrelevant, but even if there were a difference, the Bank had no intention of selling the policy within 90 days or the next quarterly premium date. The Bank waited more than a year after acquisition before it directed Landmark's manager to look for buyers, and Respondent testified that the Bank went back and forth between a plan to hold the policy or sell it depending on which avenue would be most profitable, regardless of regulatory requirements.[7] Ultimately, the Bank held the policy until 2012, three years after the purchase, and only sold it because it was ordered to do so by the FDIC. FDIC Exh. 178.

Respondent contends that the Bank's acquisition of the Wilder Policy without FDIC approval was permissible under the Sixth Circuit's decision in *Atherton v. Anderson*, 86 F.2d 518 (6th Cir. 1936), *vacated*, 302 U.S. 643 (1937). R. Exceptions ¶ G.[8] In *Atherton*, the bank had acquired a manufacturing establishment to minimize bank debt in a transaction that had not been criticized by examiners, and "there was no expectation that the bank would have to supply new money in substantial amounts to carry on the business for the purpose of preserving going-concern value." 86 F.2d at 526. The court determined that there was no evidence "that substantial future outlays were contemplated . . . no obvious uncertainty of salability, and no purpose of operating the business for an indefinite period." *Id.* at 527-28. Thus, the court held

[6] Similarly, if an asset acquired through foreclosure is speculative, the bank is required to divest it. OCC Interp. Ltr. 592 at 2. Although the Wilder Policy was not acquired through foreclosure, the OCC Interpretive Letter further illustrates the consistency of regulatory guidance against acquiring and holding speculative assets.

[7] The Wilder Policy provided for a $24 million payout upon the death of the insured, more than enough to cover the approximately $16 million in exposure for the Bank and the participant banks. Respondent does not attempt to explain why, if he did not believe the Bank was engaged in a speculative undertaking, the Bank wrote off over $4 million on the Wildwood Loans, approximately half of its exposure.

[8] As noted previously, the Sixth Circuit's decision was vacated by the Supreme Court on other grounds. *See Atherton v. Anderson*, 302 U.S. 643 (1937).

that the bank was justified in spending additional funds on a DPC asset where the expenses were directly tied to improving the likelihood of recovering on the existing loan. *Id.*

Atherton had nothing to do with the purchase of a life insurance policy for speculative investment purposes in a long-shot effort to attempt to bail out bad loans. In any event, as discussed previously, there is ample regulatory guidance on this issue. There was no going concern to maintain and no prospect of recovery on the Wildwood Loans due to the fraud and non-existent collateral. The purchase of the Wilder Policy at the bankruptcy auction was a speculative investment Respondent hoped would generate a windfall for the Bank that he could then apply to offset the inevitable loss from the Wildwood Loans. The premiums constitute "new money in substantial amount to" keep the policy intact and there is voluminous evidence that future outlays were always contemplated (the individual's life expectancy was between 5 and 7 years) and would be necessary over a prolonged period of time. No subsequent opinion has read *Atherton* to permit banks to acquire life insurance policies on borrowers whenever, in their subjective opinion, they believe it might prop up an uncreditworthy borrower. No subsequent opinion has read *Atherton* to absolve banks of their legal responsibility to obtain FDIC approval prior to engaging in an activity that has not been deemed permissible under banking statutes and regulations. *Atherton* is clearly inapposite.

(iii) Respondent Participated in The Violation of Law

Respondent also argues that, even if there was a violation of Part 362, he did not play a large enough role in the transaction to warrant prohibition. R. Exceptions at 8. A "violation" is "any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding and abetting a violation." 12 U.S.C. § 1813(v); *see also Fitzpatrick v. FDIC*, 765 F.2d 569, 576-77 (6th Cir. 1985) (affirming CMP because Respondent participated in the violation). "This extremely broad definition clearly includes any action, intentional or inadvertent, by which [an Institution Affiliated Party ("IAP")] 'participates in' the bank's violation of the FDIA." *Lowe v. FDIC*, 958 F.2d 1526, 1535 (11th Cir. 1992) (citation omitted).

Respondent was the Bank's President during the time in question, was fully aware of the plan to circumvent the Bank's own legal opinion and Part 362, received regular updates and actively participated in all phases of the Bank's purchase of the Wilder Policy and the creation of the shell company. Tr. 95, 117-18, 200; FDIC Exh. 296 at 1-2; Resp. Exh. 26. Respondent admitted that he discussed with his subordinates how much the Bank should bid and could have stopped the Bank from bidding on the Wilder Policy, but he instead instructed his subordinate to "Go win it!!" FDIC Exh. 309; Tr. 228. These acts easily qualify as "participation" in the violation, and Respondent cannot escape liability by pointing the finger at his subordinate, even if the subordinate or subordinates in following the instructions of their superior (Respondent) contributed to the losses and also engaged in the violative conduct. *See Landry v. FDIC*, 204 F.3d 1125, 1139 (D.C. Cir. 2000); *Matter of Adams*, FDIC-93-91e, 1997 WL 805273, at *5 (Nov. 12, 1997) (stating that "multiple factors, and individuals may contribute to a bank's losses," but a respondent cannot escape liability because others have contributed to the losses as well).

b. Unsafe and Unsound Conduct

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. Office of Thrift Supervision*, 37 F.3d 911, 932 (3d Cir. 1994) ("imprudent act" posing an "abnormal risk of [financial] loss or damage to an institution, its shareholders, or the agencies administering the insurance funds" is an unsafe and unsound practice (citation omitted)). Because of their inherent danger, breaches of fiduciary duty also constitute unsafe and unsound practices. *See Hoffman v. FDIC*, 912 F.2d 1172, 1174 (9th Cir. 1990).

As described in detail previously and in the Recommended Decision, Respondent approved and actively participated in the Bank's decision to extend the Landmark Loans totaling \$16.5 million to an uncreditworthy borrower. *See* R.D. at 34-37, 68-70. Landmark was a shell company with no cash flow, no income, no operating history, and no financial statements. *Id.*; Jt. Exh. 74; FDIC Exh. 338; Tr. 475-77. These were unsafe and unsound practices. *See Landry*, 204 F.3d at 1138 (a large loan to a borrower who was not creditworthy is an unsafe or unsound practice).[9] The Bank did not obtain borrower documentation, adequate collateral, or guarantees before extending the loans and failed to perform any credit analysis on the shell company to which it was lending \$16.5 million. Tr. 200, 228, 237-38, 240-42; FDIC Exhs. 282, 323.[10] These also are unsafe and unsound practices. *See Hamilton Bank, N.A. v. OCC*, 227 F. Supp. 2d 1, 5-11 (D.D.C. 2001) (finding extension of new loans to pay off past due loans, failure to obtain borrower documentation, failure to obtain collateral or guarantees, and failure to perform credit analysis constitute unsafe or unsound practices); *Matter of Stephens Security Bank*, FDIC-89-234b, 1991 WL 789326 (Aug. 9, 1991). Relatedly, Respondent's approval of loans without determining the borrower's ability to repay constitutes an unsafe and unsound practice. *Matter of Grubb*, FDIC-88-282k & 89-111e, 1992 WL 813163, at *29 (Aug. 25, 1992); *see also First State Bank of Wayne Cty. v. FDIC*, 770 F.2d 81, 82 (6th Cir. 1985) ("extending unsecured credit

[9] As previously noted, the late December 2009 Landmark 2 loan had the practical (and likely intended) effect of removing the non-performing Wildwood Loans from the Bank's books and replacing them with superficially performing loans shortly before year-end 2009 financial reporting deadlines.

[10] The collateral for the Landmark Loans was the Wilder Policy and the Wildwood Loans. The Wildwood Loans were effectively worthless. According to Respondent's rosiest estimates, the Wilder Policy had a market value of \$8 million. Jt. Exh. 74 at 55; Tr. 450-53, 455. Thus, the loans were undercollateralized by at least \$8.5 million.

without first obtaining adequate financial information" and "extending secured credit without obtaining complete supporting documentation" constitutes unsafe and unsound practice); *Gulf Fed. Sav. & Loan Ass'n v. FHLBB*, 651 F.2d 259, 264 (5th Cir. 1981) (legislative history of section 1818(e) indicates that "disregarding a borrower's ability to repay" is an unsafe and unsound practice); *Matter of Clark, Sr.*, FDIC-89-199e, 1991 WL 757819, at *4 (Jan. 29, 1991) (failure to follow "standard underwriting practices regarding the determination of a borrower's ability to pay" constituted unsafe and unsound practice); *Matter of *** Bank of *** Cty.*, FDIC-83-132b, 1984 WL 273927 (June 18, 1984) (unsecured loans without adequate financial information on obligors and secured loans without complete supporting documentation is an unsafe and unsound practice).

c. Breach of Fiduciary Duty

As President and CEO, Respondent owed a duty of care, a duty of loyalty, and a duty of candor to the Bank. *See Seidman*, 37 F.3d at 933. At its most basic, these duties include an obligation to act in good faith and in the best interests of the Bank. *Matter of ****, FDIC-85-356e, 1988 WL 583064, at *9 (Mar. 1, 1988). As President and CEO, Respondent was also required to adequately supervise his subordinates. *Id.* "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." *Matter of ****, 1988 WL 583064, at *9; *Matter of Baker*, FDIC-92-86e, 1993 WL 853599 (July 27, 1993). The duty of candor requires a corporate fiduciary to disclose "everything he knew relating to the transaction," even "if not asked." *De La Fuente II v. FDIC*, 332 F.3d 1208, 1222 (9th Cir. 2003) (fiduciary duty breached by failure to disclose relevant information to bank's board of directors when it was considering a loan even though the bank's board did not ask); *Michael*, 687 F.3d at 350; *Seidman*, 37 F.3d at 935 n.34.

The record in this case establishes that during the relevant period, Respondent engaged in multiple breaches of his duties of care and candor by failing to ensure that the loans made to the Landmark shell company complied with the law and by failing to ensure the employees who worked directly for him were not engaged in unsafe and unsound practices. Respondent breached his duty of candor by failing to provide the Bank's Board with accurate and timely information about how the Bank was handling the Wildwood loans once the fraud became known. For example, in November 2009 the Bank's Board was presented with the proposal to purchase the Wilder Policy. FDIC Exh. 182. But the Bank's Board was not informed that the Bank had already wired the funds out of the Bank, that the Bank had received estimates that Wilder's life expectancy was between five and seven years, or that the premium payments on the policy would escalate from $263,750 per year to over $4 million per year in five years. *Id.* The Bank's Board was also not informed that one of the Landmark loans had already been executed or that the Bank itself would own 50 percent of the LLC. *Id.* At no point prior to the making of the Wildwood Loans did Respondent inform the Bank's Board that the Bank had increased the amount of the Landmark Loans—and thus the Bank's exposure—to a total of $16.5 million or $3.5 million more than the $13 million total presented to the Bank's Board at its November 2009 meeting. Jt. Exhs. 52, 54; Jt. Stip. ¶ 136. The $3.5 million difference was material. Tr. 284-85, 510, 872.[11] Respondent approved the Landmark Loans in violation of the Bank's Loan Policy. These are all violations of Respondent's duty of care and candor. *See Matter of Massey*, FDIC-91-211e, 1993 WL 853749, at *5 (May 24, 1993) (concealment of information from bank's loan committee constituted breach of fiduciary duty).

[11] Respondent never asked the Bank's Board to ratify the larger loan amounts.

Respondent was President of the Bank during this time. Respondent was present at the Bank's Board meeting and knew all of these facts were omitted from the presentation and admitted that the omitted facts were important. Tr. 281-82. Respondent failed to disclose these facts to the Bank's Board. Respondent's lack of candor with respect to the shell company and the Wilder Policy as well as his failure to supervise his subordinates constitute breaches of his fiduciary duties of candor and care to the Bank. *See, e.g., Matter of* ***, 1988 WL 583064, at *9.

Respondent argues that the Board should find no breach of fiduciary duty because he personally did not make the presentation to the Bank's Board in November 2009 and did not know that it was incorrect. R. Exceptions ¶ H. Respondent also argues that he personally did not arrange for the purchase of the Wilder Policy and did not supervise Crocker. *Id.* ¶¶ K, M, Q. But as noted previously, Respondent was present at the Bank's Board meeting and had knowledge that inaccurate, incomplete, and misleading information was being submitted to the Board. As President, Respondent held the greatest authority at and utmost responsibility to the Bank, and the duty of candor requires a corporate fiduciary to disclose "everything he knew relating to the transaction," even "if not asked." *De La Fuente II*, 332 F.3d at 1222. Although Respondent might not have had direct personal responsibility for the purchase of the Wilder Policy, he did directly supervise Crocker, R.D. at 9-11, 76; Tr. 96, approved the purchase of and the bidding on the Wilder Policy, and instructed his subordinates to "Go win it." Tr. 227.

2. Effects

To show that misconduct had the required "effect" to impose a prohibition order, the evidence must establish that (1) the bank "has suffered or will probably suffer financial loss or other damage;" (2) the interests of the bank's depositors "have been or could be prejudiced;" or (3) the respondent "received financial gain or other benefit" from his misconduct. 12 U.S.C.

§ 1818(e)(1)(B)(i)-(iii). An actual loss is not required; a potential loss is sufficient so long as the risk of loss to the Bank was "reasonably foreseeable" to someone in Respondent's position. *Pharaon v. Bd. of Governors*, 135 F.3d 148, 157 (D.C. Cir. 1998); *De La Fuente II*, 332 F.3d at 1225; *Kaplan v. Office of Thrift Supervision*, 104 F.3d 417, 421 (D.C. Cir. 1997). There may be more than one cause of harm to a bank; an individual respondent need not be the proximate cause of the harm to be held liable under section 8(e). *Landry*, 204 F.3d at 1139 (explaining that the fact that other IAPs may have been "more guilty" does not absolve respondent from responsibility for his actions); *Matter of Adams*, 1997 WL 805273, at *5 (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).

The Board finds that the record establishes that the Bank suffered financial loss and that Respondent's misconduct could have prejudiced the interests of the Bank's depositors. Respondent did not lodge any exceptions to the effects findings and it is uncontested that the Bank lost at least $4 million on the Landmark Loans. Jt. Stip. ¶ 146; R.D. at 69 (FOF 58). Those loans are critical elements of Respondent's misconduct as they were made in violation of the law and in breach of his fiduciary duties to the Bank and were unsafe and unsound.

3. Culpability

Culpability, for purposes of section 1818(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). "Willful disregard" is "deliberate conduct that exposes 'the bank to abnormal risk of loss or harm contrary to prudent banking practices.'" *Michael*, 687 F.3d at 352 (quoting *De La Fuente II*, 332 F.3d at 1223). "Continuing disregard" is "conduct that has been 'voluntarily engaged in over a period of time with heedless indifference to the prospective consequences.'" *Id.* at 353 (quoting *Grubb v. FDIC*, 34 F.3d 956, 962 (10th Cir. 1994)).

"Although inadvertence alone is not sufficient to establish culpability, recklessness suffices." *Id.* (citation omitted). An IAP "cannot claim ignorance by turning a blind eye to obvious violations of his statutory and fiduciary duties." *Id.* at 352.

The Board finds that Respondent's behavior exhibited willful and continuing disregard. During the relevant period of time, Respondent was fully aware of and involved in the plan to avoid recognizing the full amount of the Bank's losses on the Wildwood Loans. Respondent received numerous pieces of correspondence and participated in meetings pertaining to the decision to bid on the Wilder Policy, the formation of the shell company, the Bank's *de facto* management and control of the shell company, and the Bank's decision to extend $16.5 million of unsecured credit to the shell company. Respondent was aware of the legal opinion from the Bank's counsel explaining that regulatory consent was required and was heavily involved in the decision not to seek prior approval from the FDIC and to instead seek to house the Wilder Policy in a shell company. Respondent also failed to fully inform the Bank's Board about the nature of the plan to acquire and hold the Wilder Policy and approved the Landmark Loans although the loans violated the Bank's Loan Policy. Respondent's position at the company combined with his actions over a multi-month timeframe constitute continuing and willful disregard.

B. The CMP Assessment is Appropriate.

The ALJ recommended a second tier CMP of $250,000,[12] and the Board concludes that the evidence in the record supports a CMP in that amount. Respondent has not taken exception to the amount of the CMP, arguing only that there is no legal basis for a CMP order for the same reasons that there is no legal basis for a prohibition order. The Board rejects that argument for the reasons set forth previously.

[12] *See* R.D. at 43-49.

A second tier CMP may be imposed against a party who (1) commits any violation of law, regulation, or certain orders or written conditions imposed by regulators; (2) recklessly engages in an unsafe or unsound practice in conducting the affairs of the institution; or (3) breaches any fiduciary duty, and whose "violation, practice, or breach . . . is part of a pattern of misconduct; causes or is likely to cause more than a minimal loss" to the institution; or "results in pecuniary gain or other benefit" to the party. 12 U.S.C. § 1818(i)(2)(B). The FDI Act authorizes up to $25,000 for each day the violation, practice, or breach continues, subject to adjustments for inflation. 12 U.S.C. § 1818(i)(2)(B); 12 C.F.R. § 509.103.

The Board has already discussed Respondent's breaches of fiduciary duty, unsafe or unsound banking practices, and violations of Part 362 as well as the effects of those acts. Respondent is subject to a second tier CMP as a result of his breaches of fiduciary duty and violations of Part 362. Although Respondent's breaches of fiduciary duty and violations of Part 362 standing alone would be sufficient to support the recommended CMP, the Board also finds that Respondent's unsafe and unsound practices were committed recklessly, providing an additional basis to support a second tier CMP.

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. Office of Thrift Supervision*, 29 F.3d 1418, 1425 (9th Cir. 1994) (similar definition of "reckless[ness]"). Conduct that demonstrates willful or continuing disregard under section 8(e) has been held to demonstrate recklessness. *Dodge*, 744 F.3d at 162. As discussed previously, the Board finds that Respondent's conduct satisfies this standard.

Because Respondent's misconduct persisted throughout the relevant period, the $250,000 penalty recommended by the ALJ is well within the authorized limit. The Board agrees with the ALJ's analysis of the statutory mitigating factors in 12 U.S.C. § 1818(i)(2)(G), which include:

(1) the gravity of the violation, (2) history of previous violations, and (3) the Respondent's financial resources and lack of good faith. R.D. at 45-49. The gravity of the violations and Respondent's financial resources support a significant CMP, and the record does not support a finding that Respondent acted in good faith. The Board therefore adopts the ALJ's recommendation of a $250,000 CMP.

C. Respondent's Remaining Exceptions

Respondent has challenged virtually every aspect of the ALJ's findings of fact and legal conclusions. The Board has addressed many of Respondent's exceptions in the relevant sections above and concludes that they lack merit or have no impact on the Board's decision. The Board is also unpersuaded, as discussed following, by Respondent's challenges to the adequacy of the process and the ALJ's authority. Any exceptions not addressed here or previously are denied.

1. The FDIC's Appointment of the Current ALJ Was Proper Under the Appointments Clause.

Respondent argues that the reassignment of his case from ALJ Miserendino to ALJ McNeil was unconstitutional. Specifically, he argues that the FDIC is not a "department" as that term is used in the Appointments Clause. This argument lacks merit.

This case was reassigned to ALJ McNeil pursuant to a July 2018 Board resolution and Order in Pending Cases, which was adopted following the Supreme Court's decision in *Lucia v. Securities & Exchange Commission*, 138 S. Ct. 2044 (2018). In that case, the Court held that ALJs at the SEC were "Officers of the United States" under the Appointments Clause of the United States Constitution. *See* U.S. Const. art. II, §2, cl. 2; 138 S. Ct. at 2055. Because the SEC ALJ in the case had been appointed by SEC staff instead of the head of the agency, the Supreme Court held that the appointment violated the Appointments Clause. 138 S. Ct. at 2053-54. The Court held that the appropriate remedy was to require a new hearing before either the full five-member body of the SEC or a constitutionally appointed ALJ other than the ALJ who had presided over the enforcement proceeding. *Id.* at 2055.

Although *Lucia* did not address directly the status of FDIC ALJs, the FDIC Board decided to afford the same relief prescribed by the Court in the SEC case at issue in *Lucia.* The FDIC Board formally appointed ALJ McNeil, and the July 2018 resolution reassigned this case to him. On October 31, 2018, ALJ McNeil informed the parties that he intended to conduct a written hearing on remand unless either party requested a new oral hearing not later than November 30, 2018. Neither party requested a new oral hearing, and on December 3, 2018, the ALJ issued an order setting a written hearing. On January 15, 2019, Respondent submitted a Supplemental Post-Hearing Brief in which he challenged the constitutionality of the reassignment. On May 14, 2019, ALJ McNeil issued his Recommended Decision on Remand, which, among other things, opined that Respondent could have challenged the reassignment when he filed his answer or when the parties were presented with the notice of reassignment. R.D. at 40. The ALJ then determined that the FDIC Board is the Head of a Department under *Free Enterprise Fund v. Public Company Accounting Oversight Board*, 561 U.S. 477 (2010) and that the reassignment and order to conduct a reassignment review were appropriate. R.D. at 40-42.

We agree with the ALJ that the Reassignment was constitutional and the FDIC Board is the head of a Department.[13] In *Lucia*, the Supreme Court remanded the enforcement proceeding

[13] Respondent did not waive the right to challenge the reassignment by not raising it in his Answer. Although Respondent could have, and did, challenge the constitutionality of the original ALJ's appointment at the time of the Answer, it was not possible for him to challenge the reassignment given that the Answer was filed four years before the case was reassigned. Had Respondent's challenge been based on something other than the FDIC's response to *Lucia*, it would be appropriate to ask whether the Respondent had raised the issue in a timely manner. The Board, however, reads the constitutional challenge presented by Respondent as being focused on the FDIC's response to *Lucia* and, specifically,

to the agency with instructions to reassign the matter to an ALJ directly appointed by the SEC itself—a constitutionally appointed ALJ—and that the ALJ not be the same ALJ who presided over the original proceeding. *Lucia*, 138 S. Ct. at 2055. That is precisely what the FDIC did here. The FDIC Board directly appointed ALJ McNeil and reassigned this matter to him (as noted earlier, a different ALJ had presided over the original hearing). ALJ McNeil then afforded the parties ample time to request a rehearing, which neither party did, and then proceeded to decide the case on the papers. Regardless of whether or not the *Lucia* decision applies to FDIC-appointed ALJs, the FDIC's actions following *Lucia* are entirely consistent with that opinion.

Moreover, the ALJ was appointed by a vote of the FDIC Board, the governing body of the FDIC. The FDIC Board possesses the authority to appoint its ALJs, and the FDIC is not subordinate to or contained within any other component of the Executive Branch. 12 U.S.C. § 1812(a) ("The management of the [FDIC] shall be vested in a Board of Directors . . . ."); 12 U.S.C. § 1819 (prescribing corporate powers, including the power to appoint officers); 5 U.S.C. § 3105 (permitting agencies to appoint their own ALJs). Thus, the FDIC is a "Department" for purposes of the Appointments Clause. *See Free Enter. Fund*, 561 U.S. at 510-11 (a component of the Executive Branch that is "not subordinate to or contained within any other such component . . . constitutes a 'Departmen[t]' for the purposes of the Appointments Clause"); 5 U.S.C. § 105 (an "Executive Agency" under Title 5 includes a Government corporation and an independent establishment, such as the FDIC).

on the FDIC's Order in Pending Cases and the Notice of Reassignment. See R. Exceptions at 12; R. Supplement Post-Hearing Brief at 4-10, Jan. 15, 2019.

2. The Dual for Cause Limitation With Respect to the Current ALJ Does Not Violate the Separation of Powers Doctrine.

Respondent also argues that "the dual cause removal of the ALJ" is unconstitutional. R. Exceptions ¶ T. We disagree.

The issue largely hinges on the interpretation of the Supreme Court's decision in *Free Enterprise Fund*. In *Free Enterprise*, the Supreme Court held that the dual limitation on the President's ability to remove inferior officers that served on the Public Company Accounting Oversight Board ("PCAOB") "subvert[ed] the President's ability to ensure that the laws are faithfully executed." 561 U.S. at 498. A "double removal restriction" existed because PCAOB board members were appointed by the SEC and could only be removed by the SEC "for cause." In turn, SEC members are appointed by the President and can also only be removed "for cause." *Id.* at 486-87. This two-level protection from "at-will" removal was what the Supreme Court held violated the Constitution's separation of powers doctrine because it overly diluted the vesting of executive power within the President. *Id.* at 484, 498.

In deciding *Free Enterprise*, the Supreme Court's majority opinion specifically exempted ALJs from the scope of its holding, stating that the "holding also does not address that subset of independent agency employees who serve as administrative law judges." *Id.* at 507 n.10. The rationale for that distinction is because ALJs perform "adjudicative" not enforcement or policymaking functions like PCAOB board members do. *Id.* Thus, *Free Enterprise* does not support Respondent's arguments that the for cause removal of ALJs performing adjudicative functions for the FDIC violates the separation of powers doctrine.

3. Respondent's Assignment of Blame to Subordinates

Respondent also argues that several of his subordinates were as culpable, if not more so, than he. R. Exceptions ¶¶ L, M, N, O. The actions of his subordinates do not exculpate

Respondent from responsibility for his own actions and his role. *Landry*, 204 F.3d at 1139 (explaining that the fact that other IAPs may have been "more guilty" does not absolve respondent from responsibility for his actions); *Matter of Adams*, 1997 WL 805273, at *5 (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).

4. Respondent's Assignment of Blame to Regulators

Respondent argues that the FDIC's Consent Order was the reason the Bank could sell the policy for only $770,000 rather than $8 million. R. Post-Hearing Brief at 18, Oct. 24, 2016; R. Proposed FOF and Conclusions of Law at 21-22, Oct. 24, 2016. Respondent's attempt to blame the FDIC fails on several levels. Respondent authorized both the bidding on the policy as well as the Bank's entire effort to obtain control of the policy, which violated Part 362. One does not get to violate the law, and then escape the consequences of his unlawful conduct by arguing that regulators were at fault for ordering the Bank to divest itself of the unlawfully obtained property. Unsurprisingly, Respondent cites no law in support of such an argument. Also, public guidance specifies that the Bank had to sell or divest life insurance policies within 90 days or the next premium date. The Bank should have been aware of this requirement at the time it acquired the Wilder Policy in the first place. The market also was aware of this requirement. The Consent Order merely echoed the regulatory guidance and, therefore, would not have altered the market's expectations regarding the timing with which the Bank was looking to divest itself of the policy.

V. CONCLUSION

After a thorough review of the record in this proceeding, and for the reasons set forth previously, the Board finds that an Order of Prohibition and Assessment of a CMP is warranted against Respondent. The record demonstrates that Respondent put the Bank at risk by engaging in deliberately reckless lending behavior in an effort to avoid recognizing losses on already bad assets. The record further demonstrates that Respondent actively participated in concealing the Bank's activities from the FDIC and the Bank's Board at a time when the Bank was experiencing financial difficulty. In light of Respondent's transgressions and violations of law and breaches of his fiduciary duties, the Board is persuaded that Respondent should be barred from the banking industry. In addition, and also in light of the record, the Board finds that the CMP imposed is appropriate and consistent with the statute's purpose.

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 Michael R. Sapp in the amount of $250,000 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 this ORDER will remain effective and in force except to the extent that, and until such time as, any provision of this ORDER shall have been modified, terminated, suspended, or set aside by the FDIC.

IT IS FURTHER ORDERED that copies of this Decision and Order shall be served on Respondent Michael R. Sapp, FDIC Enforcement Counsel, the Administrative Law Judge, and the Tennessee Department of Financial Institutions.

ORDER TO PROHIBIT

The Board of Directors ("Board") of the Federal Deposit Insurance Corporation ("FDIC"), having considered the entire record of this proceeding and finding that Respondent Michael R. Sapp, formerly the Chief Executive Officer and President of Tennessee Commerce Bank ("Bank"), Franklin, Tennessee, engaged in violations of federal law, unsafe or unsound banking practices, and breaches of his fiduciary duties resulting in loss to the Bank, and that his actions involved willful and continuing disregard for the safety and soundness of the Bank, hereby ORDERS and DECREES that:

1. Michael R. Sapp shall not participate in any manner in any conduct of the affairs of any insured depository institution, or any other institution, credit union, bank or agency enumerated in section 8(e)(7)(A) of the Federal Deposit Insurance Act ("FDI Act"), 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 FDI Act, 12 U.S.C. § 1818(e)(7)(D).

2. Michael R. Sapp 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 insured depository institution, or any other institution, credit union, bank or agency enumerated in section 8(e)(7)(A) of the FDI Act, 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 FDI Act, 12 U.S.C. § 1818(e)(7)(D).

3. Michael R. Sapp shall adhere to all voting agreements with respect to any insured depository institution, or any other institution, credit union, bank or agency enumerated in section 8(e)(7)(A) of the FDI Act, 12 U.S.C. § 1818(e)(7)(A), except as otherwise permitted, in

writing, by the FDIC and the appropriate Federal financial institutions regulatory agency, as that term is defined in section 8(e)(7)(D) of the FDI Act, 12 U.S.C. § 1818(e)(7)(D).

4. Michael R. Sapp 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 FDI Act, 12 U.S.C. § 1813(u), of any insured depository institution, or any other institution, credit union, bank or agency enumerated in section 8(e)(7)(A) of the FDI Act, 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 FDI Act, 12 U.S.C. § 1818(e)(7)(D).

5. This ORDER shall be effective thirty (30) days from the date of its issuance.

6. 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 FDIC.

SO ORDERED.

IT IS FURTHER ORDERED that copies of this Decision and Order shall be served on Michael R. Sapp, FDIC Enforcement Counsel, the Administrative Law Judge, and the Commissioner of the Tennessee Department of Financial Institutions.

By direction of the Board of Directors.

Dated at Washington, D.C. this 17th day of September, 2019.

/s/
Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation

(SEAL)

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