UNITED STATES OF AMERICA
DEPARTMENT OF THE TREASURY
OFFICE OF THE COMPTROLLER OF THE CURRENCY

In the Matter of:	Docket Nos.:
SAUL ORTEGA, Former Chief Financial Officer, Director, President, Chief Executive Officer, and Chairman of the Board,	AA-EC-2017-44
And	
DAVID ROGERS, JR., Former Chairman of the Board	AA-EC-2017-45
First National Bank Edinburg, Texas	

RECOMMENDED DECISION

Jennifer Whang, Administrative Law Judge
Office of Financial Institution Adjudication
(September 30, 2022)

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The Office of the Comptroller of the Currency ("OCC") commenced this action against Respondents Saul Ortega and David Rogers, Jr. ("Respondents") on September 25, 2017, filing a Notice of Charges ("Notice") seeking an order of prohibition and the imposition of a $250,000 civil money penalty against each Respondent pursuant to 12 U.S.C. §§ 1818(e) and 1818(i). The Notice alleges that Respondents, in their capacities as two of the directors and officers of First National Bank, Edinburg Texas ("the Bank," "First National," or "FNB"), "masked the Bank's deteriorating financial condition through misconduct that inflated earnings and capital and improperly reduced or delayed reporting losses," beginning in the midst of the global financial crisis in late 2008 and continuing in certain respects until the Bank's ultimate failure in September 2013. Notice ¶ 28. The Notice further alleges that Respondent Rogers "placed the interests of a member of his immediate family above those of the Bank" in connection with "one series of unsafe or unsound loans" taking place in or around April 2009 and January 2010. *Id.* ¶ 29.

On October 5, 2021, following briefing by Respondents and Enforcement Counsel for the OCC ("Enforcement Counsel") (collectively "the Parties"), the undersigned issued an order denying the Parties' cross-motions for summary disposition and partial summary disposition ("MSD Order") and identifying a number of disputed questions of material fact as to each of the misconduct, effect, and culpability elements of Sections 1818(e) and 1818(i) to be resolved in a hearing before this Tribunal in its fact-finding capacity.

A twelve-day virtual hearing was held between January 31, 2022 and February 15, 2022 to resolve the questions of material fact that remained in genuine dispute and to address the disposition of all other issues. During the course of the hearing, this Tribunal heard testimony from ten fact witnesses, including Respondents, and three expert witnesses or hybrid fact-expert witnesses. A total of 417 exhibits were introduced and admitted into evidence in connection with

witness testimony, along with eighteen demonstrative exhibits. Now, on the strength of the full record of this case, including the weight of the evidence, established or admitted facts, inherent probabilities, the undersigned's credibility determinations based on the testimony of witnesses, and reasonable inferences drawn from the record as a whole, and after considering the Parties' posthearing briefs ("EC Br." and "Rs Br.") and response briefs ("EC Reply" and "Rs Reply") and associated submissions containing their proposed findings and conclusions, the undersigned makes the following findings of fact, conclusions of law, and recommended orders.

I. Jurisdiction

At all times pertinent to this proceeding, the Bank was an insured depository institution pursuant to 12 U.S.C. § 1813(c)(2), and Respondents were institution-affiliated parties ("IAPs") as that term is defined in 12 U.S.C. § 1818(u).[1] The Bank is a national banking association within the meaning of 12 U.S.C. § 1813(q)(1)(A) and is chartered and examined by the OCC.[2] The OCC is therefore the appropriate federal banking agency with jurisdiction over the Bank and its IAPs for purposes of 12 U.S.C. § 1813(q), and it is authorized to initiate and maintain this prohibition and civil money penalty action against Respondents.[3]

II. Applicable Standard

The burden of proof in an administrative proceeding, unless otherwise provided by statute, is on the administrative agency to establish its charges by a preponderance of the evidence.[4] Under the preponderance-of-the-evidence standard, the party with the burden of proof must adduce evidence making it more likely than not that the facts it seeks to prove are true.[5] Here, the OCC

[1] *See* December 10, 2021 Joint Stipulation of Facts and Law ("Joint Stip.") ¶¶ 1-2.

[2] *See id.* ¶ 3.

[3] *See id.* ¶ 4.

[4] *See* 5 U.S.C. § 556(d); *Steadman v. SEC*, 450 U.S. 91, 102 (1981).

[5] *See In the Matter of Patrick Adams*, No. AA-EC-11-50, 2014 WL 8735096, at *23 (Sept. 30, 2014) (OCC final decision) (applying preponderance standard in OCC enforcement action); *Concrete Pipe & Prods. of Calif. v. Constr.*

has the burden to prove that the statutory elements for the entry of a prohibition order and the assessment of first- and second-tier civil money penalties have been satisfied.[6] This Tribunal is then tasked with making "a comparative judgment" to determine whether the agency has presented "the greater weight of the evidence" as to the satisfaction of the statutory elements.[7]

III. Elements of Sections 1818(e) and 1818(i)

To merit the entry of a prohibition order against an IAP under 12 U.S.C. § 1818(e), an appropriate federal banking agency must prove the separate elements of misconduct, effect, and culpability. The misconduct element may be satisfied, among other ways, by a showing that the IAP has (1) "directly or indirectly violated any law or regulation [or] any cease-and-desist order which has become final," (2) "engaged or participated in any unsafe or unsound practice in connection with any insured depository institution or business institution," or (3) "committed or engaged in any act, omission, or practice which constitutes a breach of such party's fiduciary duty."[8] The effect element may be satisfied by showing either that the institution at issue thereby "has suffered or probably will suffer financial loss or other damage," that the institution's depositors' interests "have been or could be prejudiced," or that the charged party "has received financial gain or other benefit."[9] And the culpability element may be satisfied when the alleged misconduct either "involves personal dishonesty" or "demonstrates willful or continuing disregard by [an IAP] for the safety or soundness of such insured depository institution."[10]

Laborers Pension Tr., 508 U.S. 602 (1993) ("The burden of showing something by a preponderance of the evidence . . . simply requires the trier of fact to believe that the existence of a fact is more probable than its nonexistence.") (internal quotation marks and citation omitted).

[6] *See* 12 U.S.C. §§ 1818(e), 1818(i). In this case, the agency seeks the assessment of second-tier civil money penalties against both Respondents, *see*, *e.g.*, EC Br. at 109-111, 118-119, but a first-tier civil money penalty only against Respondent Ortega and only for the accounting-related allegations, *see id.* at 111-112.

[7] *Almerfedi v. Obama*, 654 F.3d 1, 5 (D.C. Cir. 2011) (internal quotation marks and citations omitted).

[8] 12 U.S.C. § 1818(e)(1)(A).

[9] *Id.* § 1818(e)(1)(B).

[10] *Id.* § 1818(e)(1)(C).

The imposition of a second-tier civil money penalty under 12 U.S.C. § 1818(i) also requires the satisfaction of multiple elements.[11] First, the agency must show misconduct, which can take the form of a violation of "any law or regulation" or final cease-and-desist order,[12] the breach of "any fiduciary duty," or the *reckless* engagement "in an unsafe or unsound practice in conducting the affairs" of the institution in question.[13] Second, the agency must show some external consequence or characteristic of the IAP's alleged misconduct, likewise generally termed "effect" in past decisions issued by the Comptroller of the Currency ("Comptroller"): (1) that it "is part of a pattern of misconduct"; (2) that it "causes or is likely to cause more than a minimal loss to such depository institution"; or (3) that it "results in pecuniary gain or other benefit to such party."[14] Before any civil money penalty can be assessed upon satisfaction of these elements, the agency must take into account the appropriateness of the amount of penalty sought when considered in light of certain potentially mitigating factors, including the "good faith of the . . . person charged," "the gravity of the violation," and "such other matters as justice may require."[15]

Although the misconduct prongs of both Sections 1818(e) and (i) may be satisfied by an IAP's engagement or participation in an "unsafe or unsound practice" related to the depository institution with which he or she is affiliated, that phrase is nowhere defined in the Federal Deposit Insurance ("FDI") Act or its subsequent amendments. John Horne, Chairman of the Federal Home

[11] The assessment of a first-tier civil money penalty, by contrast, requires satisfaction of the misconduct element described here, but not the corresponding effect element. *See id.* § 1818(i)(2)(A).

[12] The misconduct elements of both Section 1818(e) and (i) can also be satisfied by the violation of a condition imposed in writing by a federal banking agency or any written agreement between such an agency and the depository institution in question. *See id.* §§ 1818(e)(1)(A)(i), (i)(2)(A). The OCC does not allege such violations in this case.

[13] *Id.* § 1818(i)(2)(B)(i).

[14] *Id.* § 1818(i)(2)(B)(ii). *See In the Matter of William R. Blanton*, No. AA-EC-2015-24, 2017 WL 4510840, at *16 (July 10, 2017) (OCC final decision), *aff'd on other grounds sub nom. Blanton v. OCC*, 909 F.3d 1161 (D.C. Cir. 2018) (referring to this as the statute's "effect" prong).

[15] 12 U.S.C. § 1818(i)(2)(G); *see also In re Sealed Case (Administrative Subpoena)*, 42 F.3d 1412, 1416 (D.C. Cir. 1994) ("In assessing money penalties, Congress requires [banking] agencies to consider several mitigating factors."); *accord*, *e.g.*, *Blanton*, 2017 WL 4510840, at *27.

Loan Bank Board ("FHLBB") during the passage of the Financial Institutions Supervisory Act of 1966, submitted a memorandum to Congress that described such practices as encompassing "any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds."[16] This so-called Horne Standard has long guided federal banking agencies, including the Comptroller, in bringing and resolving enforcement actions.[17] It has also been recognized as "the authoritative definition of an unsafe or unsound practice" by federal appellate courts.[18] The undersigned accordingly adopts the Horne Standard when evaluating charges of unsafe or unsound practices under the relevant statutes.

It is a central aspect of this statutory scheme that *only one* of the potential triggering conditions is necessary for the satisfaction of each element of Sections 1818(e) and 1818(i). That is, the "misconduct" element of Section 1818(e) is fulfilled if an IAP has breached a fiduciary duty to the institution, regardless of whether the IAP has also violated any laws or engaged in unsafe or unsound practices, and vice versa. Likewise, a second-tier civil money penalty may be assessed (assuming misconduct can be shown) if the misconduct has resulted in pecuniary gain to the IAP, even if it has not caused loss to the institution and is not part of an actionable pattern. Each component of the "misconduct" element is an independent and sufficient basis on which to ground an enforcement action if the other elements have also been shown. The same is true of the "effect" element and the "culpability" element. The OCC need only prove one component of each.

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[16] *Financial Institutions Supervisory Act of 1966: Hearings on S. 3158 Before the House Comm. on Banking and Currency*, 89th Cong., 2d Sess. 49 (1966) (statement of John H. Horne, Chairman of the FHLBB), 112 Cong. Rec. 26,474 (1966).

[17] *See*, *e.g.*, *Patrick Adams*, 2014 WL 8735096, at **8-24 (discussing Horne Standard in detail).

[18] *Gulf Federal Sav. & Loan Ass'n of Jefferson Parish v. FHLBB*, 651 F.2d 259, 264 (5th Cir. 1981); *see also Patrick Adams*, 2014 WL 8735096, at **14-17 (surveying application of Horne Standard by various circuits).

IV. Timeliness

Under 28 U.S.C. § 2462, the statute of limitations governing OCC enforcement actions, the agency has "five years from the date when the claim first accrued" in which to commence proceedings.[19] Because this action was filed on September 25, 2017, then, any claim asserted in the Notice that "first accrued" on or after September 25, 2012—five years before filing—has been timely brought. The Supreme Court has held, in turn, that "the 'standard rule' is that a claim accrues when the plaintiff has a complete and present cause of action"—that is, when all of the elements of an actionable claim have been met and can be pled.[20] It therefore necessarily follows that if not all of the elements of a cause of action have been met, then a claim has not accrued for purposes of a limitations period. This means that Section 2462's five-year limitations period only begins to run once an agency is capable of bringing an enforcement action against a given respondent—which, in the case of statutes with "effect" elements or other multi-pronged prerequisites, such as Section 1818(e) and the second-tier civil money penalty in Section 1818(i), may well be later than the date of the alleged misconduct.[21]

V. Conclusions of Law

The OCC's allegations in this case may be divided into four general topic areas, detailed respectively in Articles III (what will be termed the "Capital Raise Loans" issue), IV ("OREO

[19] The full relevant text of Section 2462 is as follows: "Except as otherwise provided by Act of Congress, an action, suit, or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued." 28 U.S.C. § 2462.

[20] *Gabelli v. SEC*, 568 U.S. 442, 448 (2013); *see also*, *e.g.*, *FERC v. Powhatan Energy Fund*, 949 F.3d 891, 898 (4th Cir. 2020) (claim accrues "when the plaintiff can file suit and obtain relief") (quoting *Wallace v. Kato*, 549 U.S. 384, 388 (2007)); *Savory v. Cannon*, 947 F.3d 409, 427 (7th Cir. 2020) (all "essential element[s] of [a] claim" necessary for accrual); *Blanton*, 909 F.3d at 1171 ("A claim normally accrues when the factual and legal prerequisites for filing suit are in place.") (internal quotation marks and citation omitted).

[21] *See Proffitt v. FDIC*, 200 F.3d 855, 863 (D.C. Cir. 2000) (noting that "the question of accrual becomes complex when considerable time intervenes between the underlying conduct and the harmful effect").

Lending Strategy”),[22] V (“Nonaccrual Loan Accounting”), and VI (“Loans to Rogers III Entities”) of the Notice. The Capital Raise Loan and OREO Lending Strategy allegations are likewise divided into two types of misconduct, which Enforcement Counsel has previously distinguished as “lending-related misconduct” and “accounting-related misconduct.”[23]

With respect to the misconduct element of Section 1818(e) and as applicable for Section 1818(i), then, the OCC seeks to prove the following:[24]

	Article III (Capital Raise Loans)	**Article IV (OREO Lending)**	**Article V (Nonaccrual Loans)**	**Article VI (Rogers III Loans)**
Violated 12 U.S.C. § 161	accounting only	accounting only	x	
Engaged in unsafe/unsound practices	x	x	x	
Breached fiduciary duty of care	x	x	x	
Breached fiduciary duty of loyalty				x

With respect to the culpability element of Section 1818(e) and as applicable for Section 1818(i), the OCC seeks to prove the following:

	Article III (Capital Raise Loans)	**Article IV (OREO Lending)**	**Article V (Nonaccrual Loans)**	**Article VI (Rogers III Loans)**
Personal dishonesty	x			x
Willful disregard	x	x	x	x
Continuing disregard	x	x	x	x
Recklessness (1818(i))	x	x	x	

[22] As discussed further *infra*, “OREO” or “ORE” in an accounting context stands for “Other Real Estate Owned,” or collateral in the form of real estate foreclosed upon by banks in lieu of a borrower’s ability to make loan payments.

[23] *See* January 16, 2018 Brief in Support of OCC’s Motion for Partial Summary Disposition on Respondents’ Seventh and Ninth Affirmative Defenses at 9, 10 (noting that “the [actionable] effects in this case are the losses suffered by the Bank as a result of the lending-related misconduct and the prejudice to the Bank’s depositors as a result of the improper accounting practices”). With respect to accounting-related misconduct, Enforcement Counsel seeks a first- and second-tier civil money penalty against Respondent Ortega but not Respondent Rogers. *See* EC Br. at 109-112.

[24] The Notice also alleges that Respondents’ participation in the OREO Lending Strategy and allegedly improper Nonaccrual Loan Accounting “violated final cease-and-desist orders,” a separate and independently actionable act of misconduct. Notice ¶¶ 55, 90, 134-135. However, Enforcement Counsel does not raise this issue as a basis for relief in either its pre- or posthearing briefing, and the undersigned accordingly does not address it here.

And with respect to the effect elements of Section 1818(e) and 1818(i), the OCC seeks to prove the following:

	Article III (Capital Raise Loans)	Article IV (OREO Lending)	Article V (Nonaccrual Loans)	Article VI (Rogers III Loans)
Financial loss or other damage to the Bank	lending only	lending only		x
Depositor prejudice	x	accounting only	x	
Financial benefit to Respondents				
Pattern of misconduct (1818(i))	x	x	x	x

In consideration of this and the factual record developed by the January 31, 2022 hearing, and as set forth in detail in this Order, the undersigned now concludes that (1) the OCC has demonstrated actionable misconduct as to each category of allegations above; (2) the effect element has likewise been sufficiently satisfied except as to Article V; and (3) the agency has failed to meet its burden with respect to Respondents' culpability, a necessary component of a Section 1818(e) prohibition order, except as to the allegations against both Respondents in Article V and against Respondent Rogers in Article VI. The undersigned also concludes that the elements for the assessment of a Section 1818(i) civil money penalty have been proven as to both Respondents. The undersigned therefore recommends the entry of a prohibition order against Respondent Rogers and the assessment of a $250,000 civil money penalty against each of the Respondents.

VI. <u>Findings of Fact</u>

These findings are drawn as appropriate from the Parties' pleadings and stipulations, from the proposed findings of fact submitted in connection with the posthearing briefing ("EPF" and "RPF" respectively),[25] from hearing testimony ("Tr."), and from supporting exhibits admitted

[25] The undersigned notes that the conclusions of law accompanying Respondents' proposed findings of fact contain a series of paragraphs challenging the validity of these proceedings on grounds relating to the Appointments Clause of the United States Constitution. *See* RPF ¶¶ 85-101. These issues were addressed in this Tribunal's March 17,

therewith ("EX," "RX," and "JX") and submitted in connection with the Parties' summary disposition briefing and oppositions thereto ("EC-PSD," "R-MSD," "EC-BIO," and "R-BIO"). The undersigned will additionally highlight the genuine questions of materially disputed fact identified at the summary disposition stage, where relevant, and indicate the extent to which these questions have been resolved or narrowed by evidence adduced at the hearing.

A. <u>Respondents and Their Duties</u>

Respondent Rogers held the position of Chairman at the Bank from 1981 to November 2011.[26] Respondent Ortega served as the Bank's Chief Financial Officer ("CFO") from 1994 through October 2011, leaving that position and replacing Respondent Rogers as the Bank's Chairman in November 2011, in which capacity he served until the Bank's closure in September 2013.[27] In January 2012, Respondent Ortega also became the Bank's President and Chief Executive Officer ("CEO").[28] Both Respondents served on the Bank's Board of Directors as well as in the capacity of officers and directors of the Bank's holding company, First National Bank Group, Inc. ("the Holding Company," "the Company," or "FNBG") from at least January 1, 2008 until November 1, 2011.[29]

Overall, there can be no dispute that "Respondents served as executive officers in the Bank's senior management, with responsibility for major Bank policies, strategic business decisions, and risk management" during the relevant time period.[30] Between 2008 and 2011, Respondents comprised two of four individuals characterized by the OCC as collectively

2020 Order Denying Respondents' Motion for Summary Disposition on the Appointments Clause, and are hereby preserved for Comptroller review.

[26] *See* Joint Stip. ¶ 2.

[27] *See id.*

[28] *See id.*

[29] *See id.* ¶ 6.

[30] EC Br. at 19.

"responsible for the day-to-day management of the Bank," along with then-President/CEO Robert Gandy and then-Chief Lending Officer ("CLO") Michael McCarthy.[31] In his position as CFO, Respondent Ortega was also "responsible for financial reporting, accounting, the Bank's books and records, and computer information systems."[32]

In addition to their other duties, Respondents were voting members of the Bank's Loan & Discount Committee ("L&D Committee") between 2008 and 2011.[33] The L&D Committee consisted of all of the Bank's directors, including five outside directors.[34] Committee members met weekly and were charged with approving all of the Bank's loans greater than $1 million.[35] The L&D Committee would occasionally approve loans by majority vote over the telephone (a "telephone tally") before ratifying those loans before the full Committee at the weekly meeting.[36] The L&D Committee also "exercised [o]versight of all lending activities within the Bank," including acting as the Bank's "primary credit approval body," monitoring credit activity and the Bank's loan review function, and having overall responsibility for the quality of the Bank's loan portfolio.[37]

Although neither Respondent is trained as a lending officer and CLO McCarthy, rather than Respondents, oversaw the Bank's lending department,[38] the undersigned credits the expert hearing testimony of Deputy Comptroller Michael Brickman that the authority exercised by L&D

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[31] EC-PSD-59 (Declaration of National Bank Examiner Ramah L. Chansen) ("Chansen Decl.") ¶ 4.

[32] EPF ¶ 25.

[33] *See* Joint Stip. ¶ 7.

[34] *See id.*; *see also* Notice ¶¶ 10-11; Answer at 2.

[35] *See* Joint Stip. ¶ 7.

[36] *See id.*

[37] EPF ¶ 43 (citing JX 8 (FNB Loan Policy effective August 14, 2008) ("2008 Loan Policy") at 7; JX 9 (FNB Loan Policy effective August 24, 2009) ("2009 Loan Policy") at 12; JX 10 (FNB Loan Policy effective January 1, 2010) ("2010 Loan Policy") at 13).

[38] *See* EX 568 (Sworn Statement Transcript of David Rogers, Jr.) ("Rogers Dep.") at 14:15-15:11, 21:11-24; EX 569 (Sworn Statement Transcript of Saul Ortega) ("Ortega Dep.") at 11:17-13:21, 35:5-19; EC-PSD-12 (Sworn Statement Transcript of Michael McCarthy) ("McCarthy Dep.") at 18:3-15.

Committee members was "not intended to be a rubber stamp of a lower level decision."[39] Rather, "[a] member of the loan committee is responsible for reviewing the terms and conditions of the loan to ensure that they align with the bank's policies and procedures," not only in isolation but with "a broader perspective of the bank's overall concentration risk [and] capital position."[40] National Bank Examiner ("NBE") Ramah Chansen likewise opined that L&D Committee members are responsible for "reviewing the credit packages being presented to them via the committee" in depth and in detail, making sure that the packages are complete and comprehensive, that any loan policy exceptions are clearly identified and explained, and that "all of the required information is provided to support the credit decision and evaluate the risk associated with that particular request."[41] Finally, it is the OCC's expectation that L&D Committee members track loan policy requests over the life of the loan "to determine the ultimate risk to the Bank."[42]

Notwithstanding these broader responsibilities, Respondent Ortega testified that as an L&D Committee member, he generally trusted the determinations and recommendations of the loan officers and credit department on a given loan package rather than closely reviewing the loan details himself. With respect to loan approvals, for example, Respondent Ortega stated that his decisions were typically "based on the front two pages" of the loan package and that he would not "dive into the numbers" or examine the credit reviews in depth to confirm that the borrower's

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[39] Brickman Tr. 102:10-11. The designation "Tr." in this Order refers to the official transcript of testimony given during the twelve-day hearing in this matter in late January and early February 2022. The name preceding that designation refers to the witness whose testimony is being given.

[40] *Id.* 101:9-11; *see also id.* 101:19-24 (opining that, in evaluating loans, L&D Committee members should "layer in their expertise in regard to the overall risk profile of the bank and whether or not that loan would pose undue risk to the capital position or to the financial performance of the financial institution").

[41] Chansen Tr. 1290:6-15; *see also id.* 1288:15-1289:4 ("[U]pon their review of those packages, they need to be asking questions to ensure that they understand the request, they understand that structure. They need to understand everything regarding that particular request."); Brickman Tr. 102:4-9 ("A loan committee member has an obligation if there's insufficient information to make a decision to follow up with the loan underwriter or the person responsible for providing the information to gather the necessary information to make the decision.").

[42] Chansen Tr. 1290:21-1291:14.

financial position was adequate or that the loan was likely to be repaid.[43] Respondent Ortega also testified that he would never question the stated purpose of a loan as recorded in a loan package, even if he might have had reason to believe that the loan purpose as stated was inaccurate.[44]

B. The Global Financial Crisis and the Bank's Collapse

It is no mere happenstance that the Notice's allegations take place against the backdrop of the global financial crisis of the late 2000s,[45] and the issues of this case, particularly with respect to culpability, must be examined with that context in mind. As a community bank headquartered in Texas's Rio Grande Valley, one of the poorest areas of the United States, there is ample evidence that First National Bank faced especially severe challenges during this time that impacted all aspects of its operations. Witness after witness testified as to the volatility of the market in 2008 and beyond and the difficult financial climate encountered by banks like First National whose loan portfolios, capital levels, and real estate holdings were affected by the crisis.[46]

One of the most significant challenges concerned the real estate properties owned by the Bank because of foreclosed collateral from a defaulted loan—properties known as Other Real

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[43] Ortega Tr. 643:21-644:19, 645:20-646:6 ("Well, the credit review, I mean, I'll tell you, that's a lot of information for me to review. . . . I have a lot of responsibilities. I wish I could read every credit review, but that was not—I mean, you must have a misconception of my vote on the L&D.").

[44] *See id.* 546:16-547:5 ("To tell you the truth, over many, many years of being on the L&D Committee, I don't know that I ever really questioned the loan purpose. . . . I don't think I ever questioned the loan purpose. There's a lot of individuals below me that understand this a lot better than I do."); *see also* Rogers Tr. 341:10-18 ("Q: The documentation that you reviewed at the L&D Committee showed you what the loan purpose of the loan that you were considering for approval was . . . [a]nd if that loan purpose was inaccurate based on your knowledge, you should have ensured that it was corrected, correct? A: That is correct, yes, ma'am.").

[45] *See* Notice ¶¶ 31-32 (alleged Capital Raise Loans misconduct beginning in April 2009), 55 (OREO Lending Strategy implemented "from late 2008 through at least September 2011"), 90 (improper accrual of interest "[b]eginning as early as 2007 and continuing until March 31, 2013"), 117 (allegedly improper preferential treatment in April 2009).

[46] *See*, *e.g.*, Chansen Tr. 1617:9-11 (stating that "the [real estate] market was fluctuating and decreasing rapidly during [the 2008 to 2013 timeframe]"); Pena Tr. 1183:10-1184:11 (agreeing that interest rates and real estate prices were extremely volatile in 2009 and 2010); Magee Tr. 2182:16-25 ("[T]he whole downturn in the real estate market was widespread, deep, so nobody was purchasing and nobody was lending."); Gandy Tr. 2227:15-21 ("There was no liquidity in the market. Nobody could go get a loan. The big banks had been told to shrink. . . . So the only way they could shrink was not to make loans. And besides that, they'd dumped billions and billions of dollars of real estate on the market."); Rogers Tr. 382:23-383:5 ("Everybody was fighting and trying to survive. The liquidity wasn't there. ORE wouldn't move. We were doing the best we could do in a really tough environment.").

Estate Owned ("ORE" or "OREO") on the Bank's balance sheet. As with many other financial institutions, the Bank's OREO holdings began to grow significantly in 2008 "as a result of increasing delinquencies and foreclosures" and posed an ever greater risk to its financial health from that point forward.[47] NBE Chansen testified that OREO properties are considered nonperforming assets that "have an adverse effect on [a] bank's financial condition" because they do not earn interest and because the cost for upkeep of the OREO can be substantial, causing the bank to lose money monthly.[48] Accordingly, it is typically in the best interests of a bank to sell its OREO properties "as quickly as possible,"[49] particularly at a time when more OREO is being added to that bank's books every month as a result of further foreclosures and repossessions.[50] The Bank's efforts to sell these nonperforming, costly properties, and the methods by which it sought to remove OREO from its books at the height of the financial crisis, are central to this action and are discussed in much greater detail below.

The Bank also experienced a shockwave in September 2008, when it suffered a $174 million investment loss in connection with the failure of the Federal National Mortgage Association ("Fannie Mae" or "Fannie") and the Federal Home Loan Mortgage Corporation ("Freddie Mac" or "Freddie").[51] This caused the Bank to fall from "well capitalized" to

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[47] EPF ¶ 190.

[48] Chansen Tr. 1293:9-14; *see also id.* 1293:15-22 (noting that the bank has to pay property taxes, maintenance, and insurance on OREO properties); Ortega Tr. 953:14-954:11 (discussing the millions of dollars of costs and expenses incurred by the Bank while holding OREO); Rogers Tr. 370:19-24 ("[W]hen the bank owns ORE, you're doing maintenance, paying taxes, maintaining the property. It was important for us to get it out of the bank and have somebody else maintaining it, paying the insurance, paying the taxes.").

[49] Leal Tr. 2288:11; *see also*, *e.g.*, Pena Tr. 1185:18-1186:1 (agreeing that putting the ORE "in the hands of a borrower who can make even, say, one payment" would "generate a better situation for the bank than just sitting there and holding it and losing money every month"); Chansen Tr. 1295:15-17 (stating that banks will "take steps to move the OREO off their books because they want to lower the risk within their balance sheet"), 1673:21-23 ("I would agree that holding OREO for an extended period of time is not in the bank's interest.").

[50] *See* Leal Tr. 2287:8-25 (stating that the Bank was repossessing more properties "as the economy continued to suffer" and adding that "we were like drinking out of a firehose. It was coming hard and we were tasked to try to get these sold. You know, you had to sell them. You had to get them back out because we were just going to drown.").

[51] *See* Joint Stip. ¶ 8.

"adequately capitalized" within the meaning of the federal banking agencies' statutory responsibility to take prompt corrective action.[52] Respondent Rogers testified that this investment loss was a "disaster" that "basically shut us down," forcing the Bank to cut back dramatically on its lending and take steps to reduce the size of its operations.[53] Respondents also acknowledged that this loss coupled with the Bank's increasing OREO portfolio led the Bank to adopt a more aggressive strategy for selling OREO properties from the spring of 2009 onward, including becoming "more lenient on loan terms" for borrowers purchasing ORE from the Bank.[54]

In light of the Bank's deteriorating financial condition, the OCC instituted measures in January and February of 2009 requiring the Bank, *inter alia*, to reduce criticized assets, achieve and maintain higher capital levels and minimum capital ratios, improve loan risk rating accuracy, and improve accounting for nonaccrual loans.[55] In doing so, the OCC described the Bank's need for higher capital levels as "exigent."[56] The OCC further underscored the importance of the corrective measures, advising the Bank "that failure to achieve the capital ratios would be considered an unsafe or unsound banking practice and failure to submit an acceptable capital plan would result in further action by the OCC."[57] The Bank's efforts to raise capital in the immediate wake of these communications are described in fuller detail in the appropriate section below, but

[52] *See id.*; *see generally* 12 U.S.C. § 1831o.

[53] Rogers Tr. 447:23, 456:22-25; *see also id.* 324:23-325:1 ("We were reducing everything, trying to reduce the loan, reducing the employees. We were trying to deleverage the bank."); Ortega Tr. 618:4-6 ("At this time we were really trying to shrink the bank size, . . . trying to reduce our loan portfolio.").

[54] Rogers Tr. 377:1-4; *see id.* 369:21-370:3 (agreeing that the Bank adopted aggressive strategy to sell OREO properties); Ortega Tr. 616:25-618:8 (agreeing that "[t]he Bank loosened its underwriting criteria in order to get rid of ORE"). The evidence indicates that the OCC at the time supported the Bank's aggressive efforts to reduce its OREO volume—although, again, the legitimacy of the precise methods used by the Bank are at issue here. *See* JX 2 (June 30, 2009 Report of Examination) ("2009 ROE") at 12 ("Management recognizes that holding OREO is not in the best interest of the bank or its shareholders. Management aggressively sells OREO to those they identify as having the best chance for success in holding the OREO and repaying the bank.").

[55] *See* EPF ¶¶ 9-11; Answer at 3.

[56] EX 147 (February 18, 2009 letter from OCC to Bank Board of Directors) ("IMCR Letter") at 2.

[57] EPF ¶ 81 (citing EX 147 (IMCR Letter) at 5).

the undersigned notes two salient facts here: First, the capital raise efforts included a $5 million contribution from Respondent Rogers and a $1 million contribution from Respondent Ortega, both made via the purchase of holding company stock and neither contribution financed by the Bank itself.[58] Second, the Bank's holding company made two capital injections totaling $35 million into the Bank by mid-August 2009, the result of which was to achieve the desired capital ratios and address the Bank's capital issues, at least temporarily.[59]

The Bank continued to have difficulty weathering the storm, and the OCC issued a consent order in February 2011 that once again increased the Bank's minimum capital ratios and required it to correct what the agency identified as unsafe or unsound practices concerning the Bank's loan portfolio management and nonaccrual loans.[60] Then, following a June 2011 onsite examination by the OCC, the Bank made significant changes to its executive management: Gandy, McCarthy, and Respondent Rogers all resigned from their positions, and Respondent Ortega ultimately assumed new roles as the Bank's Chairman, President, and CEO along with a new senior management team that included Chief Operations Officer ("COO") Ryan Leal, formerly the Bank's comptroller, and Chief Credit Officer ("CCO") Mark Magee.[61] After a January 2012 consent order and another onsite visit in March 2012, the OCC noted that the "new management team, under the direction of President Ortega, is much improved," and that the Bank had made "significant progress toward

[58] *See* RPF ¶ 40; EX 374A (spreadsheet entitled Capital Raise Loans Summary) ("Capital Raise Loans Spreadsheet"). Because neither Respondents' contribution is alleged to have been financed by a loan from the Bank itself, they are not part of the allegedly problematic Capital Raise Loans Plan at issue in this action. *See* Salvato Tr. 1903:18-1904:18 (noting that there is no concern with purchases of holding company stock that are not financed by Bank); Chansen Tr. 1568:3-1569:2 (same). The undersigned also observes that Respondent Ortega's purchase of holding company stock was made in April 2010 and therefore was not part of the initial capital raise efforts in response to the Bank's undercapitalization in the spring of 2009. *See* EX 374A (Capital Raise Loans Spreadsheet) at 2.

[59] EPF ¶¶ 150, 153 (noting $30 million injection in May 2009 and $5 million injection in August 2009); *see also* EX 163 (reconciliation of Bank's surplus ledger account dated July 31, 2013) (reflecting the $35 million in capital injections in 2009 and no further capital injections from 2009 through the Bank's closure in 2013).

[60] *See* RPF ¶ 12; JX 12 (February 2011 Consent Order) at 6-13.

[61] *See* JX 5 (May 15, 2012 letter from OCC to Bank Board of Directors relaying conclusions of March 2012 target examination) ("2012 Target ROE") at 2.

complying with the Order and [improving] both the credit and operations culture."[62] The OCC's 2012 Report of Examination (or "ROE") likewise recorded improvement, singling out Respondent Ortega again and finding, among other things, that the new management "has initiated a cultural change, set forth proper underwriting parameters for OREO financing, engaged outside firms for capital procurement and comprehensive loan review, and combined with heightened internal loan review and loan officer identification to determine the full extent of problem loans."[63]

Nevertheless, the agency stated that the Bank's overall condition remained "critically deficient" and was getting worse, including a continued decline in capital levels and asset quality.[64] While the OCC found that the new executive management team had "made a significant and aggressive effort to reduce the level of problem assets, address impairments, enhance the real estate appraisal process, and reduce OREO volume," it stated that "the problems continue to grow and this team to date has been ineffective overall at reversing the Bank's negative course."[65] The OCC also continued to identify the Bank's OREO portfolio as a significant problem, stating that it was "at an extremely high and unsafe and unsound level . . . due primarily to a credit culture that fostered poor credit risk selection and lax underwriting standards."[66] By June 2013, the Bank had become "critically undercapitalized," and the OCC ultimately closed the Bank and appointed the Federal Deposit Insurance Corporation ("FDIC") as receiver several months later.[67]

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[62] *Id.*

[63] JX 6 (June 30, 2012 Report of Examination) ("2012 ROE") at 38.

[64] JX 5 (2012 Target ROE) at 1-2.

[65] JX 7 (June 27, 2013 letter from OCC to Bank Board of Directors relaying conclusions of March 2013 target examination) ("2013 Target ROE") at 3.

[66] JX 6 (2012 ROE) at 47; *see also* JX 7 (2013 Target ROE) at 13 (finding that "[t]he high level of nonperforming assets (non-accrual loans and OREO) and lack of management expertise in the lending function are the most significant risks facing the Bank.").

[67] *See* EPF ¶¶ 14-15; Joint Stip. ¶ 9.

C. Capital Raise Loans (Article III)

Article III of the Notice alleges that "[f]rom approximately April 2009 to March 2011, Respondents originated, approved, and/or ratified unsafe or unsound loans to finance the purchase of stock in the Holding Company ("Capital Raise Loans") and then transferred the proceeds to the Bank to raise capital."[68] It further alleges that Respondents then "caused the Bank to improperly inflate its capital by including the proceeds of the Capital Raise Loans as regulatory capital in the Bank's Call Reports."[69]

In its October 5, 2021 Order on the Parties' summary disposition motions, this Tribunal identified certain questions of disputed material fact regarding the Capital Raise Loans issue, including the scope of Respondents' responsibility and involvement in the misconduct alleged by the agency; the riskiness of the Capital Raise Loans at the time they were made and the Respondents' understanding thereof; the extent to which the Capital Raise Loans were part of a plan to downstream "sham" capital from the Holding Company to the Bank; and whether and to what extent Respondents' alleged misconduct with respect to the Capital Raise Loans caused loss to the Bank.[70]

Viewing the totality of the evidence, and as elaborated upon below, the undersigned now makes the following core findings: **(1)** Respondents were among the individuals who bore ultimate responsibility for the Capital Raise Loans; **(2)** it is incontrovertible that a number of people borrowed money from the Bank to purchase Holding Company stock, often through unsecured,

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[68] Notice ¶ 31.

[69] *Id.*; *see also* Brickman Tr. 164:17-165:8 ("A call report is . . . the record of a bank's capital asset quality, liquidity, assets, and liabilities, an overall picture of their financial condition. . . . [T]he OCC requires banks to quarterly file a call report in order to be able to continuously monitor the financial condition of banks within the system.").

[70] *See* MSD Order at 17-18. Enforcement Counsel did not move for summary disposition on its allegations of improper accounting practices relating to the Capital Raise Loans, and Respondents' motion for summary disposition did not discuss those allegations in detail. As a result, there were no genuine questions of disputed material fact identified with respect to accounting-related Capital Raise Loans allegations. *See id.* at 9 n.28.

uniformly low-interest loans at a time when the Bank's capital position required that it be (and Bank management represented that it was) severely limiting its lending activity; **(3)** Respondents acknowledge that at least some of the proceeds of these Bank-financed stock purchases were downstreamed back to the Bank as putative capital, although any Capital Raise Loan—that is, a loan by the Bank for a borrower to then purchase an equivalent amount of Holding Company stock—that was made later than August 12, 2009 could not have been downstreamed to the Bank, because there were no further capital injections after that date; and **(4)** the Bank suffered a loss with respect to certain Capital Raise Loans. In addition, it is undisputed that the Bank's communications with the OCC regarding its capital raise efforts, including its capital plans that Respondent Ortega played a part in drafting, did not disclose that the Bank was making unsecured loans to individuals to finance purchases of holding company stock as part of the capital raise, nor did the Bank indicate that any portion of the proceeds from these Capital Raise Loan-financed stock purchases might be sent from the Holding Company back to the Bank to be treated as an infusion of new regulatory capital.

1. Respondents' Capital Responsibilities

Both Respondents had multiple responsibilities related to the Bank's capital position, and the 2009 capital raise efforts in particular, in their capacities as officers and directors of the Bank.[71] As Chairman, Respondent Rogers was "responsible for raising capital funds for the Bank and the Bank holding company to maintain required capitalization in terms [and] conditions most advantageous to the Bank."[72] In his role as CFO, Respondent Ortega was responsible for drafting the Bank's capital plans, with the help of counsel and accountants, and leading the efforts to compile the Holding Company's private placement memorandum in connection with its offering

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[71] *See* EPF ¶¶ 68-71.

[72] Brickman Tr. 76:21-77:5.

of stock.[73] Respondent Ortega also was responsible for "analyzing the overall impact of the capital raise on the Bank[] and tracking the Bank's progress towards meeting its capital goals."[74] And Respondents, along with the rest of the Board of Directors, were generally "responsible for making decisions related to raising capital," including developing and implementing a capital raise strategy when capital is needed.[75]

2. The Bank's Need for Capital

The September 2008 failure of government-sponsored enterprises Fannie Mae and Freddie Mac rendered the Bank's preferred stock in those entities "virtually worthless," leading the Bank to incur a $174 million loss on that investment.[76] As a result of this loss, the OCC determined that the Bank would need to raise capital "in excess of regulatory minimums," given its high level of classified assets and commercial real estate holdings amidst a "continued weak economy that is having an adverse impact on the commercial real estate portfolio."[77] After injecting $24 million from the Holding Company to the Bank in the immediate wake of the Fannie and Freddie failure, Respondent Rogers and Bank management committed to raising an additional $35 million in capital and achieving the desired capital ratios by March 31, 2009.[78] Respondent Rogers stated that this capital raise would be achieved primarily "by selling holding company common stock"

[73] *See* Ortega Tr. 499:6-14, 896:12-19; *see also* EPF ¶ 77.

[74] EPF ¶ 71; *see* Brickman Tr. 136:19-137:11.

[75] EPF ¶ 68; *see* Brickman Tr. 136:6-18.

[76] EX 148 (February 26, 2009 letter from Bank Board of Directors to OCC) ("February 2009 Capital Plan") at 3.

[77] JX 1 (September 30, 2008 Report of Examination) ("2008 ROE") at 3 (noting that the Bank's "[c]lassified assets are heavily concentrated in substandard loans that are secured by real estate for residential land development and construction projects").

[78] *See id.*; *see also* EPF ¶¶ 73-74.

and that initial discussions with the firm retained to assist in the stock offering "indicated a strong interest for participation" by prospective investors.[79]

On February 18, 2009, the OCC formally imposed an individual minimum capital ratio ("IMCR") requiring the Bank to meet ratios of 8 percent for its Tier 1 regulatory capital and 12 percent for its risk-based capital by May 10, 2009.[80] The agency and the Bank agreed that in order to meet these new capital ratios, the Bank would need to raise between $50 and $75 million in additional capital, given "the level of non-performing assets on the Bank's balance sheet and losses from [its] investment portfolio."[81] The agency also stated that the Bank was "exposed to a high degree of asset depreciation and a high volume of, or particularly severe, problem loans."[82] The agency made it clear that the Bank could not be operated in a safe and sound condition "[a]bsent the necessary capital injection."[83]

To effectuate the new minimum capital ratios, the OCC required the Bank to develop a capital plan by late February 2009 setting forth the methods by which the Bank intended to secure "additional capital to meet the Bank's current and future needs."[84] The agency stated that it would only accept a detailed and fully documented plan that was "based on realistic assumptions, is likely to succeed in restoring the Bank's capital, and will not increase the risk to the Bank."[85] Finally,

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[79] JX 1 (2008 ROE) at 12.

[80] *See* EX 147 (IMCR Letter) at 5.

[81] *Id.* at 1.

[82] *Id.* at 2 (also noting that "[h]igher minimum capital ratios are appropriate for the Bank because of the significant deterioration in the Bank's condition, including considerable problems with asset quality, exposure to substantial risk from concentrations of credit and inadequate risk management systems, and capital that is insufficient to support the risk profile of the Bank").

[83] *Id.* at 3.

[84] *Id.* at 4.

[85] *Id.* at 4-5.

the agency emphasized that "[t]he timeframes in the capital plan *should reflect a sense of urgency and an awareness of the recent rapid deterioration in the Bank's condition*."[86]

The Bank submitted its capital plan on February 26, 2009.[87] Among other things, this plan stated that the Holding Company was "actively pursuing an offering of shares of its common stock to raise capital," and that "any portion" of the proceeds of such an offering that was "injected into the Bank would count as Tier 1 capital, thereby increasing all applicable capital ratios."[88] The capital plan also stated that a certain amount of the stock sale proceeds would be "retained by the Holding Company to service its indebtedness and for other general corporate purposes," so that "both the Holding Company and the Bank would be well-capitalized" at the end.[89] The plan did not mention any possibility that the sale of Holding Company stock through this offering would be financed by loans from the Bank itself.[90]

On April 3, 2009, Respondents and then-President/CEO Gandy met with OCC Deputy Comptroller Gil Barker to discuss the steps being taken by the Bank to improve its capital ratios.[91] In this meeting, Respondents relayed their efforts "to shrink the Bank in order to comply with the IMCR," including by reducing personnel, cutting costs across the board, and scaling back lending operations so that there was "virtually NO lending occurring."[92] Respondents also told Deputy Comptroller Barker that the upcoming offering of Holding Company stock would be sold locally,

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[86] *Id.* at 5 (emphasis added).

[87] *See* EX 148 (February 2009 Capital Plan).

[88] *Id.* at 3.

[89] *Id.* at 4 (further stating that "[t]he Holding Company would monitor its cash flow needs and the capital needs of the Bank, and may decide to inject additional amounts into the Bank as needed at the Bank (and not immediately needed by the Holding Company)").

[90] *See* Brickman Tr. 124:7-17.

[91] *See* EPF ¶ 92; EX 548 (April 3, 2009 OCC meeting minutes).

[92] EX 548 (April 3, 2009 OCC meeting minutes) at 1 (stating that there was "no lending going on"); *see also* Rogers Tr. 456:24-25 ("We needed to shrink the bank. We needed to cut back on the lending."); Chansen Tr. 1257:13-1258:3 (testifying that by shrinking its loan portfolio, a bank can improve its capital ratio even if its capital levels stay the same).

and that Respondent Rogers and his family had committed to contribute at least $10 million of the $20 to 40 million the Bank was hoping to raise.[93] Once again, Bank management did not disclose to the OCC at this meeting "that the Bank was considering providing, or would be providing, loans to investors to fund their Holding Company stock purchases."[94]

3. The Stock Offering

On April 14, 2009, the Holding Company issued its Private Placement Memorandum ("PPM") in connection with the capital raise stock offering.[95] The PPM stated that the proceeds of the offering would be used to improve the regulatory capital positions of both the Bank and the Holding Company and "for general corporate purposes, including . . . servicing the Company's outstanding debt."[96] Like the Bank, the Holding Company had ceased to be well-capitalized in the fall of 2008, entering into a memorandum of understanding ("MOU") with the Federal Reserve Bank of Dallas as a result that required it to submit its own capital plan to that agency and achieve a certain minimum capital ratio.[97] The PPM estimated that selling the full offering of shares for $48.75 million would "provide the Company with sufficient capital to be classified as well capitalized for regulatory purposes," as well as allowing the Company to capitalize the Bank itself.[98] Although the PPM contemplated only $15 million of the $48.75 million in total stock sales

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[93] EX 548 (April 3, 2009 OCC meeting minutes) at 1; *see also* Ortega Tr. 564:1-12 (stating that the Bank planned to raise capital from "local customers that were inquiring about investing in the bank, friends and other investors there, in that area," because it had been unsuccessful in finding investors nationally).

[94] EPF ¶ 92; *see also* Rogers Tr. 328:8-12; Brickman Tr. 129:2-6.

[95] *See* EX 143 (2009 Holding Company PPM).

[96] *Id.* at 31 ("We anticipate using a portion of the proceeds from the Offering to inject capital into our Bank. The remaining proceeds will be used for other general corporate purposes of the Company and possible future injections of capital into the Bank.").

[97] *See id.* at 5.

[98] *Id.* (stating that "the Company and the Bank are optimistic that through the continued reduction of the Bank's asset size and the Bank's continued earnings and through the use of at least $15 million [in proceeds] to increase the capital accounts of the Bank, the Bank will comply with the [IMCR] by May 10, 2009").

being downstreamed to the Bank, it noted that "[t]he Company intends to increase the contribution to the Bank to the extent necessary to comply with the Capital Ratio Directive."[99]

To raise the capital required by the OCC, the Bank's Board of Directors focused on finding local investors in their Rio Grande Valley community.[100] While the OCC stated that the Bank's capital raise efforts "may also need to attract institutional investors" from outside the region,[101] then-President/CEO Gandy informed the OCC on April 28, 2009 that "the national capital markets . . . are essentially frozen for all community banks," making the prospect of finding institutional investors infeasible.[102] Still, Gandy expressed optimism regarding the stock offering, noting that the Bank had "communicated with 231 prospective stock purchasers so far" and received $15 million in purchases, with "firm commitments" of another $12 million.[103] Gandy predicted that a combination of the local capital raise and the Bank's efforts to shrink its assets and reduce its loan portfolio would allow the Bank to achieve the desired 8 percent Tier 1 capital ratio by May 10, 2009, although it did not anticipate being in compliance with the 12 percent risk-based ratio until the end of September of that year.[104] The letter did not disclose that the Bank would be providing loans to local investors to finance their Holding Company stock purchases.[105]

The OCC responded to Gandy's letter on April 30, 2009, stating that the February 2009 capital plan "contained a reasonable road map for complying with the IMCR" but requiring the Bank to "submit a new capital plan as soon as possible" in light of the Bank's representation that

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[99] *Id.* at 31.

[100] This Tribunal takes official notice that Edinburg, Texas, the small city in which the Bank was headquartered, is in the Rio Grande Valley in South Texas near the Mexican border, far from any major metropolitan Texas population center.

[101] EX 147 (IMCR Letter) at 1.

[102] EX 149 (April 28, 2009 letter from Robert Gandy III to the OCC) ("April 28, 2009 Letter") at 1.

[103] *Id.* (also noting that "[w]e are very encouraged by the local reception to the offer").

[104] *See id.* at 2.

[105] *See* EPF ¶ 105.

it would not be able to meet the risk-based capital ratio by the previous deadline.[106] The agency's response underscored that "[c]ompliance with the IMCR is very important and *to avoid a more severe enforcement action, you need to do everything possible to achieve and maintain the capital ratios established in the IMCR* by the commitment date."[107]

4. <u>The Capital Injections</u>

On May 11, 2009, the Holding Company transferred $30 million to the Bank as a capital injection.[108] The stock subscription log offered by Enforcement Counsel shows that the Holding Company had raised approximately $30.38 million through its offering as of this date,[109] a total that includes nearly $9 million from Respondent Rogers and his family. The Holding Company's balance sheet as of March 31, 2009 also reflects that the Holding Company had approximately $8.8 million available in cash and equity securities prior to the capital raise.[110] Respondent Ortega reported at the Bank's May 12, 2009 board meeting that the Bank had achieved the required Tier 1 capital ratio as a result of the $30 million injection, and that the Holding Company itself was now "well capitalized with the additional capital already raised."[111]

The Bank submitted a revised capital plan to the OCC on May 12, 2009.[112] In the cover letter to this communication, then-President/CEO Gandy informed the agency that the $30 million injection "increased our leverage capital ratio to 8.43% and our total risk-based capital ratio to

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[106] EX 336 (May 12, 2009 Board meeting minutes, attaching April 30, 2009 letter from OCC to Bank Board of Directors) ("May 12, 2009 Board Minutes" and "April 30, 2009 Letter," as applicable) at 6.

[107] *Id.* (emphasis added).

[108] *See* EPF ¶ 147; EX 151 (May 12, 2009 letter from Robert Gandy III to OCC attaching revised capital plan) ("May 12, 2009 Letter") ("At close of business last night, we had injected $30MM into the bank.").

[109] *See* EX 374A (Capital Raise Loans Spreadsheet). This figure was arrived at by totaling all of the stock purchases dated May 11, 2009 or earlier, irrespective of whether those purchases are putatively tied to a Capital Raise Loan from the Bank (something that is discussed further *infra*).

[110] *See* RX 87 (March 31, 2009 Holding Company balance sheet) at 5 (reflecting $6.15 million in cash and $2.7 million in equity securities held by the Holding Company); Ortega Tr. 902:24-903:5.

[111] EX 336 (May 12, 2009 Board Minutes) at 1.

[112] *See* EX 151 (May 12, 2009 Letter).

11.53%."[113] Gandy stated that the Bank "will continue our capital raising efforts until we exhaust all possibilities and anticipate that we will continue to have some success in that regard."[114] The revised capital plan cautioned, however, that "[i]n the current environment, it is difficult to raise capital by any mechanism," and that "shrinking the balance sheet of the Company" remained a necessary part of the Bank's efforts to achieve the desired capital ratio.[115] The plan concluded by noting Bank management's intent to continue to offer Holding Company shares "as long as there is interest in the offer," until the full $48.8 million offering could be issued to investors.[116]

On August 12, 2009, the Holding Company made another capital injection in the Bank, this time for $5 million.[117] The stock subscription log reflects approximately $7.78 million in new purchases of Holding Company stock between the two capital injections, for a total of $38.16 million raised by the stock offering as of this date.[118] In his letter to the OCC on August 14, 2009, then-President/CEO Gandy represented that the Bank had now achieved both individual minimum capital ratios that the agency had imposed.[119] As with all previous communications with the OCC, the letter did not mention the possibility that the capital injected back in the Bank by the Holding Company included proceeds of stock sales that had been financed by loans from the Bank itself.[120]

[113] *Id.* at 1.

[114] *Id.*

[115] *Id.* at 4.

[116] *Id.* at 6; *see also* Brickman Tr. 132:4-17 (stating that "[t]his version of the capital plan also does not disclose the bank strategy to make loans to potential shareholders and does not disclose that there are shareholders investing in this capital raise that did not independently have the financial wherewithal to participate").

[117] *See* EPF ¶ 153; EX 163 (reconciliation of Bank's surplus ledger account dated July 31, 2013).

[118] *See* EX 374A (Capital Raise Loans Spreadsheet) (totaling all stock purchases between May 12, 2009 and August 12, 2009).

[119] *See* EX 366 (August 18, 2009 Bank board minutes, attaching August 14, 2009 letter from Robert Gandy III to OCC) at 6.

[120] *See* EPF ¶¶ 151, 155.

5. The Capital Raise Loans

On April 14, 2009, the L&D Committee approved an unsecured loan in the amount of $500,000 to Kenneth Everhard, a personal friend of Respondent Rogers.[121] According to the Committee meeting minutes, the purpose of this loan was "to be used as a revolving line of credit for working capital."[122] On April 29, 2009, Mr. Everhard purchased $500,025 in Holding Company stock.[123] The similarity of these amounts is not coincidence: Respondent Rogers testified that he was contemporaneously aware, despite the stated loan purpose, that Mr. Everhard had "borrowed money from the Bank to invest in holding company stock."[124]

The Everhard loan and subsequent stock purchase is the first of a series of linked transactions beginning in April 2009 that Enforcement Counsel has termed the "Capital Raise Loans Scheme."[125] Broadly speaking, this scheme is said to consist of three discrete components: (1) the Bank used its own funds to extend loans to investors; (2) those investors purchased Holding Company stock with the proceeds from the Bank loans; (3) having received money from the stock sales, the Holding Company then contributed the same funds back to the Bank, where they were treated as new capital.[126] The third leg of this triangle—that the money from the stock sales was downstreamed back to the Bank as new capital, like someone transferring a twenty dollar bill from their left pocket to the kitchen table to their right pocket and claiming to be twenty dollars richer when they then switch the bill again to the pocket from which it started—is addressed in a separate section below. Of the first two, however, there can be no serious doubt.

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[121] *See* EX 196 (April 14, 2009 L&D Committee meeting minutes) at 1; Rogers Tr. 342:9-24.
[122] EX 196 (April 14, 2009 L&D Committee meeting minutes) at 1; *see* EPF ¶ 98.
[123] *See* EX 158 (Subscription Agreement Log); EPF ¶ 99.
[124] Rogers Tr. 345:2-5; *see* EPF ¶ 100.
[125] *See* EPF ¶ 101.
[126] *See id.* ¶ 102.

It is incontrovertible that the Bank made loans to investors in order for those investors to purchase Holding Company stock; the evidence strongly reflects this, and Respondents have acknowledged as much.[127] Enforcement Counsel's expert, NBE Chansen, has identified 63 such Capital Raise Loans between April 2009 and March 2011, which were used to purchase around $22 million worth of stock in the Holding Company.[128] Crediting NBE Chansen's analysis, it is clear that investor after investor in the Holding Company's offering was given a loan from the Bank for an equivalent amount of their stock purchase a short time beforehand. On April 28, 2009, Margaret Scott received a Bank loan of $75,000; the next day, she purchased $75,000 in Holding Company stock, which was the minimum amount permitted under the PPM.[129] Similarly, on May 8, 2009, Blanca Gonzalez received a loan in the amount of $250,000; her stock purchase of $250,050 came three days later[130]—among a flurry of rapid-fire Bank loans and corresponding stock purchases occurring in the final days prior to the May 11, 2009 capital injection.[131] The list goes on.

The documentation for these Capital Raise Loans did not state that the purpose of the loans was to purchase Holding Company stock, despite it being Bank policy that the purpose of all

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[127] *See* Rogers Tr. 330:16-19 (agreeing that he "approved loans to investors to buy Holding Company stock" as member of L&D Committee); Ortega Tr. 491:20-492:1 (agreeing that he was "aware that the Bank was making loans to purchase Holding Company stock"), 530:12-19 (stating he knew, at the time the loans were approved, that unsecured $500,000 loans to Bank directors Felo Guerra and Jack McClelland were being made for the purpose of purchasing Holding Company stock).

[128] *See* EPF ¶ 158; Chansen Tr. 1233:20-1234:10 (noting that, to reach these conclusions, it was necessary to prepare her own analysis "using information from the Bank's books and records," because "the Bank, including the Respondents, did not maintain any sort of documentation to track and monitor these types of loans for the stock purchase"); EX 374A (Capital Raise Loans Spreadsheet).

[129] *See* EX 374A (Capital Raise Loans Spreadsheet), row 16; Salvato Tr. 1775:1-1776:1 (discussing Scott's loan and stock purchase); *see also* EX 143 (2009 Holding Company PPM) at 6 (minimum purchase of $75,000).

[130] *See* EX 374A (Capital Raise Loans Spreadsheet), row 48; EX 237 (June 30, 2009 L&D Committee meeting minutes) at 4 (noting that Gonzalez's loan was "due in one year with monthly payments of interest only, unsecured").

[131] *See* EX 374A (Capital Raise Loans Spreadsheet), rows 29-34, 36-37, 43, 52-53, 55, 58-60.

unsecured loans must be clearly stated.[132] The stated purpose of the unsecured $500,000 loan to Bank director Jack McClelland was that it was "to be used as a revolving line for working capital for personal ventures," even though Respondent Ortega knew that the loan was to purchase Holding Company stock at the time it was approved.[133] Likewise, the unsecured $200,000 loan made to Bank director Oscar Garza was stated as "for rodeo riding arena event costs and promotions and other business purposes," but was linked to a contemporaneous $200,025 Holding Company stock purchase.[134] And the purpose of the unsecured loan to Ms. Gonzalez, discussed above, was given as simply "business investment" in the loan package and L&D Committee meeting minutes.[135] This vague description of a Capital Raise Loan stands in contrast to a $250,000 loan to Samuel David Deanda, discussed in the same meeting minutes, for which the purpose was plainly stated as the purchase of "shares of Lone Star National Bank stock."[136]

Moreover, the Capital Raise Loans themselves featured generally liberal terms that increased the risk to the Bank at a time when it should have been curtailing lending activity,[137] which, NBE Chansen opined, signaled that such loans were not made "based on the borrower's ability to repay the loans, but . . . on the borrower's willingness to help the Bank raise additional

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[132] *See* EPF ¶¶ 134-135, 141-142; Rogers Tr. 341:10-18 (stating that L&D Committee members should have ensured that stated loan purposes were accurate to their knowledge).

[133] EX 247 (May 5, 2009 L&D Committee meeting minutes) at 2; *see* Ortega Tr. 530:12-19.

[134] EX 237 (June 30, 2009 L&D Committee meeting minutes) at 4. NBE Chansen's analysis reflects that Mr. Garza purchased the stock in question on June 24, 2009 and then received the loan one day later, on June 25, 2009. *See* EX 374A (Capital Raise Loans Spreadsheet), row 88. This is close enough in time, and the terms of the loan sufficiently characteristic—unsecured, 4.25 percent interest rate, same amount as stock purchase—that the undersigned comfortably credits NBE Chansen's conclusion that the loan was a Capital Raise Loan.

[135] *See* EX 226 (Gonzalez loan package for Capital Raise Loan) at 1; EX 237 (June 30, 2009 L&D Committee meeting minutes) at 4.

[136] EX 237 (June 30, 2009 L&D Committee meeting minutes) at 4; *see* EPF ¶ 139. The undersigned notes that this loan to Mr. Deanda was also distinguishable from most Capital Raise Loans in that it was secured by collateral and featured a 5 percent floor interest rate. *See* EX 237 (June 30, 2009 L&D Committee meeting minutes) at 4.

[137] *See* Chansen Tr. 1258:14-1269:10 (discussing riskiness of loan terms); Brickman Tr. 147:21-22 (opining that "[t]he sum total of those loans is a big risk to the Bank"); *see also* EX 548 (April 3, 2009 OCC meeting minutes) at 1 (stating that there was "virtually NO lending occurring"); Rogers Tr. 456:24-25 ("We needed to shrink the bank. We needed to cut back on the lending.").

capital."[138] The majority of these loans were unsecured by collateral, which was particularly risky, and offered 4.25 percent interest rates, suggesting that "the Bank did not conduct individual credit determinations."[139] Some of the unsecured loans required just interest-only payments for the life of the loan before a balloon payment of the principal at maturity,[140] and most were renewed at least once, which "call[s] into question the borrower's ability to repay their debts and expose[s] the Bank to additional risks."[141] And the Bank offered significantly better terms on the unsecured Capital Raise Loans of some borrowers than on any secured loans those same borrowers had previously taken out with the Bank, indicating again that the individual borrowers' ability to pay was not a prime criterion for the loan terms.[142]

When viewing the Capital Raise Loans in the context of the Bank's urgent efforts to increase its capital ratios in the spring of 2009, a picture emerges. The OCC repeatedly impressed upon the Bank the exigency of meeting the capital goals and the dire consequences that would follow if it failed to do so.[143] While the sale of Holding Company stock was determined to be the

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[138] EPF ¶ 132 (citing Chansen Tr. 1258:14-1259:5).

[139] *Id.* ¶ 124; *see also* Brickman Tr. 146:11-14 (noting that because unsecured loans are riskier, "the bank typically will charge a higher rate of interest across the entire portfolio"),147:12-15 (opining that a 4.25 percent interest rate is "incredibly low . . . for an unsecured loan portfolio"); Chansen Tr. 1256:5-9 (opining that it would have been "very unlikely [in 2009] that borrowers would have been able to obtain an unsecured loan especially at a 4.25 percent interest rate").

[140] *See*, *e.g.*, EX 237 (June 30, 2009 L&D Committee meeting minutes) at 3-4 (reflecting unsecured Capital Raise Loans to Felo Guerra, Jose Rodriguez, and Blanca Gonzalez with interest-only payment terms).

[141] EPF ¶ 131 (citing Chansen Tr. 1256:25-1257:9); *see also id.* ¶¶ 126, 130.

[142] *See id.* ¶ 125 (citing examples). Bank director Jack McClelland, for example, had more than two dozen outstanding secured loans at the time he took out an unsecured $500,000 loan to purchase Holding Company stock, and the vast majority of those secured loans had interest rates of at least 6 percent in comparison to the 4.25 percent rate of his unsecured Capital Raise Loan. *See* EX 246 (McClelland loan package for Capital Raise Loan) at 2 (listing outstanding loans); Ortega Tr. 532:20-533:10 (discussing terms of McClelland loans). The undersigned notes that while a number of Director McClelland's outstanding secured loans were originated prior to the global financial crisis and thus in a distinctly different economic context, there are at least four secured loans on this list that were originated in 2009 with interest rates of 6 percent or higher.

[143] *See* EX 147 (IMCR Letter) at 2 ("[F]ailure to achieve the capital ratios would be considered an unsafe or unsound banking practice and failure to submit an acceptable capital plan would result in further action by the OCC."); EX 336 (May 12, 2009 Board minutes) at 6 ("[T]o avoid a more severe enforcement action, ***you need to do everything possible*** to achieve and maintain the capital ratios established in the IMCR by the commitment date.") (emphasis added).

best way to generate funds that could be used as Bank capital,[144] "[e]fforts to attract investors . . . via national markets proved unsuccessful" due to the prevailing economic climate.[145] It was therefore necessary to raise the required capital entirely from local investors, including by soliciting investments from family and friends as well as officers, directors, and "lower level employees" of the Bank.[146] And to the extent that low-level Bank employees and other prospective investors in one of the poorest regions of the nation at the height of the global financial crisis could not easily afford the minimum $75,000 investment from their own pockets (or were otherwise reluctant to do so), the Bank lent them the money to make the stock purchases, offering favorable terms as an inducement.[147] Thus the Capital Raise Loans. Furthermore, there can be no doubt of Respondents' involvement and responsibility: even if they did not set the terms of the loans themselves,[148] the undersigned agrees with Deputy Comptroller Brickman that Respondents should have been, and by their own acknowledgment were, aware of the link between loans and stock purchases from their vantage points on the Board of Directors, in approving such loans on the L&D Committee, and as CFO and Chairman in monitoring the stock subscription agreements and implementing the capital plan, and in those positions "directly furthered the strategy to lend money to potential shareholders as part of this capital raise scheme."[149]

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[144] *See* EX 148 (February 2009 Capital Plan) at 3 (discussing why "the issuance of trust preferred securities and subordinated debentures" were not viable capital options relative to the issuance of common stock by the Holding Company).

[145] EPF ¶ 91; *see also*, *e.g.*, EX 149 (April 28, 2009 Letter) at 1 ("[T]he national capital markets . . . are essentially frozen for all community banks."); Chansen Tr. 1569:23-25 ("I do know that it was hard for institutions to find investors.").

[146] Rogers Tr. 278:10-12; *see also id.* 264:11-16.

[147] *See id.* 278:13-24 (agreeing that Bank employees were given unsecured loans to purchase $75,000 in Holding Company stock).

[148] *See* Ortega Tr. 934:10-16, 938:2-4.

[149] Brickman Tr. 155:13-16; *see id.* 153:12-155:6.

6. Downstreaming and the Overstatement of Capital

It is a separate question whether, and to what extent, the proceeds from stock sales funded by the Capital Raise Loans were in fact downstreamed from the Holding Company back to the Bank and improperly treated as new capital for purposes of the IMCR and beyond. NBE Chansen has testified, and Enforcement Counsel has at times suggested, that the capital at the Bank was overstated by the full amount of all Capital Raise Loans made over a "nearly two-year period" between April 2009 and March 2011.[150] This cannot be the case, however. Because the August 12, 2009 capital injection was the last time the Holding Company transferred funds to the Bank for capital purposes, any stock purchases made after that date—or, at most, after the third quarter of 2009, which is the timeframe used by Enforcement Counsel accounting expert Christine Salvato—that were funded by Capital Raise Loans necessarily could not have been downstreamed.

That is, the Holding Company made capital injections to the Bank during the relevant period twice, on May 11, 2009 and August 12, 2009, and the Bank reported the entirety of those amounts—$35 million—as Tier 1 regulatory capital on its balance sheet and all subsequent Call Reports.[151] Assuming the accuracy of the stock subscription log proffered by Enforcement Counsel, which Respondents have not contested, the Holding Company had raised $30.38 million through stock sales at the time of the first capital injection, and an additional $7.78 million between the first and second injections, for a total of $38.17 million raised from the date of the offering

[150] EC Br. at 25; *see id.* at 23 (stating that the Capital Raise Loans were made "for the sole purpose of inflating the Bank's capital"); Chansen Tr. 1285:7-11 (asserting that "as the Bank's financial condition continued to deteriorate, the omission of the $21 million raised via the Capital Raise Loans would have made a significant impact to ratings and to the OCC's enforcement actions"); Notice ¶ 31 (alleging without limitation that "Respondents caused the Bank to improperly inflate its capital by including the proceeds of the Capital Raise Loans as regulatory capital in the Bank's Call Reports").

[151] *See* EX 367 (Bank Call Report for period ending June 30, 2009) ("June 30, 2009 Call Report") at 8 (Schedule RI-A, Line 11); EX 368 (Bank Call Report for period ending September 30, 2009) ("September 30, 2009 Call Report") at 8 (same); *see also* EPF ¶¶ 152, 157, 403, 406-407; EX 363 (Expert Report of Christine Salvato) ("Salvato Report") ¶¶ 16, 18.

through August 12, 2009.[152] Of this, $15.26 million is ostensibly linked to a Capital Raise Loan and is thus in some sense the Bank's own money being routed to the Holding Company through borrowers.[153] Ms. Salvato and NBE Chansen agree that there is no concern from an accounting or regulatory perspective if (1) stock sales funded by the Capital Raise Loans were used to capitalize the Holding Company itself or to pay the Company's debts or expenses, rather than to serve as supposed new Bank capital;[154] or (2) the Holding Company downstreamed money to the Bank that did not come from the Capital Raise Loans but from other sources, such as the Company's own cash or sales of stock that the Bank did not fund.[155] Proceeds from stock sales occurring after the capital injections are also unproblematic, regardless of whether the sales were tied to Capital Raise Loans, because they could not have been downstreamed to the Bank.[156] Of interest, then, is solely the portion of the capital contributed from the Holding Company to the Bank in May and August 2009 that can be said to have originated from the Bank itself—this was not "new" capital and should not have been treated as such.[157]

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[152] *See* EX 374A (Capital Raise Loans Spreadsheet), rows 3-91; EX 158 (Subscription Agreement Log).

[153] *See* EX 374A (Capital Raise Loans Spreadsheet), rows 15-18, 20-22, 24, 26, 29-37, 39, 43, 48, 52-53, 55, 58-61, 65-66, 68, 70-74, 76-81, 83, 88-90. In calculating the amount of Capital Raise Loan-funded stock sales through August 12, 2009, this Tribunal used the loan amount tied to a given stock sale unless the loan was larger than the sale amount, in which case the sale amount was used. *See*, *e.g.*, *id.*, row 32 (reflecting $75,000 purchase of Holding Company stock following $100,000 loan from the Bank).

[154] *See* Chansen Tr. 1598:3-12; Salvato Tr. 1905:16-23; *see also* EX 143 (2009 Holding Company PPM) (at 31 ("We anticipate using a portion of the proceeds from the Offering to inject capital into our Bank. The remaining proceeds will be used for other general corporate purposes of the Company and possible future injections of capital into the Bank.").

[155] *See* Chansen Tr. 1568:3-1569:2; Salvato Tr. 1900:21-1901:24, 1903:18-1904:18.

[156] *See* EX 363 (Salvato Report) ¶¶ 26, 29 (applying conclusions only to "the Capital Raise Loans that were originated in the quarters ending on June 30, 2009 and September 30, 2009," because the funds from these loans "were used to purchase stock in the Holding Company, which then transferred the funds to the Bank as capital contributions").

[157] *See* Brickman Tr. 135:14-25 (not permissible to treat capital injections funded by the Bank as new capital); Chansen Tr. 1607:22-1608:3 ("[T]he loans themselves . . . were not illegal. It was the method of downstreaming the capital via the capital raise loans to the bank, and the bank including that in their capital calculations which overstates the bank's financial condition."); Salvato Tr. 1794:21-1795:1 ("[A]ny of the portion of the capital raise loans that should not have been included in bank equity would have affected and reduced bank equity in all subsequent call reports through the period ending June 2013.").

Relying on the analysis prepared by NBE Chansen and generally credited by this Tribunal, Ms. Salvato concludes that $17.3 million of the $35 million in capital contributed to the Bank by the Holding Company through the two capital injections in 2009 was financed by the Capital Raise Loans and thus should not have been reported as Tier 1 regulatory capital.[158] Ms. Salvato makes several key assumptions in reaching this conclusion, including that the Capital Raise Loan spreadsheet prepared by NBE Chansen accurately and fully reflects which Holding Company stock sales were funded by Capital Raise Loans;[159] that any stock sale funded by a Capital Raise Loan that occurred within the same fiscal quarter of one of the two capital injections should be considered part of that capital injection, even if it occurred after the date of the injection itself;[160] and, most significantly, that every dollar generated from the stock sales funded by Capital Raise Loans in the second and third quarters of 2009 was ultimately downstreamed from the Holding Company to the Bank.[161] Each of these assumptions merits some additional discussion.

First, there is at least one entry on NBE Chansen's spreadsheet, that of Enrique Regules, that is different in several key ways from others denoted as Capital Raise Loans; the undersigned thus finds that there is some reason to question, based on the evidence provided, whether it is appropriately included in Ms. Salvato's calculations.[162] According to the spreadsheet, Mr. Regules purchased $2,025,000 in Holding Company stock on May 8, 2009, and subsequently received a

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[158] *See* Salvato Tr. 1793:12-14; EX 363 (Salvato Report) ¶¶ 19, 26, 29 (concluding that "the Bank's improper accounting with respect to the Capital Raise Loans caused the Bank's assets and capital to be overstated by $12.6 million beginning with the June 30, 2009 Call Report and $17.3 million as of the September 30, 2009 Call Report"). As discussed further *infra*, the discrepancy between this figure and the figure arrived at by the Tribunal above is explained by Ms. Salvato's use of the third-quarter end of September 30, 2009, rather than the August 12, 2009 capital injection, to capture all Capital Raise Loan-funded stock sales that might have been improperly downstreamed to the Bank. *See* EX 374A (Capital Raise Loans Spreadsheet), rows 92-95 (stock sales totaling $2.08 million occurring between August 14, 2009 and September 22, 2009).

[159] *See* EX 363 (Salvato Report) ¶ 14; Salvato Tr. 1774:3-23 (reliance on accuracy of spreadsheet).

[160] *See* Salvato Tr. 1772:5-1773:7, 1778:9-17.

[161] *See* EX 363 (Salvato Report) ¶ 19; Salvato Tr. 1793:6-17.

[162] *See* EX 374A (Capital Raise Loans Spreadsheet), row 26.

Bank loan in the amount of $2,180,000 on August 21, 2009.[163] The loan, which was in the name of Citricos de Tamiahua, S.A. de C.V. with Mr. Regules as guarantor, was approved at the July 21, 2009 L&D Committee meeting for the purpose of "working capital and business investments," featured a 4.25 percent interest rate, and was secured by 3,700 acres of Mexican farmland.[164]

In terms of inclusion among the cohort of Capital Raise Loans made for the purpose of purchasing Holding Company stock, the details of this loan are problematic in multiple respects. To begin with, the loan itself was made more than three months *after* the stock purchase, meaning that whatever else happened, Mr. Regule did not directly purchase the stock with money provided by the Bank.[165] This is in contrast to almost all of the Capital Raise Loans, in which the loan preceded the stock purchase and can thereby be said to have funded it more straightforwardly.[166]

Furthermore, the loan amount exceeded the amount of stock purchased by $155,000, a number that sticks out in a spreadsheet where most differences between loan amount and purchase amount are either negligible, roundly divisible, or explained in the column entitled "OCC Examiner Notes."[167] No such explanation is provided for the Regules loan. Instead, NBE Chansen notes that it is her understanding that Mr. Regules "indicated to the OCC that he obtained a loan through Citricos de Tamaiahua SA de CV to purchase stock," a recollection that she repeated at

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[163] *See id.*

[164] EX 201 (July 21, 2009 L&D Committee meeting minutes).

[165] *See* EX 256 (May 8, 2009 Regules subscription agreement) at 2 (indicating that the stock purchase was paid in full at the time of the subscription).

[166] The only other notable exception is the $1,000,000 secured loan made to Norberto Salinas, which is recorded as being made on July 23, 2009, one and a half months after Mr. Salinas's May 8, 2009 purchase of $1,000,000 of Holding Company stock. *See* EX 374A (Capital Raise Loans Spreadsheet), row 35; Chansen Tr. 1246:20-1247:3. In that case, however, Mr. Salinas's loan was approved at the May 5, 2009 L&D Committee meeting, three days prior to his stock purchase, and it is therefore far more reasonable to conclude that the two transactions are linked and that the loan was extended in connection with the Bank's capital raise efforts. *See* EX 247 (May 5, 2009 L&D Committee meeting minutes) at 2; Chansen Tr. 1247:7-12.

[167] *See*, *e.g.*, EX 374A (Capital Raise Loans Spreadsheet), rows 15-18, 21-22, 24, 29-32, 34-37, 43, 48, 55, 58-60, 65-66, 71-73, 76, 80, 83, 88, 92, 95, 102, 108 (differences of $0, $25, or $50 between loan and stock purchase); *id.*, rows 52, 61, 68, 90, 93-94, 112, 119-121, 126 (in which the loan amount is either half or twice the size of the stock purchase); *id.*, rows 33, 111 (details given re difference in amounts).

the hearing with some variation.[168] The undersigned credits NBE Chansen's recollection, and observes only that the evidence beyond this testimony that Mr. Regules's loan was one of the Capital Raise Loans is scant at best—which illustrates the somewhat precarious foundation on which Ms. Salvato's conclusions regarding overstatement of capital are situated, given that this $2 million in stock proceeds is a significant part of the $17.3 million that was allegedly improperly downstreamed.

Second, there are several Capital Raise Loans for which the corresponding stock purchases totaling $2.08 million took place after the second and final capital injection on August 12, 2009, and yet Ms. Salvato includes them in her calculations of capital that was improperly downstreamed to the Bank because both the capital injection and the loan dates occurred in the third quarter of 2009.[169] There may be a valid accounting reason for dating the respective capital injections "as of June 30, 2009" and "as of September 30, 2009" rather than on the specific dates that the capital was in fact contributed to the Bank,[170] but Enforcement Counsel does not provide one, and the undersigned notes that such an approach results in Ms. Salvato concluding that the $2.08 million in Holding Company stock sale proceeds described above was downstreamed to the Bank before the stock itself was actually sold.[171]

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[168] *Id.*, row 26; *see also* Chansen Tr. 1231:14-15 (stating that Regules "is one of the borrowers that reached out to the investigator indicating that he had invested in the bank via a loan"),1246:3-9 ("This goes back to my conversation that I had with the FDIC investigator where he informed me that Mr. Regules called the FDIC and informed him that the stock proceeds were used to purchase stock.").

[169] *See* EX 374A (Capital Raise Loans Spreadsheet), rows 92-95. It is unclear why the relevant date for determining whether the proceeds from a stock sale funded by a Capital Raise Loan were improperly downstreamed to the Bank would be the date of the loan rather than the date of the stock purchase, but this was the method employed by Ms. Salvato when the loan and stock purchase occurred in different fiscal quarters. *See* Salvato Tr. 1780:11-23 (placing Regules transaction in third quarter of 2009 for purposes of determining overstatement of capital, when stock purchase occurred in second quarter and loan was made in third quarter).

[170] Salvato Tr. 1772:13-21.

[171] *See id.* 1778:15-17 (noting that when determining which loans should be accounted for in connection with the August 12, 2009 capital injection, she "included all dates between 7/1/2009 and 9/30/2009").

Finally, the undersigned finds that Enforcement Counsel has not adequately established, from an accounting standpoint or as a matter of simple logic, why every possible downstreamed dollar of the May and August 2009 capital injections should be presumed to have improperly originated from Capital Raise Loan-funded stock sales when the Holding Company indisputably had millions of dollars from legitimate sources that could also have been used to capitalize the Bank. According to NBE Chansen's spreadsheet, $19.77 million of the Holding Company stock sold from the beginning of the offering through the first capital injection was not tied to a Capital Raise Loan and could thus be downstreamed to the Bank as new capital without concern.[172] Between the first and second capital injections, another $3.14 million of untainted capital was raised through the stock sale, for a total of $22.91 million as of August 12, 2009.[173] Add to this the $8.8 million in cash and equity securities already held by the Holding Company prior to the capital raise, and the Holding Company had nearly $32 million by which it could have capitalized the Bank without accounting for or including the Capital Raise Loans in any way.[174]

Of course, this is a counterfactual: Over $15 million in Capital Raise Loans-funded stock proceeds was in fact added to the Holding Company's coffers during this time, and there is no way to trace which particular dollars were downstreamed to the Bank and which were used for other

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[172] *See* EX 374A (Capital Raise Loans Spreadsheet), rows 1-14, 19-20, 23, 25, 27-28, 38, 40-42, 44-47, 49-52, 54, 56-57. This calculation includes the difference between stock purchase amount and loan amount in instances where a Capital Raise Loan borrower purchased more Holding Company stock than the amount of their loan.

[173] *See id.*, rows 62-64, 67, 69, 74-75, 82, 84-87, 89-91.

[174] *See* RX 87 (March 31, 2009 Holding Company balance sheet) at 5 (reflecting $6.15 million in cash and $2.7 million in equity securities held by the Holding Company); Ortega Tr. 902:24-903:5. Respondents assert that the Holding Company had over $38 million in cash not associated with the Capital Raise Loans that it could have downstreamed to the Bank, thus covering both capital injections. *See* RPF ¶ 43. This number, however, includes the proceeds from all of the capital raise efforts up through 2011, not simply the stock sales that occurred prior to the capital injections. *See id.* ("[I]t was undisputed that during the capital raise the Holding Company raised well over $30 million from sources *other* than the so-called capital raise loans.") (emphasis in original); Ortega Tr. 902:2-903:11; Chansen Tr. 1594:19-1596:3. As the undersigned has noted, funds raised after the capital injections could not have been downstreamed to the Bank regardless of their provenance, because the Holding Company did not have those funds when the money was downstreamed, and—as far as this Tribunal is aware—time is linear.

purposes.[175] But it is one thing to conclude that the Bank's regulatory capital was improperly inflated, post-capital injections, by the transfer of some undetermined amount of money from the Holding Company to the Bank that had initially come from the Bank itself—as discussed below, even Respondents themselves concede that proceeds from Capital Raise Loans-funded stock sales made their way into the capital injections to some extent. That does not mean that it is justified to assume, as Enforcement Counsel directed its accounting expert to do when forming her opinions, that *all* of the money that the Holding Company had raised at that point through Bank-financed stock purchases was recontributed to the Bank as "sham" capital in the May and August 2009 capital injections, given the commingling of that money with a large pool of other capital unrelated to the Capital Raise Loans.[176]

At bottom, Ms. Salvato was not asked to take into account any money that the Holding Company already had or had raised by non-Capital Raise Loans means when conducting her analysis,[177] and the undersigned finds that any conclusions regarding the composition of the capital injections and how much "sham" capital they may be said to have contained are outside the scope of her expert opinion as a result.[178] Further, the undersigned agrees with Respondents that the burden is on Enforcement Counsel to show that all of the proceeds from the Capital Raise Loan

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[175] *See* Chansen Tr. 1597:7-16 (stating that it would be "impossible" for anyone to "track which dollar bills from the Holding Company got downstreamed to the Bank versus other dollar bills," because "the dollar bills in the Holding Company's bank account are all in there in one account"); EC Reply at 14 ("[M]oney is fungible, and all funds maintained by the Holding Company were comingled [*sic*]."); RPF ¶ 44 ("[T]he Holding Company did not segregate its cash by source of funds.").

[176] *See* EX 363 (Salvato Report) ¶¶ 15, 17, 19 (assuming as true, for the purposes of the expert report, that $12.6 million in Capital Raise Loans was financed in the second quarter of 2009, that $4.7 million in Capital Raise Loans was financed in the third quarter of 2009, and that all $17.3 million of Capital Raise Loan-related stock sales was included in the $35 million contributed from the Holding Company to the Bank in the capital injections).

[177] *See* Salvato Tr. 1906:23-1907:18 (stating that she "would be interested in seeing a calculation" of how much other money the Holding Company had at its disposal during the second quarter of 2009).

[178] *See* EX 363 (Salvato Report) ¶ 19 ("Of the $35 million contributed to the Bank by the Holding Company in the quarters ending on June 30, 2009 and September 30, 2009, at least $17.3 million represented cash proceeds generated from the Capital Raise Loans.").

stock sales were downstreamed to the Bank in order to support a conclusion that the Bank's capital was overstated by that amount,[179] and it has not met that burden here.[180]

To some degree, this question is moot, because both Respondents acknowledged during their testimony that at least some of the dollars held by the Holding Company and originating from the Capital Raise Loans were downstreamed back to the Bank.[181] The third leg of the Capital Raise Loan Scheme triangle has thus been established. Yet the issue of exactly *how* overstated the Bank's reported capital was following the capital injections is important in its own right, as it bears upon both the materiality and the scope of the alleged misconduct. This is addressed in the appropriate sections below. For now, it is indisputable that all $35 million of the capital injections were reported as Tier 1 regulatory capital, something that the Bank never adjusted or corrected prior to its failure in 2013,[182] and the undersigned credits Ms. Salvato's expert opinion that any money originating from the Capital Raise Loans would not have counted as Tier 1 regulatory capital for the Bank and should not have been reported as such.[183] The Bank's capital levels from the second and third quarters of 2009 through the remainder of its operation were therefore overstated by whatever amount of Capital Raise Loan-related proceeds were downstreamed—whether that

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[179] *See* Rs Br. at 26.

[180] *See also* RX 41 (email chain including March 28, 2014 email from B. Paulson to R. Chansen et al.) (internal OCC email stating that "we have not proven that the source of funds for the holding company capital injection was in fact loans from FNB"); Brickman Tr. 197:7-198:2 (identifying email author and recipients as OCC personnel).

[181] *See* Rogers Tr. 328:13-20 ("Q: You have indicated that the Board of Directors approved the plan to extend bank loans to investors to buy FNBG stock and then downstream those same funds back to the bank as Tier 1 capital, correct? A: [T]hat's basically what happened, yes, ma'am."); Ortega Tr. 493:15-17 ("I would say that some of the stock, some of those loans actually came back to the Bank."); EX 569 (Ortega Dep.) at 34:24-35:4 (agreeing that the Bank "[made] loans that the borrower would then use the proceeds of the loan to purchase stock in the bank holding company and the bank holding company would then downstream the funds back to [the Bank]").

[182] *See* EX 363 (Salvato Report) ¶¶ 16, 18 (noting that the Bank recorded the capital injections "as surplus, a component of regulatory capital, . . . and continued to reflect that amount as regulatory capital in each subsequent quarterly Call Report filing until the Bank failed in September 2013"); Salvato Tr. 1795:6-13 ("[T]he Bank did not make any type of adjustment to reduce its capital as reported for the Capital Raise Loans.").

[183] *See* EX 363 (Salvato Report) ¶¶ 21, 30; Salvato Tr. 1770:24-1771:3 ("I believe a faithful representation would have been for the bank to offset the note receivable against the surplus that was reported and, as a result, eliminating any increase in capital.").

amount is $3 million (if one presumes that $32 million of the capital injections came legitimately from the Holding Company's other funds) or $17.3 million (if the assumptions relied upon by Ms. Salvato are justified), or somewhere in-between.[184]

7. Loss to the Bank

On June 12, 2013, the Bank recorded combined losses of $387,240.63 on Capital Raise Loans that it had made to Blanca Gonzalez and José Rodriguez.[185] Both of these loans and their corresponding purchases of Holding Company stock were made in early to mid-May 2009, and thus the proceeds were part of the Holding Company's commingled funds at the time of the capital injections.[186] NBE Chansen also found that, at the time of the Bank's failure in September 2013, numerous other Capital Raise Loans borrowers had not paid off their loans.[187] As a result, the FDIC as receiver for the failed Bank suffered $3,808,058.28 in losses when certain outstanding Capital Raise Loans were charged off as part of the receiver's efforts to maximize recovery on Bank assets for the receivership.[188]

D. OREO Lending Strategy (Article IV)

Article IV of the Notice alleges that "Respondents developed and implemented a new lending strategy from late 2008 through at least September 2011" ("OREO Lending Strategy") in which the Bank originated, and Respondents approved or ratified, "unsafe or unsound loans to finance the sales of the Bank's OREO at above-market prices, which enabled the Bank to reduce or avoid reported losses that it would otherwise have recorded on sales at fair market values."[189]

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[184] It should be noted that, as discussed further *infra*, Ms. Salvato testified at the hearing that even if the full amount of $17.3 million had been excluded from the Bank's reported capital, the Bank would still have had an 8.5 percent Tier 1 capital ratio, sufficient to meet the 8 percent IMCR imposed by the OCC. *See* Salvato Tr. 1923:16-1925:1.

[185] *See* EPF ¶ 182; EX 389 (Bank Loan Losses and Recoveries, 1994 to 7/12/2013), rows 24107, 24108.

[186] *See* EX 374A (Capital Raise Loans Spreadsheet), rows 48, 55.

[187] *See* EPF ¶ 183; Chansen Tr. 1242:13-1243:11.

[188] *See* EPF ¶ 184; Locke Tr. 1994:24-2006:3.

[189] Notice ¶ 55.

It furthermore alleges that Respondents then "caused the Bank to inflate its capital by improperly accounting for the OREO sales and loans with below-market rates."[190]

Given the factual complexity of these allegations, Enforcement Counsel's motion for summary disposition addressed this Article solely with respect to the Bank's loan to NAHS Real Estate, L.P. ("NAHS"), which Enforcement Counsel asserted was "representative" of the OREO Lending Strategy.[191] In its October 5, 2021 Order on the Parties' summary disposition motions, this Tribunal identified certain questions of disputed material fact regarding the NAHS loan, including the scope of Respondents' responsibility and involvement in the alleged misconduct related to the NAHS loan; the riskiness of the NAHS loan and other OREO loans at the time they were made and the Respondents' understanding thereof, based on their reliance on the information presented to them and on the expertise and assurances of colleagues; the extent to which the terms of the NAHS loan and other loans were "below-market" or otherwise deviated from typical market conditions at the time; and the extent to which the Bank or the FDIC receivership incurred a loss as a result of the NAHS loan's approval and ratification or the approval and ratification of any of the other loans at issue.[192]

Viewing the totality of the evidence, and as elaborated upon below, the undersigned now makes the following core findings: **(1)** Respondents were among the individuals who bore ultimate responsibility for the OREO Lending Strategy; **(2)** the Bank adopted an aggressive strategy to get rid of its ORE beginning in late 2008, which included loosening its underwriting standards for ORE financing and offering concessionary terms on loans to prospective borrowers identified by

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[190] *Id.*

[191] EC-PSD-59 (Chansen Decl.) ¶ 29; *see* MSD Order at 18.

[192] *See* MSD Order at 25. Enforcement Counsel did not move for summary disposition on its allegations of improper accounting practices relating to the OREO Lending Strategy, and Respondents' motion for summary disposition did not discuss those allegations in detail. *See id.* at 23 n.86.

the lending department; **(3)** there is extensive evidence that Bank management chose to finance ORE purchases in this manner because it believed the properties to be worth more than what "speculators" and "scavengers" would offer for them, and because borrowers could not get loans from other banks to purchase the Bank's ORE given the financial climate; **(4)** Respondents regularly approved and ratified OREO loans without adequate documentation of the borrowers' finances or ability to pay and, in the case of Respondent Ortega, without reading the loan packages; **(5)** Respondents regularly approved and ratified OREO loans with liberal terms that violated the Bank's loan policy and increased the risk to the Bank; and **(6)** the FDIC as receiver for the Bank suffered loss with respect to certain OREO loans. In addition, the undersigned credits the expert opinion of Ms. Salvato "that the Bank's improper accounting with respect to the OREO loans caused the Bank's assets and capital to be overstated by at least $9.5 million beginning with the December 31, 2011 Call Report" and continuing through the Bank's failure.[193]

1. The Negative Impact of OREO

The amount of OREO on the Bank's balance sheet—foreclosed real estate properties that the Bank owns because the loans for which they served as collateral have defaulted—increased significantly and continuously as the economy crashed in 2008 and throughout the financial crisis, with COO/Comptroller Ryan Leal describing it as "like drinking out of a firehose."[194] Carrying OREO properties has "an adverse effect on [a] bank's financial condition," because they earn the bank no money and can cost a substantial amount monthly.[195] The more OREO that a bank owns,

[193] EX 363 (Salvato Report) ¶¶ 46-47; Salvato Tr. 1863:10-1864:25.

[194] Leal Tr. 2287:8-25; *see* EPF ¶¶ 186, 190; Ortega Tr. 944:18-23 (stating that as of early 2013, the Bank was "dealing with about 650 different [ORE] properties . . . [with] close to $300 million in value").

[195] Chansen Tr. 1293:13-14; *see id.* 1293:15-1294:5 (noting that a bank must pay regular property tax, maintenance, insurance, and other costs on an OREO property, all of which "are a hit to the bank's earnings and [its] capital"); Ortega Tr. 953:14-954:11 (discussing the millions of dollars of costs and expenses incurred by the Bank while holding OREO); Rogers Tr. 370:21-24 ("It was important for us to get it out of the bank and have somebody else maintaining it, paying the insurance, paying the taxes.").

the worse it is for the bank; there is no real upside. External accountant Ben Pena testified that ORE can be projected to cost a bank a great deal of money even if the ORE has a significant appraised value, and that putting the ORE "in the hands of a borrower who can make even, say, one payment" would "generate a better situation for the bank than just sitting there and holding it and losing money every month."[196]

Moreover, banks are not well-equipped to manage OREO properties for an extended term, whether the property is a vacant lot or empty building that requires development or a business like a hospital (which the Bank held on its books on multiple occasions during this period) that should be actively operated in order to maintain its value and continue to provide services.[197] Respondent Ortega explained the Bank's approach to its OREO holdings during his tenure:

> You try to sell it as quickly as you can. You know, we've got to get it into – as banks, I quickly figured out that we – we're bankers. We're not good managers of real estate. We're not good managers of properties. So you quickly want to get them into the borrowers or the people that are interested in the properties. And immediately, you know, once you get it in their hand, immediately, they start paying the taxes. They start paying the insurance. They start maintenancing. They start taking care of the property. So we're way ahead once we get them into somebody else's hands.[198]

The value of OREO properties also must be regularly reappraised, which costs money and can lead to writedowns and losses if the fair market value of a property has declined, as was likely

[196] Pena Tr. 1184:22-1186:1; *see also* Chansen Tr. 1665:23-1666:13 (agreeing that it benefits a bank to remove OREO from its books even if it ends up foreclosing on the property again some months later).

[197] *See* Ortega Tr. 961:19-25 ("The value of a hospital usually is the license. . . . [T]he buildings and the real estate are worth so much, but the ability to provide a service and bill and generate revenue, there's no question that if you don't have a license, then the hospital has to be shut down."); *see also id.* 960:12-21 ("[A]t one point we were spending probably a million dollars a month to be able to pay for the supplies. . . . There's patients. There's nurses. There's doctors. These people are trying their best to try to take care of these patients. Obviously there's revenue coming in, but not enough to be able to pay for all their bills and all their payroll."), 961:9-14 ("[J]ust trying to keep this hospital open. . . . It's a very difficult situation, especially when you've got kids in the hospital. You've got older individuals that need services. I wish it was very simple just to come and say, you know, shut it down. We couldn't do it for a few reasons."); JX 6 (2012 ROE) at 48 (stating that hospital properties being carried on the Bank's books "require significant monthly operating capital").

[198] Ortega Tr. 954:15-955:2.

during the global financial crisis.[199] For this reason, "[r]esolving OREO properties in a timely manner is critically important because the value of OREO deteriorates . . . [and] the risk of loss mounts over time."[200] It is therefore in a bank's best interest "to take steps to move the OREO off [its] books" as soon as possible,[201] particularly when more OREO is being added to the bank's books every month as a result of more foreclosures and repossessions.[202] On this issue, as the crisis continued and the OREO holdings mounted, the Bank and the OCC were very much aligned.[203]

2. <u>OREO Financing and the Bank's Dilemma</u>

It appears uncontroverted, then, that beginning in 2008—as the Bank experienced severe capital issues following the failure of Fannie and Freddie—OCC examiners shared a sense of justifiable urgency with Bank management regarding the need to remove OREO from the Bank's balance sheet in whatever way that could be achieved.[204] Management, in turn, made the decision to accomplish that end through an aggressive strategy of finding potential borrowers and financing their purchase of its ORE at the appraised value of the property, often with favorable loan terms

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[199] *See* JX 3 (June 30, 2010 Report of Examination) ("2010 ROE") at 6 ("[U]ntil the level of OREO is reduced, earnings will be exposed to declines in market values of OREO."); Chansen Tr. 1293:23-1294:2; Ortega Tr. 953:19-24 ("You've got to get appraisals once a year. In the meantime, [the] real estate market is not doing well. So the longer you hold it, the more the chances the value goes down.").

[200] EPF ¶ 187; *see* Brickman Tr. 110:8-112:4.

[201] Chansen Tr. 1295:15-16; *see also id.* 1673:21-23 ("I would agree that holding OREO for an extended period of time is not in the bank's best interest.").

[202] *See* JX 6 (2012 ROE) at 3 ("OREO sales are behind the inflow of new OREO. During this examination the net OREO balance increased $22 million."); Leal Tr. 2287:11-2288:20 ("[W]e knew more was coming so we had to—it's like the produce guy. You know, you move your two-day old bananas up to the front because you've got more bananas coming in. So we had to get those things moved out as quickly as possible.").

[203] *See* JX 2 (2009 ROE) at 12 ("Management recognizes that holding OREO is not in the best interest of the bank or its shareholders."); JX 4 (June 30, 2011 Report of Examination) ("2011 ROE") at 6 ("[T]he growing OREO portfolio combined with increasing loan losses, OREO write-downs, and increased OREO holding costs will continue to negatively impact earnings.").

[204] *See* Ortega Tr. 938:21-23 (stating that examiners "were very involved and really just encouraging us to sell this ORE" because they understood that the Bank holding OREO is "not a good thing. It's not earning for us. It's costing us money. So they're really encouraging us to get it to somebody else, get it earning."), 952:24-25 ("[T]hey're telling us to sell the ORE.").

as an inducement.[205] The OCC now asserts that the Bank should either have lowered its asking price for the OREO (even if it meant writing down the property's value and recording a loss) or sold to interested parties who were being financed by other banks, rather than finance the purchases itself with concessionary terms and ultimately increase the risk to the Bank.[206] The undersigned credits the weight of the testimony by Respondents and others in Bank management that they viewed those other options as either undesirable or infeasible at the time, however, and finds that there is an element of hindsight in the agency's current position.

To begin with, Enforcement Counsel asserts that "it would have been prudent for the Bank to price its OREO properties below appraised values to sell the properties because often the Bank's appraisals were not current or because market conditions warranted a lower asking price."[207] This approach is supported by NBE Chansen's testimony that "most of the banks [that] were actively marketing their OREO properties" during this time period "were taking an active role in reducing the asking prices in order to remove those properties off their books."[208] According to NBE Chansen, the fact that the Bank did not also do this is an indication that Bank management, including Respondents, was improperly seeking to avoid recording losses on property that was not worth what they were asking.[209]

Management offers an alternative explanation. In detailed and credible testimony, Respondent Ortega and Mr. Gandy acknowledge that it would have been possible for the Bank to sell its OREO at a reduced price rather than financing purchases itself at the appraised value, but

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[205] *See*, *e.g.*, JX 2 (2009 ROE) at 12 ("Management aggressively sells OREO to those they identify as having the best chance for success in holding the OREO and repaying the bank."); Rogers Tr. 369:21-370:3, 377:1-16, 447:23-448:2 (agreeing that the Bank was aggressive in its efforts to sell ORE "after the [Fannie and Freddie] disaster").

[206] *See*, *e.g.*, EPF ¶¶ 188, 210-211; Chansen Tr. 1294:17-24, 1295:15-22.

[207] EPF ¶ 211.

[208] Chansen Tr. 1294:17-24; *see also id.* 1294:25-1295:7 (stating that when a bank lowers its OREO sale price, it will "take a loss relative to the value of what they have it on their books at" when the property is sold).

[209] *See id.* 1543:6-21; *see also* EPF ¶¶ 190, 213-214.

state that the motivations for not doing so stemmed, at least in part, from a good faith belief that the properties were worth more in the long run than the "speculators" and "scavengers" of the time were willing to pay.[210] As the individual in charge of implementing the Bank's OREO strategy, Mr. Gandy's perspective on the topic merits extended quotation:[211]

> Well, our philosophy and my philosophy in particular was, okay, we've got the OREO. It's Texas dirt. And if you know anything about economics, Texas dirt is more valuable than dirt anywhere else in the United States. Texas has got those – was at the time and still is and has been for the last 20 or 30 years the strongest market in the United States.
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> So we had a good footprint across the state. We had, as I say, the best dirt in the country even though the whole real estate market was upside-down. This Fannie and Freddie when it blew up and the big banks started dumping their real estate, it blew the heck out of the market. So there wasn't a way to sell anything in sort of the regular market because that market didn't exist. . . . [I]t was not an orderly market. It was a fragmented market that the only people that were in it basically buying stuff were the speculators and the scavengers.
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> So there was not an active market for, you know, people to buy stuff unless you wanted to buy it at 50 cents on the dollar. And we didn't want to sell our valuable real estate at 50 cents on the dollar. We'd rather make a loan to somebody who would take it at the value that it was appraised and put it to work and develop it and make a – have them make a profit and have us get paid. That was sort of the program. And so that's what we did.
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> **
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> Say you've got a million-dollar piece of OREO, right? Well, the regulators at that time would say, you need to dump this thing. You need to be like the big banks. You need to throw this thing out in the street and get what you can get for it by the scavengers. Well, the scavengers would give you 50 cents on the dollar, okay? So if you had a million-dollar piece of real estate, the scavengers would give

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[210] Gandy Tr. 2226:3.

[211] *See* Rogers Tr. 447:13-16 ("[Gandy] was very aggressive. He could see we needed to boot up the ORE. He pushed it. I thought he did a fantastic job. He got ORE back out, earning."); JX 3 (2010 ROE) at 11 (identifying Gandy as the person most responsible for resolving the Bank's OREO); Ortega Tr. 934:2-9 (same).

> you $500,000 cash for it, but it's still a million dollars' worth of real estate in Texas in good communities.[212]

Respondent Ortega agreed, testifying that he viewed it as part of his "duty to the bank" not to sell OREO properties for significantly less than their appraised value:

> I have a responsibility. And I felt very strongly of being extremely careful and not selling the properties for a value, you know, lower than the appraised value. I think that I could always have taken the idea that I'm going to sell these properties for 60, 70 percent of the appraised value. I don't know that my duty to the bank would have been correct. So any time that we were trying to sell a piece of property, I always tried to stay close to the appraised value.[213]

This Tribunal cannot vouchsafe the accuracy of Mr. Gandy's characterization of the real estate market during those extraordinarily turbulent times, nor does it express any view regarding the relative value of Texas dirt. But the undersigned credits this testimony as one plausible explanation for Bank management's reluctance to lower the asking price on the Bank's OREO properties in order to get them sold, if management felt that doing so would not reflect the properties' true value over time and if it believed that other avenues were available that would enable the Bank to reduce its OREO holdings by selling them at their appraised value.[214]

Next, the Parties disagree as to whether the Bank could easily have sold its ORE to parties financed by other banks rather than financing the purchases itself, and the undersigned finds that the weight of the evidence lies with Respondents. NBE Chansen testified that most institutions "would prefer to have the property out of the bank totally and have the OREO financed, if it had to be financed, outside of their institution to the bank down the street."[215] She stated that none of

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[212] Gandy Tr. 2224:24-2225:7, 2225:15-2226:3, 2227:22-2228:6, 2233:25-2234:11.

[213] Ortega Tr. 946:23-947:18.

[214] The undersigned also credits evidence adduced by Enforcement Counsel indicating that, even if it was not the sole motivation, a desire to avoid recording losses on sales did play a part in the Bank's approach to its OREO portfolio during this period. *See* EPF ¶¶ 214, 216, 245.

[215] Chansen Tr. 1295:15-22.

the other banks in her portfolio at that time were financing their own OREO properties, with the exception of the Bank.[216] She acknowledged, however, that she had no information regarding whether any "potential ORE purchasers ever went to another bank to inquire about financing," let alone whether they could have received it, and thus she could not opine on "what other banks were willing to do" with respect to financing the Bank's OREO specifically.[217]

By contrast, Bank management testified that there was no "bank down the street" that was amenable to financing the purchases of another bank's ORE during this period, at least in the areas in which the Bank was operating, and the undersigned credits this testimony in the absence of meaningful evidence to the contrary from Enforcement Counsel. Mr. Leal, for example, recalled that "at that point in time, nobody—and I mean no banks out there were providing financing for other banks' repossessions. We had no choice. We had to finance our own repossessions because nobody—no other bank was doing that."[218] Mr. Magee stated that "there just wasn't much of a market for real estate period, much less what was being foreclosed on or owned by other banks."[219] Mr. Gandy and Respondents offered similar recollections.[220] And in his April 28, 2009 letter to

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[216] *See id.* 1295:23-1296:4; *see also id.* 1295:8-12 (testifying that in her experience, it is "unusual for a bank to finance the sale of OREO in-house").

[217] *Id.* 1638:2-18 ("Q: The difficult financial conditions, the horrid financial conditions created a situation where there weren't other banks available to finance ORE transactions, correct? A: Again, you're asking me what other banks were willing to do, and I don't have a response to that."); *see also id.* 1638:23-1639:2 ("I don't know specifically what the potential borrowers – if they actually went to another institution to see if they could obtain a loan. I don't have that information.").

[218] Leal Tr. 2286:12-17.

[219] Magee Tr. 2083:3-18 (stating also that "[a]t that point, I think most banks had stopped lending on real estate relative to the collapse of the market"); *see also id.* at 2182:16-25 ("[T]he whole downturn in the real estate market was widespread, deep, so nobody was purchasing and nobody was lending.").

[220] *See* Gandy Tr. 2227:15-19 ("There was no liquidity in the market. Nobody could go get a loan. The big banks had been told to shrink, shrink, shrink, shrink. So the only way they could shrink was not to make loans."); Rogers Tr. 382:23-383:5 ("Everybody was fighting and trying to survive. The liquidity wasn't there. ORE wouldn't move. We were doing the best we could do in a really tough environment."); Ortega Tr. 617:5-8 ("Real estate markets were horrible. We were coming off of the worst recession since the Depression. There are no other banks that are willing to finance another bank's ORE."), 936:8-14 ("[A]t this point, after the disaster, again, it's a war zone. It's difficult. Other banks don't want to finance ORE. . . . [Y]ou know, why would they want to take our one bank – our bank's other real estate and put it on their books.").

the OCC, Mr. Gandy also framed this issue in no uncertain terms, stating that "[t]he downsizing of [the Bank's] loan portfolio has been greatly impeded by the shutdown of lending by most Texas banks including, importantly, our biggest competitors in the Valley."[221]

On balance, then, the undersigned finds that Enforcement Counsel's current stance—that the Bank could simply have lowered its asking prices or found other qualified purchasers rather than engage in in-house financing of its OREO sales—is not necessarily reflective of the difficult position in which the Bank found itself when seeking to reduce its OREO portfolio as quickly as possible, month after month, in an economically depressed region during one of the greatest financial crises in this nation's history. Because this action hinges in part on Respondents' state of mind over the course of the alleged misconduct, this Tribunal will not presume that the Bank's options were as straightforward as they would have been in more normal times, or that Respondents blithely deviated from the only reasonable paths, if there is at least some credible and uncontroverted evidence to suggest that the decisions faced by Bank management were not easy ones and the solutions in no way as clear-cut as Enforcement Counsel now suggests. This is particularly true given the evidence adduced by Respondents of the OCC examiners' general awareness and approbation of the outline (if not the details) of the Bank's OREO lending strategy in the context of the time, as described further below.[222]

The Bank's approach to selling its ORE during this period relied, at least in theory, on its loan officers' knowledge of the communities in which they operated and their familiarity with potential borrowers and the properties themselves. Then-President/CEO Gandy, the principal architect of the Bank's strategy, described it like this:

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[221] EX 149 (April 28, 2009 Letter) at 1.

[222] *See*, *e.g.*, JX 3 (2010 ROE) at 33 (stating that "[m]anagement has been able to sell OREO properties, but has had to finance the sales.").

> I tasked our loan officers – I said, you're familiar with your property because you made the loan. You need to find a borrower that knows this property that's in your community that you're familiar with that you have confidence in can make this thing work. You go find a borrower for them, and let's see if we can make a deal with them under some reasonable terms to take the property. . . . I tasked the loan officers with going out and finding customers for these properties and finding buyers for them. And they did. They did. They brought in people that were well-qualified to buy this stuff and to put it to good use. And not that every deal was perfect, but, you know, 95, 99 percent of them worked.[223]

At this point, the Bank had severely curtailed all non-OREO lending activity in an effort to shrink the Bank's balance sheet,[224] which freed up the loan officers to actively "find borrowers that we felt could take a project and make something out of it."[225]

For better or worse, personal—or at least institutional—familiarity with borrowers played a large role for Bank management as well.[226] In discussing specific OREO loans during the hearing, management repeatedly referenced the fact that the borrowers were known to the Bank,[227] in one case describing their ability to monitor the progress of a Bank-financed OREO purchase personally during their daily commutes:

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[223] Gandy Tr. 2228:13-2229:5; *see also* Ortega Tr. 936:3-7 (stating that Gandy "was selling the real estate. He was trying to get – as soon as we got a piece of property, trying to see if we could improve it, how do we get it in the hands of others, just trying to work."); Rogers Tr. 376:9-22 (stating that "many, many, many of these ORE loans ended up paying off in full. . . . [S]ome of them we foreclosed on again. But dollars and cents wise, common sense wise, I still, to this day, believe we were much better off doing this.").

[224] *See*, *e.g.*, JX 3 (2010 ROE) at 4 ("Since lending has practically stopped, the roles of existing lending officers are to collect loans and sell OREO.").

[225] Leal Tr. 2288:1-4; *see also* Ortega Tr. 935:14-19 ("We would try to get these properties into the hands of other people that – other borrowers or customers that had more expertise in trying to keep those properties and improving on the properties and developing them."); Gandy Tr. 2226:24-2227:14 (noting that the Bank sought to find buyers "who could bring their expertise and their energy to these properties, just like we would have done in normal lending times, except we were the lender of last resort").

[226] *See* Rogers Tr. 340:10-25 (stating that L&D Committee members relied on loan officers' recommendations and that "[u]nless we knew something really bad about a borrower—we discussed the loan, but unless we knew something really bad about—or some board member knew something bad about a borrower or a potential problem, then we went on with the loan.").

[227] *See*, *e.g.*, Rogers Tr. 386:9-14 (noting that he "had no problem voting for" a particular OREO loan because he was familiar with the borrower, who had done "a good job" with other properties); Ortega Tr. 619:13-18 (stating that an ORE loan was approved without financial projections because "we know that these guys know how to develop").

> [T]his is one credit I was involved watching. It's just down from my home. We could see the progress. We could see what was happening. This was a 40-acre piece of land that was being developed. And we could see that it was working. And we were trying to move ORE and having it become a performing asset was where we wanted to go. . . . [T]his particular project, McCarthy was watching it, Gandy was watching it, I was watching it. It was all on the way to work, on the way home. We were all up-to-date on this project.[228]

And lack of familiarity also mattered: when explaining the Bank's reluctance to sell OREO at discounted prices to "scavengers" who promised to develop the properties, Mr. Gandy stated that "we really didn't know who they were or whether they could do anything or not."[229]

Contemporaneous reports suggest that the OCC understood that the Bank was financing the purchase of its OREO as part of an aggressive strategy to get the properties off its books, reduce costs, and improve earnings and capital—and, at least initially, supported this approach.[230] In their 2009 Report of Examination, for example, examiners noted that "management has aggressively managed OREO. . . . Most parcels have equity and management has been able to sell the parcels to individuals they believe have the ability to manage the project or repay the debt. These actions minimize the risk of write-downs due to fair market value declines."[231] Likewise, in 2010, examiners again described the Bank's strategy of finding and financing willing ORE purchasers in approving terms:

> Management has developed a comprehensive and dynamic approach to OREO resolutions that is led by [CEO] Gandy and the Bank plans to continue with this approach. Each loan officer is responsible for the 'field' work in preparing the OREO for sale, supervising repairs and researching other property issues as needed, and marketing the property to the local market. . . . The Special Credit Division provides the accounting and file support to track

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[228] Rogers Tr. 387:9-16, 388:1-5.

[229] Gandy Tr. 2235:2-8.

[230] *See*, *e.g.*, JX 2 (2009 ROE) at 32 ("To combat the effects of OREO holding costs, management is aggressively marketing OREO through innovative lending programs.").

[231] *Id.* at 40.

> OREO balances, OREO expenses, and sales. This in-house integrated team has the ability to move quickly to take possession of a property, evaluate it, market it and close it. *To date, the results have shown low losses when compared with other bank OREO processes*.[232]

The Report of Examination went on to state that the Bank's "[l]ending had essentially stopped except for . . . loans to finance OREO sales."[233] It further noted that while "[n]ew loans to finance sales of OREO . . . are underwritten more liberally than set forth in the loan policy," these "lending practices are liberal because most [are] related to the financing and often improvement of OREO or problem loan workouts."[234] And the Report observed broadly that "[m]anagement has been able to sell OREO properties, but has had to finance these sales."[235] In other words, it was no secret to the OCC that the Bank was engaging in extensive OREO financing to get the properties off its balance sheet...and, at first, the strategy appeared to be working.[236]

To be sure, any words of praise regarding the Bank's aggressive OREO lending strategy were always contingent on the Bank adhering to prudent standards of operation and engaging in safe and sound practices when selling its ORE, which OCC examiners increasingly came to believe that the Bank was not doing. The undersigned credits NBE Chansen's expert testimony that a bank that finances its own OREO sales should tighten its underwriting standards and apply extra

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[232] JX 3 (2010 ROE) at 11 (emphasis added).

[233] *Id.* at 4; *see also id.* at 24 ("The Bank has essentially stopped [commercial real estate ("CRE")] lending, except to finance OREO sales, and aggressively managed problem CRE loans. These actions have reduced CRE loan concentrations."), 28 ("The Bank's current strategy implies a moratorium on all new commercial real estate lending other than financing sales of its OREO."), 31 ("In order to curb the increase in problem assets, management has ceased new lending, with the exception of financing OREO sales and CD secured loans, and focused efforts toward collection, work out, and sale of OREO.").

[234] *Id.* at 24.

[235] *Id.* at 33; *see also id.* at 50 ("Management has been able to sell OREO with little loss.").

[236] *See id.* at 10 ("Management has sold a tremendous amount of OREO. . . . Many OREO sales result in additional funds advanced to finish projects. This workout strategy increases the level of criticized assets but is generally appropriate because of the need to complete the projects."), 34 ("Management has implemented improved tracking and oversight of OREO sales and financing in response to criticisms noted in the prior examination. Since January 2010, management has financed $109 million in OREO sales. The Bank has not reacquired a material number of financed OREO parcels.").

scrutiny to the borrowers' ability to pay, because the OREO property "already carries a significant amount of risk" and because the consequences of the OREO returning to the Bank's balance sheet as the result of a defaulted loan can be severe.[237] Instead, there is extensive evidence that the Bank *loosened* its underwriting standards for OREO loans, frequently lending substantial sums of money to unqualified borrowers without adequate documentation, at liberal terms not commensurate with the riskiness of the loans, at a time when the Bank's financial condition was precarious and its need to reduce the risk level of its portfolio pronounced.

3. The OREO Merry-Go-Round

In its 2011 Report of Examination, the OCC concluded that the Bank was making "loans to borrowers or guarantors with little financial repayment capacity" to finance OREO purchases, and that, consequently, many of the Bank's OREO properties were returning to the Bank's portfolio after they had been sold.[238] NBE Chansen described why this pattern, which she termed "the OREO merry-go-round," was foreseeably harmful to the Bank even if, in the short term, it did relieve the Bank of the obligation of paying OREO upkeep for the period that the properties were off its balance sheet:

> The bank would lend money. They would foreclose on the property. The new borrowers could not support it. They would foreclose on it again, and we just started this repetition of in and out and in and out. And a lot of the loans, again, they extended additional monies to the entity or the borrowers, so that increased the risk that the bank was putting on their books because it's not just the OREO property now.

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[237] Chansen Tr. 1297:3-8 (stating that "if they're selling this piece of property to a borrower and financing that loan, they want to ensure that the borrower or entity has the ability to support the OREO that they're purchasing"); *see also id.* 1297:14-18 (noting that, as a nonperforming asset, an OREO property "carries a higher degree of risk by putting it back on the books"); Rogers Tr. 378:15-21 (stating that a loan to purchase ORE is "higher risk than your average normal loan").

[238] JX 4 (2011 ROE) at 5; *see also id.* at 56 (finding that the Bank's OREO strategy "has resulted in repeat foreclosures and has contributed to the overall misleading appearance of improvement at the Bank").

> Now, they're extending new money on top of that OREO property, again putting it at additional risk.[239]

Deputy Comptroller Brickman further explained the harmful effects of OREO properties returning to a bank's balance sheet through risky lending practices, and emphasized the importance of continued vigilance on the issue by Bank management:

> [U]ndertaking this strategy where those properties were not effectively resolved by the lending transaction could and did lead to additional losses to the Bank that it would otherwise not have incurred had it appropriately underwritten and gotten qualified borrowers to take on these properties. The risk of financial loss mounts over time relative to a portfolio like this. . . . [A]s the values in those properties deteriorate, the scrutiny and the sensitivity and the heightened attention that a board should pay to it is critically important.[240]

The undersigned credits this testimony and finds that the Bank's OREO lending strategy increased risk to the Bank to the extent that it increased the likelihood of OREO properties returning to the Bank's books through, *inter alia*, looser underwriting standards, approval of loans without proper documentation of borrower credit and finances, and overly liberal loan terms.

4. Underwriting Standards

It appears undisputed that "[t]he Bank loosened its underwriting standards for loans to finance the sale of OREO."[241] Enforcement Counsel offered testimony from Bank loan review manager Rebecca Rodriguez that the Bank's underwriting for OREO loans was "less stringent" than for its non-OREO commercial loans between 2009 and 2011, and that the Bank would make

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[239] Chansen Tr. 1542:13-24; *see also id.* 1394:5-1395:1 (noting that "this merry-go-round effect . . . increased the risk to the Bank and masked the true condition of the portfolio, the loan portfolio, and the Bank's financial condition").

[240] Brickman Tr. 111:16-112:4; *see also id.* 105:17-24 ("[A] bank in managing a portfolio of OREO has to be aware of the risks associated with the underlying collateral in ensuring that whoever acquires the property has the requisite financial capacity and ability to manage [and] maintain that property in accordance with the new loan terms assigned to it."); EPF ¶ 230.

[241] EPF ¶ 217; *see also*, *e.g.*, JX 2 (2009 ROE) at 25 (stating that "[y]ou must improve your underwriting of loans to finance OREO sales" and referencing "concessionary financing to weaker borrowers").

some OREO loans without performing any underwriting at all.[242] Ms. Rodriguez testified that these underwriting practices troubled both her and CCO Magee:

> The concern was that there were – like we said, the little underwriting, there was little to no equity injected. Sometimes it was just to, like, brand new entities without any financial information. . . . [T]he quality of the loan was not what I would have liked to see. . . . I didn't think that the quality of the credit was there, and I didn't think the bank was in any better position with the new loan. I know they had to, I mean, move those ORE properties, but sometimes it was not to a better borrower.[243]

Moreover, Respondent Rogers agreed that the Bank was "more lenient on loan terms after the crisis trying to turn ORE assets into earning assets,"[244] and Respondent Ortega acknowledged that "[t]he L&D Committee approved loans it otherwise would not have approved had the purpose not been to finance the sale of OREO."[245]

The OCC required the Bank to improve its underwriting practices in the 2011 and 2012 consent orders.[246] Among other things, the Bank was required to implement a new policy providing that loans could only be made "after obtaining and validating credit information on the borrower and any guarantor sufficient to fully assess and analyze the borrower's and guarantor's cash flow, debt service requirements, contingent liabilities, and global liquidity condition, and only after the credit officer prepared a documented credit analysis."[247] As described further *infra*, Enforcement

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[242] Rodriguez Tr. 1480:18-1481:1; *see also* EX 571 (sworn statement of Rebecca Rodriguez ("Rodriguez Dep.") 44:12-15 ("There was no underwriting. There was no equity injection. Really, there was nothing—it seemed like everybody kind of qualified to purchase OREO.").

[243] Rodriguez Tr. 1485:23-1486:21; *see also id.* 1488:11-1493:20 (discussing concerns shared by herself and Magee in September 2011); EX 18 (email chain including September 1, 2011 email conversation between M. Magee and R. Rodriguez).

[244] Rogers Tr. 377:1-3.

[245] EPF ¶ 218; *see* Ortega Tr. 617:3-4 ("I'm going to say we were more flexible with the conditions back then."), 618:1-12 ("A: We were mainly accommodating loans for our ORE and our better customers. Q: But the Bank made loans that it normally would not have made had the purchase not been to purchase Bank ORE, correct? A: Yeah, I agree. It's our ORE, yeah.").

[246] *See* EPF ¶ 242; JX 12 (February 2011 Consent Order); JX 13 (January 2012 Consent Order).

[247] JX 12 (February 2011 Consent Order) at 10; *see* JX 13 (January 2012 Consent Order) at 13.

Counsel asserts that the corrective actions taken by Respondent Ortega pursuant to these consent orders when he became President, CEO, and Chairman "did not fully address the issues,"[248] and the Bank continued to approve loans without a credit analysis in 2011 and 2012.[249]

5. Approval Without Credit Review

Under the Bank's loan policy, packages for all loans greater than $500,000 were required to include financial spreads and a credit analysis (or "Credit Review") "to evaluate the credit worthiness of proposed commercial borrowers [] as well as the economic viability of proposed loans to such borrowers."[250] As Enforcement Counsel notes, "[t]he Credit Review was much more detailed than the other forms contained in the loan package"—namely, the New Loan Request and Loan Officer Recommendation."[251] Unlike the Credit Review, the two other forms "generally did not contain any analysis of the borrowers' ability to repay the loan, or even much financial information on the borrower."[252] Rather, the Loan Officer Recommendation was "a narrative form describing certain aspects of the loan request . . . [that] generally did not contain any financial analysis,"[253] while the New Loan Request contained "only very basic information and [did] not contain any information on whether the borrower could repay the loan."[254]

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[248] EPF ¶ 243.

[249] *Id.* ¶ 244.

[250] *Id.* ¶ 192 (internal quotation marks and citation omitted); *see* JX 9 (2009 Loan Policy) at 35; JX 10 (2010 Loan Policy) at 37. While some exceptions to the loan policy were permitted with appropriate justification, the policy stated that they "should be disclosed within the credit package," and identified and tracked over the life of the loan "to determine the ultimate risk to the Bank." Chansen Tr. 1289:2-4, 1290:21-1291:14; *see also*, *e.g.*, JX 9 (2009 Loan Policy) at 36 ("Any exception to the Bank's loan policy should be recognized, highlighted, and specifically approved before the loan is made."), 37 ("[A]ll exceptions must be approved by the Loan & Discount Committee and documented in the appropriate credit file.").

[251] EPF ¶ 193; *see*, *e.g.*, EX 31 (NAHS loan documentation) at 1-3 (New Loan Request), 4-5 (Loan Officer Recommendation).

[252] EPF ¶ 193.

[253] *Id.* ¶ 206.

[254] *Id.* ¶ 207.

Enforcement Counsel asserts, and the evidence supports, that "[b]ecause of senior management's aggressive push to sell OREO, the Board approved loans without a Credit Review, or in some cases without 'anything on paper' at all."[255] On April 28, 2010, Mr. Magee sent an email to Mr. Gandy, Mr. Leal, Ms. Rodriguez, and others stating that the Bank's credit review department "rarely" had the opportunity "to actually receive or even look at financials before the ORE has been sold, booked and funded" as a result of the Bank's "press to move the ORE before the end of the month in which [it] is acquired."[256] He added that "those financials that we do receive typically provide little if any actual support for the proposed ORE purchase on the larger deals that we've been doing."[257]

Despite the Bank's loan policy, both Respondents acknowledge that they approved loans without any Credit Review during the relevant period,[258] and Enforcement Counsel identifies fourteen OREO loans ranging from $3 million to $56 million that one or both of the Respondents approved or ratified from April 2009 through October 2012.[259] In addition, as already noted, Respondent Ortega testified that even in cases where the Credit Review was supplied, he generally would not read it, preferring to make his decision "on the front two pages" of the loan package—that is, the New Loan Request only.[260]

Respondents assert that they relied on loan officer recommendations in determining whether or not to approve a loan.[261] The undersigned, however, credits the testimony of Deputy Comptroller Brickman and NBE Chansen that L&D Committee members each had an independent

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[255] *Id.* ¶ 197 (quoting EX 571 (Rodriguez Dep.) 45:1-3); *see also* Magee Tr. 2081:7-16 (agreeing that from 2009 to 2013, there were "very large loans" approved without any credit review).

[256] EX 8 (email chain including April 28, 2010 email from M. Magee to R. Gandy et al.).

[257] *Id.*

[258] *See* Rogers Tr. 379:3-12; Ortega Tr. 622:6-22.

[259] *See* EPF ¶ 201 (citing exhibits).

[260] Ortega Tr. 646:3-20.

[261] *See* RPF ¶¶ 62-63; *see also*, *e.g.*, Ortega Tr. 927:20-929:11 (discussing reliance on lending department).

responsibility to understand the details of a loan, confirm that "all of the required information is provided to support the credit decision"—including, without question, a detailed Credit Review or something similar—and, importantly, ensure that they are sufficiently able to "evaluate the risk associated with [each] particular request."[262] This is particularly the case for OREO loans, given the heightened risk of financial loss associated with such properties if the loans default and they return to the Bank's portfolio, especially in aggregate.[263] Deputy Comptroller Brickman testified that an L&D Committee member should not only "look at the logistics of a loan whether or not it complies with policy," but "also layer in their expertise in regard to the overall risk profile of the bank and whether or not that loan would pose undue risk to the capital position or to the financial performance of the financial institution."[264] The undersigned agrees and finds that Enforcement Counsel has satisfied its burden in showing that Respondents did not act in this manner with respect to, at minimum, many of the OREO loans at issue in this action.

6. Loan Quality

The OCC's 2011 Report of Examination concluded that the Bank's aggressive strategy of financing OREO sales in-house frequently resulted in "the financing of OREO with little or no down payment, on liberal terms, with below-market interest rates, and to individuals who did not demonstrate the ability to service the debt."[265] Enforcement Counsel has catalogued a number of

[262] Chansen Tr. 1290:6-15; *see also id.* 1315:9-13 ("[I]f they do not have the credit review, which includes discussions on the borrowers' and/or guarantors' financial ability, they're not making an informed credit decision."); Brickman Tr. 102:4-9 ("A loan committee member has an obligation if there's insufficient information to make a decision to follow up with the loan underwriter or the person responsible for providing the information to gather the necessary information to make the decision.").

[263] *See* Brickman Tr. 105:17-24, 111:16-112:4.

[264] *Id.* 101:4-24.

[265] JX 4 (2011 ROE) at 46; *see also id.* ("The Bank's strategy to reduce criticized assets through the financing of OREO was not appropriate and has resulted in additional asset quality concerns and accounting issues."); Magee Tr. 2083:19-2084:6 ("[T]he sale of OREO and the financing thereof was done at terms which were not necessarily the same terms that you would want to see in a more typical environment, much like the environment that I had when I was a lender, i.e., requiring down payments and things of that nature.").

ways in which the Bank's OREO loans during this period violated Bank loan policy, made it more likely that OREO properties would return to the Bank's portfolio, or otherwise increased the risk to the Bank, and they are detailed below.[266]

Lack of Equity: Although the Bank's loan policy generally required borrowers to provide between 15 and 25 percent hard equity on OREO loans as a down payment, Enforcement Counsel offers evidence that "Respondents regularly approved and/or ratified OREO loans with no equity contribution from the borrower."[267] The undersigned credits NBE Chansen's expert testimony that lack of hard equity reduces borrowers' incentive "to keep making payments if they run into problems" with the property, thereby increasing the risk of the loan's default.[268] Virtually all of the OREO loan packages without sufficient hard equity that were presented to Respondents failed to mention or address this exception to the Bank's loan policy.[269]

New monies: Respondents approved or ratified OREO loans that provided the borrowers with millions of dollars of additional money over and above the property's purchase price.[270] While generally intended to allow borrowers to develop or improve the properties they have purchased,[271] these new monies compound the risk to the Bank in the event that borrowers who have not demonstrated the financial ability to pay the debt ultimately default on their loans.[272]

Newly formed entities: Respondents "often" approved or ratified OREO loans to newly formed entities that had "no financial history or track record or, in some cases, guarantors to support the debt," which increased the risk of default because the L&D Committee did not have a

[266] *See* EPF ¶¶ 219-233.
[267] *Id.* ¶ 221 (citing examples).
[268] Chansen Tr. 1302:8-15; *see* EPF ¶ 223.
[269] *See* EPF ¶ 222 (citing examples).
[270] *See id.* ¶ 221(a) (citing examples).
[271] *See*, *e.g.*, Ortega Tr. 671:7-11 (new monies provided "[f]or construction and build-out").
[272] *See* Chansen Tr. 1544:16-1545:20.

sufficient basis on which to judge these entities' ability to pay.[273] In the NAHS loan transaction, for example, Respondents approved a $56 million combined loan despite having "no [] financials" on the borrower itself as a newly formed entity.[274] The undersigned credits NBE Chansen's opinion that the risks of lending to newly formed entities are exacerbated by loan terms that include no equity contribution and the provision of new monies on top of the purchase price.[275] On the other hand, the undersigned also acknowledges that in certain cases, the individuals behind these borrower entities were known to the Committee even if the entities themselves were new.[276]

Lack of guarantee: Enforcement Counsel adduces evidence that many OREO loans approved or ratified by Respondents had either no personal guarantee or a limited guarantee from a guarantor relative to the loans' size, or were loans "where the guarantors had so much debt with the Bank from purchasing OREO that the value of their guarantees were significantly diminished or worthless."[277] When sampling OREO loans during the 2011 examination, examiners found that "[t]he guarantors did not have the capacity to service the debt and their financial statements reflected little liquidity and marginal cash flow."[278] The undersigned finds that inadequate guarantees foreseeably increase the risk of default and the likelihood of loss to the Bank.[279]

Advancement of property tax or payment of past due loans: The 2011 Report of Examination found that "[m]anagement has masked problems with OREO financing on liberal terms and payment of property taxes and/or allowing customers to maintain loans current through

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[273] *Id.* 1393:15-25.

[274] EX 33 (email chain including August 4, 2010 email from Loan Officer Rachel Kelman to the Bank's Credit Group); *see also* EPF ¶ 266.

[275] *See* Chansen Tr. 1394:5-22.

[276] *See*, *e.g.*, EPF ¶ 312 (approval of $13.5 million OREO loan to newly formed entity owned by Robert Gandy IV, son of then-President/CEO Gandy).

[277] *Id.* ¶ 226 (citing examples).

[278] JX 4 (2011 ROE) at 46.

[279] *See id.* at 5 ("Often, the Bank made loans to borrowers or guarantors with little financial repayment capacity. Many of the financed properties subsequently return to the Bank's OREO portfolio.").

advances on other loans," which in turn "distorts the borrowers' true performance capabilities as well as the Bank's level of past due and nonaccrual loans."[280] As NBE Chansen explained:

> There was payment of property taxes being included in the dollar amounts lent to the borrowers. And in addition to that, there were also advances in the form of reserves being provided so the borrowers could make payments down the road. And all of those exposed the Bank to additional risk because it increased the level of the financing that was being provided, it masked the true condition of the loan portfolio, and the financial condition of the Bank.[281]

The undersigned credits this testimony, and notes further that the payment of property tax is detrimental to the Bank to the extent that it reduces the cost savings that come from moving expensive OREO off the Bank's balance sheets.[282] In the 2011 Report of Examination, examiners directed the Bank to place $62.2 million in OREO loans on nonaccrual status,[283] largely because "[the] loans had capitalized property taxes or were for the financing of OREO with liberal terms (100 percent financing, below market rates, and to borrowers that did not have the capacity to service amortizations)."[284]

<u>"Below-market" interest rates</u>: Enforcement Counsel presents evidence that the interest rates for many of the OREO loans were lower than the rates established for comparably termed OREO loans in the Bank's own Market Rate Matrix, which it developed in December 2009.[285] For

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[280] *Id.* at 46; *see also id.* at 49 ("We noted several instances where the Bank paid property taxes and extended new notes to make payments on existing debt. These practices lack any substantive benefit to the Bank [and] only mask the borrower's insufficient repayment capacity.").

[281] Chansen Tr. 1303:10-15.

[282] *See* Rogers Tr. 370:19-24 ("[W]hen the bank owns ORE, you're doing maintenance, paying taxes, maintaining the property. It was important for us to get it out of the bank and have somebody else maintaining it, paying the insurance, paying the taxes.").

[283] Roughly speaking, and as detailed further in Part VI.E *infra*, nonaccrual loans are those for which a lending institution should not accrue interest income because the loans are delinquent or there is reasonable doubt regarding their ultimate collectability. *See* EPF ¶¶ 534, 538, 540.

[284] JX 4 (2011 ROE) at 50; *see* EPF ¶ 233.

[285] *See* EPF ¶¶ 227(a), 465-466; *see also* EX 343 (May 4, 2010 L&D Committee meeting minutes) at 5 ("The bank has established a Market Rate Matrix to ensure compliance with term and pricing of these loans."), 8 ("The Market Rate Matrix will be used for all ORE financing loans."), 20 (Market Rate Matrix).

example, the Market Rate Matrix provides that a fixed interest rate of 4.25 percent is only appropriate for commercial OREO loans with one-year terms, yet Enforcement Counsel identifies "[n]umerous OREO loans" with terms longer than one year and interest rates at or below 4.25 percent.[286] Likewise, the Matrix states that that commercial OREO loans with terms of 10 to 25 years should have a fixed interest rate of 7 percent, and yet the NAHS loan (discussed further below) offered a fixed rate of 3.25 percent over the first two and a half years and then a variable rate not to exceed 6 percent for the remaining twenty-five years of its term.[287]

Respondents assert that "there is no record on which [this Tribunal] can conclude that any specific loan was made at above or below market terms," given the extreme volatility of the market at the time and the presumption that, in the absence of evidence to the contrary, loan terms are "the result of arms-length transactions between a willing borrower and a willing lender."[288] External accountant Ben Pena, whose firm reviewed the Bank's interest rates during this period, also testified that the market rate for commercial OREO loans is dependent on many factors and is "somewhat very subjective."[289] The undersigned credits Mr. Pena's testimony regarding the subjectivity of market rates in this context, particularly at a time—as Respondents state—when the market for commercial real estate was so decidedly abnormal.

Notwithstanding this point, the undersigned finds that the Market Rate Matrix reflected the Bank's broad-based view of what the market rate for commercial OREO was when the Matrix was

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[286] EPF ¶ 227(a); *see* EX 343 (May 4, 2010 L&D Committee meeting minutes) at 20 (Market Rate Matrix).

[287] *See* EPF ¶ 275(a); EX 31 (NAHS loan documentation) at 1.

[288] RPF ¶¶ 65, 67; *see also* Ortega Tr. 990:13-991:3 (stating that in the volatile market of the financial crisis, "[t]he customer had kind of the upper hand as far as what kind of rate they needed . . . [and] is always going to fight for the lower rate"); Salvato Tr. 1938:2-14 (agreeing that the presumption "is that the willing lender and the willing borrower agree to a fair and adequate interest rate," but only "to the extent that there are no factors that are inappropriately influencing the parties to transact at that value").

[289] Pena Tr. 1189:5-10; *see also* Leal Tr. 2291:10-17 ("It was never in our purview to say if a loan is below some market rate which was not clearly defined – it's unlike a mortgage. A mortgage, you know what the rate is because it's published or credit cards, but commercial loans, there isn't a range of rates that is market rates.").

devised, as Respondents have not provided a plausible basis for concluding otherwise. The severe lack of conformance of so many OREO loans with the Bank's *own* yardstick for what constituted a market interest rate further leads the undersigned to find that Enforcement Counsel has met its burden on this issue and that the Bank's OREO lending strategy led to a proliferation of loans with "below-market interest rates," as the 2011 examination concluded.[290]

7. The NAHS Loan

The details of the approval, terms, and repayment of the $54 million NAHS loan in the summer of 2010 and beyond are illustrative of the misconduct alleged by Enforcement Counsel with respect to Respondents and the OREO lending strategy, and it is worthwhile to examine them in some further depth.

NAHS was formed on or about June 17, 2010 for the primary purpose of purchasing a hospital in Grand Prairie, Texas, which was part of the Bank's OREO.[291] At the L&D Committee meeting on June 8, 2010, Respondent Ortega and the other present Committee members (not including Respondent Rogers) approved two verbal loan requests "subject to formal loan presentation": 1) a $54 million loan to NAHS (what this Order has termed "the NAHS loan"),[292] which included $38 million to purchase the unfinished hospital and $16 million in new monies for construction, and 2) a $2 million loan to North American Hospital Systems, LLC to purchase hospital equipment.[293] The Bank formally entered into the loan agreement with NAHS on June 22, 2010, and the agreement was ratified by Respondents and the other Committee members at the

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[290] JX 4 (2011 ROE) at 46.

[291] *See* EPF ¶ 248.

[292] Enforcement Counsel notes that the minutes state that the loans would be made to "North American Hospital Systems, LLC"; however, the loan was ultimately made to NAHS, in which North American Hospital Systems, LLC was the general partner. *See id.* ¶ 250.

[293] *See id.* ¶¶ 249, 255; EX 30 (June 8, 2010 L&D Committee meeting minutes) at 6. The NAHS loan made the loan relationship with NAHS one of the largest at the Bank, if not the largest. *See* Ortega Tr. 588:1-3.

August 10, 2010 L&D Committee meeting.[294] The loan enabled the Bank to sell the hospital at cost basis on its books for $37,811,851, "and thus avoid recognizing a loss on the sale."[295]

Approval of the NAHS Loan: It is undisputed that the L&D Committee was not presented with any loan package for the $54 million NAHS loan before that loan's initial, conditional approval on June 8, 2010—there was no New Loan Request form, no Loan Officer Recommendation, no Credit Review, no current appraisal of the ORE property, and no financial information on the borrower as a new entity or on the loan's guarantor.[296] Instead, loan officer Curtis Brockman made a presentation to the Committee in which he represented that NAHS was chosen from among "several offers" and that the buyers had "the ability to raise working capital for the hospital."[297] Then-President Gandy, who also supported the loan's approval, "added that this project will be owned and managed by an experienced doctor and should help insure [sic] its success."[298] After discussion, the Committee then approved the loan "subject to formal loan presentation and current appraisal."[299] Respondent Ortega testified that he relied on his loan officers' recommendations when approving the NAHS loan and did not focus on the borrowers' creditworthiness or repayment ability or the projected cash flow of the hospital.[300]

On June 10, 2010, Mr. Brockman authored a one-page memorandum for the L&D Committee that provided further details—albeit not many—on the prospective loan to NAHS.[301] The memorandum stated that the loan department "had several contracts on the sale of the hospital

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[294] *See* EPF ¶¶ 265, 267; EX 32 (NAHS loan agreement dated June 22, 2010); EX 35 (August 10, 2010 L&D Committee meeting minutes) at 3 (NAHS loan ratification).

[295] EPF ¶ 251.

[296] *See id.* ¶¶ 255-256; Ortega Tr. 587:5-588:13, 590:6-17.

[297] EX 30 (June 8, 2010 L&D Committee meeting minutes) at 6.

[298] *Id.*

[299] *Id.*

[300] *See* EPF ¶¶ 262-263; Ortega Tr. 586:1-2, 607:12-18, 985:3-22, 986:5-11, 987:8-23 (relying on "the lending expertise of the bank" regarding his decision to approve this loan).

[301] *See* EPF ¶ 258; EX 31 (NAHS loan documentation) at 6.

with different terms and conditions," but chose NAHS due to the "background and diversity" of its owners.[302] Specifically, the memorandum noted that "[o]ne partner is a Dr. with Degrease [sic] from Harvard and Yale," while [a]nother partner has experience in running Hospitals and the other partner has raised capital for large companies."[303] Mr. Brockman concluded by writing that the loan department "chose this group because we feel they have the best business plan and present the least amount of risk to the Bank."[304]

A two-page Loan Officer Recommendation was ultimately completed on June 23, 2010, one day after the Bank entered into its loan agreement with NAHS.[305] Among other things, this document stated that one of NAHS's limited partners was an accomplished surgeon, listing his qualifications in detail, while noting briefly that the other two partners had "nine years in health care contracting and medical office development" and "experience in medical management," respectively.[306] The recommendation noted that the loan would be repaid through the collection of accounts receivable from "the normal course of operation" of the hospital, although it did not include any projections of the hospital's cash flow.[307] It also graded the proposed loan as "satisfactory," determined that "financials will be waived" for NAHS initially because it was a new entity, and stated that a "credit review will be performed at the end of the fiscal year."[308]

A credit review of the NAHS loan was not prepared until after the loan's August 10, 2010 ratification, and there is evidence that it was finalized in September 2010 only in order to "give it

[302] EX 31 (NAHS loan documentation) at 6.
[303] *Id.*
[304] *Id.*
[305] *See* EPF ¶¶ 259, 265; *see also* EX 31 (NAHS loan documentation) at 4-5.
[306] *Id.* at 4.
[307] *Id.* at 5; *see* Ortega Tr. 607:12-18; JX 3 (2010 ROE) at 64 (analyzing NAHS loan and finding that "repayment is highly dependent on projected cash flow and borrower is a start-up entity (new hospital) with no previous operating experience to support debt service capacity. In addition, financial analysis during the underwriting process was limited and guarantor support is inadequate.").
[308] EX 31 (NAHS loan documentation) at 5; *see also* EPF ¶ 259; RPF ¶ 75.

to the examiner" during that year's examination.[309] The credit analysis showed that the NAHS owner-guarantors of the loan "had approximately $150,000 in combined liquidity, and one owner-guarantor had a [Fair Isaac Corporation ("FICO")] score of less than 500."[310] In his deposition, Respondent Rogers agreed that loaning $54 million to two guarantors with a combined liquidity of $150,000 "would not be a prudent thing for a bank to do."[311] It is also undisputed that a FICO credit score of 500 would be below the "policy minimum of 650," and would therefore generate an exception under the Bank's Loan Policy that would require specific approval by, in this instance, the L&D Committee, for which no evidence has been presented.[312] The Bank's 2011 Annual Loan Review for the NAHS loan also concluded that approving the loan without a credit analysis violated the Loan Policy.[313]

NAHS Loan Terms: As stated, the terms of the NAHS loan included 30 months of interest-only payments at a 3.25 percent interest rate and then a 25-year repayment term at a variable rate not to exceed 6 percent.[314] The 2011 Annual Loan Review of the NAHS loan found that the "30 months of interest-only payments exceeded the twelve month maximum in the Loan Policy."[315] The loan also provided $16 million in new monies on top of the $38 million sale price of the hospital.[316] The loan agreement did not require any equity contribution from NAHS or its owner-

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[309] EX 37 (email chain including September 8, 2010 email from M. Magee to C. Brockman et al.); *see also* EX 38 (NAHS loan credit analysis dated August 12, 2010) ("NAHS Credit Analysis"); EPF ¶ 253.

[310] *See* EX 38 (NAHS Credit Analysis) at 2-4; EPF ¶ 274.

[311] EX 568 (Rogers Dep.) at 113:19-114:1.

[312] EX 48 (First National Bank 2011 Annual Loan Review) ("2011 NAHS loan review") at 13; *see also* JX 10 (2010 Loan Policy) at 97 (noting that for loans designated with the collateral code 394, "Credit score < 650" would be a "waiver/exception item" subject to L&D Committee approval); EX 31 (NAHS loan documentation) at 1 (indicating that the NAHS loan is given the collateral code 394); EPF ¶ 270.

[313] *See* EX 48 (2011 NAHS loan review) at 13.

[314] *See* EPF ¶ 275; EX 38 (NAHS Credit Analysis) at 1.

[315] EPF ¶ 276; *see* EX 48 (2011 NAHS loan review) at 13.

[316] *See* EPF ¶ 272.

guarantors and further provided that the two principal owner-guarantors would guarantee a total of only $3 million of the $54 million loan.[317]

A 2012 review by external loan consultants Alvarez & Marsal ("A&M") concluded that the NAHS loan was "[a]n accommodation loan to rid the bank of a large piece of OREO," among eleven reasons that the firm viewed the loan as substandard and nonaccrual.[318] In addition, the review found that the "[g]uarantors have no liquidity that can support operation," that "this loan is a huge exposure for the bank and is running up against the bank's full lending limit," and that "the bank is taking excessive risk and exposure on this loan" given the limited guarantees obtained from the owner-guarantors.[319]

Repayment of the NAHS Loan: The Bank also gave NAHS assistance with repayment during the life of the loan. In order to make its first year of interest-only payments, NAHS was permitted to overdraw its account at the Bank by over $3.6 million as of November 2011.[320] The Bank covered this overdraft by advancing to NAHS funds from a new $6.5 million loan approved in October 2011, effectively capitalizing the interest payments onto the balance of the loan.[321] The Bank's annual loan review of the $54 million NAHS loan completed in May 2013 stated that "[i]n essence, the borrower did not pay any scheduled/renewal interest only payments for any note since origination all the way to 11/17/11."[322] In addition, as discussed further *infra*, the Bank restructured the NAHS loan as of September 30, 2011 to increase the loan's interest rate from 3.25 percent to 5 percent while arranging that all interest payments over the original 3.25 percent would

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[317] *See id.* ¶¶ 272-273.

[318] RX 74 (A&M Workpaper dated August 8, 2012) ("A&M Workpaper") at 871.

[319] *Id.* at 869, 871 (also noting the loan's "[v]ery liberal lending terms and conditions").

[320] *See* EPF ¶ 277; EX 50 (2012 NAHS loan review) at 16.

[321] *See* EPF ¶¶ 278-279; EX 40 (loan documentation for $6.5 million loan to NAHS); EX 50 (2012 NAHS loan review) at 16-17.

[322] EX 50 (2012 NAHS loan review); *see* EPF ¶ 281.

be effectively reimbursed to the borrower.[323] And loan consultants A&M noted that the hospital's property taxes were paid by the Bank in 2010 and that "[d]uring construction, interest was being paid from funds advanced!!"[324]

Loss Attributable to the NAHS Loan: Enforcement Counsel adduces evidence that following the closure of the Bank, the FDIC as receiver suffered a $35.15 million loss on the loan to NAHS.[325]

8. Accounting for OREO Loans

Enforcement Counsel asserts, based on the testimony of its accounting expert, that "[b]ecause the Bank used below-market financing terms as an incentive for borrowers to purchase the Bank's OREO, [Generally Accepted Accounting Principles ("GAAP")] required the Bank to discount the value of those OREO loans to their fair market value using a market interest rate (by performing present value calculations)."[326] Failure to appropriately discount the value of a below-market loan in connection with the sale of OREO leads to "overstated gain or understated loss on the sale, which results in overstated earnings and capital."[327] The undersigned finds that Enforcement Counsel has met its burden and shown that the Bank improperly accounted for its OREO sales over the relevant period by failing to discount loans with below-market interest rates to their present value of future cash flows.

First, the OCC's 2009 Report of Examination "determined that the Bank had sold and financed $133 million of OREO with liberal underwriting terms without proper accounting."[328]

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[323] *See* EX 363 (Salvato Report) ¶ 36(b).

[324] RX 74 (A&M Workpaper) at 872; *see* EPF ¶ 282.

[325] *See* EPF ¶ 284.

[326] *Id.* ¶ 453; *see* Salvato Tr. 1813:16-1814:19, 1815:7-1817:16, 1819:9-1824:11.

[327] EPF ¶ 456; *see* Salvato Tr. 1811:11-1812:11, 1818:17-1819:8; EX 353 (December 2008 Comptroller of the Currency Bank Accounting Advisory Series) ("December 2008 BAAS") at 116 (discounting to fair market value would "reduce both the effective sales price of the property and any gain (or increase the loss)").

[328] EPF ¶ 457; *see* JX 2 (2009 ROE) at 12.

Examiners therefore issued a Matter Requiring Attention ("MRA") item "requir[ing] the Bank to record discounts (losses) on OREO loans with below-market interest rates by using a present value of future cash flows analysis."[329] Enforcement Counsel offers evidence that, in response to this MRA, the Bank "took a series of superficially corrective measures, none of which addressed the fundamental problems identified [therein]."[330]

For example, the Bank engaged its external accounting firm, Burton McCumber & Cortez LLP ("BMC"), to perform an analysis of the Bank's OREO loans in December 2009, but did not direct the firm to "evaluate which loans had 'market' terms or calculate discounts on loans with below-market interest rates" as part of this analysis.[331] Moreover, although Respondent Ortega presented a memorandum to the Bank's Board in April 2010 ("the April 2010 memo") representing that "[t]he review disclosed satisfactory compliance with the Market Rate Matrix" for OREO loans established by the Bank as of December 12, 2009,[332] there is no evidence that BMC applied—or even knew about—the Market Rate Matrix in the course of its analysis, nor that Respondent Ortega conducted any independent evaluation of the Bank's OREO lending practices using the Market Rate Matrix as a guide.[333] The April 2010 memo also asserted "that the Bank would perform present value calculations for all future OREO loans with below-market interest rates" relative to the Market Rate Matrix.[334] In fact, however, "the Bank continued to originate OREO loans with below-market interest rates (in comparison with the rates established in the Market Rate Matrix)

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[329] EPF ¶ 458; *see* JX 2 (2009 ROE) at 12.

[330] EPF ¶ 461.

[331] *Id.* ¶ 463; *see also id.* ¶¶ 462, 464; Pena Tr. 1129:9-20, 1133:22-1134:18; EX 343 (May 4, 2010 L&D Committee meeting minutes) at 9-15 (November 12, 2009 letter from BMC to S. Ortega).

[332] EX 343 (May 4, 2010 L&D Committee meeting minutes) at 7-8; *see also id.* at 16-20 (April 19, 2010 memorandum from M. Magee to Board of Directors).

[333] *See* EPF ¶¶ 465-472.

[334] *Id.* ¶ 475; *see* EX 343 (May 4, 2010 L&D Committee meeting minutes) at 8.

for two more years," without discounting either prior or future OREO loans using present value calculations.[335]

In another MRA, this time in connection with its 2011 Report of Examination, "the OCC determined that, between 2008 and June 30, 2011, the Bank [had] originated over $309 million in OREO loans with interest rates below the then-market rate of 5.5 percent" and "had failed to perform present value calculations and record discounts on OREO loans with below-market interest rates."[336] NBE Chansen testified that "[t]he examiners determined that 5.5 percent was the appropriate market rate after evaluating rates in the Bank's market (throughout Texas, due to the Bank's state-wide branches), including by calling other banks to find out what those banks were charging to finance non-OREO loans."[337]

The 2011 examiners' report also cited a violation of 12 U.S.C. § 161(a), asserting that the Bank's quarterly Call Report filings were inaccurate due to "[t]he Bank's failure to adhere to proper accounting guidelines regarding OREO sales, which were financed below a fair market rate."[338] Examiners sampled eight OREO loans with below-market interest rates and concluded that approximately $14.3 million of those loans' $93.3 million value should have been discounted (or written down) to reflect a present value calculation.[339] The examiners determined that the Bank had financed a total of $309 million in OREO loans with sub-5.5 percent interest rates from 2008 to November 2011, and thus directed the Bank to "review all OREO financings to assure proper

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[335] EPF ¶ 477 (citing examples); *see id.* ¶¶ 473, 478-479.

[336] *Id.* ¶ 480; *see* JX 4 (2011 ROE) at 11-12, 47-48, 81.

[337] EPF ¶ 486; *see* Chansen Tr. 1416:11-20.

[338] JX 4 (2011 ROE) at 81; *see* EPF ¶ 484.

[339] *See* JX 4 (2011 ROE) at 47-48; *see also id.* at 81 (stating that "[t]hese transactions occurred over several Call Report reporting periods and appropriate losses should have been recognized").

accounting and income recognition," calculate the appropriate losses, and include that adjustment in the December 31, 2011 Call Report.[340]

More than $12.5 million of the $14.3 million write-down calculated by OCC examiners was attributable to the $54 million NAHS loan.[341] At the hearing, NBE Chansen testified that this $12.5 million discount was arrived at by calculating the cash flow of a 3.25 percent interest rate over the life of the loan and comparing that to a 5.5 percent market rate, even though the terms of the loan provided that the interest rate was 3.25 percent only for the first thirty months, and was variable based on the market with a ceiling of 6 percent thereafter for the next twenty-five years.[342] Respondents challenged the calculation on this basis, arguing that a $12.5 million adjustment to the NAHS loan based on a 3.25 percent interest rate was "plainly incorrect" and "not reliable" given that the actual interest rate "for nearly the entire life of the loan" would have exceeded 3.25 percent and might have approached or exceeded the 5.5 percent market rate established by the OCC.[343] In response to this critique, Enforcement Counsel's accounting expert testified that "GAAP does not allow for a present value calculation to predict future changes in the interest rate,"[344] and that as a result it was appropriate to use the introductory 3.25 percent rate to calculate the discount for the loan over the whole of its 27.5-year term.[345]

The undersigned agrees with Respondents that the discount calculation for the NAHS loan does not accurately reflect the loan's terms, given that the cash flow from the twenty-five year variable interest rate would almost certainly have been higher—and perhaps significantly so—than

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[340] *Id.* at 48; *see* EPF ¶ 489.

[341] *See* JX 4 (2011 ROE) at 47; EPF ¶ 488.

[342] *See* Chansen Tr. 1648:1-1652:21.

[343] Resp. Br. at 41-42; *see also* Chansen Tr. 1653:4-1654:7 (agreeing that using the stated variable rate for the NAHS loan "would come up with a very different calculation than using a fixed rate for the entire length of the loan").

[344] Salvato Tr. 1944:17-19.

[345] *See id.* 1944:2-1946:15.

the cash flow from the 3.25 percent fixed rate utilized by the examiners, and the required discount thereof commensurately less. Even so, the undersigned credits Ms. Salvato's expert testimony that the appropriate accounting treatment, when making present value calculations for a loan with an introductory fixed rate followed by a much longer variable rate, is to use the fixed rate as the benchmark for the life of the loan. The undersigned further notes that it is at least somewhat unlikely that the NAHS loan would have paid out as predicted regardless, given the borrowers' apparent lack of creditworthiness and the Bank's willingness to accommodate the loan relationship through overdrafts and additional advancement of funds. And it is also true that the total discount of $14.3 million was calculated based on "less than one-third of the Bank's $309 million of OREO loans originated at below-market interest rates,"[346] and so the actual required write-down amount, had the entirety of the Bank's below-market OREO loans been reviewed rather than eight loans totaling $93 million, would be higher even if the NAHS calculation itself is in error.

In any event, the Bank recorded only a $4.8 million discount of its $309 million OREO portfolio in the December 31, 2011 Call Report.[347] Ms. Salvato testified that this amount is "lower than the OCC's adjustment of $14.3 million" for three primary reasons.[348] First, the Bank used a 5 percent interest rate as the market rate for its present value of future cash flow analysis, rather than the 5.5 percent rate used by examiners.[349] Second, the Bank excluded from its review and adjustment any below-market OREO loans that were originated prior to January 1, 2010, which totaled over $100 million.[350] Third, the Bank excluded the $54 million NAHS loan entirely from the loans that it discounted.[351]

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[346] *See* EPF ¶ 487.
[347] *See id.* ¶ 492; EX 363 (Salvato Report) ¶ 36.
[348] Salvato Tr. 1846:4-9; *see also* EPF ¶ 493.
[349] *See* Salvato Tr. 1846:18-22; EX 363 (Salvato Report) ¶ 36(a).
[350] *See* Salvato Tr. 1847:1-4; EX 363 (Salvato Report) ¶ 36(b).
[351] *See* Salvato Tr. 1846:10-14, 1858:5-18; EX 363 (Salvato Report) ¶ 36(c).

According to Ms. Salvato, the Bank did not adequately justify any of these decisions, and each was inappropriate under GAAP.[352] With respect to the NAHS loan in particular, Ms. Salvato concluded that the loan's exclusion from the Bank's review was the result of that loan being restructured to increase the applicable interest rate from 3.25 percent to the Bank's ostensible market rate of 5 percent—but that the terms of that restructuring effectively reimbursed NAHS for the difference between the two rates, "such that there really wasn't any true restructuring" and the borrower continued to pay only 3.25 percent.[353] In the end, Ms. Salvato found that the December 31, 2011 Call Report and all subsequent Call Reports were misstated by at least $9.5 million of additional losses, which is the difference between the $4.8 million adjustment taken by the Bank on the entire OREO portfolio and the $14.3 million discount calculated by OCC examiners from their limited sample.[354] The undersigned credits NBE Chansen's testimony that "[f]ailing to accurately discount the Bank's OREO loans masked the true condition of the Bank by artificially inflating its earnings and, therefore, its capital."[355]

9. Loss to the Bank

Respondents note that in a March 25, 2014 internal OCC email chain, OCC employee Hub Thompson represents that it was the OCC's position at that date that the "'OREO MRA Issue' had no impact on the type or timing of any enforcement action nor any impact on the eventual timing of the bank's close."[356] Notwithstanding this, and in addition to the $35.1 million loss apparently

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[352] *See* Salvato Tr. 1853:12-1857:16 (lack of documentation for use of 5 percent as market rate), 1858:5-1860:13 (lack of justification for exclusion of NAHS loan), 1862:11-1863:25 (lack of documentation or justification for January 1, 2010 cutoff); *see also* EX 363 (Salvato Report) ¶ 45; EPF ¶¶ 494-503.

[353] Salvato Tr. 1859:22-1860:7; *see* EPF ¶¶ 504-515 (providing further details on the "remarkable restructuring maneuvers undertaken by the Bank" with respect to the NAHS loan).

[354] *See* Salvato Tr. 1863:10-1864:25; EX 363 (Salvato Report) ¶¶ 46-47.

[355] EPF ¶ 529; *see* Chansen Tr. 1424:13-1425:5.

[356] RX 52 (email chain including March 25, 2014 email from H. Thompson to R. Chansen et al.); *see also* Chansen Tr. 1659:17-1661:3; Rs Br. at 42.

suffered by the FDIC as receiver for the Bank with respect to the NAHS loan following the Bank's closure,[357] Enforcement Counsel presents evidence that the FDIC as receiver suffered approximately $61.4 million in losses related to other OREO loans that were part of the OREO lending scheme at issue in this action.[358]

E. Nonaccrual Loans Accounting (Article V)

Article V of the Notice alleges that Respondents artificially inflated the Bank's earnings and capital by improperly accruing interest income on nonaccrual loans using cash basis accounting, which resulted in the Bank filing materially inaccurate Call Reports from June 30, 2009 through March 31, 2013.[359]

In its October 5, 2021 Order on the Parties' summary disposition motions, this Tribunal identified certain questions of disputed material fact with respect to the extent of Respondents' involvement in the Bank's allegedly improper accounting treatment of nonaccrual loans during the relevant time period; and whether and to what extent Respondents took steps to address identified issues regarding the Bank's nonaccrual accounting once those issues were brought to their attention.[360]

Viewing the totality of the evidence, and as elaborated upon below, the undersigned now finds that **(1)** under Respondents' supervision, the Bank implemented a default policy of recognizing interest income on all nonaccrual loans on a cash basis without supporting documentation of the loans' collectability, in contravention of the Call Report Instructions and the OCC's Bank Accounting Advisory Series ("BAAS"); and **(2)** Respondents were among those individuals who did not take any steps to correct or improve the Bank's blanket recognition of

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[357] *See* Part VI.D.7 *supra* at 70.

[358] *See* EPF ¶¶ 292 ($24.3 million in losses), 298 ($14.4 million), 310 ($21.4 million), 316 ($859k), 337 ($177k).

[359] *See* Notice ¶¶ 90, 105, 107.

[360] *See* MSD Order at 29, 48-50.

interest income on nonaccrual loans on a cash basis until 2013, despite being directed to do so by the OCC in 2009, 2011, and 2012.

1. Nonaccrual Loans

In the normal course of events, interest on a loan accrues on a daily basis, and borrower payments are divided between the loan's principal and its interest in accordance with the loan terms.[361] The payment of principal reduces the balance of the loan receivable, while the lending institution ultimately records the interest payment as income.[362] If, however, there is reason for a bank to doubt the collectability of a loan in its portfolio, then the bank "must determine whether the loan should be placed on a nonaccrual status."[363] Under the Call Report Instructions, any loan "(1) which is maintained on a cash basis because of deterioration in the financial condition of the borrower, (2) for which payment in full of principal or interest is not expected, or (3) upon which principal or interest has been in default for a period of 90 days or more" must be classified as nonaccrual, and the bank cannot accrue interest on it unless the loan "is *both* well secured *and* in the process of collection."[364]

Nonaccrual loans are accounted for using either the cost recovery or cash basis method.[365] The cost recovery method means that a bank applies all payments to a loan's principal balance and does not recognize any interest income.[366] The undersigned credits Ms. Salvato's expert testimony and the plain language of the Call Report Instructions that the cost recovery method is used as the

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[361] *See* EPF ¶¶ 534-536; Chansen Tr. 1435:21-1436:1; Salvato Tr. 1871:6-1872:3.

[362] *See* EPF ¶¶ 536-537; Salvato Tr. 1872:4-21.

[363] EPF ¶ 538; *see* Salvato Tr. 1872:22-1873:3, 1873:6-8 ("[N]onaccrual status is based on the presumption that there is doubt about the collectability of the loan.").

[364] EX 359 (June 2009 Call Report Instructions) at 453 (emphases in original); *see also*, *e.g.*, EX 354 (March 2012 Call Report Instructions); EPF ¶ 540.

[365] *See* EPF ¶ 542; Salvato Tr. 1874:19-1875:3.

[366] *See* EPF ¶ 544; Salvato Tr. 1874:1-24; Chansen Tr. 1436:10-1437:2.

"general rule" when there is any doubt regarding the collectability of a nonaccrual loan.[367] This is so because "[w]hen a bank does not expect to collect full principal and interest, it is appropriate for them to try and minimize the amount of loss on the asset that they are holding."[368] Applying payments on nonaccrual loans to principal and not the interest is therefore "presumably a better representation of the bank's financial condition with respect to that loan."[369]

The cash basis method for nonaccrual loans, by contrast, permits a bank to separate loan payments into principal and interest and to treat the interest portion as income, as it would for loans that are not classified as nonaccrual.[370] As Enforcement Counsel observes, the Call Report Instructions provide that cash basis accounting may only be used on nonaccrual loans "in a very limited situation"—namely, "when the bank determines, after analysis and with supporting documentation, that the remaining recorded asset is fully collectible."[371] The relevant portion of the June 2009 Call Report Instructions is representative:

> When an asset is in nonaccrual status, some or all of the cash interest payments received may be treated as interest income on a cash basis as long as the remaining recorded investment in the asset (i.e., after charge-off of identified losses, if any) is deemed to be fully collectible. A bank's determination as to the ultimate collectability of the asset's remaining recorded investment *must be supported by a current, well documented credit evaluation and prospects for repayment*, including consideration of the borrower's historical repayment performance and other relevant factors.[372]

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[367] EX 359 (June 2009 Call Report Instructions) at 453; *see id.* at 454 ("When doubt exists as to the collectability of the remaining recorded investment in an asset in nonaccrual status, any payments received must be applied to reduce the recorded investment in the asset to the extent necessary to eliminate such doubt."); *see also* EPF ¶ 543; Salvato Tr. 1873:12-21.

[368] Salvato Tr. 1874:7-10.

[369] *Id.* 1874:16-18; *see* EPF ¶ 541.

[370] *See* EPF ¶ 545; Salvato Tr. 1875:13-19.

[371] EPF ¶ 546; *see* Salvato Tr. 1880:1-1881:16.

[372] EX 359 (June 2009 Call Report Instructions) at 455 (emphasis added); *see also* EX 354 (March 2012 Call Report Instructions) at 545; Salvato Tr. 1882:4-8 (stating that "there have been no substantive changes in the guidance" on this topic from 2009 to 2013).

The BAAS likewise provides that the cash basis method should not be used unless "the bank can demonstrate [that] doubt about the ultimate collectability of principal no longer exists," and that collateral values alone are insufficient to resolve the issue of collectability.[373] Ms. Salvato testified that the documentation required to support the use of cash basis for nonaccrual loans should include "some form of analysis" by the bank finding "that the borrower's financial condition on an updated basis to the current date reflects their continued ability to repay the debt," especially considering that any given loan is on nonaccrual status to begin with because there is some doubt about its collectability.[374] And NBE Chansen noted that when a bank improperly uses cash basis accounting on nonaccrual loans, "the risk is that the bank is overstating their earnings through their earned interest account, and by overstating earnings, it's increasing the capital account which is, again, a misrepresentation of the bank's financial condition."[375]

2. <u>The Bank's Nonaccrual Accounting Practices</u>

Sometime around 2007, the Bank switched to a new loan accounting system called Jack Henry Silverlake.[376] In an April 2013 internal OCC email chain regarding the Bank's nonaccrual accounting, Supervisory Examiner Bruce Staley stated that the default setting of this system was to apply the cost recovery method on nonaccrual loans, "where all payments went to the principal balance" without recording any interest income.[377] Mr. Staley relayed that "senior management at the time wanted the default to be cash basis [nonaccrual ("NA")] where cash payments were going to principal and income [sic]," however, and "[t]hey had Jack Henry change the default" as a

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[373] EX 353 (December 2008 BAAS) at 38; *see* Salvato Tr. 1882:9-24; EPF ¶ 549.

[374] Salvato Tr. 1881:1-24; *see also* Chansen Tr. 1457:24-1458:2 (stating that a cash basis determination for a nonaccrual loan must be supported by "current financial analysis"); EPF ¶ 547 ("This analysis is important so the bank fully considers the potential risk to the bank in treating a nonaccrual loan on a cash basis.").

[375] Chansen Tr. 1438:16-25.

[376] *See* EPF ¶ 550; Chansen Tr. 1444:4-17; EX 328 (email chain including April 3, 2013 email from R. Chansen to K. Alderson regarding Bank's use of Jack Henry Silverlake) at 3.

[377] EX 328 (email chain including April 3, 2013 email from B. Staley to K. Doyle and C. Neal) at 2.

result.[378] According to Mr. Staley, "[m]anagement apparently has been automatically placing loans designated as NA on a cash basis forever."[379] In the same email chain, NBE Chansen noted that Mr. Staley's information conflicted with the representations of "the president and COO"—that is, Respondent Ortega and Mr. Leal—who, when questioned in 2013 regarding the "highly unusual" practice of placing all nonaccrual loans on cash basis accounting, "indicated that the JH Silverlake system would not allow the bank to process NAs other than on a cash basis."[380]

In other words, Enforcement Counsel has presented credible and uncontroverted evidence that the Bank changed the default accounting treatment of nonaccrual loans in the Jack Henry system from the cost recovery method to the cash basis method to conform to management's preferred practice of automatically recording interest income on nonaccrual loans. This change caused the Bank to deviate, indiscriminately and on a blanket basis, from the "general rule" of the Call Report Instructions that cost recovery accounting be used on all nonaccrual loans unless and until it is determined, through "a current, well documented credit evaluation," that a specific loan is fully collectible.[381] The undersigned also credits NBE Chansen's testimony that Respondents, in their capacity as senior management of the Bank, would or should have been aware that such a change had been made, even if they did not authorize it.[382] This is especially true for Respondent Ortega, given his role overseeing the Bank's Information Technology department at this time.[383]

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[378] *Id.* Mr. Staley does not indicate from whom he learned this information, nor does Enforcement Counsel adduce any further evidence on that question.

[379] *Id.*

[380] *Id.* at 3 (April 3, 2013 email from R. Chansen to K. Alderson); *see* Chansen Tr. 1444:10-22.

[381] EX 359 (June 2009 Call Report Instructions) at 545; *See* RX 68 (email chain including October 24, 2012 email from E. Leal to J. Garcia et al.) ("The system is automatically set up for cash basis...once a loan goes to N/A (usually 90 days past due) it goes to cash basis.").

[382] *See* Chansen Tr. 1445:18-1447:2; EPF ¶ 554.

[383] *See* Ortega Tr. 644:7-16; Chansen Tr. 1445:20-22; EPF ¶ 554.

Further, there is no evidence that the Bank undertook—or, logistically, could have undertaken—"the loan-by-loan investigation, analysis, and documentation of likely collectability mandated by the Call Report Instructions" with respect to the loans for which cash basis was used by default in this manner.[384] Indeed, COO/Comptroller Ryan Leal testified that instead of requiring documentation to treat a nonaccrual loan as cash basis and thus recognize interest income, the Bank's credit review department "would look at all the loans currently on the books and . . . if it was deemed that the credit was deteriorating" and that payment in full was no longer likely even with the sale of collateral, "then it would change method" to cost recovery—precisely the *opposite* approach of the one set forth in the Call Report Instructions and the BAAS.[385]

3. <u>The January 2009 MOU</u>

In January 2009, the OCC entered into an MOU with the Bank that, among other things, required the Bank to "immediately reverse or charge off all interest that has been accrued contrary to the requirements contained in the [Call Report Instructions] governing nonaccrual loans."[386] The MOU also directed the Bank Board to "develop and implement a written policy governing the identification of and accounting treatment for nonaccrual loans . . . [that] shall be consistent with the accounting requirements contained in the Call Report Instructions."[387] Respondents were members of the Bank's MOU Compliance Committee ("MOU Committee") and were responsible, in that capacity, "for ensuring that the Bank complied with the requirements" of the January 2009 MOU,[388] although Mr. Magee and others within the lending department and elsewhere were the ones actually tasked with taking the necessary steps to achieve compliance.[389]

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[384] EPF ¶ 559.
[385] Leal Tr. 2309:1-14.
[386] JX 11 (January 2009 MOU) at 6-7; *see* EPF ¶¶ 10, 556.
[387] JX 11 (January 2009 MOU) at 7.
[388] EPF ¶ 558.
[389] *See* RPF ¶ 85.

On January 22, 2009, in an email to Respondent Rogers and the rest of senior management regarding the MOU, Respondent Ortega expressed the view that the Bank's existing nonaccrual loan policy "seem[ed] adequate" and was in compliance with the Call Report Instructions.[390] Following this, Chief Audit Officer Joe Garcia pointed out to the MOU Committee that the BAAS "require[d] the bank to demonstrate that it no longer doubts the ultimate collectivity [sic] of principal" before treating a nonaccrual loan as cash basis.[391] Mr. Garcia then suggested "that the policy on cash-basis loans reflect the guidance from the accounting series."[392]

On March 3, 2009, Mr. Leal announced to the Board that the Bank's nonaccrual loan policy had "been modified to include the accounting requirements specified in the Call Report Instructions."[393] At that same meeting, Mr. Garcia also outlined proposed audit procedures with respect to nonaccrual loans that would enable the Audit department to "[i]dentify nonaccrual loans in compliance with call report instructions" and "[v]alidate the integrity of nonaccrual system coding to the supporting documentation."[394] Respondent Ortega testified that Mr. Leal's representations regarding the changes to the nonaccrual policy led him to believe that the OCC's concerns on the issue were being addressed.[395]

In fact, however, the new nonaccrual loan policy implemented in the spring of 2009 complied with the Call Report Instructions only superficially, if at all. As Enforcement Counsel observes, "nothing in the new policy required Bank employees to undertake, much less document,

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[390] EX 317 (email chain including January 22, 2009 email from S. Ortega to D. Rogers, R. Gandy, and M. McCarthy) ("Non accruals – we just need to follow our own policy and follow call report instructions. Policy seems adequate."); *see also* Ortega Tr. 763:3-13 (agreeing that he had reviewed the nonaccrual policy and compared it to the Call Report Instructions).

[391] EX 318 (email chain including February 27, 2009 email from J. Garcia to MOU Committee).

[392] *Id.*

[393] EX 319 (March 3, 2009 Board meeting minutes) at 1.

[394] *Id.* at 8 (February 25, 2009 memorandum from J. Garcia to R. Gandy).

[395] *See* Ortega Tr. 1027:16-1029:2.

the required analysis to determine that collectability was no longer in doubt before applying the cash basis method . . . to account for a loan on nonaccrual status."[396] Nor did the revised policy address or even mention the fact that the Bank automatically applied cash basis accounting to all nonaccrual loans, something that both the Call Report Instructions *and the policy itself* did not permit where there was any doubt about a loan's collectability.[397] Instead, the new policy stated that "a bank is allowed to maintain a loan on a cash basis as long as the borrower is able to make regular payments," which is not the standard articulated by either the Call Report Instructions or the BAAS, and which would not in any case apply to loans placed on nonaccrual status for being 90 days or more past due, as was the Bank's practice.[398] The policy further underlined the Bank's commitment to recognizing interest income on nonaccrual loans, stating in no uncertain terms that "*[i]t is FNB's intent to utilize cash basis nonaccrual accounting whenever it is applicable*."[399]

The lack of documentation for cash basis accounting of nonaccrual loans did not go unnoticed by the Bank's Audit department. Following a quarterly review of the Bank's nonaccrual program as of June 30, 2009, Mr. Garcia informed Bank senior management that the "use of the cash basis of accounting on all nonaccrual loans" was unsatisfactory.[400] Specifically, Mr. Garcia stated that although the Call Report Instructions permit cash basis accounting only if a loan is deemed to be fully collectible after a well-documented credit evaluation, discussions with Bank management had revealed "that *all* nonaccrual loans are on the cash basis of income recognition;

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[396] EPF ¶ 562 (emphasis omitted); *see* EX 319 (March 3, 2009 Board meeting minutes attaching 2009 nonaccrual policy) at 10-14.

[397] *See* EPF ¶ 563; EX 319 (2009 nonaccrual policy) at 12 (stating that "[w]hen doubt exists as to the collectability of the loan in nonaccrual status, *any payments received must be applied to reduce the recorded investment in the loan until the doubt is eliminated*") (emphasis added).

[398] EX 319 (2009 nonaccrual policy) at 11; *see* EPF ¶ 561; Ortega Tr. 767:9-12 ("Q: By definition, then, nonaccruals are on nonaccrual because they are unable to make regular payments, correct? A: For over 90 days, yes.").

[399] EX 319 (2009 nonaccrual policy) at 11 (emphasis added).

[400] EX 321 (MOU-related materials including June 30, 2009 memorandum from J. Garcia to R. Gandy) ("June 2009 nonaccrual review memo") at 4. As MOU Committee members, Respondents would have received and reviewed this memo no later than August 2009. *See* Ortega Tr. 778:20-779:18; EPF ¶ 569.

and, are not supported by documentation."[401] The Audit department therefore recommended "setting a dollar threshold at which [nonaccrual] loans are required to have credit evaluations" before being treated on a cash basis.[402] Despite this warning and recommendation, there is no indication that Respondents or anyone else in Bank management took any steps in response to bring the Bank's nonaccrual loan accounting into compliance with the Call Report Instructions.[403]

4. The 2011 and 2012 Consent Orders

The February 2011 and January 2012 Consent Orders between the OCC and the Bank reiterated the directions from the 2009 MOU for the Bank to "reverse or charge off all interest that has been accrued contrary to the requirements contained in the [Call Report Instructions] governing nonaccrual loans" and to "ensure the Bank's adherence to written policies and procedures governing the supervision and control of nonaccrual loans . . . consistent with the accounting requirements contained in the Call Report Instructions."[404] Notwithstanding this, "[t]here is no evidence that Respondents caused the Bank's accounting system or its policy for accounting for nonaccrual loans to change to conform to Call Report Instructions in response to the Consent Orders."[405] Furthermore, "[n]either Respondent caused the Bank to reverse or charge off all interest accrued contrary to the Call Report Instructions—for Respondent Rogers, before he resigned from the Bank on November 1, 2011, or Respondent Ortega before the end of 2012."[406] Overall, the undersigned agrees with Enforcement Counsel that there is no evidence that either

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[401] EX 321 (June 2009 nonaccrual review memo) at 5 (emphasis in original).
[402] *Id.*
[403] *See* EPF ¶ 574.
[404] JX 12 (February 2011 Consent Order) at 12; JX 13 (January 2012 Consent Order) at 16; *see* EPF ¶¶ 575, 578.
[405] EPF ¶ 581.
[406] *Id.* ¶ 582.

Respondent "took the necessary steps from 2009 through 2012 to ensure Bank compliance with proper accounting for nonaccrual loans pursuant to Call Report Instructions."[407]

Chief Audit Officer Garcia expressed renewed concerns in October 2012 and December 2012, including to Respondent Ortega, regarding the Bank's practice of nonaccrual loans being accounted for *en masse* using the cash basis method without supporting documentation.[408] As a result, the Credit Administration department "modified the Credit Review template to include a separate section" addressing whether a loan on nonaccrual status should be treated as cash basis.[409] Nevertheless, the Bank continued to use the cash basis method to recognize interest income on all nonaccrual loans as a default.[410]

5. The 2013 Target ROE

The OCC's March 2013 targeted examination brought the issue of cash basis nonaccrual loan accounting to the forefront.[411] Examiners concluded that Bank management had "failed to

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[407] *Id.* ¶ 588.

[408] *See* EX 323 (email chain including October 23, 2012 email from J. Garcia to M. Magee et al., forwarded to S. Ortega) ("What documentation will I find in the file to support the cash basis of accounting? . . . I was informed by Loan Administration that all nonaccrual loans that are paying are on the cash basis – is this correct?"); RX 68 (email chain including October 24, 2012 email from J. Garcia to M. Karst et al., forwarded to S. Ortega) ("I [am] looking for documentation support on the decisions."); EX 325 (December 17, 2012 Board and MOU Committee meeting minutes) at 1 ("Mr. Garcia noted that the Audit department found Loan Review, Credit Review, and Special Assets write-ups did not include documentation supporting for income recognition on a cash basis.").

[409] EX 325 (December 17, 2012 Board and MOU Committee meeting minutes) at 1; *see also* EX 324 (email chain including November 8, 2012 email from M. Magee to J. Garcia et al.).

[410] *See* RX 68 (email chain including October 24, 2012 email from E. Leal to J. Garcia et al.) ("The system is automatically set up for cash basis.").

[411] Respondents contend that "[p]rior bank examiners approved of and agreed with the Bank's approach" of applying cash basis accounting to nonaccrual loans in a blanket manner without documentation of collectability. RPF ¶ 90. The only evidence cited in support of this view is an August 20, 2009 email from the OCC's then-head accountant, Rusty Thompson, to a colleague regarding whether a specific Bank loan should be accounted as OREO. *See* RX 66 (August 2009 email chain between R. Thompson and J. King). During this colloquy, Mr. Thompson ultimately suggests that the loan be treated as "a cash basis nonaccrual loan from Day 1 since there is no evidence of the borrower's ability to generate sufficient cash flow to repay the debt." *Id.* at 1. The undersigned finds that this email does not support Respondents' current contention for several reasons. First, it is clear from the context of the exchange that Mr. Thompson is suggesting that the loan in question be placed on nonaccrual status upon origination, not that it be given cash basis treatment rather than cost recovery treatment—in other words, the focus of Mr. Thompson's suggestion was that the loan be nonaccrual "from Day 1" because the borrower had not demonstrated an ability to repay it; the use of the term "cash basis" was incidental. This is underscored by the fact that accounting for a loan on a cash basis when there is no ability to repay is directly and plainly contrary to

follow cost recovery treatment for nonaccrual loans and follow guidelines within the Call Report Instructions," noting that the Bank's incorrect practice of automatically applying the cash basis method to nonaccrual loans without the required supporting analysis had "been in place for many years."[412] Of the approximately 400 nonaccrual loans on the Bank's portfolio at that time, examiners determined that all but two were recognized on a cash basis.[413] Examiners further found that fifteen of the sixteen nonaccrual loans sampled for review lacked any documentation to support their treatment as cash basis, while the final sample loan "had some support based on loan file information, but no supporting documentation by management was available or performed."[414] NBE Chansen explained the sample review process at the hearing:

> [W]hat we were looking for was how the payments had been applied since the loan was placed on non-accrual. Then we were also looking for, in the credit files themselves, the documentation to support the decision to keep it on cash basis non-accrual. Those were the items we were looking for. And when we could not locate any such documentation, we documented information, again, based on the file review as to why the borrower could not support a cash basis status.
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> [A]nd our review showed that there were significant well-defined weaknesses in each of the ones that we looked at raising questions about the ability of the borrower to support the debt and keep it on cash basis.[415]

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accounting guidelines: it is therefore absurd to interpret Mr. Thompson's statement as Respondents would have this Tribunal do. Finally, this is a single, internal OCC email, and Respondents have offered no indication that the OCC ever communicated to the Bank that it was appropriate to recognize interest income on a cash basis on this loan or any other nonaccrual loan for which the Bank lacked evidence of the borrower's ability to repay. Indeed, the opposite is true, as examiners repeatedly directed the Bank to improve its nonaccrual loan accounting and ensure compliance with the Call Report Instruction requirements, which state unequivocally that cash basis should not be used if there is doubt about a loan's collectability. It is fair to say that a loan for which "there is no evidence of the borrower's ability to generate sufficient cash flow to repay the debt" is dubiously collectible.

[412] JX 7 (2013 Target ROE) at 6 (noting that "the software supporting the Bank's financial records automatically accounts for cash basis nonaccrual, not the standard cost recovery method").

[413] *Id.*

[414] *Id.*

[415] Chansen Tr. 1449:24-1450:9, 1451:13-18.

The Report of Examination stated that as a result of the improper recognition of interest income on nonaccrual loans, the Bank's capital and earnings were overstated "for 2011, 2012, and the first quarter of 2013 by $1.4 million, $9.8 million, and $3.6 million, respectively."[416] To correct this, the Bank refiled its December 31, 2012 Call Report to reduce its reported interest income for 2011 and 2012 by a total of $11.2 million, and likewise adjusted its March 31, 2013 Call Report before it was filed.[417] Examiners also cited the Bank for a violation of 12 U.S.C. § 161(a) based on the filing of the inaccurate Call Report for the period ending December 31, 2012, finding that the primary cause of the overstatement of income "was inappropriate recognition of interest income for nonaccrual loans."[418]

Finally, the 2013 report stated that "[m]anagement is now aware of the proper accounting treatment and the Call Report requirements for cash basis nonaccrual and indicated that all new nonaccrual loans will receive proper coding for the cost recovery accounting method."[419] It further noted that "CEO Ortega and [COO] Eddie Leal have now implemented the appropriate processes and procedures ensuring proper cost recovery accounting treatment for nonaccrual loans."[420] (To recall, Respondent Rogers stepped down from his position as Bank Chairman in November 2011 and was no longer affiliated with the Bank following that date.[421])

To sum up: Cash basis accounting may only be used if there is no doubt about the collectability of a loan. The Bank used cash basis on every nonaccrual loan by default, in essence taking the position—without any supporting documentation—that there was no doubt about the

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[416] JX 7 (2013 Target ROE) at 2; *see* Chansen Tr. 1514:19-1515:2 (opining that "failure to properly account for the non-accruals overstated the bank's earnings and capital which masked the financial condition of the bank to regulators, depositors, and stockholders").

[417] *See* EPF ¶¶ 594-595; Salvato Tr. 1883:3-1887:10; JX 7 (2013 Target ROE) at 6.

[418] JX 7 (2013 Target ROE) at 22.

[419] *Id.* at 6.

[420] *Id.*

[421] *See* Notice ¶ 6.

collectability of any of those loans despite the fact that they were more than 90 days in default or had some other negative feature that had, after all, resulted in their nonaccrual status to begin with. This was consistent with the Bank's stated philosophy of "utiliz[ing] cash basis nonaccrual accounting whenever it is applicable" and recognizing as much interest income as possible, but plainly contrary to the requirements set forth in the Call Report Instructions and the BAAS. As a consequence of the Bank's practice, interest income was improperly recognized, over the course of many years, on hundreds of nonaccrual loans whose collectability remained very much in doubt. Put another way, once a loan is placed on nonaccrual status, the onus is on the Bank to show that it no longer has any doubt about the loan's collectability and may therefore apply cash basis accounting and recognize interest income. Not only did the Bank not do this for the overwhelming majority of its nonaccrual loans from 2007 through 2012 before recognizing interest income on them, but to all appearances it did not even try—and the undersigned credits the testimony of Enforcement Counsel's experts that "Respondents, as directors of the Bank, were ultimately responsible for the Bank's policies and ensuring the Bank's compliance with proper accounting principles, especially in response to supervisor communications from examiners and warnings from the Bank's internal auditor about its improper accounting for nonaccrual loans."[422]

6. Materiality

Respondents cite to two internal OCC emails from March 2014 in which examiners represent that "the amount of overstated earnings [due to improper nonaccrual loan accounting] ultimately identified by the OCC was not material to FNB's failure"[423] and that "the 'Nonaccrual Issue' . . . had no impact on the type or timing of any enforcement action nor any impact on the

[422] EPF ¶ 586; *see* Brickman Tr. 83:15-84:13; Chansen Tr. 1417:12-1418:1.

[423] RX 41 (email chain including March 28, 2014 email from B. Paulson to R. Chansen et al.).

eventual timing of the bank's close."[424] These more contemporaneous representations conflict, to at least some degree, with the opinions of Deputy Comptroller Brickman and NBE Chansen at the hearing that the improperly recognized interest income was material because "[h]ad Respondents required the Bank to comply with Call Report Instructions and accurately account for nonaccrual loans over [prior] years," the Bank's losses in those years would have been higher, and "[h]igher losses in prior years may have accelerated or escalated examiners' supervisory actions."[425] The undersigned addresses this further *infra* in Part VII.C.4.

F. Loans to Rogers III Entities (Article VI)

Article VI alleges that Respondent Rogers "placed the interests of a member of his immediate family above those of the Bank" in connection with "one series of unsafe or unsound loans" taking place in or around April 2009 and January 2010 by concealing material information from the Bank's Board of Directors and L&D Committee.[426] Specifically and in pertinent part,[427] this Article alleges that Respondent Rogers's son, David Rogers III ("Rogers III"), contrived to protect his own financial interests in a manner detrimental to the Bank by effecting a scheme in which the Bank foreclosed on certain properties that were the subject of loans to a Rogers III-owned entity in which Rogers III had a personal guarantee, thereby releasing him from that guarantee, and then financed the sale of those same properties to new Rogers III-owned entities, this time without a personal guarantee. As developed further by Enforcement Counsel over the

[424] RX 52 (email chain including March 25, 2014 email from H. Thompson to R. Chansen et al.); *see* RPF ¶ 92.

[425] EPF ¶ 600; *see also* Brickman Tr. 174:10-175:8; Chansen Tr. 1454:16-1455:3.

[426] Notice ¶ 29; *see id.* ¶¶ 110-129.

[427] There are several allegations in Article VI that Enforcement Counsel no longer appears to be asserting, given the lack of any evidence or argument regarding those allegations at the hearing or in Enforcement Counsel's posthearing briefs. *See*, *e.g.*, *id.* ¶¶ 124-126 (allegations regarding "Company Z" and "Bank A"). The undersigned accordingly confines her analysis to the allegations against Respondent Rogers for which evidence has been adduced by the Parties and on which judgment is now sought by Enforcement Counsel—namely, those involving Griqualand (Company X in the Notice), Petro Icon (Company Y in the Notice), and the 2009 allegations regarding Obra Homes (Company W in the Notice). *See* EPF ¶¶ 620-660.

course of this proceeding, the Article additionally alleges that Respondent Rogers had knowledge of this scheme, knew it was not in the Bank's best interests, and yet took no steps to inform others at the Bank, thus causing the Bank loss.

Enforcement Counsel focused its motion for summary disposition of this Article on the allegations regarding one particular transaction involving a company named Griqualand LLC ("Griqualand"), which is styled as Company X in the Notice (hereinafter "the Griqualand transaction" or "the Griqualand loan").[428] In its October 5, 2021 Order on the Parties' summary disposition motions, this Tribunal identified certain questions of disputed material fact regarding the Griqualand transaction and the allegations in Article VI more generally, including what information was available to the L&D Committee prior to its approval of the Griqualand loan; the extent to which Respondent Rogers could have influenced, or did influence, the L&D Committee's perception of the merits of the Griqualand loan by sharing information not previously known to it; whether, based on all information known to Respondent Rogers at that time, the loan can be said to have been in the Bank's best interests when it was approved; and whether the Bank or the receivership in fact suffered loss as a result of the loan's approval.[429]

Viewing the totality of the evidence, and as elaborated upon below, the undersigned now makes the following core findings: **(1)** Respondent Rogers believed that it would not be in the best interests of the Bank to foreclose on collateral for loans that were personally guaranteed and then refinance the purchase of that collateral by the same borrower without a personal guarantee; **(2)** Respondent Rogers was aware of information regarding his son's financial situation that was pertinent to the Bank's decision to approve loans to newly formed entities owned by his son, without personal guarantees, to repurchase assets that his son previously owned through another

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[428] *See* OCC Mot. at 10 n.7; Notice ¶¶ 117-120, 129.
[429] *See* MSD Order at 36-37, 50-52.

entity; **(3)** Respondent Rogers did not ensure that L&D Committee members were fully apprised of this information before the Committee approved those loans; and **(4)** the Bank and the receivership ultimately incurred losses on the loans in question.

1. Background

Rogers III was a businessman with ownership interests in multiple companies, including Obra Homes, Inc. ("Obra Homes" or "Obra"), a homebuilding company, for which he also served as President.[430] At the beginning of the relevant period, Obra Homes had numerous outstanding loans from the Bank that Rogers III had personally guaranteed, most of which were also secured by collateral in the form of real property.[431] Rogers III had previously been a director at the Bank and was generally known by Bank management and Board members.[432] Respondent Rogers testified that he and his son kept their personal relationship entirely separate from his son's dealings at the Bank and did not involve themselves in each other's business affairs: "I stayed out of his business, and he stayed out of my business. . . . I've been in his Houston office once in this 20 or 30 years time gone by. I'm close to him, but I'm not involved in his business. I'd do anything within reason for him."[433]

2. The Yollick Email

On February 11, 2009, Rogers III forwarded an email to his father that had been sent from Rogers III's attorney, Erick Yollick, two days earlier.[434] The forwarded email discussed the

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[430] *See* EPF ¶ 621.

[431] *See id.* ¶¶ 621-622; EX 268 (2007 Annual Review of Obra Homes loan relationship) at 1-3.

[432] *See* Rogers Tr. 394:1-395:17, 397:5-6, 412:11-12 ("Everybody knew my son. He'd served on the Board with them."); EX 569 (Ortega Dep.) at 216:12-16 ("Q: So the only reason to make this loan is that you knew that the borrower is related to Mr. Rogers? A: No, and knowing his history with the bank."); EC-PSD-12 (McCarthy Dep.) 238:13-17 ("David Rogers III always took care of his business, paid on time, and worked very well with whoever he was assigned to work with.").

[433] Rogers Tr. 397:17-19, 398:1-4; *see also id.* 405:19-22 ("I stayed so far away from my son's business. . . . I didn't lobby for him. I didn't lobby against him. I just stayed away from him.").

[434] *See* EPF ¶¶ 623-625; EX 269 (February 11, 2009 email from D. Rogers III to Respondent Rogers, forwarding February 9, 2009 email from E. Yollick to D. Rogers III) ("Yollick email").

increasing likelihood that Obra Homes would be placed into receivership in order to satisfy an impending judgment from one or more of the 18 lawsuits then being brought by creditors against the company, the majority of which the lawyer asserted were "suits on debts which Obra is unlikely to win."[435] Mr. Yollick stated that such an outcome "would result in your total loss of control of Obra and its assets," which would in turn frustrate Rogers III's efforts to "liquidate [Obra's] assets in an orderly manner to satisfy [his] obligations to" the Bank and an institution denoted "RBC."[436]

Mr. Yollick then proposed that Rogers III work with the Bank and RBC to empty Obra of "all of [its] assets" through foreclosure by those institutions, thus leaving nothing for Obra's other creditors and obviating any concern about possible judgments.[437] Mr. Yollick hypothesized that Rogers III could even come to an agreement with the Bank and RBC whereby he could form "another corporation" and reacquire the assets, this time without a personal guarantee:

> I strongly urge that you consider that option – of working with the banks to ensure swift foreclosure and an agreement between you and them to market the assets – and possible marketing agreements with RBC and FNB so that you may maintain control of Obra's assets, *maximize your chance of eliminating your personal liability to RNB and FNC*, and end your payment of personal assets into Obra's coffers. Remember, *you could even have an arrangement with the banks to repurchase the assets in another corporation after foreclosure* (or, with greater risk, at the foreclosure) in order to market them.[438]

In short, then, Mr. Yollick described a scenario in which (1) Obra Homes would default on certain loans to the Bank that were secured by collateral and backed by a personal guarantee;[439] (2) the Bank would foreclose on the collateral in lieu of pursuing Rogers III's own assets through

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[435] EX 269 (Yollick email) at 1.

[436] *Id.* (also warning that "[a] receiver could conduct an investigation of Obra's assets to determine whether past transactions benefited the company or whether they could be deemed fraudulent transfers").

[437] *Id.* (stating that "[i]f Obra had nothing left, then there would be no reason for you to have to pay settlements in these lawsuits. Furthermore, there would not even be a need to file bankruptcy on behalf of Obra.").

[438] *Id.* (emphases added); *see* EPF ¶¶ 623-624.

[439] The Parties do not adduce evidence regarding the size of Rogers III's personal guarantees on the loans in question.

the personal guarantees; (3) Obra Homes would now lack any assets for other creditors, relieving Rogers III of the prospect of costly settlements without the need for Obra to file for bankruptcy; (4) the foreclosed collateral would be placed on the Bank's books as ORE; and (5) Rogers III would then assist the Bank in selling this ORE, whether by marketing the property to other borrowers or by forming a new corporation that, unlike Obra, was not mired in financial and legal troubles and repurchasing the collateral property himself through Bank-financed loans, ideally on repayment terms for which he was no longer personally liable.

It goes without saying that such a scheme relied on the consent of the Bank to succeed: Rogers III could not force the Bank to release him from his personal guarantee on the Obra loans, nor could he unilaterally dictate the terms by which he repurchased the collateral from the Bank under the guise of a new corporation. Rather, decision-makers at the Bank—from the credit department to the loan officer to the L&D Committee—would have to conclude, given sufficient information about the transactions, that it was in the Bank's interests to foreclose and remarket the Obra collateral, whether to Rogers III or someone else, if the alternative was the diminution or encumbrance of Obra's assets by other creditor claims and lawsuits and an only partial recoupment of the defaulted loan principal through Rogers III's existing personal guarantees.

Respondent Rogers agrees that he recognized at the time that the plan outlined by Mr. Yollick was not necessarily in the Bank's best interests.[440] According to Respondent Rogers, he contacted his son soon after receiving the Yollick email to express his worry:

> I remember this very well. I called my son when I got this email either the same day or the next morning. I was, at the time, very concerned about it. I told him whatever he did, he must protect the

[440] *See*, *e.g.*, Rogers Tr. 403:7-11 ("Q: In your experience, the proposed arrangement that Mr. Yollick advises your son about would not be in the bank's best interest, would it? A: I wouldn't think so.").

> bank. . . . I didn't discuss all the proposal. I just said son, whatever you do, please, you have to protect the bank.[441]

Respondent Rogers testified that he let his son assuage his concerns during this call and did not feel the need to tell anyone at the Bank about the email as a result.

> He assured me there was no problem. He was going to take care of everything, which he did. . . . He said, dad, I am going to protect the bank. Nothing will happen to the bank.[442]
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> Q: To ensure that the bank was protected, did you then forward this email or this information on to the individuals that you mentioned that were responsible for the lending relationship of FNB with your son?
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> A: I did not. I had all the confidence in the world in my son. When he told me he would take care of the bank, I relaxed and felt very, very comfortable.[443]

Respondent Rogers acknowledged that his son was no longer a bank director and therefore did not have any duty to protect the Bank, stating that "I would think that the duty would be to himself to protect himself."[444] There is also no evidence that Respondent Rogers ever raised the issue of the personal guarantee with his son or asked how the Bank could be protected if it was left with more exposure on its loans after the contemplated transactions.[445] Ultimately, Respondent Rogers opted to stay out of it entirely, even though he knew that the arrangement described by the Yollick email would not be good for the Bank:

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[441] *Id.* 403:11-16, 404:23-25.

[442] *Id.* 404:11-13, 405:1-2; *see also id.* 406:22-407:2 ("I do remember distinctly telling him several times, son, you must protect the bank, and him telling me, I'm fine, I'm tight with liquidity for a little bit, I have plenty of assets, I will be fine. And he was. And he did pay the bank.").

[443] *Id.* 407:3-11; *see also id.* 408:10-12 ("When I told my son protect the bank and he told me he would protect the bank, no problem, I was very comfortable with that.").

[444] *Id.* 437:17-18; *see also id.* 436:3-437:16.

[445] *See* Chansen Tr. 1526:15-21 ("So again, it gets back to it's the same entity that the bank foreclosed on and then lent on. And when all of this happened, the Bank came out in a worse position than they were because [] now Mr. Rogers doesn't have any skin in the game. He's not personally liable for the debt."); Ortega Tr. 703:22-704:7 (agreeing that the lack of a personal guarantee had the potential to "put the Bank in a much worse condition").

> Q: You testified earlier that this proposal would not be in the best interest of the bank, correct?
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> A: *I wouldn't think it would be good for the bank*, but I don't know what the circumstances were. I don't know why they would go through that process. I just left it alone.[446]

The undersigned credits NBE Chansen's expert testimony that the information in the Yollick email would have been "material to future lending decisions involving Mr. Rogers III."[447] As NBE Chansen stated, "the information contained in this email details the inability to support the current debt provided to Mr. Rogers III, which [] raises questions about his ability going forward to repay any debts or any loans that the bank would have made to him"[448] and would have been important for the Bank to know, particularly given the email's proposal for Rogers III to "release [his] personal guarantee or liability on the loans with the bank while retaining ownership of the same assets," putting the Bank in a potentially worse position than it was before.[449] Despite this, it is uncontroverted that Respondent Rogers never raised the topic of the email or its contents with "anyone within the Bank who had responsibility for maintaining the lending relationship between the Bank and Rogers III."[450]

3. <u>The Griqualand Loan</u>

Rogers III appears to have acted consistently with his attorney's advice, forming Griqualand in March 2009 and using it over the following months as a vehicle for the repurchase

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[446] Rogers Tr. 405:23-406:5 (emphasis added).
[447] Chansen Tr. 1525:21-22; *see* EPF ¶ 646.
[448] Chansen Tr. 1525:22-1526:4.
[449] *Id.* 1526:11-14.
[450] EPF ¶ 629; *see also* EX 568 (Rogers Dep.) 195:24-196:4; Ortega Tr. 710:21-711:2.

of Obra assets from the Bank.[451] It is undisputed that Rogers III had a 100 percent ownership interest in Griqualand at all times relevant to the instant allegations.[452]

On or around April 7, 2009, the Bank foreclosed on certain of its loans to Obra Homes and took ownership of the related collateral, placing those properties on its balance sheet as OREO.[453] In so doing, the Bank released Rogers III from his personal guarantee on the defaulted loans.[454] Consistent with the costly nature of OREO discussed *supra*, the Bank also paid thousands of dollars of outstanding property taxes on the foreclosed properties.[455]

On April 30, 2009, the L&D Committee approved a $3,234,688.90 loan to Griqualand by telephone tally.[456] On May 12, 2009, the L&D Committee ratified the loan, with Respondent Rogers abstaining.[457] Through Griqualand, Rogers III then repurchased the foreclosed-upon Obra properties from the Bank using the proceeds of this loan.[458] The materials provided to the L&D Committee during the approval and ratification process stated that the purpose of the loan was "to purchase [OREO] property from FNB to develop and resell."[459]

In effectuating the loan to Griqualand, "[t]he Bank did not require any equity contribution from Griqualand or Rogers III, financed 100 percent of the purchase price, and included $100,000

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[451] *See* EPF ¶¶ 630-631; EX 282 (Griqualand formation materials) at 2 (March 26, 2009 Certificate of Formation).

[452] Documents proffered by Enforcement Counsel as the minutes of March 27, 2009 meetings of the "Members" of Griqualand and of the Griqualand Board of Managers appear to reflect that Mr. Drake, serving as the Board's sole Board Member, President, and Secretary, sold a 100 percent ownership interest in Griqualand to Rogers III, the sole Member of the company, who had appointed Mr. Drake to his position on the Board earlier that day. *See* EX 282 at 4-5 (March 27, 2009 meeting minutes of the Member of Griqualand), 8-11 (March 27, 2009 meeting minutes of Griqualand Board of Managers); *see also* EX 274 (balance sheet indicating that Rogers III had 100 percent ownership of Griqualand as of December 31, 2010 and December 31, 2011); Rogers III Tr. 2375:17-21.

[453] *See* EX 288 (Obra Homes case history); EPF ¶ 632.

[454] *See* EPF ¶ 632.

[455] *See*, *e.g.*, EX 288 at 1 (Obra Homes case history) (payment of $27,342.47 in property taxes owed), 2 (payment of $19,698.77 in outstanding 2008 property taxes); *see also* EPF ¶ 633.

[456] *See* EX 349 (Griqualand L&D ratification package) at 2.

[457] *See id.* at 1.

[458] *See* EPF ¶ 635 (citing exhibits).

[459] EX 349 (Griqualand L&D ratification package) at 5.

in new monies for development costs."[460] There was no appraisal completed and no financial information provided on Griqualand.[461] Unlike the previous loans to Obra Homes, the Griqualand loan also did not require a personal guarantee from the borrower, which the L&D Committee ratification package stated was done "to facilitate" the sale of the newly Bank-owned Obra properties to Griqualand.[462] NBE Chansen testified that, in her experience as a national bank examiner, she had never seen another transaction in which a bank foreclosed on a property as collateral for a defaulted loan and then proceeded to sell the property back to the same owner acting through a newly formed entity, let alone under more favorable loan terms than the original defaulted loan and after such a short span of time.[463]

Although loan officer Edna Martinez testified that she was aware at the time of the Griqualand loan that the foreclosed Obra properties were being repurchased by "the same individual . . . under the name of a new company,"[464] the loan package presented to the L&D Committee did not contain that information.[465] To the contrary, the package's loan officer recommendation appears to actively go out of its way to avoid making a connection to Rogers III. Instead of naming Rogers III, for example—who, again, was indisputably Griqualand's sole owner—in the section entitled "Background information on Borrower/Principal/Cosignor/ Guarantor," the package states that Griqualand "was formed by Roland W. Drake and others," providing a lengthy paragraph of detailed biographical data on Mr. Drake and identifying him as

[460] EPF ¶ 637; *see* Rogers Tr. 409:24-410:2 (agreeing that the loan included new funds extended for working capital).

[461] *See* EX 349 (Griqualand L&D ratification package) at 5 (stating that Griqualand "is a start up company"); Rogers Tr. 409:4-23.

[462] EX 349 (Griqualand L&D ratification package) at 5.

[463] *See* Chansen Tr. 1519:24-1521:9.

[464] R-BIO-10 (excepts of sworn statement testimony of Edna Martinez) at 56:2-22.

[465] *See* EPF ¶ 641.

Griqualand's managing director and the one who "developed the concept for Griqualand."[466] That section then proceeds to offer information on Mr. Drake's son ("studying to be an anthropologist") and his three daughters ("two of whom are professional librarians and one of whom is a published historical novelist"), who had no involvement with Griqualand.[467] Finally, the section adds off-handedly that "Griqualand's investors include a prominent homebuilder and financier who have [sic] substantial experience as a developer and real estate investor," in what Enforcement Counsel asserts without dispute is the document's sole oblique reference to Rogers III.[468]

The undersigned agrees with Respondents that, to all appearances, "Rogers III went through normal channels to do business with the Bank," and Respondent Rogers was not involved in advancing the Griqualand loan or handling it in any way.[469] The Bank officers handling and ultimately recommending the loan for approval were Ms. Martinez and Curtis Brockman,[470] and there is no evidence that Respondent Rogers contacted either of those officers regarding the loan or actively attempted to influence the loan process. Further, there can be no argument that when the time came to vote on the Griqualand loan, Respondent Rogers abstained—in his own words, "I stayed away from discussing my son's business with the Board."[471]

At the summary disposition stage, the undersigned concluded that it was a disputed question of material fact whether the other Board members had all relevant information regarding Rogers III's ownership of Griqualand, including the financial difficulties experienced by Obra and his plan to reacquire the foreclosed assets without a personal guarantee, at the time that they

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[466] EX 349 (Griqualand L&D ratification package) at 5 (among many other things unrelated to real estate, championing Mr. Drake's military service and his three decades' work "as a private investigator for many of the Greater Houston area's most prominent law firms").

[467] *Id.*

[468] *Id.*; *see* EPF ¶ 649.

[469] RPF ¶ 96; *see* Rogers Tr. 407:22-23 ("I stayed a million miles away from my son's loan.").

[470] *See* RPF ¶ 96.

[471] Rogers Tr. 409:13-15; *see* EX 349 (Griqualand L&D ratification package) at 1.

approved the loan.[472] The hearing did not do much to clarify matters—Respondents continue to assert that "the Bank and L&D Committee knew of Rogers III's involvement,"[473] and Enforcement Counsel did not adduce any further evidence to resolve the question. It is also possible that full knowledge of the circumstances might have made individuals on the L&D Committee *more* likely to approve the loan, if they viewed Rogers III as a reliable borrower and saw the transaction as a way to remove encumbrances from the assets.[474] Respondent Ortega, for instance, testified that a transaction in which "the bank foreclosed and then resold the same assets back to the borrower in a new entity but with no personal guarantee" would be risky and irrational if the Bank's management was not familiar with the borrower, but that in this case "we kind of knew [that] Mr. Rogers III was involved in this thing."[475]

In some sense, however, the L&D Committee's actual knowledge of who owned Griqualand is immaterial. What matters is that Respondent Rogers was aware of the circumstances surrounding the Griqualand loan and yet did not take steps to ensure that the rest of the Committee members were fully informed, despite believing that the arrangement described in the Yollick email—and in particular the lack of personal guarantee by a borrower currently experiencing financial difficulties and defaulted loans—would or could be harmful to the Bank. When Respondent Rogers saw that the purpose of the Griqualand loan was to purchase foreclosed Obra

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[472] *See* MSD Order at 50-51.

[473] RPF ¶ 97; *see* Rogers Tr. 410:9-11 ("I could imagine everybody in that room knew who Griqualand was. Certainly the loan officer did, and I'm sure the Board did, too."), 412:7-9 ("[Y]our Board members knew who the Griqualand [owner] was. I don't think anybody will have any doubt.").

[474] *See*, *e.g.*, EC-PSD-12 (McCarthy Dep.) 238:13-17 ("David Rogers III always took care of his business, paid on time, and worked very well with whoever he was assigned to work with."); Ortega Tr. 712:14-21 ("I think if we find out that it's Mr. Rogers III making the loan, I mean, I think he's good to pay his debt.").

[475] Ortega Tr. 702:15-703:1. On the other hand, Respondent Ortega agreed that the L&D Committee "should have been informed of Mr. Rogers III's and Obra's financial condition before [they] had to decide on the loan to Griqualand." *Id.* 712:7-13 ("[I]f we're making a loan to him, maybe we should have had some financials."); *see also* EX 569 (Ortega Dep.) 227:13-25 (stating that the information about Rogers III's financial situation from the Yollick email "obviously" would have made a difference in whether he would have voted to approve the loan).

assets previously held and guaranteed by his son, that the terms of the loan contained no personal guarantee, and that his son was not identified in the loan documentation as Griqualand's sole owner—in other words, that the loan package obscured or withheld pertinent information that he happened to possess as a result of the Yollick email—he could have made certain that Committee members had this information at their disposal and that the recommendation of the loan officers was appropriately backed. Instead, Respondent Rogers abstained, accepting his son's assurances that the Bank would be protected and leaving his fellow directors unenlightened regarding the potential risk posed by the transaction.

Respondent Rogers knew or should have known that the fact that Rogers III's properties were entangled in so much litigation and that Obra Homes was in financial distress was material to a decision to offer an unguaranteed loan to repurchase foreclosed assets to the same borrower under a new name. True, L&D Committee members might have known this information independently and incorporated it into their determination of whether the Griqualand loan was in the Bank's best interest—but Respondent Rogers did not see fit to ask.

4. The Petro Icon Loans

In January 2010, Rogers III purchased 100 percent ownership of an entity whose name he changed to Petro Icon, LLC ("Petro Icon").[476] On or around January 26, 2010, the L&D Committee approved loans of $421,437 and $20,229 to Petro Icon ("Petro Icon loans") by telephone tally.[477] Through Petro Icon, Rogers III then repurchased certain Obra properties that had been foreclosed upon in late 2009, and for which his personal guarantee on the defaulted loans had been released

[476] *See* EPF ¶¶ 652-653; EX 274 (balance sheet indicating that Rogers III had 100 percent ownership of Petro Icon as of December 31, 2010 and December 31, 2011).

[477] *See* EX 314 (Petro Icon L&D ratification package) at 1. Although Enforcement Counsel does not submit L&D Committee meeting minutes evidencing the loans' ratification, it is uncontested that they were ultimately ratified. *See* EX 271 (showing outstanding principal balance of $421,437.44 on loan to Petro Icon as of February 18, 2010).

by the foreclosures.[478] The terms of the new loans did not include any equity contribution from Petro Icon or Rogers III, did not contain any financial information on Petro Icon, and were not backed by a personal guarantee.[479]

As with Griqualand, the Petro Icon loan package did not mention Rogers III by name or identify him as the company's sole owner. Instead of Mr. Drake, the background information section of the loan officer recommendation this time focused on a lawyer named Chris Owens, providing biographical data for Mr. Owens, his wife, and his "three school-age children" and stating that Mr. Owens had "developed the concept for" Petro Icon, formed the company, and was now serving as its managing director.[480] Once again, the only glancing reference to Rogers III was a statement that "Petro Icon, LLC investors include a prominent homebuilder and financier who has substantial experience as a developer and real estate investor."[481]

Enforcement Counsel does not offer additional evidence regarding the ratification of the Petro Icon loans, including whether Respondent Rogers again abstained as he did for Griqualand. Nevertheless, the undersigned finds that Respondent Rogers was aware of his son's ownership of Petro Icon and, at least as of February 2010, was regularly monitoring the loan balances on Bank loans to Petro Icon, Griqualand, and Obra Homes.[482] The undersigned also finds that there is no

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[478] *See* EPF ¶¶ 651, 655, 657 (stating that "[t]he Bank's loans to Petro Icon financed 100 percent of the purchase price of the foreclosed properties"); EX 316 (email chain including April 16, 2010 email from E. Martinez to J. Crabb) ("This documentation has to do with the foreclosure we did late last year on Obra. The lots were sold to Petro.").

[479] *See* EPF ¶¶ 657-658; EX 314 (Petro Icon L&D ratification package) at 3, 7 ("In order to facilitate the sell [sic] of the ORE at this time there will be no personal guarantee. There is no financial information since this is a start up company.").

[480] EX 314 (Petro Icon L&D ratification package) at 3, 7.

[481] *Id.* The undersigned notes in passing the arguably misleading nature of a statement that "investors include" an individual with 100 percent ownership interest in the company when there is no evidence that other investors exist, much as it would be deceptive to say, for example, that the actors who have portrayed the character Michael Scott on the television series *The Office* "include" Steve Carell, or that the fruits used to make 100 percent orange juice "include" the orange.

[482] *See* EX 271 (showing outstanding principal balances for loans to Obra Homes, Griqualand, and Petro Icon as of February 18, 2010); EX 270 (email chain including March 1, 2010 email from E. Martinez to C. Brockman

evidence that Respondent Rogers ever raised the matter of his son's ownership of Petro Icon with L&D Committee members or expressed any concerns that the Petro Icon loan package omitted information that was pertinent to the Committee's approval of the Petro Icon loans—namely, that the loans would permit Rogers III to reacquire property that had just been foreclosed upon, at more favorable terms to Rogers III and less favorable terms to the Bank.

5. Loss to the Bank and Receivership

The Griqualand loan was renewed on June 7, 2011, still without a personal guarantee; Respondent Rogers abstained from the loan's ratification.[483] In connection with the renewal, Ms. Martinez provided a credit review package to L&D Committee members stating, among other things, that "David Rogers III owns Griqualand, LLC 100%" and that one weakness of the Griqualand loan was "[l]ack of guarantors."[484]

In a May 1, 2013 email regarding a subsequent renewal of the loan to Griqualand, which was on nonaccrual status, CCO Mark Magee noted that "[w]e are attaining the personal guarantee of David Rogers III for the Griqualand debt, which previously held no personal guarantee."[485] Mr. Magee went on to characterize the terms of the renewal as "concessionary and liberal with a fixed interest rate of 3.25% for five years on a considerably under-secured loan."[486] The record does not indicate whether the personal guarantee was ultimately obtained.

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attaching document with principal balances and stating that "[t]his is the recap Janie sends [to Respondent Rogers] every other week. It will list the different relationships.").

[483] *See* EX 489 (Griqualand L&D renewal package) at 1 (showing Respondent Rogers's abstention), 5 ("There is no personal guarantee at this time. I would like approval to waive tax return for Griqualand. It is a single owner entity and as per CPA, Mr. Everhard, it is a 'disregarded company' and will be included in the personal tax return.").

[484] EX 489 (Griqualand L&D renewal package including April 19, 2011 memorandum re Griqualand) at 6, 9.

[485] EX 290 (May 1, 2013 email from M. Magee to S. Ortega et al.).

[486] *Id.*

Enforcement Counsel adduces evidence that both the Bank and the FDIC in its capacity as receiver for the Bank suffered losses related to the Griqualand loan.[487] Specifically, the Bank suffered a $432,000 loss on the Griqualand loan on September 13, 2012.[488] FDIC witness Mary Jane Locke testified that the Griqualand loan was then passed to Bank acquirer PlainsCapital Bank ("PlainsCapital") following the Bank's failure in September 2013, and $111,000 of the loan was ultimately charged off by PlainsCapital, leading the receivership to suffer an $88,000 loss as part of the loss-sharing agreement between the receiver and the acquiring institution.[489] Enforcement Counsel further states that the Bank did not suffer loss on the Petro Icon loans prior to its failure, but that the receivership incurred $170,978 in combined losses on those loans in a similar manner to the post-failure loss on the Griqualand loans.[490]

G. Additional Evidence Bearing On Culpability

Respondents offer various pieces of evidence in support of their argument that they have not demonstrated a requisitely culpable state of mind over the course of their alleged misconduct, and the undersigned marshals the most salient examples here. With respect to Respondent Rogers, for example, Respondents adduce evidence that he was well-regarded by OCC examiners, at least early in the relevant period.[491] In an internal OCC email chain in early August 2008, an examiner stated that "[Respondent] Rogers has historically been very up front with us, kept us informed, and has aggressively dealt with problems. He is already reducing credit risk by shutting down all lending activities, without us asking him to do it."[492] Another examiner on the same chain concurred, noting that "David has always done what we asked him to do, his cooperation with

[487] *See* EPF ¶¶ 649-650.
[488] *See id.* ¶ 649 (citing exhibit).
[489] *See* Locke Tr. 2028:1-22; EPF ¶ 650 (citing exhibit).
[490] *See* EPF ¶ 660 (citing exhibit).
[491] *See* RPF ¶ 7.
[492] RX 15 (email chain including August 6, 2008 email from N. Ward to R. Kuehn et al.).

[our] office has been honest, and he generally leans toward a conservative approach to correct problems."[493] And on a separate internal email around the same time, an examiner expressed reluctance to impose an IMCR on the Bank, expressing confidence in Respondent Rogers's ability to handle the situation: "I recall a message that [Chairman] Rogers sent to us some time ago about his concern with the market and his plan to SLOW way down. In the past when he has said that, he has taken a very aggressive stance in dealing with problem credits. . . . He has ALWAYS done what he said he would do."[494]

Respondent Ortega likewise has been praised by examiners.[495] In an internal OCC email chain in September 2011 regarding the Bank's many problems, examiner Rodney Edmondson stated that "the only officer that gets it and is trying to address the issues by putting together a plan is Sal Ortega."[496] The 2011 Report of Examination drafted in part by NBE Chansen echoed this sentiment, finding that "[t]he only member of the executive management team to demonstrate foresight, implement change where needed, and devise reasonable plans and solutions to address the numerous deficiencies has been CFO Ortega."[497] The 2012 and 2013 Reports of Examination similarly singled out Respondent Ortega's leadership and direction in "initiat[ing] a cultural change" and "[making] a significant and aggressive effort to reduce the level of problem assets, address impairments, enhance the real estate appraisal process, and reduce OREO volume."[498]

Others both inside and outside the Bank testified as to Respondents' character and integrity. Former Bank president Gandy stated:

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[493] RX 16 (email chain including August 6, 2008 email from P. Lindsey to R. Kuehn et al.).

[494] RX 17 (email chain including August 7, 2008 email from G. Hagar to G. Barker and R. Kuehn).

[495] *See* RPF ¶ 8.

[496] RX 33 (email chain including September 21, 2011 email from R. Edmondson to P. Lindsey).

[497] JX 4 (2011 ROE) at 38; *see* Chansen Tr. 1563:6-15.

[498] JX 6 (2012 ROE) at 49; JX 7 (2013 Target ROE) at 3; *see also* JX 5 (2012 Target ROE) at 2 ("Your new management team, under the direction of President Ortega, is much improved. We noted significant progress toward complying with the Order and both the credit and operations culture is improving.").

> I worked with [Respondents] for 30 years, and I always found them to be supportive, upright, hard-working, always had the bank's best interest at heart. . . . We worked our tails off to make the bank successful, to grow the bank, to serve our communities, and they were supportive the whole time.
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> And they're good people. We all worked ourselves to death on this thing, put everything we had in it, every ounce of energy. And, you know it was just – it was so unnecessary and just – it was tragic, really tragic.[499]

Joseph Quiroga, a director of the Federal Reserve Bank of Dallas, described his interactions with Respondent Ortega in connection with Respondent Ortega's recent leadership positions at Texas National Bank,[500] of which Mr. Quiroga is president:

> Mr. Ortega provides a lot of leadership for Texas National Bank. He's someone that I've worked with, you know, hand-in-hand since the day I stepped into this bank. He's provided a great amount of experience for us. He's always been a person of the utmost character that, you know, we've just – we've never had any issues. This bank has performed extremely well over the years and, you know, it's been a joy to work with him hand-in-hand.[501]

When asked about his interactions with OCC examiners regarding the performance of Texas National Bank under Respondent Ortega's leadership, Mr. Quiroga stated that "[w]e have never had any negative conversations. It's always been extremely positive about the job that the entire organization is doing and specifically what Saul has done for this organization."[502]

Finally, the undersigned credits Respondent Ortega's testimony regarding the emergency major heart surgery he required in early February 2013, which caused him to be out of the office

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[499] Gandy Tr. 2237:6-15, 2238:5-10; *see* Leal Tr. 2282:7-10 ("I've known Saul for 30 years, you know, and he's always put on a strong front. He's always shown leadership even under duress.").

[500] The undersigned takes notice of Respondents' July 1, 2022 Rule 19.7 Notice and Enforcement Counsel's July 20, 2022 Response, in which the Parties contest the manner in which Respondent Ortega characterized the scope of his current role at Texas National Bank in his hearing testimony, and finds that it is unnecessary to address the matter further. The Parties do not dispute that Respondent Ortega currently serves as CEO of Texas National Bank and previously also served that bank as Chairman and a member of its Board of Directors.

[501] Quiroga Tr. 2390:7-17.

[502] *Id.* 2392:5-9.

for over two months.[503] Respondent Ortega recalled the period prior to the surgery as being one of enormous stress as he worked long hours in an attempt to make the improvements to Bank practices and the Bank's condition required by the OCC examiners.[504]

> [W]e have a lawsuit that we lost for $65 million. [The examiners] give me instruction to go and settle this deal. This is in December. I worked all through January. Spent a lot of time in Lubbock trying to settle this case. They tell me, you have no choice, you settle or we're going to close the Bank down. I go and I settle that loan. They tell me, you've got to settle it before January 31st. I think I settled it around the 24th of January. What is it? A week or two after I'm in the hospital having an eight bypass on February the 7th.[505]

Respondent Ortega testified that by the time he returned to the office after his surgery, FDIC examiners were "already in the Bank" making contingency preparations for the Bank's eventual closure.[506] The undersigned credits the testimony of Mr. Leal that, by the spring of 2013, the FDIC viewed the Bank's failure as likely inevitable and tasked Bank management with keeping the Bank afloat long enough for the agency to find an acquiring institution:

> It was pretty stressful. There were times where we didn't sleep for days. My wife begged me to quit. She's like, just leave. Just walk away. What's going to happen to you is what happened to Saul.
>
> So I decided that I had to stay. I had to see it through. I had to help transition. And I got a lot of help from the guys from the FDIC because they kept encouraging me. They kept saying, you're doing the right thing, just keep doing it. Keep it together. Give us enough time. You know, the best result would be [] that we find somebody

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[503] *See* Ortega Tr. 694:15-18 ("I was out March and April, and I'm barely getting back in after being out for approximately 65 days."), 839:25-841:21; RX 34 (February 13, 2013 email from R. Edmondson to R. Chansen and P. Lindsey) ("Eddie relayed that Sal went into the hospital on Sunday and had a bypass performed on Monday. . . . Unfortunately, Sal will be out for the next couple of weeks and when he does return I would assume his time and activity will be limited.").

[504] *See* Ortega Tr. 840:1-6 ("I almost gave up my life trying to get to point A with the examiners' help. . . . And yeah, I get emotional because I almost died.").

[505] *Id.* 840:14-841:1.

[506] *Id.* 849:6-9; *see also* Leal Tr. 2281:11-18 ("He probably came back sooner than what the doctor had asked him to. I mean, he was really concerned about what was going on at the bank and, you know, wanted to make sure that everybody's work continued. When he came back or before he left, he was aware that the FDIC was in the bank. So he knew that the process had begun.").

> that buys the bank. You know, you don't want depositors to lose their money. I said no, no, I don't.
>
> So we muscled in. We did what it took to get to that point. *At that point, we knew we could not save the bank. It was just about giving the FDIC enough time.*[507]

In the end, multiple banks bid to acquire the Bank, with PlainsCapital emerging as the successful bidder and executing a purchase and assumption agreement with the FDIC as receiver to take over the Bank's operations in September 2013 without interruption to depositors.[508]

VII. Analysis

Having made its factual findings,[509] this Tribunal now addresses the questions of law relevant to whether, and to what extent, Respondents have engaged in actionable misconduct, triggered some applicable effect, and demonstrated a requisitely culpable state of mind sufficient for the imposition of a prohibition order and the assessment of a second-tier civil money penalty in the amount of $250,000 against each Respondent, as sought by the OCC under 12 U.S.C. §§ 1818(e) and 1818(i), respectively. The undersigned also considers the appropriateness of this civil money penalty amount in light of the mitigating factors set forth in 12 U.S.C. § 1818(i)(2)(G).

A. Capital Raise Loans

Enforcement Counsel argues that Respondents' involvement in the Bank's Capital Raise Loans Scheme (Article III) constituted a breach of their fiduciary duties of care and an engagement in actionably unsafe and unsound banking practices that caused loss to the Bank, prejudiced its

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[507] Leal Tr. 2278:11-2279:4 (emphasis added); *see id.* 2280:3-10 ("We would have other banks that would come in and, you know, we would have nondisclosure agreements. . . . So we were actively trying to find somebody that wanted to buy the bank."), 2283:8-19 ("[A]t some point, I realized that the bank was not going to continue. And the guys with the FDIC are the ones that, you know, kept me cool. . . . [T]he goal is we want to find somebody. You can't run out of cash. You can't run out of capital. You have to continue to put this together.").

[508] *See* Locke Tr. 2015:14-24, 2035:3-10; Magee Tr. 2072:13-20; Leal Tr. 2281:22-2282:1.

[509] While the federal banking agencies "generally defer[] to an ALJ's factual findings, especially those based on the ALJ's judgments as to the credibility of the witnesses, the [agency] is not bound by them, and may reach different factual findings so long as there is substantial evidence in the record to support those findings." *In the Matter of Preston J. Brooks*, No. AA-EC-91-153,1993 WL 13966512, at *15 (June 17, 1993) (OCC final decision); *accord Patrick Adams*, 2014 WL 8735096, at *7.

depositors, and was undertaken with personal dishonesty or continuing or willful disregard for the Bank's safety and soundness.[510] For the reasons discussed below, the undersigned agrees that Enforcement Counsel has demonstrated misconduct and effect with respect to these allegations, but concludes that it has not met the burden of proving, by a preponderance of the evidence, that Respondents acted with a requisitely culpable state of mind.

1. Unsafe or Unsound Practices

As discussed in Part III *supra*, an unsafe or unsound banking practice is defined as "any action or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds."[511] Enforcement Counsel argues that Respondents' conduct relating to the Capital Raise Loans was unsafe and unsound "because (1) the Capital Raise Loans Scheme raised sham capital using the Bank's existing funds; and (2) the Capital Raise Loans featured concessionary loan terms that, in aggregate, constituted an excessive and unwarranted increase in risky lending that was contrary to the Board-approved strategy to reduce its loan portfolio."[512] The undersigned agrees.

Actionably unsafe or unsound practices are those that pose "a reasonably foreseeable undue risk to the institution," which the Comptroller and the D.C. Circuit have interpreted to mean an "increased risk of some kind."[513] Furthermore, to support a determination that the conduct in

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[510] *See* EC Br. at 19-33 (misconduct), 33-34 (loss), 34-40 (culpability). Enforcement Counsel's allegations regarding the accounting-related Capital Raise Loans misconduct are addressed along with the accounting-related OREO allegations in Part VII.D *infra*.

[511] *In the Matter of Steven J. Ellsworth*, Nos. AA-EC-11-41 & -42, 2016 WL 11597958, at *13 (Mar. 23, 2016) (OCC final decision) (internal quotation marks and citation omitted). The fulfillment of this aspect of the corresponding prong of Section 1818(i) requires not only a conclusion that Respondents have engaged in unsafe or unsound practices, but that they have done so *recklessly*. *See* 12 U.S.C. § 1818(i)(2)(B)(i); *Patrick Adams*, 2014 WL 8735096, at *49 (articulating recklessness standard).

[512] EC Br. at 22-23.

[513] *Patrick Adams*, 2014 WL 8735096, at *5; *accord Blanton*, 909 F.3d at 1172 (internal quotation marks and citation omitted).

question is contrary to accepted standards of prudent operation, the agency "must make some showing as to the relevant standards and the departure from those standards."[514] Enforcement Counsel's examiner experts identified multiple types of heightened risk, reasonably foreseeable to Respondents, resulting from the Bank's departure from standards of prudent operation with respect to the Capital Raise Loans, and it is worth examining them in some depth.[515]

First, by approving dozens of unsecured loans to potentially unqualified borrowers in the spring and summer of 2009 to finance the purchase of Holding Company stock, Respondents and the rest of the L&D Committee risked the Bank's existing capital at a time that the Bank urgently needed to increase its capital ratios.[516] Respondents agreed that reducing the number of new loans made was an important part of the Bank's strategy to achieve the minimum capital ratios imposed by the OCC following the Fannie and Freddie collapse[517]—and, indeed, Respondents represented to the agency on April 3, 2009 that "[i]n an effort to shrink the bank in order to comply with the IMCR," there was "virtually NO lending occurring."[518] Three weeks later, the Bank approved the first Capital Raise Loan, which was followed by 45 more such loans between that date and the

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[514] *Patrick Adams*, 2014 WL 8735096, at *37.

[515] The Comptroller has held that the conclusions of OCC examiners regarding the extent to which "a particular practice poses a safety and soundness concern" are entitled to a significant measure of deference by the ALJ. *Ellsworth*, 2016 11597958, at *14; *see also Patrick Adams*, 2014 WL 8735096, at *36 (noting that "[t]he expression of expert judgment as to whether a given set of facts represents an unsafe or unsound practice is very much within the competence of the OCC's [examiners]"). Examiner judgments and conclusions on unsafe or unsound practices that are based on "objectively verifiable facts" may not be rejected by the ALJ "unless there is a finding that they are a) without an objective factual basis, or b) outside the zone of reasonableness or arbitrary and capricious." *Ellsworth*, 2016 11597958, at *14. Unless otherwise noted, then, the undersigned accords due deference to all expert opinions offered by Deputy Comptroller Brickman and NBE Chansen regarding the extent to which Respondents' conduct meets the standard for unsafe or unsound banking practices.

[516] *See* EC Br. at 24-25.

[517] *See*, *e.g.*, Rogers Tr. 323:9-10 ("We were trying to reduce our lending, trying to shrink the size of the bank."), 456:22-25 ("We took the $174 million [Fannie and Freddie loss], and that basically shut us down. We started cutting back. We needed to shrink the bank. We needed to cut back on the lending."); Ortega Tr. 504:4-5 ("[W]e were going to just hold the fort and try to keep new loans from coming on."), 618:4-6 ("At this time we were really trying to shrink the bank size, . . . trying to reduce our loan portfolio.").

[518] EX 548 (April 3, 2009 OCC meeting minutes) at 1.

second capital injection.[519] Regardless of whether the proceeds of those loans were then used to buy Holding Company stock or for some other purpose,[520] they jeopardized the Bank's overriding priority at that time, ran counter to the Bank's representations to the OCC, and generally placed the Bank in a more uncertain financial position than it would have been without the loans.[521]

The unsecured nature of the Capital Raise Loans posed a special risk. Unsecured loans are "a higher risk loan category that deserves . . . scrutiny and attention by the Board of Directors."[522] The fact that the majority of the loans were not only unsecured but had low interest rates and other concessionary terms should have been a red flag to Respondents as the Bank struggled to improve its financial condition in the midst of the crisis.[523] Deputy Comptroller Brickman opined that these loans, taken together, represented "a big risk to the Bank," and that he would expect Bank board members "to manage this portfolio by looking at it [both] from the individual loan relationship perspective" as well as with "an aggregate reporting on performance on the overall potential risk and exposure the Bank has to it."[524]

To control the risk of the Capital Raise Loans, NBE Chansen opined that Respondents should have required that they be secured by collateral wherever possible.[525] Failing that, "Respondents should have ensured the underwriting for the Capital Raise Loans was appropriate, including analyzing whether the borrower could repay the debt and whether the Bank could absorb

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[519] *See* EX 374A (Capital Raise Loans Spreadsheet).

[520] *See* Rs Br. at 26 (arguing that "[b]orrowers were free to use the loan proceeds as they wished"); Ortega Tr. 910:1-5 ("[T]he borrower basically can do whatever they want with the funds. They can decide to buy something else. They can take their money. They can go to Vegas to gamble.").

[521] *See* Chansen Tr. 1258:9-13 ("When a decision is made to shrink a balance sheet, it's generally for a specific reason. And by turning around and making loans, that negates the purpose of shrinking a balance sheet.").

[522] Brickman Tr. 146:6-8.

[523] *See id.* 148:8-18 ("All things being equal, . . . [t]o make a loan to a borrower without any collateral at a 4 and a quarter percent rate at the peak of a financial crisis is an extremely low rate and does not offset the risk of that portfolio."); *see also* Chansen Tr. 1257:8-9 (stating that the fact that so many of the unsecured Capital Raise Loans were later renewed "exposed the Bank to additional risk").

[524] Brickman Tr. 147:18-148:3.

[525] *See* Chansen Tr. 1277:20-25.

the loss if the borrower defaulted."[526] There is no evidence that such an analysis was ever required or performed, and both Respondents "admitted to approving loans with misleading descriptions despite being aware that the loans were Capital Raise Loans."[527]

Lack of accurate documentation and loose underwriting standards also increased the risk that the Capital Raise Loans were being made to unqualified borrowers who were likely to default. Respondent Ortega testified that most of those loans were made to individuals who had a "high net worth" and "long-term relationships with the Bank with different types of businesses," and that all of the Capital Raise Loans borrowers were known to him as "pretty good customers of the Bank"[528]—suggesting, in short, that even the unsecured, concessionary loans were not risky, because the Bank had a strong basis to believe that they would be repaid.[529] While it is certainly reasonable to conclude that Bank directors had some level of familiarity with the individuals to whom they extended these loans, however,[530] the undersigned agrees with NBE Chansen that this is no substitute for following proper underwriting policy, particularly at a time when increased risk to the Bank could have compounded negative effects on its safety and soundness.[531]

Respondents further increased the risk to the Bank by failing to ensure that the unsecured Capital Raise Loan portfolio was tracked and monitored for risk and that the loan proceeds themselves were accounted for correctly, if not fully segregated from any funds to be

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526 EPF ¶ 161; *see* Chansen Tr. 1277:8-19.

527 EC Br. at 37; *see* Rogers Tr. 345:2-5; Ortega Tr. 530:12-19.

528 Ortega Tr. 907:10-908:5.

529 *See also* Rs Br. at 30 (arguing that "Respondents were assured by the loan officers at the Bank that [the] loans were good risks, and as such believed that they were safe and sound").

530 *See* Rogers Tr. 264:11-25 (stating that potential investors in Holding Company stock included Bank officers, directors, and employees as well as their family and friends).

531 *See* Chansen Tr. 1260:2-15 (opining that "Respondents should have ensured that the individuals purchasing the stock . . . were qualified borrowers and they had the ability to absorb losses based on their financial statements. The fact that they were great customers of the Bank is not a sole basis for approving a loan.").

downstreamed from the Holding Company to the Bank as regulatory capital.[532] As Enforcement Counsel stated based on the opinion of Deputy Comptroller Brickman:

> When a bank has a large portfolio of unsecured loans, like the Capital Raise Loans, directors should demand aggregate reporting to understand the risk, and the directors should monitor the unsecured loans. Unsecured lending should be included in a board package and analyzed on a regular basis. This monitoring would ultimately help the L&D Committee determine whether the Capital Raise Loans would pose undue risk to the capital position or to the financial performance of the financial institution.[533]

Instead, "the Bank, including the Respondents, did not maintain any sort of documentation to track and monitor these types of loans for the stock purchase."[534] Deputy Comptroller Brickman aptly summarized Respondents' failures in this regard:

> The pattern of behavior covering multiple borrowers who then turned around and invested the exact dollar amount of that loan into the capital raise was indicative of a strategy specifically designed for the bank to lend money to borrowers to participate in the capital raise, and *any reasonable person sitting on that board of directors would have known the connection between the lending strategy and the investment strategy and would have an obligation to make sure the accurate record existed of that transaction* including and not limited to copies of those purchase agreements being included within the loan file documentation as part of the decision package. . . . [I]ndependent of them reviewing these individual loan files, [Respondents] would certainly have an awareness and understanding of how this strategy was working its way through, you know, and impacting the bank's strategic plan.[535]

In addition, Respondents never disclosed to regulators, or ensured that the Bank disclosed, that the Bank was financing the purchase of Holding Company stock.[536] The undersigned agrees

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[532] *See id.* 1278:1-8 ("[A]ny loans made and associated with the capital raise that was done should have been tracked and monitored. And the amount raised via this method should have been disallowed or discounted from the capital calculations to ensure that it did not misstate the bank's books and records, specifically their capital position.").

[533] EPF ¶ 160; *see* Brickman Tr. 148:19-149:16.

[534] Chansen Tr. 1233:20-21.

[535] Brickman Tr. 153:20-155:6 (emphasis added).

[536] EC Br. at 25.

with Enforcement Counsel that "the OCC's ability to effectively supervise the Bank was impeded" as a result.[537] Enforcement Counsel's experts opined that the Capital Raise Loans Scheme should have been disclosed "to the OCC whenever the Bank discussed the sale of Holding Company stock to raise capital,"[538] and yet none of the Bank's communications with the agency from April through August 2009 (or beyond) ever stated that the Bank was loaning borrowers money for stock purchases associated with the capital raise.[539] The undersigned credits Deputy Comptroller Brickman's emphatic testimony on this point:

> It's incredibly surprising to me that there would be no record at all of that strategy being discussed, being approved, being decided particularly where there were, you know, dozens and dozens of loans being made relative to this capital raise loan strategy. The complete absence of information in the substantive documents provided to the OCC and in the substantive meetings held with the OCC, to me, is indicative of extreme lack of oversight.[540]

Mr. Brickman also explained that the failure to disclose the Capital Raise Loans added regulatory risk because the agency did not have an accurate understanding of how the Bank planned to raise capital, something that Respondents should reasonably have understood as experienced bankers:

> [I]f the bank is in a position where it has insufficient capital, we need to be able to assess the quality and accuracy of plans to raise capital in order to conclude whether those strategies are reasonable or whether we need to redirect the bank and take additional or different strategies that would lead to the end result of having more capital.[541]
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> The sources of capital in any common stock or preferred stock capital raise are critically important. And information regarding the number of shareholders interested and able to invest it is critically important in understanding whether or not the bank is going to meet

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[537] *Id.* at 26.

[538] EPF ¶ 174 (citing testimony).

[539] *See*, *e.g.*, EX 149 (April 28, 2009 Letter); EX 151 (May 12, 2009 Letter); EX 366 (August 18, 2009 Bank board minutes, attaching August 14, 2009 letter from Robert Gandy III to OCC) at 6.

[540] Brickman Tr. 142:8-17.

[541] *Id.* 116:6-14.

> its capital raising target. *So our understanding that there was a population of potential shareholders that would need financial assistance in order to invest would be a very specific and important piece of information relative to our assessment of the overall viability of this capital raise strategy.*[542]

The undersigned concurs with this assessment in all particulars.

Finally, while Enforcement Counsel did not meet its burden with respect to the assertion that *all* money raised through the Capital Raise Loans was ultimately downstreamed back to the Bank where it was improperly treated as Tier I regulatory capital,[543] the undersigned credits the testimony of Enforcement Counsel's experts that whatever portion of the loan proceeds *was* downstreamed—which is necessarily somewhere between $3 million and $17.3 million, as discussed *supra*—also created a reasonably foreseeable heightened risk to the Bank. As NBE Chansen states, using the Bank's existing funds to finance loans, the proceeds of which are then counted as new capital, would "mask[] the true financial condition of the Bank's balance sheet," thus "overstat[ing] the loan portfolio and the capital position" and misleading "regulators, potential investors or investors, shareholders, and depositors."[544] The undersigned comfortably concludes that making loans for the purpose of the proceeds of those loans being downstreamed back to the Bank as regulatory capital, to whatever extent it occurred in this case, is—like the other forms of misconduct discussed above—contrary to generally accepted standards of prudent banking operation and an actionably unsafe or unsound practice. Enforcement Counsel has therefore demonstrated this aspect of Section 1818(e)'s misconduct prong several times over.

Respondents' arguments to the contrary are not persuasive. To begin with, Respondents' contention (Rs Br. at 26) that the Holding Company had over $38 million in funds separate from

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542 *Id.* 129:13-130:1 (emphasis added).
543 *See* Part VI.C.6 *supra* at 34-42.
544 Chansen Tr. 1252:20-1253:2.

the Capital Raise Loan proceeds, and thus the amount downstreamed could have included no improperly reported regulatory capital at all, is contradicted by the record evidence and by Respondents' testimony itself.[545]

Second, Respondents' argument that the Capital Raise Loans were not unsafe or unsound because "[b]orrowers were free to use the loan proceeds as they wished" (*id.*) misunderstands the inquiry: as stated above, risking the Bank's capital by making dozens of unsecured, poorly underwritten loans—many with demonstrably *deceptive* stated loan purposes[546]—at a time when the Bank's need for capital was exigent, while representing to the OCC that the Bank had almost entirely curtailed its lending activity, would be unsafe and unsound if the loans were spent on jellybeans, lottery tickets, or anything else; this aspect of the Capital Raise Loans misconduct has very little to do with the actual capital raise.[547]

Third, Respondents argue that the Capital Raise Loans were not material and that the Bank would have achieved its IMCR even if the full amount calculated by Ms. Salvato was excluded from the Bank's reported capital (*see id.* at 27)—again, even if true, this does not alleviate the riskiness of the loan portfolio itself, let alone the Bank's failure to track and monitor the loans or to disclose to the OCC that Bank-financed stock purchases were a significant component of the capital plan.

Fourth, it is no escape from liability in this instance to contend (*id.* at 29-30) that Respondents did not make the loans themselves and merely followed the recommendations of the

[545] *See* Part VI.C.6 *supra* at 39 n. 174.

[546] *See* Part VI.C.5 *supra* at 30-31.

[547] In other words, the Bank should not have been making these unsecured loans in such volume at this time, period, given the Bank's undercapitalization and the overall turbulence of the economic climate. *See* Rogers Tr. 324:23-325:1 ("We were reducing everything, trying to reduce the loan, reducing the employees. We were trying to deleverage the bank.").

Bank's loan department when approving them.[548] Respondents had independent and affirmative responsibilities, both as L&D Committee members and in their capacities as officers and directors of the Bank, to ensure that the Bank's lending decisions were appropriate and did not improperly increase the Bank's risk exposure, rather than acting as rubber stamps for the decisions of subordinates.[549] Respondents also bore responsibility for developing, implementing, and overseeing the Bank's capital strategy in a manner that did not expose the Bank to inordinate risk.[550] The factual record makes it clear that they did not adequately fulfill these responsibilities.

2. Breach of Fiduciary Duty

For the same reasons that Respondents' actions and inactions concerning the Capital Raise Loans constituted unsafe or unsound banking practices, they also represented a breach of Respondents' fiduciary duty of care.[551] This duty required Respondents at all times "to act in good faith and in a manner reasonably believed to be in the [B]ank's best interest,"[552] as well as requiring them to "act diligently, prudently, honestly, and carefully in carrying out their responsibilities."[553] The duty of care further demanded "the proper supervision of subordinates" and "constant concern of the safety and soundness of the bank" on Respondents' part.[554]

Here, the undersigned finds that Respondents breached their fiduciary duty by failing to act prudently, diligently, and carefully in the course of their own responsibilities, and by not

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[548] Respondents' related argument that they acted in good faith with respect to the Capital Raise Loans and "used their best professional judgment during a very difficult time" (Rs Br. at 30) is addressed in the culpability section below.

[549] *See* Part VI.A *supra* at 13-14.

[550] *See* Part VI.C.1 *supra* at 21-22.

[551] *See* EC Br. at 29-33.

[552] *Ellsworth*, 2016 WL 11597958, at *15; *see also Michael v. FDIC*, 687 F.3d 337, 350-51 (7th Cir. 2012) (stating that bank directors and officers have a duty to act "with the care an ordinarily prudent person in a like position would exercise under similar circumstances") (internal quotation marks and citation omitted).

[553] *In the Matter of Tonya Williams*, No. 11-553e, 2015 WL 3644010, at *9 (Apr. 21, 2015) (FDIC final decision) (internal quotation marks and citation omitted).

[554] *In the Matter of Douglas V. Conover*, Nos. 13-214e & -217k, 2016 WL 10822038, at *19 (Dec. 14, 2016) (FDIC final decision) (internal quotation marks and citation omitted).

properly supervising the risky or imprudent decisions of subordinates.[555] The undersigned agrees with Enforcement Counsel, for example, that the Capital Raise Loans constituted "an excessive and unwarranted increase in risky lending" that a reasonably prudent director or officer would not have approved, especially in aggregate.[556] Respondents also breached their duty of care "by approving and/or ratifying loans with vague and/or misleading loan purposes," given that Respondents knew or should have known that the purpose of the Capital Raise Loans was to purchase Holding Company stock.[557] Instead of raising this issue and seeking that it be corrected, Respondents "stood by when they reviewed the loan packages and allowed these vague or misleading descriptions to support loan approvals and/or ratifications."[558] And Respondents certainly breached their fiduciary duty of care when they failed to ensure that the Bank disclose to the OCC or its own outside accountants that it was financing dozens of purchases of Holding Company stock at the time of the capital raise.[559] For these reasons and more—including failing to ensure that the proceeds of the Holding Company stock purchases were not downstreamed back to the Bank and improperly treated as new regulatory capital—the undersigned concludes that this aspect of the Section 1818 misconduct elements has been met as well.

3. <u>Effect</u>

Enforcement Counsel adduced evidence that the Bank recorded combined losses of $387,240.63 on two of the Capital Raise Loans on June 12, 2013, a date that is within the five-

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[555] As discussed in Part VII.A.4 *infra*, the undersigned concludes that there is substantial evidence that Respondents were generally acting in good faith and with the Bank's best interests in mind throughout their involvement with the Capital Raise Loans, and that their actions were in fact motivated by a concern for the Bank's safety and soundness.

[556] EC Br. at 32; *see* Brickman Tr.147:18-19 (opining that "the aggregate volume of unsecured capital raise loans increase[d] the risk to the Bank").

[557] EC Br. at 33.

[558] *Id.*; *see* Ortega Tr. 547:21-25 (agreeing that he "would want to know the purpose of [a] loan with specificity" when reviewing it as a member of the L&D Committee), 546:16-19 (stating that "over many, many years of being on the L&D Committee, I don't know that I ever really questioned the loan purpose").

[559] *See* EC Br. at 31.

year limitations period required for the agency's claims regarding the Capital Raise Loans to have been timely asserted.[560] Furthermore, there can be no serious disagreement that this loss occurred "by reason of" the alleged misconduct;[561] the loans would not have been made were it not for Bank management's decision to finance the purchase of Holding Company stock in this manner. The effect element of Section 1818(e) has thus been satisfied.

Respondents raise two arguments in response, both of which are unavailing. First, Respondents argue that the Bank "suffered no loss as a result of the Capital Raise Loans" because "these transactions were an accounting issue that resulted in neither a gain nor a loss to the Bank."[562] This is a mischaracterization of the nature of the misconduct alleged with respect to the downstreaming of inappropriately recycled capital, and is in any event irrelevant: the Bank made loans to borrowers to purchase Holding Company stock; those loans were improper for the reasons enumerated above; at least two of the loans defaulted, causing the Bank loss. Second, Respondents contend that, notwithstanding the loss that occurred in 2013, the Capital Raise Loan claims are time-barred because certain other triggers of the Section 1818(e) effect element that Enforcement Counsel does not plead[563] had previously occurred outside of the limitations period, thus ostensibly beginning the clock on the agency's claims.[564] It is settled law, however, that it is meaningless for limitations purposes that an agency could conceivably have brought its claim earlier based on a different effect (and thus a different cause of action) that it did not plead.[565]

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[560] *See* Part VI.C.7 *supra* at 42 (indicating that the receivership recorded an additional $3.8 million in losses on Capital Raise Loans following the Bank's failure); *see also* Part IV *supra* (discussing applicable statute of limitations).

[561] 12 U.S.C. § 1818(e)(1)(B).

[562] Rs Br. at 33-34.

[563] Namely, the points at which Bank loss due to the Capital Raise Loans became probable and at which depositor prejudice became possible, each of which is an independently sufficient condition for satisfaction of this element. *See* 12 U.S.C. §§ 1818(e)(1)(B)(i), (ii); *see also* Part III *supra* at 6-8.

[564] *See* Rs Br. at 34-35.

[565] *See Blanton*, 909 F.3d at 1172 ("[E]ven though the OCC might well have brought an action earlier, its failure to do so does not make the claims it elected to bring untimely.") (internal quotation marks and citation omitted); *Proffitt*,

In addition to Bank loss, Enforcement Counsel argues that the effect element is satisfied because Respondents' Capital Raise Loan-related misconduct prejudiced the interests of depositors.[566] In this, the undersigned concludes that Enforcement Counsel has not met its burden. The crux of the argument is that "reporting the Capital Raise Loan proceeds as capital allowed the Bank to appear to be in better financial condition, thereby preventing depositors from making informed decisions about whether to maintain their deposits at the Bank."[567] But this formulation seeks to prove too much. Even if all Capital Raise Loan proceeds from the second and third quarters of 2009 were improperly downstreamed to the Bank, which Enforcement Counsel has not shown,[568] Ms. Salvato testified that excluding the resulting amount from the Bank's recorded capital would still have allowed the Bank to meet its 8 percent Tier 1 IMCR and thus be sufficiently well capitalized.[569] It is overly speculative to suggest that depositors would have based a decision "about whether to maintain their deposits at the Bank" on whether, for example, the Bank had reported a capital level of $309 million rather than $326 million for the third quarter of 2009,[570] especially if both levels would be adequate from a regulatory perspective.[571] The undersigned

200 F.3d at 864-65 (noting that Section 1818 was intended to provide enforcement agencies with some flexibility when determining when to bring actions).

[566] *See* EC Br. at 34.

[567] *Id.*

[568] *See* Part VI.C.6 *supra* at 34-42.

[569] *See* Salvato Tr. 1923:16-1925:1. This stands in contrast to the facts of the *Dodge* case cited by Enforcement Counsel (*see* EC Br. at 34), in which the D.C. Circuit found that the respondent's improperly recorded capital contributions had concealed his bank's true capital ratios of 1.6 percent and 3.1 percent, which were "levels low enough to make it 'critically undercapitalized' under [the applicable] regulations." *Dodge v. Comptroller of Currency*, 744 F.3d 148, 158 (D.C. Cir. 2014) (concluding that "[t]he potential liquidity crisis could have prejudiced depositors by compromising [that bank's] ability to meet its obligations to them"). While the Capital Raise Loans scheme certainly overstated the Bank's capital levels, as the undersigned has held, there is a marked qualitative difference between a bank that "appeared well-capitalized" (*id.*) and was in fact critically undercapitalized, as was the case in *Dodge*, and a bank with capital levels sufficient to satisfy the heightened minimum ratio imposed by the OCC even in its true financial condition, as Ms. Salvato has testified was the case here.

[570] *See* EX 368 (September 30, 2009 Call Report) at 8 (Schedule RI-A, Line 11).

[571] The undersigned also notes that the natural consequence of Enforcement Counsel's logic is that depositors were prejudiced because, had they known the true financial condition of the Bank, they might have withdrawn their money *en masse*—thereby putting the Bank in worse financial condition than before, and conceivably jeopardizing

therefore declines to adopt Enforcement Counsel's reasoning—and a showing of depositor prejudice is unnecessary in any event, as bank loss has already been proven.

4. Culpability

Before a federal banking agency "may impose the ultimate sanction of a prohibition order against a banker that forever bans him or her from working in the American banking industry, the [agency] must show a degree of culpability well beyond mere negligence."[572] For this reason, "[b]oth the personal dishonesty and willful or continuous disregard elements [of Section 1818(e)] require some showing of scienter"—that is, evidence not merely of the misconduct, but of an intentionality or recklessness to the charged individual's state of mind.[573]

Enforcement Counsel argues that the culpability element of Section 1818(e) is fulfilled as to the Capital Raise Loans because Respondents acted with personal dishonesty and continuing or willful disregard for the Bank's safety and soundness. The undersigned disagrees and concludes that, while actionable misconduct certainly occurred, there is substantial evidence—backed by credible testimony—that Respondents found themselves in a difficult and exigent situation with no good solutions and that their actions were motivated by a good faith concern for the Bank and its depositors during a time of crisis. The Bank had been given a mandate to improve its capital ratios urgently and by any means necessary, and was told that continued operation in its existing condition would be unsafe and unsound. It had no access to national capital markets. There were few options for the Bank's survival. Placed in this position, Respondents' decision to finance the capitalization of the Holding Company (and, at least to some extent, the Bank) through unsecured

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the interests of *all* depositors had the Bank then failed more quickly as a result. It cannot be true that the Bank's depositors would have been better off if the Bank had failed in 2009 rather than 2013. *See also* Part VII.C.4 *infra*.

[572] *Kim v. OTS*, 40 F.3d 1050, 1054 (9th Cir. 1994) (collecting authority); *see also In the Matter of Larry B. Faigin and John J. Lannan*, Nos. 11-269e, -270k, -252e, & -254k, 2015 WL 9855325, at *83 (Dec. 15, 2015) (FDIC final decision).

[573] *See Dodge*, 744 F.3d at 160.

loans to local borrowers was a poor exercise of judgment, and it was reasonably foreseeable that doing so in the manner they did would ultimately increase rather than decrease the risk to the Bank, even if disaster could be averted in the short term through their actions. But the evidence suggests that to the extent Respondents understood this risk, they—perhaps rightly, in the circumstances—viewed it as a problem for a different day. The undersigned cannot conclude that choices made under fire that may credibly be attributed to a "sense of urgency" and a sincere desire to remedy "the recent rapid deterioration in the Bank's condition" are reflective of dishonesty or disregard for the Bank's safety and soundness as must be shown under this statutory scheme.[574]

Personal Dishonesty

Personal dishonesty within the meaning of Section 1818(e) encompasses "a range of behavior, including a disposition to lie, cheat, or defraud; untrustworthiness; lack of integrity; misrepresentation of facts and deliberate deception by pretense and stealth; or want of fairness or straightforwardness."[575] The personal dishonesty standard is also "satisfied when a person disguises wrongdoing . . . or fails to disclose material information," but only if it can be shown that they have done so with the requisite knowledge of the wrongfulness of their actions.[576]

According to Enforcement Counsel, Respondents demonstrated personal dishonesty (1) when they failed to disclose to the OCC and others that the Bank was financing Capital Raise Loans; (2) through the Bank's lack of documentation of the Capital Raise Loans strategy in its own documents; and (3) by approving and ratifying loan packages "that disguised the true purpose of the loans."[577] The undersigned agrees with Enforcement Counsel that it is important for bank

[574] EX 147 (IMCR Letter) at 5.
[575] *Williams*, 2015 WL 3644010, at *10 (internal quotation marks and citation omitted).
[576] *Dodge*, 744 F.3d at 160; *accord*, *e.g.*, *In the Matter of Frank E. Smith and Mark A. Kiolbasa*, No. 18-036-E-I, 2021 WL 1590337, at *28 (Mar. 24, 2021) (FRB final decision).
[577] EC Br. at 35.

management to be open and transparent with OCC examiners, particularly in matters pertaining to bank capital.[578] It is also true that Respondents should have disclosed the Capital Raise Loans to the OCC or otherwise sought to ensure their disclosure. But Enforcement Counsel does not offer evidence that this failure to disclose was deliberate rather than mere negligence, carelessness, or inattention to detail. The OCC was indisputably aware that the Bank would be relying entirely on local investors for the Holding Company stock offering,[579] and it is at least plausible that Respondents (incorrectly) did not view the fact that the Bank would be financing some of those stock purchases from select individuals who they knew and believed to be creditworthy to be salient information.[580] In the absence of some evidence that Respondents intentionally contrived to keep the OCC from finding out about the Capital Raise Loans, then, Enforcement Counsel has not met its burden on personal dishonesty here.

Likewise, while the lack of Bank documentation of the Capital Raise Loans strategy may be "indicative of extreme lack of oversight," as Deputy Comptroller Brickman suggests, this is not evidence of malign motive.[581] And Respondents' approval of Capital Raise Loans with vague or misleading stated purposes must be measured against Respondent Ortega's admission that he *never* questioned the purpose of loans he reviewed "over many, many years of being on the L&D

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[578] *See id.*

[579] *See* Ortega Tr. 914:3-4 ("At some point we let the examiners know that we're going to try to get investors from the area, right, customers or friends or family to invest."); EX 548 (April 3, 2009 OCC meeting minutes) at 1 ("They have made the decision that while [a national investment bank] will still be helping them with the stock offering, they will be selling it locally. Mr. Rogers and his family have committed for at least 10MM of the 20-40MM they want to raise."); EX 149 (April 28, 2009 Letter) at 1 ("We are very encouraged by the local reception to the offer, but the national capital markets, as you know, are essentially frozen for all community banks, and private capital is the only viable option for most of us. So we will have to go all local.").

[580] *See* Ortega Tr. 504:6-13 ("[W]e have customers that have been with us, . . . reputable customers that have a lot of deposits, that have good credit. So, of course, they're going to come to the bank."), 904:12-16 ("[M]y understanding is, you know, some of these individuals are very creditworthy and they're able to borrow money on an unsecured basis, and basically able to buy the stock as they please.").

[581] Brickman Tr. 142:17-18. Deputy Comptroller Brickman then conjectured that the failure of the Bank to document or disclose the Capital Raise Loans strategy also reflected "potentially the desire to hide the nature of that transaction and prevent the OCC from understanding the strategy," *id.* 142:19-21, a speculation that the undersigned accords due weight in light of the lack of supporting evidence.

Committee."[582] If there was some evidence that Respondents had directed that the loan purposes be obscured or otherwise had a hand in drafting them, then that would satisfy the personal dishonesty standard; in the face of this admitted habitual inattention, however, mere negligence is at least as likely an explanation for Respondents' conduct.

Willful Disregard

Nor has Enforcement Counsel shown that Respondents acted with willful disregard for the Bank's safety and soundness in connection with the Capital Raise Loans. Here, context is crucial, and Enforcement Counsel generally does not take into account the specific challenges faced by Bank management during the spring and summer of 2009 as it draws conclusions regarding the culpability of Respondents' state of mind. The undersigned finds that Respondents and other Bank personnel offered consistently credible testimony that they acted with the Bank's best interests in mind as they sought to right the ship and comply with the OCC's capital directive following the $174 million Fannie and Freddie investment losses, and there is substantial evidence in the record to support their accounts.

Generally speaking, "[w]illful disregard is deliberate conduct that exposes the bank to abnormal risk of loss or harm contrary to prudent banking practices."[583] The latter half of this formulation is familiar as the Horne Standard for unsafe or unsound practices—"deliberate conduct" that is unsafe or unsound, then, constitutes willful disregard. Yet while it is true that conduct is "deliberate" merely if it is intentional rather than "technical or inadvertent"[584]—in other words, that the IAP need not have knowledge that his conduct in question is wrongful, only that

[582] Ortega Tr. 546:16-19; *see also* Rogers Tr. 340:20-25 ("Unless we knew something really bad about a borrower . . . then we went on with the loan.").
[583] *Ellsworth*, 2016 WL 11597958, at *17 (internal quotation marks and citation omitted).
[584] *Conover*, 2016 WL 10822038, at *28 (internal quotation marks and citation omitted).

he is engaging in that conduct[585]—it must also be the case that the Section 1818(e) culpability inquiry cannot end simply by determining that a bank officer has discharged her duties in an unsafe or unsound way; the statutory elements are distinct.[586] The undersigned thus finds it helpful, in evaluating whether Respondents acted with willful disregard for the safety and soundness of the Bank, to also employ Enforcement Counsel's further articulation of that standard: to wit, "[w]illful disregard exists when an IAP 'deliberately and consciously takes part in an action that evidences utter lack of attention to an institution's safety and soundness' or demonstrates 'a willingness to turn a blind eye to the institution's interests in the face of known risk.'"[587]

A review of the facts in evidence regarding the Bank's 2009 capital raise efforts does not reveal "utter lack of attention" to the Bank's safety or soundness or "a willingness to turn a blind eye to the [Bank's] interests" on the part of either Respondent. Rather, the record reflects that Respondents recognized the "immediate and ongoing need for the Bank to achieve and maintain adequate capital" and sought ways to meet the new minimum capital ratios with exigency,[588] including Respondent Rogers contributing $5 million of his own money to the Holding Company's coffers along with nearly $4 million from other members of his family.[589] The OCC stressed that

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[585] *See Smith and Kiolbasa*, 2021 WL 1590337, at *29 ("An officer acts willfully when he is aware of his conduct; willfulness does not require a showing that Respondent was aware of the law").

[586] *See Duncan v. Walker*, 533 U.S. 167, 174 (2001) (it is a court's duty to "give effect, if possible, to every clause and word of a statute") (internal quotation marks omitted). In *Patrick Adams*, the Comptroller rejected an interpretation of the Horne Standard that required a threat to an institution's financial stability before unsafe or unsound practices could be found, reasoning that such a standard "conflicts with the fundamental structure of the FDI Act by introducing an effects element, textually reserved as a predicate for more severe remedies, into the definition of an element of misconduct." *Patrick Adams*, 2014 WL 8735096, at *16. So too here, interpreting willful disregard for the safety and soundness of an institution to definitionally encompass all unsafe or unsound practices engaged in in the course of a bank officer's duties would subsume the culpability element into the finding of misconduct in those instances, effectively writing out any separate inquiry into the respondent's state of mind.

[587] EC Br. at 13 (quoting *Cavallari v. OCC*, 57 F.3d 137, 145 (2d Cir. 1995) (bracketing omitted)); *see also Michael*, 687 F.3d at 352 ("[An IAP] cannot claim ignorance by turning a blind eye to obvious violations of his statutory and fiduciary duties.").

[588] EX 147 (IMCR Letter) at 4.

[589] *See* EX 374A (Capital Raise Loans Spreadsheet) (reflecting, among other Rogers family contributions, share purchases of $1,995,000 and $1,827,450 by Michael J. Rogers and, through a company, David Rogers III, neither of which was financed by the Bank). As noted previously, Respondent Ortega also used personal funds to purchase

the Bank's capital plan "should reflect a sense of urgency and an awareness of the recent rapid deterioration in the Bank's condition."[590] The agency also repeatedly emphasized that there would be severe regulatory consequences should the Bank fail to achieve the IMCR, stating that the Bank therefore "***need[ed] to do everything possible*** to achieve and maintain the capital ratios established in the IMCR by the commitment date."[591] And the OCC warned the Bank that it could not continue to operate with its present level of capital, and that doing so was unsafe and unsound.[592]

It was imperative, then, from both the Bank's perspective and the OCC's, that the Bank do everything in its power to find new capital, and quickly; otherwise, it was possible that it would not survive the swirling financial crisis for long.[593] Moreover, the Bank could only rely on local investors for its capital raise efforts, as the crisis had rendered national capital markets inaccessible, yet it was located in one of the poorest regions of the country. To make matters worse, there was little chance that other banks could finance borrowers' purchases of Holding Company stock—as Mr. Gandy noted in his April 28, 2009 letter to the OCC, the circumstances had seen the "shutdown of lending by most Texas banks including, importantly, our biggest competitors in the Valley."[594] But some solution had to be found.

$1 million in Holding Company stock in April 2010, following the two capital injections, and therefore did not make a contribution during the initial capital raise efforts. *See id.*

[590] EX 147 (IMCR Letter) at 5.

[591] EX 336 (April 30, 2009 Letter) at 6; *see also* EX 147 (IMCR Letter) at 5 ("[I]f the Bank does not achieve and maintain the minimum capital ratio established herein, . . . it will be subject to such administrative action or sanctions as the OCC considers appropriate.").

[592] *See* EX 147 (IMCR Letter) at 3 ("[T]he Bank's senior management will need the assistance of a capital injection in order to safely restore the Bank to a safe and sound condition."), 4 ("[T]he Bank needs a higher level of capital in order to operate in a safe and sound manner."), 5 ("Failure of the Bank to maintain at least the minimum capital ratios established herein will be deemed to constitute an unsafe or unsound banking practice within the meaning of 12 U.S.C. § 1818.").

[593] *See id.* at 3 ("[T]he Bank is exposed to a higher degree of risk associated with exposure to a weakening real estate market. These circumstances have resulted in increasing risk to capital and significant deterioration in earnings."), 4 (noting "the severe and continuing deterioration in the Bank's asset portfolio" and stating that the Bank's declining capital ratios and "significant decline in capital" were "serious concerns given the deteriorating economy and the exigency of potential problems").

[594] EX 149 (April 28, 2009 Letter) at 1; *see also* Gandy Tr. 2227:15-16 ("There was no liquidity in the market. Nobody could go get a loan.").

In many ways, the Bank was placed in an impossible situation. The Bank needed to find as many investors as it could as quickly as possible for the capital raise in order to maximize its chances of achieving the IMCR. Failing to achieve the desired capital ratios, at a time of nearly unparalleled financial tumult, would leave the Bank in an unsafe and unsound condition and possibly lead to its outright failure. Achieving the capital ratios by financing some stock purchases itself with favorably-termed loans to borrowers it deemed creditworthy might save the Bank now, but would increase the Bank's risk in the longer term.[595] Ultimately, the Bank met the capital ratios and continued operations for another four years. It is difficult to conclude that Respondents acted with "utter lack of attention" or turned "a blind eye to the [Bank's] interests" if the alternative path presented its own set of risks, but on a shorter time frame.

Would it have been better if Bank management had not pursued the Capital Raise Loans scheme, if not doing so would have significantly increased the chances of the Bank failing in 2009? Enforcement Counsel does not answer this question, nor does it say what the Bank should or could otherwise have done in its position to raise capital and achieve the IMCR, at that time, in that financial climate, other than to find more qualified borrowers.[596] Not only is there no evidence that such a pool of willing borrowers existed, beyond the individuals who invested at the time, but the

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[595] This is true whether or not the Capital Raise Loan proceeds were ultimately and improperly downstreamed to the Bank, given the fungibility of Holding Company funds and the fact that the Holding Company itself was undercapitalized and acting under an IMCR. *See* EX 143 (2009 Holding Company PPM) at 5 ("Because of losses in the Company's investment portfolio, the Company was required to institute new and revised policies for its investments and capital maintenance. . . . [A]ssuming all Shares are sold, the Offering will provide the Company with sufficient capital to be classified as well capitalized for regulatory purposes."). Setting aside the longer-term risk of unsecured loans, the Capital Raise Loans indisputably provided the Holding Company with at least some capital that it would not otherwise have had, which benefited the Bank even if that capital stayed entirely at the Holding Company level and went to improve the Holding Company's capital ratios and service Holding Company debt. *See* EX 548 (April 3, 2009 OCC meeting minutes) at 1 (noting that the Company had "[e]stimated debt service requirements" of $11-12 million per year).

[596] *See* Chansen Tr. 1260:7-12 (opining that "Respondents should have ensured that the individuals purchasing the stock, or the borrowers, were qualified borrowers and they had the ability to absorb losses based on their financial statements").

undersigned credits Respondents' testimony regarding their personal familiarity with the financial situations of many of the Capital Raise Loans borrowers.[597]

As an example, Bank director Jack McClelland received an unsecured $500,000 loan that he used to purchase Holding Company stock.[598] Enforcement Counsel has noted that this unsecured loan had a significantly lower interest rate than many of Mr. McClelland's other loans with the Bank.[599] When asked at the hearing, Respondent Ortega explained why he was comfortable extending Mr. McClelland a loan with those terms:

> Mr. McClelland obviously is a real estate developer. I don't have the loan request here, but he's got millions of dollars that we lended, that we lended him over the years. He's a director of the bank. I don't have all the information, but I'm pretty sure that his Empirica score is strong, plenty of liquidity. I'm pretty sure he had plenty of deposits at the bank. Solid individual. He's owned an electric company for years. He's done very well over the course of my 27 years there where we live in Edinburg, Texas. A really, really strong individual, plenty of loans that we've issued over time. I don't think – without looking at the detail, but I don't think he was ever past due on any loan. I don't think we ever foreclosed a property on him. Solid individual probably with a very high credit score and a high net worth.[600]

Respondent Ortega offered similar details regarding several other borrowers.[601]

Of course, personal familiarity with these borrowers does not absolve Respondents from approving risky loans or loans with incomplete underwriting, too-vague purposes, or without proper documentation—those are still unsafe or unsound banking practices, as the undersigned holds above. Nor does it change the impropriety of treating some or all of the loan proceeds as

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[597] *See*, *e.g.*, Ortega Tr. 907:23-908:5 ("[M]ost of those loans, they were individuals that had either a lot of history with the Bank, they were high net worth, they – most of them had long-term relationships with the Bank with different types of businesses. And to me they were – all of them were pretty good customers of the Bank.").

[598] *See* EX 374A (Capital Raise Loans Spreadsheet), row 30.

[599] *See supra* n. 142.

[600] Ortega Tr. 920:23-921:19.

[601] *See id.* 917:6-919:3, 922:7-927:19.

recycled capital, however creditworthy the borrowers may have been.[602] But it is a relevant consideration when determining whether Respondents had a good faith belief that they were acting in the Bank's best interests, all things considered, in approving the loan.

Respondents were faced with a choice between extending potentially risky loans to borrowers who were known to the Bank, thus giving the Holding Company more money and increasing the chances that both the Bank and the Holding Company would be adequately capitalized when the dust settled, or issuing fewer Capital Raise Loans and lowering the risk to the Bank long term, which would result in fewer Holding Company investors and make it more difficult for the Bank and the Holding Company to achieve their respective IMCRs. There is no way to know what would have happened had Respondents pursued the other approach, and it is easy to second-guess—most likely the Bank would have still emerged unscathed, given Ms. Salvato's testimony that its Tier 1 capital ratio would have exceeded 8 percent even without the Capital Raise Loans. What cannot be said, however, is that Respondents lacked concern about the Bank's safety and soundness, when their actions at the time belie that characterization.

Finally, Enforcement Counsel argues that the D.C. Circuit's *Dodge* decision supports a finding of willful disregard here.[603] It does not. The respondent in *Dodge* misled regulators about his bank's financial condition by improperly reporting capital contributions that made it seem as though the bank was well-capitalized when in fact it was "critically undercapitalized" with ratios of 1.6 percent and 3.1 percent.[604] The Comptroller there found, and the Circuit affirmed, that the respondent "directed the Bank to report contributions as capital that were unlikely to produce cash for the Bank, knowing that the OTS would have no reason to doubt that the Bank was well-

[602] *See* Chansen Tr. 1253:11-16.
[603] *See* EC Br. at 39-40.
[604] *See Dodge*, 744 F.3d at 158 ("Absent the challenged capital contributions, the Bank would not have appeared well-capitalized in the months before August 2008, when regulators could have required corrective action.").

capitalized and take corrective action," thus "knowingly expos[ing] the Bank and its depositors to substantial risk."[605] Here, by contrast, the Bank would have been well-capitalized with or without any downstreaming of Capital Raise Loan proceeds, and there is no evidence that Respondents knowingly misled regulators or knowingly exposed the Bank to risk. At most, the evidence shows that Respondents sought to trade immediate and profound short-term risk to the Bank—deficient capital levels causing it to operate in an unsafe and unsound condition at the height of the financial crisis, at a time that it was experiencing "significant deterioration in earnings" and "severe and continuing deterioration in the Bank's asset portfolio"[606]—for more speculative long-term risk, and while the way in which they did so may have been misguided and imprudent, it does not constitute willful disregard for the Bank's safety and soundness.

Continuing Disregard

Enforcement Counsel also argues that Respondents' conduct meets the standard for continuing disregard, which need not rise to the level of willfulness, but instead requires evidence of "a mental state akin to recklessness."[607] Continuing disregard is conduct that has been "voluntarily engaged in over a period of time *with heedless indifference to the prospective consequences*."[608] It may manifest through, for example, the "voluntary and repeated inattention to" unsafe and unsound practices, or the "knowledge of and failure to correct clearly imprudent and abnormal practices that have been ongoing."[609]

For purposes of continuing disregard, Respondents' Capital Raise Loans-related conduct may be divided into two periods: April 2009 through the second and final capital injection in mid-

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[605] *Id.* at 161.

[606] EX 147 (IMCR Letter) at 3, 4.

[607] *Smith and Kiolbasa*, 2021 WL 1590337, at *29 (internal quotation marks and citation omitted); *see* EC Br. at 40.

[608] *Ellsworth*, 2016 WL 11597958, at *17 (internal quotation marks and citation omitted) (emphasis added).

[609] *In the Matter of Lawrence A. Swanson, Jr.*, No. AP-ATL-93-7, 1995 WL 329616, at *5 (Apr. 4, 1995) (OTS final decision on reconsideration).

August 2009, during which time Capital Raise Loan proceeds were downstreamed to the Bank, and the autumn of 2009 through March 2011, when the final Capital Raise Loan was made.[610] There is no evidence that Respondents acted with recklessness or heedless indifference regarding the Capital Raise Loans in either period. In the initial period, Respondents' actions evinced good faith concern for the Bank for the reasons detailed above; they were taking steps, in the moment, to improve the capital conditions of the Bank and the Holding Company at a time when the Bank's deficient capital levels were unsafe and unsound. Likewise in the latter period, Enforcement Counsel offers no basis to conclude that the Bank loans to purchase Holding Company stock were extended recklessly or "with heedless indifference to the prospective consequences," given Respondent Ortega's uncontroverted testimony that most Capital Raise Loans borrowers were customers with a high net worth and a previously established loan history with the Bank.[611] The undersigned therefore finds that Enforcement Counsel has not met its burden here.

With respect to the downstreaming of Capital Raise Loan proceeds in particular, the undersigned finds that there is some basis to question whether conduct taking place twice at most over a three month period—that is, during the May 11, 2009 and August 12, 2009 capital injections—can constitute continuing disregard even if the standard had otherwise been met. Although there is no minimum length that an IAP must be heedlessly indifferent in order for their disregard to be "continuing" for purposes of culpability, the undersigned's review of previous matters in which that threshold has been met reveals periods of misconduct generally longer than the three months at issue here. [612] The undersigned need not decide this issue, however.

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[610] *See* EX 374A (Capital Raise Loans Spreadsheet).

[611] *See*, *e.g.*, Ortega Tr. 907:23-908:5.

[612] *See*, *e.g.*, *Ellsworth*, 2016 WL 11597958, at *17 (continuing disregard where misconduct "involved repeated acts over more than a year"); *In the Matter of Donald V. Watkins, Sr.*, Nos. 17-154e & -155k, 2019 WL 6700075, at *9 (Oct. 15, 2019) (FDIC final decision) (continuing disregard where misconduct took place "repeatedly . . . between July 2010 and November 2012"); *In the Matter of Charles F. Watts*, Nos. 98-046e & -044k, 2002 WL 31259465,

5. Section 1818(i)

Both elements of the OCC's claim for an assessment of a second-tier civil money penalty under 12 U.S.C. § 1818(i) in connection with the Capital Raise Loans have been satisfied.[613] First, the undersigned has held that Respondents breached their fiduciary duty of care with respect to this claim. This constitutes actionable misconduct.[614] The undersigned has also held that the Bank suffered loss as a result of the Capital Raise Loans, and she now makes the further finding that the loss was "more than minimal."[615] This constitutes actionable effect. In addition, Enforcement Counsel has argued that the misconduct and effect prongs of a second-tier civil money penalty claim have been satisfied, respectively, by Respondents' *reckless* engagement in unsafe or unsound practices and by the fact that the misconduct was "part of a pattern of misconduct."[616] Because Enforcement Counsel has already met its burden here on fiduciary duty and bank loss, however, it is unnecessary to resolve these additional claims.

B. OREO Lending Strategy

Enforcement Counsel argues that Respondents' actions in connection with the Bank's OREO Lending Strategy (Article IV) breached their fiduciary duties of care and constituted actionably unsafe or unsound banking practices, caused loss to the Bank, and were undertaken with continuing or willful disregard for the Bank's safety and soundness. As with the Capital Raise

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at *8 (Aug. 6, 2002) (FDIC final decision) (continuing disregard where misconduct amounted to "at least 80 incidents occurring over a period of nearly two years"); *In the Matter of Charles R. Vickery, Jr.*, No. AA-EC-96-95, 1997 WL 269105, at *8 (Apr. 14, 1997) (OCC final decision) (finding that "conduct reflecting recklessness or indifference with respect to an institution's safety" was continuing disregard when "made over a period of some months"); *Dodge*, 744 F.3d at 161 (continuing disregard where conduct took place "on multiple occasions over six reporting periods").

[613] *See* Part III *supra* at 7 (elements of Section 1818(i) claim). Beyond "recklessness" as a requisite component before the engagement in unsafe or unsound practices can merit a second-tier civil money penalty, Section 1818(i) contains no culpability element.

[614] *See* 12 U.S.C. § 1818(i)(2)(B)(i)(III).

[615] *Id.* § 1818(i)(2)(B)(ii)(II).

[616] *See* EC Br. at 40-42; *see also* 12 U.S.C. §§ 1818(i)(2)(B)(i)(II), 1818(i)(2)(B)(ii)(I).

Loans claims *supra*, and for the reasons discussed below, the undersigned concludes that Enforcement Counsel has demonstrated misconduct and effect, but not culpability.

1. Unsafe or Unsound Practices

To begin with, Enforcement Counsel makes a more than sufficient showing that Respondents engaged in unsafe or unsound practices with respect to the Bank's OREO lending during the relevant time period. In their capacities as members of the L&D Committee and Bank officers and directors, Respondents had independent responsibilities to evaluate the risk associated with all loans presented to them for approval on the strength of comprehensive loan packages, as well as ensuring that the Bank's overall strategy for managing its OREO portfolio complied with Bank policy and did not pose undue risk to the Bank's financial performance or capital position.[617] Instead, Respondents effectively abdicated these responsibilities, habitually relying solely on the recommendations of loan officers to approve loans with incomplete documentation, inadequate underwriting, and concessionary terms that foreseeably and unduly increased the Bank's risk.

Enforcement Counsel argues that Respondents engaged in unsafe or unsound banking practices when financing the sale of OREO by approving and ratifying loans "(1) without a credit analysis to determine the borrowers' ability to repay the loans; and (2) with concessionary and below-market terms to unqualified borrowers."[618] The undersigned concurs. The evidence supporting this conclusion as to each category of misconduct is set forth in great detail in the factual findings in Part VI.D *supra* at 58-75, but in brief:

Approval without Credit Review

Respondents frequently approved loans greater than $500,000—including the $56 million combined NAHS loan—even if the loan packages did not contain a detailed credit review and

[617] *See* Brickman Tr. 101:4-24.
[618] EC Br. at 43.

other financial spreads pertaining to the borrowers' repayment ability, notwithstanding the increased risk on OREO loan defaults and the Bank's policy that such an analysis must always accompany loans of that size.[619] In an internal 2010 email, CCO Magee stated that due to the Bank's aggressive OREO strategy, the credit review department "rarely" had the opportunity to view the financial information for borrowers on OREO loans before the loans were funded.[620] Furthermore, Respondent Ortega testified that even when a loan package was accompanied by a credit review, he generally would not read it, making his decision on the package's first two pages, which were far less detailed.[621]

The undersigned credits NBE Chansen's testimony that Respondents should never have approved loans without a credit review and related financial data, because they are unable to make a fully informed decision regarding the borrower's ability to repay.[622] This is particularly true for large loans, for loans financing the sale of OREO, and for loans with little or no down payment, little or no guaranty, and other liberal terms, all of which carry a foreseeably heightened risk to the Bank in the event of default.[623] Yet Respondents approved loans with some or all of these qualities and no credit review with relative regularity; the NAHS loan is an exemplar.[624] NBE Chansen offered the well-supported expert opinion that approving OREO loans of substantial size without "all the relevant and required information to support a credit decision" is an unsafe and unsound

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[619] *See* EPF ¶ 201 (identifying fourteen OREO loans of amounts between $3 million and $56 million that one or both of the Respondents approved or ratified without a credit review from April 2009 through October 2012); EC Br. at 43-48.

[620] EX 8 (email chain including April 28, 2010 email from M. Magee to R. Gandy et al.) (adding that "those financials that we do receive typically provide little if any actual support for the proposed ORE purchase on the larger deals that we've been doing").

[621] *See* Ortega Tr. 646:3-20.

[622] *See* Chansen Tr. 1315:5-20.

[623] *See*, *e.g.*, Brickman Tr. 105:17-24, 111:16-112:4.

[624] *See* Part VI.D.7 *supra* at 65-70; Magee Tr. 2135:22-2136:13 (expressing concern that the NAHS loan would be approved without giving the credit review department "the opportunity to run it through the appropriate process," analyze the financial and appraisal information, and communicate their analysis to the L&D Committee, who otherwise "don't have the information they need to make an informed decision").

practice that exposes banks to foreseeable additional risk.[625] As it happens, Respondents agree.[626] So too does the undersigned.

Respondents' current rationale for their conduct is unpersuasive. First, it is Respondents' contention that they share no blame for approving risky OREO loans because they were simply relying on "trusted and experienced loan officers" and other Bank management, secure in the knowledge that CCO Magee would "ensure that [the] credit administration was being done correctly, including all proper documentation," and trusting that the loan department had already "conducted detailed reviews and analysis of borrowers" before recommending the loans.[627] As with the Capital Raise Loans, this defense ignores Respondents' independent responsibilities to understand a loan's details, confirm that "all of the required information is provided to support the credit decision," and ensure that they are sufficiently able to "evaluate the risk associated with [each] particular request" before making their approval decision.[628] Moreover, as Enforcement Counsel points out, Respondents' assertion that they relied on CCO Magee to compile "all proper documentation" makes little sense when Respondents were happily approving large OREO loans *without* the proper documentation (which was required to be included in the loan packages), and

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[625] Chansen Tr. 1348:9-16; *see also In the Matter of Steven D. Haynes*, Nos. 11-370e & -371k, 2014 WL 4640797, at *8 (July 15, 2014) (FDIC final decision), *aff'd sub nom. Haynes v. FDIC*, 664 Fed. Appx. 635 (9th Cir. 2016) (holding that "[a]pproving loans without determining the borrower's ability to repay constitutes an unsafe and unsound practice").

[626] *See* EX 568 (Rogers Dep.) 101:3-9 ("Q: [W]ould you agree that it's not consistent with safety and soundness for the bank to lend money to – on large loans – loans to commercial real estate loans without a credit review? A: Yes. I would agree."); EX 569 (Ortega Dep.) 130:4-12 ("Q: [I]s it ever appropriate to lend, let's say well over $1 million, without credit review getting the financials on the borrower? A: That's not appropriate. Q: [W]ould you say it's not safe and sound, as well? A: Yeah, it shouldn't happen. It shouldn't happen.").

[627] Rs Br. at 35-36.

[628] Chansen Tr. 1290:6-15; *see* Brickman Tr. 102:4-9 ("A loan committee member has an obligation if there's insufficient information to make a decision to follow up with the loan underwriter or the person responsible for providing the information to gather the necessary information to make the decision.").

when CCO Magee's department was not being given the time to complete credit reviews "or even look at financials before the ORE has been sold, booked, and funded."[629]

Respondents also state that "they thoroughly reviewed the materials provided to them."[630] But this is plainly untrue, given Respondent Ortega's testimony that he would only read the first two pages of loan packages and the statement by Respondent Rogers that the L&D Committee would default to approving all loans recommended to them "[u]nless we knew something really bad about a borrower."[631]

Last, Respondents attempt to shift responsibility to OCC examiners, professing that they "reasonably expected and believed, with all the coordination going on between examiners and the loan department, that the OREO lending practices occurred with the knowledge and concurrence of the OCC."[632] According to Respondents, "[w]hen concerns were raised, examiners assured Respondents that these concerns had been corrected to the examiners' satisfaction."[633] The only evidence provided for this assertion is selected quotes from reports of examination purporting to show that examiners recognized some positive developments and improvements with the Bank's OREO practices in 2011 and 2012.[634] Even if examiners noted improvement in OREO lending, however, this is a far cry from "assur[ing] Respondents that these concerns had been corrected to the examiners' satisfaction"—and in any event would not give Respondents license to approve large OREO loans without a credit review, in contravention of Bank policy and safe and sound

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[629] EX 8 (email chain including April 28, 2010 email from M. Magee to R. Gandy et al.) (attributing this to "a press to move the ORE before the end of the month in which [it] is acquired"); *see* EC Reply at 7-8.

[630] Rs Br. at 36.

[631] Rogers Tr. 340:10-25; *see* Ortega Tr. 643:21-644:19, 645:60-646:6 (stating that he did not tend to read credit reviews when they were provided or "dive into the numbers" on a borrower's repayment ability).

[632] Rs Br. at 36-37.

[633] *Id.* at 37.

[634] *See id.* (citing RX 31 (2012 ROE) at 14 (stating that "[u]nderwriting for OREO improved and the accounting treatment on OREO sales have been addressed")). The undersigned notes that RX 31 is the same document as JX 6, except that RX 31 contains highlighting by Respondents' counsel on passages deemed pertinent by Respondents.

banking practices. Furthermore, Respondents' citation to 2011 and 2012 reports of examination elides the fact that the bulk of the challenged practices occurred in 2009 and 2010,[635] and Respondents fail to mention that the 2011 and 2012 consent orders between the OCC and the Bank underscored that the Bank should only approve loans "after obtaining and validating credit information on the borrower and any guarantor sufficient to fully assess and analyze the borrower's and guarantor's cash flow, debt service requirements, contingent liabilities, and global liquidity condition, *and only after the credit officer prepared a documented credit analysis*."[636]

Loan Quality

The evidence also shows, as examiners concluded in 2011, that the Bank's aggressive strategy of financing the sale of its own OREO—for which Respondents shared responsibility with others in Bank senior management—often resulted in loans "with little or no down payment, on liberal terms, with below-market interest rates, and to individuals who did not demonstrate the ability to service the debt."[637] Ms. Rodriguez and Mr. Magee were troubled by the Bank's willingness to extend OREO loans to "brand new entities without any financial information" during this period without requiring any equity,[638] while Respondents agreed that "the Bank made loans that it normally would not have made" and was "more lenient on loan terms" in order to move OREO from the Bank's books.[639] Other common features of concessionary OREO loans made by the Bank under Respondents' leadership include new monies provided to borrowers over

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[635] *See* EPF ¶ 201 (twelve of fourteen large OREO loans approved by Respondents without credit review made in 2009 and 2010).

[636] JX 12 (February 2011 Consent Order) at 10 (emphasis added); *see* JX 13 (January 2012 Consent Order) at 13.

[637] JX 4 (2011 ROE) at 46.

[638] Rodriguez Tr. 1486:1-2; *see also id.* 1486:4-5 ("[T]he quality of the loan was not what I would have liked to see."); Magee Tr. 2083:19-2084:6 ("[T]he sale of OREO and the financing thereof was done at terms which were not necessarily the same terms that you would want to see in a more typical environment, . . . i.e., requiring down payments and things of that nature.").

[639] Ortega Tr. 618:1-12; Rogers Tr. 377:1-3.

and above the OREO purchase price; inadequate or nonexistent personal guarantees from individuals with little liquidity and cash flow; and the advancement of property tax or the payment of OREO borrowers' past due loans.[640] Again, the NAHS loan is a typical, if uncommonly large, example of an OREO loan with these concessionary features,[641] and external consultants in 2012 concluded among other things that the loan was "[a]n accommodation loan to rid the bank of a large piece of OREO," that the guarantors had "no liquidity that can support operation," and that the Bank was "taking excessive risk and exposure on this loan."[642]

Each of these practices foreseeably increased the risk to the Bank and, especially taken together, were actionably unsafe or unsound. OCC examiners found as much in their 2011 report of examination, and NBE Chansen and Deputy Comptroller Brickman reiterated those conclusions at the hearing.[643] Loaning to new entities without financial data, requiring no down payment, extending loans to borrowers with inadequate repayment prospects and no personal guarantee—all of these things make it more likely that a loan will default, which increases the risk to the Bank for reasons that should be apparent. Offering interest rates not commensurate with a borrower's creditworthiness or repayment ability or including new monies on a loan to an unqualified borrower likewise fails to balance the Bank's gain on a loan relationship against the default risk. Adding property tax payments to the loan balance and allowing borrowers to pay past due OREO loans with the proceeds of new loans serves to "distort[] the borrowers' true performance capabilities as well as the Bank's level of past due and nonaccrual loans," masking the Bank's

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[640] *See* Part VI.D.6 *supra* at 60-65; *see* JX 4 (2011 ROE) at 46 ("Management has masked problems with OREO financing on liberal terms and payment of property taxes and/or allowing customers to maintain loans current through advances on other loans. Our sample noted nine instances where management advanced proceeds to pay property taxes and one instance where it advanced funds to make note payments.").

[641] *See* Part VI.D.7 *supra* at 65-70.

[642] RX 74 (A&M Workpaper) at 869-871.

[643] *See* EPF ¶¶ 228-232; EC Br. at 49-56.

financial condition.[644] And all of this is compounded, for loans financing OREO sales, by the danger of the OREO collateral returning to the Bank's balance sheet if the loan defaults, increasing the Bank's risk and losses through the properties' significant holding costs and making it even more difficult for the Bank to find a new borrower given the deterioration in value of OREO over time.[645] In short, providing concessionary loan terms to borrowers without demonstrated repayment ability who can "default on the loans and walk away from the properties without meaningful consequences" is risky;[646] doing so on loans that will place millions of dollars of nonperforming assets back on the Bank's balance sheet if the loan defaults is riskier still.[647] There is no doubt, as Enforcement Counsel asserts, that the way in which the Bank implemented its aggressive OREO lending strategy "posed an unwarranted and abnormal risk to the Bank."[648]

Respondents make two principal arguments in response.[649] First, Respondents assert that the OREO loans benefited the Bank, both in an absolute sense ("by generating cash from a money losing asset, where the alternative was to hold the asset and lose money every month") and relative to any other options that the Bank had at the time.[650] While it is true that holding ORE has "an adverse effect on [a] bank's financial condition" and that it can be beneficial to sell it as quickly as possible to avoid the substantial monthly holding costs,[651] Respondents do not acknowledge the

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[644] JX 4 (2011 ROE) at 46.

[645] *See id.* at 5 ("Often, the Bank made loans to borrowers or guarantors with little financial repayment capacity. Many of the financed properties subsequently return to the Bank's OREO portfolio, which is an unsafe or unsound practice."); Chansen Tr. 1542:13-24 (describing OREO merry-go-round); Brickman Tr. 111:16-112:4 ("The risk of financial loss mounts over time relative to a portfolio like this. . . . [A]s the values in those properties deteriorate, the scrutiny and the sensitivity and the heightened attention that a board should pay to it is critically important.").

[646] EC Br. at 49; *see* Rodriguez Tr. 1487:1-4 ("There was no equity injection. So really there was no – the borrower had no skin in the game. They had nothing to lose.").

[647] *See* Rogers Tr. 378:15-21 (stating that a loan to purchase ORE is "higher risk than your average normal loan").

[648] EC Br. at 50.

[649] *See* Rs Br. at 37-39; Rs Reply at 19-22.

[650] Rs Reply at 19; *see* Rs Br. at 39 (asserting that "OCC witnesses presented no evidence of any reasonable alternative that would have benefited the Bank more").

[651] Chansen Tr. 1293:13-14; *see also* Part VI.D.1 *supra* at 44-46.

reasonably foreseeable deleterious effect of the OREO merry-go-round—that is, while it may be better in the short term to finance quick OREO sales to even unqualified borrowers in order to remove the cost of the ORE from the Bank's balance sheets, such an indiscriminate approach can hurt the Bank in the future if the foreclosed property returns to the Bank at diminished value, making it more difficult to sell without significant write-offs and costing the Bank money in the interim while presenting an overly rosy impression of the Bank's financial condition during the time the OREO is temporarily off its books.[652] As for the argument that there were no better alternatives available to Bank management at the time, this is relevant to Respondents' state of mind when overseeing the Bank's OREO lending practices, and as such is addressed in the appropriate section below.

Second, Respondents argue that Enforcement Counsel has presented no evidence that the OREO loans in question were made at below-market terms,[653] particularly considering the extreme volatility of the market during this period and the presumption that the loan terms all legitimately arose from an arm's length negotiation "between a willing borrower and a willing lender."[654] Respondents assert that "[i]n the difficult times of the financial crisis, there was no evidence that the loan terms observed at the Bank were not appropriate given the unusual period, market volatility, geographic region, industry, and other specialized factors affecting each loan."[655] Respondents further focus on the 5.5 percent interest rate applied by examiners in 2011 in their analysis of whether OREO loans were being made at below-market rates, arguing that it was not

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[652] *See* JX 4 (2011 ROE) at 56 ("To promote OREO sales, the Bank also offers liberal in-house financing including zero down payments and non-recourse terms. These offerings have improved OREO sales, but most are to unqualified borrowers who cannot service the debt. This has resulted in repeat foreclosures and has contributed to the overall misleading appearance of improvement at the Bank.").

[653] *See* Rs Reply at 22 (contending that "[t]he assertions that the loan terms were below market are simply not supported by any studies by experts of comparable loans at the time or analysis of the market").

[654] Rs Br. at 38.

[655] Rs Reply at 22.

consistent with GAAP.[656] And Respondents argue that they had every reason to believe that the terms of the NAHS loan and the Bank's other sales of hospital OREO were appropriate and reasonable at the time they were made.[657]

None of Respondents' arguments change the conclusion that the Bank's OREO lending practices, driven by an effort by the Bank's management to sell OREO as quickly as possible, foreseeably increased the risk to the Bank by offering consistently liberal loan terms to borrowers who had not demonstrated the ability to service the debt. Respondents invoke the volatility of the market as a reason why loan terms might be "highly variable from loan to loan"[658]—the concern here, however, is not that the terms of the Bank's OREO loans varied too widely, but that they were too similar to one another in ways that foreseeably increased the Bank's risk individually and compounded that risk in aggregate.[659]

By averring that the loans were made between a willing borrower and a willing lender, Respondents also mistake the purpose of this analysis: a finding of unsafe or unsound practices under Section 1818 here does not depend on whether, for example, the interest rates on an OREO loan were lower than some market rate baseline, but on whether the terms of the loan overall posed "a reasonably foreseeable undue risk to the institution."[660] The Bank could have offered a 5.5 percent interest rate on every one of the challenged OREO loans, and yet the loans (and the Bank's OREO lending strategy writ large) would still be unsafe or unsound if that 5.5 percent interest rate

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[656] *See* Rs Br. at 38.

[657] *See id.* at 39-40; Rs Reply at 23-26.

[658] Rs. Br. at 38.

[659] *See* JX 4 (2011 ROE) at 46 ("The most dominant finding in our loan sample was the financing of OREO with little or no down payment, on liberal terms, with below-market interest rates, and to individuals who did not demonstrate the ability to service the debt."), 47 ("The review of [OREO financing] found liberal underwriting and non-conformance to Bank policy including: 100 percent financing; below market interest rates; interest only financing terms; new loans to borrowers with little support toward the repayment of the debt; and built in interest reserves.").

[660] *Patrick Adams*, 2014 WL 8735096, at *5.

was accompanied by overly liberal terms such as no down payment requirement, an inadequate personal guaranty, the provision of new monies, and the advancement of property taxes to a brand new entity with no financial information or an unqualified borrower "with little financial repayment capacity."[661] Those terms foreseeably increase the risk that the loans will default and otherwise increase the Bank's risk, interest rate notwithstanding, and the willingness of the parties to conduct an arm's length transaction is immaterial to that determination. Indeed, if the Bank is willingly offering concessionary terms that unduly increase its future risk, that is more an indictment of Bank management than a defense of the practice.

With respect to the safety and soundness of the NAHS loan, the undersigned finds that Respondents' arguments largely repackage their reliance arguments discussed *supra*—namely, that they approved the loan because it "had been graded satisfactory by expert credit staff" and because "a trusted and experienced lender, Curtis Brockman, had evaluated multiple possible borrowers and settled on NAHS because it had the best likelihood of success and was in the best interests of the Bank."[662] But regardless of the basis for Respondents' approval and ratification of the NAHS loan,[663] the terms of that loan—from the lack of financial information on the borrower and the $16 million in new monies to the lack of equity contribution and the minuscule personal guarantee from guarantors with poor credit and inadequate liquidity, not to mention the capitalization of interest payments and the lack of credit review or current appraisal at the time the loan was approved[664]—foreseeably and unduly increased the Bank's risk. Respondents may have

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[661] JX 4 (2011 ROE) at 5.

[662] Rs Br. at 40; *see* Rs Reply at 23 ("The non-lenders in the Bank reasonably relied on the loan grades, appraisals, and negotiated loan terms of the lending experts.").

[663] Enforcement Counsel notes that although Respondent Ortega now suggests that his approval of the loan was based in part on the satisfactory loan grade it had received, in fact "the NAHS loan grade was not documented until two weeks *after* he approved the loan." EC Reply at 11 (citing EPF ¶¶ 249, 259) (emphasis in original).

[664] *See* Part VI.D.7 *supra* at 65-70.

made a good faith judgment that the loan was the Bank's best option, concessionary terms and all, from among the alternatives, but this goes to culpability rather than misconduct. The loan itself was actionably unsafe or unsound.

2. Breach of Fiduciary Duty

The undersigned likewise concludes that Respondents' approval of risky loans to finance the sale of Bank OREO without any credit analysis to assess the borrower's repayment ability constitutes a breach of their fiduciary duty of care.[665] In its *Haynes* decision, the FDIC Board of Directors held that the respondent had a "duty to ascertain [a] borrower's ability to repay prior to approving a loan," which he breached by approving loans "without verifying borrowers' financial information—and, in some cases, without obtaining any such information at all."[666] The undersigned also credits Deputy Comptroller Brickman's testimony that it was Respondents' "duty to independently evaluate every loan presented to them for approval or ratification against the bank's loan policy."[667] As noted previously, Respondents routinely approved large OREO loans during this period without a credit review, and Respondent Ortega testified that he typically would read only the first two pages of a loan package in any event. The undersigned therefore finds that Respondents have breached their fiduciary duty of care in this regard.

Similarly, Respondents breached their duty of care by approving numerous loans containing terms that did not comply with the standards set forth in the Bank's loan policy, which Respondents and the rest of the Board approved annually as "principles that are fundamental to sound lending."[668] For example, the loan policy required that loans financing the sale of OREO

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[665] *See* EC Br. at 69-70.

[666] *Haynes*, 2014 WL 4640797, at *11.

[667] Brickman 104:10-14.

[668] JX 10 (2010 Loan Policy) at 10; *see id.* at 8 (noting that "[t]his policy contains minimum acceptable guidelines and should not preclude individual lending officers from applying more stringent lending guidelines as circumstances and situations dictate"), 45 (stating that "the Bank's [] lending policies reflect the level of risk that is acceptable to

contain an equity contribution requirement of between 15 and 25 percent, depending on the nature of the OREO property.[669] But, as has already been established, Respondents regularly approved and ratified large OREO loans that did not require the borrower to make any equity contribution.[670] The undersigned agrees with Enforcement Counsel that "[t]here is no evidence that Respondents (or the Board) ever meaningfully deliberated, either on a loan-by-loan basis or more generally, whether it was prudent to disregard the Board-approved Loan Policy with respect to so many loans."[671] This is therefore a breach of Respondents' fiduciary duty as well.[672]

3. Effect

Enforcement Counsel adduced evidence that the FDIC as receiver for the Bank recorded a loss of $35,152,664.68 on the NAHS loan sometime following the Bank's closure on September 13, 2013, a date that is within the five-year limitations period required for the agency's claims regarding the Capital Raise Loans to have been timely asserted.[673] In addition to the loss on the NAHS loan, the Bank recorded a combined loss of $7,330,502 on six OREO loans between September 27, 2012 and March 5, 2013—all of which losses are also within the five-year limitations period—and the receivership recorded another $71,285,874.32 in post-closure losses on thirteen non-NAHS OREO loans.[674]

Respondents make several arguments as to why these losses do not suffice to fulfill the effect elements of Sections 1818(e) and 1818(i) with respect to the OREO lending claims. First,

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the Board of Directors and Senior Management to ensure lending personnel adhere to clear and measurable underwriting standards to evaluate all relevant credit factors").

[669] *See* EPF ¶ 220; *see also*, *e.g.*, JX 10 (2010 Loan Policy) at 54, 75, 137.

[670] *See* EPF ¶ 221 (citing exhibits).

[671] EC Br. at 70.

[672] The undersigned notes that neither Respondents' posthearing brief nor their reply specifically addressed the issue of fiduciary duty with respect to Respondents' role in the Bank's OREO lending practices.

[673] *See* EPF ¶ 284.

[674] *See* EC Br. at 71.

Respondents argue that the action is untimely because the agency could have pled earlier actionable effects that occurred outside of the limitations period;[675] the undersigned rejects this argument just as it was rejected *supra* in connection with the Capital Raise Loans claims. Second, Respondents take issue with the post-closure losses recorded by the FDIC as receiver, arguing that the government can effectively "choose[] the date of the loss" in a way that, under some interpretations of the applicable statute of limitations, could toll the limitations period indefinitely as long as the receivership was open and there were loans for which losses had not yet been recorded.[676] Putting aside the fact that the FDIC and the FDIC as receiver are separate entities,[677] and that the OCC and the FDIC as receiver are more separate still, the undersigned agrees that the Comptroller's current construction of 28 U.S.C. § 2462, in which the "first" accrual of a Section 1818 cause of action could occur upon the second, third, or fifteenth instance of the same actionable effect,[678] may result in circumstances in which the limitations period is held in abeyance for as long as a receivership is open (or, for that matter, as long as an institution has a loan on its

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[675] *See* Rs Br. at 48. Respondents further argue that the first-tier civil money penalty claims against Respondents related to OREO lending practices are necessarily untimely because there is no effect element for such claims, meaning that they accrue at the point of misconduct, which was more than five years prior to the filing of the Notice. *See id.* at 48-49. While Respondents are correct that a claim for a first-tier civil money penalty lacks an effect element and therefore "first accrues" for purposes of 28 U.S.C. § 2462 when the misconduct occurs, their argument nevertheless fails in this instance because Enforcement Counsel seeks only a second-tier civil money penalty on the OREO claims. *See* EC Br. at 75-77.

[676] *See* Rs Br. 49 (citing FDIC fact witness Mary Jane Locke for the proposition that until a receivership closes, which can be years, "there are still transactions that could take place in the future that would cause a loss to the receivership"); Rs Reply at 26 (asserting that "the OCC continues to argue that its claims are not time-barred despite the fact that under its rubric the government ***chooses*** when the statute of limitations begins to run") (emphasis in original).

[677] *See* 12 U.S.C. § 1821(d)(2)(A) (stating that FDIC as receiver for a failed insured depository institution succeeds to "all rights, titles, powers, and privileges of the insured depository institution"); *FDIC ex rel. Co-op. Bank v. Rippy*, 799 F.3d 301, 307 n.1 (4th Cir. 2015) ("The FDIC in its corporate capacity is an insurer and federal regulator, and it performs a separate function from the FDIC in its capacity as receiver of failed banks."); *Miller v. FDIC*, 738 F.3d 836, 838 n.1 (7th Cir. 2013) ("[I]t is well-settled that the FDIC operates in two separate and legally distinct capacities, each with very different responsibilities.").

[678] *See* December 18, 2020 Order Granting Cross-Motions for Interlocutory Review and Vacating and Reversing in Part April 9 Order, *In the Matter of Saul Ortega and David Rogers, Jr.*, OCC Nos. AA-EC-2017-44 and -45, at 14 (holding that a claim can "first" accrue for purposes of starting the Section 2462 limitations clock "based on a subsequent occurrence of the same type of effect" that earlier could have completed the agency's cause of action).

books related to the alleged misconduct that could someday be written off) and, for this reason, remains hopeful that this ruling will be revisited.[679] In this instance, however, the question is moot, because there is no dispute that the Bank itself, pre-closure, recorded losses on multiple OREO loans. Thus, even if the post-closure losses were disregarded entirely as "subjective government decisions about whether to write down a loan,"[680] the agency's claims on the OREO lending issue would still have been timely asserted.

Respondents' last argument is that Enforcement Counsel has not met its burden of demonstrating loss to the Bank because it has not shown that the Bank lost more as a result of the OREO loans than it would have if it had simply "held on to the OREO, or engaged in some alternative transaction."[681] In some sense, it is certainly unknowable whether a different path would have yielded better results across the board—as the undersigned notes *infra*, the Bank's ever-growing and ever more costly OREO portfolio during this period may have made significant losses inevitable no matter what strategy the Bank employed. But the undersigned can comfortably conclude, given the foreseeable and undue risk engendered by each of the many concessionary features of the loans originated under the Bank's aggressive OREO lending strategy, that the Bank suffered greater losses with respect to the loans that it made than it would have if the underwriting had been even slightly sounder or if the loan terms had been a little less liberal. Put another way, the question here is not whether self-financing OREO loans was a comparable option, in terms of likely loss, to selling the properties to "speculators" and "scavengers" at greatly discounted value. Rather, the relevant comparison is between the loans as made—no equity contribution, no credit

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[679] *See Gabelli*, 568 U.S. at 448, 452 (emphasizing the importance of "set[ting] a fixed date when exposure to . . . [g]overnment efforts ends" and noting "the basic objective of repose underlying the very notion of a limitations period").

[680] Rs Reply at 26. The undersigned also separately concludes that losses to the receivership must constitute losses to the Bank for purposes of Section 1818 for the reasons provided in Part VII.E.2 *infra* at 180-181.

[681] Rs Reply at 27.

analysis, illiquid guarantors, new monies, other liberal terms—and the less risky loans that might have resulted, in a world where the Bank still determined that the best way forward was to finance its own OREO sales, had Respondents exercised some greater modicum of oversight over the Bank's lending. There can be no question that, in the latter case, the Bank would have been in a better position, that the risk to the Bank would have been lower, and that the losses ultimately suffered on the loans would have been by some measure less severe. The undersigned therefore finds that Enforcement Counsel has adequately demonstrated Bank loss on this claim.

4. Culpability

Enforcement Counsel contends that Respondents' actions in connection with the Bank's OREO lending were "part of a deliberate and concerted effort to mask the Bank's deteriorating financial condition" and as such constituted willful disregard for the safety and soundness of the Bank.[682] The undersigned cannot agree. Once again, there is credible testimony and substantial record evidence that, in aggressively financing the sale of OREO to remove it from the Bank's balance sheet, Respondents believed they were acting in the Bank's best interests in the face of an unprecedented crisis. Both the OCC and the Bank recognized that the sharply rising level of OREO in the Bank's portfolio had an adverse effect on the Bank's financial condition and risk exposure that would severely worsen over time.[683] Holding onto existing ORE for a sustained period was not an option, given the substantial monthly costs of maintaining the properties,[684] the deterioration of the value of the properties due to market conditions,[685] and the fact that more new ORE was

[682] EC Br. at 72.

[683] *See*, *e.g.*, JX 4 (2011 ROE) at 6 ("[T]he growing OREO portfolio combined with increasing loan losses, OREO write-downs, and increased OREO holding costs will continue to negatively impact earnings."); Chansen Tr. 1293:6-1294:5 (OREO is a "nonperforming asset[]" that results in "a hit to the bank's earnings and [its] capital"); *see also* Part VI.D.1 at 44-46.

[684] *See* Part VI.D.1 at 44 n.195.

[685] *See*, *e.g.*, Ortega Tr. 953:19-24 ("You've got to get appraisals once a year. In the meantime, [the] real estate market is not doing well. So the longer you hold it, the more the chances the value goes down.").

continuing to flood the Bank's books each month.[686] It is no overstatement to say that taking measures to constantly sell existing OREO quickly was potentially a matter of life and death for the Bank from the fall of 2008 onward.[687]

Moreover, it is uncontroverted that the OCC repeatedly imparted a sense of urgency to the Bank regarding its need to sell its OREO,[688] and at first approved of the Bank's aggressive efforts to do so through self-financing.[689] Enforcement Counsel now asserts that the Bank should simply have lowered the asking price on its properties or found qualified buyers who were financed by other banks rather than finance the OREO sales itself,[690] but both the record and the weight of the testimony suggest that, at the time, the choice would not have been so easy or clear-cut. Respondents and other Bank personnel offered credible, detailed rationales for not pursuing those alternate paths that were not refuted by Enforcement Counsel witnesses.[691]

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[686] *See* JX 6 (2012 ROE) at 5 ("OREO sales are behind the inflow of new OREO. During this examination the net OREO balance increased $22 million. The holding costs, write-downs, and loss on sales weigh heavy on the negative earnings."); Leal Tr. 2287:8-25 (stating that the bank was repossessing more and more properties "as the economy continued to suffer" and adding that "we were like drinking out of a firehose. It was coming hard and we were tasked to try to get these sold. You know, you had to sell them. You had to get them back out because we were just going to drown.").

[687] *See* JX 6 (2012 ROE) at 4 ("The stagnation of the loan portfolio and growing OREO portfolio has crippled earnings, threatens remaining capital, and threatens the near term viability of the Bank.").

[688] *See* JX 2 (2009 ROE) at 12 ("Management recognizes that holding OREO is not in the best interest of the bank or its shareholders."); JX 3 (2010 ROE) at 6 ("[U]ntil the level of OREO is reduced, earnings will be exposed to declines in market values of OREO."); JX 6 (2012 ROE) at 4 ("OREO volume must be reduced."); Ortega Tr. 938:21-23 (stating that examiners "were very involved and really just encouraging us to sell this ORE" because they understood that the Bank holding OREO is "not a good thing. It's not earning for us. It's costing us money. So they're really encouraging us to get it to somebody else, get it earning."), 952:24-25 ("[T]hey're telling us to sell the ORE.").

[689] *See* Part VI.D.2 at 53-54; *see also*, *e.g.*, JX 2 (2009 ROE) at 12 ("Management aggressively sells OREO to those they identify as having the best chance for success in holding the OREO and repaying the bank."); JX 3 (2010 ROE) at 10 ("Management has sold a tremendous amount of OREO. . . . Many OREO sales result in additional funds advanced to finish projects. This workout strategy increases the level of criticized assets but is generally appropriate because of the need to complete the projects.").

[690] *See* EC Br. at 70 ("The prudent course of action for the Bank with respect to its growing OREO portfolio would have been to lower its asking prices to attract more qualified borrowers who were willing to invest equity and accept personal liability."); Chansen Tr. 1295:15-22, 1543:6-21.

[691] *See* Part VI.D.2 *supra* at 47-51.

With respect to the OREO asking prices, for example, the undersigned credits the testimony of Mr. Gandy and Respondent Ortega that they were motivated by a good faith belief that the properties were more valuable long-term than what "speculators" and "scavengers" would have offered in the depressed and volatile real estate market of the day.[692] The undersigned also notes that lowering the asking prices on its OREO would have ensured that the Bank recognized losses on the sale of those properties, something that would have had a negative impact on its earnings.[693] In other words, Enforcement Counsel's preferred path would have adversely affected the Bank in the moment by forcing it to write down its property values in line with whatever a purchaser was willing to pay in the midst of an extraordinarily turbulent financial climate. Of course, this is preferable to carrying the OREO at an inflated value if in fact the appraisals were inaccurate—and it is certainly preferable to financing an OREO sale with a loan that subsequently defaults, placing the OREO back on the Bank's books at diminished value—but it shows that Respondents' decision to prioritize a strategy of self-financing OREO sales at the appraised value (in which the Bank recognizes no losses now, but takes on additional risk in the future) over discounting the property until it can be sold without financing (which minimizes future risk at the expense of present losses) could plausibly have been made with the Bank's interests in mind, as they profess.

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[692] *See* Gandy Tr. 2227:24-2228:5 ("[W]e didn't want to sell our valuable real estate at 50 cents on the dollar. We'd rather make a loan to somebody who would take it at the value that it was appraised and put it to work and develop it. . . . And so that's what we did."); Ortega Tr. 947:12-16 ("I could always have taken the idea that I'm going to sell these properties for 60, 70 percent of the appraised value. I don't know that my duty to the bank would have been correct."); *see also* Chansen Tr. 1617:5-11 ("Q: And you're not expressing any opinion as to what – as you're not an appraiser – what real estate values were in 2008 to 2013, correct? A: Other than my comments that the market was fluctuating and decreasing rapidly during those time frames, no.").

[693] *See* Chansen Tr. 1294:25-1295:7 ("Q: What happens if a bank lowers the asking price or the sale price of its OREO properties? A: So generally when that happens, they're going to take a loss relative to the value of what they have it on their books at. So they're going to recognize the loss when they do the sale.").

There is a passage from the OCC's 2012 report of examination that succinctly expresses why the Bank's OREO dilemma was not as easily resolved as Enforcement Counsel suggests. In the section entitled "Key Supervisory Concerns and Risks," examiners write:

> The level of OREO continues to grow. Holding costs and losses on sales are severely impacting earnings. OREO volume must be reduced.[694]

This shows the multiple prongs of the problem facing the Bank throughout this period. The cost of holding OREO on its portfolio is severely impacting the Bank's earnings, and the volume of the portfolio "must be reduced." As the OREO level grows, so too will the holding costs and the earnings impact, until the point where it will "threaten[] the near term viability of the Bank."[695] Yet simply selling the properties at a discounted price is not an ideal solution, because the losses that the Bank records on those sales *also* severely impact its earnings. If the Bank is somehow able to move the OREO at its appraised value, this reduces OREO volume without a corresponding earnings hit. But it must do it rapidly, because—as the report of examination goes on to observe—if "OREO sales are behind the inflow of new OREO,"[696] then the net OREO balance (and corresponding risk to the Bank) will increase even if the Bank is able to sell some of what it currently has. Speed is of the essence.

The Bank's solution, as the evidence reflects, was to turn to its lending officers—who were familiar with the properties—to find potential borrowers in their communities who the officers believed could take on the ORE and turn it into a performing asset.[697] L&D Committee members, including Respondents, likewise based their lending decisions in part on their personal knowledge

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[694] JX 6 (2012 ROE) at 4.
[695] *Id.*
[696] *Id.* at 5 (stating that "[t]he holding costs, write-downs, and loss on sales weigh heavy on the negative earnings)".
[697] *See* Part VI.D.2 *supra* at 51-52.

of the prospective borrowers.[698] Recognizing that the Bank was not well-suited to manage and operate OREO properties,[699] Bank management sought borrowers "who could bring their expertise and their energy to [the] properties" while simultaneously allowing the Bank to push the ORE from its books and into the hands of someone who could pay its monthly costs.[700] Moreover, even if some of the properties ultimately returned to the Bank's balance sheet through foreclosure, the Bank would benefit (in their eyes) from the cost savings in the interim, and the property could be sold again.[701] Irrespective of the wisdom of this approach relative to other options the Bank may have had, the undersigned credits the testimony of Respondents, Mr. Gandy, and others that it was their thought process at the time.[702] Bank management, in other words, offered articulable and plausible reasons for choosing to self-finance that demonstrate something other than the "utter lack of attention to [the Bank's] safety and soundness" that the willful disregard standard requires.[703]

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[698] *See id.* at 52-53; *see also*, *e.g.*, Rogers Tr. 386:9-14 (noting that he "had no problem voting for" a particular OREO loan because he was familiar with the borrower, who had done "a good job" with other properties); Ortega Tr. 619:13-18 (stating that an ORE loan was approved without financial projections because "we know that these guys know how to develop").

[699] *See* Ortega Tr. 954:15-955:2; *see also* Part VI.D.1 *supra* at 45.

[700] Gandy Tr. 2227:11-12; *see also*, *e.g.*, Leal Tr. 2288:1-4; Ortega Tr. 935:14-19; Rogers Tr. 370:21-24 ("It was important for us to get it out of the bank and have somebody else maintaining it, paying the insurance, paying the taxes."). Enforcement Counsel argues that the Bank's advancement of property taxes on some of the OREO loans "runs contrary to Respondents' claims that they were hurriedly getting OREO off the Bank's books to avoid paying property taxes," EC Br. at 63; *see also* EC Reply at 9 (claiming that "the OREO Lending Strategy was worse for the Bank than holding the properties" because "[t]he Bank regularly paid property taxes on behalf of the borrower"), but this ignores the uncontested testimony, including by Enforcement Counsel's own expert, that the monthly holding costs for OREO property would include not just payment of property taxes, but maintenance, insurance, appraisal costs, operating costs, and other costs, all of which expenses would be alleviated even if the Bank was still paying property tax under the terms of the loan. *See* Chansen Tr. 1293:15-1294:5 (noting that a bank must pay regular property tax, maintenance, insurance, and other costs on an OREO property, all of which "are a hit to the bank's earnings and [its] capital"); Ortega Tr. 960:12-21 (recalling that "at one point we were spending probably a million dollars a month to be able to pay for [hospital] supplies").

[701] *See* Pena Tr. 1184:22-1186:1 (agreeing that putting ORE "in the hands of a borrower who can make even, say, one payment" would "generate a better situation for the bank than just sitting there and holding it and losing money each month"); Chansen Tr. 1665:23-1666:13 (agreeing that it benefits a bank to remove OREO from its books even if it ends up foreclosing on the property again some months later).

[702] *See* Rogers Tr. 376:9-22 (stating that "many, many, many of these ORE loans ended up paying off in full. . . . [S]ome of them we foreclosed on again. But dollars and cents wise, common sense wise, I still, to this day, believe we were much better off doing this.").

[703] EC Br. at 13 (internal quotation marks and citation omitted).

Would the Bank have preferred that its OREO sales be financed by a different institution, as Ms. Chansen stated should have been done?[704] Almost certainly. All of the evidence presented suggests, however, that this was not a feasible option—there was no "bank down the street" willing to relieve the Bank of its OREO burden.[705] Enforcement Counsel does not acknowledge the circumstances that led OCC examiners at the time to view self-financing as an acceptable, even necessary part of the Bank's efforts to reduce its OREO volume.[706]

The undersigned agrees entirely with NBE Chansen that the Bank should have tightened its underwriting standards when financing the sale of OREO, rather than loosened them, as the properties "already carrie[d] a significant amount of risk" that would be compounded by risky loans.[707] But this goes to misconduct (which has already been established) more than culpability, and there is some force to the perspective that—in the specific climate faced by the Bank at the time—reducing the Bank's OREO was important and urgent enough that considerations of future risk of default and foreclosure mattered somewhat less when taking steps to achieve that aim.[708] The undersigned need not share this perspective to recognize it as broadly reasonable. As with the Capital Raise Loans, one may conclude that Respondents genuinely believed they were acting in the Bank's interests, rather than with willful disregard for its safety and soundness, in pursuing a

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[704] *See* Chansen Tr. 1295:15-22.

[705] *See* Part VI.D.2 *supra* at 50-51; *see also*, *e.g.*, Leal Tr. 2286:12-17 ("[A]t that point in time, nobody—and I mean no banks out there were providing financing for other banks' repossessions. We had no choice. We had to finance our own repossessions because nobody—no other bank was doing that.").

[706] *See* Part VI.D.2 *supra* at 53-54; *see also* JX 2 (2009 ROE) at 24 ("To combat the effects of OREO holding costs, management is aggressively marketing OREO through innovative lending programs."); JX 3 (2010 ROE) at 33 ("Management has been able to sell OREO properties, but has had to finance these sales.").

[707] Chansen Tr. 1297:3-4; *see id.* at 1297:14-18 ("In fact, there should be more scrutiny to these types of loans. Again, because it's a nonperforming asset so it carries a higher degree of risk by putting it back on the books.").

[708] *See* Ortega Tr. 616:1-617:25 (stating that the Bank was "more flexible" with its OREO underwriting in 2010 because there were "no banks that [were] willing to finance another bank's ORE" and the Bank "needed to take this big piece of property and get it in somebody else's hands versus us carrying it and paying for taxes and paying for expenses to maintain it").

goal that was necessary for the Bank's short-term and long-term health, but did so in a manner that was imprudent and that foreseeably increased risk to the Bank. Such is the case here.

Nor, for the same reasons, does Respondents' conduct constitute continuing disregard. Enforcement Counsel argues that Respondents "demonstrated a heedless indifference to the prospective consequences" of "their aggressive efforts to sell OREO without recognizing losses on the sales,"[709] but there is substantial evidence that the OREO lending strategy was undertaken, even if misguidedly in the details, with the Bank's well-being firmly in mind. Overall, Enforcement Counsel has not proven that Respondents showed "a degree of culpability well beyond mere negligence" in their actions relating to the sale of OREO during the relevant period,[710] and the culpability element of Section 1818(e) has therefore not been satisfied.

5. Section 1818(i)

The undersigned has concluded that Respondents breached their fiduciary duty of care and caused more than minimal loss to the Bank in connection with the OREO lending claims. As a result, the elements for the assessment of a second-tier civil money penalty under 12 U.S.C. § 1818(i) have been met, and it is not necessary to further resolve whether Respondents' actions meet the standard for reckless engagement of unsafe or unsound practices or whether their misconduct constituted a pattern of misconduct, as Enforcement Counsel also contends.[711]

C. Nonaccrual Loan Accounting

Enforcement Counsel argues that Respondents' failure to correct the Bank's improper blanket recognition of interest income on nonaccrual loans (Article V) resulted in the Bank filing materially inaccurate Call Reports that overstated the Bank's regulatory capital and masked its

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[709] EC Br. at 74.
[710] *Faigin and Lannan*, 2015 WL 9855325, at *83 (internal quotation marks and citation omitted).
[711] *See* EC Br. at 75-77.

financial condition, thereby violating 12 U.S.C. § 161(a), breaching Respondents' fiduciary duties of care, and constituting actionably unsafe or unsound banking practices.[712] Enforcement Counsel also contends that this misconduct prejudiced the interests of Bank depositors and involved a willful or continuing disregard for the Bank's safety and soundness on the part of Respondents.[713] Finally, Enforcement Counsel asserts that the elements for a first- and second-tier civil money penalty have been met as to Respondent Ortega in connection with the nonaccrual loan accounting claims.[714] The undersigned concludes that Enforcement Counsel has not met its burden regarding depositor prejudice, but agrees in all other respects.

1. Violation of 12 U.S.C. § 161(a)

Under the National Bank Act, banks are required "to file periodic call reports with the OCC that describe the bank's financial condition, including the value of its assets and liabilities."[715] These call reports "must accurately reflect the capital of the bank," among other things, and any "bank officer who signs off on the report must attest that the report is true and correct to the best of his knowledge and belief."[716] Call reports must be prepared in accordance with GAAP and the Call Report Instructions,[717] and it is well-settled that the filing of materially inaccurate call reports can give rise to a violation of 12 U.S.C. § 161(a).[718] The statute, however, does not impose strict

[712] *See* EC Br. at 78-80, 92-103.
[713] *See id.* at 103-109.
[714] *See id.* at 109-112.
[715] *Blanton*, 909 F.3d at 1174.
[716] *Id.* (internal quotation marks and citations omitted); *see also* 12 U.S.C. § 161(a); 12 C.F.R. § 304.3(a) ("All assets and liabilities, including contingent assets and liabilities, must be reported in, or otherwise taken into account in the preparation of, the Call Report.").
[717] *See* 12 U.S.C. § 1831n(2)(A) (providing that "the accounting principles applicable to reports or statements required to be filed with Federal banking agencies by all insured depository institutions shall be uniform and consistent with generally accepted accounting principles"); 12 C.F.R. § 304.3(a) (call reports must be filed in accordance with call report instructions).
[718] *See Blanton*, 909 F.3d at 1174; *Yates v. Jones Nat'l Bank*, 206 U.S. 158, 176-77 (1907).

liability on the signing officials, and a signatory "does not violate the law if she reasonably believes in the reports' accuracy, even if the reports later prove inaccurate."[719]

Enforcement Counsel asserts that the Bank filed materially inaccurate Call Reports from June 30, 2009 through December 31, 2012 as a result of its inappropriate recognition of interest income on nonaccrual loans on a blanket basis without documentation or justification, thus improperly overstating the Bank's earnings and capital for those periods.[720] Enforcement Counsel further argues that Respondents, who signed several of the Call Reports in question,[721] did not have a reasonable basis to believe in the accuracy of the Bank's nonaccrual loan accounting, given repeated warnings from the OCC and the Bank's internal auditor that treating all nonaccrual loans on a cash basis as a general rule did not comply with the Call Report Instructions, thus violating 12 U.S.C. § 161(a).[722] The undersigned agrees with Enforcement Counsel.

Inaccuracy

It is beyond dispute that the Bank's practice of automatically recognizing interest income on loans that have been placed on nonaccrual status—without a determination of full collectability supported by "a current, well documented credit evaluation"—is contrary to the Call Report

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[719] *Blanton*, 909 F.3d at 1174 (internal quotation marks and citation omitted).

[720] *See* EC Br. at 99 ("The Bank offered no corrections to its earlier-filed Call Reports until it filed the amended Call Report for the period ending December 30, 2012—and even that was only a partial correction to eliminate the improper accounting for nonaccrual loans.").

[721] *See* EPF ¶¶ 604, 607-608. Specifically, Respondent Rogers signed the June 30, 2009 Call Report (EX 367), Respondent Ortega signed the September 30, 2011 and June 30, 2012 Call Reports (EX 370, EX 371), and both Respondents signed the Call Reports for the periods ending September 30, 2009 and September 30, 2010 (EX 368, EX 369), attesting to the truth and accuracy of the Call Reports' disclosures in each instance. Enforcement Counsel also argues that Respondents brought about the Bank's violation of 12 U.S.C. § 161(a) as to other Call Reports during this period even when they were not signatories, given that "the final responsibility for ensuring the accuracy of the Bank's accounting rested squarely with them as directors and officers of the Bank." EC Reply at 20; *see* EC Br. at 80. Because the undersigned concludes that Respondents violated 12 U.S.C. § 161(a) with respect to the Call Reports that bear their signature, it is unnecessary to address the extent to which a bank official who has not attested to the truth and accuracy of a Call Report can violate the statute.

[722] *See* EC Br. at 79-80, 92-95.

Instructions and to GAAP.[723] Cost recovery accounting is the "general rule" for nonaccrual loans, but the Bank employed a default setting in which all nonaccrual loans were accounted for on a cash basis, thus allowing the Bank to recognize interest income on them, regardless of whether the Bank had performed the required analysis to determine that the loans were fully collectible.[724] Any Call Reports that reflected this practice in their reported interest income, as Enforcement Counsel uncontestedly claims that all of the Bank Call Reports did during the relevant period, are therefore inarguably inaccurate.[725]

Respondents' arguments to the contrary are largely smokescreens.[726] First, Respondents contend that the Bank's nonaccrual loan accounting was not improper because the Bank took the "sound, conservative approach" of placing all loans on nonaccrual status once they became 90 days delinquent, then leaving it to the loan department "to further downgrade the loan if necessary, based on their expertise."[727] As Enforcement Counsel notes, however, "the question of *whether* a loan should be placed on nonaccrual status in the first place is separate from the question of, once a loan is *on* nonaccrual status, how a bank must account for interest on that loan and what a bank must do to support its accounting choice."[728]

Second, Respondents assert that the Bank was entitled to use cash basis accounting on nonaccrual loans when the loans are "fully secured with solid appraisals," as Respondents aver that the loans were here.[729] But putting aside the fact that Respondents never offered evidence of

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[723] EX 359 (June 2009 Call Report Instructions) at 455; *see* Part VI.E.1 *supra* at 77-79.

[724] EX 359 (June 2009 Call Report Instructions) at 453; *see id.* at 454 ("When doubt exists as to the collectability of the remaining recorded investment in an asset in nonaccrual status, any payments received must be applied to reduce the recorded investment in the asset to the extent necessary to eliminate such doubt.").

[725] *See* EC Br. at 94-95.

[726] *See* Rs Br. at 49-51; Rs Reply at 32-33.

[727] Rs Br. at 50.

[728] EC Reply at 18 (emphases in original).

[729] Rs Br. at 51.

these appraisals, they misstate the standard: banks may not accrue interest on loans in nonaccrual status unless the loans are "*both* well secured *and* in the process of collection,"[730] and Respondents offer no reason why loans that are ***by definition*** delinquent for 90 days or more when first placed on nonaccrual status should be considered to fit these categories by default.[731] An appraisal may well be "documentation that could support a loan's repayment," as Respondents claim,[732] but it does not constitute a "current, well documented credit evaluation," whether or not the loan is fully secured, and it is insufficient to justify the use of cash basis accounting on loans that have been placed on nonaccrual.[733]

Finally, Respondents argue that Enforcement Counsel "failed to present evidence at trial that the loans were not fully secured or that the appraisals were flawed."[734] This too is wrong. To the extent that it was Enforcement Counsel's burden to show that interest income was being improperly recognized on specific loans, it met this burden comfortably with the evidence that (1) the Bank automatically treated nonaccrual loans using cash basis accounting, contrary to GAAP and the Call Report Instructions; (2) "[n]either the Bank's accounting system, nor Bank policy or practice, required Bank personnel to undertake the steps required by the Call Report Instructions" before a nonaccrual loan could be treated as cash basis;[735] and (3) fifteen of the sixteen nonaccrual loans sampled for review during the OCC's March 2013 targeted examination of the Bank lacked any documentation at all to support their cash basis accounting treatment, while the final sample loan "had some support based on loan file information, but no supporting

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[730] EX 359 (June 2009 Call Report Instructions) at 453 (emphases in original).

[731] *See id.* (stating that "[a]n asset is 'in the process of collection' if collection of the asset is proceeding in due course" through legal action or other collection efforts "which are reasonably expected to result in repayment of the debt or in its restoration to a current status in the near future").

[732] Rs Br. at 51.

[733] EX 359 (June 2009 Call Report Instructions) at 455.

[734] Rs Br. at 51.

[735] EC Br. at 92.

documentation by management was available or performed."[736] The undersigned agrees with Enforcement Counsel that "[w]ithout the documented analysis for each nonaccrual loan, the Bank improperly accrued interest, and recognized interest income, on nonaccrual loans from 2009 through early 2013."[737]

Materiality

The undersigned also concludes that the inaccuracies in the Call Reports regarding improper interest income recognition on nonaccrual loans were material. The Call Report Instructions at the time defined materiality as "the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement."[738] The Instructions further noted that "[g]uidance on the consideration of all relevant factors when assessing the materiality of misstatements" could be found in SEC Accounting Bulletin No. 99, *Materiality* ("SAB 99").[739]

Among other things, SAB 99 provides that materiality assessments are matters of both "quantitative and qualitative considerations," and that the interaction between the two may make even "misstatements of relatively small amounts" material in certain circumstances.[740] Such qualitative considerations that "may well render material a quantitatively small misstatement of a financial statement item" include "whether the misstatement masks a change in earnings or other trends"; "whether the misstatement changes a loss into income or vice versa"; and "whether the

[736] JX 7 (2013 Target ROE) at 6 (noting that of the 400 nonaccrual loans on the Bank's books at that time, all but two were being accounted for using the cash basis method).
[737] EC Br. at 93.
[738] EX 359 (June 2009 Call Report Instructions) at 12 (quoting Financial Accounting Standards Board ("FASB") Concepts No. 2); *see also* EX 363 (Salvato Report) ¶ 59 n.3).
[739] EX 359 (June 2009 Call Report Instructions) at 380; *see also* SAB 99, 1999 WL 1123073 (Aug. 12, 1999).
[740] SAB 99, 1999 WL 1123073, at *3; *see also* EX 363 (Salvato Report) ¶ 60.

misstatement affects [] compliance with regulatory requirements."[741] The guidance also states that "[i]n determining whether multiple misstatements cause the financial statements to be materially misstated, registrants and the auditors of their financial statements should consider each misstatement separately and the aggregate effect of all misstatements."[742] It notes that "[e]ven though a misstatement of an individual amount may not cause the financial statements taken as a whole to be materially misstated, it may nonetheless, when aggregated with other misstatements, render the financial statements taken as a whole to be materially misleading."[743]

Here, Enforcement Counsel's accounting expert opined that the combined effect of the accounting errors alleged in the Notice—that is, the Bank's accounting practices with respect to nonaccrual loans, the Capital Raise Loans, and OREO lending—caused the Call Reports during this period to materially overstate the Bank's capital.[744] This opinion, however, is based on facts that Enforcement Counsel has not proven—namely, that the Capital Raise Loans caused the Bank's capital to be overstated by $17.3 million, and not $3 million or some figure in-between.[745] Enforcement Counsel states that "[e]ach overstatement [from September 30, 2012 through June 30, 2013] was quantitatively material because it overstated the Bank's capital by more than 10 percent,"[746] but this calculation depends on that $17.3 million figure being accurate. Ms. Salvato's

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[741] SAB 99, 1999 WL 1123073, at **3-4.

[742] *Id.* at *5.

[743] *Id.*

[744] *See* EX 363 (Salvato Report) ¶ 64 ("The nature and magnitude of the Bank's capital overstatement from the combined accounting errors is material because Call Report users may formulate decisions on the basis of that information. These material inaccuracies misrepresented the true financial condition of the Bank."); *see also* EC Br. at 97 (stating that "[t]he combined effect of the improper accounting practices . . . caused a material overstatement of the Bank's capital").

[745] *See* Part VI.C.6 *supra* at 34-42. This means that the totals used by Ms. Salvato as the amounts by which the Bank's capital was overstated at different periods, which form the basis of her materiality determinations, are not reliable. *See* EX 363 (Salvato Report) ¶¶ 61 (stating that the Bank's capital was overstated "by at least $42 million" as of April 2013), 62 (stating that "[t]he December 31, 2012 Call Report as originally filed overstated capital by $38.4 million"), 63 (stating that the June 30, 2013 Call Report reflected an overstatement of capital of "at least $26.8 million" related to the Capital Raise Loans and OREO lending).

[746] EC Br. at 97.

conclusion that the Bank would have been "critically undercapitalized" in December 2012 had its capital levels been reported accurately is likewise premised on that assumption.[747]

Further, Ms. Salvato never opines on the materiality of the misstatements attributable to the improper nonaccrual loan accounting standing alone.[748] Nor does Enforcement Counsel present any evidence on the amount by which the Bank's capital was overstated due to interest income recognition on nonaccrual loans in 2009 and 2010; there is evidence that nonaccrual loan accounting caused an overstatement of $1.4 million in 2011, $9.8 million in 2012, and $3.6 million in the first quarter of 2013 before the issue was corrected, but nothing from prior years.[749] For these reasons, the undersigned cannot make a determination of materiality as to the nonaccrual loan accounting based on a purely quantitative assessment.

Nevertheless, the undersigned finds that the overstatement of interest income due to improper nonaccrual loan accounting was material in a qualitative sense.[750] The nature of the misstatement is such that it implicates multiple of the considerations identified in SAB 99, including whether the misstatement affects compliance with regulatory requirements (it does) and whether it "masks a change in earnings" or "changes a loss into income."[751] For years, the Bank was recognizing interest income on all of its nonaccrual loans despite not being permitted to do so by the applicable guidance. A reasonable person relying on the Bank's Call Reports over this time

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[747] EX 363 (Salvato Report) ¶ 65.

[748] *See id.* ¶¶ 48-65.

[749] *See id.* ¶ 53.

[750] Respondents argue that the nonaccrual loan accounting was immaterial "[b]y the OCC's own admission," Rs Br. at 53, citing a March 2014 internal OCC email stating that "the 'Nonaccrual Issue' . . . had no impact on the type or timing of any enforcement action nor any impact on the eventual timing of the bank's close." RX 52 (email chain including March 25, 2014 email from H. Thompson to R. Chansen et al.). This argument fails because, as Enforcement Counsel states, "a Call Report violation may be material for financial reporting purposes even if it would not have had a significant impact on a bank's ratings or enforcement actions." EC Reply at 20.

[751] SAB 99, 1999 WL 1123073, at **3-4. Certain of the other considerations listed, such as "whether the misstatement arises from an item capable of precise measurement" and whether it "concerns a segment or other portion of the registrant's business that has been identified as playing a significant role in the registrant's operations or profitability," are also pertinent. *Id.* at *3.

would have had a misleadingly high impression of how many loans in the Bank's portfolio it deemed to be fully collectible, in a financial climate where loan defaults and delinquencies were causing banks to fail. This, in turn, could reasonably create a misleading impression of the Bank's financial condition. There is a material difference between the way in which the Bank recognized its interest income and the way it would have done had it adhered to GAAP and the Call Report Instructions and applied cost recovery for all nonaccrual loans as a default.

Reasonable Belief

Respondents were repeatedly put on notice that the Bank's method of accounting for nonaccrual loans was inappropriate; therefore, they could not have reasonably believed in the accuracy of the interest income recognized in the Call Reports.[752] Respondents argue that "[w]hen cash basis accounting was brought up in 2009, the documents and testimony showed that the Bank addressed the matter and there was no reason for Mr. Ortega, Mr. Rogers, or any board member to believe otherwise."[753] Even if this were true in March 2009, however, when Mr. Leal (incorrectly) represented to the Board that the Bank's nonaccrual loan policy "had been modified to include the accounting requirements specified in the Call Report Instructions,"[754] it was no longer true as soon as the Bank's Chief Audit Officer warned Bank management that summer that the "use of the cash basis of accounting on all nonaccrual loans" was unsatisfactory and that the Bank was improperly recognizing interest income without the required supporting documentation.[755] Yet Respondents attested to the truth and accuracy of Call Reports for the periods ending September 30, 2009 and September 30, 2010 that continued to use cash basis for nonaccrual loans.

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[752] *See* EC Br. at 92-95.

[753] Rs Br. at 51.

[754] EX 319 (March 3, 2009 Board meeting minutes) at 1; *see* Part VI.E.3 *supra* at 81-82.

[755] EX 321 (June 2009 nonaccrual review memo) at 4; *see also id.* at 5 ("Through discussion with management, we note that *all* non-accrual loans are on the cash basis of income recognition; and, are not supported by documentation.") (emphasis in original).

Similarly, the OCC made it clear in 2011 and 2012 that the Bank needed to "reverse or charge off all interest that has been accrued contrary to the requirements contained in the [Call Report Instructions] governing nonaccrual loans" and to "ensure the Bank's adherence to written policies and procedures governing the supervision and control of nonaccrual loans . . . consistent with the accounting requirements contained in the Call Report Instructions"—the very same issues that the agency had flagged several years earlier in its 2009 MOU.[756] Again Respondents took no steps to ensure that the Bank addressed these concerns,[757] and again Respondent Ortega signed multiple Call Reports attesting to the accuracy of the Bank's nonaccrual loan accounting before the Bank finally changed its accounting system settings in the spring of 2013.[758]

All in all, the nonaccrual loan accounting issue was raised with Bank senior management three times by the Bank's Chief Audit Officer (in June 2009, October 2012, and December 2012) and three times by the OCC (in January 2009, February 2011, and January 2012). Mr. Garcia in particular sounded the alarm to Respondents on multiple occasions that the Call Report Instructions required supporting documentation before interest income could be recognized on nonaccrual loans and that the Bank was not in compliance.[759] As a result, Respondents "cannot have had a reasonable belief in the accuracy of the Bank's Call Reports with respect to the Bank's use of cash basis income recognition for nonaccrual loans,"[760] and the undersigned finds that Enforcement Counsel has proven that Respondents violated 12 U.S.C. § 161(a).

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[756] JX 12 (February 2011 Consent Order) at 12; JX 13 (January 2012 Consent Order) at 16.

[757] *See* Part VI.E.4 *supra* at 84-85.

[758] *See* EX 370 (September 30, 2011 Call Report); EX 371 (June 30, 2012 Call Report).

[759] *See* EX 321 (June 2009 nonaccrual review memo) at 5; EX 323 (email chain including October 23, 2012 email from J. Garcia to M. Magee et al., forwarded to S. Ortega) ("What documentation will I find in the file to support the cash basis of accounting? . . . I was informed by Loan Administration that all nonaccrual loans that are paying are on the cash basis – is this correct?"); EX 325 (December 17, 2012 Board and MOU Committee meeting minutes) at 1 ("Mr. Garcia noted that the Audit department found Loan Review, Credit Review, and Special Assets write-ups did not include documentation supporting for income recognition on a cash basis.").

[760] EC Br. at 95.

2. Breach of Fiduciary Duty

Respondents' failure to address the Bank's improper nonaccrual loan accounting from 2009 through 2012[761] also breached their fiduciary duty of care. As bank officers and directors, Respondents had the duty to ensure that the Bank complied with applicable statutory and regulatory requirements, including ensuring that the Bank's Call Reports were prepared in accordance with GAAP.[762] The undersigned agrees with Enforcement Counsel that Respondents further had the duty "to promptly address regulator and internal audit warnings about improper accounting practices."[763] As shown above, Respondents did not do so, instead permitting the Bank—over the course of several years—to apply a default accounting method to its nonaccrual loans that they knew or should have known would result in improperly recognized interest income and misstated Call Reports. This did not demonstrate "constant concern for the safety and soundness of the Bank,"[764] and it is not what an ordinarily prudent person, acting diligently and carefully, would have done in those circumstances.[765]

3. Unsafe or Unsound Practices

The federal banking agencies have held that "[f]iduciary duties define standards of prudent operation[,] and thus an act in violation of such duties is by its nature imprudent and unsafe."[766] To whatever extent those standards are not coextensive here, the undersigned finds it unnecessary to determine whether Respondents' failure to ensure that the Bank corrected its improper

[761] Or, in Respondent Rogers's case, through his departure from the Bank in November 2011.

[762] *See Ellsworth*, 2016 WL 11597958, at *15.

[763] EC Br. at 101; *see Brickner v. FDIC*, 747 F.2d 1198, 1202 (8th Cir. 1984) (finding that regulator warnings "should have led to greatly increased vigilance by [bank officer] petitioners over the Bank's lending practices").

[764] *Conover*, 2016 WL 10822038, at *19 (internal quotation marks and citation omitted).

[765] *See Watkins*, 2019 WL 6700075, at *7; *Michael*, 687 F.3d at 350-51.

[766] *Smith and Kiolbasa*, 2021 WL 1590337, at *24; *see also In the Matter of Michael D. Landry and Alton B. Lewis*, No. FDIC-95-65e, 1999 WL 440608, at *15 (May 25, 1999) (FDIC final decision) (holding that "[a] breach of fiduciary duty by a director or officer to the Bank is *per se* unsafe and unsound"), *aff'd on other grounds sub nom. Landry v. FDIC*, 204 F.3d 1125, 1138 (D.C. Cir. 2000).

nonaccrual loan accounting practices caused "a reasonably foreseeable undue risk to the institution,"[767] given the clear evidence that Respondents' conduct constituted a violation of 12 U.S.C. § 161(a) and a breach of their fiduciary duty, as detailed above.

4. Effect

Enforcement Counsel argues that Respondents' misconduct with respect to the Bank's nonaccrual loan accounting prejudiced the interests of the Bank's depositors, thus satisfying the effect element of 12 U.S.C. § 1818(e).[768] The undersigned concludes that Enforcement Counsel has not met its burden in this regard.

First, Enforcement Counsel contends that "Respondents' failure to cause the Bank to file materially accurate Call Reports, over time, delayed statutorily required prompt corrective action."[769] According to Enforcement Counsel, "[b]ecause this material overstatement of the Bank's regulatory capital masked the true financial condition of the Bank, examiners did not have critical information that would otherwise have led them to escalate or accelerate enforcement action with respect to the Bank's capital to protect the Deposit Insurance Fund"[770]—thus, in some way, prejudicing the Bank's depositors.[771] This contention, however, is directly contradicted by the internal OCC email on March 25, 2014 stating unequivocally that "the 'Nonaccrual Issue' and 'OREO MRA Issue' *had no impact on the type or timing of any enforcement action* nor any impact

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767 *Patrick Adams*, 2014 WL 8735096, at *5.

768 *See* EC Br. at 106-109. Enforcement Counsel makes this same argument as to the allegedly improper accounting practices relating to the Capital Raise Loans and the Bank's OREO lending, which are discussed in the appropriate sections below.

769 *Id.* at 108.

770 EPF ¶ 605; *see* EC Br. at 107 (asserting that "Respondents avoided alerting the OCC that the Bank lacked sufficient capital to survive a potential liquidity crisis") (internal quotation marks and citation omitted).

771 The undersigned notes that to the extent that Enforcement Counsel uses loss to the Deposit Insurance Fund as a proxy for depositor prejudice, *see also* EC Br. at 108-109, it offers no reason for this, nor does it explain its assertion that the Bank failing in September 2013 rather than six months earlier "increased the long-term losses to the Deposit Insurance Fund." *Id.* at 109.

on the eventual timing of the bank's close."[772] By March 2014, the agency understood the full scope of the Bank's misconduct with regard to nonaccrual loan accounting, having discovered that virtually all of the Bank's nonaccrual loans were being treated on a cash basis without justification a year earlier and directed the Bank to reverse the improperly accrued interest and change its practices;[773] there is no allegation that additional nonaccrual-related misconduct only came to light after the date of this email. The undersigned therefore credits the representation made in this email and finds that, although the nonaccrual loan accounting issue was material for Call Report purposes,[774] it "had no impact on the type or timing of any enforcement action"—and thus any argument that the OCC would have acted more quickly had it known sooner that the Bank was improperly recognizing interest income on nonaccrual loans must fail.

Nor does Enforcement Counsel's citation to the D.C. Circuit's *Dodge* decision change matters.[775] In that case, the D.C. Circuit held that the respondent had overstated the bank's capital to make it appear well-capitalized when it was actually critically undercapitalized, and that "[t]he potential liquidity crisis" caused by the Bank's deceptively low capital levels "could have prejudiced depositors by compromising the Bank's ability to meet its obligations to them."[776] But Enforcement Counsel has not presented evidence that the improperly recognized interest income masked a potential liquidity crisis—which makes sense, given the OCC's internal conclusion that the nonaccrual accounting issue would not have led to enforcement action.[777] While Ms. Salvato

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[772] RX 52 (email chain including March 25, 2014 email from H. Thompson to R. Chansen et al.) (emphasis added).

[773] *See* JX 7 (2013 Target ROE) at 6 (noting that "the software supporting the Bank's financial records automatically accounts for cash basis nonaccrual, not the standard cost recovery method" and finding that all but two of the 400 nonaccrual loans then on the Bank's books were being accounted for using cash basis); EX 328 (email chain including April 3, 2013 email from B. Staley to K. Doyle and C. Neal) at 2 ("Management apparently has been automatically placing loans designated as NA on a cash basis forever.").

[774] *See* Part VII.C.1 *supra* at 157-160.

[775] *See* EC Br. at 107.

[776] *Dodge*, 744 F.3d at 158.

[777] *See* RX 52 (email chain including March 25, 2014 email from H. Thompson to R. Chansen et al.).

does opine that the Bank would have been "critically undercapitalized" as of December 31, 2012 had the overstatement of capital from the nonaccrual loan accounting, Capital Raise Loans, and OREO lending all been corrected, this calculation is based on a $17.3 million overstatement relating to the Capital Raise Loans that Enforcement Counsel simply has not shown.[778]

Second, it is Enforcement Counsel's position that the improper recognition of interest income on nonaccrual loans, and the overstatement of Bank capital due to improper accounting generally, prejudiced depositors by "preventing [them] from making an informed decision about where to maintain their deposits."[779] In support of this argument, Enforcement Counsel cites to a decision by the Office of Thrift Supervision for the proposition that it is prejudicial to depositors to avoid providing them "with information that might 'persuade a depositor that his or her funds were subject to a substantial risk.'"[780] But the *Cousin* decision cited by Enforcement Counsel says the opposite, if anything: it holds that "conduct that injures the reputation of the institution or *otherwise would persuade a depositor that his or her funds were subject to a substantial risk*" is prejudicial to depositors.[781] The Second Circuit's affirmance in that case underlined this reasoning, finding depositor prejudice where the respondent's "illegality could potentially injure depositor confidence in [the bank] and lead to an exodus of depositors."[782]

Here, by contrast, loss of depositor confidence and an "exodus of depositors" appear to be what Enforcement Counsel believes should have happened, given its claim that depositors were prejudiced by not having information that would make them want to withdraw their funds.

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[778] *See* Part VI.C.6 *supra* at 34-42; *see also* RX 41 (email chain including March 28, 2014 email from B. Paulson to R. Chansen et al.) (internal OCC email stating that "we have not proven that the source of funds for the holding company capital injection was in fact loans from FNB").

[779] EC Br. at 106.

[780] *Id.* at 107 (quoting *In the Matter of Michael Cousin* ("*Michael Cousin*"), No. AP-94-48, 1994 WL 621240, at *15 (Oct. 11, 1994) (OTS final decision), *aff'd sub nom. Cousin v. OTS*, 73 F.3d 1242 (2d Cir. 1996)).

[781] *Michael Cousin*, 1994 WL 621240, at *15 (emphasis added).

[782] *Cousin*, 73 F.3d at 1252.

Enforcement Counsel offers no support for the novel theory that the interests of Bank depositors would have been better served had the Bank failed sooner than it did.[783] Indeed, although it in no way justifies Respondents' misconduct, there is some uncontroverted evidence that depositors benefited by the Bank staying open long enough for the FDIC to find an acquiring institution and ensure that Bank services continued to operate without interruption.[784]

Not every misstatement within a bank's accounting will prejudice its depositors, even if it is qualitatively material. Rather, the scale of the improper accounting must meet some threshold past which bank depositors are detrimentally being deprived of information or the bank itself and its deposits are being put at risk. The undersigned cannot conclude that this threshold has been met when the agency's own conclusion was that the nonaccrual accounting issue "had no impact on the type or timing of any enforcement action"—surely any overstatement of interest income serious enough to influence depositors to believe that their money was no longer safe at the Bank would also be sufficient impetus for prompt action by the OCC, and yet no such action was apparently warranted. The undersigned therefore concludes that Enforcement Counsel has not demonstrated that the Bank's improper recognition of interest income on nonaccrual loans prejudiced the Bank's depositors, and the effect element of Section 1818(e) in connection with Article V of the Notice has consequently not been satisfied.

5. Culpability

Enforcement Counsel argues that Respondents' conduct in connection with the nonaccrual loan accounting issue evinced willful or continuing disregard for the Bank's safety and

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[783] *See* EC Br. at 108-109 (arguing that the Bank should have been placed into receivership six months sooner).

[784] *See* Part VI.G *supra* at 106-107; *see also* Leal Tr. 2278:16-25 (recalling FDIC examiners telling him in the spring of 2013, "[Y]ou're doing the right thing, just keep doing it. Keep it together. Give us enough time. You know, the best result would be [] that we find somebody that buys the bank. You know, you don't want depositors to lose their money."), 2279:2-4 ("At that point, we knew we could not save the bank. It was just about giving the FDIC enough time.").

soundness.[785] The undersigned agrees.

Respondents' failure to correct the Bank's improper blanket use of cash basis accounting without justification on nonaccrual loans, over the course of years and despite multiple warnings from OCC examiners and the Bank's internal auditor, represents, at minimum, continuing disregard for the safety and soundness of the Bank. Respondents were on notice that, under the Call Report Instructions, interest income could only be recognized on nonaccrual loans if there was no longer any doubt about the loans' full collectability—a finding that must be made on a loan by loan basis and "supported by a current, well documented credit evaluation" in each case.[786] Respondents also knew or should have known that the default setting of the Bank's accounting system had been changed to automatically recognize interest income on all loans that were placed on nonaccrual, without any requirement for documentation.[787] Yet Respondents took no steps to remedy this situation or bring the Bank's nonaccrual accounting practices into compliance with the Call Report Instructions from 2009 through late 2012,[788] during which time they signed multiple Call Reports attesting to the accuracy of the interest income recognized by the Bank in that period. This shows, at the very least, that Respondents knew about and failed to correct ongoing practices that were clearly imprudent, over a lengthy period of time, and "with heedless indifference to the prospective consequences," all hallmarks of continuing disregard. The culpability element of Section 1818(e) is therefore satisfied as to the agency's nonaccrual accounting claims.[789]

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[785] *See* EC Br. at 103-106.

[786] EX 359 (June 2009 Call Report Instructions) at 455; *see also*, *e.g.*, EX 354 (March 2012 Call Report Instructions) at 545 (same).

[787] *See* Part VI.E.2 *supra* at 79-80.

[788] *See* EPF ¶ 25 (noting that "[a]s CFO, Respondent Ortega was responsible for financial reporting, accounting, the Bank's books and records, and computer information systems").

[789] Because it is unnecessary to determine whether Respondents' conduct in connection with the nonaccrual loan accounting constituted unsafe or unsound banking practices, *see supra* at 162-163, and because the culpability

Respondents make several arguments in response, the bulk of which have been addressed in the misconduct analysis *supra*—it is demonstrably untrue, for example, that "[e]xtensive evidence showed that Respondents were reassured that [the nonaccrual accounting] issue was being handled."[790] Nor does it matter that Respondents were not the ones responsible for grading the nonaccrual loans;[791] they knew that the Bank's nonaccrual accounting practices did not comply with the Call Report Instructions, they were in a position to seek to remedy that noncompliance at any point over a long period of time, and they did not do so. Further, while Respondent Ortega did eventually take remedial steps to address the concerns of the OCC and his Chief Audit Officer,[792] this does not make up for his failure to do so from 2009 through sometime in 2012.

Respondents also invoke the financial crisis in contesting their culpability, arguing that their "state of mind was not characterized by culpable intent but by the untenable position reactive to the extraordinary and unprecedented situation created by the Fannie Mae debacle."[793] This argument holds no water. Unlike with the Capital Raise Loans and the Bank's self-financed OREO sales, there was no exigent circumstance here that Respondents were seeking to navigate as best they could in the interests of the Bank. Rather, the Bank had a longstanding practice of recognizing interest income on all nonaccrual loans by default that Respondents knew or should have known contradicted the BAAS and the Call Report Instructions.[794] They could have changed it, but they did not—by all accounts because it was the Bank's policy to recognize as much nonaccrual interest

element has been satisfied here in any event, the undersigned finds that it is similarly unnecessary to decide whether Respondents acted with willful disregard for the Bank's safety and soundness, which incorporates a determination of unsafe or unsound conduct into its own standard.

[790] Rs Br. at 54.

[791] *See id.*; Rs Reply at 34.

[792] *See* Rs Br. at 52-53; Rs Reply at 35.

[793] Rs Br. at 54 (also asserting that "[t]he only motive or intent by the Respondents was to try and cope with the banking crisis – not to engage in misconduct").

[794] *See* Part VI.E.2 *supra* at 79-81.

income as possible.[795] This has nothing to do with the stresses and pressures and difficult choices engendered by the global financial crisis. Moreover, although Enforcement Counsel does not allege personal dishonesty in connection with the nonaccrual loan accounting, there is some evidence that Respondent Ortega sought to mislead NBE Chansen on the issue in 2013 by telling her "that the JH Silverlake system would not allow the bank to process [nonaccruals] other than on a cash basis," something he should have known was inaccurate.[796] In short, while the impact of the financial crisis and the Fannie and Freddie losses on the Bank is context that must be considered with respect to certain other claims against Respondents (and their state of mind), Respondents have made no showing that it is relevant here.

6. Section 1818(i)

Enforcement Counsel asserts that Respondent Ortega should be assessed a first- and second-tier civil money penalty on the basis of his misconduct relating to the nonaccrual loan accounting.[797] The undersigned agrees that the statutory elements have been met. Respondent Ortega violated 12 U.S.C. § 161(a) by causing the Bank to file materially misstated Call Reports, which satisfies the requirement for a first-tier civil money penalty and the misconduct element of a second-tier civil money penalty.[798] Respondent Ortega's breach of his fiduciary duty of care in

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[795] *See* EX 319 (2009 nonaccrual policy) at 11 ("It is FNB's intent to utilize cash basis nonaccrual accounting whenever it is applicable."); EX 328 (email chain including April 3, 2013 email from B. Staley to K. Doyle and C. Neal) ("Found out that when they converted to Jack Henry from ITI four or five years ago, Jack Henry's default was NA where all payments went to the principal balance. However, senior management at the time wanted the default to be cash basis NA where cash payments were going to principal and income. They had Jack Henry change the default.").

[796] EX 328 (email chain including April 3, 2013 email from R. Chansen to K. Alderson) at 3.

[797] *See* EC Br. at 109-112.

[798] *See* 12 U.S.C. §§ 1818(i)(2)(A)(i), 1818(i)(2)(B)(i)(I). Although the last Call Report alleged to have been signed by Respondent Ortega was submitted on July 30, 2012, *see* EX 371 (June 30, 2012 Call Report) at 1, more than five years prior to the commencement of this action, the undersigned agrees with Enforcement Counsel that "a capital overstatement in one Call Report carries through and continues in all subsequent Call Reports unless corrected," EC Br. at 110. Here, the Call Reports were not corrected, and the nonaccrual loan accounting practices were not addressed, until within the applicable limitations period, and the agency's 12 U.S.C. § 161(a) and breach of fiduciary duty claims were therefore timely asserted.

connection with this claim also suffices to justify a second-tier penalty.[799] In addition, the undersigned finds that Respondent Ortega's failure to address the Bank's improper nonaccrual loan accounting practices from 2009 through 2012, and his signing of multiple Call Reports during that time that he knew or should have known improperly recognized interest income on nonaccrual loans, constitutes a pattern of misconduct for purposes of Section 1818(i)'s second-tier "effect" element.[800] The undersigned will therefore recommend the assessment of first- and second-tier civil money penalties against Respondent Ortega with respect to Article V of the Notice.[801]

D. Other Accounting-Related Claims

Enforcement Counsel argues that the Bank's improper accounting in connection with the Capital Raise Loans and the sale of OREO during the relevant period also contributed to the material overstatement of capital on the Bank's Call Reports.[802] According to Enforcement Counsel, Respondents' failure to correct these practices, and their attestations as to the truth and accuracy of the materially misstated Call Reports, constituted violations of 12 U.S.C. § 161(a), breaches of their fiduciary duty of care, and unsafe or unsound banking practices that prejudiced depositors and for which Respondents demonstrated actionable culpability.[803] As with the nonaccrual loan accounting, Enforcement Counsel asserts that Respondent Ortega's misconduct in this regard merits the assessment of first- and second-tier civil money penalties.[804] The undersigned considers each aspect of these claims in turn, drawing upon the nonaccrual accounting

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[799] *See* 12 U.S.C. § 1818(i)(2)(B)(i)(III).

[800] *See id.* § 1818(i)(2)(B)(ii)(I); *see also* Part VI.E *supra* at 76-88.

[801] It is unnecessary to determine whether Respondent Ortega recklessly engaged in unsafe or unsound banking practices or violated the January 2012 Consent Order in connection with the Bank's nonaccrual loan accounting, as the misconduct element of Section 1818(i) has already been satisfied. *See* EC Br. at 109, 111-112.

[802] *See* EC Br. at 96-98.

[803] *See id.* at 80-92, 100-109.

[804] *See id.* at 109-112.

analysis above and the prior sections on the Capital Raise Loans and the Bank's OREO lending practices where appropriate.

1. Violation of 12 U.S.C. § 161(a)

It is Enforcement Counsel's position that the Bank's Call Reports from 2009 through 2013 were materially misstated as a result of improper accounting for the Capital Raise Loans and the sale of OREO and that Respondents would not have reasonably believed in the Call Reports' accuracy in this regard at the times they acted as signatories.[805]

With respect to the Capital Raise Loans, the undersigned agrees that the Call Reports overstated the Bank's regulatory capital to whatever extent proceeds of the Capital Raise Loans were downstreamed from the Holding Company during the two capital injections in 2009—an amount that the undersigned has found to be at least $3 million.[806] The undersigned also agrees that the overstatement of the Bank's Tier 1 regulatory capital on the Call Reports was qualitatively material for largely the same reasons as the overstatement of nonaccrual-related interest income discussed *supra*. And the undersigned finds that Respondents did not have a reasonable belief that Capital Raise Loan proceeds could properly be treated as "new" capital for the Bank, something both Respondents knew had happened to at least some degree.[807] Taken together, this is grounds for a finding that Respondents violated 12 U.S.C. § 161(a).

With respect to the OREO lending practices, it is not quite as straightforward, but the conclusion is the same. The undersigned has already credited the testimony of Enforcement

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[805] *See id.* at 80-85 (Capital Raise Loans), 85-92 (OREO).

[806] *See* Part VI.C.6 *supra* at 41-42.

[807] *See* Rogers Tr. 328:13-20 ("Q: You have indicated that the Board of Directors approved the plan to extend bank loans to investors to buy FNBG stock and then downstream those same funds back to the bank as Tier 1 capital, correct? A: [T]hat's basically what happened, yes, ma'am."); Ortega Tr. 493:15-17 ("I would say that some of the stock, some of those loans actually came back to the Bank."); EX 569 (Ortega Dep.) at 34:24-35:4 (agreeing that the Bank "[made] loans that the borrower would then use the proceeds of the loan to purchase stock in the bank holding company and the bank holding company would then downstream the funds back to [the Bank]").

Counsel's accounting expert and found that the Bank improperly accounted for its OREO sales over the relevant period by failing to discount loans with below-market interest rates to their present value of future cash flows, something that artificially overstated the Bank's earnings and its capital.[808] As with the nonaccrual loan accounting and the treatment of Capital Raise Loan proceeds as regulatory capital, this artificial overstatement was qualitatively material.

And while it is a closer call whether Respondents could have had a reasonable belief that the accounting for OREO sales was correct at the time they signed the Call Reports, given the volatility of the market and the subjectivity of market rates, the undersigned finds that the MRAs in 2009 and 2011,[809] in conjunction with the Bank's own Market Rate Matrix, should have alerted Respondents that the Bank was not sufficiently discounting its OREO loans based on present value calculations even after the "superficially corrective measures" taken by the Bank.[810] Thus, Respondent Ortega, at least, should have known that the Bank was still not accounting for below-market interest rates on OREO loans correctly when he attested to the opposite in the June 30, 2012 Call Report—and Enforcement Counsel amply describes why both Respondents should have known the OREO accounting was not correct during this period.[811]

2. <u>Breach of Fiduciary Duty and Unsafe or Unsound Practices</u>

Because the undersigned finds that Respondents violated 12 U.S.C. § 161(a) with respect to the Bank's Capital Raise Loan and OREO accounting practices, it is unnecessary to also decide

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[808] *See* Part VI.D.8 *supra* at 70-75.

[809] *See* JX 2 (2009 ROE) at 12 (finding that the Bank had failed "to properly account for OREO financing" and directing the Bank "to review each sale of OREO and determine if proper accounting has been applied," and then take appropriate discounts); JX 4 (2011 ROE) at 47-48 (finding that the Bank had financed $309 million in OREO loans with below-market rates from 2008 to November 2011); *see also id.* at 81 (stating that "[t]hese transactions occurred over several Call Report reporting periods and appropriate losses should have been recognized"); *see also* Part VI.D.8 *supra* at 70-73.

[810] EPF ¶ 461; *see also* Part VI.D.8 *supra* at 71-72 (describing limits to corrective measures taken after 2009 ROE); Salvato Tr. 1853:12-1863:25 (explaining why the $4.8 million adjustment taken by the Bank following the 2011 ROE was inadequate and unjustified).

[811] *See* EC Br. at 85-91.

whether Respondents' conduct as to the accounting in particular constituted a breach of their fiduciary duties of care or actionably unsafe or unsound banking practices.

3. Effect

Enforcement Counsel maintains that the overstatement of Bank capital as a result of the improper Capital Raise Loan and OREO accounting practices prejudiced the interests of the Bank's depositors for the same reasons that they were prejudiced by the improper interest income recognition on nonaccrual loans.[812] The undersigned's conclusions here mirror her conclusions on that issue—Enforcement Counsel has not met its burden on the effect element because it has not demonstrated that depositors were prejudiced in the ways that it asserts.[813]

4. Culpability

Enforcement Counsel's arguments for why Respondents' Capital Raise Loan and OREO accounting-related misconduct constituted willful and continuing disregard for the Bank's safety and soundness—and, as to the Capital Raise Loan accounting, personal dishonesty—are premised on the same foundations as its culpability arguments on the underlying lending-related claims.[814] It contends, for example, that the Bank's failure to account for these items correctly was an "important part[] of Respondents', and the other members of senior management's, efforts to mask the Bank's deteriorating financial condition."[815] But, as the undersigned has already concluded,

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[812] *See* EC Br. at 106-108.

[813] *See* Part VII.C.4 *supra* at 163-166; *see also* RX 52 (email chain including March 25, 2014 email from H. Thompson to R. Chansen et al.) (stating that "the 'Nonaccrual Issue' and *'OREO MRA Issue'* had no impact on the type or timing of any enforcement action nor any impact on the eventual timing of the bank's close") (emphasis added); RX 37 (April 17, 2014 Material Loss Review of First National Bank conducted by the Office of the Inspector General of the Department of the Treasury) at 12 (discussing the treatment of Capital Raise Loan proceeds as Tier 1 regulatory capital and stating that even if $26 million—more than the $17 million calculated by NBE Chansen—had been improperly downstreamed and had to be excluded from the Bank's capital levels, "[a]ccording to OCC officials, . . . this exclusion from Tier 1 capital would not have had a significant impact on First National's ratings or the OCC's enforcement actions at that time").

[814] *See* EC Br. at 103-106.

[815] *Id.* at 103-104.

there is substantial evidence that Respondents did not engage in the underlying misconduct with a culpable state of mind.[816] As the similarity of Enforcement Counsel's arguments in each case suggests, this conclusion applies with equal force to the associated accounting claims.

5. Section 1818(i)

It verges on overkill, at this point, to find that the elements for the assessment of first- and second-tier civil money penalties against Respondent Ortega have been satisfied with respect to these claims, as they have been for nonaccrual loan accounting and (albeit for second-tier only) for the Capital Raise Loans and OREO lending-related misconduct. Nevertheless, Respondent Ortega's violation of 12 U.S.C. § 161(a) over the course of several Call Reports, the effect of which continued into the five-year limitations period window, was a pattern of misconduct sufficient to meet the standard for first- and second-tier civil money penalty assessments under Section 1818(i) here as well.

E. Loans to Rogers III Entities

Enforcement Counsel argues that Respondent Rogers breached his fiduciary duty of loyalty to the Bank by failing to ensure that the Bank Board and L&D Committee were aware of all material information regarding the loans approved in April 2009 and January 2010 to Griqualand and Petro Icon, newly formed entities owned by his son.[817] The undersigned agrees that the statutory elements for a prohibition order and the assessment of a second-tier civil money penalty against Respondent Rogers have been satisfied here.

1. Misconduct

The circumstances surrounding the Griqualand and Petro Icon loans have been described in detail in Part VI.F *supra*, but to sum up: Respondent Rogers received information that his son

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[816] *See* Parts VII.A.4 and VII.B.4 *supra* at 120-131, 146-152.
[817] *See* EC Br. at 113-116.

was arranging to resolve financial and legal difficulties facing his company Obra Homes by defaulting on loans to the Bank that he had personally guaranteed, having the Bank foreclose on the properties securing those loans, and then repurchasing those properties via Bank loans to new entities that he owned, this time without a personal guarantee. Respondent Rogers understood that such an arrangement would or could be harmful to the Bank, because it would leave the Bank more exposed in the event of the loans' default. Respondent Rogers also knew or should have known that the loan packages recommending the loans to the newly formed entities did not mention Obra Homes or its financial difficulties and went out of the way to avoid identifying his son as the owner of those entities. Yet despite this knowledge, Respondent Rogers did not take any steps to ensure that the other L&D Committee members understood that the properties were being resold to the same individual from whom they had just been foreclosed, but on less favorable loan terms. Instead, Respondent Rogers was silent as the Committee approved the loans.

As a director and officer, Respondent Rogers owed the Bank a fiduciary duty of loyalty that required him "to avoid conflicts of interests and to act solely for the [Bank's] benefit."[818] Furthermore, "[a] crucial component of the duty of loyalty is the duty of candor,"[819] which requires these individuals "to disclose all material relevant to [bank] decisions from which they may derive a personal benefit."[820] Indeed, "[o]missions are sufficient to trigger a violation of this duty"[821]—the duty of candor obliges fiduciaries to disclose to the bank everything they know about

[818] *Ellsworth*, 2016 WL 11597958, at *15; *see also Smith and Kiolbasa*, 2021 WL 1590337, at *27 (duty of loyalty requires IAPs "to put the interests of the bank before their own").

[819] *Smith and Kiolbasa* at *27 (internal quotation marks and citation omitted).

[820] *Williams*, 2015 WL 3644010, at **8-9 (internal quotation marks and citation omitted); *accord Ellsworth*, 2016 WL 11597958, at *15.

[821] *Smith and Kiolbasa* at *27.

transactions in which they hold a personal financial (or familial) interest, "even if not asked."[822] Simply abstaining from voting on the transaction in question is not enough.[823]

Here, Respondent Rogers failed to put the Bank's interests above the interests of his son when he allowed the L&D Committee to approve the Griqualand and Petro Icon loans without disclosing his son's involvement and the circumstances of the Obra Homes defaults, or at least making sure that Committee members were suitably apprised. The email forwarded to Respondent Rogers by his son—which he indisputably received, read, and understood—described a company in disarray. Obra was the subject of eighteen pending lawsuits, most of them over debts on which it was "unlikely to win."[824] The prospect of large judgments against the company was increasingly imminent. Rogers III's attorney expressed concern that Obra would be placed into receivership to satisfy its legal obligations, which in turn might prompt "an investigation of Obra's assets to determine whether past transactions benefitted the company or whether they could be deemed fraudulent transfers."[825] Rogers III was at risk of a "total loss of control of Obra and its assets."[826] It is with this backdrop that his attorney proposed the scheme to strip the company of anything of value to evade its creditors, with the goal of repurchasing the foreclosed assets from the Bank under a new company name and under more favorable terms to Rogers III.[827]

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[822] *In the Matter of Michael Sapp*, Nos. 13-477e & 13-478k, 2019 WL 5823871, at *14 (Sept. 17, 2019) (FDIC final decision) (internal quotation marks and citation omitted).

[823] *See In the Matter of Neil M. Bush*, No. AP-91-16, 1991 WL 540753, at *7 (Apr. 18, 1991) (OTS final decision) ("The director's recusal must be accompanied by disclosure of the nature and extent of the conflicting interest and the facts known to the director as to the matter under consideration by the board.").

[824] EX 269 (Yollick email) at 1.

[825] *Id.*

[826] *Id.*

[827] *See id.* ("strongly" urging Rogers III to consider the option "of working with the banks to ensure swift foreclosure . . . and possible marketing agreements with RBC and FNB so that you may maintain control of Obra's assets, maximize your chance of eliminating your personal liability to RBC and FNB, and end your payment of personal assets into Obra's coffers"); *see also id.* (adding that Rogers III "could even have an arrangement with the banks to repurchase the assets in another corporation after foreclosure . . . in order to market them").

The picture painted by the email was serious enough that Respondent Rogers—who testified that he stayed entirely away from his son's business dealings[828]—contacted his son after receiving it to exhort him repeatedly to "protect the Bank."[829] And although Rogers III gave his father assurances that the Bank would be protected, Respondent Rogers should have been vigilant when, two months later, the Bank foreclosed on the Obra Homes collateral, thereby releasing Rogers III from his personal guarantee and signaling that the scheme outlined in the email had been set into motion.[830] Even if he did not deem it essential to act before this, the fact that the L&D Committee was then presented with a loan package for purchasing that collateral that contrived to give the misleading impression that a different individual was the driving force behind Griqualand should have alerted Respondent Rogers to the possibility that Committee members did not have all of the necessary information to evaluate the proposed transaction.[831] There can be no question that Respondent Rogers understood that his son owned Griqualand; he would not have abstained otherwise. But mere abstention was not sufficient to discharge his fiduciary duty—at the very least, as Enforcement Counsel notes, "[t]he fact that Rogers III and Obra Homes were encountering numerous lawsuits and possible bankruptcy calls into question . . . his ability as a real estate developer" as well as his creditworthiness,[832] considerations that would be pertinent to the L&D Committee's decision whether to extend a $3.2 million loan to him collateralized with OREO property and with no personal guarantee.

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[828] *See* Rogers Tr. 405:19-22 ("I stayed so far away from my son's business. . . . I didn't lobby for him. I didn't lobby against him. I just stayed away from him.").

[829] *See id.* 403:14-16 ("I was, at the time, very concerned about it. I told him whatever he did, he must protect the bank."), 406:22-23 ("I do remember distinctly telling him several times, son, you must protect the bank.").

[830] *See* EX 288 (Obra Homes case history).

[831] *See* EX 349 (Griqualand L&D ratification package) at 5 (identifying Roland Drake as the person who "developed the concept for Griqualand," formed the company, and served as its managing director).

[832] EC Br. at 115; *see also* Chansen Tr. 1525:21-22 (opining that the information in the Yollick email would have been "material to future lending decisions involving Mr. Rogers III").

Moreover, the information in the email remained relevant even after the Griqualand loan was approved, and Respondent Rogers had multiple other opportunities to ensure that Committee members were fully apprised. The January 2010 loan package for Petro Icon again obscured Rogers III's identity as that company's sole owner, something that Respondent Rogers should have noticed and addressed.[833] As before, there is no doubt that Respondent Rogers was aware of his son's ownership of Petro Icon, because he was receiving bi-weekly updates on the status of Bank loans to Petro Icon, Griqualand, and Obra Homes.[834] And while the loan package for the Griqualand loan's renewal in June 2011 did state that Rogers III owned "100%" of that company, the fact that the terms of the renewal still did not include a personal guarantee should have prompted Respondent Rogers to speak up and disclose the information that he possessed regarding his son and the defaulted Obra Homes loans, rather than simply abstaining again.[835]

Respondents argue that the Bank ultimately received a personal guarantee from Rogers III on the Griqualand loan and that "the loan performed in the interim,"[836] but this misses the point in several respects. First, there is no evidence that a personal guarantee was indeed obtained, however belatedly; the record reflects that the Bank was in the process of securing a guarantee in May 2013, but does not confirm its consummation.[837] Second, Respondents do not assert that a personal guarantee was ever made in connection with the Petro Icon loans, and so those loans presented

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[833] *See* EX 314 (Petro Icon L&D ratification package) at 3 ("Petro Icon, L.L.C. is a Texas limited liability company that was formed by Chris Owens, Managing Director and others as a means for experienced real estate investors to pool their knowledge into investments in the Texas economy and in Texas real estate. . . . Through business contacts he developed in Montgomery County – and through his experience as a businessman – Chris developed the concept for Petro Icon, L.L.C.").

[834] *See* EX 270 (email chain including March 1, 2010 email from E. Martinez to C. Brockman attaching document with principal balances and stating that "[t]his is the recap Janie sends [to Respondent Rogers] every other week. It will list the different relationships."); EX 271 (showing outstanding principal balances for loans to Obra Homes, Griqualand, and Petro Icon as of February 18, 2010).

[835] EX 489 (Griqualand L& D renewal package including April 19, 2011 memorandum re Griqualand) at 6; *see also id.* at 9 (noting that one weakness of the loan was "[l]ack of guarantors").

[836] Rs Reply at 7 (emphasis omitted).

[837] *See* Part VI.F.5 *supra* at 102; *see also* EX 290 (May 1, 2013 email from M. Magee to S. Ortega et al.).

increased risk to the Bank in any event.[838] Third, any personal guarantee that the Bank may have received on the Griqualand loan in 2013 would not relieve Respondent Rogers of the obligation, in 2009 and 2011, to disclose information material to that loan's approval and renewal. Nor is it particularly relevant, for purposes of determining that Respondent Rogers breached his fiduciary duty of loyalty, whether or not the Griqualand loan performed and for how long—Respondent Rogers testified that the arrangement proposed in the February 2009 email would not be in the Bank's best interests, and yet he chose to elevate his son's interests over those of the Bank.[839] Respondent Rogers did not ensure that Bank management was aware of information regarding a transaction in which he had a personal interest that would foreseeably increase the risk to the Bank, and this constitutes a breach of his fiduciary duty.

2. Effect

Enforcement Counsel has offered evidence that the Bank recorded a $432,000 loss on the Griqualand loan on September 13, 2012, and that the receivership also suffered an $88,000 loss on the loan through a loss-sharing agreement with PlainsCapital following the Bank's failure.[840] Additionally, the receivership recorded a combined post-failure loss of $170,978 with respect to the Petro Icon loans under the same loss-sharing agreement.[841] For the reasons below, these losses occurred "by reason of" Respondent Rogers's breach of his fiduciary duty of care.[842] The effect element of 12 U.S.C. § 1818(e) as to this claim is therefore satisfied.

[838] *See* EPF ¶¶ 657-658.

[839] *See* Rogers Tr. 405:23-406:5 ("Q: You testified earlier that this proposal would not be in the best interest of the bank, correct? A: I wouldn't think it would be good for the bank, but I don't know what the circumstances were. I don't know why they would go through that process. I just left it alone."); *see also* Ortega Tr. 703:22-704:7 (agreeing that the lack of a personal guarantee had the potential to "put the Bank in a much worse condition").

[840] *See* EPF ¶¶ 649-650; Locke Tr. 2028:1-22.

[841] *See* EPF ¶ 660.

[842] 12 U.S.C. § 1818(e)(1)(B).

Respondents make several arguments in response. To begin with, they argue that the September 2012 loss on the Griqualand loan occurred more than five years prior to the commencement of this action and thus cannot serve as the basis for a timely asserted claim.[843] They then contend that the loans otherwise performed the entire time they were on the Bank's books, meaning that the lack of a personal guarantee was ultimately immaterial and could not have caused loss to the Bank.[844] Finally, Respondents assert that losses that occurred post-closure were "taken by the FDIC not the Bank" and simply represent the agency's "unilateral decisions to book losses" on dates that it chose rather than any actual loss incurred by these specific loans.[845]

These arguments fall short. While Respondents are correct that a claim predicated on the loss recorded on September 13, 2012 would not be timely, the post-closure losses occurred within five years of the Notice. Even if one were to disregard the Griqualand losses under the reasoning that a claim on that loan first accrued outside the limitations period—a conclusion that would likely be contrary to the Comptroller's interpretation of 12 U.S.C. § 2462, as discussed *supra*—there was no loss recorded on the Petro Icon loans until after the Bank's failure, and Respondent Rogers's failure to disclose material information regarding his son's business dealings in advance of those loans' approval is a separate, and separately accruing, breach of fiduciary duty than for the Griqualand loan, rendering the Article VI claim timely regardless.

This is so because financial loss suffered by the FDIC as receiver for a failed institution must constitute loss to that institution for purposes of Section 1818's effect prongs, as long as that loss is caused by misconduct occurring prior to the institution's failure. Any other result would, as Enforcement Counsel asserts, "allow an IAP to commit flagrant violations of the law yet be

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[843] *See* Rs Br. at 59.
[844] *See* Rs Reply at 36-37.
[845] *Id.* at 37.

immune from consequences if his or her misconduct is sufficiently bad to render the bank into receivership before a regulator could act."[846] Further, Respondents' broad statement that it is "the FDIC" as an agency that records post-failure losses to the receivership is incorrect as a matter of law—as stated earlier,[847] the FDIC as receiver is a separate and legally distinct entity from the FDIC in its corporate capacity, and one that is empowered to take over the rights, assets, and obligations of the failed institution, perform its functions, and wind up its affairs in an orderly fashion while maximizing recovery for the receivership and its creditors (including the Deposit Insurance Fund).[848] Ms. Locke's testimony indicates that loss sharing agreements are one tool used by the FDIC as receiver to induce an acquiring institution to assume the failed institution's assets, including its loan portfolio, and ensure minimal disruption for the failed institution's depositors and borrowers.[849] Respondents' argument that the loans in question performed up until a loss was booked by the receivership is therefore largely beside the point: losses recorded by the receiver are no less "real" than losses recorded by the Bank, and the receiver was legally obligated under the loss sharing agreement to take a loss on these (and other) loans when, and to the extent that, PlainsCapital determined that a writeoff was appropriate.[850]

3. Culpability

The undersigned also finds that, by failing to disclose information that would have been material to the Bank's lending decisions regarding his son, Respondent Rogers acted with willful

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[846] EC Br. at 10.

[847] *See* Part VII.B.3 *supra* at 144 n. 677.

[848] *See* 12 U.S.C. § 1821(d).

[849] *See* Locke Tr. 2017:7-14 ("[W]hen a purchase [and] assumption agreement includes a shared loss agreement, the shared loss agreement will provide for the FDIC to share losses that the assuming institution may ultimately experience during a defined period of time as well as any upsides or recovery of losses that the assuming institution experiences.").

[850] *See id.* 2018:6-10 ("[T]he shared loss agreement that was executed as part of the purchase and assumption agreement required the FDIC to share in losses less recoveries of 80 percent of the amount.").

disregard for the safety and soundness of the Bank. Respondent Rogers understood that the scheme described in the February 2009 email would expose the Bank to risk by removing Rogers III's personal guarantee, and he had reason to believe that the L&D Committee did not have all the details about the circumstances surrounding the proposed loans to Griqualand and Petro Icon. Respondent Rogers was aware that the L&D Committee was considering lending to newly formed companies owned by an individual whose previous company had been the subject of eighteen lawsuits and who chose to default on Bank loans in order to empty that company of its assets. He was further aware that the loan packages did not identify his son as the sole owner of the new companies or provide any information or context about his financial condition. He knew that the new loans would place the same collateral back in his son's hands while removing any personal guarantee. Rather than ensure that Committee members were fully informed about the risks of these loans, however, Respondent Rogers was willing to turn a blind eye to the Bank's interests and say nothing. This is the quintessence of willful disregard.

Respondents argue that the Griqualand and Petro Icon loans, like the Bank's other OREO loans, were simply "the result of lenders and the lending department . . . making the best decisions they could to deal with the growing OREO of the Bank during the global financial crisis."[851] But the difference between these loans and other Bank loans to finance the sale of OREO is clear—there is undisputed evidence here that Respondent Rogers believed that the specific arrangement proposed in the email to his son would not be in the Bank's best interests, and yet he took no substantive steps to prevent the arrangement from occurring or otherwise act upon that belief. It may be, as Respondents contend, that Respondent Rogers felt "that by abstaining from the vote on the L&D Committee, staying out of it, and allowing lenders Brockman and Martinez to handle the

[851] Rs Reply at 35.

loans without influence from him," he was doing "what he thought was right."[852] This is no defense, however. It was a clear and improper abdication of responsibility for Respondent Rogers to rely on his son's assurances that the Bank would not be harmed by the scheme, when he recognized that—unlike he himself—his son had no duty to the Bank at all.[853] If Respondent Rogers truly believed that staying silent in the face of a known risk to the Bank was the right thing to do, then he is just as culpable as if his silence was complicit.[854]

4. Section 1818(i)

Respondent Rogers breached his fiduciary duty of loyalty in a way that caused more than minimal loss to the Bank, thus satisfying the elements for a second-tier civil money penalty assessment under 12 U.S.C. § 1818(i).[855] The undersigned need not decide additionally whether Respondent Rogers's conduct with respect to the Griqualand and Petro Icon loans constitutes an actionable pattern of misconduct for purposes of the statute.

F. Civil Money Penalties

Before assessing a civil money penalty, the federal banking agencies are bound to consider the appropriateness of the amount being assessed in light of five mitigating factors: (1) the size of the respondent's financial resources; (2) the respondent's good faith; (3) the gravity of the respondent's violation; (4) the history of any previous violations; and (5) "such other matters as justice may require."[856] With respect to the $250,000 civil money penalty sought by the OCC

[852] *Id.*

[853] *See* Rogers Tr. 437:17-18 ("I would think that the duty would be to himself to protect himself."); *see also* Part VI.F.2 *supra* at 94.

[854] Because the undersigned has concluded that Respondent Rogers acted with willful disregard for the Bank's safety and soundness in connection with the Griqualand and Petro Icon loans, it is unnecessary to also determine whether he acted with continuing disregard or personal dishonesty within the meaning of 12 U.S.C. § 1818(e). *See* EC Br. at 116-118.

[855] *See id.* at 118-119.

[856] 12 U.S.C. § 1818(i)(2)(G).

against each Respondent in this matter, Enforcement Counsel has made a submission adverting to these factors and to the thirteen interagency factors that financial institution regulatory agencies must also weigh in conjunction when determining a civil money penalty amount.[857] Considering Enforcement Counsel's submission, assessing the relevant factors, and for the reasons given below, this Tribunal recommends to the Comptroller that $250,000 is an appropriate monetary penalty for each Respondents' misconduct in this case.

The purpose of a civil money penalty "is to deprive the violators of any financial benefit derived as a result of the violations, provide a sufficient degree of punishment, and [act as] an adequate deterrent to the respondents and others from future violations of banking laws and regulations."[858] The interagency guidance regarding the assessment of civil money penalties further states that "in cases where the violation, practice, or breach causes quantifiable, economic benefit or loss," a civil money penalty amount that merely recompenses the loss or strips the violator of their benefit will be insufficient "to promote compliance with statutory and regulatory requirements."[859] Rather, "[t]he penalty amount should reflect a remedial purpose and should provide a deterrent to future misconduct."[860] The undersigned will address each of the five mitigating factors in turn, bearing in mind the punitive, deterrent, and remedial goals that civil money penalties are intended to achieve.

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[857] *See* EC Br. at 119-123 (in support of the $250,000 CMP assessments). Respondents did not directly address the statutory mitigating factors or the appropriateness of the civil money penalty amount in their posthearing briefing, beyond taking the broad position that no civil money penalty in any amount was appropriate. *See* Rs Reply at 38 (stating that this Tribunal "should decline to impose either a civil money penalty or a prohibition").

[858] *In the Matter of Richard D. Donohoo and Craig R. Mathies*, Nos. 92-249c & b *et seq.*, 1995 WL 618673, at *27 (FDIC final decision); *see also Long v. Bd. of Gov. of the Fed. Res. Sys.*, 117 F.3d 1145, 1154 (10th Cir. 1997) (civil money penalties provide banking agencies with "the flexibility [they] need[] to secure compliance" with the relevant banking laws and to "serve as deterrents to violations of laws, rules, regulations, and orders of the agencies") (internal quotation marks and citation omitted).

[859] Civil Money Penalties Interagency Statement, OCC Bulletin No. 98-32, 1998 WL 434432, at *2 (adopting Federal Financial Institutions Examination Council's Interagency Policy Regarding the Assessment of Civil Money Penalties by the Federal Financial Institutions Regulatory Agencies (June 3, 1998)) ("Interagency CMP Policy").

[860] *Id.*

1. Respondents' Financial Resources

The Parties have jointly stipulated that "Respondents each individually possess the financial resources and ability to pay the proposed $250,000 civil money penalties."[861] This factor therefore does not warrant mitigation of the penalty amounts sought in this matter.

2. Respondents' Good Faith

The mitigating factor of good faith, in the undersigned's view, encompasses both good faith shown (or not shown) in the course of a respondent's misconduct as well as any showing of good faith made by a respondent, for example through willing cooperation or genuinely expressed regret and responsibility for their actions, during the agency's investigation and the enforcement proceedings themselves. Such an interpretation provides an incentive for respondents to be forthcoming and cooperative through the investigative and enforcement process. That interpretation also lessens the duplicative effect that a finding of personal dishonesty or willfulness or a conscious engagement in misconduct might otherwise have on this mitigating factor—otherwise, no showing of good faith sufficient to mitigate an assessed penalty could ever be made in most cases before this Tribunal.

Here, the undersigned has found that there is substantial evidence and credible testimony that Respondents were acting in good faith with respect to the Capital Raise Loans and OREO lending strategy issues, but not with respect to nonaccrual loan accounting and the loans to the entities owned by Respondent Rogers's son. As for good faith during the enforcement process, the undersigned finds that Respondents have been reasonably candid and cooperative in the course of these proceedings, except to the extent that they have sought to minimize their misconduct in connection with the nonaccrual loan accounting and (for Respondent Rogers) the Griqualand and

[861] Joint Stip. ¶ 10.

Petro Icons loans. In particular, the undersigned notes that Respondent Ortega's testimony on the Bank's accounting for nonaccrual loans repeatedly and misleadingly framed this issue in terms of when it was proper for the Bank to place loans on nonaccrual status, the determination of which the agency is not contesting here, rather than whether loans that had been placed on nonaccrual should be accounted for by default using cash basis to recognize interest income.[862] Thus, on balance, Respondents' good faith is not a significant mitigating factor.

3. Gravity of the Violation

Enforcement Counsel argues that the gravity of Respondents' misconduct was substantial, given "[t]he duration and the frequency of the misconduct" and the fact that the violations caused losses to the Bank, the receivership, and—through the unjustified provision of new monies in loans financing the sale of OREO—the Deposit Insurance Fund.[863] Enforcement Counsel highlights the approval and ratification of the NAHS loan and other large OREO loans without adequate documentation of the borrowers' finances and repayment ability as especially egregious.[864] The undersigned agrees that the gravity of the violations is significant, most notably Respondents' ongoing failure to correct the Bank's blanket practice of improper nonaccrual loan accounting despite being directed again and again to do so by examiners and the Bank's internal auditor over the course of years.[865] The undersigned accordingly finds that there is nothing about the gravity of the proven violations that would warrant mitigation of the civil money penalty amount.

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[862] *See*, *e.g.*, Ortega Tr. 775:2-8 ("Q: I'm specifically asking about your system. It was set up so that nonaccrual loans would be treated as cash basis, correct? A: It was set up if there was – once they go to the – where they're past due more than 90 days, it will go to nonaccrual automatically, yes.").

[863] EC Br. at 121. Enforcement Counsel notes that these considerations apply to interagency factors 2 (duration and frequency of misconduct) and 6 (degree of loss to the institution) as well. *See id.*; *see also* Interagency CMP Policy, 1998 WL 434432, at *2.

[864] *See* EC Br. at 121-122. The undersigned does not credit Enforcement Counsel's additional assertion that "the gravity of the Call Report violations were significant because they enabled the Bank to avoid 'critically undercapitalized' status for at least two quarters," in light of her earlier finding that Enforcement Counsel had not met its burden in that regard. *Id.* at 122.

[865] *See* Part VI.E *supra* at 76-89.

4. History of Violations

Enforcement Counsel states that "there is no evidence of a history of previous violations and no evidence that Respondents were previously criticized for similar actions by the OCC."[866] This criterion thus serves as a potential mitigating factor for the civil money penalty amount.

5. Such Other Matters as Justice May Require

Enforcement Counsel acknowledges that "Respondents made significant personal investments into the Bank during the 2009 capital raise, which demonstrates some effort to legitimately rehabilitate the Bank."[867] To this the undersigned would add the substantial evidence and credible testimony that, in connection with both the capital raise and the Bank's efforts to divest itself of a growing flood of OREO, Respondents were acting in good faith and with the best interests of the Bank in mind, at the height of the financial crisis, in a difficult position without any clear solutions.[868] The undersigned also credits the testimony of Respondent Ortega and Mr. Leal regarding the efforts made by Respondent Ortega, at great personal cost to his own health, to address issues raised by regulators in late 2012 and early 2013.[869] Nevertheless, the undersigned finds that the sustained nature of the nonaccrual loan accounting violations in the face of years of regulator warnings, as well as the negligence displayed with the Capital Raise Loans and the approval of too-risky concessionary OREO financing, outweighs these considerations, making a $250,000 civil money penalty appropriate as to each Respondent.

VIII. Conclusion and Recommended Orders

For all of the reasons above, the undersigned finds that the statutory elements of 12 U.S.C. § 1818(e) have been met in this action as to certain of the claims set forth in the Notice, but not as

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[866] EC Br. at 122.
[867] *Id.* (emphasis omitted).
[868] *See* Parts VII.A.4 and VII.B.4 *supra* at 120-131, 146-152.
[869] *See* Part VI.G *supra* at 105-106.

to others. Specifically, a preponderance of the evidence reflects that (1) Respondents' actions in connection with the Capital Raise Loans (Article III) and the OREO Lending Strategy (Article IV) constituted unsafe or unsound practices and a breach of their fiduciary duty of care that caused loss to the Bank, but that Respondents did not demonstrate actionably culpable states of mind;[870] (2) Respondents' actions in connection with the Nonaccrual Loan Accounting (Article V) violated 12 U.S.C. § 161(a) and breached Respondents' fiduciary duty of care in a way that demonstrated continuing disregard for the safety and soundness of the Bank, but that Enforcement Counsel did not meet its burden on showing that this misconduct caused depositor prejudice; and (3) Respondent Rogers's actions in connection with the Griqualand and Petro Icon loans (Article VI) constituted a breach of his fiduciary duty of loyalty which caused loss to the Bank, and which Respondent Rogers undertook with willful disregard for the Bank's safety and soundness. Furthermore, for purposes of 12 U.S.C. § 1818(i), the undersigned finds that the statutory elements have been met as to all claims. In accordance with 12 C.F.R. § 19.38, the undersigned therefore recommends that the Comptroller enter a prohibition order against Respondent Rogers and assess a second-tier civil money penalty in the amount of $250,000 against each Respondent in consequence of their misconduct. The record of this proceeding will be transmitted to the Comptroller in conjunction with this Recommended Decision, as well as a certified index of the administrative record and an index of exhibits.

SO ORDERED.

September 30, 2022

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Jennifer Whang, Administrative Law Judge
Office of Financial Institution Adjudication

[870] For the accounting-related claims of Articles III and IV, Enforcement Counsel demonstrated a violation of 12 U.S.C. § 161(a) for the misconduct element, but not effect or culpability.