25th Anniversary

Appeals Process

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1. Appeal of Composite and CAMEL Ratings

Background

The boards of directors of a group of banks, collectively, appealed to the Ombudsman the composite and CAMELS ratings assigned by the supervisory office in the most recent report of examination.

The banks expressed concern that they were being evaluated collectively as a complex institution rather than as less complex, separate, and independent institutions. While all the banks appealed their composite rating, they each appealed different component ratings. The banks requested that the supervisory office apply the rating summary matrix and description on risk management systems relative to a bank's size, complexity, and risk profile as stated in OCC Bulletin 97-1, "Uniform Financial Institutions Rating System and Disclosure of Component Ratings," (January 7, 1997).

Discussion

The Ombudsman conducted a review of the information submitted by the banks and supporting documentation from the supervisory office. The review included discussions with the banks' senior management as well as with members of the supervisory office.

While the chosen corporate structure is comprised of individually chartered financial institutions, it is evident from these discussions that the bank management teams are significantly influenced by one major principal. Additionally, the organizational structure provides for centralized decision-making and back-room operations. Furthermore, the Ombudsman found that risk management systems throughout the banks warrant significant improvement in the areas of credit administration, nonaccrual accounting, and budget reporting.

Conclusion

The Ombudsman concluded that the composite and CAMELS ratings as assigned by the supervisory office in the report of examination were appropriate. The Ombudsman encouraged the banks to strengthen their overall risk management practices in the lending area and formalize their planning and budgeting processes to assist them in addressing potential risk exposures.

2. Appeal of Memorandum of Understanding

Background

The bank's board of directors appealed the supervisory office's decision not to remove the Memorandum of Understanding (MOU). The bank has been rated a 2 for the last three years and the board believes that the most recent examination indicates stronger results in all areas except for earnings. The bank is in compliance with all articles except for the article related to earnings performance.

The board believes that they have met the intent of the MOU. While earnings are marginal, they are consistent with the strategic plan which includes expenses associated with the opening of a new branch. The supervisory office believes that compliance with the article regarding the profit plan cannot be achieved until the bank demonstrates sustained earnings.

Discussion and Conclusions

The Ombudsman conducted a review of the information submitted by the bank and supporting documentation from the supervisory office. The review included discussions with the bank's senior management as well as with members of the supervisory office.

The Ombudsman concluded that the existing MOU had served its intended purpose and should be terminated. The bank's board of directors had demonstrated a commitment to institutionalize a culture of risk controls and processes that will serve the institution well.

3. Appeal of a Nonaccrual Status

Background

The boards of directors of a group of banks, collectively, appealed to the Ombudsman a decision rendered by the supervisory office to place a group of loans on nonaccrual status. The banks also appealed the supervisory office's directive to re-file the Consolidated Reports of Condition and Income (call reports).

The various bank boards disagreed with the nonaccrual status because they consider the loans "well secured" and "in the process of collection" within the context of the call report instructions. The boards requested that the Ombudsman's office review these loans to determine if accrual status on the affected loans is appropriate, thereby negating the need to re-file the call reports.

Discussion

The Ombudsman conducted a review of the information submitted by the bank and supporting documentation from the supervisory office. The review included discussions with the banks' senior management as well as with members of the supervisory office.

The Ombudsman's analysis specifically focused on the issue of whether the loans were "well secured" and "in the process of collection," as defined in the call report instructions. While the affected loans were collateralized by improved real estate, the value of the collateral was not supported by current independent appraisals or a comprehensive analysis that substantiated the banks' basis of valuation. The appraisals maintained by the banks were outdated and did not provide full assurance that all principal, interest, and accruing fees would be received. Furthermore, the guarantor provided no significant financial support to the credits due to an illiquid cash position and a high level of contingent liabilities.

A legal process was initiated by the borrower, with support from the bank, to have a court appointed receiver control the liquidation of the company. While the Ombudsman acknowledged that a legal process was initiated as of a given quarter, there was no assurance that the loans would be restored to a current status within a reasonable time frame.

Conclusion

The Ombudsman concluded that the nonaccrual designation assigned by the supervisory office was appropriate. While the banks had taken steps to support "in the process of collection," there was inadequate support for "well secured." The banks were directed to place the loans on nonaccrual as of the same quarter the legal process was initiated and to reverse all accrued and uncollected interest, and other fees. Any interest income recorded since the particular quarter in question should be applied towards principal until the remaining recorded investment in the asset (i.e., after charge off of identified losses, if any) is deemed fully collectible. Additionally, the banks were directed to make the adjusting accounting entries and re-file the affected call reports.