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# Appeals Process

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## Appeal 1— Appeal of Noncompliance with Two Articles in a Formal Agreement

### Background

A bank appealed the OCC's conclusions contained in the Report of Examination (ROE) regarding the bank's compliance with two articles in their formal agreement. Specifically, bank management disagreed with the OCC's noncompliance determination with articles focusing on loan administration and criticized assets.

The appeal was based on the following:

### Loan administration

- The article required the board to, within 60 days, develop and implement a written program to improve the bank's loan administration. A copy of the program was to be forwarded to the assistant deputy comptroller (ADC), along with a copy of the revised job descriptions and policies and procedures. The article also required the board to ensure that the bank had processes, personnel, and control systems to ensure implementation of and adherence to the program developed pursuant to this article.
- The report of examination (ROE) noted noncompliance with this article because of a number of relationships with credit and collateral documentation exceptions, while noting that the framework had been established to improve the administration of the portfolio. The ROE further stated that achieving full compliance with this article is negatively affected by the continuation of the newly hired management's education of the existing customers and review of the existing relationships.
- The bank appealed the conclusion on the level of compliance with this article because the bank was doing all that was required. The assistant deputy comptroller had been forwarded a copy of all adopted policies and procedures. Moreover, the bank has put in place and is implementing the systems to ensure compliance with these policies and procedures.

### Criticized assets

- The article required the bank to take immediate and continuing action to protect its interest in those as-

sets criticized in the ROE, in any subsequent ROE, by internal or external loan review, or in any list provided to management by the bank examiners during any examination. Within 60 days the board was to adopt, implement, and thereafter ensure bank adherence to a written program to eliminate the basis of criticism of assets noted in the ROE, in any subsequent ROE, or by any internal or external loan review, or in any list provided by the bank's examiners during any examination as "doubtful," "substandard," or "special mention." A copy of the adopted program for all criticized assets equal to or exceeding \$100,000 was to be forwarded to the ADC. The article also required the board to ensure that the bank has processes, personnel, and control systems to ensure implementation of and adherence to the program developed pursuant to this article. Other requirements included a quarterly review of the criticized assets, a submission to the ADC of these quarterly reviews, and the establishment of a committee to review loan activity involving these credits.

- The ROE noted noncompliance with this article because the supervisory office, while recognizing the bank's efforts and results thus far, could not assess the bank's adherence to the criticized assets initiatives.
- The bank also appealed the conclusion on the compliance level of this article because the bank board had adopted and implemented plans to eliminate the basis of criticism for each of its problem loans. The appeal submission also stated that the board realized that compliance with this article would be judged on an ongoing basis.

### Discussion

OCC's Policy and Procedures Manual (PPM) 5310-3 (REV), "Bank Supervision Operations—Enforcement Action Policy," provides internal OCC guidance for assessing compliance with enforcement actions. The PPM states that a rating of compliance can only be achieved on a particular article if the bank has adopted, implemented, and adhered to all of the corrective actions set forth in the article; the corrective actions are effective in addressing the bank's problems; and OCC examiners have verified through the examination process that this has been accomplished. It also states that a bank should not be considered in compliance with an article in an enforcement

document simply because they have made progress or a good faith effort toward complying with the article.

The PPM further states that articles for which a bank has not achieved compliance include those articles where the bank has adopted and begun the implementation of all of the corrective actions required by the article, but sufficient time has not passed to verify that the actions have been fully implemented, are being adhered to, and are effective in addressing the bank's problems. In these situations, there is nothing additional for management and the board to do other than fully implement, adhere to, and assess the effectiveness of the corrective actions.

## Conclusion

Both articles in the bank's formal agreement contain the following paragraph that requires not only the implementation of, but also the adherence to, the developed program under each of the corresponding articles:

The Board shall ensure that the Bank has processes, personnel, and control systems to ensure implementation of and adherence to the program developed pursuant to this Article.

Bank management had taken appropriate action to implement the policies and procedures to comply with these two articles. However, at the time of examination, given the relatively short time since implementation, the supervisory office could not assess the bank's *adherence* to the loan administration and criticized assets initiatives. Therefore, it was concluded that the supervisory office's assessment of noncompliance with articles, at the time of the examination, was appropriate and consistent with OCC's "Enforcement Action Policy."

## Appeal 2— Appeal of an Insider Violation for Preferential Treatment

### Background

A bank appealed a violation of 12 USC 375b and 12 CFR 215.4(a)(1)(i) cited in the bank's Report of Examination (ROE) in connection with a loan extended by the bank to a director. Bank management believed the facts associated with the transaction did not represent preferential terms on the credit extended to the insider.

The transaction involved the refinancing of an automobile loan from the insider's business to the insider personally.

The loan to the business was at the bank's prime rate for commercial customers plus 100 basis points and was structured on an interest-only time/demand note. When the loan was refinanced into the individual's name, the borrower paid down over 40 percent of the outstanding balance, and received the going installment loan rate for a 48 month auto loan, approximately 200 basis points less than the previous loan. However, the loan was left on an interest-only time/demand note, maturing in 12 months with quarterly interest payments. An analysis of the financial information supported the borrower's credit worthiness with minimum debt, strong net worth, and good liquidity.

The bank's rate sheet detailed separate rates for loans structured on an installment basis versus those on a time/demand basis. The supervisory office cited the violation because management granted the lower installment loan rate for a loan secured by a 1999 automobile for a 48 month term, not the higher time/demand rate listed on the bank's rate sheet. The supervisory office position was that an installment loan rate should only be applicable for loans actually on an installment basis with monthly or quarterly principal and interest payments. During the examination, bank management was not able to provide any acceptable transactions that were comparable in pricing and structure to demonstrate that the terms extended to the director were also available to other non-insider customers of the bank.

### Discussion

Regulation O, 12 CFR 215, "Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks," section 215.4(a)(1)(i), states:

- (1) No member bank may extend credit to any insider of a bank or insider of its affiliates unless the extension of credit:
  - (i) Is made on substantially the same terms (including interest rates and collateral) as, and following credit underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions by the bank with other persons that are not covered by this part and who are not employed by the bank.

The bank provided the ombudsman with an example of a similarly structured loan that was granted to a non-insider to demonstrate that the time/demand structure of the loan was available to other customers of the bank. The ombudsman found the loan to the non-insider was extended before the insider's loan and the pricing methodology and the structure were consistent for both transactions, although other terms varied slightly.

## Conclusion

The ombudsman found the bank's loan rate sheet to be ambiguous and determined that it could be interpreted in various ways. It did not clearly specify whether the rate should be based on the collateral or structure. According to the rate sheet:

- The rate on personal loans was determined by the collateral, in this case rates for the collateral (1999 vehicle) were 7.50 percent for 36 months, 7.75 percent for 48 months and 7.90 percent for 60 months.
- The rate on time/demand loans was prime rate (9.50 percent) plus 50 or 100 basis points, even when secured by deposits in the bank.

As shown above, it would not be clear which rate should be applied on a personal loan, with an automobile as collateral and structured on a time/demand basis.

Considering all the above, the ombudsman did not believe the loan in question represented preferential treatment for an insider and thus it was not a violation of 12 CFR 215.4. While the bank was able to provide a comparable transaction, that was not the basis for the ombudsman's conclusion.

Directors' business and personal dealings with the bank must be structured to comply with legal requirements and to avoid even the appearance of a conflict of interest. The ombudsman encouraged bank management and the board to thoroughly review and revise the bank's rate sheet so that all ambiguities are eliminated.