

# APPEALS PROCESS

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## **Appeal 1—Appeal of Report of Examination Conclusions**

### **Background**

A bank formally appealed the examination conclusions regarding the condition of the bank. Specifically, bank management believed the report of examination

- Overstated the adverse condition of the bank's commercial loan portfolio;
- Unduly criticized the bank's strategic planning process;
- Assigned a troubled condition designation to the bank without any reference to any standard; or benchmark against which the bank was judged; and,
- Incorrectly assessed the bank's risk profile and capital rating.

### **Discussion**

The bank acknowledged deterioration in its commercial loan portfolio, but stated that

- The Office of the Comptroller of the Currency (OCC) Canary benchmarks reflecting the operation of its credit function were inherently conservative;
- The loan portfolio has remained well balanced between retail, real estate, commercial, and construction;
- In 1999 asset quality was rated 2; since then, asset quality has improved and capital has grown;
- Risk from unsecured credit has been steadily declining since 1996;
- The commercial loan portfolio consists of loans to locally owned and operated businesses;
- The level of non-accrual loans, past-due loans, and charge-offs has improved; and,
- The allowance for loan and lease losses (ALLL) has been adequate.

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The appeal further states that the objective measures reflected an asset quality rating of 2 while subjective and harsh comments were made in the report of examination (ROE) that resulted in an assigned rating of 3.

The OCC believed that the bank's overall condition remained unsatisfactory and that the level of risk remained moderate and increasing. Subprime credit represented 150 percent of Tier 1 capital. Capital was insufficient in relation to the overall risk profile of the bank, and earnings continued to suffer because of high overhead and losses from loans and other assets. Asset quality and credit administration practices were less than satisfactory. Classified loans increased from 15 percent to 37 percent, the loan review function and account officers failed to accurately identify problem loans, and the level of retail credit accounts with low credit scores was high. Also, while some progress had been made towards complying with the formal agreement, most articles were in noncompliance.

### **Conclusion**

The ombudsman concluded that, while the tone of the report was unduly harsh, the overall assessment and ratings assigned in the report on examination (ROE) complied with agency policy and are reasonably reflective of the bank's condition at that time. There was evidence of increased credit risk and the level of noncompliance with the formal agreement appropriately impacted the ratings, risk profile, and overall condition of the bank.

### **Subsequent Event**

Subsequent to the appeal, the supervisory office completed a review of the first quarter 2003 financial and asset quality information submitted by the bank. The review was initiated to assess management and the board's progress in improving the bank's earnings performance and lowering its risk profile. As a result, capital, asset quality, and liquidity ratings were upgraded. Additionally, the credit risk profile was reflected as moderate with a stable direction. A complete assessment of the composite and other component ratings was not performed. The ombudsman concurred with these changes.

## **Appeal 2—Appeal CRA Rating and Examination Conclusions**

### **Background**

A bank formally appealed its overall Community Reinvestment Act (CRA) rating and the examination conclusions. At the most recent CRA examination, the bank's overall performance was downgraded from "outstanding" to "needs to improve." The bank asks the ombudsman to restore the "outstanding" rating and amend the conclusions of the CRA examination

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During the bank's most recent CRA examination, the lending test was rated "outstanding," the investment test was rated "outstanding," and the service test was rated "high satisfactory." However, the supervisory office concluded that the bank violated the Federal Trade Commission Act (the Act) in connection with its marketing of subprime credit cards. The marketing practices used to solicit consumers were misleading and deceptive as defined in the Act and had a material adverse impact upon the cardholders. The bank was also cited for violations of the safety and soundness standards set forth in 12 CFR part 30 appendix A. In its payday-lending program, the bank failed to identify the source of repayment and to assess the borrower's ability to repay the loan at each extension of credit.

Although the bank voluntarily discontinued its subprime lending programs and, by consent order, exited the payday-lending business, the supervisory office concluded that the egregiousness of these violations also impacted the bank's overall CRA performance, resulting in a downgrade from "outstanding" to "needs to improve."

In its appeal, the bank disagreed with the Office of the Comptroller of the Currency's (OCC's) decision to downgrade the bank's CRA performance rating based on the aforementioned violations. The bank's appeal asserts that the supervisory office misinterpreted 12 CFR 25 in applying these violations to the CRA rating. The appeal also states that the ratings assigned to the lending, investment, and service tests genuinely reflect the level of service to its local community.

### **Discussion and Conclusion**

The ombudsman found that there were elements of the bank's CRA performance that technically supported an "outstanding" rating. However, the ombudsman agreed with the supervisory office regarding the egregiousness of the violations. Therefore, the consumer violations and the adverse impact on consumers were appropriately considered in determining the bank's overall CRA rating. The ombudsman also recognized that the bank had discontinued both programs, either voluntarily or by consent order. These actions should prevent further harm to the consumers and preclude future violations. After weighing the cumulative factors of the bank's CRA performance and corrective actions taken, the ombudsman concluded that the appropriate CRA rating was a downgrade to "satisfactory."