

Quarterly Journal

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Appeal 1—Appeal of Semiannual Assessment Fee

Background

A bank formally appealed the OCC's right to retain the full semiannual assessment fee for the period of January 1 through June 30 since the bank converted to a state chartered commercial bank on January 1.

Discussion

The bank requested a full refund of its semiannual assessment because the supervisory responsibility shifted from the OCC to the state on January 1 and therefore no supervisory activities would be conducted by the OCC during the period covered by the assessment.

The ombudsman reviewed OCC regulations regarding payment of semiannual assessment fees. According to paragraph (5) under section (a) of 12 CFR 8 Assessment of Fees, "Each bank subject to the jurisdiction of the Comptroller of the Currency on the date of the second or fourth quarterly Call Report required by the OCC under 12 USC 161 is subject to the full assessment for the next six-month period." The OCC assessment is levied against all institutions that are in the national banking system as of December 31st and June 30th. Therefore, any bank that is a national bank on the assessment date is required to pay the full semiannual assessment for the upcoming six-month period.

Conclusion

After careful review of OCC regulations, and finding no basis for an exception, the ombudsman determined that no refund was due to the bank.

Appeal 2—Appeal of Composite and Component Ratings

Background

The bank's board of directors appealed the downgrade to a 3 of its overall composite rating and the component ratings for asset quality, management, and consumer compliance. Additionally,

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the board appealed the violations of law of the legal lending limit. The bank was placed under a formal agreement prior to filing the appeal.

Discussion

The appeal states that the report of examination (ROE) contains unfounded allegations regarding the bank's relationship with a third-party subprime mortgage vendor, which resulted in unsatisfactory ratings in asset quality, management, and consumer compliance. Furthermore, the board stated that the legal lending limit violations were based on the manner in which the lending program operated as opposed to the written agreements between the subprime mortgage vendor and the bank.

According to the appeal, even when considering the subprime nature of the mortgage loan portfolio, the bank had not experienced losses as a result of its relationship with the subprime mortgage vendor. Bank management stated that the supervisory office was advised of the bank's interest in purchasing participations from the subprime mortgage vendor and raised no objections. Management questioned the OCC's decision to pursue an administrative action, including civil money penalties, after the bank decided to wind down its participation with the subprime mortgage vendor. The appeal also stated that the component ratings that were downgraded in this examination had been assigned satisfactory ratings only four months prior. Finally, the appeal states that the bank has not done anything wrong, much less illegal, predatory or abusive, in its relationship with the subprime mortgage vendor.

The supervisory office stated that bank management failed to provide adequate oversight of its relationship with the subprime mortgage vendor. The lack of policies and procedures for the subprime mortgage portfolio, poor loan administration and risk management practices coupled with the predatory nature of the portfolio, exposed the bank to increased reputation and financial risk. Loan officers responsible for the subprime mortgage portfolio lacked the knowledge necessary to identify violations of law and regulation in the portfolio. This indicated a lack of proper training over consumer laws and regulations along with weak internal controls. Based on the weaknesses noted in the areas of credit, risk management, and consumer compliance, including the resulting violations of law, management and board supervision were considered weak.

Conclusion

The ombudsman conducted a review of the information submitted by the bank and support documentation from the supervisory office. The review included meetings with the bank's senior management and legal counsel, as well as with members of the supervisory office.

Because the bank was operating under an enforcement action, the ombudsman's review was limited to a determination of reasonableness as defined in OCC Bulletin 2002-9, "National Bank Appeals Process," (February 25, 2002). Essentially, the ombudsman used a process similar to that of a federal appeals judge versus the de-novo review process that is customarily employed on

non-enforcement-related appellate matters. Therefore, the review focused on whether the ratings were reasonable as assigned based on the condition of the bank at the time of the examination. Additionally, the violations of law were deemed to be outside of the scope of the appeal.

The ombudsman ruled that the conclusions reached by the supervisory office regarding asset quality, management, and consumer compliance were reasonable and well supported by the facts at the time of the examination. Additionally, the overall condition of the bank met the criteria of a composite-3-rated bank as prescribed by the Uniform Financial Institutions Rating System (UFIRS), (OCC Bulletin 97-1, "Uniform Financial Institutions Rating System and Disclosure of Component Ratings," January 3, 1997).

Appeal 3—Appeal of the Composite and Certain Component Ratings

Background

A bank, operating under a formal agreement, appealed the composite and component ratings for capital, asset quality, management, earnings, and liquidity assigned at the most recent examination.

Discussion

The bank's board of directors appealed the conclusions noted in the most recent safety and soundness examination that resulted in the downgrade of the bank's composite rating from 2 to 4. According to the appeal, the primary cause of the criticisms noted in the report of examination (ROE) can be traced to a former senior loan officer and were not reflective of overall bank supervision. The appeal further states that the downgrades for capital, asset quality, management, earnings, and liquidity were primarily based upon the perception that classified assets were increasing, and this increase would cause net losses and liquidity issues. Since the examination, the board believes that management has improved asset quality problems, created an adequate allowance for loan and lease losses, collected a significant amount of classified assets, and implemented proper policies and procedures in the lending area. Consequently, the perceived negative impact on capital, earnings, and liquidity did not materialize. Therefore, the board believes the composite, capital, asset quality, management, and earnings ratings each merit a 3 and liquidity should be rated 2.

The supervisory office response notes that the appeal discusses actions taken by the board post-examination but does not refute findings noted during the examination. As such, conclusions cited in the ROE are a valid representation of the bank's condition at that time. Asset quality was deemed unacceptable and credit risks were high. The board had failed to implement adequate procedures to prevent insider abuse and to implement an effective risk management system. Earnings performance was poor; loan losses and increased provision expenses led to net losses for the year

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and the current quarter. These factors as well as an increasing overall risk profile had an impact on capital adequacy. The diminishing level of secondary funding sources also affected liquidity. The supervisory office restated its position that the assigned composite of 4 and component ratings of 4, 4, 4, 4, and 3 for capital, asset quality, management, earnings, and liquidity, respectively, met the criteria in the Uniform Financial Institutions Ratings System (UFIRS).

Conclusion

The ombudsman reviewed the bank's submission as well as information supplied by the supervisory office. Because the bank was operating under an enforcement action, the ombudsman's review was limited to a determination of reasonableness as defined in OCC Bulletin 2002-9, "National Bank Appeals Process." Essentially, the ombudsman used a process similar to that of a federal appeals judge versus the de-novo review process that is customarily employed on non-enforcement-related appellate matters. Therefore, the review focused on whether the ratings were reasonable as assigned based on the condition of the bank at the time of the examination.

The ombudsman opined that the conclusions reached by the supervisory office were reasonable, well supported by the facts at the time of the examination, and met the definition of a composite 4 bank as prescribed by UFIRS. The ombudsman also found that the assigned component ratings for capital, asset quality, management, earnings, and liquidity were reasonable and accurately reflected the bank's condition at the time of the examination.