BACKGROUND

The CEO of BestBank acquired 100 percent ownership of the bank on March 15, 1989. At that time, most of the loans and assets had been sold, which left cash as the major asset purchased by the new owner. As a result, the bank had many characteristics of a newly established bank. During the FDIC's 1989 examination, the examiners stated that the CEO appeared "to be a man of many talents who, however, is very unfamiliar with many aspects of banking." In 1992, BestBank's Board of Directors elected to hire a bank president to run the day-to-day operations. The newly hired president was a former president of a Sioux Falls, South Dakota bank. According to an FDIC Field Office Supervisor, the president was "largely responsible for getting the Sioux Falls bank heavily into credit card receivables and related investments that have caused tremendous reversals and significant problems in the bank." Under this management team, BestBank assets and the return on assets increased significantly. In 1995, an *American Banker*[1] newspaper story said that BestBank "is the best performer among U.S. banks" based upon its return on assets of 4.64 percent.

According to FDIC examiners, BestBank developed "market niches which include automated teller machines, credit cards for high risk individuals, and consumer lending secured primarily by second deeds of trust." When the bank entered a new market, management would commit a sizable portion of the bank's assets. FDIC and State examiners consistently determined that there was little evidence of pre-planning activities or analysis of the market prior to the initial investment. The examiners also found that the bank did not adopt or implement appropriate policies or procedures prior to funding new business ventures and internal controls were deficient. For example, financial statements on third parties, such as those associated with the unsecured credit cards and Century, were not reviewed or analyzed. These practices resulted in concentrations of the bank's assets in business ventures without the benefit of pre-funding analysis. Presented in table 1 are specific examples of concerns related to BestBank management's entry into new markets, extracted from FDIC and State examination reports.

Table 1: Examples of Examiners' Concerns About BestBank Management

Automatic Teller Machines (ATMs) (1991)
▪ Failed to notify the regulatory authorities of the ATMs prior to installing them.
▪ Failed to develop and implement Board approved strategic plan including budget, cost analysis, breakeven analysis, parameters for site selection, goals, or contingency alternatives for unforeseen events.
Fresh Start Credit Card Program (1992)
▪ Failed to develop adequate credit card policy despite the fact that more than 40 percent of the loan portfolio is credit card related.
▪ Failed to develop adequate monitoring system as evidenced by large losses in excess of the borrowers' credit limit.
Lease Receivables (1993)
▪ Failed to obtain financial information on servicer or leasing company.
▪ Failed to exercise adequate controls over the program as evidenced by the reliance placed on third-party servicers to originate and document credits in the lease portfolio.
▪ Failed to place limits on loan-to-value collateral requirements as evidenced by providing financing up to 115 percent of the collateral value.
Merchant Credit Card Processing Activities (1995)
▪ Failed to establish adequate policies and procedures to effectively supervise credit card processing activity.
▪ Failed to incorporate target market descriptions and underwriting guidelines in the Merchant Credit Card Processing and Acquiring Policy.
▪ Failed to develop and implement adequate internal controls, monitoring systems, and management information systems pertaining to the merchant credit card processing.

Source: FDIC and State Examination Reports

[1] *American Banker*, The Daily Financial Services Newspaper, June 7, 1995.

These deficiencies indicate management's repeated failure to establish adequate internal controls. Similar practices continued with the unsecured credit card travel program that ultimately resulted in the bank's failure.

BestBank became a concern to regulatory authorities shortly after the 1989 change in bank ownership. Table 2 details the various regulatory actions pursued against BestBank from 1992 until its closing in 1998. It also illustrates the attempts made by the FDIC and the State to address areas of weakness noted at each examination.

Table 2: Examination Results and Regulatory Actions for BestBank

Exam Date & Agency	CAMELS ^ Ratings	Recommended Action(s) By FDIC and State Examiners	Action Date	Resulting Action
10/02/92 FDIC	3-2-5-4-4/4	Recommended Cease & Desist Order (C&D) section 8(b).	01/31/94	C&D issued.
		Recommended removal Action section 8(e) COB/CEO/President.		No action taken.
		Civil Money Penalties Recommended.		No action taken.
06/16/93 State	3-3-4-5-3/4	Recommended Written Agreement.	01/31/94	C&D issued.
01/07/94 FDIC	2-2-4-4-3/3	Civil Money Penalties recommended for Violations of Federal Reserve Act, section 23 A & B and Regulation O.		No action taken.
07/05/94 State	2-2-3-2-3/3	No action recommended.		
01/23/95 FDIC	2-3-3-2-2/3	Proposed Memorandum of Understanding (MOU) to replace C&D.	10/04/95	C&D terminated. Board Resolutions accepted in lieu of MOU.
02/05/96 State *	4-3-4-4-3/4	State contemplated supervisory action. FDIC proposed MOU.		No action taken.
10/28/96 FDIC	3-2-3-2-3/3	FDIC proposed MOU.	02/09/97	Board Resolutions accepted in lieu of MOU.
10/14/97 State *	3-2-3-1-3-2/3	State & FDIC wanted to propose MOU and if it was not signed, will propose C&D.		No action taken.
06/24/98 FDIC *	5-5-5-5-5-5/5	Section 10(c) Order of Investigation to gain access to examine Century. Recommended section 8(e) action.	07/22/98	Gained access to Century's data processing affiliate under a January 1997 Marketing, Processing and Consulting Agreement. Section 8(e) actions on-going. Prompt Corrective Action – notification of Critically Undercapitalized status.
			07/23/98	Colorado State Banking Board closed BestBank.

^ Refer to Glossary

* Joint Examination with Lead Agency Indicated
Source: DOS and Colorado Division of Banking

The FDIC's October 1992 examination reported numerous concerns regarding managerial deficiencies. As indicated in table 2, the bank was rated an overall composite of "4," with a component rating of "5" for management. The FDIC recommended a Cease and Desist Order (C&D) to address the weaknesses; however, the CEO contested the proposed enforcement action. The FDIC examiners also recommended a section 8(e) action (removal of an institution-affiliated party) to remove the CEO from banking because of his disregard for the safe and sound operation of the bank related to the bank's payment of specific personal expenses of the CEO. However, we found no evidence that the FDIC took further action to remove the CEO. Following the June 1993 examination by the State, the CEO offered to consider some other form of written agreement in lieu of the FDIC's proposed C&D. However, the FDIC pursued the C&D up to and including setting a hearing date with an Administrative Law Judge. BestBank finally stipulated to the C&D on January 31, 1994.

As a result of the FDIC's January 1994 examination, Civil Money Penalties (CMPs) were recommended for apparent violations of law concerning the payment of the CEO's personal expenses by the bank. Action on the recommendation was delayed pending an audit of the CEO's personal expenses by an independent Certified Public Accountant (CPA). The CPA firm concluded that some of the expenses were personal in nature and that the CEO should reimburse the bank for those costs. The CEO subsequently repaid the expenses. We have no documentation indicating any action was taken by the FDIC regarding the proposed CMPs.

The FDIC's January 1995 examination noted sufficient improvements in the bank to warrant removing the C&D. FDIC examiners recommended a Memorandum of Understanding (MOU), an informal administrative action, to replace the outstanding C&D. The MOU was recommended to address outstanding sections of the C&D where the bank had not attained full compliance as well as new areas of concern. However, the Dallas Regional Office terminated the C&D in October 1995 after accepting Board Resolutions in lieu of an MOU.

Our interviews with examiners disclosed that disagreements over proposed actions and the CEO's stance against regulatory action continued during the next three examinations. Each time the regulators proposed an MOU, the CEO countered with Board Resolutions, which the FDIC and the State accepted. While there were outstanding Board Resolutions when BestBank was closed in July 1998, there were no regulatory imposed corrective measures in place to address weaknesses identified in previous examinations.

The CEO of BestBank sent a letter dated March 18, 1996 to the FDIC Chairman that listed 10 allegations of "unprofessional, unethical, and unlawful conduct" by DOS examiners in the Dallas Regional Office and Denver field office. Subsequently, the FDIC Chairman requested the FDIC's Office of Inspector General (OIG) to conduct a review of the BestBank allegations. This was interpreted by several examiners to suggest that the CEO had direct access to the FDIC Chairman, and they felt under pressure to be more cautious when dealing with BestBank. One FDIC examiner commented that the CEO's goal was to undermine the authority of the FDIC and that the CEO was successful in this regard. To avoid any appearance that the Denver field office was biased toward BestBank, the Dallas Regional Director assigned oversight responsibility for subsequent examinations to the Lubbock, Texas, field office. The OIG issued a report to the Chairman on July 10, 1996.[2] In the report, the OIG did not fully substantiate any of the allegations, found several of the allegations to be without merit, and generally concluded that examiners followed applicable FDIC policies and procedures. (See appendix A, Excerpt From OIG's *Review of the Allegations Regarding the Federal Deposit Insurance Corporation's Supervision of BestBank in Boulder, Colorado.*) According to the DOS examiners, they were not told of the OIG's conclusions, but were merely informed that the OIG had "exonerated" them.

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[2] *Review of the Allegations Regarding the Federal Deposit Insurance Corporation's Supervision of BestBank in Boulder, Colorado* (INS-96-008); July 10, 1996.