UNITED STATES OF AMERICA
DEPARTMENT OF THE TREASURY
OFFICE OF THE COMPTROLLER OF THE CURRENCY

IN THE MATTER OF PRESTON J. BROOKS FORMER PRESIDENT AND CHAIRMAN OF THE BOARD FIRST NATIONAL BANK OF DEPORT, DEPORT, TEXAS	AA-EC-01-153

RECEIVED
O.C.C.
CHIEF COUNSEL

DECISION OF THE COMPTROLLER OF THE CURRENCY[1]

I. SUMMARY

Pursuant to 12 U.S.C. §§ 93b, 504, and 1818(i)[2] the Comptroller of the Currency ("Comptroller") assesses a civil money penalty ("CMP") against the Respondent, Preston J. Brooks, former President and Chairman of the Board of the First National Bank of Deport, Deport, Texas ("FNB-Deport" or "Bank"), for violations of law, unsafe or unsound practices and breach of fiduciary duty. After fully considering the record in this case and the statutory factors for determining the amount of a CMP set forth at 12 U.S.C. §§ 93(b), 504, and 1818(i) the Comptroller assesses Respondent a CMP in the amount of $18,000.

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[1]Throughout this Decision the Administrative Law Judge's ("ALJ's") Recommended Decision will be cited as "ALJ-D," the OCC's exceptions to the ALJ's Recommended Decision will be cited as "Excp.," the OCC exhibits will be cited as "OCCX- " and excerpts from the hearing transcripts will be cited as "TR."

[2]Sections 12 U.S.C. §§ 93b, 504 and 1818(i) authorize the Comptroller to assess civil money penalties against bank affiliated persons based on violations of law or regulation and certain unsafe or unsound practices and breaches of fiduciary duty.

II. INTRODUCTION

On September 9, 1991, the Office of the Comptroller of the Currency ("OCC") issued a Notice of Assessment of Civil Money Penalty ("Notice") against Respondent in the amount of $25,000.[3] The Notice charged Respondent with unsafe and unsound practices with respect to certain wire transfers that Respondent executed The Notice also charged Respondent with violations of 12 U.S.C. §§ 24(7),[4] 60,[5] 375b.[6]

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[3]On September 9, 1991, the OCC also issued a Notice of Intention to Prohibit Further Participation, brought under the provisions of 12 U.S.C. § 1818(e). The OCC certified the ALJ's Recommended Decision in the removal action to the Board of Governors of the Federal Reserve System for a determination of whether a removal order shall be issued, pursuant to 12 U.S.C. § 1818(e)(4). Consequently, issues relating to the removal action are not addressed in this decision.

[4]Enforcement Counsel alleged that Respondent had violated 12 U.S.C. § 24(7) because the Bank had engaged in impermissible real estate brokerage activities. These activiites were brought to the Bank's attention in 1985 and the activity was stopped.

Respondent argued in briefs submitted to the ALJ that assessment of a civil money penalty based on the violation of 12 U.S.C. § 24(7) described in the Notice is now barred by the general statute of limitations contained at 28 U.S.C § 2462. The ALJ concluded that 28 U.S.C § 2462 does not bar assessment of a civil money penalty based on the violation of 12 U.S.C. § 24(7) that occurred in 1984, since 28 U.S.C § 2462 by its terms only applies to a "proceeding for the <u>enforcement</u> of any civil fine." ALJ-D at 11-14, <u>quoting</u> 28 U.S.C.S § 2462 (1990) (emphasis added). <u>But see</u>, <u>United States v. Meyer</u>, 808 F.2d 912, 914 (1st Cir. 1987) (Noting with approval that the parties had assumed that 28 U.S.C § 2462 "at least requires that any administrative action aimed at imposing a civil penalty . . . be brought within five years of the alleged violation.").

Respondent did not file exceptions to the ALJ's recommended decision and, therefore, may be deemed pursuant to 12 C.F.R. § 19.39(b)(1) to have waived an further consideration of the statute of limitations issue. Moreover, the Comptroller has determined not to assess civil money penalties against Respondent based on the alleged violation of 12 U.S.C. § 24(7) described in the Notice. Consequently, the Comptroller need not address this issue in this case.

A. Facts

1. Regarding the Respondent's Alleged Unsafe or Unsound Practices and Breach of Fiduciary Duty Involving Certain Wire Transfers

On October 31, 1989, Respondent initiated and executed a wire transfer of Bank funds in the amount of $5,000 from the Bank's correspondent account with Texas Independent Bank ("TIB") to a trust account, known as "the Herman Jacobs Trust" ("Jacobs Trust") for which Respondent is a beneficiary and Respondent's mother and sister are co-trustees. OCCX-8 through 23; TR at 59-64, 115, 120-124, 141-155. Although the Bank's correspondent account at TIB received a debit in the amount of $5,000 on October 31, 1989, the entry was not recorded on the Bank's records until November 14, 1989.

Later in the day on October 31, Respondent initiated and executed another wire transfer of Bank funds in the amount of

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[5] Section 60 authorizes a national bank's board of directors to declare a dividend of so much of the net profits of the bank as they judge expedient, "except that until the surplus fund of such association [equals its capital], no dividends shall be declared unless there has been carried to the surplus fund . . . [at least] one-tenth of . . . its net profits of the preceding two consecutive [years]. 12 U.S.C.A. § 60(a) (West 1989). In addition, "[t]he approval of the Comptroller of the Currency shall be required if the total of all dividends declared by such association in any calendar year shall exceed the total of its net profits of that year combined with its retained net profits of the preceding two years . . . ." 12 U.S.C.A. § 60(b) (West 1989).

[6] Section 375b, inter alia, prohibits a bank from making loans to its executive officers or directors unless the terms of the loans are substantially the same as those for comparable transactions with other persons and the loans do not involve more than the normal risk of repayment. 12 U.S.C.A. § 375b (West 1989).

$18,150 from the Bank's correspondent account with TIB to the Jacobs Trust. Once again the Bank's correspondent account at TIB received a debit entry in the amount of $18,150 on October 31, 1989, but the entry was not reflected on the Bank's records until November 14, 1989.

Similarly, on November 8, 1989, Respondent initiated and executed a wire transfer of Bank funds in the amount of $700 from the Bank's correspondent account with TIB to the account of Respondent's sister-in-law at a bank in Austin, Texas. OCCX-8; OCCX-33 through 41; TR 60-73, 115. Also on November 8, 1989, Respondent initiated and executed a wire transfer of Bank funds in the amount of $300 from the Bank's correspondent account with TIB to the account of Respondent's brother at the same bank in Austin, Texas. These transfers were not charged against the appropriate account with the Bank until December 29, 1989.

2. Regarding Respondent's Alleged Violation of 12 U.S.C. § 60

On August 15 and December 19, 1989, the Board, including Respondent, approved dividends in the amounts of $36,520.54 and $40,000, respectively. OCCX-60; TR 234, 235. These dividends when combined with dividends made on February 17 and May 12, 1989, exceeded the amount permissible for the Bank under 12 U.S.C. § 60 by $63,736. OCCX-7 and 42; TR 217, 218.

All the dividends were paid by the Bank to Deport Bancshares, Inc. ("DBI"). (OCCX-7, p. 1; OCCX-8, p. 11;

OCCX-70). The Bank was a wholly owned subsidiary of DBI.[7] DBI in turn is a wholly owned subsidiary of Deport Financial Company, Inc. ("DFC") for which Respondent was a controlling and principal shareholder. OCCX-2, at A-14; OCCX-3 at 5, 6; OCCX-52.

DBI and DFC had stock loans which were renewed and combined under a Loan Agreement dated November 9, 1987, between DBI, DFC and Texas Independent Bank, in the principal amount of $797,000 ("Loan Agreement"). OCCX-50; TR 132. Pursuant to provisions of Loan Agreement, Respondent agreed to personally guarantee payment of all obligations of DBI and DFC to TIB. OCCX-50, pp. 3 and 10. As a guarantor and obligated party, Respondent was jointly and severally liable for the entire debt of DBI and DFC. OCCX-50, p. 10. Upon the default of DBI and/or DFC, TIB could foreclose on the DFC stock held by Respondent and assume control of DEC, DBI, and the Bank. OCCX-50.

The OCC reviewed the dividends declared and paid by the Bank during 1989 as part an off-site examination of the Bank as of March 1, 1990. TR 207. As a result of the analysis conducted during the March 1, 1990, off-site examination, the OCC cited the Bank for violations of 12 U.S.C. § 60. OCCX-7, pp. 1 and 3. Respondent requested retroactive approval by the OCC of the illegal dividend. OCCX-8, pp. 2, 11; OCCX-69; TR 157, 218. In a letter dated August 3, 1990, the OCC denied Respondent's request for retroactive approval of the 1989 dividend based on the Bank's

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[7] The Federal Deposit Insurance Corporation was appointed receiver for the Bank on July 9, 1992.

weak equity capital position, large amount of high risk assets, and the OCC's concerns regarding management's administration of the Bank. OCCX-69, 70; TR 158, 159.

On October 21, 1990, the Bank entered into an Order to Cease and Desist ("C&D"). OCCX-73 and 74; TR 160. Under the terms of the C&D, the Board was required to reimburse the Bank for the dividends declared and paid in excess of the limitations imposed by 12 U.S.C. § 60, plus interest on the amount of the excess dividend. OCCX-74, Article XII, p. 16; TR 160, 161. On December 28, 1990, the six Bank directors, including Respondent, paid the Bank the sum of $63,736.02, without the additional required interest payment, as restitution for payment of the illegal dividend. OCCX-74; TR 163.

3. Regarding Respondent's Alleged Violation of 12 U.S.C. § 375b

The Board's minutes indicate that on October 31, 1989, the Board approved a loan to Respondent from the Bank, in the amount of $18,150. OCCX-24, 27; TR at 118, 345. The Bank's general ledger indicates that the loan was not booked until November 9, 1989. OCCX-24; TR at 119-121. The proceeds from the loan were advanced on November 9, 1989. OCCX-24.

The terms of the Respondent's loan are considered preferential because the note would take approximately 110 months (more than nine years) to amortize. OCCX-5, p. 2, OCCX-8 at 26; OCCX-27; TR at 118. In addition, the note was classified

substandard because there was a lack of current financial information on Respondent at the time the loan was granted. OCCX-5 at 2, A-I. In addition, as it turned out, Respondent was financially illiquid, had numerous and continuous overdraft problems, and had a high level of contingent liabilities; Respondent's credit quality did not support an extension of credit on the terms granted; and Respondent failed to provide an appraisal of the value of the collateral which secured the loan at the time his extension of credit was granted. OCCX-8 at 3, 7, 21-22, 26; OCCX-27; TR at 118, 124, 126-127, 137-138.

Generally, the Bank disburses loan proceeds either in the form of a cashier's check to the borrower (or a third party) or directly into the borrower's account at the Bank. TR 130. On November 14, 1989, the proceeds from the loan were deposited directly into the Bank's correspondent account. OCCX-8, p. 26; OCCX-26; TR 56, 129.

B. Hearing before the Administrative Law Judge

A hearing was held on the Notice before an administrative law judge ("ALJ") on September 22 and 23, 1992. During the hearing, Counsel for the OCC's Enforcement and Compliance Division ("Enforcement Counsel") objected to permitting Respondent to testify on the grounds that Respondent had asserted his Fifth Amendment right against self-incrimination during a pre-hearing deposition. The ALJ overruled Enforcement Counsel's objections and permitted Respondent to testify.

The ALJ certified his Recommended Decision to the Comptroller on March 21, 1993. The ALJ proposed a CMP of $3,500, based on findings that Respondent was liable for violations of 12 U.S.C. §§ 24(7), 60 and 375b. The ALJ also concluded that Respondent was not liable for any unsafe or unsound practices involving the wire transfers described in the Notice.

Enforcement Counsel filed exceptions to the ALJ's Recommended Decision. Enforcement Counsel excepted to: (1) the ALJ allowing Respondent to testify at the hearing; (2) the ALJ's conclusion that Respondent was not liable for unsafe and unsound practices involving certain wire transfers he made to members of his family; (3) the ALJ's conclusion that second tier penalties were not applicable to Respondent's violations of 12 U.S.C. § 60; and (4) the amount of the CMP. Excp. at 3-9, 13, 60-73.

Respondent did not file exceptions to the ALJ's Recommended Decision.

III. ISSUES

The ALJ's Recommended Decision and Enforcement Counsel's exceptions thereto raise the following issues.

1. Whether Respondent's testimony was properly admitted into evidence.
2. Whether the ALJ's properly concluded that Respondent was not liable for unsafe and unsound practices involving certain wire transfers.

3. Whether the ALJ applied the provisions of 12 U.S.C. §§ 93(b)(2), 504(b) and 1818(i)(2)(b) correctly with respect to Respondent's conduct.

4. The amount of the assessment.

IV. DISCUSSION

A. Respondent's Testimony Was Properly Admitted into Evidence

Enforcement Counsel argues that Respondent's testimony during the hearing before the ALJ should be stricken because: (1) he refused to give testimony during a pre-hearing deposition, asserting his Fifth Amendment right against self-incrimination; and (2) he failed to comply with the OCC's rules of procedure at 12 C.F.R. § 19.32 regarding pre-hearing statements. Excp. at 3-9.

1. The Fifth Amendment Argument

Although the Fifth Amendement privilege against self-incrimination applies to administrative as well as civil and criminal litigation, a party may not refuse to be examined altogether, but rather must invoke the privilege as to specific questions when and as posed. See Matin I. Kaminsky, Preventing Unfair Use of the Privilege Against Self-Incrimination of Private Civil Litigation: A Critical Analysis, 39 Brook. L. Rev. 121, 122, 139-142. A party who invokes the privilege during discovery may be prohibited from testifying as to that matter at trial.

Enforcement Counsel argues that Respondent's testimony at the hearing should be stricken because Respondent refused to

answer questions posed to him during a deposition. Because the deposition was not admitted into evidence, it cannot be determined whether Respondent improperly testified to matters at the hearing for which he had previously claimed the privilege. Consequently, because the Enforcement and Compliance Division has the burden of proof on this issue, Enforcement Counsel's motion to strike Respondent's testimony was properly denied.

2. Compliance with 12 C.F.R. § 19.32

Pursuant to 12 U.S.C. § 19.32 parties to an administrative action must file a pre-hearing statement which must contain, inter alia, a list of witnesses to be called at the hearing, together with a narrative summary of their expected testimony. 12 C.F.R. § 19.32 (1993).

Enforcement Counsel contends that Respondent's pre-hearing statement did not comport with 12 C.F.R. § 19.32 because Respondent "failed to definitively identify Respondent as a witness at trial" and failed to provide an adequate summary of Respondent's expected testimony. Excp. at 5. With regard to his list of witnesses to be called at the hearing, Respondent's pre-hearing statement explained that "[i]t has not been decided whether Mr. Brooks will testify," and then gave a narrative summary of what his testimony would be should he testify.

In denying Enforcement Counsel's motion to strike the statement, the ALJ apparently concluded that Respondent's

statement complied with 12 C.F.R. § 19.32. Although the Comptroller is not bound by the ALJ's findings,[8] based on these facts the Comptroller finds no reason to upset the ALJ's conclusion on this issue.

B. The ALJ's Conclusion that Respondent Did Not Engage in Unsafe or Unsound Practices or Breach his Fiduciary Duty with Regard to the Wire Transfer Transactions Cited in the Notice of Charges Is Correct

Section 1818(i)(2)(B) authorizes the Comptroller to assess a civil money penalty against a director or officer of a national bank who "recklessly engages in an unsafe or unsound practice" or "breaches any fiduciary duty" in conducting the affairs of the bank. 12 U.S.C.A. 1818(i)(2) (West 1989).

OCC examiners concluded that the failure to properly record the wire transfers that Respondent initiated and executed to the Jacobs Trust on October 31, 1989, and to the accounts of his sister-in-law and brother on November 8, 1989, which resulted in the Bank's TIB account being out of balance, was an unsafe or unsound practice.

As was noted by the Eighth Circuit in First National Bank of Eden v. Comptroller of the Currency:

> Unsafe or unsound practices . . . encompass what may generally be viewed as conduct deemed contrary to accepted standards of banking operation which might result in abnormal risk or loss to a banking institution or shareholder.

[8] Accord Starret v. Special Counsel, 792 F.2d 1246 (4th Cir. 1986).

568 F.2d 610, 611 (8th Cir. 1978); see also Northwest Nat'l Bank v. Office of the Comptroller of the Currency, 917 F.2d 1111, 1115 (8th Cir. 1990).

In this case, OCC examiners noted that recordkeeping practices such as those described with respect to the wire transfers that Respondent initiated and executed on October 31, 1989, and November 8, 1982, "greatly increase the opportunity for defalcations to occur." OCCX-8 at 14. On the basis of conclusions of the OCC's examiners regarding these practices, the Comptroller concludes that the wire transfer transactions constituted an unsafe or unsound practice.[9]

Enforcement Counsel argues that Respondent, as president of the Bank, should be held responsible for this unsafe or unsound practice. The record, however, shows that the internal control policy of the Bank would not have permitted Respondent to make bookkeeping entries for wire transfers that he initiated. The Bank's cashier was primarily responsible for reconciling wire transfer entries. On the basis of these facts and on the basis of Respondent's uncontradicted testimony that he was not aware that the wire transfers remained out of balance until OCC examiners informed him and the rest of the Board of this fact, the ALJ concluded that the OCC had failed to show that Respondent

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[9]As noted by Enforcement Counsel, given the expertise of Federal bank examiners and the highly technical nature of the subject matter involved, substantial deference is given to the findings and conclusions of the examiners. See Sunshine State Bank v. Federal Deposit Insurance Corporation, 783 F.2d 1580, 1584 (11th Cir. 1986).

had engaged in an unsafe and unsound practice or breached his fiduciary duty "by manipulating and drawing on Bank funds"[10] as alleged in the Notice. ALJ-D at 21-23. The Comptroller defers to the ALJ's findings of fact on this issue and, therefore, concurs in his conclusion that the evidence of this allegation is insufficient to establish liability on the part of Respondent.

C. The ALJ Did Not Apply the Provisions of 12 U.S.C. §§ 93(b)(2), 504(b) and 1818(i)(2)(B) Correctly with Respect to Respondent's Violations of 12 U.S.C. § 60 and the Violation of Law, Unsafe or Unsound Practice and Breach of Fiduciary Duty Involving a Loan Made to Respondent on October 31, 1989.

1. Violation of 12 U.S.C. § 60

Based on the facts contained in the record,[11] the ALJ concluded that Respondent had violated 12 U.S.C. § 60. The Comptroller concurs in the ALJ's conclusion.

In discussing the Comptroller's statutory authority to assess civil money penalties for violations of 12 U.S.C. § 60, the ALJ concluded that the version of 12 U.S.C. § 93(b) prior to the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") was applicable. The violation of 12 U.S.C. § 60, however, resulted from the August 15, 1989, and December 19, 1989, dividend payments which occurred after the effective date of the FIRREA amendments to 12 U.S.C. § 93(b). See Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73 § 907(1), 103 Stat. 183 (1989) ("The

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[10] See Notice at 7-9 and 11-13.

[11] See pp. 4-6, supra for a summary of the facts.

amendments made by [section 907 which includes the amendments to 12 U.S.C. § 93(b)] shall apply with respect to conduct engaged in by any person after the date of enactment of this Act [August 8, 1989]). Consequently, the Comptroller concludes that the post-FIRREA version of 12 U.S.C. § 93(b) applies to Respondent's violations of 12 U.S.C. § 60.

2. Effect of the FIRREA Amendments

FIRREA enhanced the OCC's civil money penalty authority under 12 U.S.C. § 93(b) (as well as 12 U.S.C. §§ 504 and 1818(i)) by establishing a three tiered penalty structure. Each tier is tailored to succeeding levels of severity of conduct and authorizes higher per-day assessment amounts.

The second tier authorizes assessment of a civil money penalty against any officer or director who, inter alia:

> 1. Violates any law or regulation; or
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> 2. Recklessly engages in an unsafe or unsound practice in conducting the affairs of such association; or
>
> 3. Breaches any fiduciary duty;
>
> which violation, practice, or breach: (i) is part of a pattern of misconduct; (ii) causes or is likely to cause more than a minimal loss to such association; or (iii) results in pecuniary gain or other benefit to such party. The second tier authorizes a maximum $25,000 assessment for each day during which such violation, practice, or breach continues.

12 U.S.C.A. § 93(b)(2)(West 1989 & Supp. 1992) (emphasis added).

Respondent clearly received pecuniary gain as a result of the violation of 12 U.S.C. § 60 described in the Notice since the

dividends were used to pay debts owed by DBI and DFC for which Respondent was a guarantor and jointly and severally liable. For this reason, the Comptroller concludes that Respondent is liable under 12 U.S.C. § 93(b)(2) for a civil money penalty of up to $25,000 per day for each day that the violation continued.[12]

3. Violation of 12 U.S.C. § 375b

Section 504 of Title 12 U.S.C. authorizes the Comptroller to assess a civil money penalty against any officer or director of a national bank for violation of 12 U.S.C. § 375b or any regulation issued pursuant thereto. 12 U.S.C. § 504(a). The ALJ concluded that the Bank's loan to Respondent, approved by the Board on October 31, 1989, was granted on preferential terms and, thus, violated 12 U.S.C. § 375b and its implementing regulation at 12 C.F.R. Part 215. ALJ-D at 24-25. The Comptroller concurs in this conclusion. Consequently, Respondent is liable under 12 U.S.C. §§ 504(b) for a civil money penalty of up to $25,000 per day beginning October 31, 1989, through the present.

[12] In construing the language that authorizes a second tier assessment in connection with Respondent's violation of 12 U.S.C. § 375b, discussed below, the ALJ erroneously adds the word "AND" after the provision that authorizes second tier assessments for certain violations of law. Consequently, the ALJ combines the first two elements to conclude that a second tier penalty requires both a violation of law and either a reckless unsafe and unsound practices or a breach of fiduciary duty to the institution. ALJ-D at 17. This section, however, is written in the disjunctive, with the final element in the series separated by an "OR." Consequently, the existence of any one of the elements--a violation of law _or_ a reckless unsafe or unsound practice _or_ a breach of fiduciary duty combined with a pattern of misconduct or loss to the bank or pecuniary gain to a respondent authorizes assessment of a civil money penalty under 12 U.S.C. §§ 93(b)(2), 504(b) and 1818(i)(2)(B).

4. Unsafe or Unsound Practices

In addition, the record establishes that the October 31, 1989, loan was made before the Bank obtained all the necessary information from Respondent as borrower. OCCX-5 at 2, A-I; OCCX-8 at 3, 7, 21, 22, 26; TR at 126-127, 137-138. A loan is not booked in a safe and sound manner unless and until the Bank obtains all the necessary information from the borrower and completes all the necessary bookkeeping entries. TR at 109-110.

Also, it is highly unusual for loan proceeds to be disbursed directly into a bank controlled account as were the proceeds of Respondent's loan. Moreover, it is considered to be an unsafe, unsound, and imprudent banking practice because it does not provide a clear audit trail. TR at 129-131, 204.

For these reasons, not only did the loan to Respondent result in a violation of 12 U.S.C. § 375b, but the manner in which it was handled constituted an unsafe or unsound practice which, given Respondent's extensive experience and regulatory background,[13] can only be considered reckless.

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[13]Respondent's Background: Respondent has an undergraduate degree with a major in accounting and a minor in finance, a master's degree with a major in banking and a minor in economics, and attended two years at Stonier Graduate School of Banking. TR at 326. Respondent also is a certified public accountant and worked as a national bank examiner for the OCC for over three years and progressed to become an examiner-in-charge. TR at 326-327. After his employment with the OCC, Respondent worked as vice president of a $30 million bank and then vice president and treasurer of a $70 million savings and loan, both in northeast Texas. TR at 326. In 1983, Respondent acquired control of the Bank. In May 1985, Respondent became the Bank's President and Chief Executive Officer. TR at 331.

Furthermore, because Respondent was financially illiquid, had numerous and continuous overdraft problems, had a high level of contingent liabilities,[14] and had credit quality that did not support an extension of credit on the terms granted (OCCX-8 at 3, 7, 21, 22, 26; TR at 126-127, 137-138), Respondent breached his fiduciary duty to the Bank by accepting the loan.

Since the loan obviously inured to Respondent's pecuniary benefit, the Comptroller concludes that Respondent is liable under 12 U.S.C. § 1818(i)(2)(B) for a civil money penalty of up to $25,000 per day.

D. Amount of the Assessment

1. Maximum Penalties

Sections 93(b)(2), 504(b) and 1818(i)(2)(b) authorize the Comptroller to assess a CMP of up to $25,000 per day for violations of law that meet the criteria for a second tier assessment for each day the violations continue. As discussed above, Respondent's violations of 12 U.S.C. §§ 60 and 375b meet the criteria for a second tier assessment. Respondent's violation of 12 U.S.C. § 60 existed from August 15, 1989 (the date on which the amount of dividends that the Board declared exceeded the amount authorized by 12 U.S.C. § 60) through December 28, 1990 (the date on which the Board made restitution

[14]Respondent was a guarantor on a $734,000 stock loan between his holding companies and TIB. OCCX-8, p. 26, OCCX-50; TR 131, 136.

to the Bank). Respondent's violation of 12 U.S.C. § 375b began on the date on which the loan was made.

Section 1818(i)(2)(b) also authorizes the Comptroller to assess a CMP of up to $25,000 per day for unsafe or unsound practices and breaches of fiduciary duty for each day that the practice or breach continues. As noted above, Respondent also breached his fiduciary duty with regard to the loan he obtained from the Bank on October 31, 1989.

2. Additional factors to be considered in determining the amount of the penalty

In addition to the maximum penalty amounts authorized under 12 U.S.C. § 93(b), 504 and 1818(i), the Comptroller also must consider the following factors in determining the appropriate amount of the CMP assessment: (1) the gravity of the violation; (2) the history of previous violations; (3) the good faith of the person charged; (4) the financial resources of the Respondent; and (5) other such matters as justice may require. See 12 U.S.C. § 93(b)(5), 504(e) 1818(i)(2)(G) (1989).

a. The gravity of the violation

The record establishes that the Bank was in a weakened capital position prior to Respondent's distribution of the unlawful dividends. OCCX-8; OCC-74. Respondent's violation of 12 U.S.C. § 60 further reduced the Bank's capital which was not replenished until the Board agreed to reimburse the dividend payments pursuant to the C&D. Thus, the effect of the 12 U.S.C. § 60 violation upon the Bank weighs in favor of a higher assessment.

The record also shows that at the time that Respondent obtained his substandard loan from the Bank, in violation of 12 U.S.C. § 375b and in breach of his fiduciary duty, the Bank already had a high level of classified assets. OCC-8. Respondent's loan would have required an additional provision to the Bank's Allowance for Loan and Lease Losses (ALLL), and since the Bank had weak earnings this provision also may have resulted in a reduction in the Bank's capital. Consequently the effect of Respondent's 12 U.S.C. § 375b violation, the unsafe/unsound practice and breach of fiduciary duty involving the October 31, 1989 loan also weigh in favor of a higher assessment.

b. History of previous violations

The record establishes a pattern of violations of law and unsafe and unsound practices at the Bank involving Respondent's conduct since 1985 when Respondent became President and CEO of the Bank. OCCX-1 through 8. Thus, the Respondent's history of previous violations does not weigh in favor of mitigating the amount of the assessment.

c. Respondent's good faith

The ALJ found that Respondent acted in good faith. ALJ-D at 31. This finding is questionable given Respondent's failure to heed the OCC's warnings following the February 28, 1989 examination regarding the permissibility of future dividends. In addition, given Respondent's experience as both banker and a bank examiner, it seems he should have known that the manner in which

he obtained funds from the Bank on October 31, 1989 was unacceptable. For these reasons, the Comptroller concludes that the good faith factor weighs very little (if at all) in favor of mitigating the amount of the assessment.

d. Financial Resources

The ALJ concluded that Respondent's financial resources are sufficient to support "some penalty," but that there was "no evidence to suggest that he can withstand the $25,000 that has been assessed." ALJ-D at 30. The ALJ also cites to Respondent's "lack of personal resources and other excessive liabilities" in support of a reduced assessment amount. Id. Given that, as stated below, the total amount of the assessment has been set at $18,000 which Respondent may arrange to pay in installments, the Comptroller concludes that the information regarding Respondent's financial resources does not weigh in favor of a reduced assessment.

e. Other factors

The ALJ did not note nor does the Comptroller find any additional factors which weigh in favor of mitigating the amount of the assessment against Respondent.

IV. CONCLUSION

After a careful review of the entire record and the recommendations of the ALJ, the Comptroller finds that the Respondent violated 12 U.S.C. §§ 60 and 375b and engaged in unsafe or unsound practices and breached his fiduciary duty with respect to the loan made to him on October 31, 1989.

Accordingly, after consideration of the factors enumerated in 12 U.S.C. § 1818(i)(2)(G), the Comptroller issues the attached final order of assessment against Respondent Preston J. Brooks in the amount of $18,000.

VI. FINDINGS OF FACT

The Comptroller adopts paragraphs 1-45, 47-49, 52, 54-65, and 69-87, of the Administrative Law Judge's Findings of Fact.

In addition, the Comptroller adopts the following findings of fact:

The loan that the Bank's board of directors granted to Respondent on October 31, 1989 loan was substandard because:

1. there was a lack of current financial information on Respondent at the time the loan was granted;

2. Respondent was financially illiquid, had numerous and continuous overdraft problems, and had a high level of contingent liabilities;

3. Respondent's credit quality did not support an extension of credit on the terms granted; and

4. Respondent failed to provide an appraisal of the value of the collateral which secured the loan at the time his extension of credit was granted.

VII. CONCLUSIONS OF LAW

The Comptroller adopts paragraphs 1-4, 6, and 9 of the Administrative Law Judge's Conclusions of Law.

In addition the Comptroller concludes the following:

1. The assessment of civil money penalties under the provisions of 12 U.S.C. § 93 for the violations 12 U.S.C. § 60 is legally permissible.

2. The violation of 12 U.S.C. § 60 resulted in pecuniary gain to Respondent.

3. A second tier civil money penalty against Respondent for the violations of 12 U.S.C. § 60 is legally permissible under the provisions of 12 U.S.C. § 93.

4. The assessment of civil money penalties under the provisions of 12 U.S.C. § 504, for Respondent's 12 U.S.C. § 375b violation is legally permissible.

5. The violation of 12 U.S.C. § 375b resulted in pecuniary gain to Respondent.

6. The Respondent's acceptance of the loan to him that Bank's Board of directors approved on October 31, 1989, constituted a breach of his fiduciary duty to the Bank.

7. The assessment of civil money penalties under the provisions of 12 U.S.C. § 1818(i), for engaging in an unsafe or unsound practice by accepting the loan the Bank's board of directors approved to him on October 31, 1989 is legally permissible.

8. The assessment of civil money penalties against Respondent under the provisions of 12 U.S.C. § 1818(i), for breach of his fiduciary duty to the Bank by accepting the loan the Bank's board of directors approved to him on October 31, 1989 is legally permissible.

9. The unsafe or unsound practice and breach of fiduciary duty with regard to Respondent's acceptance of the loan the Bank's board of directors granted to him on October 30, 1989, resulted in pecuniary gain to Respondent.

10. A second tier civil money penalty against Respondent for unsafe or unsound practices and breach of fiduciary duty with regard to his acceptance of the loan granted to him by the Bank's

board of directors on October 30, 1989, is legally permissible under the provisions of 12 U.S.C. § 1818(i)(2)(B).

Dated this 17th day of June, 1993.

Comptroller of the Currency

UNITED STATES OF AMERICA
DEPARTMENT OF THE TREASURY
OFFICE OF THE COMPTROLLER OF THE CURRENCY

IN THE MATTER OF PRESTON J. BROOKS FORMER PRESIDENT AND CHAIRMAN OF THE BOARD FIRST NATIONAL BANK OF DEPORT, DEPORT, TEXAS	**ORDER** AA-EC-91-153

ASSESSMENT OF CIVIL MONEY PENALTIES

WHEREAS, on September 9, 1991, the Comptroller of the Currency of the United States of America ("Comptroller") issued a Notice of Assessment of Civil Money Penalty ("Notice") against the Respondent, Preston J. Brooks, former President and Chairman of the Board, First National Bank of Deport, Deport Texas; and

WHEREAS, Respondent duly filed an Answer to the allegations contained in the Notice, and requested an administrative hearing pursuant to 12 U.S.C. §§ 93(b), 504 and 1818(i), and the Comptroller's Rules of Practice and Procedure, 12 C.F.R. Part 19; and

WHEREAS, on September 22 and 23, 1992, such hearing was held on the Notice in Dallas, Texas, giving all parties the opportunity to be heard; and

WHEREAS, the Comptroller having considered the evidence presented at said hearing, and the briefs and arguments of both counsel, and the Recommended Decision issued by the presiding Administrative Law Judge;

IT IS HEREBY ORDERED, that Respondent J. Brooks be assessed a civil money penalty in the amount of $18,000.

So Ordered, this 17th day of June, 1993.

Comptroller of the Currency

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

ON CERTIFICATION OF THE DEPARTMENT OF THE TREASURY --OFFICE OF THE COMPTROLLER OF THE CURRENCY In the Matter of PRESTON J. BROOKS, Former President and Director of First National Bank of Deport, N.A., Deport, Texas, Respondent.	OCC No. AA-EC-91-154

FINAL DECISION

This is an administrative proceeding pursuant to section 8(e) of the Federal Deposit Insurance Act ("FDI Act"), 12 U.S.C. § 1818(e), in which the Office of the Comptroller of the Currency of the United States of America ("OCC") seeks to prohibit Preston J. Brooks from further participation in the affairs of any federally-supervised financial institution as a result of his conduct during his former affiliation as president and director of First National Bank of Deport, N.A., Deport, Texas (the "Bank"). As required by the FDI Act, the OCC has referred the action to the Board of Governors of the Federal Reserve System ("Board") for final decision.

The proceeding comes before the Board in the form of a Recommended Decision by Administrative Law Judge ("ALJ") Arthur L. Shipe, issued following an administrative hearing held on September 22 and 23, 1992, in Dallas, Texas, and the filing of

post-hearing briefs by the parties. In the Recommended Decision, the ALJ found that as president and chairman of the Bank, Brooks participated in violations of banking laws and engaged in an unsafe and unsound practice that caused loss to the Bank and financial gain to him. The ALJ concluded, however, that the violations did not reflect willful or continuing disregard for safety or soundness or personal dishonesty, but instead resulted from good-faith mistakes and therefore were not of a sufficiently serious character to justify Brooks's prohibition from banking.

The OCC's Enforcement and Compliance Division, which prosecuted the case, has submitted exceptions to the Recommended Decision. The OCC argues, first, that Brooks's testimony at the hearing should be stricken from the record because he refused to answer questions at a pre-hearing deposition on the basis of his rights under the Fifth Amendment. The OCC also argues that the ALJ applied erroneous legal standards in concluding that Brooks's violations of law and unsafe and unsound practices were insufficiently serious to satisfy the culpability requirements for an order of prohibition. Brooks has filed no exceptions.

Upon review of the record and the OCC's exceptions, the Board concludes that the record establishes that Brooks was responsible for a variety of substandard practices during his tenure with the Bank, and that a number of these were unsafe or unsound practices or violated regulatory restrictions, thereby satisfying the first, misconduct, test for prohibition. The Board also finds the effects test satisfied in that some of these

practices resulted in financial gain to Brooks or in loss or other damage to the Bank.

The Board concludes, however, after a close review of the record including the ALJ's findings of fact, that the preponderance of the evidence does not support the OCC's allegations as to Brooks's culpability. Accordingly, the Board adopts the ALJ's findings and conclusions, except as specifically noted, and orders that this proceeding be dismissed.[1/]

STATEMENT OF THE CASE

A. STANDARDS FOR PROHIBITION ORDER

Under the FDI Act, the ALJ is responsible for conducting an administrative hearing on a notice of intention to prohibit participation. 12 U.S.C. § 1818(e)(4). Following the hearing, the ALJ issues a recommended decision that is referred to the Board. The parties may then file with the Board exceptions to the ALJ's recommendations. The Board makes the final findings of fact, conclusions of law, and determination whether to issue an order of prohibition. Id.; 12 C.F.R. § 263.40.

The FDI Act sets forth the substantive basis upon which a federal banking agency may issue against a bank official an order of prohibition from further participation in banking. In order to issue such an order pursuant to section 1818(e)(1), the Board must make each of three findings: 1) there must be a specified

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[1/] The Board notes that the Comptroller of the Currency has penalized Brooks $18,000 in a parallel civil money penalty proceeding on the basis of the illegal dividend and preferential loan charges discussed below. In the Matter of Preston J. Brooks, No. AA-EC-91-153, June 17, 1993.

type of **misconduct** -- violation of law, unsafe or unsound practice,[2/] or breach of fiduciary duty;[3/] 2) the misconduct must have a prescribed **effect** -- financial gain or other benefit to the respondent or financial harm or other damage[4/] to the institution or prejudice to the institution's depositors; and 3) the misconduct must involve **culpability** of a certain degree -- personal dishonesty or willful or continuing disregard for the safety or soundness of the institution.

"Disregard for safety or soundness" is established by participation in an unsafe or unsound practice, i.e. one that is contrary to prudent practices and that could expose a bank to abnormal risk of harm or loss. In the Matter of Magee, 78 Fed. Res. Bull. 968, 974 (1992). A "continuing disregard for safety or soundness" standard is established by a mental state akin to "recklessness" in connection with a repetition of unsafe or unsound banking practices. Brickner v. FDIC, 747 F.2d 1198, 1203

2/ An "unsafe or unsound banking practice" has been defined as a practice "deemed contrary to accepted standards of banking operations which might result in abnormal risk or loss to a banking institution or shareholder." First Nat'l Bank of Eden v. Comptroller of the Currency, 568 F.2d 610, 611 n.2 (8th Cir. 1978)(per curiam).

3/ As the OCC notes in its exceptions, the Recommended Decision misstated this standard by indicating that the misconduct prong requires both a finding of a violation of law and either an unsafe or unsound practice or breach of fiduciary duty. Recommended Decision ("RD") 32. There is no indication that this error is reflected in the ALJ's analysis or that it is anything other than a clerical error.

4/ Because of statutory amendments, a slightly different standard for the effects requirement applies to conduct engaged in before August 15, 1989, but the culpability standards that are here at issue remained substantively unchanged by the amendments.

& n.6.[5] (8th Cir. 1984). The Board has generally found that a "continuing disregard" exists when a respondent continues to engage in an unsafe or unsound course of action after the occurrence of some event, such as a warning from a regulator, that should have made him or her aware that the practice was unsafe and unsound. See, e.g., In the Matter of Freitag, OCC No. AA-EC-89-139 (1991). "Willful disregard" may be shown in the absence of a continuing course of conduct where the unsafe or unsound practice is such that a degree of intent greater than recklessness may be inferred. See Brickner, 747 F.2d at 1203.

B. RELEVANT INDIVIDUALS AND BUSINESS ENTITIES

At all times relevant to this proceeding, the Bank was a national banking association, chartered and examined by the OCC. Recommended Finding of Fact ("RFF") 1. At all times relevant to this proceeding, Brooks was chairman of the board of directors and chief executive officer of the Bank and therefore an "institution-affiliated party" under the terms of the FDI Act subject to the OCC's supervisory authority. RFF 4. Brooks was a controlling and principal shareholder of Deport Financial

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[5] The Brickner court made clear that the standard did not encompass an "honest error of judgment," 747 F.2d at 1201, 1202, but also rejected the argument that the agency must show that the respondent intentionally did something to endanger the bank's safety. Id. at 1202. In Brickner, the respondents conceded that, after a warning from a regulator, they knew that the practices found unsafe and unsound were occurring, but failed to disclose that knowledge to the board of directors or to take other steps to prevent losses to the bank. The court found such failure to act sufficient to establish continuing disregard for safety or soundness, even though the respondents had not been directly responsible for the practices, and had received no benefit as a result. Id.

himself as a witness, purportedly reserving the decision to testify to see whether the OCC established a *prima facie* case against him. Brooks did, however, provide a roughly three-page summary of his expected testimony in the event that he did testify.

The OCC states that "[o]n the eve of trial and out of an abundance of caution" the OCC conducted a deposition of Brooks as a potential hearing witness five days before the hearing. OCC Except. 5. The OCC asserts, without contradiction from Brooks, that at the deposition Brooks refused to answer any substantive questions on Fifth Amendment grounds. At the hearing, the OCC moved to prohibit Brooks from testifying on the basis of his failure to identify himself definitively as a witness, and because of his failure to respond to questions at the deposition. Transcript ("Tr.") 21-23. Brooks replied that his pre-hearing statement provided sufficient detail to preclude unfair surprise to the OCC, and that the OCC was at fault for noticing the deposition only on the eve of trial. Tr. 23-25. The ALJ denied the OCC's motion without explanation and permitted Brooks to testify. Tr. 25. The OCC did not move to adjourn the hearing to depose Brooks before his hearing testimony, did not cross-examine Brooks, and did not address the issue in its post-hearing brief to the ALJ. The OCC asks that the Board strike Brooks's testimony from consideration. OCC Except. 7.

In these circumstances, the Board declines to impose the extreme sanction of striking the testimony of a respondent in his

own defense. The ALJ is generally vested with "all powers necessary to conduct a proceeding in a fair and impartial manner and to avoid unnecessary delay." 12 C.F.R. § 19.5(a). More specifically, the ALJ is vested with the power "to consider and rule upon all procedural and other motions [other than granting a motion to dismiss] appropriate in an adjudicatory proceeding. 12 C.F.R. § 19.5(b)(7). An ALJ's evidentiary rulings therefore are generally accorded deference in the absence of an abuse of discretion or manifest unfairness.

While the Board is concerned about the potential for misuse of the Fifth Amendment privilege to evade pre-hearing deposition testimony, the Board cannot conclude on the circumstances of this case, including the availability to OCC Enforcement Counsel of alternatives that were not pursued at the hearing stage, that the ALJ's decision to permit Brooks to testify rendered the proceeding manifestly unfair. Accordingly, the Board finds that the OCC has not sustained its burden of showing that the ALJ abused his discretion in permitting Brooks to testify and declines to strike Brooks's testimony.

B. SUBSTANTIVE BASIS FOR PROHIBITION

1. Illegal Dividend Payments

The OCC charged that in 1989 Brooks caused the Bank to declare dividends that exceeded the amount permitted by section 60 of the National Bank Act. 12 U.S.C. § 60. The OCC alleged that this conduct warranted Brooks' prohibition from banking in that he engaged in a violation of law that resulted in financial

gain to him and that involved willful or continuing disregard for the safety and soundness of the Bank.[6] The ALJ found that Brooks had violated Section 60 by causing the Bank to declare and pay excessive dividends, and that Brooks received some financial gain by reason of this violation.[7] Recommended Conclusion of Law 4; RD 32; RFF 14-18. The ALJ further found that Brooks's violation resulted from an "honest mistake" and did not evidence a willful or continuing disregard for the safety and soundness of the Bank, and therefore did not warrant his prohibition from banking.

OCC Enforcement Counsel strongly excepts to the ALJ's conclusions regarding the absence of willful or continuing disregard for safety or soundness. The OCC argues, among other things, that the record supports a finding that Brooks's actions demonstrated continuing disregard in that Brooks, in declaring an illegal dividend, recklessly failed to heed prior OCC warnings.

While the Board generally defers to an ALJ's factual findings, especially those based on the ALJ's judgments as to the credibility of the witnesses, the Board is not bound by them, and

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[6] The OCC does not argue that the misconduct satisfied the alternative culpability test of "personal dishonesty". OCC Except. 50-60.

[7] The dividends declared by the Bank were paid to its holding companies in order to enable them to service debt that Brooks had personally guaranteed.

may reach different factual findings so long as there is substantial evidence in the record to support those findings.[8/]

Here, however, upon a careful review of the record, the Board concludes that while there is some record evidence supporting a finding that Brooks's conduct in causing illegal dividends meets the culpability test of section 1818(e), that evidence is outweighed by countervailing evidence showing that Brooks did not act recklessly or with willful disregard for safety and soundness. Accordingly, the Board adopts the ALJ's conclusion that the OCC did not establish that Brooks's actions with respect to the excessive dividends demonstrated willful or continuing disregard for safety or soundness.

Section 60 limits the dividends that a national bank may declare out of the "net profits" of the bank. The approval of the OCC is required if the total of the dividends in a calendar year exceeds the total of its net profits for that year combined with its retained net profits of the preceding two years (less any required transfers to surplus or a fund for the retirement of any preferred stock). 12 U.S.C. § 60(b). "Net profits" is defined by the statute as current earnings plus certain

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[8/] Universal Camera Corp. v. NLRB, 340 U.S. 474, 496 (1951). It is the agency, and not the ALJ, whose factual determinations are entitled to deference by a reviewing court. Penasquitos Village, Inc. v. NLRB, 565 F.2d 1074, 1076 (9th Cir. 1977). Thus, the Board has been upheld by reviewing courts in enforcement decisions where it has declined to adopt an ALJ's findings, both as to issues of legal interpretation (Van Dyke v. Board of Governors, 876 F.2d 1377, 1379 (8th Cir. 1989)), and as to issues of fact, including credibility (Stanley v. Board of Governors, 940 F.2d 267, 272 (7th Cir. 1991)).

adjustments (such as actual loan recoveries) less current expenses and certain other deductions (such as actual loan losses).[9] Prior to December 1990,[10] a Federal Reserve interpretation of section 60 applicable to national banks established a uniform means of determining net profits for purposes of dividend restrictions. 12 C.F.R. § 250.104 (1989). The interpretation allowed "net profits" to be computed using net income determined from the call report, with certain other additions and deductions required by the terms of section 60 (such as actual recoveries and losses). Id.

The record shows that Brooks was responsible for making the computations necessary to assure that dividends paid by the Bank complied with the limitations in section 60. RD 16. Beginning in at least May 1987 and continuing through at least 1990, Brooks used a consistent method to determine the amount of net profits that were eligible under section 60 to be paid out as dividends in each quarter. Respondent Exhibit ("RX") 4. Under this method, Brooks computed net profits by adding the amount of net income from the prior quarter that had not been paid out as dividends to the net income from the current quarter. Id. This method of computing net profits differed from the method

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[9] The statute defines "net profits" as "the remainder of all earnings from current operations plus actual recoveries on loans and investments and other assets, after deducting from the total thereof all current operating expenses, actual losses, accrued dividends on preferred stock, and all Federal and state taxes". 12 U.S.C. § 60(c).

[10] The interpretation was repealed in December 1990, as discussed below.

prescribed in section 60 and described in the Board's interpretation in two ways. First, this method did not limit the amount of prior years' retained net profits used in the calculations to the previous two years, as required by the terms of section 60. Second, this method did not make the specific additions and subtractions to net income (such as actual loan recoveries and losses) required by the applicable interpretation. RX 4.[11]

The Bank paid dividends for each quarter in 1989, aggregating $143,000 for the year, using Brooks's method for calculating net profits for purposes of section 60.[12] RD 14. In January 1990, Brooks caused the holding company to refund $1,347 of the $40,000 fourth quarter 1989 dividend, which turned out to be excessive under Brooks's computation method, as a result of unexpected losses during December. RD 16.

11/ Although the method Brooks used to calculate net profits did not comply with section 60, there is no evidence in the record that the dividends paid by the Bank during the years 1987 and 1988 exceeded the limits in that provision. The OCC examinations of the Bank in early 1988 and early 1989 found no violations of section 60. For those years, there is no evidence that the OCC reviewed the specific computations the Bank used to apply the section 60 limitation on dividends.

12/ At the end of the OCC's examination that began in February 1989, the OCC advised the Bank's board of directors that earnings for year-to-date 1989 were weak. Noting that the holding company's debt service requirements were anticipated to exceed 1988's earnings, the Report of Supervisory Activity expressly advised the Bank that "[a] careful review of 12 USC § 56 and 12 USC § 60 should be performed prior to the declaration of dividends to ensure future dividend payments do not exceed legal limitations." OCCX 5 at 3.

In March 1990, the OCC, based on a routine off-site review of the Bank's filings, advised the Bank that its dividends for 1989 exceeded the section 60 limitations by over $63,000.[13/] RD 16-17. Brooks then wrote to the OCC admitting the miscalculation of the permissible dividend amount, taking responsibility for the error, and asking that the OCC retroactively grant approval for the excessive dividends. RD 17. When approval was denied,[14/] the board of directors, including Brooks, stipulated to the entry of a cease and desist order by the OCC calling for the members of the board of directors to pay back into the bank the excessive dividends plus interest. RFF 48-49. The six directors who had voted for the excessive dividends, including Brooks, then reimbursed the Bank for the excessive dividends (but not interest on those amounts) pursuant to the order. RD 18; RFF 42.

The Board finds, as the OCC asserts, that there is evidence in the record tending to show that Brooks's use of his own method of calculating permissible dividends is considerably more serious than an "honest mistake". This evidence includes Brooks's background as a CPA and bank examiner, the OCC's repeated criticisms of Brooks's conduct at the Bank and general warning to comply with dividend restrictions, and Brooks's apparent motive

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13/ The Bank had experienced reduced earnings in the last quarter of 1989.

14/ The OCC denied the request on August 3, 1990, because the dividends caused the Bank's capital to be low, because the Bank was exposed to loss from high-risk loans, and because of the OCC's concerns with the Bank's supervision and management. OCCX 70.

to maximize dividends in light of the need to meet debt service obligations.

On balance, however, the Board finds that the weight of the evidence in the record as a whole does not support the conclusion that Brooks acted with continuing or willful disregard for the Bank's safety or soundness. Brooks testified that the method he used for computing compliance with section 60 was one he devised when he was an OCC examiner.[15] Brooks offered into evidence a sheet of calculations purporting to show how he calculated the available dividends from 1987 to 1990. RX 4. While Brooks does not except to the ALJ's finding that his dividend calculation method caused the Bank to pay dividends during 1989 that violated section 60, it does not appear that his calculation method was in all respects inherently disadvantageous to the Bank. As explained above, one of the reasons why Brooks's method was inconsistent with section 60 was that, in determining the amount of "net profits" for purposes of these restriction, Brooks failed to make the adjustments to the Bank's reported net income -- adjustments for amounts added to the Bank's provision for loan loss reserves and for actual loan recoveries and charge-offs --

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[15] Brooks testified that: "[T]he basis of my computation of the compliance sheet was the fact that when I worked for the OCC and we analyzed the change to accrual accounting, we decided that the most conservative way to compute the dividend -- to restrict the dividends according to 12 USC 60 was by just taking the fully-accrued earnings and subtracting off the dividend, and then ... taking the previous two years' excess ...." Tr. at 334-35. Brooks denied ever having seen the OCC's compliance worksheet that implemented 12 C.F.R. § 250.104 (OCCX 42) until the OCC's 1990 examination revealed the excessive dividends. Tr. 334.

called for by the applicable regulatory interpretation of net profits. See 12 C.F.R. § 225.104(e)(1989). However, shortly thereafter, in December 1990, the OCC and the Board adopted new rules for computing net profits providing that, given current accounting principles and regulatory reporting procedures, these adjustments to net income should not be made.[16/] Although adoption of the new rules in 1990 does not excuse the violation of section 60 in 1989, the new rules, which employ a method that coincides at least in part with the method Brooks had been using, tend to show that he was not acting in a manner that was necessarily detrimental to the Bank. Moreover, the fact that Brooks used a consistent method to calculate the section 60 limitations from at least 1987 until 1989 tends to negate the allegation that Brooks devised his calculation method solely as a means to assure high dividend levels in the face of declining earnings in 1989, so that debt service demands could be met.[17/] Other facts of record also mitigate Brooks's culpability with

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[16/] 12 C.F.R. § 208.19(b)(2); 12 C.F.R. § 5.62(c). The amended regulations did not alter the two-year limitation on use of prior year retained net profits.

[17/] The ALJ's conclusion as to Brooks's culpability was also based on the ALJ's finding, grounded solely on Brooks's uncorroborated testimony, that in September 1989, before all of the excessive dividends had been paid, an OCC examiner reviewed the Bank's dividend computation method. RD 19. The OCC excepts to this finding as unsupported by the weight of the evidence, arguing that the OCC examiners involved denied discussing dividends with Brooks at that time. The Board finds it unnecessary to resolve this factual dispute. Even if the OCC's version were to be accepted, there would, in the Board's judgment, still be inadequate evidence in the record to support the requisite determination of culpability.

respect to the excessive dividends. There is no evidence that Brooks deliberately concealed his method of calculating the dividends. The OCC's previous general warnings as to capitalization and compliance with section 60, while they should have made Brooks more careful with respect to his dividend calculations, did not alert him that his specific method of computing dividends was impermissible. Moreover, Brooks promptly and on his own initiative caused the bank holding company to refund to the Bank $1,300 in January 1990 when his method indicated that the Bank dividends paid in December had been excessive in that amount.[18/]

Accordingly, while the excessive dividends were a violation of law and an unsafe or unsound practice from which Brooks received financial gain, the Board concludes that, on this record, the OCC has not sustained its burden of establishing that the misconduct demonstrated the willful or continuing disregard for safety or soundness necessary for an order of prohibition.

2. Unauthorized Real Estate Brokerage.

The OCC based this prohibition action in part on allegations that Brooks caused the Bank to exceed its statutory authority

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[18/] The Board adopts OCC Enforcement Counsel's argument that the ALJ was in error in finding that the improper dividends were the result of Brooks's mistaken use of the cash accounting method, rather than the accrual method. There is abundant evidence that Brooks knew that the Bank used accrual accounting, as national banks have been required to do since 1976. The erroneous dividends were caused, not by a mistake over the proper accounting method, but by Brooks's failure to make the adjustments to current earnings required by the applicable interpretation and by failing to use the three-year statutory computation period.

under 12 U.S.C. § 24(seventh) to engage in banking activities by operating a real estate agency for one year, and that Brooks received benefit from its operation. RD 5-6. The ALJ found, however, that the OCC did not establish that the practice evidenced a willful or continuing disregard for safety or soundness by Brooks. RD 10-11.

The ALJ found that in 1984 the Bank's board of directors approved the establishment of a real estate brokerage in the Bank in order to sell a number of vacant houses located in the small town where the Bank was located. RD 5. Brooks, as a licensed real estate broker, was responsible for the operation of the real estate activities, which continued for one year, and which generated commissions for the Bank. RD 5-6. After an OCC examination criticized the real estate operation as an unauthorized activity for a national bank, Brooks reimbursed the Bank for the expenses of the operation borne by the Bank, and claimed the commissions generated by the sales. RD 5-6, 11.

The ALJ found that the real estate activities exceeded the authorization of the statute, but found that the violation resulted from the board of directors' mistaken belief that it was a permissible activity. RD 9. The ALJ found that the Bank conducted the activity openly, with no attempt to conceal the activities from the OCC. RD 10. Accordingly, the ALJ found that Brooks did not act with the culpability requisite to an order of prohibition. RD 11.

The OCC excepts to that conclusion, arguing that the factual record indicates that Brooks in fact commingled his real estate operations with those of the Bank, keeping the commissions earned while charging the Bank with the expenses, without the knowledge of the board of directors. OCC Except. 38-40. The OCC also argues that the mistake-of-law finding is inherently flawed in light of Brooks's previous experience as a national bank examiner. OCC Except. 42.

The Board finds that the record is insufficient to establish the precise circumstances of Brooks's involvement in the real estate operations in 1984-1985, including the circumstances bearing upon his culpability. The Board notes that the record evidence cited by the OCC tends to show that the real estate operation was entirely owned and operated by Brooks, which, if true, would not establish a violation of 12 U.S.C. § 24. Accordingly, the Board finds that the OCC has not proved its charges with respect to the real estate operations.

3. Alleged manipulation of bank accounts.

The OCC alleged that Brooks engaged in an unsafe and unsound practice and breach of fiduciary duty in connection with alleged manipulation of the Bank's correspondent account at another bank based on four wire transfers from the account. The first two transfers were made on October 31, 1989, from the Bank's correspondent account to an account at another bank owned by a trust for which Brooks's mother was trustee and Brooks a beneficiary. RFF 55-58. The ALJ found that the transfers were

made pursuant to loans approved by the board of directors, one a $5,000 loan to a bank customer that was then used to buy an automobile from Brooks, and the second, an $18,150 loan to Brooks to repay a debt to his mother. RD 19. The other two wire-transfers, in the amounts of $700 and $300, were initiated by Brooks on November 8, 1993, to transfer funds on behalf of his brother to an account held by his sister-in-law. RD 20-21. In each case, the accounts were not promptly reconciled after the transfers and remained out of balance for 14 days with respect to the first two transfers, and for 51 days with respect to the second two. RD 20-21.

The ALJ found that Brooks was not responsible for posting the wire-transferred amounts,[19/] and was not aware of the delays in reconciling the account. RFF 69, 70. The ALJ therefore rejected the OCC charges that Brooks had directed that unauthorized wire transfers be made to members of his family, then tried to correct the problem with subsequently authorized loans, the proceeds of which were used to reconcile the Bank's correspondent account. Instead, the ALJ found that the transfers were authorized and that the Bank's cashier was responsible for the delays in posting the wire-transferred amounts. RD 21-24.

The Board adopts the ALJ's findings on this issue, which are based on conflicting evidence, and in part, on credibility

[19/] Indeed, the ALJ noted that the internal control policy of the Bank prohibited Brooks from making debit entries to the correspondent account for wire transfer activities that he initiated.

determinations. While Brooks's actions with regard to the wire transfers were unsafe and unsound, and as discussed below embodied a preferential extension of credit, the record is insufficient to find that these actions evidenced the culpability requisite for an order of prohibition.

4. Preferential extension of credit.

The ALJ found, as the OCC alleged, that a $18,150 loan to Brooks that funded one of the wire transfers on October 31, 1989 was preferential, and therefore a violation of 12 U.S.C. § 375b, and 12 C.F.R. § 215. RD 23-25. The loan clearly constituted financial gain to Brooks. The ALJ concluded, however, that the violation did not evidence a willful or continuing disregard for safety or soundness. RD 33.

The Federal Reserve Act and Regulation O require that extensions of credit from banks to individuals who are bank "insiders," i.e., individuals who are bank executive officers, directors, or principal shareholders, must be on substantially the same terms as are available to non-insiders. 12 U.S.C. § 375b(3); 12 C.F.R. § 215.4.

The ALJ reasonably found that the loan was preferential in a number of respects. RD 23-25. Brooks wire-transferred the proceeds from the loan to an account other than his own immediately upon signing the promissory note, an action possible only because of his position with the Bank. RD 24. The value of the collateral for the loan, a 1964 Corvette and a 1984 recreational boat with outboard motor, was not supported by an

appraisal or other documentation. RD 24. An OCC examination also criticized the extension of credit to Brooks because he was financially illiquid, had numerous and continuing overdraft problems, had a high level of contingent liabilities, and because his creditworthiness did not support an extension of credit on the terms applied. RD 24. The ALJ therefore found that the loan was a violation of law, a breach of Brooks's fiduciary duty, and an unsafe and unsound banking practice. While Brooks clearly received financial gain as a result of the violation, the ALJ found that he did not act with the requisite culpability to justify his prohibition.

The OCC's theory of the case was that it was Brooks's entire course of conduct with respect to the manipulation of the Bank accounts that included the preferential loan that justified his prohibition. Notice of Intention to Prohibit, Articles IV-VIII; OCC Except. 28-35. The OCC therefore did not argue that the single preferential loan, standing alone, was a basis for prohibition. In the past, the Board has found that isolated or discrete violations of the restrictions against insider-dealing do not necessarily warrant an order of prohibition, while they may readily be the subject of civil money penalties.[20/] See In the Matter of John Van Dyke, OCC No. AA-EC-87-88 (1988) at 36. In these circumstances, the Board adopts the ALJ's conclusion

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[20/] The Board notes that the preferential loan was part of the basis for the Comptroller's final civil money penalty.

that the record did not establish a basis for Brooks's prohibition with respect to the preferential loan.

CONCLUSION

After a close examination of the record, the Board concludes that the OCC has established by a preponderance of the evidence that Brooks engaged in misconduct -- violation of laws and unsafe or unsound practices-- which caused financial gain to Brooks and loss to the Bank, thereby satisfying the first two requirements for an order of prohibition. The Board is unable to conclude on this record, however, that the OCC established the third requirement, that Brooks's misconduct reflected personal dishonesty or willful or continuing disregard for safety or soundness. This conclusion in no way indicates that the OCC lacked a reasonable basis for bringing this action. Nor does this disposition excuse Brooks's actions, which clearly involved a variety of substandard practices.

Accordingly, the Board orders that this prohibition proceeding be dismissed.

By Order of the Board of Governors, this 6th day of August, 1993.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

William W. Wiles
Secretary of the Board