Decision of the
Supervision Appeals Review Committee
In the Matter of * * * * *
Case No. 2016-02

I. Summary of Findings

After consideration of the timely filed written submission of * * * * Bank ("Bank"), the record of this case, and following the June 9, 2016 deliberative meeting of this Committee, we have denied the Bank's appeal. For the reasons set forth in this decision, the Committee finds that the Capital, Asset Quality, Management, and Liquidity Component Ratings and the Composite Rating, as well as the underlying findings related to the numerous Bank Secrecy Act / Anti-Money Laundering ("BSA/AML") Program deficiencies set out in the report of examination provided to the Bank on * * * * *, 2015, and the supervisory determinations therein are reasonable, well-supported, and consistent with the policies, practices, and mission of the FDIC.

II. Background

This appeal arises from material supervisory determinations set forth in the report of examination delivered to the Bank on * * * * , 2015 ("2015 ROE"). The examination of the Bank, a $* * * billion institution, commenced on ***** 2015, and was conducted by the FDIC's * * * * * Regional Office and the * * * * * ("[State Banking Authority]"). The examination resulted in CAMELS ratings of 233222/3.[1] The Bank's prior three on-site risk management examinations noted an inadequate BSA/AML compliance program with multiple deficiencies.

On December 24, 2015, the Bank filed a request for review ("Request for Review") with the Director of the Division of Risk Management Supervision ("RMS Director"). The Bank sought revisions to the 2015 ROE for Capital, Asset Quality, Management, Liquidity, and its Composite rating, as well as the findings underlying those ratings.[2]

The RMS Director affirmed the examination ratings in a letter dated February 12, 2016 ("RMS's Response"); however, the RMS Director changed a loan classification, corrected the concentrations discussion, and removed one of the violations related to currency transaction report ("CTR") filings.

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[1] Capital "2," Asset Quality "3," Management "3," Earnings "2," Liquidity "2," Sensitivity to Risk "2,"and Composite "3." Prior to the 2015 full-scope examination, in * * * * 2015, the FDIC performed an off-site, limited scope review upon a request from the Bank's Chairman. In this interim review, the FDIC and * * * * * [State Banking Authority] upgraded the Bank's Liquidity component rating from a "2" to a "1," based upon a perceived improvement in funds management practices and the overall balance sheet structure. This review was based on information provided by the Bank on funds management practices implemented at the Bank to improve performance and the year-end 2014 Call Report and Uniform Bank Performance Report. This upgrade in the Liquidity rating led to an upgrade in the Composite rating from a "3" to a "2." These ratings both declined in the 2015 ROE.

[2] It requested that the ratings be upgraded to: Capital "1," Asset Quality "2," Management "2," Earnings "2," Liquidity "1," Sensitivity to Risk "2,"and Composite "2."

The Bank timely filed an appeal with the Committee by letter dated March 14, 2016. The Bank appeals the RMS Director's determination affirming the 2015 exam ratings. In accordance with The FDIC's *Guidelines for Appeal of Supervisory Determinations*[3] ("*Guidelines*") the Committee reviewed the appeal for consistency with the policies, practices, and mission of the FDIC, and the reasonableness of and support for the positions of the parties. The Committee met to consider the appeal and to hear oral presentation from the parties on June 9, 2016. The Committee carefully considered the written submissions and the oral presentations of the parties. Under the *Guidelines*, the burden of proof on all matters at issue rests with the institution. Further, the scope of the Committee's review is limited to the facts and circumstances existing at the time of the 2015 joint examination.

III. Procedural Issues

Scope of Review

As part of its Request for Review, the Bank challenged findings that it violated the Bank Secrecy Act ("BSA") and implementing regulations.[4] In particular, the Bank requested that RMS revise the 2015 ROE to "properly reflect the substantial improvement in the Bank's BSA/AML compliance program"[5] made since the 2014 examination, and challenged the * * * ** findings in the 2015 ROE regarding * * * and BSA/AML program deficiencies * * *.

RMS's Response addressed * * * * of these issues: * * * *

RMS's Response concluded that the remaining BSA/AML findings were outside the scope of review for supervisory appeals under the *Guidelines*, as they related to determinations regarding compliance with a consent order entered into by the FDIC and the Bank, dated * * * * , 2015 ("Consent Order").[6,7] Pursuant to Section D of the *Guidelines*, "material supervisory determinations" subject to appeal through the supervisory appeals process do not include "[f]ormal enforcement-related actions and decisions, including determinations and the underlying facts and circumstances that form the basis of a recommended or pending formal enforcement action, and FDIC determinations regarding compliance with an existing formal enforcement action."[8]

In its appeal to this Committee, the Bank argued that RMS misapplied the *Guidelines* and requested that the Committee consider and decide the previously excluded aspects of the appeal.

[3] 77 Fed. Reg. 17055 (March 23, 2012)(available at http://www.fdic.gov/regulations/laws/sarc/sarcguidelines.html). The *Guidelines* implement an independent intra-agency appellate process for the review of material supervisory determinations, as required by the *Riegle Community Development and Regulatory Improvement Act of 1994* ("*Riegle Act*").

[4] In accordance with the Uniform Financial Institution Rating System ("UFIRS"), the FDIC incorporates the BSA/AML compliance review into the risk management examination and considers the effectiveness of the BSA compliance program in the Management rating, and ultimately, the institution's Composite rating.

[5] Request for Review, p. 42.

[6] The Consent Order requires the Bank to address BSA compliance * * * *.

[7] The Committee notes that the Bank also entered into a BSA-related consent order with the [State Banking Authority] effective * * * *, 2015.

[8] The *Guidelines* define "material supervisory determination" for purposes of the appeal process, consistent with the *Riegle Act*.

Specifically, the Bank argued that it was not contesting any determinations regarding compliance with the Consent Order. Rather, it was contesting the BSA-related findings themselves and the Management rating, which was supported by those BSA findings. The Bank's appeal incorporated by reference the BSA-related arguments from its Request for Review, and it provided an additional summary of the arguments.

The Committee accepted the entirety of the Bank's appeal, as submitted, which included the request to consider all of the arguments in the Bank's Request for Review, RMS's Response, the 2015 ROE, and the Consent Order. In this instance, because of the interrelation between the BSA-related claims and the other elements of the Bank's appeal, the Committee waived the exclusions from the definition of "material supervisory determination" to ensure that all of the Bank's BSA-related claims could be heard.[9] In any event, the Committee did not notify the Bank that it had placed any limitations on the scope of its appeal. The Committee accepted and considered the entirety of the Bank's appeal without limitation, including those issues not specifically addressed by the RMS Director, and invited the Bank to give an oral presentation at a June 9, 2016 Committee meeting.

At the June 9, 2016 meeting, the Bank requested for the first time that the entire appeal be remanded to the RMS Director for another review. The Bank argued that the Committee should instruct RMS to rule on each of its claims, including those that RMS had previously determined were outside the scope of review. At the meeting, the Bank focused principally on its other substantive claims and discussed the BSA issues in the context of requesting remand of the case to the RMS Director. We note that the Bank did not request remand in its written materials. Rather it requested that the Committee "consider this appeal and the arguments advanced in the [Request for Review] including those disregarded by RMS,"[10] and argued that the Committee "must consider the Bank's excluded arguments in order to afford the Bank with an appeal that comports with the language and directive of the *Guidelines*."[11]

As described above, the Committee did not limit the scope of the appeal. The Committee reviewed all materials submitted by the Bank, including its appeal, its request for review and all supporting documentation, the 2015 ROE, and the RMS Director's response to the Bank's request for review. The Committee denies the Bank's request for remand made at the June 9th meeting, and issues the following decision on the entirety of the appeal, as requested by the Bank in its written appeal to the Committee.

IV. Analysis

The Bank disputes its component ratings for Capital, Asset Quality, Management, and Liquidity, as well as its Composite rating. Each of these ratings is addressed below, beginning with the Management rating.

A. Management

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[9] Section O of the *Guidelines* provides that the Committee retains discretion to waive any provision of the *Guidelines* for good cause.

[10] Bank's appeal, cover letter to Robert Feldman, Executive Secretary, FDIC.

[11] Bank's appeal at 7.

The Bank was assigned a Management component rating of "3" in the 2015 ROE. In its Request for Review, the Bank requested that the Management rating be changed to "2." The RMS Director upheld the "3" rating, and the Bank appeals that determination. The Management "3" rating rests, in part, on findings related to BSA compliance and related programs detailed below. The Bank also contests a cited violation of Regulation O that contributed to the Management "3" rating.

BSA-Related Findings **[Summary of Decision]**

The Bank disagrees with nearly every one of the examiners' criticisms of its BSA program. The Committee finds that the Bank did not produce evidence sufficient to support a reversal of the examiners' conclusions, including that the BSA/AML program remained deficient and there were apparent violations of law.

In its December 24, 2015 Request for Review, the Bank challenged the BSA findings in the 2015 ROE. The Bank argued that: the 2015 ROE should be revised to reflect substantial improvement in the Bank's BSA/AML compliance program; the 2015 ROE included misstatements about conditions at the Bank and the BSA program met the FFIEC Guidance requirements; and the violations of law are unsubstantiated and should be removed from the 2015 ROE. The Bank also asserted that, assuming this Committee overturns all the challenged findings, the Management rating will require upward adjustment because all of the noted BSA related deficiencies on which the "3" rating rests will have been removed.

The Committee's Findings on the BSA/AML determinations. The Committee's review is limited to the facts and circumstances existing at the time of the 2015 joint examination. Later developments, shortcomings addressed after the conclusion of the exam, and materials not presented for examiner review do not bear on the reasonableness or support for supervisory determinations made in the exam, or on whether those findings are consistent with the policies, practices, and mission of the FDIC. We note that the burden of proof on all matters at issue rests with the institution. The examiners' conclusions were well documented, and the Bank did not produce evidence sufficient to support a reversal of those conclusions; therefore, the Committee upholds the BSA-related findings in the 2015 ROE, which identify significant concerns with the Bank's BSA program.

Examiners documented numerous weaknesses in the Bank's BSA/AML program as well as apparent violations of law. The Committee reviewed all of the findings the Bank challenged, and also evaluated the BSA program as a whole.

The 2015 ROE depicts a Bank with serious BSA-related problems that is in the beginning stages of addressing them. This conclusion is supported by the fact that the Bank entered into a BSA-specific consent order with its regulators.[12] A consent order memorializes the agreement by the Bank to address and correct the deficiencies noted in the order and in prior ROEs. Having

[12] The Bank entered into the Consent Order with the FDIC on * * * *, 2015, and entered into its agreement with [State Banking Authority] on * * * * 2015, a few weeks prior to the start of the on-site portion of 2015 Examination.

entered into a consent order does not address the underlying problems, however, and the findings in the 2015 ROE reflect the weaknesses, deficiencies, and violations of law that existed at the time of the examination. Entry into the order and the associated actions taken to comply with the requirements of the order are positive steps, and the Committee believes that the ratings will reflect improvement once the Bank has demonstrated that it has, in fact, corrected the weaknesses, improved its program, and corrected the violations of law.

In a number of cases, the Bank challenges RMS's findings, citing evidence of some partial cure. In certain cases, the Bank appears to be taking steps to address the underlying problems. But taking such steps is not sufficient to overturn the findings and does not mean that there is no apparent violation of law. In several instances, the Bank alludes to good policy but had not yet followed through in a way that would cure the fundamental problem. At the time of the exam, improvements in some of these areas were planned, but not yet operational or consistently applied.

Regulation O

The Management "3" rating also rests, in part, on a finding that the Bank violated Regulation O in 2012. The Regulation O violation relates to loans totaling $* * million made in 2012 to a group of entities controlled by: (1) [A], the annuitant beneficiary of a trust that owned * * percent of the Bank's voting stock when the loans were made; and (2) members of [A]'s family. These loans were cited as apparent violations of Regulation O in the 2013 and 2014 exams, but the Bank had not previously appealed the determinations.

The Bank was established in * * * * *. In 2007, the Bank had * * * * shares of common stock outstanding. [A] owned at least * * * * shares, or 45 percent of the outstanding shares.[13] According to RMS, in 2007, [A] established a voting trust (the "2007 Trust") and transferred * * * * of [his/her] shares to the 2007 Trust.[14] [A] can terminate the 2007 Trust at any time.

In 2010, the trustee of the 2007 Trust transferred its * * * * shares of common stock in the Bank to a new trust that [A] had established (the "2010 Trust"). At that time, [A] also transferred into the 2010 Trust an additional * * * * shares of common stock in the Bank that [he/she] held in [his/her] own name. As a result of these transfers, the 2010 Trust owned * * * * shares, or 60 percent, of the Bank's * * * * outstanding shares of common stock. In connection with the establishment of the 2010 Trust, the Trustee (* * * * *) filed a Notice of Change in Bank Control with the FDIC Regional Office, and the Regional Office issued a letter of non-objection.

[A] is a beneficiary of the 2010 Trust. Specifically, the Trustee is required to pay [A], at least annually, an amount equal to a set percentage of the initial value of the assets transferred to the 2010 Trust, which may be paid from either income or principal.

The 2010 Trust document limits the Trustee's authority by creating the positions of Advisor and Trust Protector. The Trustee may buy, sell, lease, exchange, mortgage or pledge

[13] RMS's Response, p. 6.
[14] RMS's Response, p. 6.

property only upon receiving written instruction from the Advisor. Under the terms of the 2010 Trust, * * * * * is the initial Advisor. The Trust Protector, [A], may remove the Trustee or the Advisor without cause and appoint a successor Trustee or Advisor. The provisions relating to the Trust Protector's powers are preceded by the following language:

> From and after the termination of the [2007 Trust], the following provisions shall be applicable after notification to the [State Banking Authority] and such approval as the [State Banking Authority] may deem necessary."[15]

In 2012, the Bank originated loans of $10 million to three entities controlled by [A] and members of [his/her] family. These loans were not approved by the Bank's Board of Directors prior to being disbursed. This was cited as a violation of Regulation O in the 2013 ROE. The underlying loans remained on the Bank's books as of * * * * , 2014 and the FDIC 2014 ROE reiterated the earlier citation of the Regulation O violation. At a * * * *, 2014 meeting, the Bank's Board of Directors retroactively approved the loans in question for the purpose of curing that aspect of the Regulation O violation.

The Bank's Position. The Bank argues that [A] is not a principal shareholder subject to Regulation O restrictions because [he/she] is not the titled owner of 60 percent of the Bank's common shares. Rather, the 2010 Trust is the titled owner of those shares and [A] is an annuitant beneficiary of the 2010 Trust. The Bank contends that [A] does not control the shares, and therefore, does not control the Bank. In support of this contention, the Bank relies, in part, on FDIC Advisory Opinion 79-10, which states that a "beneficiary is not a principal shareholder (i.e., 'owner' within the meaning of Regulation O) if he/she merely reaps the economic benefit of stock ownership."[16] The Bank argues that [A] reaps the economic benefits of the stock in the trust, but has no other incidents of ownership, such as title and right to transmit the stock to others, and hence, Regulation O does not apply.

The Bank argues that [A]'s role as Trust Protector, and ability to remove the Trustee without cause, does not afford [him/her] control of the Trust's * * * * shares because under the 2010 Trust document, [A] must seek approval of the [State Banking Authority] before exercising any of the Trust Protector powers. The 2010 Trust is a contract, and contains the condition precedent that [State Banking Authority] approval be received for the Trust Protector powers to pass to [A]. Until the 2007 Trust is terminated and [A] receives [State Banking Authority] approval, [he/she] cannot exercise the Trust Protector powers.

RMS's Position. Regulation O provides that a trust can be a related interest of a bank insider if the insider controls the trust. A person controls a trust if [he/she] has the power to remove the trustee (and in this case, the Trust Advisor) and to appoint successors to those positions. [A] has these powers as Trust Protector of the 2010 Trust.

[A] continues to own approximately 60 percent of the voting securities of the Bank, satisfying the first prong of the definition of control. As Trust Protector, [A] controls the shares

[15] 2010 Trust, p. 23 (submitted by the Bank as Exhibit 3).
[16] FDIC Advisory Opinion 79-10 (Oct. 29, 1979)

of voting common stock placed in the 2010 Trust, which comprise more than 25 percent of a class of voting securities.

RMS dismisses the Bank's argument that [A] cannot exercise [his/her] powers as Trust Protector because of two conditions precedent, arguing that these conditions do not present sufficient obstacles to the exercise of the Trust Protector powers. Thus, [A] should be considered to have the Trust Protector powers regardless of the conditions. As Trust Protector, [A] controls the shares held in the 2010 Trust, and therefore, controls the Bank. [A] is subject to Regulation O and loans made to [him/her] or [his/her] related interest must comply with Section 215.4.

The Committee's Findings on Regulation O. Section 22(h) of the Federal Reserve Act imposes restrictions on extensions of credit to insiders of a member bank, including principal shareholders, and the Board of Governors of the Federal Reserve System has implemented these restrictions in its Regulation O.[17] The Federal Deposit Insurance Act provides that the Federal Reserve Act restrictions on extensions of credit to insiders apply to insured nonmember banks, and the FDIC has adopted a regulation making Regulation O applicable to state nonmember banks.[18]

An *insider* is an executive officer, director, or principal shareholder, and includes any related interest of such a person.[19] A *principal shareholder* is a person that directly or indirectly, or acting through or in concert with one or more persons, owns, controls, or has the power to vote more than 10 percent of any class of voting securities of a member bank or company. Shares owned or controlled by a member of an individual's immediate family are considered to be held by the individual.[20] *Control* of a bank means that a person directly or indirectly, or acting through or in concert with one or more persons:

- Owns, controls, or has the power to vote 25 percent or more of any class of voting securities of the bank;
- Controls in any manner the election of a majority of the directors of the bank; or
- Has the power to exercise a controlling influence over the management of the bank.[21]

A person may rebut a presumption of control by submitting to the appropriate Federal banking agency written material that, in the agency's judgment, demonstrates an absence of control.[22]

Regulation O prohibits member banks from making extensions of credit to an insider unless the extension of credit:

[17] 12 USC 375b; 12 CFR part 215.
[18] 12 USC 1828(j)(2); 12 CFR §337.3.
[19] 12 CFR §215.2(h).
[20] 12 CFR §215.2(m).
[21] 12 CFR §215.2(c).
[22] 12 CFR §215.2(c)(4).

1. is made on substantially the same terms (including interest rate and collateral) as, and following credit underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions by the bank with other persons that are not covered by Regulation O and who are not employed by the bank; and

2. does not involve more than a normal risk of repayment or present other unfavorable features.[23]

As a general matter, the titled owner of a controlling share of a bank stock is a principal shareholder of the Bank for purposes of applying Regulation O. However, the definition of control includes "the power to exercise a controlling influence over the management of the company or bank." Regulation O is silent as to how restrictions on extensions of credit apply to a beneficiary of a trust that is a principal shareholder. An FDIC Staff Advisory Opinion, cited by the Bank, has addressed this question in a manner that supports the finding of an apparent violation. It provides in relevant part:

> In our opinion, a beneficiary of a trust that holds more than 10 percent of the stock of a bank is a principal shareholder *if* the beneficiary can direct the voting of the stock, terminate the trust, remove the trustee or otherwise control the voting of the stock.[24]

As Trust Protector, [A] has the power to remove the trustee. The Bank argues that [A]'s Trust Protector powers do not establish control because [he/she] can only exercise those powers after providing notice to [State Banking Authority] and receiving approval of [State Banking Authority].[25] It is clear, however, that [A] can invoke [his/her] Trust Protector powers at any time by terminating the 2007 Trust, providing notice to [State Banking Authority], and obtaining "such approval as the [State Banking Authority] *may deem necessary*" (emphasis added). The agreement does not memorialize what sort of approval would be necessary, or even affirmatively require approval. The Committee believes that the Bank has not met the burden of demonstrating that [A]'s authority to remove the Trustee or the Advisor without cause does not give [him/her] control over the Bank shares for purposes of Regulation O.[26]

[A] therefore is a principal shareholder of the Bank and was an insider with respect to the * * * * shares of common stock owned by the 2010 Trust. The Bank has not challenged the underlying facts surrounding the disbursement of the loans or the repayment risk they posed. The Committee accordingly upholds the determination of an apparent violation of Regulation O.

<u>The Committee's Findings on the Management rating</u>. The Uniform Financial Institutions Rating System ("UFIRS") provides the following guidance on the Management rating:

[23] 12 CFR §215.4(a).
[24] FDIC Advisory Opinion 79-10 (Oct. 29, 1979).
[25] Bank's Appeal, p. 37.
[26] The Bank's reliance on FDIC Advisory Opinion 05-04 (July 6, 2005) is misplaced. Advisory Opinion No. 05-04 deals with escrow agreements, and the Bank's attempt to analogize the facts of the 2010 Trust to escrow agreements is unpersuasive.

> The capability of the board of directors and management, in their respective roles, to identify, measure, monitor, and control the risks of an institution's activities and to ensure a financial institution's safe, sound, and efficient operation in compliance with applicable laws and regulations is reflected in this rating. Generally, directors need not be actively involved in day-to-day operations; however, they must provide clear guidance regarding acceptable risk exposure levels and ensure that appropriate policies, procedures, and practices have been established. Senior management is responsible for developing and implementing policies, procedures, and practices that translate the board's goals, objectives, and risk limits into prudent operating standards.
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> . . . Sound management practices are demonstrated by: active oversight by the board of directors and management; competent personnel; adequate policies, processes, and controls taking into consideration the size and sophistication of the institution; maintenance of an appropriate audit program and internal control environment; and effective risk monitoring and management information systems. This rating should reflect the board's and management's ability as it applies to all aspects of banking operations as well as other financial service activities in which the institution is involved.[27]

A "2" rating "indicates satisfactory management and board performance and risk management practices relative to the institution's size, complexity, and risk profile. Minor weaknesses may exist, but are not material to the safety and soundness of the institution and are being addressed. In general, significant risks and problems are effectively identified, measured, monitored, and controlled."[28]

A "3" rating "indicates management and board performance that need improvement or risk management practices that are less than satisfactory given the nature of the institution's activities. The capabilities of management or the board of directors may be insufficient for the type, size, or condition of the institution. Problems and significant risks may be inadequately identified, measured, monitored, or controlled."[29]

The Committee, having upheld the BSA-related and Regulation O findings from the 2015 ROE, declines to upgrade the Bank's management rating. The Committee notes that the Management rating has been "3" over the last three full-scope examinations. The serious weaknesses identified in the 2015 ROE regarding BSA-related compliance, as well as the Regulation O violation, indicate that management and board performance need improvement and that risk management practices are less than satisfactory given the institution's activities.

B. Asset Quality

The Bank was assigned an Asset Quality rating of "3" in the 2015 ROE. In its Request for Review, the Bank requested that the Asset Quality Rating be changed to "2." The RMS Director upheld the "3" rating, and the Bank has appealed that determination.

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[27] 62 Fed. Reg. 754-55.
[28] 62 Fed. Reg. 755.
[29] 62 Fed. Reg. 755.

The Uniform Financial Institution Rating System (UFIRS) defines asset quality ratings of "2" and "3" as follows:

> An asset quality rating of "2" indicates satisfactory asset quality and credit administration practices. The level and severity of classifications and other weaknesses warrant a limited level of supervisory attention. Risk exposure is commensurate with capital protection and management's ability.
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> An asset quality rating of "3" indicates asset quality or credit administration practices are less than satisfactory. Trends may be stable or indicate deterioration in asset quality or an increase in risk exposure. The level of severity of classified assets, other weaknesses, and risks require an elevated level of supervisory concern. There is generally a need to improve credit administration and risk management practices.

Bank's Position. The Bank points out that its Asset Quality was rated a "2" in the 2014 ROE, and nothing has changed since then to justify the downgrade without a significant increase in criticized asset levels.[30] The Bank claims that the rating should have been upgraded to a "2" rating after the RMS Director corrected the risk rating for the [B] credit in response to the Bank's Request for Review. Additionally, Asset Quality, as measured by classified assets and Special Mention credits, remained stable during the examination period. The Bank argues that examiners failed to consider the current state of community bank lending and inappropriately uses the word "weakness" to describe what is properly characterized as "easing" with respect to certain aspects of the Bank's underwriting.

RMS's Position. The Bank's Asset Quality warranted a "3" rating due to the increasing risk exposure arising from the unsatisfactory credit underwriting and administration practices identified in the 2015 ROE. This approach is consistent with forward-looking supervision that identifies, assesses, and, if necessary, mitigates the potential impact of an institution's new or growing risks before they manifest in the Bank's performance metrics. Examiners noted in the 2015 ROE that concerns with the Bank's underwriting and credit administration practices raised the overall risk profile of the commercial real estate (CRE) portfolio. Weaknesses included failing to conduct accurate and comprehensive global cash flow analyses and originating new or modified credits with liberal terms and numerous exceptions to the Bank's Loan Policy, many of which were not identified and reported to the Board as required by the Bank's own Board-approved Loan Policy.

The Committee's Findings. The Committee upholds the "3" rating. The ROE's findings that the Bank's underwriting and credit administration practices raised the overall risk profile of the commercial real estate portfolio appear well documented and consistent with the policies,

[30] [In an * * * * , 2015 letter, the * * * * * Regional Office continued the Bank's previous Asset Quality "2" rating from the 2014 Examination Report based on December 21, 2014 Call Report data, despite revising the Liquidity and Composite ratings. (*The Bank has not argued that the Asset Quality "3" rating was a departure from the Asset Quality "2" rating provided in the * * * * , 2015 letter. Rather it compares the "3" rating in the 2015 exam report to the "2" rating in the previous 2014 Exam report.)]*

practices, and mission of the FDIC. Weaknesses included failing to conduct accurate and comprehensive global cash flow analyses and originating new or modified credits with liberal terms and numerous exceptions to the Bank's Loan Policy, many of which were not identified and reported to the Board as required by the policy. Below are specific issues that the Bank raised in challenging the Asset Quality "3" rating and the Committee's findings with respect to each issue.

Trends in Asset Quality. The Bank pointed to positive trends in asset quality from the previous 2014 ROE and noted that reversing the Substandard classification on the [B] loan lowers the adversely classified assets ratio. However, asset quality needed improvement as the volume of adversely classified items increased by 26 percent even after excluding the [B] loan. The level of adversely classified assets has increased, albeit modestly but steadily, over the last three examinations, along with continued weaknesses in underwriting and credit administration.

Trends in Special Mention. The Bank argues that the modest increase in Special Mention loans is primarily due to one relationship and that this increase does not support an Asset Quality rating of "3." We note, however, that the $* * * million in Special Mention items was a nearly 10 percent increase from the previous examination and a 97 percent increase from the 2013 examination. The total loans subject to adverse classification or listed for Special Mention was over $* * * million and represented *** percent of the total loan portfolio. Several of these loans were new or modified credits that Bank management had approved with liberal terms and numerous exceptions to the Bank's Loan Policy. The Committee affirms that these facts support the overall "3" rating.

Intentional Limited Board Reporting. Examiners found that Bank management had limited the number of loan policy exceptions that were reported to the Bank's Board. The Bank argues that this change in Board reporting was to enable the Board to focus on eight categories of exceptions that management had determined to be the most significant and requiring attention. The Committee notes that many of the exceptions in the Special Mention loans that were not reported to the Board represented one of the eight exception types that management had, as a matter of policy, determined to be the most significant and requiring Board attention. Generally, all exceptions to the loan policy should be reported to the Board. The Committee concludes that examiner concerns regarding the practice of the limiting of reporting loan exceptions to the Board supported the Asset Quality rating.

Volume of Exceptions is an Anomaly. The Bank argues that the loan policy exceptions are anomalies and it reduced the number of exceptions by eliminating two debt service coverage ratio exceptions from the Board report. However, the Bank's March 31, 2015 internal Tracking Report reflects that about 53 percent of the commercial real estate loans originated in March 2015, had exceptions to the loan policy. Of these loans, 80 percent had exceptions pertaining to the debt service coverage ratio, loan-to-value ratio, or both.

Competitive Market and "Easing" of Lending Standards. The nature and volume of exceptions to the Board-approved Loan Policy raised supervisory concerns. Examiners noted that credit underwriting and administration practices regarding new loan originations and renewals or modifications are aggressive. The significant volume of Loan Policy exceptions reflect that management's actual underwriting and administration practices do not adhere to the Board-approved objectives for the loan portfolio as detailed in the Bank's Strategic Plan.

Uniform Financial Institution Rating System Factors. The Bank argued that the RMS did not fully assess the Bank's Asset Quality with respect to Uniform Financial Institution Rating System Factors for Asset Quality, giving no weight to 9 of the 11 prescribed factors. However, in addition to other issues, the 2015 ROE documented the Bank's weaknesses in UFIRS requirements that the Bank has not successfully rebutted pertaining to the Bank's: (1) underwriting standards; (2) credit administration practices; (3) internal cash flow analyses; (4) high volume of new or modified loans that resulted in credit concentrations with significant documentation exceptions; (5) risk identification practices; and (6) management's ability to properly administer the Bank's assets.

For these reasons, the Committee affirms the RMS Director's determinations and upholds the "3" rating.

C. Capital

The Bank was assigned a Capital rating of "2." In its Request for Review, the Bank requested that the Capital Rating be changed to "1." The RMS Director upheld the "2" rating, and the Bank has appealed that determination.

The Uniform Financial Institutions Rating System defines the composite "1" and "2" ratings for Capital as follows:

> A rating of "1" indicates a strong capital level relative to the institution's risk profile.
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> A rating of "2" indicates a satisfactory capital level relative to the financial institution's risk profile.

The capital adequacy of an institution is rated based upon, but not limited to, an assessment of the following evaluation factors as applicable:

1. The level and quality of capital and the overall financial condition of the institution;
2. The ability of management to address emerging needs for additional capital;
3. The nature, trends, and volume of problem assets, and the adequacy of allowances for loan and lease losses and other valuation reserves;
4. Balance sheet composition, including the nature and amounts of intangible assets, market risk, concentration risk, and risks associated with nontraditional activities;
5. Risk exposures represented by off-balance sheet activities;
6. The quality and strength of earnings, and the reasonableness of dividends;
7. Prospects and plans for growth, as well as past experience in managing growth;
8. Access to capital markets and other sources of capital, including support provided by a parent holding company.

The Bank's Position. The Bank argues that RMS does not provide any objective metric for determining the appropriate level of capital protection, and instead summarily dismisses the standards offered by the Bank. The Bank suggests three different standards for evaluating appropriate capital protection, each of which proved the Bank to have strong capital that provided the appropriate level of capital protection.

First, the Bank compared its leverage ratio to its peers. As of * * * *, 2015, the Bank had a Tier 1 leverage ratio of * * * percent, placing it in the top 15 percent of its peer group of 1,239 banks nationwide. Second, the Bank's leverage ratio was [significantly higher than] the amount required to be considered well-capitalized under Prompt Corrective Action. Third, the Bank's Tier 1 leverage ratio was nearly [significantly] greater than the average leverage ratio prescribed by the FDIC in the last * * * consent orders it issued that contain capital directives.

Additionally, the Bank argues that RMS erred when it concluded that substandard and special mention loans weigh against a strong capital rating. The Bank claims that RMS erred in application of regulatory guidance and recitation of the underlying facts in referring to asset concentrations when assessing capital adequacy. The Bank contends that the guidance is clear that concentrations are not *per se* problems and RMS's reference to the existence of concentrations and underlying statistics do not support a determination that capital is merely satisfactory.

Furthermore, the Bank argues it will remain well-capitalized under extreme economic stress, even after repaying amounts outstanding to the U.S. Treasury Department. Accordingly, there is no compelling need for the Bank to raise capital. Problem assets are negligible in light of the Bank's capital levels, concentration risk is mitigated by effective planning and controls, earnings are stable and growth plans are in line with the market.

The Bank argues that its capital is also composed of stable core capital elements. More than 82 percent of its $* * * million of capital is common equity, with a mere $* * * million, or less than 16.3 percent, composed of securities issued to the U.S. Treasury's Small Business Lending Fund ("SBLF"). In accordance with the FDIC's Statement of Policy on Capital Adequacy, voting common stockholders' equity constitutes the dominant form of Tier 1 capital at the Bank and the Bank does not unduly rely on nonvoting equity, preferred stock or minority interests. The Bank's capital is strong in both volume and character.

The Bank claims that its ALLL, at * * * percent of total assets, is [significantly] higher than the reserve coverage for its peer group as of * * * *, 2015. The ALLL provides a substantial barrier between any potential losses and the Bank's capital, which should translate into a strong capital component rating.

The Bank contends that its well-diversified loan portfolio, its significant cash position, and liquid securities portfolio are evidence of a strong balance sheet. The Bank's off-balance sheet activity at * * * *, 2015 was limited to the issuance of an aggregate of $* * * million in standby letters of credit, all of which was fully secured by deposits held at the Bank. This off-balance sheet activity was negligible relative to the size of the Bank.

The Bank grew from $* * * million in total assets at December 31, 2007 to $* * * million in total assets as of the date of the 2015 ROE. The Bank's 2015-2017 Strategic Plan assumes asset growth of 20 percent, 14 percent, and 14 percent of each of the three years, respectively. The Bank cites a list of the top 25 banks with assets between $500 million and $5 billion and claims that these banks averaged 28.83 percent loan growth in 2014. The Bank argues that it "cannot reasonably be accused of planning 'aggressive' asset growth when such projections lag the industry by 30 percent during the first year and 50 percent thereafter."

RMS's Position. The examiners assessed capital as satisfactory in relation to the relevant factors listed above and the Bank's risk profile from the point of view of asset quality. Risks that support a satisfactory rather than strong capital rating include less than satisfactory asset quality, asset concentrations, declining earnings retention, aggressive growth plans, high cost or potential redemption of $* * * million (or 16 percent of Tier 1 Capital) in SBLF preferred stock, and capital planning weaknesses.

Asset quality concerns are a significant driver in determining the appropriate level of capital protection. As a percentage of Tier 1 Capital plus the Allowance for Loan and Lease Losses, Substandard loans represent ** percent and Special Mention loans represent ** percent, when adjusting for the [B] loan. As a percentage of Total Capital, Non-Owner Occupied CRE loans represent *** percent, commercial and industrial loans represent *** percent, and loans with policy exceptions represent *** percent. Additionally, examiners identified inaccurate loan risk ratings and weaknesses regarding underwriting and credit administration which if not remedied could lead to further growth in problem assets.

Earnings retention was characterized as satisfactory for supporting capital augmentation, although the return on assets exhibited a declining trend year-over-year. Earnings prospects may be hindered by lower-than-expected loan yields, and high overhead expenses due to BSA compliance efforts. Management reduced the balance sheet by $* * * million in 2014 to focus efforts on enforcement action compliance. However, the 2015-2017 Strategic Plan projects asset growth in 2015, 2016, and 2017.

The examiners also relied on the high cost or potential redemption of the Bank's SBLF preferred stock in declining to change the Capital Rating to "1." In 2011, the Bank had received $* * * million from the SBLF in exchange for preferred stock. Effective * * * * 2016, the dividend payment that the Bank was scheduled to make was scheduled to increase from 1 percent to 9 percent. If redeemed, the Adverse and Severely Adverse scenarios under capital stress tests conducted by an outside contractor would result in Tier 1 Leverage ratios of 8.5 percent and 5.8 percent, respectively. Based solely on the reported ratios, viewed in isolation from other UFIRS factors, the Bank technically would remain Well Capitalized under these scenarios if the SBLF preferred shares were redeemed – though it would only slightly exceed the threshold for the Adequately Capitalized category. Neither the Bank's 2015-2017 Strategic Plan nor its 2015 stress test addressed the potential SBLF redemption or increased cost of capital.

The Committee's Findings. The Committee affirms the RMS Director's determination and upholds the "2" Capital rating.

In assessing the adequacy of the Bank's capital, the effects of deteriorating earnings, deficient risk management practices, and other cited weaknesses cannot be ignored. The Bank's capital, when considered in the context of its total risk profile, does not warrant an increase in the Capital rating.

Asset Quality. The Committee agrees with the findings relating to asset quality that are documented in the ROE. The 2015 ROE documents that, as of * * * *, 2015, the Bank's assets exhibited less than satisfactory asset quality, asset concentration, and credit underwriting and administration weaknesses. Substandard loans represent 27 percent of capital and reserves while Special Mention loans represent an additional 42 percent of capital and reserves. Asset concentrations include non-owner occupied commercial real estate loans comprising *** percent of total capital and all commercial real estate loans representing *** percent of total capital. Of the commercial real estate loans, 24 percent were originated with exceptions to the Bank's loan policy. In addition, the examination documents several underwriting and administration weaknesses for failure to accurately conduct global cash flow analyses.

Asset Growth. The Committee is not persuaded by the Bank's argument that it did not plan aggressive asset growth. While the top 25 banks may have grown at an average of 28.83 percent in 2014, the banking industry as a whole only grew by 5.6 percent that year. Thus, the Bank's asset growth plans outpace the 2014 industry growth by 3.6 times in 2015 and 2.5 times in the following two years.

Small Business Lending Fund Preferred Stock. The Committee is not persuaded by the Bank's argument concerning the SBLF preferred stock. Being Well Capitalized does not automatically make a bank's capital "strong," nor warrant a "1" rating for Capital. Further, the Committee finds that the lack of a quantitative forecast as of * * * *, 2015, regarding the impact of a SBLF redemption on capital is a weakness in the Bank's capital planning that also weighs against a "1" rating for Capital.

Comparisons With Other Capital Measures. The Committee finds that the Bank's comparisons of its capital to industry averages are not relevant to apply the UFIRS factors for capital. Rather, capital adequacy is assessed relative to the nature and extent of risks at a particular institution. Thus, the Committee does not view the comparisons cited by the Bank as supporting a "1" rating for Capital.

Earnings Trend. The Committee concludes that the Bank's earnings trend supports the determination that the Bank's capital is not strong. While the Bank's actual drop in ROA from calendar year 2013 to calendar year 2014 is only * * * percentage points, rather than the annualized * * * percentage point cited by RMS, it still represents a decrease of 12 percent from the * * * percent ROA in 2013.

Accordingly, the Committee concludes that the Capital rating assigned in the ROE is well-supported.

D. Liquidity

The Bank was assigned a "2" rating for Liquidity. In its Request for Review, the Bank requested that the Liquidity Rating be changed to "1." The RMS Director upheld the "2" rating, and the Bank has appealed that determination.

The Uniform Financial Institutions Rating System defines the composite "1" and "2" ratings for Liquidity as follows:

> A rating of "1" indicates strong liquidity levels and well-developed funds management practices. The institution has reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs.
>
> A rating of "2"indicates satisfactory liquidity levels and funds management practices. The institution has access to sufficient sources of funds on acceptable terms to meet present and anticipated liquidity needs. Modest weaknesses may be evident in funds management practices.

The Bank argues that its stable liquidity metrics were trending positive and its reduced liquid asset position was caused by a prudent, long-term strategic decision to enhance earnings, that is, matching maturity dates of liabilities to assets.

<u>Historical Background</u>

Interim Limited Scope off-site review

The Bank Chairman wrote to the FDIC and [State Banking Authority] on * * * *, 2015, in response to the 2014 ROE which was delivered on * * * *, 2015. The Bank requested a reassessment of certain material supervisory determinations in the 2014 ROE, specifically the Capital, Liquidity, Sensitivity to Risk, and Composite ratings. RMS reviewed the request and information on funds management practices and balance sheet metrics as reported by the Bank. RMS also reviewed the 2014 Call Report and the Uniform Bank Performance Report (UBPR). The Liquidity rating was upgraded to a "1" rating as a result of this limited-scope, off-site review after which RMS and [State Banking Authority] determined that funds management and the overall balance sheet structure of the Bank had improved. RMS determined from the limited information that: the volume of brokered deposits decreased from $* * * million to $* * * million; the Bank did not have outstanding borrowings; the Bank relied on deposits and assets to fund loan growth; available borrowing capacity through the FHLB and correspondent banks totaled approximately $* * * million; and the primary liquidity sources such as cash, interest bearing bank balances, Federal funds sold, and unpledged marketable securities totaled $* * * million or 14 percent of total assets.

Examiners also noted that the Bank reported the following improved practices: the Asset Liability Management Policy was updated to include liquidity metrics and processes recommended during the prior exam; enhancements to the liquidity stress scenario data supported assumptions to include more relevant on and off balance sheet items; the pro forma cash flow projections improved by including off balance sheet items and documentation of assumptions.

The 2015 ROE

Liquidity levels and funds management practices were satisfactory. Adequate funding sources were in place to meet then current and anticipated requirements, and primary liquidity sources declined markedly since the previous examination to support material strategic growth in the loan portfolio, shifting lower-yielding and more liquid balance sheet assets into higher-yielding but less liquid commercial and CRE loans. This strategy caused a simultaneous decline in primary liquidity sources. The ratio of Net Loans and Leases to Total Deposits increased to levels exceeding the internal goal in the Strategic Plan.

Primary liquidity significantly declined to $* * * million, or 14.42 percent of total assets, and included cash and due from balances, Federal funds sold, and unencumbered available-for-sale securities. Continued growth objectives planned in the commercial loan portfolios would further strain the liquidity position of the Bank. The Net Non-Core Funding Dependence ratio increased to * * * percent from * * * percent due to the shift in assets from short-term investments to long-term assets.

The Bank had $* * * million in potentially volatile internet deposits. Brokered and internet deposits represented 10.34 percent of total deposits. Overall, risk management practices were satisfactory. However, exceptions to the strategic plan goals, discrepancies between the Asset and Liability Committee Policy and the Strategic Plan, and unrealistic cash flow assumptions for new loan originations were noted.

The Bank's Position. The downgrade to the Bank's Liquidity rating is conclusory and lacks adequate factual support. RMS's decision either does not address or does not substantively refute the following arguments:

- The Bank has demonstrated strong performance across the UFIRS factors, specifically, (i) adequacy of liquidity sources, (ii) availability of assets readily convertible to cash, (iii) lack of reliance on volatile funding sources, (iv) trends and stability of deposits, and (v) management's ability to monitor and control the Bank's liquidity position.

- The Bank cannot be deemed to have less-than-strong liquidity based on a decline in primary liquidity when those primary liquidity levels continue to exceed the peer group. The Bank has $* * * million in readily available liquidity in the form of cash, Federal funds sold, available-for-sale securities and unused borrowing lines. Core deposits represent 87 percent of total deposits at the Bank, and stable, lower-cost funding sources.

- RMS's claims that funding needs may be elevated given aggressive growth plans and deposit rates well above local competition are not based on any facts. Moreover, higher deposit rates should relieve funding needs because higher rates attract depositors and deter them from making withdrawals.

The Bank notes that the FDIC upgraded the Bank's Liquidity rating to a "1" rating on * * * * , 2015, based on the Bank's financial statements filed for December 31, 2014, and it argues that between December 31, 2014, and March 31, 2015, there were two material changes to the Bank's liquidity ratios, each of which reflect strong liquidity: (1) short-term liabilities were reduced as a percentage of total assets; and (2) brokered deposits with upcoming maturities were reduced relative to the overall brokered deposit portfolio. The Bank argues that what the FDIC determined was strong in December remained strong in March and there are no intervening facts to change that assessment.

The Bank also argues that its net non-core funding dependence decreased from 2009 through 2013 with a slight uptick in 2014, and that it is not exposing itself to increased liquidity risk because it is using core deposits as the funding source for loans. The Bank claims that a trend analysis of six Uniform Bank Performance Report ratios (Net Non-Core Funding Dependence, Loans to Assets, Pledged Securities to Total Securities, Loans to Deposits, Short Term Assets to Short Term Liabilities, and Core Deposits to Assets) dating back to 2009 demonstrates its liquidity strength since 2009, a time horizon when relevant economic and industry factors have exhibited reasonably positive trends.

The Bank also claims that it reduced the amount of its securities pledged to secure funding lines during the last five years by 50 percent. The Bank has more assets readily available for conversion to cash. The Bank eliminated excessive short-term assets relative to its short-term liabilities, specifically cash. Short-term asset levels were 98 percent the amount of short-term liabilities. This one-to-one matching is the most cost efficient way to protect liquidity without sacrificing yield.

<u>RMS's Position</u>. The 2015 ROE accurately assessed the Liquidity component, and weaknesses were noted regarding funds management practices. The Liquidity component received the following ratings:

- "2" at the examination as of * * * *, 2014
- "1" based on an interim rating change as of * * * *, 2014
- "2" at the examination as of * * * * , 2015

The Bank provided a comparison of 13 ratios between * * * *, 2014, and * * * *, 2015, to argue that the Liquidity rating should not have been downgraded. Prior ratings are not in question, and the 2015 ROE rating is based on the facts at the time of the examination.

The interim upgrade to "1" rating was a result of a limited-scope, off-site review, while the "2" rating assigned in the 2015 ROE resulted from a full-scope examination. Examiners noted an adverse trend in the liquidity risk profile of the balance sheet. The negative trend had been sustained for approximately 18 months. As a result of this risk assessment and identified funds management weaknesses, examiners assessed the liquidity component to be only satisfactory overall.

Relying on deposits as the Bank's sole funding source is a strength of the liquidity profile. However, the stability of these deposits may be influenced by market dynamics, as deposit growth was achieved by offering rates well above peer averages. The Bank's average deposit cost is very high at * * * times the peer median of 0.48 percent. Additionally, two of the six UBPR liquidity ratios (Loans-to-Assets and Loans-to-Deposits) experienced adverse trends since 2011 as they relate to the liquidity risk profile. These adverse trends indicate a reduction in the liquid asset cushion expected from the regulatory agencies to effectively respond to potential liquidity stress.

The strength of the Bank's liquidity has declined. Loans as a percentage of assets increased from ** percent to ** percent since the * * * *, 2014 examination, and liquid assets dropped from ** percent to ** percent of total assets. These changes funded 10 percent loan growth and 4 percent deposit runoff. Management's justification for this balance sheet shift is that this is an effort to improve earnings prospects.

Liquidity needs are expected to be substantial given that the 2015-2017 Strategic Plan forecasted asset growth of 20 percent, 14 percent, and 14 percent over three years. These growth objectives are aggressive considering that the industry asset growth was 5.6 percent in 2014. The payment of above-market rates for funding does not correspond to favorable terms, which is central to a "1" Liquidity component rating.

While the Bank's cash levels have been higher than peer averages, aggregate primary liquid assets (cash and unencumbered investment securities) declined significantly from 23 percent of total assets to just 14 percent. Despite the Bank's justification for shifting the balance sheet toward less liquid assets in order to increase earnings and accrete capital, the effect remains a reduction in primary liquidity.

The Bank's claimed $* * * million in readily available liquidity is not all liquid assets. In fact, $* * * million of this figure represents off-balance sheet contingency funding lines available: secured ($* * * million) and unsecured ($* * * million). Based on experience from the financial crisis, contingent funding lines may not be available when needed and are not equivalent to unencumbered, on-balance sheet liquid assets.

The Committee's Findings. The Committee affirms the decision of the RMS Director. The Bank did not produce evidence sufficient to support reversing the examiners' well-documented conclusions. The interim upgrade in liquidity was a result of the limited-scope, off-site review, and once the examiners conducted the full-scope, on-site examination, they discovered that the condition of liquidity warranted a downgrade from the findings previously reported in the interim review. The Committee notes that the interim limited-scope examination was a review only of the financial metrics reported by the Bank.

Moreover, the interim upgrades do not bind the examiners to those ratings at the 2015 full-scope, on-site examination. The on-site examination was comprehensive, based on, among other things, a more thorough examination of the Bank, its liquidity management practices, and an additional quarter of financial statements. The Bank argues that trends in financial metrics demonstrate stability in most areas and improvement in others. The full-scope examination revealed weaknesses including: increasing ratios of net loan and leases to deposits and assets, net non-core funding dependence increased, primary liquidity significantly declined, unrealistic cash flow assumptions for new loan originations were noted, and exceptions to the Bank's Strategic

Plan were not reported to the Board or designated committee. The Committee concludes that a rating of "2" for Liquidity is well-supported.

E. Composite Rating

The Bank was assigned a Composite rating of "3." In its Request for Review, the Bank requested that the Composite be changed to "2." The RMS Director upheld the Composite "3" rating, and the Bank has appealed that determination.

The Uniform Financial Institutions Rating System defines the composite "2" and "3" ratings as follows:

> Composite 2. Financial institutions in this group are fundamentally sound. For a financial institution to receive this rating, generally no component rating should be more severe than 3. Only moderate weaknesses are present and are will within the board of directors' and management's capabilities and willingness to correct. These financial institutions are stable and are capable of withstanding business fluctuations. These financial institutions are in substantial compliance with laws and regulations. Overall risk management practices are satisfactory relative to the institution's size, complexity, and risk profile. There are no material supervisory concerns and, as a result, the supervisory response is informal and limited.
>
> Composite 3. Financial institutions in this group exhibit some degree of supervisory concern in one or more of the component areas. These financial institutions exhibit a combination of weaknesses that may range from moderate to severe; however, the magnitude of the deficiencies generally will not cause a component to be rated more severely than 4. Management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Financial institutions in this group generally are less capable of withstanding business fluctuations and are more vulnerable to outside influences than those institutions rated a composite 1 or 2. Additionally, these financial institutions may be in significant noncompliance with laws and regulations. Risk management practices may be less than satisfactory relative to the institution's size, complexity, and risk profile. These financial institutions require more than normal supervision, which may include formal or informal enforcement actions. Failure appears unlikely, however, given the overall strength and financial capacity of these institutions.

The Bank's Position. The Bank argues that its Composite rating should be upgraded back to the "2" it received as a result of the interim review in * * * * 2015. That upgrade was on the basis of stronger liquidity and, with the exception of Management, satisfactory ratings across the other components. The Bank notes that even a bank in satisfactory condition is permitted to have one or more 3-rated component ratings. The Bank concedes that its ongoing BSA program remediation could result in a less-than-satisfactory rating for its Management component, but still argues that a "2" composite rating is warranted.

RMS's Position. RMS concludes that the 2015 ROE is correct and that the Bank's overall condition is less than satisfactory. RMS also notes that the rating upgrades in * * * * 2015 were interim rating upgrades based on off-site review of financial metrics and not a full-scope, on-site examination of the Bank's risk management practices. At the full-scope exam, management performance and Board supervision were found to be less than satisfactory. The BSA/AML compliance program continues to be affected by multiple deficiencies. These weaknesses, as well as other managerial and strategic issues identified, are causes for regulatory concern. The volume of adversely classified items increased by 26 percent, and the volume of Special Mention items increased by 10 percent and by 97 percent from the 2013 examination. Weaknesses in credit underwriting and administration practices included numerous exceptions to Board-established policies, such as exceptions to loan-to-value and debt service coverage requirements, many of which were not properly tracked internally, and significant weaknesses in the Bank's internally prepared cash flow analyses for many borrowers. There was a decline in traditional balance sheet liquidity parameters, as the emphasis on increasing CRE lending tightened the liquidity posture of the Bank. Overall earnings trends were deteriorating with the reduction in the net interest income, escalated overhead costs, and rising provisions for loan and lease losses.

The Committee's Findings. The Committee upholds the Composite rating of "3." The rating is well-supported in the record and accurately reflects the 2015 examination findings. Continued deficiencies in the BSA/AML compliance program, coupled with negative trends in asset quality and ongoing managerial deficiencies identified during the examination, support the findings and demonstrate that management has not been willing and able to correct deficiencies noted over several examination reports. Additionally, the decline in liquidity, troubling concentrations in CRE lending, and numerous unreported exceptions to the loan policy all confirm that the Bank requires additional improvement before its ratings can be upgraded.

V. Conclusion

The Committee reviewed all materials submitted by the Bank, including, but not limited to: the interim review dated * * * * , 2015; 2015 ROE; the Request for Review; RMS's Response; and the Bank's Appeal, including the seven volumes of exhibits numbered 1 through 59. The Committee acknowledges that the Bank has taken positive steps to address many of the findings and to improve deficiencies noted in prior examinations, and encourages the Bank to continue making progress. The Committee concludes, however, that the 2015 examination findings and ratings were reasonable, well-supported, and consistent with the policies, practices, and mission of the FDIC.

For the reasons detailed above, the Bank's appeal is denied. This decision is considered a final supervisory decision by the FDIC.

By direction of the Supervision Appeals Review Committee of the FDIC, dated July 25, 2016.