

GAO

Report to the Chairman, Committee on  
Government Reform and Oversight,  
House of Representatives

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June 1998

# BANK SUPERVISION

## Closure of the Rushville National Bank



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General Government Division

B- 278532

June 15, 1998

The Honorable Dan Burton  
Chairman, Committee on Government  
Reform and Oversight  
House of Representatives

Dear Mr. Chairman:

This letter responds to your August 1, 1997, request for an independent review of the events leading up to the 1992 closure of the Rushville National Bank (Rushville) by the Office of the Comptroller of the Currency (OCC). Accordingly, we reviewed whether OCC followed its policies and procedures in its (1) net worth calculation and loan classifications, which led to Rushville's being declared insolvent; (2) decision to close the bank before implementation of the Federal Deposit Insurance Corporation Improvement Act (FDICIA);<sup>1</sup> (3) contacts with the bank that recalled a loan to Rushville's holding company; (4) determination of civil money penalties assessed against the former Rushville chairman and directors (hereafter referred to as Rushville directors); and (5) involvement with the proposed sale of Rushville holding company stock by Rushville's suspended chairman.

To respond to your request, we interviewed officials of OCC, the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve, and the Department of Justice. We also met with Rushville directors and reviewed over 100 boxes of documents concerning Rushville, which were maintained by OCC and FDIC, as well as other related material. We also reviewed documents that we obtained from the Federal Reserve and Rushville directors. See appendix I for a detailed discussion of our scope and methodology.

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## Results in Brief

During our review, we found that OCC properly calculated Rushville's net worth. Also, we did not find evidence that OCC's loan classifications or insolvency determination were improper. Although some calculations and classifications were based to a great extent on examiner judgment, the examiners' net worth calculation and loan classifications followed OCC procedures. However, our review of loan classifications was made more difficult by the lack of certain documentation.

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<sup>1</sup>P.L. 102-242, 105 Stat. 2236 (1991).

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We determined that FDICIA's prompt corrective action provisions—which went into effect the day after Rushville was closed—would not have allowed Rushville to remain open longer. Congress enacted FDICIA to eliminate delays in the closure of problem institutions, and OCC officials told us that, for that reason, even if they had not had a pre-FDICIA basis to close Rushville, they would have closed the bank without delay once FDICIA was implemented.

In our review of OCC E-mail and related documents, we found no support for the allegation that OCC tried to close Rushville by seeking to influence the recall of a loan made by a creditor bank to Rushville's holding company. OCC officials and officers of the creditor bank told us that OCC never attempted to influence the recall of the holding company loan. Officers of the creditor bank told us that they first sought repayment of the loan in 1990 because the Rushville bank stock that collateralized the loan was of questionable value and they doubted the Rushville chairman's capacity to repay the loan.

Regarding the penalties assessed against Rushville directors, we found that OCC followed its policies and procedures. However, in a number of instances in the 1990s, the penalties ultimately assessed by OCC were higher than those originally proposed by district officials. While documentation was insufficient for us to ascertain how the OCC amounts were determined, OCC procedures allow for such penalty adjustments when circumstances warrant.

We found no evidence substantiating the Rushville directors' assertion that an OCC official told the Rushville chairman during the meeting at which he was suspended that he could not sell his stock. Moreover, when OCC became aware of the misunderstanding, OCC sent a letter to the chairman stating that he could sell his stock subject to OCC approval.

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## Background

OCC closed Rushville on December 18, 1992, on the basis of its determination that the bank had a negative net worth of about \$326,000 and thus was insolvent. At the time, Rushville was a two-branch bank with \$38 million in assets. During that same year, OCC also closed 15 other small U.S. banks with assets under \$50 million.

Rushville had been the subject of OCC scrutiny since at least 1978 when it entered into a memorandum of understanding with OCC in which Rushville directors agreed to correct such insider abuses as excessive insider fees

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and overdraft payments to directors. The Rushville directors consented to an OCC cease-and-desist order in June 1983 directing the bank to correct unacceptable lending practices, and the directors consented to an amended order OCC issued a year later in response to questionable expense payments to insiders. In 1984, OCC took the first of four civil money penalty actions against several Rushville directors on the basis of violations of banking laws. Finally, on November 12, 1992, OCC suspended the chairman from participating in the affairs of the bank for engaging in unsafe and unsound practices, and, on December 11, 1992, all but one bank director resigned from the board. Appendix II shows key events affecting Rushville, with a focus on events surrounding OCC's closure of the bank.

OCC assessed 14 Rushville directors civil money penalties totaling \$374,000 from 1984 to 1993. OCC based these penalties on the individuals' having undertaken prohibited actions, such as improper payments of Rushville directors' legal fees; multiple violations of limits on loans to executive officers; and illegal loans to its holding company. When we completed our audit work in April 1998, civil money penalties of \$295,000 assessed against bank directors had not been paid.

From the mid-1980s until after Rushville's closure, Rushville directors initiated a number of lawsuits seeking redress in the federal courts for what the directors believed were wrongful actions by federal banking regulators. In response to OCC's 1985 civil money penalty assessment, the directors initially requested an administrative hearing to contest the penalties, but subsequently requested that OCC's civil money penalty assessment be dismissed. The directors asserted that OCC did not have the authority to assess these civil money penalties. When the administrative law judge denied the request for dismissal, the directors unsuccessfully filed suit in the district court questioning OCC's authority to assess civil money penalties.<sup>2</sup> When the court found that it lacked jurisdiction to hear the case, the directors again requested an administrative hearing. The administrative law judge upheld the original penalty assessment. In June 1989, at the end of the administrative process, OCC imposed the penalties. The directors unsuccessfully appealed OCC's decision to the Seventh Circuit Court of Appeals and the Supreme Court.<sup>3</sup>

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<sup>2</sup>The district court found that the law (12 U.S.C. 1818(h)) establishes a review procedure that allows an individual to request an administrative hearing to review the assessment. The individual may then appeal an unfavorable administrative ruling to the court of appeals. The court found that the only exception to this appeal process exists where the actions of the Comptroller of the Currency clearly depart from his statutory authority. *Abercrombie v. Clarke*, 641 F. Supp. 598 (S.D. Ind. 1986); *aff'd* 833 F.2d 672 (7th Cir. 1987).

<sup>3</sup>*Abercrombie v. Clarke*, 920 F.2d 1351 (7th Cir. 1990), *cert. denied* 112 S. Ct. 52 (1991).

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In 1994, the directors filed suit in district court seeking money damages from the government for various common law and constitutional torts alleging that OCC violated the Administrative Procedure Act when it closed Rushville. The case was dismissed by the district court and the appeal at the Seventh Circuit Court of Appeals was dismissed.

Subsequently, the directors filed three suits seeking redress. One suit alleged violations of the constitutional due process rights of Rushville's directors by individual OCC officials.<sup>4</sup> Another suit appealed OCC's imposition of penalties and restitution in the early 1990s.<sup>5</sup> Both suits were dismissed by the courts. The remaining suit seeking compensation for OCC's seizure of the bank as a taking under the Fifth Amendment is still pending.<sup>6</sup>

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## No Evidence Found That OCC's Net Worth Calculation and Loan Classifications Were Improper

Rushville directors have questioned whether OCC followed its policies and procedures in closing Rushville and have alleged that OCC misclassified performing loans during its last examination to make it appear that the bank was insolvent. Accordingly, you asked us to review whether OCC followed its policies and procedures in its net worth calculation and loan classifications during its final examination before Rushville's closure. Although our in-depth review of 25 problem loans found that many loan classifications were not well documented, we found that, except for the lack of documentation, examiners followed established OCC procedures and generally accepted accounting principles in their net worth calculation and loan classifications.

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## GAO's Review of OCC's Net Worth Calculation

Our review found that OCC's net worth calculation showing that Rushville was insolvent by about \$326,000 was essentially based on examiners' determination that the bank lacked sufficient equity to cover estimated loan losses from problem loans. Documentation from past examinations and interviews indicate that, over the previous decade, OCC had been critical of Rushville's allowance for loan losses, which represented a reserve for bad debts. In 1983, the directors consented to an OCC cease-and-desist order that required Rushville to maintain a capital ratio of

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<sup>4</sup>*Hoosier Bancorp v. Rasmussen*, 90 F. 3d 180 (7th Cir. 1996).

<sup>5</sup>*Snyder v. Board of Governors of the Federal Reserve System*, No. 96-1403 (D.C. Cir. May 8, 1997).

<sup>6</sup>*Hedrick v. United States*, No. 95-684C (Ct. Cl. filed Oct. 16, 1995).

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7 percent.<sup>7</sup> In December 1992, Rushville's capital ratio was at minus 1 percent, which was well below the level required by the cease-and-desist order.

Following generally accepted accounting principles, OCC examiners determined Rushville's net worth during the December 1992 examination by valuing its loan portfolio and then determining the amount of equity the bank should be setting aside to absorb losses. By comparing the two amounts, the examiners determined that Rushville lacked sufficient bank equity to cover loan losses. Table 1 shows the calculation that OCC used to make its determination.

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<sup>7</sup>The capital-to-asset ratio measures the level of protection available to cover future losses. As a general rule, a higher capital-to-asset ratio provides more protection against future losses. A well-capitalized bank has a total risk-based capital ratio of 10 percent or more.

**Table 1: OCC's Calculation of Rushville's Net Worth (as of Dec. 17, 1992)**

Calculation	Amount
1. OCC charge-offs to allowance <sup>a</sup>	\$694,858
2. OCC calculated general reserve <sup>b</sup>	319,549
3. OCC calculated specific reserves <sup>c</sup>	736,800
4. Total: OCC required allowance for loan losses (Add lines 1, 2, and 3) <sup>d</sup>	1,751,207
5. Less: Rushville's allowance for loan losses <sup>d</sup>	626,706
6. Total: Required provision for loss (Subtract line 5 from line 4)	1,124,501
7. Reversal of interest and expenses previously recorded <sup>e</sup>	304,578
8. OCC calculated other real estate disposition reserves <sup>f</sup>	42,924
9. Total: Equity required (Add lines 6, 7, and 8)	1,472,003
10. Less: Bank equity <sup>g</sup>	1,145,214
11. Total: Equity capital deficit (Subtract line 10 from line 9)	(\$326,789)

<sup>a</sup>Charge-offs represent loans removed from the asset balances in the accounting records because the probability of collection for such loans is remote. When a charge-off occurs, a corresponding amount of the allowance for losses is also removed or a current provision for loss is charged against income.

<sup>b</sup>A reserve for general losses in a bank's loan portfolio. The size of the reserve is based on historical loss rates for different loss categories of classified loans.

<sup>c</sup>A reserve for specific loans where collection in full is highly questionable.

<sup>d</sup>A reserve of funds to absorb estimated loan losses from the problem assets of a bank's loan and lease portfolio.

<sup>e</sup>An adjustment to reverse interest receivable on loans where receipt of future interest payments is unlikely and to reverse expenses that the bank has not paid.

<sup>f</sup>A reserve for other real estate owned—real estate Rushville acquired by default from borrowers who were not able to meet their loan payments—to adjust the value to market value and to account for the costs of disposing of the asset.

<sup>g</sup>Represents capital stock, bank surplus, undivided profits, and gross earnings.

Source: OCC.

We reviewed OCC workpapers from the final examination of Rushville and traced the amounts shown in table 1 back to the bank's accounting records, and we met on several occasions with OCC officials to discuss the net worth calculation. After reviewing the OCC calculations, we found OCC's determination to be appropriate. In a few instances, we found that OCC examiners chose to apply less stringent bases for their net worth calculation than they might have applied. For example, when OCC examiners calculated Rushville's general reserve, they chose to use a 3-year average (1989 through 1991), which resulted in a lower general

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reserve amount. Examiners could have used the 3-year period of 1990 through 1992—the year of Rushville’s closure—which would have increased the reserve requirements by \$53,000. However, examiners used the earlier 3-year average because they wanted to use a period that would not be influenced by their 1992 loan classifications.

The largest OCC adjustment during the December 1992 net worth calculation was the \$736,800 that examiners established for specific reserves, as shown in table 1. Examination records indicated that OCC examiners based this adjustment on their judgments (1) that borrowers were unlikely to repay some questionable loans and (2) that the supporting collateral was weak. We focused most of our attention on how the examiners supported this part of the net worth calculation because the specific reserves had the greatest impact on Rushville’s insolvency determination. The results of our review of Rushville’s loan portfolio are discussed in the following section.

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## GAO’s Review of Rushville’s Loan Portfolio

Workpapers from OCC’s final Rushville examination documenting the loan portfolio analysis indicated that examiners focused on a large number of problem loans, which are loans posing a greater than normal risk of default. OCC examiners reviewed 134 loans, or 77 percent of Rushville’s loan portfolio, which included 175 loans with a combined value of about \$17.8 million. Of this 175-loan portfolio, examiners classified loans totaling \$5.9 million as problem loans. OCC further documented decisions reached on 71 of these problem loans (64 reclassified loans from the previous examination and 7 newly classified loans) through a process called a migration analysis, which OCC uses in such cases to compare classifications and explain the basis for changes.

Our review of these comparisons was the first step we took in reviewing the Rushville directors’ allegation that OCC inappropriately downgraded sound loans, thereby causing Rushville’s insolvency. We reviewed all 71 loans from OCC’s migration analysis and then focused on 20 of these loans that had outstanding balances of over \$100,000. The loan comparison was a key starting point because it listed loans with a classification that had changed from the previous year. Rushville directors were concerned that many loans were improperly classified in 1992.

In addition, we identified for further study five other loans from OCC’s loan comparison that had relatively large outstanding balances and OCC calculated specific reserves. These loans were not sufficiently documented

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by OCC for us to initially determine why the loans were written down. OCC examiners told us that many of the bank's loans were poorly documented, and that they had to exercise considerable judgment in classifying Rushville loans because of poor loan records and the departure of Rushville directors and loan officers who were most knowledgeable about the loans.

The anticipated losses from the 25 problem loans we reviewed represented over 88 percent of the \$694,858 OCC charge-offs and over 77 percent of the \$736,800 OCC calculated specific reserves. For 12 of the loans in our sample, where it was possible to identify the underlying rationale for the classification, OCC's classifications seemed justified. For the remaining 13 loans in our sample, it was not completely clear how examiners arrived at their classifications. Such insufficient documentation was an agency problem we previously identified during an earlier 1993 review of the quality of OCC's examinations.<sup>8</sup> We also noted that the limited documentation OCC had on some of the Rushville loans exceeding \$100,000 did not meet agency requirements that were in effect at the time of Rushville's closure in 1992. OCC's procedural guidance at that time required sufficient documentation of significant write-downs for loans over \$100,000 so that a reviewer could understand the rationale for the write-down.<sup>9</sup>

To better understand the basis for OCC's classifications of the remaining 13 sampled loans, we reviewed available Rushville loan files maintained by FDIC in Chicago and Dallas. We also asked OCC examiners and Washington, D.C., staff to summarize the factors influencing their classification of these loans. The FDIC files contained actual bank documents on some of the 13 loans, including loan files, security agreements, minutes from board meetings, and various legal documents, but we were unable to find key documents that would have allowed us to fully ascertain the basis for the examiners' loan classifications for the 13 loans. In these cases, we used OCC summaries prepared at our request that generally supported OCC officials' statements asserting that examiners used accepted agency norms for valuing loans. On the basis of the additional information provided by OCC on these loans and the lack of conflicting information in Rushville loan files maintained by FDIC, OCC's classifications appeared appropriate.

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<sup>8</sup>Bank Examination Quality: OCC Examinations Do Not Fully Assess Bank Safety and Soundness (GAO/AFMD-93-14, Feb. 16, 1993).

<sup>9</sup>In 1993, OCC removed this requirement because OCC officials thought the additional documentation was not needed for their purposes.

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Finally, to ascertain the disposition value of the 13 problem loans, we asked FDIC to tell us the amount it received on the loans or their collateral at the time of their disposition. FDIC records showed that the 13 loans were sold with other FDIC assets, written off by FDIC, or sold for lower amounts than those that were shown on Rushville's records following negotiations with the borrower. On average, FDIC received 35 percent of the loan's book value, not considering the reserves for loan losses. Specifically, 10 of the loans were disposed of at an amount lower than the value projected by OCC, and the other 3 loans were sold for an amount higher than the amount OCC initially projected. (See app. III.)

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## FDICIA Intent Was to Speed the Closure of Problem Institutions

OCC closed Rushville 1 day before new regulatory procedures for closing problem institutions became effective on December 19, 1992, following the enactment of FDICIA. Rushville directors have expressed the belief that these new FDICIA procedures would have allowed the bank to remain open for at least an additional 90 days, and they have alleged that OCC closed the bank before the procedures came into effect to prevent Rushville's directors from restoring Rushville to solvency.

Accordingly, you asked us to review whether OCC closed Rushville before FDICIA's implementation to prevent the bank from remaining open for at least another 90 days, and whether other banks were closed before the implementation of FDICIA to avoid having to keep them open under FDICIA. Our analysis of FDICIA and its effect on Rushville's closure indicated that FDICIA's implementation would not have provided an additional time period in which OCC would have let Rushville stay open. We found that OCC did not appear to have taken actions to quickly close other banks to avoid the effects of FDICIA's implementation.

To obtain evidence and views on whether FDICIA affected Rushville's closure, we reviewed the requirements of FDICIA and met with Rushville directors and with OCC officials. Contrary to the Rushville directors' belief that FDICIA allows for more lenient treatment of problem institutions, FDICIA's capital provisions direct federal banking regulators to take prompt corrective action to resolve the capital weakness of institutions that fall below minimum capital standards.<sup>10</sup>

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<sup>10</sup>Bank and Thrift Regulation: Implementation of FDICIA's Prompt Regulatory Action Provisions (GAO/GGD-97-18, Nov. 21, 1996).

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Specifically, the FDICIA provisions require OCC to promptly close critically undercapitalized banks, such as Rushville.<sup>11</sup> The provisions, which supplement rather than limit or replace OCC's existing enforcement authority and earlier capital adequacy guidelines, give OCC up to 90 days<sup>12</sup> to recapitalize, sell, or close such banks. However, OCC can take action to close such banks at any time during the 90-day period. According to OCC officials, they would have not delayed closing Rushville because of its insolvency and its inability to raise capital.

Our review of other banks closed in the 6 months before and after the closure of Rushville did not find evidence that the other banks were treated more favorably. In the 6 months before Rushville's closure, OCC closed 22 national banks—although 13 of the 22 banks were subsidiaries of a single holding company. We found that OCC closed these banks for reasons similar to those that were the basis for Rushville's closure (i.e., insider abuse, inadequate reserves, and weak loan administration). Our review of these banks' closing books indicated that OCC did not hasten their closure so as to close them before FDICIA came into effect. Similarly, we did not find evidence that other banks closed during the 6 months after Rushville's closure were treated more favorably than Rushville. In the 6 months after Rushville's closure, OCC closed 15 national banks. We did not find that these banks were allowed to remain open after FDICIA came into effect without an active plan for their recapitalization.

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<sup>11</sup>A critically undercapitalized bank is a bank whose capital levels have decreased to less than 2 percent of the bank's ratio of tangible equity to total assets. Before FDICIA, banks could have capital ratios between zero and 2 percent and remain open. However, with FDICIA, OCC would have been required to close the bank or take other corrective action when the bank's capital level fell below \$740,000, instead of waiting for Rushville's capital to fall below zero.

<sup>12</sup>Under 12 U.S.C. 1831o(h)(3), OCC may extend the initial 90-day closing period to 270 days. If a bank receiver is not appointed within 90 days, OCC must determine, with the concurrence of FDIC, that the decision to keep the bank open better serves the purposes of the statute and document the reasons for its conclusions. This decision must be reviewed every 90 days and a receiver or conservator must be appointed, unless a new determination is made. In any case, a receiver must be appointed if the institution is critically undercapitalized during the quarter beginning 270 days after the date it became critically undercapitalized, unless OCC determines that the bank meets certain conditions, including positive net worth.

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## No Evidence Found That OCC Influenced the Decision to Recall Holding Company Loan

Rushville directors alleged that, in early 1992, OCC conspired to close Rushville by contacting Liberty National Bank of Louisville (Liberty) to suggest that it call in a \$800,000 loan<sup>13</sup> to Rushville's holding company, Hoosier Bancorp, which was collateralized by Rushville stock. In response to your request that we examine whether OCC was involved with the recall of the Hoosier Bancorp loan and determine whether OCC followed its policies and procedures in this matter, we reviewed OCC and Liberty documents but found no evidence that OCC's contacts with Liberty were contrary to OCC policies and procedures.

Our interviews with OCC officials and others found no support for the Rushville directors' claim that OCC asked Liberty to recall the Hoosier loan. OCC officials and Liberty officers stated that OCC had not attempted to influence the recall of the Hoosier Bancorp loan. Moreover, our review of internal OCC documents and trial depositions did not reveal any evidence that OCC officials had asked Liberty officers to recall the loan. Officers of the creditor bank told us that an internal loan review committee identified the Hoosier loan as a problem in 1990 because the Rushville bank stock that collateralized the loan was of questionable value and they doubted the Rushville chairman's capacity to repay the loan.

Our review found that communication between Liberty and OCC during the period immediately preceding the 1992 loan recall involved Liberty officials' initiating contacts with OCC officials to inform them of the bank's intent to recall the loan and to later inform them about Rushville and its directors' lawsuits against Liberty. OCC officials told us that although they might direct a bank to improve its loan portfolio, they would not direct a national bank to initiate a loan recall because such an action would necessitate OCC's sharing information among banks. According to the officials, OCC would share information among banks only in situations where there is a compelling supervisory reason, such as when it learns of criminal activity that affects other banks. OCC examiners in Louisville said that they were never told by OCC officials in the Chicago district office or Washington, D.C., headquarters to ask Liberty to recall the Hoosier Bancorp loan. Examiners explained that the recall was strictly a business decision by bank officials in which they were not involved.

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<sup>13</sup>The Hoosier Bancorp loan originated in 1977 with a loan from Louisville Trust Bank at a principal value of \$900,000. The terms and conditions of the loan were renegotiated in 1980 and the principal value was \$1.7 million. Louisville Trust Bank merged with United Kentucky Bank in the early 1980s. By 1985, United Kentucky had merged with Liberty and the principal value of the loan was \$1.6 million. Liberty renegotiated and extended the loan several times in the early 1990s, reducing the principal value. In July 1992, the Rushville chairman paid \$530,000 against the principal, bringing the outstanding loan amount to about \$800,000. Another \$100,000 principal payment was made in November 1992; at maturity in December 1992, the loan had an outstanding balance of \$700,000.

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Liberty officers told us that they sought repayment of Liberty's loan to Hoosier Bancorp in 1992 because the Rushville bank stock that collateralized the loan was of questionable value. Liberty officers conducted several examinations of Rushville and were concerned about its poor financial condition. The officials said they were also prompted to seek repayment by their doubts about the Rushville chairman's capacity to repay the loan. Records also show that Liberty sought termination of the Hoosier loan on two previous occasions.

Liberty officers said their final recall decision was partly based on their concern that Rushville could be closed and their collateral rendered worthless under the prompt corrective action provisions of FDICIA. Liberty officers told us that they were also prompted to recall the loan by the November 12, 1992, suspension of the chairman from participating in managing Rushville. In retrospect, they said that their concerns about the chairman's repayment ability were borne out by his failure to pay any of the outstanding loan amount since November 1992. A 1997 federal court judgment affirmed that Hoosier Bancorp and the chairman were liable for the full amount of the loan.<sup>14</sup>

Finally, we found no evidence that OCC examinations of Liberty in the 3 years before the recall influenced Liberty's decision to seek the recall by singling out the Hoosier Bancorp loan as a problem loan warranting special attention. Reports on OCC examinations of Liberty did not list the Rushville loan as a problem loan until 1992. That year's OCC report on the Liberty examination mentioned the loan as one of Liberty's large problem loans. In the examination report, OCC agreed with Liberty's internal classification of the Hoosier Bancorp loan and with Liberty's allowance for losses on the loan.

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## Civil Money Penalties Followed OCC Procedures

Rushville directors alleged that the penalties OCC assessed against them since the 1980s were arbitrary and excessive, and that OCC arbitrarily assessed several directors penalties because they were publicly critical of OCC. Accordingly, you asked us whether OCC had a process for determining penalties, whether the process was followed in the Rushville case, and whether the Rushville penalties were excessive. We found that OCC

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<sup>14</sup>Rushville directors filed suit against Liberty's corporate successor—Bank One, Kentucky. They alleged that there was a conspiracy between the Comptroller of the Currency and Bank One to declare Rushville in default on the loan, and that Bank One's possession of the Rushville stock should be considered satisfaction of the loan agreement. The Seventh Circuit Court of Appeals found that the stock did not satisfy the debt and that there was no evidence that Bank One's actions were improper. Bank One counterclaimed, seeking to recover the principal and interest on the loan. The district court entered judgment for Bank One. *Snyder v. Bank One, Kentucky, N.A.*, 113 F.3d 774 (7th Cir. 1997).

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examiners and managers appear to have followed agency guidance in assessing penalties. However, we were unable to determine how OCC set many penalty amounts because documentation was incomplete, missing, or unavailable due to the length of time that has elapsed since many of the penalties were assessed. We did not find that OCC arbitrarily assessed directors penalties because they were publicly critical of OCC, as alleged by Rushville directors. In addition, we found that the penalties OCC assessed the Rushville directors, including the \$250,000 penalty OCC assessed the Rushville chairman, while higher than average, were not the highest OCC has assessed directors and officers of other banks since 1989.

OCC's process for determining civil money penalties is a multistep process involving examiners and officials in the applicable OCC district office and Washington, D.C.<sup>15</sup> After identifying violations and in concert with OCC district officials, examiners consider whether actions by responsible bank officers or directors warrant their recommending a money penalty and, if so, what level the penalty should be.<sup>16</sup> These recommendations are sent to OCC staff in Washington, D.C., for review and analysis. The staff presents the case to OCC's Supervision Review Committee, which is made up of senior OCC officials. The committee makes a recommendation to a Senior Deputy Comptroller who determines the final recommended penalty amounts. In the course of determining whether to assess a civil money penalty and the amount of the penalty, OCC issues a 15-day letter to affected individuals soliciting their views. At this point, the director or officer is provided an opportunity to negotiate the penalty. If the penalty assessment is contested, the case is brought before an independent administrative law judge. The judge's decision is sent to the Comptroller of the Currency for the final determination of the penalty. The OCC's determination may be appealed to the U.S. court of appeals.

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<sup>15</sup>The Financial Institution Regulatory and Interest Rate Control Act of 1978, P.L. 95-630, 92 Stat. 3641 (1978), gave OCC authority to levy money penalties for violations of various federal statutes and regulations, including a money penalty of up to \$1,000 per day for violation of a cease-and-desist order. Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, P.L. 101-73, 103 Stat. 183 (1989), OCC's authority was expanded and money penalties were grouped into three categories. The maximum penalty that could be assessed under each of the three tiers was \$5,000 per day; \$25,000 per day; and \$1,000,000 per day. The harsher penalties are associated with more serious offenses. The law requires that OCC take the following factors into account: (1) the financial resources of the person, (2) good faith, (3) the gravity of the violation, (4) a history of previous violations, and (5) such other factors as justice may require.

<sup>16</sup>OCC procedures require penalty amounts below \$10,000 to be reviewed by the applicable OCC district office. Similarly, penalties above \$10,000 are to be referred to the Washington, D.C., office and ultimately are reviewed by the Supervision Review Committee. District office penalty review authority was increased to \$20,000 in June 1992.

Evidence we reviewed indicated OCC followed its policies and procedures for the penalties it assessed against Rushville directors in the 1990s. We were not able to come to a similar conclusion on the penalties assessed in the 1980s because complete documentation was not available. Table 2 shows the amounts of penalties and their resolution for the penalties OCC assessed Rushville directors since 1984, which was the first year penalties were assessed against the Rushville directors.<sup>17</sup>

**Table 2: Civil Money Penalties OCC Assessed Against Rushville Directors or Officers**

Calendar year of assessment	Position	Number of individuals assessed money penalties	Individual penalty assessments		
			Proposed <sup>a</sup>	Actual <sup>b</sup>	Amount paid
1984	Director	1	\$10,000	\$5,000	\$5,000
	Director	1	10,000	10,000	0
1985	Chairman	1	15,000	15,000	15,000
	Director	2	10,000	10,000	10,000
	Director	1	10,000	10,000	10,000
	Director	1	10,000	10,000	0
	Director	1	10,000	2,000	2,000
1992	Chairman	1	20,000	10,000	10,000
	Director	1	15,000	2,000	2,000
	Director	3	10,000	3,000	3,000
	Director	2	1,000	1,000	1,000
1993	Chairman	1	250,000	250,000	0
	Vice Chairman	1	25,000	25,000	0
	Officer	1	25,000	4,000	4,000

<sup>a</sup>The proposed civil money penalty assessment is the amount determined by the Supervision Review Committee.

<sup>b</sup>The actual civil money penalty assessment is the amount determined by OCC after negotiations with the assessed individual.

Source: OCC.

OCC was able to provide us with limited documentation in support of the penalty amounts it assessed in the 1980s. OCC officials told us that, with the passage of 14 years, it was difficult for them to locate additional records pertaining to some of the penalties assessed in 1984 and 1985. OCC's inability to locate such records limited our ability to determine how the

<sup>17</sup>In addition to the penalties mentioned in table 2, OCC is seeking to recover an additional \$451,686 from the chairman and a director as restitution for losses resulting from insider transactions and improper activities involving legal fees to defend the directors that were improperly paid by the bank.

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amounts were chosen. Moreover, we noted that OCC's penalty assessment procedures at that time did not include guidance on the possible ranges of penalty amounts that could be assessed.

We found that OCC initially set the amounts of the penalties it assessed in 1992 and 1993 on the basis of a penalty assessment matrix it began using in January 1991. The penalty matrix provides guidance for examiners to use in determining whether to assess civil money penalties and the amount of such penalties. The matrix, which is intended to make the process of civil money penalty assessment consistent and equitable, weights such factors as severity, intent, pecuniary gain, loss to the bank, and concealment.

Although district examiners initially based the penalties they assessed in 1992 on penalty matrices, we found that many penalty amounts were increased as the penalty assessments went through OCC's review process. We found that OCC procedures allow for such increases when examiners-in-charge and OCC officials believe circumstances warrant them. Specifically, written OCC policies and procedures emphasize that the matrix is only a guide to use in determining an appropriate penalty. OCC policies and procedures state that the matrix was not intended to reduce the penalty assessment process to a mathematical equation, and that it should not be a substitute for sound supervisory judgment.

In setting the 1992 Rushville penalties, OCC appears to have followed its procedures that allow for such increases, but for two of the four assessments we found little documentation to support the increases in amounts or the use of factors not covered in the penalty matrix as the basis for setting penalties. Specifically, documented explanations for the 1992 penalty amounts were missing or incomplete in the following two instances.

- The \$20,000 assessment against the chairman and the \$15,000 assessment against a director reflected \$10,000 and \$5,000 increases, respectively, beyond the level the matrix recommended. The district staff's recommendation for a higher amount was based on similar noncompliance by the chairman and director almost a decade earlier and by their continuing disregard for a cease-and-desist order. The district's recommendation did not explain how the increases were chosen. Washington, D.C., staff disagreed with the district recommendation, arguing that the penalty matrix takes into account all of the circumstances that should be considered in assessing a penalty. The district's recommendation was accepted by the Supervision Review Committee

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because of the chairman's and the director's significant and long-standing noncompliance.

- Penalties assessed against three directors were assessed at levels exceeding the initial recommended amounts that district examiners calculated using the matrix. In these instances, the matrix prepared by the district staff recommended a letter of reprimand, but OCC's district office assessed the directors \$10,000 each. The rationale given for the increase was that setting a penalty of less than \$10,000 would imply that OCC viewed the directors' current noncompliance as less serious than their previous noncompliance, which resulted in a \$10,000 assessment, according to OCC documents.

OCC officials said they also based the penalties they assessed in 1993 on penalty matrices. However, OCC was not able to furnish us with the applicable matrices because they could not be located. Other documents in OCC files provided insight into the rationale for the 1993 assessments, but these documents provided less insight into how penalty amounts for two of the three assessments were calculated. Specifically, documented explanations for the 1993 penalty assessments were missing or incomplete in the following two instances.

- The \$25,000 penalty assessed against a director was first proposed to be \$10,000. However, the Supervision Review Committee increased the penalty to \$25,000 because the director was the nominal recipient of a \$300,000 loan, which caused a loss of about \$300,000. Although we found no documentation explaining how OCC arrived at the \$25,000 penalty amount, an independent administrative law judge found that the assessment could have been as much as \$5 million.<sup>18</sup> The Comptroller of the Currency subsequently adopted the \$25,000 amount.
- The \$250,000 penalty assessed against the chairman was based on the district's recommendation of a penalty amount of \$125,000 or more. Although the Supervision Review Committee cited the chairman's demonstrated "reckless disregard" for the law, for the soundness of the bank, and for his own fiduciary duties as the reason for assessing \$250,000, we found no documentation explaining how OCC calculated the increased amount. OCC officials told us that there are numerous violations described in a variety of OCC documents justifying the \$250,000 penalty. An independent administrative law judge found that the assessment could

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<sup>18</sup>The administrative law judge's amount was based on the violation being assessable under the federal statute at \$5,000 per day for a period of about 3 years—the period during which the lending limit restriction was violated. The administrative law judge agreed with OCC's original assessment of \$25,000.

have been as much as \$1.7 million,<sup>19</sup> but subsequently the Comptroller of the Currency adopted the \$250,000 amount.

Evidence we reviewed indicated that OCC appears to have followed its policies and procedures in assessing penalties against Rushville directors who were publicly critical of OCC. Specifically, we did not find that OCC arbitrarily assessed two directors penalties because of their public comments, as alleged by Rushville directors. We found the directors were actually assessed penalties for various violations, including their noncompliance with a cease-and-desist order. Our review indicates that certain public statements by Rushville directors in newspapers in July 1993 were made after penalties were assessed and thus could not have influenced OCC penalty determinations in January 1993. OCC officials told us that it is common for bank officials to make statements critical of OCC after having civil money penalties assessed against them or having their banks closed. OCC officials said that the penalty-setting process does not consider these comments, and that such comments by Rushville officials were not part of the penalty determination.

We found that the \$250,000 penalty OCC assessed against the Rushville chairman was not the highest penalty OCC had assessed since 1989.<sup>20</sup> Over the past 9 years, OCC assessed 21 individuals \$250,000 or more. Twelve of these individuals were assessed over \$250,000, of which 5 were assessed \$1 million, and the highest amount assessed against 1 individual was \$1.9 million. Our comparison of OCC's penalty assessment for the chairman to its assessments in four similar cases involving penalties of more than \$250,000 indicated that OCC did not appear to have applied a more stringent standard to the Rushville assessment.

## No Evidence to Support Claims of Stock Sale Prohibition

Former Rushville directors alleged that OCC prevented the chairman from selling his bank stock. You asked us whether OCC followed its policies and procedures in its involvement with the proposed sale of Rushville stock. In addition, you asked (1) whether OCC procedures and practices prevented a director or officer of a bank from selling stock in the bank and (2) how many times in the last 5 years OCC had prevented a director or officer from

<sup>19</sup>The administrative law judge's amount was based on the violation being assessable under federal statutes at \$1,000 per day (pre-Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA)) for about 240 days and \$5,000 per day (under the law as changed by FIRREA) for a period of about 300 days—the periods of time during which the bank made illegal payments of legal fees. The administrative law judge agreed with OCC's original assessment of \$250,000.

<sup>20</sup>Information on penalties first became public in 1989. Penalty information before 1989 was not readily available, according to an OCC official.

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selling stock. Our review of OCC procedures and practices indicated that OCC does not prevent bank directors or officers from selling stock. Furthermore, our review of documentation and discussions with OCC officials provided no evidence that OCC had prevented a director or officer from selling stock during the last 5 years or that it would prevent such a stock sale in the future.

Regarding this allegation, a number of the Rushville directors claimed that an OCC attorney expressly stated at the November 12, 1992, meeting at which the chairman was suspended from banking that he could not sell his Rushville stock. To better understand this allegation, we interviewed Rushville directors and OCC officials present at the meeting and reviewed their affidavits on the matter.

We did not find any documentation substantiating the allegation that OCC officials prohibited the sale of stock. The OCC officials we interviewed denied the Rushville directors' claim. These officials told us that it is OCC's policy to approve the sale of stock by a suspended bank director or officer, and they said, generally, that their only concern is that a suspended director or officer not continue to be involved with the bank's affairs. Specifically, the officials told us that at the suspension meeting, they told the chairman that he was being suspended, and then an OCC attorney read aloud the applicable banking law<sup>21</sup> under which he was being suspended.

OCC officials told us that a misunderstanding could have occurred because of the complicated language of the law and the adversarial nature of the suspension meeting. The law read to the chairman says that a person subject to a suspension order cannot transfer or attempt to transfer voting rights in any institution, but the law does not address the subject of stock sales. The suspension order presented to the Rushville chairman did not address the issue of whether he could sell his Rushville stock. OCC officials told us that they provided the chairman with no written guidance or instructions, and they said that OCC has no written procedures on steps to take in a suspension because suspensions occur so infrequently.

In response to a lawsuit filed to allow the chairman to sell his stock, OCC officials sent a letter to the chairman's attorney on December 4, 1992, telling him that the chairman could sell his stock. However, the officials stated in the letter that OCC would have to approve such a sale to ensure that the person purchasing the stock had no connection to the chairman.

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<sup>21</sup>12 U.S.C. 1818(e).

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On December 23, 1992, the Department of Justice also notified the chairman's attorney that the chairman could sell his stock.

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## Rushville Liquidation Cost Almost \$9 Million

Following its closing, Rushville's assets were acquired by FDIC in its role as the liquidator for the Bank Insurance Fund. Liquidation, which is the next step after an insolvent bank's closure, is the process by which FDIC disposes of a bank's assets and attempts to recover the costs it incurs in closing a bank. The final liquidation loss for Rushville amounted to about \$8.8 million.

This \$8.8 million in liquidation costs can be broadly categorized as \$2.4 million in liquidation expenses, which represent FDIC's operational costs, and \$6.4 million in losses<sup>22</sup> from the disposition of Rushville assets, according to FDIC documents. Operational costs represent the cost of FDIC personnel directly assigned to the Rushville liquidation; other FDIC personnel supporting the liquidation; and professional fees for auditors, tax accountants, and appraisers. Losses from the disposition of assets mostly represented losses from the sale of Rushville's commercial and real estate loans. Liquidation costs were partly offset by revenues from interest on performing loans and earnings from Rushville's securities.

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## Agency Comments

We requested comments on a draft of this report from OCC, FDIC, and the Federal Reserve. OCC generally agreed with the draft report's contents (see app. IV). FDIC and the Federal Reserve neither expressed any concerns nor offered any comments.

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We are sending copies of this report to the Ranking Minority Member of your committee, the Indiana congressional delegation, other interested congressional committees, the Comptroller of the Currency, the Chairman of the Federal Deposit Insurance Corporation, the Chairman of the Board of Governors at the Federal Reserve System, and other interested parties. We will also make copies available to others upon request.

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<sup>22</sup>Loss is the difference between the book value of a loan when FDIC acquires it and FDIC's receipts from selling the loan. The two largest loss categories for Rushville were commercial loan losses, which totaled \$2.9 million, and real estate mortgage losses, which amounted to \$2.1 million.

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Major contributors to this report are listed in appendix V. Please contact me at (202) 512-8678 if you or your staff have any questions.

Sincerely yours,

A handwritten signature in black ink that reads "Richard J. Hillman" followed by a horizontal line extending to the right.

Richard J. Hillman  
Associate Director, Financial  
Institutions and Markets Issues

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**Contents**

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**Abbreviations**

FDIC	Federal Deposit Insurance Corporation
FDICIA	Federal Deposit Insurance Corporation Improvement Act
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act
OCC	Office of the Comptroller of the Currency

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# Scope and Methodology

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To determine whether OCC followed its policies and procedures in calculating Rushville's net worth and classifying the bank's loans, we met with OCC officials and staff in Washington, D.C.; Chicago, IL; Indianapolis, IN; and Louisville, KY. In addition, we reviewed documentation available at each of these locations, including examination workpapers. We also asked the Rushville directors to indicate which loans they believed were misclassified. Since the directors did not provide us with a list of misclassified loans, we focused our attention on 71 problem loans (64 reclassified loans from the previous examination and 7 newly classified loans) that were in OCC's migration analysis. We then focused on 20 loans that had outstanding balances exceeding \$100,000. In addition, we identified five smaller loans that had relatively large outstanding balances and OCC calculated specific reserves from OCC's migration analysis for further study.

In addition, we reviewed Rushville loan files maintained by FDIC. We also discussed the final examination and closure with FDIC staff in Washington, D.C.; Chicago; Indianapolis; and Dallas; and the Federal Reserve staff in Washington, D.C., and Chicago. Staff in our Accounting and Information Management Division also reviewed OCC's net worth calculation to determine whether OCC followed generally accepted accounting principles.

To determine the impact of FDICIA on the closure of Rushville, we met with Rushville directors and their attorneys to discuss their views on Rushville. In addition, we discussed their allegations with OCC officials and staff in Washington, D.C.; Chicago; Indianapolis; and Louisville and reviewed OCC documentation. We also reviewed OCC's closing books on 18 banks closed before and after the implementation of FDICIA. Additionally, we discussed FDICIA implications with the Federal Reserve staff in Washington, D.C., and Chicago. Our Office of the General Counsel also reviewed legal issues concerning FDICIA and the Rushville closure.

To determine whether OCC contacts with Liberty regarding the recall of the Hoosier Bancorp loan followed OCC policies and procedures, we met with directors from Rushville and several Liberty officers and reviewed documentation they provided. In addition, we discussed the recall allegation with OCC officials and staff in Washington, D.C.; Chicago; Indianapolis; and Louisville. We also reviewed OCC documentation on contacts with Liberty.

To determine whether OCC followed its policies and procedures in assessing civil money penalties, we met with directors from Rushville and

reviewed documentation they provided. In addition, we discussed the Rushville civil money penalty allegation with OCC officials and staff in Washington, D.C.; Chicago; and Indianapolis. We also reviewed available documentation at each location and discussed this allegation with the Federal Reserve staff in Washington, D.C. Our Office of the General Counsel also reviewed the legal questions concerning the assessment of civil money penalties.

To ascertain the nature of OCC's involvement with the proposed sale of Rushville stock by the chairman and whether OCC followed its policies and procedures, we met with Rushville directors and reviewed documentation they provided. In addition, we discussed the proposed Rushville stock sale allegation with OCC officials and staff in Washington, D.C., and Indianapolis and also reviewed available documentation at each location. Additionally, our Office of the General Counsel reviewed the legal issues concerning the chairman's suspension as it related to the proposed sale of stock, and we discussed this allegation with a Justice attorney who had responsibility for representing OCC in this matter.

Finally, we reviewed various documents provided to us by several sources. The directors of Rushville gave us documents that they considered relevant, including a chronology of events and related depositions. We reviewed approximately 100 boxes containing OCC documents subpoenaed by your office and Rushville loan files maintained by FDIC. We also reviewed OCC's supervisory monitoring system files on Rushville and Liberty, which provided a comprehensive picture of the background, condition, and status of the banks and OCC's supervisory plans. In addition, we reviewed legal documents from federal courts involving recent court proceedings regarding Rushville directors.

We conducted our review from August 1997 through April 1998 in accordance with generally accepted government auditing standards.

# Selected Events Concerning the Rushville National Bank Closure

<b>Date</b>	<b>Event</b>
December 31, 1982	OCC examination disclosed unacceptable lending practices and deterioration in Rushville's overall condition.
June 29, 1983	Rushville directors consented to an OCC cease-and-desist order addressing criticized loans, loan policy, credit and collateral exceptions, loan review, allowance for loan and lease losses, budgets, expenses, and conflicts of interest.
June 27, 1991	Rushville directors consented to an OCC cease-and-desist order requiring the appointment of a president and a certified accountant.
May 26, 1992	A national newspaper listed Rushville as one of the nation's most troubled banks.
June 1, 1992	A Liberty officer contacted OCC to inform it that Liberty intended to demand payment in full on the Hoosier Bancorp loan.
October 31, 1992	OCC began its final examination of Rushville.
November 12, 1992	OCC suspended the bank chairman for engaging in unsafe and unsound practices and insider abuse.
November 16, 1992	State of Indiana withdrew its funds, thereby straining liquidity.
November 19, 1992	Liberty declared holding company loan in default and demanded principal and interest.
December 10, 1992	OCC asked for FDIC-assisted purchase of Rushville or payout of insured deposits.
December 11, 1992	Four Rushville directors resigned.
December 18, 1992	OCC examination showed the bank was capital insolvent and its liquidity seriously impaired. The Comptroller of the Currency declared Rushville insolvent, and FDIC was appointed its receiver.
December 18, 1992	OCC closed Rushville.

Source: OCC.

# Results of GAO's Detailed Loan Review

Loan	Amount <sup>a</sup>	OCC adjustment <sup>b</sup>	OCC adjusted book value	FDIC disposition value	Difference <sup>c</sup>
1.	\$205,030	\$205,030	\$0	\$121,500	\$121,500
2.	72,015	72,015	0	60,641	60,641
3.	89,928	49,928	40,000	43,666	3,666
4.	340,587	21,050	319,537	172,905	(146,632)
5.	418,117	238,117	180,000	35,000	(145,000)
6.	150,000	25,000	125,000	0	(125,000)
7.	113,753	56,553	57,200	12,500	(44,700)
8.	146,223	30,000	116,223	72,467	(43,756)
9.	100,471	24,000	76,471	49,699	(26,772)
10.	74,541	20,000	54,541	36,350	(18,191)
11.	127,788	70,188	57,600	45,580 <sup>d</sup>	(12,020)
12.	70,000	53,177	16,823	10,306	(6,517)
13.	58,347	29,000	29,347	26,989	(2,358)
<b>Total</b>	<b>\$1,966,800</b>	<b>\$894,058</b>	<b>\$1,072,742</b>	<b>\$687,603</b>	<b>(\$385,139)</b>

<sup>a</sup>This was the loan amount at the time of the Rushville closure prior to OCC adjustment.

<sup>b</sup>OCC adjustments for specific allocation and/or loss write-off.

<sup>c</sup>FDIC disposition value less the OCC adjusted book value.

<sup>d</sup>This amount represents the difference between the FDIC disposition value and FDIC's cost to acquire the property from the first lien holder and its foreclosure costs.

Sources: OCC and FDIC.

# Comments From the Office of the Comptroller of the Currency



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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

June 2, 1998

Mr. Richard J. Hillman  
Associate Director, Financial Institutions and Markets Issues  
General Government Division  
United States General Accounting Office  
Washington, D.C. 20548

Dear Mr. Hillman:

We have reviewed your draft audit report titled Closure of Rushville National Bank. The report was prepared in response to a congressional request for an independent review of the events leading up to the 1992 closure of the Rushville National Bank (Rushville) by the Office of the Comptroller of the Currency (OCC). The portion of the audit conducted at the OCC included interviews of examiners and management officials and a review of every paper and electronic document in the OCC's possession that pertained to the OCC's supervision of Rushville. In short, the review was thorough and meticulous.

We concur in your findings that:

- the OCC's net worth calculation and loan classifications were proper;
- the intent of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) was to speed the closure of problem institutions;
- the OCC did not influence Liberty National Bank of Louisville in recalling its loan to Rushville's holding company;
- the OCC followed its procedures in assessing civil money penalties; and
- the OCC did not tell Rushville's suspended chairman that he could not sell his stock.

Thank you for the opportunity to review and comment on the draft report.

Sincerely,

A handwritten signature in black ink, appearing to read 'E. Hanley'.

Edward J. Hanley  
Senior Deputy Comptroller for Administration

# Major Contributors to This Report

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