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

IN THE MATTER OF	)	
	)	
Paul Lowder	)	OCC-AA-EC-93-73
	)	OCC-AA-EC-93-74
Former Director, Agent, and	)	
Institution-affiliated party,	)	
First National Bank in Kaufman,	)	
Kaufman, Texas	)	

DECISION AND ORDER

I. Summary

A. Nature of Proceedings

This matter is before the Comptroller of the Currency on a motion by counsel for the Office of the Comptroller of the Currency's Enforcement and Compliance Division ("Enforcement Counsel") for entry of a default judgment on a Notice of Charges in a cease and desist proceeding brought pursuant to 12 U.S.C. § 1818(b) ("C&D Notice") and a Notice of Assessment in a civil money penalty proceeding brought pursuant to 12 U.S.C. § 1818(i) ("Assessment Notice"). The C&D Notice seeks $559,699 in restitution, to be paid to the Federal Deposit Insurance Corporation ("FDIC") as the receiver for the now defunct First National Bank in Kaufman, Kaufman, Texas ("Bank"),[1] and the Assessment Notice seeks a civil money penalty of $15,000. Restitution is sought for Respondent's involvement in and receipt of the Bank's payment of allegedly excessive commissions, constituting both

[1] The Bank was declared insolvent, and the FDIC was appointed as receiver, on February 7, 1991.

an unsafe and unsound banking practice and payment of dividends exceeding the limitations of 12 U.S.C. §§ 56 and 60. The civil money penalty is sought for payment of these commissions and for the Bank's alleged violations of 12 U.S.C. § 84 and 12 C.F.R. § 32.5 in connection with its purchases of notes from two entities.

B. Decision and Order

Upon consideration of the entire record of the proceedings, the pleadings, the Recommended Decision of the Administrative Law Judge ("ALJ"), additional information submitted in response to the Decision of the Comptroller of the Currency, dated March 23, 1994, and for the reasons stated below, the Comptroller hereby:

A. Grants Enforcement Counsel's motion for entry of a default judgment on the C&D Notice, and orders Respondent to pay $559,699 in restitution;

B. Grants Enforcement Counsel's motion for entry of a default judgment on the charges contained in Article II of the Assessment Notice, but declines to impose that portion of the civil money penalty sought in the Assessment Notice that is attributable to the charges contained in Article II[2]; and

C. Denies Enforcement Counsel's motion for entry of a default judgment on Article III of the Assessment Notice and dismisses the charges against Respondent contained therein.

II. Procedural Background

The procedural background pre-dating March 23, 1994, is set out in the Decision of the

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[2] Article I of the Assessment Notice merely identifies the Bank, the OCC, and Respondent, and notes that the Bank was declared insolvent.

Comptroller of the Currency, dated March 23, 1994, at 1-2. On March 23, 1994, the Comptroller issued a decision concluding that a default judgment could not be entered without sufficient information for ascertaining the appropriate sums for a civil money penalty and restitution, which information was not in the record. Consequently, the Comptroller ordered the parties to submit additional information concerning commissions that similarly situated banks generally pay for loans from brokerage firms and how the $15,000 amount requested as a civil money penalty was arrived at. Enforcement Counsel submitted limited additional information. Respondent did not respond.

III. Decision

A. Summary of Factual Findings

Respondent's failure to appear is deemed an admission of the facts as alleged in the Notices. 12 C.F.R. § 19.21. Therefore, pursuant to 12 C.F.R. § 19.21, the Comptroller finds the facts in this case to be as alleged in the Notices.

1. Facts Regarding the Bank's Payment of Allegedly Excessive Commissions

According to the Notices, between 1987 and 1989, the Bank purchased notes with a face value of approximately $7.5 million from a brokerage firm, NPCA, Inc., which was owned by Bank insiders. C&D Notice at 2; Assessment Notice at 2. NPCA purchased the loans at below their face value and then sold them to the Bank at face value. C&D Notice at 3; Assessment Notice at 2. NPCA retained the difference, approximately 22% of the face value of the notes, as commissions. Id. NPCA passed these commissions onto shareholders of the Bank and the Bank's holding company for brokerage services rendered. C&D Notice at 3; Assessment Notice at 3; Response to Comptroller's Request for Additional Information,

dated April 6, 1994, at 3. Respondent, a director of the Bank, and also a shareholder of the Bank's holding company, received $648,072 in commissions from NPCA. C&D Notice at 3; Assessment Notice at 3. Based on the commissions NPCA received during this period from sales of notes to two other banks not affiliated with the Bank, the C&D Notice states that the maximum reasonable commission for the loans that the Bank purchased was 3% of the purchase price. C&D Notice at 5. Thus, according to the C&D Notice, Respondent is entitled to retain, based on the 3% figure, only $88,373 of his commissions, and must pay restitution in the amount of the remainder, that is, $559,699. Id. According to the C&D Notice, payment of the excessive commissions constituted an unsafe and unsound practice from which the Bank suffered substantial loss and from which Respondent was unjustly enriched. Id. at 6.[3]

In response to the Comptroller's March 23, 1994 Decision, Enforcement Counsel submitted the following documentation in support of his conclusion that the commissions

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[3] Also, according to the C&D Notice, payment of the excessive commissions constituted payment of improper dividends to Respondent and the other participants in the NPCA transaction. Id. This is because income lost to the excessive commissions should have been credited to the Bank which would then be able to pay it out as dividends, subject to the legal restrictions in 12 U.S.C. § § 56 and 60, which are designed to protect bank capital. Id. at 7. (Section 56 prohibits national banks from paying dividends out of capital. Section 60 limits dividend payments to the amount of the bank's profits). Instead, according to the C&D Notice, the Bank circumvented the restrictions on dividends in sections 56 and 60 by referring to the payments as "finders fees." Id. And, according to the C&D Notice, the excessive portion of the commissions amounted to over $850,000, exceeding the Bank's available retained earnings and profits, which were $793,042 as of January 3, 1989. The difference of about $57,000 was paid out of capital surplus, in violation of sections 56 and 60. Id. Failure to report the dividends to the OCC also resulted in a violation of 12 U.S.C. § 161(b). Id. The Comptroller does not take the foregoing information into account in reaching his Decision. If, as he does here, the Comptroller determines that the commissions were excessive because they were well above 3%, and so constituted an unsafe or unsound practice, the inquiry need go no further.

from the Bank to NPCA were excessive: (1) documentation of the transactions between NPCA and the Bank and between NPCA and the two other banks to which NPCA sold loans; (2) a copy of a brokerage agreement attached to a letter from a brokerage firm in Pennsylvania that provided for commissions of 1/2% to 1-1/2% of the "net cash proceeds"; and (3) an affidavit by an accountant in the OCC's Southwestern District Office opining the appropriate commission to have been the greater of 1% of face value or $75 per loan.[4] Respondent submitted no evidence whatsoever.

2. Facts Regarding Respondent's Alleged Violations of 12 U.S.C. § 84

Article III of the Assessment Notice alleges that Respondent violated 12 U.S.C. § 84 and 12 C.F.R. § 32.5[5] as a result of transactions between the Bank and two entities -- Anglin & Associates ("Anglin") and Willow Lake Development Company ("Willow Lake").

a. Anglin

On December 21, 1987, the Bank purchased $513,370 in notes from Anglin. Assessment Notice at 7. The Bank's lending limit to a single borrower on this day was $214,000. Id.

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[4] Enforcement Counsel also submitted an affidavit from a shareholder of the Bank's holding company indicating that the commissions paid to NPCA were intended to provide funds to service holding company debt which was secured by Bank stock. The affiant, who neither performed services for NPCA nor held an ownership interest therein, attests that he received about $35,000 in commissions.

[5] Section 84 limits loans or extensions of credit that a national bank can make to any one borrower (and the borrower's affiliated interests). 12 C.F.R. § 32.5 sets forth circumstances (i.e., loan combination rules) under which loans or extensions of credit to one person will be attributed to other persons for purposes of determining whether the loans exceed any of the lending limits set forth in 12 U.S.C. § 84.

According to the Assessment Notice, a "replacement agreement" bound the "developer"[6] to repurchase or replace "certain past due Notes within a limited period of time." Id. Also, according to the Assessment Notice, the Bank failed to investigate the income and credit histories of the individual borrowers, demonstrating that "Anglin was perceived as a common source of repayment for all the notes," pursuant to 12 C.F.R. § 32.5(a)(2)(ii). Id. Respondent was one of the brokers for the Bank's purchase of the notes and participated in the inspection of the underlying property for at least $304,000 worth of the notes before the Bank purchased them. Respondent, as a member of the Bank's board of directors, also approved the Bank's purchase of the notes.

b. Willow Lake

On July 14, 1987, the Bank purchased $544,945 in notes from Willow Lake. Assessment Notice at 8. The Bank's lending limit on that date was $234,000. According to the Assessment Notice, a "replacement agreement" bound the "seller"[7] to repurchase or replace "certain past due Notes." Id. The Bank failed to investigate the income and credit histories of the individual borrowers. Id. Respondent participated in the inspection of the underlying property for the notes before the Bank purchased them. Id.

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[6] Although it is not entirely clear from the Assessment Notice, the Comptroller is assuming, for purposes of this discussion, that Anglin is the "developer" for purposes of the replacement agreement.

[7] Although it is not entirely clear from the Assessment Notice, the Comptroller is assuming, for purposes of this discussion, that Willow Lake is the "seller" for purposes of the replacement agreement.

B. Discussion

1. There is Sufficient Evidence Under the Circumstances That the Commissions the Bank Paid to NPCA Were Excessive.

The Comptroller finds that, under the circumstances, Enforcement Counsel has offered sufficient evidence that the commission payments to NPCA of 22% of the face value of the notes sold were excessive, and thus constituted unsafe and unsound practices. Enforcement Counsel's showing that 22% is an unreasonably high commission, and that the maximum reasonable commission is 3% consists, in essence, of: (1) Evidence of sales of notes by NPCA to two banks not affiliated with the Bank; (2) an agreement form of a single brokerage firm in Pennsylvania that buys accounts receivable and provides for a sliding scale of commissions ranging from 0.5% to 1.5%; and (3) an affidavit by an OCC accountant opining the appropriate commission to have been the greater of 1% of face value or $75 per loan. At no point did the Respondent even attempt to show the contrary, that is, that a commission of 22% was reasonable. Thus, Enforcement Counsel has provided support for Enforcement Counsel's position that the commissions were excessive, while Respondent has failed to produce any evidence to the contrary. Enforcement Counsel's evidence is, therefore, sufficient to show that the commissions, to the extent that they exceeded the 3% maximum proposed by Enforcement Counsel, were excessive.

2. There is Insufficient Evidence of Violations of 12 U.S.C. § 84.

The Assessment Notice bases its citation of violations of the legal lending limit in connection with the Anglin and Willow Lake transactions on a theory that the notes

purchased in each transaction are "combinable" [sic][8] for lending limit purposes with other notes purchased in the same transaction. The basis for this "combining" is alleged to be twofold: (1) the existence of the "replacement agreements," and (2) the Bank's failure to investigate the income and credit histories of the individual borrowers on the notes. As alleged by Enforcement Counsel, however, these bases fail to support lending limit violations. It is true that, when a seller of third party notes agrees to repurchase the notes upon default, the total dollar amount of the notes subject to the agreement counts against the amount the bank purchasing the notes may legally lend the seller. 12 C.F.R. § 32.104. The Assessment Notice, however, fails to state what dollar amounts of notes are subject to the "replacement agreements." On the contrary, it alleges, as to each transaction, only that "certain" of the notes were subject to the "replacement agreements." Thus, no lending limit violation is appropriately alleged.

Nothing is added by the allegation that, as regards some or all of the purchased notes, the Bank failed to investigate the repayment capacities of the individual borrowers. Such failure by itself does not render any of the notes part of the seller's debt, absent the seller's assumption, albeit contingently, of an obligation to repay. This leads back to the point discussed immediately above: the Assessment Notice alleges that some notes in each transaction carry the seller's obligation to repay and thus "count" against the lending limit,

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[8]Enforcement Counsel misuses the term "combinable." The term refers to the adding together, for lending limit purposes, of obligations of two or more persons. Here, in each of the two instances, the lending limit for only one borrower, the seller of the notes, is involved. The issue is not whether the separate debts of the primary obligors on the notes are "combinable" with the seller's debts [and/or with each other]. Rather, it is whether the seller's independent obligations on all the notes subject to the repurchase agreements exceed the amount the bank may lend that party.

but it fails to allege that a sufficient amount of notes may thus be counted so as to exceed the lending limit. Therefore, even assuming the truth of the facts alleged, lending limit violations are not made out.

3. Respondent is Ordered to Pay Restitution but not a Civil Money Penalty.

Based on the Comptroller's conclusion that the Bank's commissions to NPCA were excessive, Respondent is hereby ordered to pay the amount of $559,699 in restitution. Because of the size of restitution ordered, the Comptroller declines to impose a civil money penalty attributable to the excessive commissions. Finally, based on the Comptroller's conclusion that there is insufficient evidence of any lending limit violations, the Comptroller denies the request for a civil money penalty to the extent that it is attributable to the lending limit allegations.

IV. Order

Based upon the entire record of the proceedings, the pleadings, the Recommended Decision of the Administrative Law Judge ("ALJ"), additional information submitted in response to the Decision of the Comptroller of the Currency dated March 23, 1994, and for the reasons set forth in the accompanying Decision, the Comptroller hereby:

A. Grants Enforcement Counsel's motion for entry of a default judgment on the C&D Notice, and orders Respondent to make restitution in the amount of $559,699, to affirmatively correct the conditions resulting from his practices while affiliated with the First National Bank in Kaufman, Kaufman, Texas;

B. Grants Enforcement Counsel's motion for entry of a default judgment on the charges contained in Article II of the Assessment Notice, but declines to impose that portion of

the civil money penalty sought in the Assessment Notice that is attributable to the charges contained in Article II; and

C. Denies Enforcement Counsel's motion for entry of a default judgment on Article III of the Assessment Notice and dismisses the charges against Respondent contained therein.

IT IS SO ORDERED this 9 day of May, 1995.

EUGENE A. LUDWIG
Comptroller of the Currency