

UNITED STATES OF AMERICA
Before The
OFFICE OF THRIFT SUPERVISION
DEPARTMENT OF THE TREASURY

In the Matter of:)

INDEPENDENCE FEDERAL)
SAVINGS BANK)

No.: AP-10-06

Washington, District of Columbia)
OTS Docket No. 07173)

Effective Date: November 16, 2010

NOTICE OF CHARGES AND HEARING FOR CEASE AND DESIST ORDER FOR
AFFIRMATIVE RELIEF

I. PRELIMINARY STATEMENT.

1. The Director of the Office of Thrift Supervision (OTS), pursuant to Section 8(b) of the Federal Deposit Insurance Act (FDIA), 12 U.S.C. § 1818(b), issues this Notice of Charges and Hearing for Cease and Desist Order for Affirmative Relief (Notice). By issuing this Notice, OTS commences administrative adjudicatory proceedings against Independence Federal Savings Bank (Independence or Association), Washington, District of Columbia, OTS Docket No. 07173.

2. OTS charges that Independence has engaged in unsafe or unsound practices, including, but not limited to:

(a) Operating the Association with an insufficient level of capital protection for the volume, type, and quality of assets held by the Association;

(b) Operating the Association with insufficient earnings to fund growth and augment capital; and

(c) Operating the Association with an excessive amount of adversely classified loans or assets.

3. OTS charges that Independence has engaged in violations of law or regulation including, but not limited to:

(a) 12 C.F.R. § 560.93(f)(2) (compliance with lending limitations, and recordkeeping regarding the same);

(b) 12 C.F.R. § 203.4(a) (compilation of loan data);

(c) 12 C.F.R. § 229.13(g)(1) (notices of exemptions to the Expedited Funds Availability Act (EFA Act)); and

(d) 12 C.F.R. § 229.18(e) (disclosure requirements of EFA Act).

4. OTS charges that grounds exist to require Independence to cease and desist from violations of law and regulations and/or unsafe or unsound practices, and to take other affirmative correction action pursuant to 12 U.S.C. § 1818(b).

II. JURISDICTION.

5. Independence is, and at relevant times, has been, a stock form federal savings association with a charter issued under the Home Owners' Loan Act (HOLA), 12 U.S.C. §§ 1461 *et. seq.* Independence maintains its home office in Washington, District of Columbia. Among other banking services, Independence accepts deposits and such deposits are insured by the Federal Deposit Insurance Corporation (FDIC). *See* 12 U.S.C. §§ 1811 *et seq.* Independence is, and at all relevant times, has been, a "savings association" (as defined by 12 U.S.C. §§ 1462(4) and 1813 (b)) and an "insured depository institution" (as defined by 12 U.S.C. §§ 1813(c)(1)).

6. Pursuant to Sections 4 and 5 of the HOLA, 12 U.S.C. §§ 1463 and 1464, Independence is, and has been, subject to examination, supervision and regulation by OTS.

7. OTS is the “appropriate federal banking agency” to initiate cease and desist proceedings against Independence pursuant to 12 U.S.C. §1818(b). *See* 12 U.S.C. §§ 1813(q)(4) and 1464(d)(1)(A).

III. FACTUAL ALLEGATIONS AND CHARGES.

A. Background.

8. OTS commenced a comprehensive risk-focused safety and soundness, and compliance examination of Independence on January 4, 2010, which was completed on April 26, 2010 (2010 Examination). The 2010 Examination included a review and evaluation of capital adequacy, asset quality, management effectiveness, earnings performance, liquidity, asset/liability management, sensitivity to market risk and compliance with law and regulation.

9. The previous comprehensive examination of Independence commenced on October 14, 2008 and concluded on March 25, 2009 (2008 Examination). After the conclusion of the 2008 Examination, Independence consented to a Cease and Desist Order, effective August 3, 2009 (Order).

B. Independence’s Unsafe or Unsound Practices.

1. Unsafe and Unsound Capital Levels.

10. As of December 31, 2009, Independence reported Tier 1 (core) and total risk-based regulatory capital ratios of 3.26 percent and 7.56 percent, respectively.

11. As of December 31, 2009, total adversely classified assets had increased \$6.3 million or 76 percent since the last examination period, which ended September 30, 2008.

12. At September 30, 2008, total adversely classified assets were \$8.3 million or 73 percent of Tier 1 capital plus ALLL. At December 31, 2009, total adversely classified assets equaled \$14.6 million, or 193 percent of Tier 1 capital plus ALLL.

13. Total delinquent loans and repossessed assets were \$5.7 million as of September 30, 2008, and increased to \$17.3 million as of December 31, 2009. Delinquent loans and repossessed assets increased from 49.94 percent of Tier1 Capital (core) plus ALLL at September 30, 2008 to 229.73 percent at December 30, 2009.

14. The Association's credit administration and monitoring practices remain weak. Specifically, the OTS found during the 2010 examination that the Association was unable to adequately track large loans and/or borrowers (*see infra* ¶¶ 32-36), not consistently updating financial information for commercial borrowers, and did not have an exception tracking system to monitor loans granted as an exception to policy.

15. Independence had *negative* net income of more than \$ 4 million for the year ended December 31, 2009.

16. As of August 31, 2010, Independence reported Tier 1 (core) and total risk based capital ratios of 4.01 percent and 8.14 percent, due largely to the sale of some below investment grade securities in the first quarter of 2010. Total adversely classified assets as a percentage of Tier 1 capital plus ALLL at August 31, 2010 remained high at 181 percent.

17. The OTS has determined that Independence's current capital levels are inadequate considering the Association's concentrations in higher risk loan categories, high level of classified loans, and high level of losses. The OTS has concluded that Independence should have regulatory capital ratios of 8 percent for Tier 1 (core) capital and 12 percent for total risk based capital in order to operate in a safe and sound manner.

18. The OTS has determined that Independence engaged in an unsafe and unsound practice by failing to take adequate steps to maintain and/or augment the Association's capital to the appropriate levels for the Association's risk and has so informed Independence throughout 2010. To date, since the conclusion of the 2010 exam, Independence has not had any infusion of capital, and none is currently planned.

2. Insufficient Earnings to Augment Capital.

19. Independence had negative net income for the three calendar years ending December 31, 2009.

20. The Association has historically had a significant student lending operation, and various contracts with the District of Columbia municipality. As these ventures were phased out in recent years, the bank's profitability declined. Independence is currently operating without an OTS-approved business plan.

21. For the year ending December 31, 2009, Independence had negative net income of \$4.3 million, a loss 190 percent larger than 2008. The loss would have been greater if not for \$2 million in nonrecurring income derived from a litigation settlement.

22. The Association's negative earnings are attributable to high general and administrative (G&A) expense (in excess of net interest income), a weak net interest margin, an increasing number of non-performing loans, and loss recognition on impaired loans and real estate owned (REO).

23. At this time, the bank's only source of capital augmentation would be a capital infusion as core earnings are negative and growth in assets to produce additional interest income to offset expenses cannot occur without additional capital.

24. During the 2010 Examination, OTS determined that Independence engaged in unsafe or unsound practices by operating the Association with insufficient earnings to augment capital.

3. Problem Loan Plan.

25. OTS considers an asset concentration to exist when the total dollar amount of such asset exceeds 25 percent of Tier 1 Capital plus the ALLL.

26. The term “higher risk loan” is used to describe a loan that presents greater overall risk than a conventional 1-4 family mortgage loan.

27. As of the 2010 Examination, Independence maintained concentrations in several higher risk loan categories. For instance, Independence had a concentration in Permanent Nonresidential Mortgages (259 percent of Core Capital plus ALLL), Church Loans (96 percent of Core Capital plus ALLL), Permanent Multifamily (39 percent of Core Capital plus ALLL) and Nonresidential Construction (35 percent of Core Capital plus ALLL).

28. As of the 2010 Examination, Independence failed to maintain an appropriate frequency of internal asset reviews for its delinquent loans, particularly loans or groups of loans with higher risk characteristics.

29. During 2009, the Association was not tracking loan pools for credit quality and/or delinquency. The Association belatedly discovered that it had 6 loans over 180 days past due totaling \$2.23 million at December 31, 2009.

30. Moreover, as of the 2010 Examination, classified assets had increased significantly, as had delinquent loans and REO assets. (*see* ¶¶ 11-13 *supra*).

31. Consequently, the OTS determined, at the close of the 2010 examination, that Independence engaged in unsafe or unsound practices by operating with an excessive amount of

higher risk and/or classified loans without (i) implementing appropriate policies, procedures, and practices to monitor and reduce the volume of such assets, and (ii) developing specific plans to address each problem asset or group of loans to any one borrower or loan relationship of \$500,000 or greater.

4. Loans To One Borrower Limitation.

32. During the 2010 Examination, OTS determined that Independence did not maintain a list of loans to major or multiple borrowers.

33. Further, during the 2010 Examination, the OTS discovered that Independence had not documented any review of loans over five percent of unimpaired capital and unimpaired surplus to ensure that such loans were being made consistent with the Loans to One Borrower (LTOB) restrictions, as required by 12 C.F.R. § 560.93(f)(2).

34. Because such loans are not tracked, the Board of Directors is not provided with information about whether such loans exist at the Association, and to what degree.

35. In 2009, the Association extended loans to two entities that each exceeded their LTOB limit – the Singleton loan and the Rock Creek Petroleum loan (the LTOB limit at the time these loans were extended was \$1.575 million).

36. During the 2010 examination, the OTS determined that the Association did not sufficiently evaluate its compliance with the LTOB limitation and extended two loans that exceeded its LTOB limit, and thereby violated 12 C.F.R. § 560.93.

C. Violations of Law.

37. The 2010 Examination cited Independence for its failure to comply with several laws and regulations.

38. The OTS found numerous reporting errors with respect to the 2008 data reported by Independence on the 2008 HMDA Loan/Application Register, in violation of 12 C.F.R. § 203.4(a).

39. The OTS found that exception hold notices were completed with inaccurate time frames and dollar amounts in violation of the Expedited Funds Availability Act (EFAA), 12 C.F.R. § 229.13(g)(1).

40. The OTS found that the bank's disclosures concerning changes to its funds availability policy failed to comply with the EFAA, 12 C.F.R. § 229.18(e) and Appendix E to Part 229, because the disclosures failed to specifically direct the customer to the changed terms.

IV. STATUTORY CHARGES UNDER 12 U.S.C. § 1818(b).

41. As alleged above, Independence has engaged in unsafe or unsound practices, and violated laws and regulations.

42. OTS charges that grounds exist for the issuance to Independence of a cease and desist order with affirmative corrective action provisions and provisions imposing limitations on activities, pursuant to 12 U.S.C. § 1818(b) (including paragraphs (b)(6) and (b)(7)).

V. REQUESTED RELIEF AND NOTICE OF HEARING.

43. Notice is hereby given that a hearing will be held in or near Washington, District of Columbia, for the purpose of taking evidence on the charges specified above in order to determine whether an appropriate order to cease and desist should be issued under Section 8(b) of the FDIA, 12 U.S.C. § 1818(b), to require Independence to cease and desist from the violations of law or regulation and unsafe or unsound practices charged above in this Notice and whether such an order should include:

- (a) affirmative corrective action provisions under 12 U.S.C. § 1818(b)(6); and

(b) the imposition of limitations on the activities or functions of Independence pursuant to 12 U.S.C. § 1818(b)(7).

VI. PROCEDURES GENERALLY.

44. OTS hereby appoints Administrative Law Judge C. Richard Miserendino (the ALJ) of the Office of Financial Institution Adjudication to preside over the hearing for the cease and desist order referred to above (in Part V) of this Notice. Unless otherwise set by the ALJ or by agreement of the parties, the hearing should commence on or before the sixtieth day following service of this Notice. The exact time of day and any change in location will be announced at a later time by the ALJ. The hearing will be conducted before the ALJ in accordance with the provisions of the Administrative Procedure Act, 5 U.S. C. §§ 554-557, as made applicable by 12 U.S.C. § 1818(h) and 12 C.F.R. Part 509.

45. Independence is directed to file an Answer to this Notice within twenty (20) days of service. The requirements of the Answer and the consequences of failing to file an Answer are set forth at 12 C.F.R. § 509.19.

46. Section 509.10 of the OTS Rules, 12 C.F.R. § 509.10, governs the filing of papers in this proceeding. Except as otherwise provided by that rule, any papers required to be filed shall be filed with the Office of Financial Institution Adjudication, Attn: Honorable C. Richard Miserendino, ALJ, 3501 North Fairfax Drive, Suite D8116, Arlington, VA 22226.

47. Independence also shall serve a copy of each and every of its filings on: Susan L. Chomicz, Deputy Chief Counsel, Enforcement, Office of Thrift Supervision, 1700 G. Street, N.W., Washington, DC, 20552, susan.chomicz@ots.treas.gov; Lisa M. Cameron, Senior Attorney, Enforcement Division, Office of Thrift Supervision, 1700 G. Street, N.W., Washington, DC, 20552, lisa.cameron@ots.treas.gov; and Alan Faircloth, Regional Enforcement

Counsel, Southeast Region, Office of Thrift Supervision, 1475 Peachtree Street, N.E., Atlanta, Georgia, 30309, alan.faircloth@ots.treas.gov.

48. Within twenty (20) days after service of this Notice, Independence may file a written request for a private hearing. Section 509.23 of the OTS rules, 12 C.F.R. § 509.23, sets out the requirements for any such request and any replies thereto. The evidentiary hearing of this matter before the presiding Administrative Law Judge will be open to the public, unless the Director of OTS, in his sole discretion, determines that an open hearing will be contrary to the public interest. *See* 12 U.S.C. § 1818(u)(2). The Director (or a duly authorized representative) will rule on any request filed under Section 509.23(a), and copies of any such request should be sent to the Acting Director of OTS, c/o Ms. Sandra Evans, Secretary for Adjudicatory Proceedings, Office of Thrift Supervision, 1700 G Street, N.W., Fifth Floor, M2, Washington, DC 20552.

The Office of Thrift Supervision, by its Acting Director (or his duly authorized designee), issues this Notice on this 16 day of November 2010.

OFFICE OF THRIFT SUPERVISION

By: 

Thomas A. Barnes
Deputy Director, Supervision, Examinations
and Consumer Protection