

FEDERAL RESERVE press release



For immediate release

February 7, 1997

The Federal Reserve Board today announced the execution of a Written Agreement between the Cuyamaca Bank, Santee, California, and the Federal Reserve Bank of San Francisco.

A copy of the Written Agreement is attached.

Attachment

UNITED STATES OF AMERICA

BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

WASHINGTON, D. C.

Written Agreement By and Between

CUYAMACA BANK
Santee, California

and

FEDERAL RESERVE BANK OF SAN FRANCISCO
San Francisco, California

DOCKET NO. 96-021-WA/RB-SM

WHEREAS, in recognition of their common goal to restore and maintain the financial and managerial soundness of the Cuyamaca Bank, Santee, California (the "Bank"), a state chartered bank which is a member of the Federal Reserve System, the Federal Reserve Bank of San Francisco (the "Reserve Bank") and the Bank have mutually agreed to enter into this Written Agreement (the "Agreement");

WHEREAS, this Agreement is being executed in accordance with the Rules Regarding Delegation of Authority of the Board of Governors of the Federal Reserve System (the "Board of Governors"), specifically 12 C.F.R. 265.11(a)(15), and the Reserve Bank has received the prior approval of the Director of the Division of Banking Supervision and Regulation (the "Director") and the General Counsel of the Board of Governors to enter into this Agreement with the Bank; and

WHEREAS, on January 22, 1997, the board of directors of the Bank, at a duly constituted meeting, adopted a resolution authorizing and directing Mr. Allan A. Farias to enter into this Agreement on behalf of the Bank and consented to compliance with each and every provision of this Agreement by the Bank and its institution-affiliated parties, as that term is defined in section 3(u) of the Federal Deposit Insurance Act, as amended (the "FDI Act") (12 U.S.C. 1813(u)).

NOW, THEREFORE, before the taking of any testimony or adjudication of, or finding on any issue of fact or law herein, and without this Agreement constituting an admission of any allegation made or implied by the Board of Governors, and solely for the purpose of settling this matter without further proceedings, the Reserve Bank and the Bank hereby agree as follows:

1. (a) The Bank shall not declare or pay any dividends, or make any other form of payment representing a reduction of capital, without the prior written approval of the Reserve Bank and the Director. All requests for prior approval shall be received at least thirty (30) days prior to the proposed dividend declaration date and shall include, but not be limited to, information on the amount proposed to be paid, Bank earnings and capital levels for the most recent annual period and the fiscal year to date, and an analysis of the proposed dividend in light of the Board of Governors' Policy Statement on the Payment of Cash Dividends by State Member Banks and Bank Holding Companies, dated November 14, 1985.

2. (a) Within ^{sixty (60)}~~thirty (30)~~ days of this Agreement, the Bank shall submit to the Reserve Bank a written business plan, approved by the Bank's board of directors, concerning the Bank's proposed business activities for the years 1997 and 1998. The business plan shall contain provisions that address the requirements of this Agreement, and, at a minimum, include:

- (i) Financial performance objectives, including plans for asset and deposit growth, asset quality, earnings, liquidity, and capital, supported by detailed, quarterly pro-forma financial statements;
- (ii) the customer base the Bank expects to service;
- (iii) the types of loans the Bank expects to make and concentration limits by loan type;
- (iv) the types of banking and nonbanking services the Bank plans to offer its customers;
- (v) the geographic area the Bank intends to serve;
- (vi) the physical plant needs of the Bank;

- (vii) establishment of a quarterly review process to monitor the actual income and expenses of the Bank in comparison to budgetary projections; and
- (viii) the requirement that the current business plan be revised quarterly as necessary, to reflect, at a minimum, financial performance, changes in the Bank's customer base and product mix, and any extraordinary events affecting the Bank's condition or future prospects.

(b) Business plans for each calendar year subsequent to 1998 shall be submitted to the Reserve Bank by January 31st of the applicable calendar year.

(c) Any revisions to the business plans required by paragraph 2(a)(viii) hereof shall be approved by the Bank's board of directors and shall be submitted to the Reserve Bank within five (5) days of approval by the Bank's board of directors.

3. Within sixty (60) days of this Agreement, the Bank shall submit to the Reserve Bank an acceptable written plan to achieve and thereafter maintain an adequate capital position. The plan shall, at a minimum, contain provisions that address the requirements of this Agreement, and address and consider:

(a) The Bank's current and future capital requirements, including compliance with the Capital Adequacy Guidelines of the Board of Governors for State Member Banks: Risk Based Measures and Tier 1 Leverage Measure (12 C.F.R. Part 208, App. A and B);

(b) the volume of the Bank's adversely classified assets and the potential for additional asset quality problems at the Bank;

(c) the business plan required under paragraph 2(a)(viii) and the growth in the Bank's assets and its relationship to the Bank's capital ratios;

(d) the Bank's anticipated levels of retained earnings;

(e) the source and timing of additional funds to fulfill the future capital and loan loss requirements set forth in this Agreement; and,

(f) procedures for the Bank to notify the Reserve Bank, in writing, within five (5) days of the end of any calendar quarter in which the Bank's capital ratios decline such that the Bank becomes less than "well capitalized", as such term is defined in section 208.33(b) of Regulation H of the Board of Governors (12 C.F.R 208.33(b)).

4. Within sixty (60) days of this Agreement, the Bank shall submit to the Reserve Bank a written amended compliance plan regarding applicable provisions of the Currency and Foreign Transactions Reporting Act (31 U.S.C. 5311 et seq.) and the accompanying regulations issued by the U.S. Department of the Treasury (31 C.F.F. 103.11 et seq.) (collectively referred to herein as the Bank Secrecy Act (the "BSA")) and section 308.20 of Regulation H of the Board of Governors (12 C.F.R. 308.20). The amended plan shall include, at a minimum: (a) improved documentation of the annual BSA employee training sessions and internal audit reviews of the Bank's BSA compliance, as required by the Bank's existing written compliance policy; and (b) an improved "know your customer" policy that enhances the Bank's ability to (i) predict the types of prospective transactions with each of its customers, (ii) monitor each transaction for consistency with the customers' regular practices and investigate further, where appropriate, (iii) report, in accordance with suspicious activity reporting procedures; and/or (iv) prohibit transactions when the customers' identities or activities cannot be confirmed or explained.

5. (a) The Bank shall at all times maintain, through charges to current operating income, an adequate valuation reserve for loan losses. The adequacy of the reserves shall be determined in light of the volume of weighted classified loans, the current level of nonperforming loans, past loss experience, evaluation of the potential for losses in the Bank's portfolio, current economic conditions, examiners' other criticisms contained in the Reserve Bank's Report of Examination, dated January 8, 1996 (the "Report of Examination"), and the requirements of the Interagency Policy Statement on the

Allowance for Loan and Lease Losses, dated December 21, 1993. A written record shall be maintained indicating the methodology used in determining the amount of the reserve needed. This record shall be submitted to the Reserve Bank within thirty (30) days of this Agreement. Thereafter, the Bank shall conduct, at a minimum, a quarterly assessment of its loan loss reserve and its nonperforming loans and shall submit documentation of each quarterly assessment to this Reserve Bank within thirty (30) days of the end of each quarter. The Bank shall not alter or amend its methodology submitted to the Reserve Bank pursuant to this paragraph without providing the Reserve Bank with thirty (30) days prior written notice. All records required by this paragraph shall be maintained by the Bank for subsequent supervisory review.

(b) The requirements of this paragraph shall not be construed as a standard for future operations of the Bank after termination of this Agreement. It is the intention of these requirements to provide for an appropriate reduction in adversely classified assets and to maintain adequate loan loss reserves during the term of this Agreement.

6. Within sixty (60) days of this Agreement, the Bank shall submit to the Reserve Bank acceptable written loan review procedures designed to identify and categorize problem credits and to assess the overall quality of the Bank's loan portfolio. The loan review procedures shall, at a minimum, include the following:

(a) Procedures to confirm the accuracy of all risk grades assigned by the Bank's loan officers;

(b) procedures to identify adequately problem loans and, thereafter, to place such loans on the bank's watch list;

(c) for each loan identified as a watch list loan, a written statement, maintained in the appropriate credit file, of the reason(s) why such loan merits special attention; and

(d) a mechanism for reporting, at least quarterly, to the Bank's board of directors the status of each watch list loan and the action(s)

taken by bank management to improve the Bank's position on each watch list loan.

7. Within ninety (90) days of this Agreement, the Bank shall submit to the Reserve Bank acceptable revised asset/liability management policies and procedures to provide for the maintenance of an adequate liquidity position. The policies and procedures shall, at a minimum, address and consider:

- (a) The Bank's level of volatile liabilities;
- (b) the Bank's reliance on Super Money Market Demand Accounts ("SMMDAs");
- (c) the cost and use of deposits obtained through SMMDAs;
- (d) the volume of liquid assets required to provide for contingency funding needs;
- (e) quantitative guidelines or controls which limit the Bank's exposure to interest rate risk;
- (f) parameters for the ratio of rate-sensitive assets to rate-sensitive liabilities, and the necessary courses of action to achieve and thereafter maintain future compliance with such parameters;
- (g) objectives for Bank net interest margins;
- (h) guidelines for monitoring and controlling exposure to changing interest rates;
- (i) the provision of regular monthly management reports to the Bank's board of directors;
- (j) maintenance of written asset/liability committee meeting minutes which shall be available for supervisory review; and,
- (k) the duties of the asset/liability management committee.

8. Within sixty (60) days of this Agreement, the Bank shall take all necessary steps to correct all documentation and credit information deficiencies in the Bank's loan files listed in the Report of Examination, including obtaining accurate and current financial statements and appraisals and

thereafter maintain and update such documentation and credit information. During the term of this Agreement, the Bank shall take all steps necessary to maintain current and complete documentation on all loans consistent with its loan policy. In all cases where the Bank is unable to obtain needed documentation or credit information, it shall document the actions taken to secure the information, the reason the information could not be obtained, and shall maintain such documentation in the appropriate file for subsequent supervisory review.

9. (a) The audit committee of the Bank shall consist entirely of outside directors. The committee shall, at a minimum, (i) meet at least once every month; (ii) maintain full and complete minutes of its actions; and (iii) report, in writing, to the full board of directors each month.

(b) For the purpose of this Agreement, the terms (i) "outside director" shall be defined as an individual who is not an employee or executive officer of the Bank, an individual who does not have direct or indirect control of more than five (5) percent of any class of the Bank's outstanding shares of stock, an individual who is not an officer or employee of any affiliate of the Bank, or an individual who does not have direct or indirect control of more than five (5) percent of any class of the outstanding stock of any affiliate of the Bank; (ii) "executive officer" shall be defined as set forth in section 215.2(e) of Regulation O of the Board of Governors ("Regulation O") (12 C.F.R. 215.2(e)), and (iii) "affiliate" shall be defined as set forth in section 23A(b)(1) of the Federal Reserve Act (12 U.S.C. 371c(b)(1)).

(c) Within sixty (60) days of this Agreement, the Bank shall submit to the Reserve Bank acceptable written audit policies and procedures designed to strengthen the operation of the Bank's internal audit function. The policies and procedures shall include, without limitation, the following:

- (i) Procedures to ensure that the Bank's internal auditors report directly to the audit committee

on a monthly basis and that all internal audit reports are directly reviewed by the audit committee;

- (ii) procedures that define the scope and frequency of internal audits with a requirement that a complete audit of all of the Bank's departments be conducted on at least an annual basis;
- (iii) procedures to ensure that operating management respond in writing to each report provided by internal auditors, which report shall be maintained for subsequent supervisory review; and,
- (iv) establishment of procedures for an effective method of resolving discrepancies between audit and operating management concerning audit exceptions and recommendations, with any disputes to be resolved by the Bank's audit committee.

10. Within sixty (60) days of this Agreement, the Bank shall develop acceptable written policies and procedures designed to strengthen and maintain its records, systems and internal controls and shall submit a copy of these policies and procedures to the Reserve Bank. The policies and procedures shall include, without limitation, corrective steps that are responsive to the criticism of the Bank's current procedures respecting internal controls as set forth in the Report of Examination, including, but not limited to the following:

- (a) Controls to ensure that cash drawer limits are maintained and reviewed;
- (b) policies for reporting suspected criminal activity in accordance with the requirements of section 208.20 of Regulation H of the Board of Governors (12 C.F.R. 208.20);
- (c) controls to ensure that documented audits of wire transfer activity are performed and maintained;
- (d) development of policies and procedures addressing bank premises and fixed assets; and,
- (e) development of procedures to ensure the accuracy of subsidiary ledgers.

11. The Bank shall not engage, directly or indirectly, in any violation of Regulation O (12 C.F.R. Part 215).

12. The plans, policies, and procedures required by paragraphs 3, 4, 6, 7, 9(c) and 10 hereof shall be submitted to the Reserve Bank for review and approval. Acceptable plans, policies, and procedures shall be submitted to the Reserve Bank within the required time periods. The Bank shall adopt the approved plans, policies, and procedures within ~~ten~~ ^{thirty (30)} days of approval by the Reserve Bank and then shall fully comply with them. During the term of this Agreement, the approved plans, policies, and procedures shall not be amended or rescinded without the prior written approval of the Reserve Bank.

13. Within thirty (30) days of the end of each calendar quarter (March 31, June 30, September 30 and December 31) following the date of this Agreement, the Bank shall furnish to the Reserve Bank written progress reports detailing the form and manner of all actions taken to secure compliance with this Agreement and the results thereof. Such reports may be discontinued when the corrections required by this Agreement have been accomplished, and the Reserve Bank has, in writing, released the Bank from making further reports.

14. All communications regarding this Agreement shall be sent to:

- (a) Mr. Harold H. Blum
Director, Banking and Trust Supervision
Federal Reserve Bank of San Francisco
P. O. Box 7702
San Francisco, California 94120-7702
- (b) Ms. Sharon Dunlavey
Deputy Superintendent of Banks
California State Banking Department
9609 Waples Street, Suite 100
San Diego, California 92121
- (c) Mr. Allan A. Farias
President and Chief Executive Officer
Cuyamaca Bank
9955 Mission Gorge Road
Santee, California 92071

15. The provisions of this Agreement shall be binding upon the Bank and all of its institution-affiliated parties, in their capacities as such, and their successors and assigns.

16. Notwithstanding any provision of this Agreement to the contrary, the Reserve Bank, in its sole discretion, may grant written extensions of time to the Bank to comply with any provision of this Agreement.

17. The provisions of this Agreement shall not bar, estop, or otherwise prevent the Board of Governors or any other federal or state agency or department from taking any other action affecting the Bank or any of its current or former institution-affiliated parties and its successors or assigns.

18. Each provision of this Agreement shall remain effective and enforceable until stayed, modified, terminated or suspended by the Reserve Bank.

19. This Agreement supersedes the Written Agreement between the Reserve Bank and the Bank, dated June 17, 1992, which is hereby terminated.

