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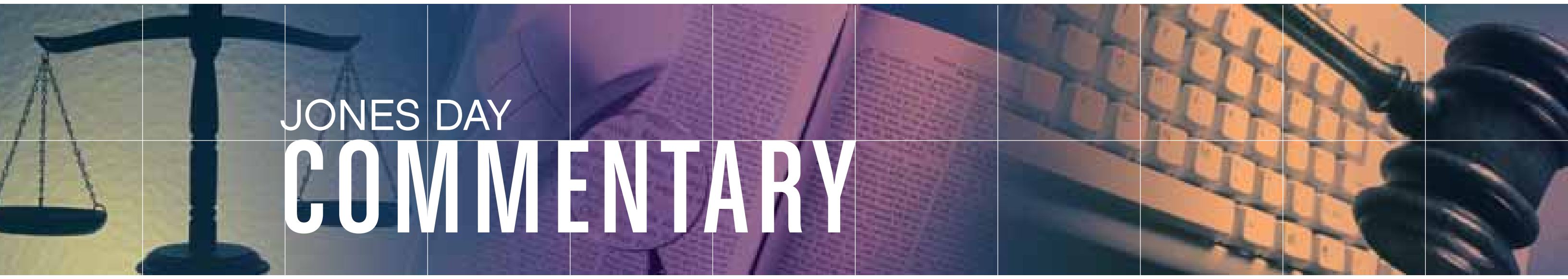

CRIMINAL ACTIONS AGAINST FAILED BANK EXECUTIVES

One of the defining characteristics of the current financial crisis has been the large number of banks that have failed—348 during 2008 through March 2011—taking investor money and the FDIC's Deposit Insurance Fund ("DIF") funds with them. These failed banks had approximately $604.4 billion of assets, and cost the DIF approximately $80.1 billion. Not surprisingly, the financial crisis has triggered an outcry from politicians, the public, regulators, and law enforcement, who are concerned that improper behavior contributed to the economic meltdown, or caused losses to the Troubled Asset Relief Program ("TARP") or the DIF, and believe that those responsible should be held accountable and pursued civilly and/or criminally.

Much of this outcry has been directed toward "Wall Street," although executives and directors of failed banks, most of which were community banks, are now potential targets of prosecutorial zeal. A handful of bank executives have been charged, and brief summaries of those cases are provided to illustrate the approach taken so far. It is unknown whether this small number of prosecutions is just the beginning of a trend similar to the over 1,800 criminal cases brought against bank insiders in the wake of the savings & loan crisis of 1988—1994 (the "S&L Crisis"), but these cases should be watched by those involved with troubled or failed banks. These cases also provide useful examples of operating risks and the need for strong internal controls and active oversight for healthy banks.

The Fraud Enforcement and Recovery Act of 2009 was enacted as a response to the financial crisis. This Act, among other things, authorized significant appropriations for various federal agencies including the Department of Justice ("DOJ"), FBI, and SEC to hire new agents and staff to investigate and prosecute financial fraud. The Emergency Economic Stabilization Act of 2008 also created the Special Inspector General for the TARP ("SIGTARP") to uncover and prosecute fraud and waste of TARP funds. Additionally, the DOJ launched a specialized interagency Financial Fraud Task Force to combat financial crime, with Attorney General Eric H. Holder, Jr., vowing to root out financial wrongdoing that helped bring about the meltdown and prosecute future criminal actions by "unscrupulous executives," boldly declaring, "We will investigate you, we will prosecute you, and we will incarcerate you."[1]

This increase in resources continued into 2010, with the DOJ securing a 12 percent budget increase to fight financial fraud and requesting an additional 23 percent increase in 2011.[2] The enforcement effort also has continued to clearly target executives of financial entities, including banks. For example, in a September report to the Senate on current Fraud Enforcement, Assistant Attorney General Lanny A. Breuer described the ongoing "aggressive efforts to hold bank executives to account" and stressed DOJ's intention to make enforcement examples out of them through future prosecutions.[3]

Despite the rhetoric, increased resources, and ever-increasing list of failed banks, there have been only a handful of prosecutions of failed bank executives. There are significant numbers of ongoing investigations and prosecutions relating to mortgage fraud and bad loans,[4] but, other than the several bank actions summarized below, the vast majority of the prosecutions to date have been against mortgage brokers and borrowers rather than bank executives. This may be because individual mortgage brokers and borrowers are "low hanging fruit" for prosecutors, with politically attractive results on behalf of consumer borrowers.

Still, executives of failed and failing banks should be wary. First, prosecutions of bank executives often involve complex and resource-intensive investigations, which delay the bringing of charges. It is difficult to distinguish between what actions were merely business judgments that ended poorly in the recession versus actions that were made with criminal intent. After the S&L Crisis, over 1,800 bank insiders were prosecuted between 1990 and 1995, resulting in more than 1,000 officers, directors, and other officials being sent to prison—but the prosecutions were often brought years later, as late as 1998.[5] Indeed, the FDIC's current deputy inspector general, Fred W. Gibson, noted that charges often are not filed for at least 18 months after a bank has failed.[6]

Second, prosecutors appear convinced there were plenty of bad actors in the banking industry leading to the meltdown. Undoubtedly, many banks were merely victims of fraudulent borrowers and mortgage brokers, or the economic downturn. The FDIC's acting general counsel assured bankers in late 2010 that "as long as they compl[ied] with their legal duties, they don't have anything to worry about."[7] However, federal officials are seeking to identify bankers who played fast and loose with regulations, looked the other way as borrowers diverted funds from their intended purpose, or failed to properly account for the true market value of assets. Even though few such cases have been brought so far, prosecutors have publicly stated that they are actively pursuing criminal investigations in connection with a number of failed banks, and further indictments are likely.[8] After each bank failure, the FDIC investigates, along with the DOJ and the FBI, possible grounds for recovery of its losses against bank officers, directors, and insiders, and whether the likely recoveries outweigh the expenses of pursuing claims

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1 Remarks of Attorney General Eric Holder at the Financial Fraud Enforcement Task Force Press Conference, Nov. 17, 2009, *available at* http://www.justice.gov/ag/speeches/2009/ag-speech-091117.html.

2 Jerry Markon, "Cases Against Wall Street Lag Despite Holder's Vows To Target Financial Fraud," *Wash. Post*, June 18, 2010, at A3.

3 Statement of Assistant Attorney General Lanny Breuer Before the Senate Judiciary Committee at a Hearing Regarding Financial Fraud Enforcement, Sept. 22, 2010, *available at* http://www.justice.gov/criminal/pr/speeches/2010/crm-speech-100922.html.

4 For example, the DOJ's largest mortgage-fraud sweep ever—"Operation Stolen Dreams"—culminated in June 2010, rounding up 1,517 criminal defendants. *Id.*

5 *See* Jean Eaglesham, "U.S. Sets 50 Bank Probes," *Wall St. J.*, Nov. 17, 2010, at A1; Steven M. Biskupic, "Fine Tuning the Bank Fraud Statute: A Prosecutor's Perspective," 82 *Marq. L. Rev.* 381, 390-91 (1999); Dep't of Justice, Financial Institution Fraud Special Report, June 30, 1995.

6 *See* Eaglesham, *supra* note 5.

7 *See id.*

8 The U.S. Attorney for the Northern District of Georgia, Sally Yates, has noted that Georgia has had more bank failures that any other state, and that her office has opened criminal investigations into a number of those failures. *See* Bill Rankin & Paul Donsky, "Bank Failures Draw Criminal Probes," *Atlanta Journal-Constitution*, Apr. 28, 2010. So far, her office has brought charges against executives at four of those banks, securing guilty pleas in three of the cases.

against insiders.[9] This can be a long process. The FDIC has recently confirmed that it is actively conducting investigations and considering criminal claims against insiders of about 50 failed banks, with the targeted individuals typically ranking as vice president or higher (including former directors), and it expects the heightened industry scrutiny to continue for years.[10]

Third, when prosecutors do decide to institute a criminal proceeding as a result of improper conduct, they have a wide range of laws with which to prosecute bankers. Beyond traditional bank fraud[11] and embezzlement[12] statutes, prosecutors can also base charges on a wide range of banking and general fraud violations including making false statements[13] or concealing material facts,[14] making false entries in bank books and records,[15] receipt of commissions or gifts for procuring loans,[16] mail or wire fraud,[17] and organizing a continuing financial crimes enterprise.[18] Additionally, there are newly created offenses related to fraud connected with TARP funds.[19]

Bank insiders should be mindful of the heightened scrutiny of the industry and increased government resources being focused on seeking to identify and prosecuting fraud. The facts uncovered in civil actions and FDIC investigations, as well as bank regulatory examinations and enforcement actions taken before a FDIC-insured institution fails, may be used in criminal actions.

CRIMINAL PROSECUTIONS OF EXECUTIVES OF FAILED BANKS

The following is a short summary of the primary criminal prosecutions to date of executives of failed banks from the current financial crisis, including the first two TARP-fraud indictments ever, as well as prosecutions that may be on the horizon.

Integrity Bank, Alpharetta, Georgia. Integrity Bank ("Integrity") failed in August 2008. Real estate developer Guy Mitchell and related parties obtained over $80 million in business loans from Integrity between 2004 and January 2007 with the help of Integrity's Executive Vice President and Chief Lending Officer, Douglas Ballard. Mitchell was unable to repay the loans, and Integrity became undercapitalized.

On April 14, 2010, Ballard was indicted on more than 20 counts of bank fraud, receipt of bribes, securities fraud, evasion of currency reporting requirements, and conspiracy. The indictment was unsealed on May 7, 2010, and Ballard entered a guilty plea on July 6, 2010 for conspiracy and one additional new count of tax evasion. As part of the plea, Ballard admitted to conspiring with Mitchell to receive loans under false pretenses and improperly distributing nearly $20 million in loan proceeds to Mitchell's businesses to Mitchell's personal account to be used for his personal purposes in violation of the Bank's loan approvals and documents. In return, Ballard received over $200,000 in bribes

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9 The FDIC is required by statute to investigate the causes of FDIC-insured bank failures that result in a material loss to the FDIC. *See* 12 U.S.C. § 1831o(k) (requiring a report after a material loss to the DIF). The FDIC may then bring claims against responsible parties for the benefit of the FDIC as Receiver. *See* 12 U.S.C. § 1821(k) (stating that an officer or director of an insured depository institution may be held personally liable for monetary damages in any civil action by, on behalf of, or at the request or direction of the FDIC).

10 *See* Eaglesham, *supra* note 5.

11 *See* 18 U.S.C. § 1344.

12 *See* 18 U.S.C. § 656.

13 *See* 18 U.S.C. § 1001(a)(2).

14 *See* 18 U.S.C. § 1001(a)(1).

15 *See* 18 U.S.C. § 1005.

16 *See* 18 U.S.C. § 215.

17 *See* 18 U.S.C. § 1341, 1343.

18 *See* 18 U.S.C. § 225. A "continuing financial crimes enterprise" is defined as a series of enumerated violations (such as bank fraud, making false entries in bank books or records, embezzlement, or mail and wire fraud affecting a financial institution) committed by at least four persons acting in concert. 18 U.S.C. § 225(b).

19 *See* 15 U.S.C. §§ 77q(a), 77x.

from Mitchell. Ballard could receive 10 years in prison and a $500,000 fine.

Additionally, in the April 14, 2010 indictment, Integrity's Vice President of Risk Management, Joseph Todd Foster, was charged with two counts of securities fraud based on insider trading in the publicly traded stock of Integrity's parent holding company. Foster entered a guilty plea to both of those counts on July 6, 2010, admitting that he discovered in 2006 that Mitchell was in a precarious financial situation, that Mitchell was likely to default on the loans, and that Integrity did not have sufficient liquid capital to survive that default. In light of this nonpublic knowledge of Integrity's likely failure in the near future, Foster sold the shares of Integrity that he owned. He could receive up to 20 years in prison and a $5 million fine.

Ballard and Foster have not yet been sentenced. Mitchell was charged in the April 14, 2010 indictment as well but has entered a plea of not-guilty and is proceeding toward trial. The court has postponed sentencing Ballard and Foster until after conclusion of the case against Mitchell. Additionally, civil charges seeking recovery of the estimated $250-350 million of losses to the DIF from Integrity's failure were brought by the FDIC against selected Integrity insiders on January 14, 2011, in the U.S. District Court for the Northern District of Georgia (Case No. 1:11-cv-111.).

Bank of Clark County, Vancouver, Washington. Bank of Clark County ("BOCC") was scheduled for a safety and soundness examination by FDIC and state regulators on November 3, 2008. In the two weeks prior to that examination, however, BOCC's Chief Lending Officer, David S. Kennelly, received updated appraisals on a number of subdivision and condo properties that served as security for some of BOCC's loans. The appraisals showed that the value of the properties had depreciated by several million dollars. For example, one subdivision property's appraised value dropped from $8.1 million to $2.9 million. Fearing the negative effect the appraisals would have on the examination and on BOCC's capitalization, Kennelly panicked, concealed the appraisals from the regulators, and falsely told regulators that all current appraisals had been provided to them. Two weeks later, a whistleblower alerted the FDIC, and examiners returned to BOCC and confronted Kennelly. Kennelly initially denied the appraisals existed but ultimately produced them and instructed other BOCC personnel to claim they had not been originally scanned into the system due to disorganization and staff being too busy.

After reviewing the concealed appraisals, the FDIC declared BOCC undercapitalized, and BOCC entered FDIC receivership on January 16, 2009.

In February 2010, Kennelly was charged with one count of scheming to conceal a material fact pursuant to 18 U.S.C. § 1001(a)(1), and entered a guilty plea one week later. Kennelly asked the sentencing judge to forgo any incarceration because Kennelly did not personally profit from his actions and was only acting to preserve the welfare of BOCC, its employees, shareholders, and depositors. The court, however, did not find Kennelly's arguments persuasive and sentenced him to four months' incarceration, 120 days of electronically monitored home confinement, 100 hours of community service, three years of supervised release, and a fine of $5,000. He has been banned for life from employment in the financial services industry without prior written approval from federal regulatory agencies.

FirstCity Bank, Stockbridge, Georgia. FirstCity Bank ("FirstCity") reported a relatively healthy Tier 1 capital ratio of 7.29 percent and a total risk-based ratio of 8.54 percent as of December 31, 2008, even though approximately one-third of its loans were in some stage of default. On March 20, 2009, FirstCity was closed.

Two years later, on March 21, 2011, federal agents arrested Mark A. Conner, who had served as FirstCity's President and interim CEO and Chairman of the Board of Directors, at the Miami International Airport. That same day, the U.S. Attorney's Office in Atlanta unsealed a criminal indictment charging him with bank fraud, conspiracy to commit bank fraud, and conducting a continuing financial crimes enterprise. The indictment also charged Clayton A. Coe, former Vice President and Senior Loan Officer, with bank fraud, conspiracy to commit bank fraud, and making false statements to a financial institution.

Prosecutors claim Conner and Coe falsified documents and caused the Bank's loan committee and board to approve several multimillion dollar commercial loans for borrowers to purchase property that was, unbeknownst to FirstCity, actually owned by Conner and Coe. Conner and Coe then allegedly caused other banks to purchase participations in these loans to shift some of the risk of default and routinely misled regulators to conceal the scheme. Connor also, according to the indictment, made an unsuccessful application for TARP funds.

Conner faces a mandatory minimum sentence of 10 years in prison, a maximum sentence of life in prison, and a potential fine of up to $10 million for organizing a continuing financial crimes enterprise. Connor and Coe each face a maximum of 30 years in prison and fine of up to $1 million on each of the counts of bank fraud and conspiracy to commit bank fraud.

Omni National Bank, Atlanta, Georgia. Omni National Bank ("Omni"), which was a community development financial institution or "CDFI," had a Community Redevelopment Department, headed by Omni's co-founder and Executive Vice President, Jeffrey L. Levine. Omni borrowed federal funds at low rates to make high-interest, short-term loans to borrowers for purchasing and rehabilitating distressed properties for resale or Section 8 rental in run-down, inner-city neighborhoods. These loans were often made to borrowers with less than stellar credit and often no steady employment or formal education, and many of the borrowers failed to sufficiently rehabilitate the property. Omni had a high rate of foreclosures and significantly lower profits than originally predicted. As real estate market prices fell, Omni masked its deteriorating financial condition by listing properties at values higher than they were worth, and even recycling foreclosed loans into higher-value new loans to disguise losses. In the summer of 2008, regulators ordered Omni to write off 33 percent of the value of its foreclosed properties.

On March 27, 2009, Omni was closed and taken over by the FDIC, leaving large amounts of decrepit real estate that had not been redeveloped.

On December 22, 2009, Levine was charged in a criminal information with making, and causing others to make, materially false statements in bank books, reports, and statements. Levine entered a guilty plea on January 14, 2010, admitting to knowing that Omni's loans were overvalued but failing to disclose violations of Omni's policies and procedures for many of the loans, which resulted in an overvaluation of Omni's assets by regulators, auditors, and shareholders. He is scheduled to be sentenced on April 22, 2011, and could receive up to 30 years in prison and a $1 million fine.

Colonial Bank, Montgomery, Alabama. In 2008, Colonial Bank ("Colonial") was one of the 50 largest banks in the United States, with 350 branches, approximately $26 billion in assets, and $19 billion in deposits. However, on August 14, 2009, Colonial was closed and taken over by the FDIC, becoming the fifth largest bank failure in U.S. history.

Lee Bentley Farkas is the former chairman of Taylor, Bean & Whitaker Mortgage Corporation ("TBW") (once one of the largest private mortgage companies in the United States and one of Colonial's largest customers). He was charged in a 16-count indictment on June 15, 2010, with perpetrating a massive fraud scheme with fake mortgages and a fraudulent application for TARP money by Colonial, resulting in losses exceeding $1.9 billion and contributing to the Bank's failure. Farkas' indictment alleged that he orchestrated and executed his scheme with the help of co-conspirators that included unnamed executives and employees of Colonial, and prosecutors stated publicly that they would seek to hold other individuals accountable at a later time.

Following through with that assertion, federal prosecutors have secured guilty pleas from a number of former TBW executives in connection with the alleged scheme:

- Desiree Brown, the former treasurer of TBW, pleaded guilty on February 24, 2011, to one count of conspiracy to commit wire fraud, bank fraud, and securities fraud. Brown is scheduled to be sentenced on June 10 and faces up to 30 years in prison, a $250,000 fine, and restitution to victims.
- Raymond E. Bowman, the former president of TBW, pleaded guilty on March 14, 2011, to one count of conspiracy to commit wire fraud, bank fraud, and securities fraud, and one count of making false statements. Bowman is scheduled to be sentenced on June 10 and faces up to five years in prison and a $250,000 fine on each count, and restitution to victims.

- Sean Ragland, a former senior financial analyst of TBW, pleaded guilty on March 31, 2011, to one count of conspiracy to commit bank fraud and wire fraud. Ragland is scheduled to be sentenced on June 21 and faces up to five years in prison, a $250,000 fine, and restitution to victims.
- Paul Allen, the former CEO of TBW, pleaded guilty on April 1, 2011, to one count of conspiracy to commit bank fraud and wire fraud, and one count of making false statements. Allen is scheduled to be sentenced on June 21 and faces up to five years in prison and a $250,000 fine on each count, and restitution to victims.

Criminal law enforcement actions have also been taken against Colonial executives:

- Catherine L. Kissick, a former senior vice president and head of Colonial's Mortgage Warehouse Lending Division, pleaded guilty on March 2, 2011, to conspiracy to commit wire fraud, bank fraud, and securities fraud. Kissick is scheduled to be sentenced June 17 and faces up to 30 years in prison, a $250,000 fine, and restitution.
- Teresa A. Kelly, a former operations supervisor at Colonial's Mortgage Warehouse Lending Division, pleaded guilty on March 16, 2011, to conspiracy to commit wire fraud, bank fraud, and securities fraud. Kelly is scheduled to be sentenced June 17 and faces up to five years in prison, a $250,000 fine, and restitution.

Furthermore, the SEC has charged Kissick and Kelly with securities fraud for falsely reporting TBW-originated loans and mortgage securities held by Colonial to the investing public as high-quality, liquid assets. The SEC announcements regarding these charges reflect the interrelationship between civil and criminal investigations and the numerous agencies involved, which included the Fraud Section of the DOJ's Criminal Division, the FBI, SIGTARP, the FDIC's Office of the Inspector General, the U.S. Department of Housing and Urban Development's Office of the Inspector General, and the Civil Division of the U.S. Attorney's Office for the Eastern District of Virginia as part of the Financial Fraud Enforcement Task Force.

Community Bank & Trust, Cornelia, Georgia. Community Bank & Trust ("CBT") opened in 1900 and had 36 branches, 400 employees, and $1.1 billion in assets. It was closed by the FDIC on January 29, 2010, and an FDIC Inspector General report in September 2010 found that CBT had failed to follow its loan policies and had made more than $10 million in bad loans.

On January 20, 2011, CBT's former Executive Vice President and Chief Credit Officer Robert "Randy" Jones pleaded guilty to conspiracy to commit bank fraud. The criminal information stated that Jones had received over $770,000 in kickbacks for approving loans so a customer could purchase tracts of land, and then caused the Bank to finance subsequent purchases of the land at inflated prices. It alleged Jones also made loans to straw purchasers and issued loans in the names of unsuspecting family members.

On February 24, 2011, Jones agreed to a Prohibition Order from the FDIC banning him from working in the banking industry. He is scheduled to be sentenced on May 10, 2011 and faces up to 30 years in prison and a fine of up to $1 million.

La Coste National Bank, La Coste, Texas. La Coste National Bank ("LCNB"), a bank founded in 1921, had not been the subject of FDIC enforcement actions and even made a profit for 2009. However, $7.3 million in fraudulent transactions and $1.1 million in related loan losses were uncovered in early 2010, which the FDIC attributed to an unnamed former LCNB executive. The Bank's financials gave no indication of potential problems, much less failure, and we suspect these problems were only discovered as part of a regulatory examination late in the Bank's life.

The Comptroller of the Currency, LCNB's primary regulator, determined that LCNB was critically undercapitalized with no reasonable chance at recovery, and placed LCNB into FDIC receivership on February 19, 2010.

On April 21, 2010, a seven-count indictment charging embezzlement and bank fraud was issued against LCNB's former President, Jody P. Gwyn. Gwyn was hired by LCNB in 1995 as Assistant Vice President and promoted to President in 2009. The indictment alleges that from 2007 to 2010, Gwyn made a number a transfers, including transfers from LCNB's asset accounts into customer accounts, then withdrew or diverted the monies from client accounts for his own use. Gwyn entered a guilty plea on October 27, 2010, and is scheduled to be sentenced on April 7, 2011. He faces three to five years' imprisonment and $8 million restitution.

Also, on June 16, 2010, former LCNB Vice President Mary Magdalene Crawford was indicted on two counts of embezzlement related to fraud discovered after LCNB failed. The indictment alleged that Crawford fraudulently prepared 10 cashier checks for $3,000 each, which she used to pay bills, and balanced LCNB's accounts by withdrawing funds from a customer's individual retirement account. It also alleged Crawford stole $10,000 from LCNB's vault. Crawford entered a guilty plea on October 10, 2010, to the count involving cashier checks, but has stated she does not have any knowledge of the fraud allegedly committed by Gwyn. She is scheduled to be sentenced on April 20, 2011.

Park Avenue Bank, New York, New York. Park Avenue Bank ("PAB") had retail branches in Manhattan and Brooklyn, with a client base primarily consisting of small businesses. Between October 2008 and February 2009, PAB applied for and tried to obtain over $11 million in funds from TARP, but its application was ultimately denied and regulators became suspicious of PAB's capitalization.

On March 12, 2010, PAB was closed and taken over by the FDIC due to ineffective management and inadequate capital. The next day, a 10-count criminal complaint was issued against Charles J. Antonucci, Sr., who was PAB's President and Chief Executive Officer from 2004 to 2009. Antonucci was arrested on March 15, 2010, and became the first defendant to be charged with fraud on TARP by falsifying PAB's capital position. On October 8, 2010, Antonucci, a former bank examiner, entered a guilty plea to six counts, becoming the first defendant to be convicted of fraud on TARP.

As part of the guilty plea, Antonucci admitted misrepresenting PAB's capital position in pursuit of TARP funds by orchestrating a sham "round-trip" using the Bank's own money to make it appear he had made a personal investment in the Bank. Prosecutors said PAB made loans to a group of companies tied to Antonucci, these entities funneled the loan proceeds to Antonucci, and then Antonucci invested the funds back into PAB. In exchange for the "investment," Antonucci received more than 308,000 shares in the Bank, giving him about 52 percent of the Bank's outstanding shares. In order to conceal the "round-trip" investment, Antonucci allegedly created a counterfeit certificate of deposit, in the amount of $2.3 million, purportedly issued by the Bank. Additionally, Antonucci admitted to a number of other crimes, including accepting over $250,000 in bribes for approval of various banking transactions, self-dealing, embezzlement and misappropriation of bank funds, and false statements in connection with the sale of an insurance company that later failed. Antonucci already consented to an $11.2 million judgment entered against him, and he is scheduled to be sentenced on April 8, 2011. He faces up to 135 years in prison.

Most recently, insurers that had supplied PAB's director and officer insurance and blanket bond brought an action to rescind these policies based on misrepresentations in the applications for renewal of these policies, and reimbursement for $70,000 of claims paid.[20] The claim is based, in part, upon Antonucci's guilty plea in the criminal proceedings. If successful, the rescission will leave other PAB directors and officers without coverage.

OTHER FAILURES THAT MAY LEAD TO CRIMINAL CHARGES

First Southern Bank, Batesville, Arkansas. First Southern Bank ("First Southern"), which was extremely well-capitalized as of September 30, 2010, with an 11.1 percent Tier 1 leverage capital ratio, failed suddenly on December 17, 2010 as a result of an apparent bond fraud. First Southern purchased approximately $22.0 million worth of rural improvement district bonds (the "Bonds") from December 2008 through September 2010. These purchases exceeded the Bank's equity. According to *Arkansas Business*, bank officials, the FDIC, and possibly the FBI began scrutinizing the Bonds in November 2010. First Southern believed that the Bonds might be fraudulent and tried to contact attorney Kevin Lewis, who sold the Bonds to the Bank but had disappeared in December 2010. *Arkansas Business* reported that Kevin

20 Tim Zawacki, "Insurer seeks to rescind policies involving bank exec convicted of defrauding TARP," *SNL Financial*, Mar. 29, 2011.

Lewis is a member of the family that controlled First Southern when the Bank failed. Several other Arkansas banks have sued Lewis for damages related to these banks, and an attorney for Lewis has stated that Lewis is "under investigation by federal law enforcement authorities."

Pierce Commercial Bank, Tacoma, Washington. Pierce Commercial Bank ("Pierce") failed on November 5, 2010. In 2008 and 2009, Pierce, along with other area lenders, fell prey to a mortgage fraud scheme involving real estate flips reminiscent of the Texas bank failures in 1988-1994 where Seattle resident Mark Ashmore, with the help of several associates in the mortgage industry, recruited "straw buyers" to purchase homes by taking out inflated mortgage loans. Ashmore and his associates would skim the excess over the actual sales price based on the inflated property values. Usually, the loans also were based on false application information regarding the buyers' employment and income, which Ashmore sometimes supported with fake documentation. The same homes would be sold and resold to different "straw buyers" as part of the scheme. On each flip, the homes were sold at higher and higher prices. Eventually, many of the loans on the properties went into foreclosure, resulting in losses to the lending banks. Christopher DiCugno, a loan officer at Pierce, was one of four men, including Ashmore, indicted in November 2009. All of the men involved were charged with multiple counts of wire fraud and conspiracy to commit wire fraud. Three of the four charged in the scam pleaded guilty, and Ashmore was convicted in September 2010. DiCugno was sentenced to eight months' imprisonment for his role, with the amount of restitution to be determined at a later date.

As a result of this mortgage scheme and the general downturn in the residential mortgage market, Pierce's home loan portfolio suffered severe damage. Despite a $4.5 million injection of TARP proceeds, Pierce struggled to keep up with its losses. Before it failed, Pierce consented to a cease and desist order (the "C&D Order") from the Federal Reserve and the Washington Department of Financial Institutions on December 4, 2009, after selling the mortgage banking division in an attempt to "correct deficiencies in its residential mortgage underwriting, consumer compliance, and operational risk management." The C&D Order prohibited the Bank from making any more residential mortgage loans and required the Bank to institute an improved consumer compliance program.

Further criminal charges relating to the Pierce failure may be forthcoming. Government prosecutors have stated in court filings that DiCugno is assisting them in ongoing investigations into activities at Pierce. Additionally, prosecutors have filed a civil forfeiture action alleging that Shawn Portmann, a Senior Vice President of Pierce until July 2008, and "two other principals" at Pierce made a large number of fraudulent loans, and that a related criminal investigation is ongoing.

CONCLUSIONS

The extensive regulation of banks creates legal risks for directors, officers, and other "institution-affiliated parties."[21] Regulatory enforcement powers are broad, ranging from corrective actions to personal civil money penalties to individual bans from the industry. Banks and holding companies, especially those that are public, are subject to enforcement actions, as well as civil and criminal penalties under federal securities laws.

Banks and their directors and officers should carefully consider their compliance programs and create a culture of compliance within their organization, including appropriate internal controls and effective insider trading policies. Prompt filing of confidential suspicious activity reports ("SARs") should be made timely and provided to the bank's board of directors whenever there is a known or suspected violation of federal law or a suspected money laundering activity or Bank Secrecy Act violation.[22] Bank directors should make sure their bank has appropriate procedures for timely filing SARs.

21 Federal Deposit Insurance ("FDI") Act, Section 3(u).

22 *See* FDIC Regs. Part 353 (12 C.F.R. pt. 353); Office of the Comptroller of the Currency Regs. Part 21 (12 C.F.R. pt. 21); and Board of Governors of the Federal Reserve System Reg. H (12 C.F.R. pt. 208, subpt. F).

So far, the financial crisis that began in 2008 has claimed numerous banks but has resulted in few criminal sanctions. Civil actions by the FDIC to recover losses to the DIF from failed bank insiders are at an early stage. Potential criminal charges are likely to lag behind the civil actions, except in the most obvious cases and where criminal investigations were underway before the banks failed, such as the Park Avenue Bank and Pierce Commercial Bank failures.

Civil and criminal actions can be interrelated and may have widespread consequences, including FDIC claims upon insurance policies and blanket bonds, and even loss of such insurance as the insurers seek rescission based upon fraudulent or other misrepresentation in the insurance applications. Both of these may leave bank directors and officers further exposed, personally.

Prevention, early detection, and correction of crimes against banks—whether by third parties, insiders, or some combination—are fundamental. Directors and officers of banks that become unhealthy or subject to regulatory enforcement should consider their activities with a view to avoiding potential later civil and criminal charges, especially in the event the bank fails. Boards of directors should consider very carefully their institutions' responses to:

- insider dealings;
- transactions and results that are "too good to be true;"
- any indications that the company's books and records, including the accounting and valuation of assets, may be inaccurate;
- indicia of fraud and possible illegal activity reported by employees, auditors, and customers;
- information from regulators, including examination reports and enforcement actions; and
- civil money penalties against insiders personally and bars or suspensions under FDI Act, Section 19.

The good news is that few bank failures during 2008-2011 appear, based on public information, to have been caused by illegal activities. Banks in trouble and their boards of directors should be sensitive to potential civil and possibly criminal charges if their institutions fail, and they should be fully informed as to how to minimize these risks.

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