

## OFFICE OF THRIFT SUPERVISION

### Receivership of a Federal Savings Association

**Date:** April 17, 2009  
**Order No.:** 2009-21  
**OTS Docket No.** 15909

The Acting Director of the Office of Thrift Supervision (OTS), or his designee, in cooperation with the Federal Deposit Insurance Corporation (FDIC), has determined to appoint the FDIC as receiver of American Sterling Bank, Sugar Creek, Missouri (Savings Bank).

#### **GROUNDS FOR APPOINTMENT OF FDIC AS RECEIVER FOR THE SAVINGS BANK**

The Acting Director, or his designee, based upon the administrative record, finds and determines the following:

- (i) The Savings Bank is in an unsafe and unsound condition to transact business;
- (ii) The Savings Bank has incurred losses or is likely to incur losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the institution to become adequately capitalized (as defined in 12 U.S.C. § 1831o(b)) without Federal assistance;
- (iii) The Savings Bank has consented to the appointment of a conservator or receiver;
- (iv) The Savings Bank is critically undercapitalized; and
- (v) The Savings Bank has substantially insufficient capital.

The Savings Bank is a Federally chartered savings bank, the accounts of which are insured by the Deposit Insurance Fund (DIF). The Savings Bank has its home office in Sugar Creek, Missouri. As of December 31, 2008, the Savings Bank reported approximately \$181.28 million in assets, \$168.88 million in liabilities, \$12.39 million in stockholders' equity, and a net loss for the twelve months ended December 31, 2008, of approximately \$17.95 million. At December 31, 2008, the Savings Bank reported tangible, core and total risk-based capital of negative 1.12 percent, negative 1.12 percent, and negative 2.31 percent, respectively. The Savings Bank is wholly owned by American Sterling Corporation (Holding Company).

## **DISCUSSION OF GROUNDS FOR APPOINTMENT OF A RECEIVER FOR THE SAVINGS BANK**

Section 5(d)(2)(A) of the Home Owners' Loan Act (HOLA), 12 U.S.C. § 1464(d)(2)(A), provides that the Director may appoint a receiver for any insured savings association if the Director determines that one or more grounds specified in section 11(c)(5) of the FDIA, 12 U.S.C. § 1821(c)(5), exist.

### Unsafe and Unsound Condition

Under section 11(c)(5)(C) of the FDIA, OTS may appoint a receiver if a savings association is in an unsafe and unsound condition to transact business. The Savings Bank has repeatedly misstated its books and records by recording false or inaccurate entries, not recording entries on a timely basis, and not recording transactions. The various matters are summarized below.

Separately from the other matters listed below, the Savings Bank made false entries or inaccurate entries to its general ledger, failed to properly reconcile and balance its general ledger, and failed to maintain proper supporting documentation to support accounting entries in its general ledger. The Savings Bank's false or inaccurate entries, failure to properly reconcile its accounts, and to maintain supporting documentation to support entries results in a failure to maintain accurate books and records. Correction of improper entries in the Savings Bank's book has resulted in the Savings Bank having to make downward adjustments to its capital accounts totaling approximately \$3.6 million.

In addition, the Holding Company contributed a loan to the Savings Bank and the Savings Bank recorded a capital contribution of approximately \$400,000, or approximately \$265,000, net of tax. The loan was essentially uncollectible when contributed (Contributed Loan), was not offset by an allowance for loan losses, and was improperly included in capital. The loan contribution and failure to record an allowance for loan losses caused the Savings Bank to overstate its assets and capital.

Similarly, the Holding Company contributed a \$2 million participation in a loan to a political party to the Savings Bank (Political Party Loan). The Savings Bank recorded a capital contribution of \$2 million. The Political Party Loan was not repaid in accordance with its terms and became past due. The Savings Bank did not record an allowance for loan losses for this loan. Further, the transaction should have been recorded as a political contribution rather than a loan, because it failed to meet two criteria stated in 11 C.F.R. § 100.82 regarding loans to political parties.

On December 31, 2007, the Savings Bank recorded two journal entries for accounts receivable from the Holding Company for \$280,000 and \$470,000 with a credit to the Savings Bank as "capital surplus" of \$750,000 (Capital Surplus Entries). The Capital Surplus Entries were not supported by any documentation or actual capital contributed to the Savings Bank.

In December 2007, the Savings Bank entered into a Lender's Representation and Warranty Master Policy (Master Policy) issued by an insurance subsidiary of the Holding Company (Subsidiary). Using the Master Policy, the Savings Bank improperly spread the impact of loan losses over the 24 month contract period by treating the losses as not occurring and, instead, charging off the monthly premiums as expense. The Savings Bank received \$877,885 in insurance proceeds on submitted claims and paid \$720,000 in insurance premiums before the Master Policy was rescinded at OTS's direction.

The Holding Company agreed to rescind the Master Policy. The Rescission Agreement required the Subsidiary to return \$720,574 in premiums to the Savings Bank and required the Savings Bank to return to the Subsidiary \$877,856 in loss payments. The net payment of \$157,312 resulted in a net loss to the Savings Bank and a reduction of capital.

The Savings Bank elected to adopt Statement of Financial Accounting Standards No. 157 "Fair Value Measurement" (SFAS No. 157) and Statement of Financial Accounting Standards No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159) as of January 1, 2007, and therefore, the Savings Bank should have obtained fair value measurements of its held-for-sale (HFS) loans and real estate owned (REO) portfolio beginning in the first quarter of 2007, but did not do so.

At the direction of OTS, in the third quarter of 2008, the Savings Bank obtained a third party valuation of REO and HFS loans. Prior to receipt of the third party valuation, the Savings Bank recorded valuation adjustments of \$4.666 million for REO and HFS loans. The third party valuation of REO portfolio and the HFS loans reported that additional valuation allowances of approximately \$7.46 million, or approximately \$11.5 million in total valuation allowances, were required to state REO and the HFS loans at fair value (based on August 31, 2008, balances). The Savings Bank recorded the remaining \$7.46 million valuation adjustments in September 2008, resulting in a diminution of total assets and capital. In addition, the Savings Bank has not properly updated the valuations of HFS loans and REO for the fourth quarter of 2008.

Pursuant to a Loan Purchase Agreement (Purchase Agreement) between an unaffiliated party (Purchaser) and the Savings Bank, the Purchaser agreed to purchase loans from the Savings Bank. Under the Purchase Agreement, the Savings Bank committed that it would repurchase any loan sold to the Purchaser under specified circumstances. In June 2008, the Purchaser submitted to the Savings Bank a written demand for the Savings Bank's repurchase of approximately 124 loans. The demand cited "early payment defaults" as the basis for its claim, *i.e.*, one of the specified circumstances.

The Savings Bank has not repurchased the loans covered by the June 2008, demand. However, the Purchaser has retained some proceeds due the Savings Bank from the purchase of other loans sold by the Savings Bank to the Purchaser. As of August 31, 2008, the retained proceeds totaled approximately \$4.1 million and that were reported as accounts receivable by the Savings Bank. As of June 30, 2008, the Savings Bank had not established an allowance for the potential loss relating to the purchased loan loss contingency. The Savings Bank's management

indicated this claim will most likely be settled for \$2 million, but there is no agreement that supports this assertion.

Based on the uncertainty of the Savings Bank's ability to collect the full amount withheld by the Purchaser, on September 24, 2008, OTS directed the Savings Bank to record a \$2.6 million valuation allowance against the \$4.1 million receivable, noting however, that the Savings Bank's exposure could increase.

As of January 26, 2009, the Savings Bank had received approximately \$18,308,158 in claims for repurchase of loans from other loan purchasers (collectively with above, the Loan Repurchase Disputes). The Savings Bank has not established an estimated liability allowance under Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies" (SFAS No. 5). The Savings Bank has potential recourse exposure related to \$3.5 billion of mortgage loans sold to the secondary market. While the total extent of any potential liability is not yet determinable and any loss presently may not be reasonably estimable, some loss can be expected that would further diminish assets and capital.

As of December 31, 2007, the Savings Bank had approximately \$11.8 million of cumulative net operating losses, which resulted in a deferred tax asset (DTA) of \$4.6 million. The Savings Bank's management was unable to provide adequate supporting analysis for the realization of the DTA. As a result, and in accordance with U.S. generally accepted accounting principles (GAAP), a valuation allowance was appropriate for the full amount of the DTA. On August 15, 2008, the Savings Bank recorded the appropriate allowance resulting in decreased capital of approximately \$4.6 million.

In December 2008, the Savings Bank reported to OTS that prior management had recorded \$706,949 of loan fee income on April 30, 2008, in advance, related to refinancing a group of mortgage loans which the Savings Bank did not own. The loans were never subsequently refinanced or purchased by the Savings Bank. At the time the loan fee accrual was made, there were no written loan commitments to individual loan customers that would support the recording of such fees. In addition, there were no forward sales commitments related to the loans. As a result, net losses for the quarters ended June 30, and September 30, 2008 were understated, and the Savings Bank's capital position and reported capital ratios were overstated on the June and September 2008 Thrift Financial Reports (TFR). The improper entry was reversed in December 2008.

A summary of the above matters resulting in inaccurate books and records follows:

| <u>Description</u>   | <u>Capital<br/>Impact</u><br>Inc.<Dec.> |
|--|---|
| Unreconciled/unsupported G/L accounts  | \$ <3,600,000>                          |
| Contributed Loan in Default, net   | <265,000>                               |
| Political Party Loan   | <2,000,000>                             |
| Capital Surplus Entries  | <750,000>                               |
| Lender's Representation and Warranty Master Policy   | <157,312>                               |
| Failure to obtain HFS Loans and REO Valuations<br>for 2007 and 1 <sup>st</sup> and 2 <sup>nd</sup> Qtr. 2008 | <11,500,000>                            |
| Loan Repurchase Disputes   | <2,600,000>*                            |
| December 31, 2007 Deferred Taxes   | <4,600,000>                             |
| Accrued Loan Fee Income  | <706,949>                               |
| Failure to obtain HFS Loans and REO Valuations<br>for 3 <sup>rd</sup> and 4th Qtr. 2008                      | <u>unknown</u>                          |
| Total  | <u>\$&lt;26,179,261&gt;</u>             |

\* Potential additional settlement amounts are indeterminable presently. Such amounts could further negatively impact the Savings Bank's capital position.

Therefore, OTS concludes that the inaccurate, false, untimely and missing entries have caused the Savings Bank's books and records to be misstated, masking the actual condition of the Savings Bank. Therefore, the Acting Director, or his designee, concludes that the Savings Bank is in an unsafe and unsound condition to transact business.

#### Losses That Will Deplete Capital

Under section 11(c)(5)(G) of the FDIA, OTS may appoint a receiver for a savings association if it has incurred losses or is likely to incur losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the institution to become adequately capitalized (as defined in 12 U.S.C. § 1831o(b)) without Federal assistance.

The Savings Bank reported negative net income of: (i) \$1.7 million in 2006; (ii) \$3.7 million in 2007; and (iii) \$18.0 million in 2008. The Savings Bank is projecting a \$2.2 million loss for the first quarter of 2009. The Savings Bank is critically undercapitalized, reporting a core capital ratio of negative 1.12 percent and a total risk-based capital of negative 2.31 percent. Losses recognized to date have depleted all of its regulatory capital. If the Savings Bank had properly recorded other matters, it probably would not have reported net income in any quarter during the past three years, and probably would have reported greater operating losses and lesser capital amounts. The Savings Bank has commitments and contingent liabilities related to: (i) lease termination costs; and (ii) recourse liabilities associated with its mortgage production business. While the total liability and income (and capital) impact associated with these claims has not yet been determined, the Savings Bank is likely to accrue additional liabilities that will have a further adverse impact on net income and capital. In addition, the decline in the Savings

Bank's HFS loans and REO portfolio is expected to continue. These matters likely will result in further dissipation of the Savings Bank's remaining capital.

The Savings Bank has not been able to implement a profitable business strategy. The Savings Bank has not submitted a viable capital plan for restoration to adequately capitalized status. OTS has denied the capital restoration plan submitted by the Savings Bank on February 17, 2009. Despite the Holding Company's entering into an agreement with a potential acquiror and OTS's approval of the acquiror's application to acquire the Savings Bank, it is unclear whether the acquisition will be consummated because it is subject to contingencies beyond the control of either the Savings Bank or the acquirer that have not been met. The Savings Bank has not submitted any other alternative plans for its recapitalization that can be accomplished within the foreseeable future.

The Acting Director, or his designee, concludes that the Savings Bank has incurred losses or is likely to incur losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the Savings Bank to become adequately capitalized without Federal assistance.

#### Consent

Under section 11(c)(5)(I) of the FDIA, a resolution by the board of directors consenting to the appointment of a conservator or receiver provides sufficient grounds for such an appointment. The board of directors of the Savings Bank, by resolution dated January 14, 2009, consented to the appointment of a conservator or receiver by the Acting Director, provided that the Savings Bank is significantly or critically undercapitalized. The Savings Bank has reported that it is critically undercapitalized. The Acting Director, or his designee, finds that, under section 11(c)(5)(I) of the FDIA, the January 14, 2009, resolution and entering into the stipulation and consent agreement by the board of directors provides a sufficient basis for the appointment of a receiver.

#### Critically Undercapitalized

Under section 11(c)(5)(L)(i) of the FDIA, OTS may appoint a receiver for a savings association if it is critically undercapitalized, as defined in 12 U.S.C. § 1831o(b). Under section 1831o(b), an institution is critically undercapitalized if it fails to meet any level of capital specified under section 1831o(c)(3)(A) of the FDIA. Section 1831o(c)(3)(A) provides for the appropriate banking agency to set a ratio of tangible equity to total assets at which an institution is critically undercapitalized. OTS has promulgated 12 C.F.R. § 565.4(b)(5), which defines an institution as critically undercapitalized if it has a ratio of tangible equity to total assets that is equal to or less than two percent. As of December 31, 2008, the Savings Bank reported a tangible capital ratio of negative 1.12 percent. Thus, the Acting Director, or his designee, concludes that the Savings Bank is critically undercapitalized.

### Substantially Insufficient Capital

Under section 11(c)(5)(L)(ii) of the FDIA, OTS may appoint a receiver if a savings association has substantially insufficient capital. Pursuant to the authority granted in sections 5(t)(1)(A)(i) and 5(t)(2)(A) of the HOLA, OTS has promulgated 12 C.F.R. Part 567 requiring all savings associations that are not “one” rated to maintain a leverage capital ratio of 4 percent and all savings associations to maintain a minimum risk-based capital ratio of 8 percent of the institution’s risk-based assets, as defined. OTS has concluded that failure to maintain at least two-thirds of any capital required by 12 C.F.R. Part 567 of OTS’s regulations constitutes a substantial capital insufficiency within the meaning of the 12 U.S.C. § 1821(c)(5)(L)(ii).

The Savings Bank is not “one” rated and has a leverage capital ratio of negative 1.12 percent. The Savings Bank’s risk-based capital is negative 2.31 percent. Therefore, the Acting Director, or his designee, concludes that the Savings Bank has substantially insufficient capital.

The Acting Director, or his designee, therefore, has determined that grounds for the appointment for a receiver for the Savings Bank exist under section 5(d)(2) of the HOLA, and sections 11(c)(5)(C), (G), (I), (L)(i), and (L)(ii) of the FDIA, 12 U.S.C. §§ 1821(c)(5)(C), (G), (I), (L)(i), and (L)(ii).

### **ACTIONS ORDERED OR APPROVED**

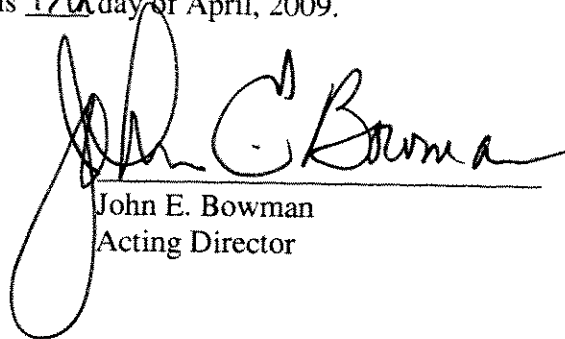
#### **Appointment of a Receiver**

The Acting Director, or his designee, hereby appoints the FDIC as receiver for the Savings Bank, for the purpose of liquidation, pursuant to section 5(d)(2) of the HOLA, 12 U.S.C. § 1464(d)(2), and section 11(c)(6)(B) of the FDIA, 12 U.S.C. § 1821(c)(6)(B).

### **DELEGATION OF AUTHORITY TO ACT FOR OTS**

The Acting Director, or his designee, hereby authorizes the OTS Western Regional Director, or his designee, and the Deputy Chief Counsel for the Business Transactions Division of the Chief Counsel’s Office, or his designee, to: (1) certify orders; (2) sign, execute, attest or certify other documents of OTS issued or authorized by this Order; (3) designate the person or entity that will give notice of the appointment of a receiver for the Savings Bank and serve the Savings Bank with a copy of this Order pursuant to 12 C.F.R. § 558.2; and (4) perform such other actions of OTS necessary or appropriate for the implementation of such Order. All documents to be issued under the authority of this Order must be first approved, in form and content, by the Chief Counsel’s Office. In addition, the Acting Director, or his designee, hereby authorizes the Deputy Chief Counsel for the Business Transactions Division, or his designee, to make any subsequent technical corrections, that might be necessary, to this Order, or any documents issued under the authority of this Order.

By Order of the Acting Director of OTS, or his designee, effective immediately upon service of this Order on the Savings Bank this 17<sup>th</sup> day of April, 2009.



John E. Bowman  
Acting Director