

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D.C.

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In the Matter of )  
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SILVERGATE BANK )  
LA JOLLA, CALIFORNIA )  
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(INSURED STATE NONMEMBER BANK) )  
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ORDER TO  
CEASE AND DESIST

Docket No. FDIC-06-200b

Silvergate Bank, La Jolla, California ("Bank"), having been advised of its right to a Notice of Charges and of Hearing detailing the unsafe or unsound banking practices and violations of law and/or regulations alleged to have been committed by the Bank and of its right to a hearing on the alleged charges under section 8(b)(1) of the Federal Deposit Insurance Act ("Act"), 12 U.S.C. § 1818(b)(1), and having waived those rights, entered into a STIPULATION AND CONSENT TO THE ISSUANCE OF AN ORDER TO CEASE AND DESIST ("CONSENT AGREEMENT") with counsel for the Federal Deposit Insurance Corporation ("FDIC"), dated December 18, 2006, whereby solely for the purpose of this proceeding and without admitting or denying the alleged charges of unsafe or unsound banking practices and violations of law and/or regulations, the Bank consented to the issuance of an ORDER TO CEASE AND DESIST ("ORDER") by the FDIC.

The FDIC considered the matter and determined that it had reason to believe that the Bank had engaged in unsafe or unsound banking practices and had committed violations of law and/or regulations. The FDIC, therefore, accepted the CONSENT AGREEMENT and issued the following:

ORDER TO CEASE AND DESIST

IT IS HEREBY ORDERED, that the Bank, its institution-affiliated parties, as that term is defined in section 3(u) of the Act, 12 U.S.C. § 1813(u), and its successors and assigns cease and desist from the following unsafe and unsound banking practices and violations of law and/or regulation.

- (a) operating with management whose policies and practices are detrimental to the Bank and jeopardize the safety of its deposits;
- (b) operating with a board of directors which has failed to provide adequate supervision over and direction to the active management of the Bank;
- (c) operating in such a manner as to produce low earnings;
- (d) operating with inadequate provisions for liquidity;
- (e) operating in violation of section 326.8 of the FDIC Rules and Regulations, 12 C.F.R. § 326.8, as more fully described on pages 22-23 in the FDIC's and the Department of Financial Institutions of the State of California ("DFI") Joint Report of Examination dated May 1, 2006;
- (f) operating in violation of section 23A of the Federal Reserve Act, 12 U.S.C. § 371c, made applicable to state nonmember insured institutions by section 18(j)(1) of the Act, 12 U.S.C. § 1828(j)(1), as more fully described on page 23 of the Report of Examination dated May 1, 2006; section 1936 of the California Financial Code, Cal. Fin. Code § 1936, as more fully described on pages 23-24 of the Report of Examination dated May 1, 2006; Appendix A of Part 364 of the FDIC's Rules and Regulations, 12 C.F.R. § 364, App.A, as more fully described on pages 24-25 of the Report of Examination dated May 1, 2006; Part 309 of the FDIC's Rules and Regulations, 12 C.F.R. § 309, as more fully described on page 25 of the Report of Examination

dated May 1, 2006; and section 32 of the Act, 12 U.S.C. § 1831i, as more fully described on pages 25-26 of the Report of Examination dated May 1, 2006;

(g) operating with an inadequate loan valuation reserve;

(h) operating with inadequate capital in relation to the bank's weak earnings, strained liquidity and over-reliance on non-core funding sources; and

(i) operating with inadequate internal routine and controls policies;

IT IS FURTHER ORDERED, that the Bank, its institution-affiliated parties, and its successors and assigns, take affirmative action as follows:

1. Within 60 days from the effective date of this ORDER, the Bank shall have and retain qualified management.

(a) Each member of management shall have qualifications and experience commensurate with his or her duties and responsibilities at the Bank. Management shall include a chief executive officer with proven ability in managing a Bank of comparable size, developing strategic plans, improving earnings and other matters needing particular attention. Management shall also include a senior lending officer with significant appropriate lending, collection, and loan supervision experience. Each member of management shall be provided appropriate written authority from the Bank's board of directors to implement the provisions of this ORDER.

(b) The qualifications of management shall be assessed on its ability to:

(i) comply with the requirements of this ORDER;

(ii) operate the Bank in a safe and sound manner;

(iii) comply with applicable laws and regulations; and

(iv) restore all aspects of the Bank to a safe and sound condition,

including earnings, management effectiveness, liquidity, and sensitivity to market risk.

(c) Within 90 days from the effective date of this ORDER, the board of directors shall appoint a committee whose membership will consist exclusively of outside directors to undertake an independent, in-depth analysis and review of the Bank's managerial and staffing needs and make a written report ("Management Report") on the Bank's management requirements. The Management Report shall incorporate an analysis of the Bank's management and staffing requirements, and shall, at a minimum;

(i) describe both the number and types of positions needed to properly manage the Bank ;

(ii) clearly and concisely describe the qualifications and experience needed for each position;

(iii) evaluate each executive Bank officer indicating whether these officials possess the ability, experience, and other qualifications required to perform present and anticipated duties, including adherence to the Bank's established policies and practices, and maintenance of the Bank in a safe and sound condition. Such evaluation shall specifically address compensation paid to each executive officer;

(iv) establish a plan to recruit, hire, or replace personnel with requisite ability and experience;

(v) establish a plan for providing for periodic evaluation of each individual's job performance; and

(vi) provide for periodic review of the Bank's management.

The Bank shall formulate a plan to implement the recommendations of the study. The plan shall be acceptable to the Regional Director of the FDIC's San Francisco Regional Office ("Regional Director") as determined at subsequent examinations.

(d) Pursuant to the requirements of section 32 of the Act, the Bank shall notify the Regional Director and the Commissioner of the DFI ("Commissioner") in writing when it proposes to add any individual to the Bank's board of directors or employ any individual as a senior executive officer. The notification must be received at least 30 days before such addition or employment is intended to become effective and should include a description of the background and experience of the individual or individuals to be added or employed.

(e) Within 90 days from the effective date of this ORDER, the Bank shall develop, adopt, and implement a written ethics policy ("Ethics Policy") and procedure ("Ethics Program"), acceptable to the Regional Director and the Commissioner as determined at subsequent examinations.

2. Within 90 days from the effective date of this ORDER, the Bank shall adopt an employee compensation plan after undertaking a review of compensation paid to any of the Bank's executive officers and directors. At a minimum, the review shall include the following:

(a) a critical analysis of each individual's background, experience, duties and responsibilities, and an appraisal of each individual's performance compared to the present level of compensation; and

(b) a comparison of each officer's total compensation with compensation received by officers with similar responsibilities in similar institutions.

For the purposes of this paragraph, "compensation" refers to any and all salaries, bonuses, and other benefits of every kind and nature whatsoever, whether paid directly or indirectly. The compensation plan and its implementation shall be in a form and manner acceptable to the Regional Director and the Commissioner as determined at subsequent examinations.

3. Within 90 days of the effective date of this ORDER, the Bank shall develop and submit to the Regional Director and the Commissioner a written three-year strategic plan. Such plan shall include specific goals for the dollar volume of total loans, total investment securities, and total deposits as of December 31, 2007, December 31, 2008, and December 31, 2009. For each time frame, the plan will also specify the anticipated average maturity and average yield on loans and securities; the average maturity and average cost of deposits; the level of earning assets as a percentage of total assets; and the ratio of net interest income to average earning assets. The plan shall be in a form and manner acceptable to the Regional Director and the Commissioner as determined at subsequent examinations and/or visitations.

4. Within 90 days from the effective date of this ORDER, the Bank shall formulate and implement a written profit plan. This plan shall be forwarded to the Regional Director and the Commissioner for review and comment and shall address, at a minimum, the following:

(a) goals and strategies for improving and sustaining the earnings of the Bank, including:

(i) an identification of the major areas in, and means by which, the board of directors will seek to improve the Bank's operating performance;

(ii) realistic and comprehensive budgets;

(iii) a budget review process to monitor the income and expenses of the Bank to compare actual figures with budgetary projections; and

(iv) a description of the operating assumptions that form the basis for, and adequately support, major projected income and expense components.

(b) coordination of the Bank's loan, investment, and operating policies, and budget and profit planning, with the funds management policy.

5. Within 60 days of the effective date of this ORDER, the Bank shall comply with the Bank Secrecy Act ("BSA") and its rules and regulations.

6. Within 60 days of the effective date of this ORDER, the Bank shall develop, adopt and implement a written compliance program, as required by the applicable provisions of section 326.8 of the FDIC's Rules and Regulations, 12 C.F.R. § 326.8, designed to, among other things, ensure and maintain compliance by the Bank with the BSA and the rules and regulations issued pursuant thereto. The program shall ensure that clear and comprehensive BSA compliance reports are provided to the Bank's Board of Directors on a monthly basis. Such program and its implementation shall be in a manner acceptable to the Regional Director and the Commissioner as determined at subsequent examinations and/or visitations of the Bank. At a minimum, the program shall:

(a) Establish a system of internal controls to ensure compliance with the BSA and the rules and regulations issued pursuant thereto, including policies and procedures to detect and monitor all transactions to ensure that they are not being conducted for illegitimate purposes and that there is full compliance with all applicable laws and regulations.

(b) Provide for independent testing of compliance with the BSA, all applicable rules and regulations related to the BSA, and the reporting of suspicious transactions required to be reported pursuant to Part 353 of the FDIC's Rules and Regulations, 12 C.F.R. Part 353. The independent testing shall be conducted on an annual basis in compliance with the procedures described in the FDIC's "Guidelines for Monitoring Bank Secrecy Act Compliance." The testing, at a minimum, shall include the following:

(i) a test of the Bank's internal procedures for monitoring the BSA;

(ii) a sampling of large currency transactions followed by a review of the Currency Transaction Report filings;

(iii) a test of the validity and reasonableness of the customer exemptions granted by the Bank;

(iv) a test of the Bank's recordkeeping system for compliance with the BSA; and

(v) documentation of the scope of the testing procedures performed and the findings of the testing.

Written reports shall be prepared which document the testing results and provide recommendations for improvement. Such reports shall be presented to the Bank's Board of Directors.

(c) Ensure that the Bank's BSA compliance program is managed by a qualified officer who shall have responsibility for all BSA compliance and related matters, including, without limitation;

(i) the identification of timely, accurate and complete reporting to law enforcement and supervisory authorities of unusual or suspicious activity or known or suspected criminal activity perpetrated against or involving the Bank; and

(ii) monitoring the Bank's compliance and ensuring that full and complete corrective action is taken with respect to previously identified violations and deficiencies.

(d) Provide and document training by competent staff and/or independent contractors of all board members and all appropriate personnel, including, without limitation, tellers, customer service representatives, lending officers, private and personal banking officers

and all other customer contact personnel, in all aspects of regulatory and internal policies and procedures related to the BSA, with a specific concentration on accurate recordkeeping, form completion and the detection and reporting of known and/or suspected criminal activity.

Training shall be updated on a regular basis to ensure that all personnel are provided with the most current and up to date information.

7. Within 90 days from the effective date of this ORDER, the Bank shall develop or revise, adopt, and implement a written liquidity and funds management policy. Such policy and its implementation shall be in a form and manner acceptable to the Regional Director and the Commissioner as determined at subsequent examinations and/or visitations.

8. Within 90 days from the effective date of this ORDER, the Bank shall adopt and implement a policy for the operation of the Bank in such a manner as to provide adequate internal routine and control policies consistent with safe and sound banking practices. Such policy and its implementation shall be satisfactory to the Regional Director and the Commissioner as determined at subsequent examinations and/or visitations.

9. Within 90 days from the effective date of this ORDER, the Bank shall develop, adopt, and implement a written policy satisfactory to the Regional Director and the Commissioner, which policy shall govern the relationship between the Bank and its holding company, and shall limit the payment of any management, consulting, or other fees or funds of any nature, directly or indirectly, to or for the benefit of the Bank's holding company to only those fees or funds paid in connection with services performed by the Bank's holding company on behalf of or for the benefit of the Bank.

10. Upon the effective date of this ORDER, the Bank shall not increase the amount of brokered deposits above the amount outstanding on that date.

Within ten 10 days of the effective date of this ORDER, the Bank shall submit to the Regional Director and the Commissioner a written plan for reducing its reliance on brokered deposits. The plan should contain details as to the current composition of brokered deposits by maturity and explain the means by which such deposits will be paid or rolled over. The Regional Director shall have the right to reject the Bank's plan. On the 10th of each month following the previous month's end, the Bank shall provide a written progress report to the Regional Director and the Commissioner detailing the level, source, and use of brokered deposits with specific reference to progress under the Bank's plan. For purposes of this ORDER, brokered deposits are defined as described in section 337.6(a)(2) of the FDIC Rules and Regulations to include any deposits funded by third party agents or nominees for depositors, including deposits managed by a trustee or custodian when each individual beneficial interest is entitled to or asserts a right to federal deposit insurance.

11. (a) On the effective date of this ORDER, the Bank shall maintain Tier 1 capital in such an amount as to equal or exceed 8.0 percent of the Bank's total assets.

(b) The level of Tier 1 capital to be maintained during the life of this ORDER pursuant to Subparagraph 3 (a) shall be in addition to a fully funded allowance for loan and lease losses, the adequacy of which shall be satisfactory to the Regional Director and the Commissioner as determined at subsequent examinations and/or visitations.

(c) Any increase in Tier 1 capital necessary to meet the requirements of Paragraph 3 of this ORDER may be accomplished by the following:

- (i) the sale of common stock; or
- (ii) the sale of noncumulative perpetual preferred stock; or

(iii) any other means acceptable to the Regional Director and the Commissioner; or

(iv) any combination of the above means.

Any increase in Tier 1 capital necessary to meet the requirements of Paragraph 3 of this ORDER may not be accomplished through a deduction from the Bank's allowance for loan and lease losses.

(d) If all or part of the increase in Tier 1 capital required by Paragraph 3 of this ORDER is accomplished by the sale of new securities, the board of directors shall forthwith take all necessary steps to adopt and implement a plan for the sale of such additional securities, including the voting of any shares owned or proxies held or controlled by them in favor of the plan. Should the implementation of the plan involve a public distribution of the Bank's securities (including a distribution limited only to the Bank's existing shareholders), the Bank shall prepare offering materials fully describing the securities being offered, including an accurate description of the financial condition of the Bank and the circumstances giving rise to the offering, and any other material disclosures necessary to comply with the Federal securities laws. Prior to the implementation of the plan and, in any event, not less than 15 days prior to the dissemination of such materials, the plan and any materials used in the sale of the securities shall be submitted to the FDIC, Registration and Disclosure Unit, Washington, D.C. 20429, for review. Any changes requested to be made in the plan or materials by the FDIC shall be made prior to their dissemination. If the increase in Tier 1 capital is provided by the sale of noncumulative perpetual preferred stock, then all terms and conditions of the issue, including but not limited to those terms and conditions relative to interest rate and convertibility factor, shall be presented to the Regional Director and the Commissioner for prior approval.

(e) In complying with the provisions of Paragraph 3 of this ORDER, the Bank shall provide to any subscriber and/or purchaser of the Bank's securities, a written notice of any planned or existing development or other changes which are materially different from the information reflected in any offering materials used in connection with the sale of Bank securities. The written notice required by this paragraph shall be furnished within 10 days from the date such material development or change was planned or occurred, whichever is earlier, and shall be furnished to every subscriber and/or purchaser of the Bank's securities who received or was tendered the information contained in the Bank's original offering materials.

(f) For the purposes of this ORDER, the terms "Tier 1 capital" and "total assets" shall have, the meanings ascribed to them in Part 325 of the FDIC Rules and Regulations, 12 C.F.R. §§ 325.2(v) and 325.2(x).

12. Within 10 days from the effective date of this ORDER, the Bank shall increase and thereafter maintain its allowance for loan and lease losses by \$150,000.

Additionally, within 10 days from the effective date of this ORDER, the board of directors shall develop or revise, adopt and implement a comprehensive policy for determining the adequacy of the allowance for loan and lease losses. For the purpose of this determination, the adequacy of the reserve shall be determined after the charge-off of all loans or other items classified "Loss." The policy shall provide for a review of the allowance at least once each calendar quarter. Said review should be completed in order that the findings of the board of directors with respect to the loan and lease loss allowance may be properly reported in the quarterly Reports of Condition and Income. The review should focus on the results of the Bank's internal loan review, loan loss experience, trends of delinquent and non-accrual loans, an estimate of potential loss exposure of significant credits, concentrations of credit, and present

and prospective economic conditions. A deficiency in the allowance shall be remedied in the calendar quarter it is discovered, prior to submitting the Report of Condition, by a charge to current operating earnings. The minutes of the board of directors meeting at which such review is undertaken shall indicate the results of the review. Upon completion of the review, the Bank shall increase and maintain its allowance for loan and lease losses consistent with the allowance for loan and lease loss policy established. Such policy and its implementation shall be satisfactory to the Regional Director and the Commissioner as determined at subsequent examinations and/or visitations.

13. Within 30 days from the effective date of this ORDER, the Bank shall eliminate and/or correct all violations of law which are more fully set out on pages 22-26 in the FDIC's Report of Examination dated May 1, 2006. In addition, the Bank shall take all necessary steps to ensure future compliance with all applicable laws and regulations.

14. The Bank shall not pay cash dividends without the prior written consent of the Regional Director and the Commissioner.

15. Within 30 days of the end of the first quarter, following the effective date of this ORDER, and within 30 days of the end of each quarter thereafter, the Bank shall furnish written progress reports to the Regional Director and the Commissioner detailing the form and manner of any actions taken to secure compliance with this ORDER and the results thereof. Such reports shall include a copy of the Bank's Report of Condition and the Bank's Report of Income. Such reports may be discontinued when the corrections required by this ORDER have been accomplished and the Regional Director and the Commissioner have released the Bank in writing from making further reports.

This ORDER shall become effective immediately upon its issuance by the FDIC. The provisions of this ORDER shall remain effective and enforceable except to the extent that, and until such time as, any provisions of this ORDER shall have been modified, terminated, suspended, or set aside by the FDIC.

Pursuant to delegated authority.

Dated at San Francisco, California, this 18<sup>th</sup> day of December, 2006.

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John F. Carter  
Regional Director  
Division of Supervision and Consumer Protection  
San Francisco Region  
Federal Deposit Insurance Corporation