

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D.C.

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In the Matter of )	
FIRST STATE BANK )	AMENDED
CRANFORD, NEW JERSEY )	NOTICE OF CHARGES
(INSURED STATE NONMEMBER BANK) )	AND OF HEARING
_____ )	FDIC-08-166b

The Federal Deposit Insurance Corporation ("FDIC"), having reasonable cause to believe that First State Bank, Cranford, New Jersey ("Bank"), had engaged in unsafe or unsound banking practices as well as violations of law and/or regulations and based upon the findings of two successive examinations, that unless restrained, the Bank will continue to engage in such practices and violations in conducting the business of the Bank, instituted this proceeding for the purpose of determining whether an appropriate order should be issued against the Bank under the provisions of section 8(b)(1) of the Federal Deposit Insurance Act ("Act"), 12 U.S.C. § 1818(b)(1). Pursuant to the provisions of the Act, the FDIC Rules of Practice and Procedure, 12 C.F.R. Part 308, specifically, section 308.20 of FDIC Rules of Practice and Procedure, 12 C.F.R. § 308.20, the FDIC hereby amends and restates the Notice of Charges and of Hearing the FDIC issued on December 12, 2008, by filing this AMENDED NOTICE OF CHARGES AND

OF HEARING ("Amended Notice") and alleges as follows:

**JURISDICTION**

1. The Bank, a corporation existing and doing business under the laws of the State of New Jersey and having its principal place of business in Cranford, New Jersey, is and has been at all times pertinent to this proceeding, a State nonmember bank within the meaning of section 3(e)(2) of the Act, 12 U.S.C. § 1813(e)(2), and an insured depository institution within the meaning of section 3(c)(2) of the Act, 12 U.S.C. § 1813(c)(2). The Bank is therefore subject to the Act, 12 U.S.C. §§ 1811-1831aa, the Rules and Regulations of the FDIC, 12 C.F.R. Chapter III ("FDIC's Regulations"), and the laws of the State of New Jersey. The FDIC has jurisdiction over the Bank and the subject matter of this proceeding.

**OPERATIONAL DATA**

2. The Bank commenced operations on January 18, 2006.
3. In or around April of 2007 the Bank established an indirect automobile lending division ("IAL Division").
4. The IAL Division began originating indirect automobile loans ("IALs") in or around July of 2007.
5. The December 31, 2007 Consolidated Reports of Condition and Income ("Call Report") filed by the Bank reflected a Total Risk-Based Capital Ratio, as defined by section 325.2(y) of the

FDIC's Regulations, 12 C.F.R. § 325.2(y), of 9.64% placing the Bank in the "adequately capitalized" category for purposes of section 38 of the Act ("Section 38"), 12 U.S.C. § 1831o, and its implementing regulation, Subpart B of Part 325 of the FDIC's Regulations ("Part 325"), 12 C.F.R. Part 325.

6. The March 31, 2008 Call Report filed by the Bank reflected a Total Risk-Based Capital Ratio of 8.76% and the Bank remained in the Section 38/Part 325 "adequately capitalized" category.

7. The Bank was examined by the FDIC on February 18, 2008 utilizing financial information as of March 31, 2008 ("2008 Examination"). The FDIC Report of Examination reflected that as of March 31, 2008:

(a) Total deposits equaled \$169,868,000;

(b) Third-party brokered deposits, as defined in section 337.6(a)(2) of the FDIC's Rules, 12 C.F.R. § 337.6(a)(2), ("Brokered Deposits") and time deposits greater than \$100,000 totaled \$74,403,000 and comprised 44% of total deposits;

(c) Total loans and leases equaled \$165,565,000;

(d) IALs totaled \$62,649,000, of these \$11,390,000 were considered subprime and comprised 38% and 7% of total loans and leases, respectively;

(e) "Total assets", as defined in section 325.2(x) of the FDIC's Regulations equaled \$184,674,000;

(f) Average assets increased 236% since December 31, 2006;

(g) "Allowance for loans and lease losses", as defined in section 325.2(a) of the FDIC's Regulations ("ALLL"), equaled \$1,652,000;

(h) "Tier 1 or Core Capital", as defined in section 325.2(v) of the FDIC's Regulations ("Tier 1 capital"), equaled \$13,412,000 (after a \$229,000 adjustment for an inadequate ALLL);

(i) IALs comprised 467% of Tier 1 capital; subprime IALs comprised 85% of Tier 1 capital;

(j) Approximately 68% of the \$855,000 assets classified "Substandard" and all of the \$109,000 classified "Loss" were IALs; and

(k) The entire IAL portfolio was listed for "Special Mention" due in large part to deficient credit administration practices in the IAL Division.

8. The Bank ceased IAL originations in or around June 2008. The IAL portfolio totaled approximately \$85,000,000 at the time IAL originations were discontinued.

9. The June 30, 2008 Call Report filed by the Bank reflected a Total Risk-Based Capital Ratio of 9.00% and the Bank remained in the Section 38/Part 325 "adequately capitalized" category.

10. The September 30, 2008 Call Report filed by the Bank

reflected a Total Risk-Based Capital Ratio of 9.45% and the Bank remained in the Section 38/Part 325 "adequately capitalized" category.

11. The December 31, 2008 Call Report filed by the Bank reflected a Total Risk-Based Capital Ratio of 9.71% and the Bank remained in the Section 38/Part 325 "adequately capitalized" category.

12. The March 31, 2009 Call Report filed by the Bank reflected a Total Risk-Based Capital Ratio of 9.57% and the Bank remained in the Section 38/Part 325 "adequately capitalized" category.

13. The Bank was examined jointly by the FDIC and the New Jersey Department of Banking and Insurance ("DOBI") on March 30, 2009 utilizing financial information as of December 31, 2008 and as of March 31, 2009, where available ("2009 Examination"). The joint Report of Examination issued as a result of the 2009 Examination ("2009 ROE") along with the Bank's March 31, 2009 Call Report reflected that:

(a) As of December 31, 2008, total deposits equaled \$214,676,000;

(b) As of December 31, 2008, third-party Brokered Deposits and time deposits greater than \$100,000 totaled \$78,918,000 and comprised 37% of total deposits;

(c) As of March 31, 2009, third-party Brokered

Deposits and time deposits greater than \$100,000 totaled \$79,734,000 and comprised 36% of total deposits;

(d) As of December 31, 2008, total loans and leases equaled \$211,288,000;

(e) As of March 31, 2009, the IAL portfolio totaled \$67,300,000 with \$10,300,000 considered subprime and comprising 32% and 5% of total loans and leases, respectively;

(f) As of December 31, 2008, total assets equaled \$234,525,000. Much of the Bank's asset growth took place in the Bank's IAL and commercial real estate loan ("CREL") portfolios between June 30, 2007 and June 30, 2008. During this period, total assets increased by \$142,300,000 from \$86,200,000 to \$228,500,000; an increase of almost 165%. Total assets grew by \$72,812,000 just between December 31, 2007 and June 30, 2008; an increase of 46.8%. This growth was funded with high cost deposits, both certificates of deposit and money market deposit accounts, with interest rates that were more than 75 basis points over the deposit rates offered in the Bank's normal market area. The Bank attracted \$120,000,000 in certificates of deposits and almost \$13,000,000 in money market deposit accounts in this manner to fund asset growth;

(g) Between March 31, 2009 and May 28, 2009, the Bank increased total assets by another \$13,800,000. This increase, along with an outflow of \$3,400,000 in certificates of deposits,

was funded with \$14,700,000 in new money market deposit accounts with rates that were significantly higher than the deposit rates offered in the Bank's normal market area;

(h) As of December 31, 2008, average total assets equaled \$232,301,000, an increase of 57% from December 31, 2007;

(i) As of December 31, 2008, the ALLL equaled \$2,572,000 and as of March 31, 2009, the ALLL equaled \$2,680,000;

(j) As of December 31, 2008, Tier 1 Capital, equaled \$18,658,000;

(k) As of March 31, 2009, the IAL portfolio was approximately \$67,300,000 and represented 368.46% of Tier 1 capital, with the sub-prime portion comprising \$10,300,000 of it and representing 56.39 of Tier 1 capital. CRELs totaled \$85,800,000 and represented 469.75% of Tier 1 capital;

(l) Adverse classifications in the 2009 Examination represented 21.63% of Tier 1 capital plus the ALLL; adverse classifications in the 2008 Examination represented 6.30% of Tier 1 capital plus the ALLL. Substandard and Loss amounts for the 2009 Examination included \$3,450,000 and \$91,000 in commercial loans and \$747,000 and \$305,000 in IALs respectively. As of March 31, 2009, past due and nonaccrual loans represented 7.35% of total loans (compared to 3.86% at December 31, 2008 and 0.93% at March 31, 2008) and 83.78% of Tier 1 capital;

(m) Earnings from operations in 2008 resulted in a net

loss of \$1,900,000 with a return on average assets ("ROAA") of -0.90%. As of March 31, 2009, net loss totaled \$600,000 with an ROAA of -1.02%. Earnings for the first four months of 2009 resulted in a net loss of approximately \$832,000 with an approximate ROAA of -1.06%; and

(n) The Bank's net interest margin ("NIM") at year end 2008 was 2.83% and low compared to the Bank's peer group which had a NIM of 3.34%. As of March 31, 2009, the Bank's NIM was 2.43%; its peer group had a NIM of 3.07%.

#### **UNSAFE AND/OR UNSOUND PRACTICES**

14. The Bank has engaged in unsafe and unsound banking practices in that the Bank has been operating without effective oversight by the Bank's board of directors and without adequate supervision by management. These inadequacies include, but are not limited to:

(a) Establishing the IAL Division without adequate planning and revision of the Bank's business/strategic plan and financial forecasts;

(b) Establishing and operating the IAL Division without appropriately considering and monitoring the IAL Division's impact on the Bank's capital, earnings, liquidity and funds management;

(c) Rapidly increasing the IAL and CREL portfolios



with a flawed asset funding plan and without appropriately monitoring the growth of these portfolios and the resulting impact on the Bank's capital, earnings, liquidity and funds management;

(d) Operating the Bank with an inadequate level of capital in relation to the volume, growth, quality and risk of assets and liabilities held by the Bank;

(e) Operating the Bank in a manner which generates earnings that are inadequate to fund growth, support operations and augment capital;

(f) Operating the Bank with inadequate net interest margins;

(g) Operating the Bank with a heavy reliance on short-term, potentially volatile deposits as a source for funding longer-term assets;

(h) Operating the Bank with inadequate liquidity in relation to the volume, growth, quality and risk of liabilities held by the Bank;

(i) Operating the Bank without proper regard for asset/liability and funds management processes in relation to the volume, growth, quality and risk of assets and liabilities held by the Bank;

(j) Operating the Bank without a well-defined contingency funding plan; and

(k) Operating the Bank with an increasing and unsatisfactory level of delinquent and/or adversely classified loans.

15. The Bank has engaged in unsafe and unsound banking practices in that the Bank has been operating with an inadequate level of capital in relation to the volume, growth, quality and risk of assets and liabilities held by the Bank.

16. The Bank has engaged in unsafe and unsound banking practices in that the Bank has been operating in a manner which generates earnings that are inadequate to fund growth, support operations and augment capital.

17. The Bank has engaged in unsafe and unsound banking practices in that the Bank has been operating with inadequate net interest margins.

18. The Bank has engaged in unsafe and unsound banking practices in that the Bank has been operating with a heavy reliance on short-term, potentially volatile deposits as a source for funding longer-term assets.

19. The Bank has engaged in unsafe and unsound banking practices in that the Bank has been operating with inadequate liquidity in relation to the volume, growth, quality and risk of liabilities held by the Bank.

20. The Bank has engaged in unsafe and unsound banking practices in that the Bank has been operating without proper

regard for asset/liability and funds management processes in relation to the volume, growth, quality and risk of assets and liabilities held by the Bank.

21. The Bank has engaged in unsafe and unsound banking practices in that the Bank has been operating with an increasing and unsatisfactory level of delinquent and/or adversely classified loans.

#### **VIOLATIONS OF LAW AND/OR REGULATIONS**

22. Brokered Deposits: The Bank has been operating in violation of section 29 of the Act, 12 U.S.C. § 1831f, as implemented by section 337.6 of the FDIC's Regulations ("Section 337.6"), 12 C.F.R. § 337.6, which prohibits an insured depository institution that is "adequately capitalized" for Section 38 purposes from accepting funds obtained from a deposit broker. As the Bank's Section 38/Part 325 capital category has been "adequately capitalized" at all times pertinent to this proceeding and it solicited and accepted deposits with interest rates that were significantly higher than the prevailing rates offered by other insured depository institutions in its normal market area while in this capital category, the Bank is a "deposit broker" as defined by Section 337.6, specifically subparagraph (a)(5)(iii), and all of the deposits solicited in this manner are Brokered Deposits. The Bank, therefore, has been

operating in violation of Section 337.6.

23. Call Reports: The Bank has been operating in violation of section 304.3 of the FDIC's Regulations, 12 C.F.R. § 304.3, which requires the Bank to file Call Reports in accordance with Call Report instructions. Call Reports are used by the FDIC to, among other things, monitor the condition, performance and risk profile of an individual bank and the banking industry as a whole. Specifically, the Bank repeatedly failed to comply with Call Report instructions and report deposits bearing interest rates that were more than 75 basis points over the rates offered in its normal market area that it solicited and accepted while in the Section 38/Part 325 "adequately capitalized" category as Brokered Deposits as required. Not one of the Call Reports filed by the Bank during the time periods pertinent to this proceeding included and accurately reflected the Bank's Brokered Deposits.

24. Temporary Liquidity Guarantee Program ("TLGP"): The Bank has been operating in violation of section 370.5(h) of the FDIC's Regulations, 12 C.F.R. § 370.5(h), which requires an insured depository institution offering noninterest-bearing transaction accounts to post a prominent notice in the lobby of its main office, each domestic branch and on its website if it offers Internet deposit services clearly indicating whether the institution is participating in the TLGP's transaction account guarantee program and if so that the funds held in the noninterest-bearing transactions accounts are guaranteed in full by the FDIC. Although the Bank is participating in the TLGP's transaction account guarantee program, the notice posted in its lobby fails to appropriately reflect its participation in the program or that funds held in noninterest-bearing transactions accounts are guaranteed in full by the FDIC. Additionally, the Bank failed to post any disclosures relating to the TLGP's transaction account guarantee program on its website.

#### **NOTICE OF HEARING**

25. Notice is hereby given that a hearing will be held in either Essex or Union County, New Jersey, the exact location of which will be set by the subsequent order of the Honorable C. Richard Miserendino, the Administrative Law Judge assigned by the Office of Financial Institution Adjudication pursuant to 5 U.S.C.

§ 3105, as noted in the February 13, 2009 *Scheduling Order*. As also noted in the February 13, 2009 *Scheduling Order*, the hearing will commence on October 5, 2009 or such other time as may be set by Judge Miserendino by subsequent order for the purpose of taking evidence on the charges specified above and determining whether an Order should be issued under the Act requiring the Bank to: (1) cease and desist from the unsafe or unsound banking practices and violations of law and/or regulation herein specified; and/or (2) take affirmative action to correct the conditions resulting from such practices and violations.

26. The hearing will be public, unless the FDIC shall determine that an open hearing would be contrary to the public interest, and in all respects will be conducted in compliance with the provisions of the Act and Part 308 of the FDIC's Regulations.

27. The Bank is hereby directed to file an Answer to this Amended Notice in accordance with the *Order Compelling Production of Documents and Status Conference Order* issued by Judge Miserendino on July 16, 2009 and Part 308 of the FDIC's Regulations, 12 C.F.R. Part 308.

28. Pursuant to section 308.10(b)(4) of the FDIC's Regulations, 12 C.F.R. § 308.10(b)(4), all documents required to be filed, excluding documents produced in response to a discovery request pursuant to sections 308.25 and 308.26 of the FDIC's

Regulations, 12 C.F.R. §§ 308.25 and 308.26, shall be filed electronically with the Office of Financial Institution Adjudication via electronic mail at [ofia@fdic.gov](mailto:ofia@fdic.gov), and shall be served upon opposing counsel (Wendy L. Markee, Counsel at [wmarkee@fdic.gov](mailto:wmarkee@fdic.gov); Carl J. Gold, Counsel at [cgold@fdic.gov](mailto:cgold@fdic.gov); Stephen L. Rodgers, Acting Regional Counsel (Supervision) at [srodgers@fdic.gov](mailto:srodgers@fdic.gov); and Ramona J. Nicholson, Senior Regional Attorney at [ranicholson@fdic.gov](mailto:ranicholson@fdic.gov).) in accordance with section 308.11 of the FDIC's Regulations, 12 C.F.R. § 308.11, as instructed in the December 19, 2008 *Notice of Designation and Order Requiring Electronic Filing*, and shall also be served electronically upon the Office of the Executive Secretary, Federal Deposit Insurance Corporation, Valerie J. Best, Assistant Executive Secretary and A.T. Dill, Assistant General Counsel at [chammond@fdic.gov](mailto:chammond@fdic.gov); [vbest@fdic.gov](mailto:vbest@fdic.gov); and [adill@fdic.gov](mailto:adill@fdic.gov).

Pursuant to delegated authority.

Dated at New York, New York, this 22<sup>nd</sup> day of July, 2009.

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/s/  
John M. Lane  
Acting Regional Director

**CERTIFICATE OF SERVICE**

The undersigned certifies that on July 22, 2009, the foregoing Amended Notice of Charges and of Hearing along with the proposed Order to Cease and Desist was served by electronic mail upon the following persons:

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