

FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON, D.C.

In the Matter of)
VENTURE BANK)
LACEY, WASHINGTON)
(INSURED STATE NONMEMBER BANK))
AMENDED
NOTICE OF CHARGES
AND OF HEARING
FDIC-08-394b

The Federal Deposit Insurance Corporation ("FDIC"), having reasonable cause to believe that Venture Bank, Lacey, Washington ("Bank"), has engaged in unsafe or unsound banking practices, and, unless restrained, will continue to engage in such practices in conducting the business of the Bank, hereby institutes 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). The FDIC issues this NOTICE OF CHARGES AND OF HEARING ("NOTICE") pursuant to the provisions of the Act and the FDIC Rules of Practice and Procedures, 12 C.F.R. Part 308, and alleges as follows:

JURISDICTION AND DEFINITIONS

1. The Bank is a corporation existing and doing business under the laws of the State of Washington and has its principal place of business at Lacey, Washington. The Bank 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), an insured depository institution within the meaning of section 3(c)(2) of the Act, 12 U.S.C. § 1813(c)(2), and subject to the Act, 12 U.S.C. §§ 1811-1831aa, the Rules and Regulations of the FDIC, 12 C.F.R. Chapter III (“Rules”), and

the laws of the State of Washington. The FDIC has jurisdiction over the Bank and the subject matter of this proceeding.

SEPTEMBER 22, 2008 EXAMINATION

2. The Bank was examined by examiners from the FDIC and the State of Washington starting September 22, 2008, utilizing financial information as of June 30, 2008 (“Examination”):

- (a) The Bank’s total deposits equaled \$916,882,000;
- (b) The Bank’s total loans and leases equaled \$818,032,000;
- (c) The Bank’s “total assets”, as defined in section 325.2(x) of the Rules (“total assets”), equaled \$1,223,658,000;
- (d) The Bank’s “Tier 1 or Core Capital”, as defined in section 325.2(v) of the Rules (“Tier 1 Capital”), equaled \$56,041,000 after incorporating the findings of the Examination; and
- (e) The Bank’s “allowance for loan and lease losses”, as defined in section 325.2(a) of the Rules (“ALLL”), equaled \$13,267,000.

UNSAFE OR UNSOUND PRACTICES

Asset Quality

3. The Bank has engaged in unsafe and unsound banking practices in that it has invested in high risk securities that have depleted capital, including the following:

- (a) The Bank invested \$42.3 million in Federal National Mortgage Association (“FNMA” or “Fannie Mae”) and Federal Home Loan Mortgage Corporation (“FHLMC” or “Freddie Mac”) preferred stock for which the Bank recognized a \$40.1 million impairment when Fannie Mae and Freddie Mac were placed in conservatorship;

(b) The Bank invested \$42.7 million in two issues of Alesco Funding Preferred Trust Collateralized Debt Obligations (“CDOs”). The value of these securities has severely depreciated due to distressed market conditions. The Bank had not adequately evaluated these securities at the time of purchase nor analyzed for impairment prior to the Examination;

(c) The Fannie Mae and Freddie Mac stock has been classified loss for their impairment with the balance classified substandard; the CDOs have been classified substandard.

(d) The classifications of the FNMA and FHLMC preferred stock and the Alesco Funding CDOs represented 95 percent of the Bank’s Tier 1 capital as of the Examination.

4. The Bank has engaged in unsafe or unsound banking practices in that it has engaged in hazardous lending policies and practices, including the following:

(a) The Bank has engaged in excessive loan concentrations in real estate acquisition, development and construction (“ADC”) loans, which, including non-funded loan commitments, represented 470 percent of the Bank’s total capital as of the Examination. The Bank’s ADC concentration is one of the highest in the State of Washington and surpasses 98 percent of the banks and thrifts in the nation;

(b) The Bank has operated with an inadequate system to monitor the risks associated the excessive levels of ADC concentrations, including failure to implement stress testing despite recommendations at previous examinations;

(c) The Bank has failed to operate within its own lending guidelines pertaining to ADC concentrations; and

(d) A total of \$121 million in loans have been adversely classified and represented 118 percent of Tier 1 capital and reserves as of the Examination.

5. As a result of the Bank's hazardous lending practices and investment in high risk securities described above:

- (a) The Bank's total adversely classified assets equaled \$209,852,000 as of the Examination, compared to only \$8,199,000 at the last FDIC examination in 2007, representing an increase in dollar volume of over 2,450 percent;
- (b) The Bank's total adversely classified assets at the Examination equaled 195.30 percent of the Bank's Tier 1 capital plus the ALLL and 17.15 percent of total assets; and
- (c) As of the Examination, the Bank's past due and non-accrual loans and leases represented 5.07 percent of total loans and leases. By December 31, 2008, as evidenced by the Bank's Reports of Condition and Income ("Call Report") as of that date, this figure had increased to 13.23 percent.

Liquidity

6. The Bank has engaged in unsafe or unsound practices by operating with inadequate liquidity in relation to the volume, kind and quality of assets held by the Bank, as evidenced by the following:

- (a) The Bank's long term liquidity prospects are poor unless capital and asset quality problems are corrected;
- (b) To support asset growth and meet its liquidity needs, the Bank has increasingly relied on non-core funding sources such as brokered deposits, which reached 39 percent of total deposits by September 2008. By October 31, 2008, approximately 50 percent of total deposits consisted of brokered and Internet deposits and high-rate retail deposits;
- (c) The Bank's ability to offer brokered deposits and high-rate retail deposits became severely restricted when it became "undercapitalized" pursuant to 12 C.F.R. section 325.103(b)(3) when it filed the September 30, 2008 Call Report.

(d) Bank management did not fully comply with the interest rate restrictions applicable to the Bank pursuant to 12 C.F.R. section 337.6; as of October 24, 2008, the Bank was still offering Internet Money Market Accounts with the fourth highest rate listed on Bankrate.com;

(e) Liquidity is declining due to the depreciation in the securities and loan portfolios; there is little potential for liquidation of balance sheet assets without negatively impacting capital; and

(f) The Bank's borrowing capacity continues to decline due to the cancellation of its inter-bank Federal fund lines, its decreased capital, the depreciating value of the collateral that can be pledged, and the Federal Home Loan Bank's ("FHLB") decision to require physical possession of collateral documents and case-by case approval for advances as conditions to lending to the Bank, which has significantly reduced the Bank's borrowing capacity.

Earnings

7. The Bank has engaged in unsafe or unsound practices in that it has operated with unsatisfactory earnings, as evidenced by the following:

(a) The Examination revealed that, on a pre-tax basis, an additional \$56 million were needed to increase the Bank's ALLL. If such reserve provision and other direct losses identified at the Examination were properly reflected in the June 30, 2008 quarterly results, the Bank's Return on Assets ("ROA") would have declined to a negative 5.42 percent;

(b) The Examination found that the Bank's methodology for determining the adequacy of the ALLL was flawed. As a result, the ALLL is underfunded by \$13 million;

(c) The Bank made a \$10.4 million provision in the ALLL during the third quarter of 2008 as a result of the Examination. The Bank only made a \$1.5 million provision in

the ALLL during the further quarter of 2008 despite a continued deterioration in the loan portfolio; and

(d) The Bank reported a net operating loss of \$22,666,000 or an annualized negative ROA of 1.93 percent for the year of 2008.

Capital

8. The Bank has engaged in unsafe or unsound practices in that it has maintained inadequate capital in relation to the Bank's risk profile as follows:

(a) As of September 30, 2008, the Bank's Tier 1 leverage capital ratio was 5.60 percent, representing a substantial decrease from its 8.19 Tier 1 capital ratio as of the previous Examination;

(b) The Bank's total risk-based capital ratio has declined over the past three examinations from 10.70 percent as of the March 31, 2006 Report of Examination to 7.79 percent as of September 30, 2008;

(c) As of September 30, 2008, the Bank became "undercapitalized" pursuant to 12 C.F.R. section 325.103(b)(3); and

(d) The Bank has not submitted an acceptable capital restoration plan as required.

Management

9. The Bank has engaged in unsafe or unsound practices by operating with management whose policies and practices are detrimental to the Bank and jeopardize the safety of the Bank's deposits as described above.

10. The Bank's board of directors has engaged in unsafe or unsound practices by failing to provide adequate supervision over and direction to the active officers of the Bank to prevent the unsafe or unsound banking practices described above.

JANUARY 22, 2009 VISITATION

11. The Bank was examined by examiners from the FDIC starting on January 22, 2009 (“January Visitation”); the scope of the January Visitation was, among others, to evaluate the CDOs, determine the extent of their impairment, identify a reasonable valuation method, and assess whether the CDOs were other than temporarily impaired (“OTTI.”)

12. The Bank has received copy of the Report of Visitation for the January Visitation.

UNSAFE OR UNSOUND PRACTICES

Asset Quality

13. The Bank has engaged in unsafe and unsound banking practices in that it has concentrated investments in the CDOs, including the following:

- (a) Management did not document its analysis or support for its due diligence prior to acquisition of the CDOs, for example, management was unaware that included in the CDOs was debt issued by entities that issue credit default swaps;
- (b) Since acquisition of the CDOs, the underlying collateral has performed poorly;
- (c) The CDOs were downgraded by Moody's to Ba2 in August 2008; this is a sub-investment grade rating;
- (d) Management's identifying, monitoring and measurement of critical performance factors for the CDOs has been weak; and
- (e) Management has failed to recognize that the CDOs are OTTI.

14. Recognizing that the CDOs are OTTI would result in a \$36,326,000 loss that would bring the Bank's capital category to significantly undercapitalized for Prompt Corrective Act purposes.

15. The Bank's capital ratios adjusted for OTTI in the CDOs would result in a Tier 1 leverage capital ratio of 2.71 percent and a total risk based capital ratio of 4.50 percent.

16. On May 11, 2009, the Bank filed an appeal of Material Supervisory Determinations in the January Visitation. Specifically, the Bank appealed, among other things, the determination that the CDOs were OTTI in the amount of \$36,326,000 and the valuation method used to price the CDOs.

17. The Bank's appeal of the Material Supervisory Determinations was resolved and the Bank was notified on July 27, 2009. The final determination was that the CDOs are subject to OTTI with a split classification between doubtful and loss and should be written down to the Bank's fair value estimate of 42 cents on the dollar as originally reported on the Bank's December 31, 2008 Call Report with the remaining adversely classified as doubtful.

18. On August 26, 2009, the Bank appealed to the Supervision Appeals Review Committee.

JUNE 15, 2009 VISITATION

19. The Bank was examined by examiners from the FDIC starting June 15, 2009, utilizing financial information as of March 31, 2009 ("June Visitation") with a primary focus on the loan portfolio and other real estate owned ("OREO"):

- (a) The Bank has received copy of the Report of Visitation for the June Visitation and the findings have been discussed with its board of directors;
- (b) The Bank's total deposits equaled \$1,010,793,000;
- (c) The Bank's total loans and leases equaled \$730,573,000;
- (d) The Bank's total assets equaled \$1,097,263,000; and
- (e) The Bank's Tier 1 Capital equaled \$29,517,000 after incorporating the findings of the June Visitation.

UNSAFE OR UNSOUND PRACTICES

Asset Quality

20. The Bank has engaged in unsafe or unsound banking practices in that it has engaged in hazardous lending policies and practices, including the following:

- (a) The Bank fails to follow its Loan Policy for obtaining updated property appraisals for real estate collateralized loans or for the acquisition of other real estate. Of the loans reviewed during the June Visitation, 48 percent had appraisals older than 2008 and approximately 83 percent had appraisals dated prior to October 1, 2008;
- (b) The Bank has continued to operate with an inadequate system to monitor the risks in its loan portfolio; and
- (c) The Bank's March 31, 2009 Call Report of \$346,000 in troubled debt restructures is significantly understated; a more accurate estimate is \$5 million.

21. As a result of the Bank's hazardous lending and credit administration practices:

- (a) The Bank's total adversely classified loans and OREO equaled \$248,129,000 as of the June Visitation, compared to \$124,789,000 in adversely classified loans and OREO at the Examination, representing an increase in dollar volume of over 98.8 percent;
- (b) The Bank's total adversely classified loans and OREO at the June Visitation equaled 323.5 percent of the Bank's Tier 1 capital plus the ALLL and 22.7 percent of total assets. These asset quality measures do not include investment securities as they were not part of the scope of the June Visitation;
- (c) As of the Examination, the Bank's past due and non-accrual loans and leases represented 5.07 percent of total loans and leases. By March 31, 2009, as evidenced by the Call Report as of that date, this figure had increased to 17.77 percent; and

(d) The Bank has been operating in contravention of the Interagency Policy Statement on the Allowance for Loan and Lease Losses; the Interagency Guidelines for Real Estate Lending, Appendix A to Part 365, 12 C.F.R. 365; and the Interagency Guidelines Establishing Standards for Safety and Soundness, Appendix A to Part 364, 12 C.F.R. 364.

Earnings

22. The Bank has engaged in unsafe or unsound practices in that it has operated with unsatisfactory earnings, as evidenced by the following:

(a) The June Visitation revealed that, at a minimum, an additional \$19,200,000 was needed to increase the Bank's ALLL to \$38,800,000. If such reserve provision and other direct losses identified at the June Visitation were properly reflected in the March 31, 2009 quarterly results, the Bank should have reported a net loss of \$16,670,000;

(b) The June Visitation found that the Bank's methodology for determining the adequacy of the ALLL was flawed, in part due to its failure to timely obtain appraisals for real estate collateralized loans and OREO; and

(c) At its initial Call Report filing for June 30, 2009, the Bank reported a year-to-date net operating loss of \$3,510,000 or an annualized negative ROA of 0.65. However, this does not include the findings of the June Visitation that would require additional provision to the ALLL, resulting in higher operating losses to be reported.

Capital

23. The Bank has engaged in unsafe or unsound practices in that it has maintained inadequate capital in relation to the Bank's risk profile as follows:

(a) As of the date of the June Visitation, the Bank's Tier 1 leverage capital ratio was 3.14 percent, representing a substantial decrease from its 5.60 Tier 1 capital ratio as of the Examination;

(b) The Bank's total risk-based capital ratio has declined over the past three examinations from 10.70 percent as of the March 31, 2006 Report of Examination to 7.79 percent as of the Examination to 4.50 percent as of the June Visitation;

(c) When the capital ratios are adjusted for the most recent information (excluding the CDOs, which were outside the scope of the June Visitation), the Tier 1 leverage capital ratio should be 2.69 percent and the total risk-based capital ratio should be 4.09 percent;

(d) Based on the June Visitation findings, the Bank became "significantly undercapitalized" for Prompt Corrective Act purposes;

(e) If the Bank recognized the OTTI of the CDOs, which was outside the scope of the June Visitation, its capital would be further reduced to critically deficient levels; and

(f) The Bank has not submitted an acceptable capital restoration plan as required.

Notice and Hearing

24. Notice is hereby given that a hearing will be held at Seattle, Washington, commencing 60 days from the date of service of this NOTICE on the Bank, or on such other date as may be set by the Administrative Law Judge appointed to hear this matter, for the purpose of taking evidence on the above-mentioned charges in order to determine whether an order should be issued under the Act requiring the Bank: (1) to cease and desist from the unsafe or unsound banking practices herein specified; and (2) to take affirmative action to correct the conditions resulting from such practices.

25. The hearing referred to in paragraph 11 will be held before an Administrative Law Judge to be assigned by the Office of Financial Institution Adjudication pursuant to 5 U.S.C. § 3105. The hearing will be public, and in all respects will be conducted in compliance with the provisions of the Act and the FDIC Rules of Practice and Procedure.

26. The Bank is hereby directed to file an Answer to this NOTICE within 20 days from the date of service of this NOTICE on the Bank, as provided by section 308.19 of the FDIC's Rules of Practice and Procedure, 12 C.F.R. § 308.19. An original and one copy of all papers filed in this proceeding shall be served upon the Office of Financial Institution Adjudication, 3501 N. Fairfax Dr., Office VS-D-8116, Arlington, VA, 22226-3500, pursuant to section 308.10 of the FDIC's Rules of Practice and Procedure, 12 C.F.R. § 308.10. Copies of all papers filed in this proceeding shall be served upon the Executive Secretary, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429-9990; A. T. Dill, III, Assistant General Counsel, Legal Division, Enforcement Unit; Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D. C. 20429-9990; and upon Joseph J. Sano, Regional Counsel, San Francisco Regional Office, Federal Deposit Insurance Corporation, 25 Jessie Street at Ecker Square, Suite 1400, San Francisco, California 94105.

Pursuant to delegated authority.

Dated this 31st day of August, 2009.

/s/
Stan Ivie
Regional Director
Division of Supervision and Consumer Protection
San Francisco Region
Federal Deposit Insurance Corporation