

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D.C.

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In the Matter of	)	
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BALBOA THRIFT AND LOAN	)	NOTICE OF CHARGES
ASSOCIATION	)	AND OF HEARING
CHULA VISTA, CALIFORNIA	)	
	)	FDIC-09-531b
	)	
(INSURED STATE NONMEMBER BANK)	)	
	)	
_____	)	

The Federal Deposit Insurance Corporation (“FDIC”), having reasonable cause to believe that Balboa Thrift and Loan Association, Chula Vista, California (“Thrift”), has engaged in unsafe or unsound banking practices and, unless restrained, will continue to engage in such practices in conducting the business of the Thrift, hereby institutes this proceeding for the purpose of determining whether an appropriate order should be issued against the Thrift 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 Thrift is a corporation existing and doing business under the laws of the State of California and has its principal place of business at Chula Vista, California. The Thrift 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 California. The FDIC has jurisdiction over the Thrift and the subject matter of this proceeding.

2. The Thrift was examined by examiners from the FDIC starting March 2, 2009, utilizing financial information as of December 31, 2008 (“Examination”):

- (a) The Thrift’s total deposits equaled \$189,689,000;
- (b) The Thrift’s total loans and leases equaled \$193,692,00;
- (c) The Thrift’s “total assets”, as defined in section 325.2(x) of the Rules (“total assets”), equaled \$205,263,000;
- (d) The Thrift’s “Tier 1 or Core Capital”, as defined in section 325.2(v) of the Rules (“Tier 1 Capital”), equaled \$18,035,000 after incorporating the findings of the Examination; and
- (e) The Thrift’s “allowance for loan and lease losses”, as defined in section 325.2(a) of the Rules (“ALLL”), equaled \$4,908,000.

### **UNSAFE OR UNSOUND PRACTICES**

#### **Management**

3. The Thrift has engaged in unsafe or unsound practices by operating with management whose policies and practices are detrimental to the Thrift and jeopardize the safety of the Thrift’s deposits. Management’s unsafe and unsound practices, include, but are not limited to, operating the Thrift:

- (a) without providing formal guidelines for modifying and restructuring loans, thus increasing the risk in the loan portfolio;

- (b) without complying with Generally Accepted Accounting Practices (“GAAP”) and regulatory reporting requirements for restructured troubled debt and loans delinquent for over 120 days where full recovery is not expected;
- (c) without having properly controlled the risk in the portfolio or managed operational risk through independent reviews;
- (d) with deficient policies and procedures in the areas of loan concentrations, ALLL, liquidity, capital maintenance and subprime loans;
- (e) with deficient credit administration, stress testing and liquidity contingency planning;
- (f) resisting the adoption of regulatory recommendations and avoiding compliance with current and previous examination recommendations; and
- (g) in contravention of regulatory policy.

4. The Thrift’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 Thrift to prevent the unsafe or unsound banking practices. The board of directors’ unsafe and unsound practices include, but are not limited, to:

- (a) failing to meet more frequently than once per quarter despite the deterioration in the condition of the Thrift; and
- (b) having brief board minutes that do not accurately describe the discussions undertaken.

**Asset Quality**

5. The Thrift has engaged in unsafe and unsound banking practices in that it has unsatisfactory asset quality as follows:

(a) Adversely classified assets have increased from \$1,805,000, or 8 percent of Tier 1 Capital and the ALLL, at the September 4, 2007 California Department of Financial Institutions examination to \$14,117,876 or 62 percent of Tier 1 Capital and the ALLL; and

(b) Adversely classified loans include \$630,000 in loans classified as Loss based on a review of specific credits in a sampling of consumer loans 31 to 89 days past due and larger real estate credits.

6. The Thrift has engaged in unsafe and unsound banking practices in that losses have not been identified and recognized in a timely manner or in accordance with FDIC's Uniform Retail Credit Classification and Account Management Policy resulting in an under-reporting of loan losses. The aggressive use of loan restructurings and loan modifications has further understated the level of delinquencies and losses.

(a) The volume of restructured credits has grown significantly to \$6,500,000 or nearly 4 percent of all consumer loans. The Thrift's policy governing loan restructures lacks the necessary controls and guidelines or appropriate policies and practices, thus increasing the Thrift's risk profile; and

(b) The Thrift has artificially reduced delinquencies by backdating the modification dates on several loans, and using extensions to push forward payment due dates in others.

7. The Thrift's ALLL methodology is not appropriate and does not comply with the Interagency Policy Statement on the ALLL. The ALLL is underfunded by at least \$1,300,000.

8. The Thrift has engaged in unsafe and unsound banking practices in that proper accounting procedures for repossessed assets have not been followed. Specifically, the Thrift has:

(a) Failed to charge-off through the ALLL the loan balances exceeding the fair value of the collateral received at the time of repossession;

(b) Provided insufficient allocation to the ALLL for the expected losses; and

(c) Failed to obtain accurate and realistic wholesale collateral values.

9. The Thrift has engaged in unsafe and unsound banking practices in that subprime consumer loans represent 68 percent of the total consumer loan portfolio and 493 percent of Tier 1 Capital and the ALLL. The Thrift has not adequately monitored and controlled the subprime concentration risk. The Thrift's reporting and monitoring of the subprime consumer loan portfolio is overly simplistic and lacks adequate metrics for analysis.

### **Capital**

10. The Thrift has engaged in unsafe or unsound banking practices in that it has allowed capital levels to fall to less than satisfactory levels for the Thrift's risk profile. The Total Risk-Based Capital ratio has declined from 11.70 percent at year end 2005 to 10.45 percent at year end 2008.

11. The 2001 Interagency Expanded Guidance on Subprime Lending Programs requires a capital shock test to determine if additional capital is necessary to cover the higher risk associated with the subprime loan portfolio. The Thrift has engaged in unsafe and unsound banking practices in that its capital shock test is deficient because:

(a) It does not shock test all subprime loans in the portfolio; and

(b) The Thrift has not responded in an appropriate and timely manner to the results of the capital shock testing process.

### Liquidity

12. The Thrift 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 Thrift, as evidenced by the following:

- (a) The Thrift has increasingly relied on Certificates of Deposit (“CDs”) which constituted 93 percent of total liabilities.
- (b) The Thrift has an excessive level of brokered deposits;
- (c) The Net Non-Core Funding Dependency ratio was 40 percent, the maximum allowed by policy;
- (d) The Thrift’s does not have sufficient existing external sources of liquidity;
- (e) In spite of its low levels of liquidity, the Thrift’s only formal liquidity monitoring consists of monthly liquidity calculations presented at quarterly meetings of the Thrift’s board of directors; and
- (f) The Thrift lacks a Contingency Funding Plan that incorporates events that could rapidly affect its liquidity.

### Earnings

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

- (a) The Thrift posted net income of \$179,000 for a low year-end 2008 Return on Assets (ROA) of 0.09 percent, however, net income for 2008 is overstated, as the ALLL was found to be deficient during the FDIC’s examination;
- (b) The FDIC’s examination revealed that an additional \$1,300,000 are needed to increase the Thrift’s ALLL;

(c) The Thrift reported a ROA of 0.37 percent for the first six months of 2009; and

(d) The Loss Ratio, which is the ratio of net loan losses as a percent of average total loans, has risen steadily during the last three years going from 1.41 percent in 2006, to 1.97 percent in 2007 to 2.78 percent in 2008.

14. The Thrift has engaged in unsafe and unsound banking practices in that its 2009 budget projections are not appropriate due to the trend of growing loan losses and the rising volume of delinquent loans and repossessions every month.

**Notice and Hearing**

15. Notice is hereby given that a hearing will be held at San Diego, California, commencing 60 days from the date of service of this NOTICE on the Thrift, 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 Thrift: (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.

16. The hearing referred to in paragraph 15 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.

17. The Thrift is hereby directed to file an Answer to this NOTICE within 20 days from the date of service of this NOTICE on the Thrift, 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 15th day of December, 2009.

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