OFFICE OF THRIFT SUPERVISION

Receivership of a Federal Savings Bank

Date: February 19, 2010
Order No.: 2010-09
Docket No.: 08247

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 La Jolla Bank, La Jolla, California (Savings Bank).

GROUNDS FOR APPOINTMENT OF FDIC AS RECEIVER FOR THE SAVINGS BANK

The Acting Director, or his designee, based on 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 is undercapitalized, as defined in section 38(b) of the Federal Deposit Insurance Act (FDIA), and has no reasonable prospect of becoming adequately capitalized;

(iii) The Savings Bank is critically undercapitalized; and

(iv) The Savings Bank has substantially insufficient capital.

The Savings Bank is a federally chartered savings bank, the accounts of which are insured by the DIF. The Savings Bank's home office is in La Jolla, California. The Savings Bank is wholly owned by La Jolla Bancorp, Inc.

As of December 31, 2009, the Savings Bank's Thrift Financial Report (TFR) reported approximately \$3.646 billion in assets, approximately \$3.618 billion in liabilities, approximately \$28.51 million in stockholders' equity, and a net loss for the twelve months ended December 31, 2009, of approximately \$253.88 million. At December 31, 2009, the Savings Bank reported tangible, tier one (core), tier one risk-based, and total risk-based capital ratios of 0.67 percent, 0.67 percent, 0.90 percent, and 1.79 percent, respectively. The Savings Bank's December 31, 2009, TFR indicates that the Savings Bank is "critically undercapitalized" pursuant to OTS's Prompt Corrective Action (PCA) regulation, 12 C.F.R. Part 565. The Savings Bank historically originated multifamily and non-residential mortgage loans. More recently, the Savings Bank has engaged in nonresidential real estate, construction and lending for the purpose of land acquisition and development.

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 OTS may appoint a receiver for any insured savings association if OTS determines that one or more grounds specified in section 11(c)(5) of the Federal Deposit Insurance Act (FDIA), 12 U.S.C. § 1821(c)(5), exist.

Unsafe or Unsound Condition to Transact Business

Under section 11(c)(5)(C), OTS may appoint a receiver for a savings association if a savings association is in an unsafe and unsound condition to transact business. An unsafe or unsound condition has been identified as one where an institution is operated in a manner that causes an unacceptable risk to its depositors' funds. See Franklin Savings Association v. Director, OTS, 934 F.2d 1127, 1145 (10th Cir. 1991), cert. denied, 503 U.S. 937 (1992).

At December 31, 2009, the Savings Bank reported tangible, tier one (core), tier one risk-based, and total risk-based capital of 0.67 percent, 0.67 percent, 0.90 percent, and 1.79 percent, respectively. The Savings Bank's December 31, 2009 TFR indicates that the Savings Bank is critically undercapitalized. The Savings Bank experienced a net loss for the fiscal year ended December 31, 2009, of approximately $253.88 million, which losses have depleted its equity and regulatory capital.

The Institution's nonperforming loans have increased from approximately $70.36 million (1.85 percent of total assets) at December 31, 2008, to approximately $739.83 million (20.29 percent of total assets) at December 31, 2009. In addition, the Institution's classified assets have increased from approximately $66.63 million (1.75 percent of total assets) at December 31, 2008, to approximately $858.56 million (23.55 percent of total assets) at December 31, 2009.

The Savings Bank has engaged in nonresidential real estate, construction and lending for the purpose of land acquisition and development. The Savings Bank's operations have suffered due to significant underwriting, loan policies and procedures, and credit administration deficiencies. On certain higher-risk loans, borrowers contributed little cash equity and the Savings Bank permitted seller carryback loans and other forms of subordinate financing. In many of the larger lending relationships, management relied upon its knowledge of the borrower and on the borrower's stated net worth rather than on updated documentation of the borrower's current financial condition.

Loan modifications were not well documented or prudently underwritten. Numerous loan modifications and extensions were used to support borrowers and declining collateral values on the land loan portfolio. In many instances, the modifications and extensions provided additional interest reserves. For a number of the larger multiple-loan borrower relationships, the Savings Bank granted additional extensions of credit through commercial lines of credit that were used to make payments on land and construction loans. OTS examiners also found outdated appraisals and a significant violation of loans-to-one-borrower limits.

In addition, the Savings Bank's Internal Asset Review (IAR) department did not have the independence, staffing or expertise necessary to properly evaluate the effectiveness of the Savings Bank's loan polices, procedures and internal controls, or to appropriately assess the credit quality of the portfolio. There was minimal review of land, construction or complex commercial real estate loans, despite such loans representing a significant, higher-risk concentration of loans. Accordingly, the reported levels of classifications through the third quarter of 2009 understated the deteriorating condition of the assets as well as the levels of reserves necessary to address those deficiencies. Additional declines in asset values are likely, thereby further depleting capital and jeopardizing the Savings Bank's operations.

As a result of an internal investigation, in July 2009, the Savings Bank's audit committee became aware of potential self-dealing and other misconduct by certain of the Savings Bank's officers. The Savings Bank's board of directors failed to act in a timely manner when presented with significant evidence of malfeasance, thereby exposing the Savings Bank to the potential for continued misconduct by the subjects of the investigation.

Therefore, the Acting Director, or his designee, concludes that the Savings Bank is in an unsafe and unsound condition to transact business.

Undercapitalized and No Reasonable Prospect of Becoming Adequately Capitalized

Under section 11(c)(5)(K)(i) of the FDIA, OTS may appoint a receiver if a savings association is undercapitalized as defined in 12 U.S.C. § 1831o(b) and has no reasonable prospect of becoming adequately capitalized. Under section 1831o(b) an institution is undercapitalized if it fails to meet any required minimum capital level. OTS has determined that an institution is undercapitalized if it has a total risk-based capital ratio that is less than 8 percent or, if the institution is not "1" rated, a leverage ratio that is less than 4 percent.[1]

The Savings Bank reported that, as of December 31, 2009, it had leverage (core) capital ratio of 0.67 percent, and total risk-based capital ratio of 1.79 percent.

During the past year, the Savings Bank has attempted to raise additional capital through various sources. The Savings Bank's controlling parties have stated that they are not able to infuse additional capital into the Savings Bank. The Savings Bank is unable to return to adequately capitalized status through generation of earnings, or other proposed means, such as loan sales, or an exchange of subordinated debt for equity. A recent investment inquiry is subject to significant contingencies and raises issues that are likely to prevent its successful completion in the near term. Given the Savings Bank's lack of success in raising capital, and the

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[1] A leverage ratio of 3 percent is permissible if the institution has a CAMELS composite rating of "1" The Savings Bank is not "1" rated.

Savings Bank's deteriorating financial position, it is unlikely that the Savings Bank will be able to raise additional capital through other sources.

Therefore, the Acting Director, or his designee, concludes that the Savings Bank is undercapitalized and that it has no reasonable prospect of becoming adequately capitalized.

Critically Undercapitalized

Under section 11(c)(5)(L)(i), OTS may appoint a receiver for a savings association if an institution 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, 2009, the Savings Bank reported a tangible capital ratio of 0.67 percent. Therefore, the Acting Director, or his designee, concludes that the Savings Bank is critically undercapitalized.

Substantially Insufficient Capital

Under section 11(c)(5)(L)(ii), OTS may appoint a receiver for a savings association if it 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 "1" 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 previously that failure to maintain at least two-thirds of any capital required by 12 C.F.R. Part 567 constitutes a substantial capital insufficiency within the meaning of the 12 U.S.C. § 1821(c)(5)(L)(ii).

The Savings Bank is not "1" rated and has a leverage capital ratio of 0.67 percent. The Savings Bank's risk-based capital ratio is 1.79 percent. Accordingly, the Savings Bank's leverage capital ratio and risk-based capital ratio both are less than two-thirds of the applicable capital requirements. Accordingly, 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), (K)(i), (L)(i) and (L)(ii) of the FDIA, 12 U.S.C. §§ 1821(c)(5)(C), (K)(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 or winding up the affairs of the Savings Bank, 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 Business Transactions of the Chief Counsel's Office, or his designee, to: (i) certify orders; (ii) sign, execute, attest or certify other documents of OTS issued or authorized by this Order; (iii) 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 (iv) 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. Further, the Acting Director, or his designee, authorizes the Deputy Chief Counsel for Business Transactions, 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: (i) as to the above matters regarding the delegation of authority, immediately upon signature; and (ii) as to the above matters regarding the appointment of the FDIC as receiver, immediately upon service of this Order on the Savings Bank.

Executed this 19 day of February, 2010.

John C. Bowman

John E. Bowman
Acting Director