#N12-003

UNITED STATES OF AMERICA
DEPARTMENT OF THE TREASURY
OFFICE OF THE COMPTROLLER OF THE CURRENCY

In the Matter of:	)	
	)	
Priority Bank	)	AA-SO-12-53
Ozark, Arkansas	)	
	)	

NOTICE OF CHARGES FOR AN ORDER TO CEASE AND DESIST

The Comptroller of the Currency of the United States of America ("Comptroller" or "OCC"), having reasonable cause to believe that Priority Bank, Ozark, Arkansas ("Bank"), has engaged in unsafe or unsound practices and violations of law, rule, or regulation, hereby files this Notice of Charges for issuance of a Cease and Desist Order against the Bank pursuant to section 8(b) of the Federal Deposit Insurance Act, 12 U.S.C. § 1818(b).

TAKE NOTICE that a hearing will commence in Fort Smith, Arkansas pursuant to 12 U.S.C. § 1818(b) on a date to be set by the Administrative Law Judge concerning the charges set forth herein to determine whether a Cease and Desist Order should be issued against the Bank. The hearing shall be open to the public unless the Comptroller, in his discretion, determines that an open hearing would be contrary to the public interest.

After examination and investigation into the affairs of the Bank, the Comptroller has determined that the Bank engaged in unsafe or unsound practices and violations of law, rule or regulation. The Comptroller intends to order the Bank to cease and desist from the unsafe or unsound practices and violations specified herein and, further, to take affirmative action to correct the conditions resulting from such practices.

In support of this Notice of Charges, the Comptroller charges the following:

ARTICLE I

JURISDICTION

At all times relevant to the charges set forth below:

(1) The Bank was a federal savings association, supervised and examined by the OCC pursuant to 12 U.S.C. § 5412(b).[1]

(2) The Bank was an "insured depository institution" as defined in 12 U.S.C. § 1813(c)(2) and within in the meaning of 12 U.S.C. § 1818(b).

(3) The OCC is "the appropriate Federal banking agency" within the meaning of 12 U.S.C. § 1813(q)(1) and for the purposes of 12 U.S.C. § 1818(b) to initiate an enforcement proceeding against a federal savings association.

ARTICLE II

BACKGROUND

(4) The Bank is a community bank that currently operates two full service offices, located in Ozark and Fayetteville, Arkansas. The Bank is wholly owned by Priority One Holding Company ("Holding Company"), a bank holding company in Fayetteville, Arkansas. As of December 31, 2011, the Bank had approximately $87 million in total assets.

[1] Prior to July 21, 2011 the Bank was regulated by the Office of Thrift Supervision ("OTS"). Pursuant to Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010), all functions of the Office of Thrift Supervision ("OTS") related to Federal savings associations were transferred to the Office of the Comptroller of the Currency ("OCC") on July 21, 2011. See Dodd-Frank Act, § 312(b), 12 U.S.C. § 5412.

(5) The Holding Company is wholly owned by Trevor Lavy. Mr. Lavy serves as the Chief Executive Officer ("CEO") and Chairman of the Board of the Holding Company as well as the President, CEO, and Chairman of the Board of the Bank.

(6) The Bank's predominant business is owner-occupied single family mortgage lending.

2009 Examination Findings

(7) The OTS conducted a full-scope examination of the Bank beginning on October 26, 2009 ("2009 Examination"). The OTS reviewed the Bank's financial information as of September 30, 2009 to determine the Bank's ratings under the Uniform Financial Institutions Rating System ("UFIRS"). UFIRS consists of nine components, eight of which are rated numerically on a scale of "1" to "5," and one of which is rated adjectively. The eight numerically rated components are "capital," "asset quality," "management," "earnings," "liquidity," "sensitivity to market risk," "information technology," and "consumer compliance." These components are commonly referred to as "CAMELSICC" or "CAMELS." The Bank also receives a composite rating based on an evaluation of all nine components. Any component rated "3" or greater is considered less than satisfactory. The same is true of the Bank's composite rating.

(8) As a result of the OTS's findings during the 2009 Examination, the OTS retained the Bank's composite rating of "2," but downgraded liquidity from "2" to "3." The Bank's liquidity relied heavily on funding from volatile sources, including fixed-rate borrowings from the Federal Home Loan Bank and brokered deposits. Asset quality was adequate, despite increases in the levels of delinquent, nonperforming, and adversely classified assets. The OTS noted concern with the Bank's monitoring of potential

concentrations in single family mortgage lending. The OTS also retained the Bank's adequate rating for capital. The Bank's ratio of Tier 1 capital to adjusted total assets was 7.35 percent, and the ratio of total risk-based capital to risk-weighted assets was 12.46 percent. The areas of management and sensitivity to market risk received ratings of adequate, and earnings performance was rated strong.

(9) On or about January 6, 2010, the OTS delivered to the Bank a report of examination ("2009 ROE"), which informed the Bank of the downgrade in liquidity from "2" to "3."

2011 Compliance Limited Examination Findings

(10) The OTS conducted a compliance limited examination of the Bank beginning on April 18, 2011 ("2011 Compliance Limited Examination"). This examination focused on the Bank's loan pricing parameters, and did not update the Bank's CAMELS ratings.

2011 Transitional Examination Findings

(11) The OTS conducted a transitional examination of the Bank beginning on June 20, 2011 ("2011 Transitional Examination"). This examination involved limited examination procedures and was tailored to following up on corrective actions from the 2009 Examination and assessing the overall condition of the Bank. As a result of the OTS's findings during this examination, the OTS retained the Bank's composite rating of "2," and upgraded liquidity from "3" to "2."

2011 Full-Scope Examination Findings

(12) The OCC conducted a full-scope examination of the Bank beginning on August 17, 2011 ("2011 Full-Scope Examination"). The OCC reviewed the Bank's

financial information as of June 30, 2011, updated to September 30, 2011 where available. At this examination, the OCC determined that the Bank's overall condition had deteriorated.

(13) Capital levels as of September 30, 2011 were 8.08 percent for the Tier 1 capital to adjusted average assets ratio and 14.28 percent for the total risk-based capital to risk-weighted assets ratio. The OCC determined these levels were less than satisfactory given the increasing risk profile of the Bank, which had become elevated due to, among other causes, a significant increase in the level of advances for taxes and insurance over the preceding two years, as well as deficient practices in making those advancements. The OCC downgraded capital to a "3." The Bank paid dividends to the Holding Company of $1.1 million in 2010 and $1.4 million from January 2011 to September 30, 2011.

(14) Asset quality at the 2011 Full-Scope Examination showed deterioration, with classified assets at 209.2 percent of Tier 1 capital plus the Allowance for Loan and Lease Losses ("ALLL") at September 30, 2011, compared to 29.6 percent at the 2009 Examination. The increase in classified assets resulted from the OCC's classification as Substandard the $14.6 million principal balance of the segment of the Bank's residential loan portfolio consisting of borrowers who have not paid their taxes, insurance, or both ("T&I"). The OCC also classified the $573 thousand that the Bank has made in T&I advances for these borrowers. The Bank did not demonstrate these borrowers have the capacity to repay the T&I advances. The OCC determined asset quality to be deficient and downgraded the rating to a "4."

(15) In addition to the deterioration in asset quality, the examination uncovered evidence of weak credit risk management. The Bank did not provide escrow services to its higher-risk borrower base and did not have a policy or procedures to address the collection of T&I advances.

(16) At the time of the 2011 Full-Scope Examination, management had not established concentration risk tolerance levels as a percentage of capital, approved a formal Capital Plan, or approved a Dividend Policy. Management and the Board refused to properly report on its December 31, 2011 Thrift Financial Report ("TFR") the Substandard and Doubtful classifications identified by the OCC in the Bank's residential loan portfolio. The OCC determined management to be deficient and downgraded the rating to a "4."

(17) Earnings at the 2011 Full-Scope Examination were adequate but deteriorated to a "2" due to a $416 thousand adjustment to the ALLL balance. The ALLL is a valuation reserve established and maintained by charges against the Bank's operating income. As a valuation reserve, it is an estimate of an uncollectible amount that is used to reduce the book value of loans and leases to the amount that is expected to be collected.

(18) Liquidity risk at this examination was high and increasing. The Bank continued to heavily rely on FHLB advances for liquidity funding purposes. Liquidity was less than satisfactory and was downgraded to a "3" rating.

(19) Based on the above less-than-satisfactory ratings in capital, asset quality, management, and liquidity, the OCC downgraded the Bank's overall composite rating from "2" to "3." The OCC notified the Bank of the results of the 2011 Full-Scope

Examination in a report of examination ("2011 ROE") delivered to the Bank on April 10, 2012.

(20) The 2011 ROE notified the Bank that it is designated in "troubled condition" for the purpose of 12 U.S.C. § 1831i and as a result, the Bank is subject to the provisions of 12 U.S.C. § 1831i and 12 C.F.R. Part 163, Subpart H regarding providing the OCC with prior notice of changes to directors and senior executive officers and 12 C.F.R. Part 359 regarding golden parachute payments.

(21) The 2011 ROE also identified 14 problems that required the Board's immediate attention, specified as Matters Requiring Attention ("MRA"). An MRA is a matter that deviates from sound fundamental banking principles, internal controls or risk management. If not corrected by the Bank, an MRA is likely to result in financial harm or substantive violations of law, as well as expose the Bank's earnings and capital to risk. When the OCC communicates an MRA to a bank, the MRA serves as notification in writing of a deficiency, and requires a bank's board of directors to take immediate corrective action. The 14 MRAs addressed the areas of (1) credit risk, (2) residential loan underwriting, (3) criticized assets, (4) loan portfolio management, (5) problem loan identification and risk rating accuracy, (6) higher minimums, capital plan, and strategic plan, (7) ALLL methodology, (8) other real estate owned ("OREO") accounting, (9) concentration risk management, (10) transactions with affiliates, (11) conflict of interest with respect to insider transactions, (12) conflict of interest with respect to purchases of loans originated by an affiliate, (13) inaccurate TFR, and (14) force placement of flood insurance. The MRAs describe necessary actions that the Bank must take in order to

remedy or correct the unsafe or unsound practices and to cure the unsafe or unsound condition described in the 2011 ROE.

ARTICLE III

UNSAFE OR UNSOUND PRACTICES

(22) The OCC reasserts and realleges the allegations in paragraphs (4) through (21).

Inadequate Credit Risk Management

(23) The Bank failed to implement repayment policies or procedures for taxes and insurance advances that it has made on borrowers' behalf. This unsafe or unsound practice resulted in a high level of classified assets.

(24) The Bank failed to maintain prudent underwriting practices associated with borrowers' capacity to pay on the residential loan portfolio. The Bank did not review the underwriting of the loans it purchased that were originated by Priority One Mortgage Company.

(25) The Bank failed to consider all relevant housing-related obligations in determining borrowers' creditworthiness and capacity to repay. The Bank did not include real estate taxes and insurance in its debt-to-income calculations.

(26) The Bank has engaged in unsafe or unsound practices by failing to properly manage and address credit risk.

(27) As a result of these unsafe or unsound practices, the Bank has a high and increasing level of credit risk due to its excessive level of classified assets, and the quality

of the Bank's credit risk management is weak, particularly in its residential loan portfolio.

Inadequate Management of Criticized Assets

(28) The Bank has a high level of criticized assets, indicated by its ratio of adversely classified assets to Tier 1 capital plus the ALLL of 209.2 percent, as of September 30, 2011.

(29) The excessive level of classified assets is composed mainly of residential loans where the Bank advanced payments for borrowers' taxes, insurance, or both and did not implement a system to ensure the repayment of these advances by the borrowers.

(30) The Bank failed to accurately report its level of criticized assets on its December 31, 2011 Thrift Financial Report.

(31) The Bank has engaged in unsafe or unsound practices by failing to properly manage and report criticized assets.

Inadequate Loan Portfolio Management

(32) The Bank has not established an effective process to accurately validate the quality of its loan portfolio or correct credit administration weaknesses.

(33) The Bank has not developed adequate collection procedures on advances for borrowers' taxes and insurance. The Bank has not properly considered the taxes and insurance obligations on the underlying collateral in determining the borrowers' capacity to repay.

(34) The Bank does not have an effective process to accurately validate its loan risk ratings.

(35) The Board of Directors has not established limitations for loan concentrations in relation to capital.

(36) The Bank failed to obtain current financial information on loans in its commercial loan portfolio, resulting in an excessive level of credit and collateral documentation exceptions.

(37) The weaknesses in the Bank's loan portfolio management have resulted in a high level of classified assets, inaccurate TFR reporting, and high aggregate levels of credit, liquidity, operational, and reputation risk.

(38) The Bank has engaged in unsafe or unsound practices by failing to properly manage its loan portfolio.

Inadequate Problem Loan Identification and Loan Review

(39) During the 2011 Full-Scope Examination, the OCC changed risk ratings for 28 percent of the loans it reviewed.

(40) In addition, 158 of the Bank's 1-4 family residential loans on which the Bank advanced property taxes and insurance were not appropriately risk rated. Pursuant to OTS CEO Memo 128 and OCC Bulletin 2000-20, *Uniform Retail Credit Classification and Account Management Policy*, the inability of a borrower to pay all required obligations, including taxes and insurance, is a well-defined credit weakness that requires a loan to be adversely classified.

(41) The Bank failed to regularly obtain a credible external loan review, and consequently, risk ratings are not validated on an ongoing basis.

(42) Training for loan officers is either absent or ineffective.

(43) The Bank has engaged in unsafe or unsound practices by failing to properly identify problem loans and obtain a regular, independent, external loan review.

Inadequate Capital Levels

(44) Management has not prepared a formal capital plan or dividend policy addressing plans for maintaining capital at an adequate level. The Bank's informal policies and projections do not adequately address the risk to capital from continued asset growth and dividend requirements.

(45) The Bank has experienced high growth in its loan portfolio, increasing its asset base significantly over the last two years. Due to the increase in assets, the Bank has required capital injections from the holding company to maintain capital at acceptable levels, including the 8 percent Tier 1 Leverage Ratio required by the OTS.

(46) The Bank has engaged in unsafe or unsound practices by failing to implement a formal capital plan or dividend policy addressing plans for maintaining satisfactory levels of capital.

Inadequate Allowance for Loan and Lease Losses Methodology

(47) The Bank's ALLL methodology does not fully conform with Accounting Standards Codification ("ASC") 450, "Accounting for Contingencies," and ASC 310, "Accounting by Creditors for Impairment of a Loan" (formerly FAS 5 and FAS 114, respectively) or OTS CEO Memo 250 or OCC Bulletin 2006-47, *Allowance for Loan and Lease Losses*. The Bank's methodology does not appropriately identify loans to be assessed for impairment or properly identify and support impairment amounts. In addition, the Bank's narratives supporting the qualitative methodology factors are inadequate.

(48) The Bank has engaged in unsafe or unsound practices by failing to maintain an adequate ALLL methodology.

Improper Other Real Estate Owned Accounting

(49) The Bank's Other Real Estate Owned ("OREO") accounting practices do not fully conform to generally accepted accounting principles ("GAAP") or TFR instructions. The procedures did not conform in that: repairs are made to properties prior to obtaining title; the OREO balance is improperly reduced by amounts received in earnest money; regular maintenance and repair costs are improperly capitalized to the OREO balance; collateral values are not adequately supported; and, the OREO balance is improperly reduced by declines in value while in the holding period. File documentation also needs improvement.

(50) The Bank has engaged in unsafe or unsound practices by failing to properly account for its OREO.

Inadequate Concentration Risk Management

(51) The Board has not established limits for concentrations of credit as a percentage of capital by which to manage its loan portfolio. Risk limits are needed to provide assurance that current and future activities match the strategic risk appetite of the Board, to provide for a diversified asset mix, and to highlight potential capital exposure within certain pools of loans.

(52) The Bank has engaged in unsafe or unsound practices by failing to properly manage and address concentration risk.

Inadequate Controls Over Affiliate and Insider Transactions

(53) Priority One Mortgage Company ("POMC") is wholly owned by CEO Lavy. The Bank pays fees to POMC for services provided in mortgage loan underwriting. The Bank also purchases loans from third parties that were originated by POMC and does not perform any independent underwriting, including determining the borrowers' ability to pay or determining the current value of the collateral. Also, Bank subsidiary Priority Credit Corporation provides sub-servicing on POMC mortgages.

(54) Vice President and Director William Reich owns a controlling interest in five home building companies whose customers apply for permanent loans through the Bank to pay off their construction loans obtained by Director Reich or other sources. The Bank does not track the volume of these loans and does not set limits for its exposure to these loans.

(55) The Bank has failed to implement and adhere to a written, comprehensive conflicts of interest policy.

(56) The Bank has engaged in unsafe or unsound practices by failing to implement policies, procedures, or internal controls to properly monitor affiliate and insider transactions, including the responsibility to determine that all fees paid to affiliates were reasonable, commensurate with the fair value of the services provided, expended for a legitimate or necessary Bank purpose and with consideration of the impact on the Bank's earnings.

ARTICLE IV

VIOLATION OF 12 U.S.C. § 1464(V), 12 C.F.R. §§ 160.160(A)(1) AND (2), 163.170(C), 163.180(A) AND (B), AND 12 C.F.R. PART 162

(57) The OCC reasserts and realleges the allegations in paragraphs (4) through (56).

(58) The Bank violated 12 C.F.R. § 160.160(a)(1) by failing to adversely classify 158 1-4 family residential loans on which the Bank advanced property taxes and insurance and by failing to adversely classify the T&I advancements. The Bank's evaluation and classification of its assets is not consistent with, or reconcilable to, the asset classification system used by the OTS and OCC.

(59) The Bank violated 12 C.F.R. § 160.160(a)(2), which requires an association to recognize examiner classifications in its reports to the OCC. Despite being directed to adversely classify the 1-4 family residential loans for which T&I advancements were made and the T&I advancements themselves, the Bank refused to do so, and did not correctly report them on its December 31, 2011 TFR.

(60) The Bank violated 12 U.S.C. § 1464(v), 12 C.F.R. Part 162 and 12 C.F.R. §§ 163.170(c) and 163.180(a) and (b) in its failure to follow regulatory reporting requirements and properly report classifications of the family residential loans for which T&I advancements were made and the T&I loans in its December 31, 2011 TFR.

(61) The Bank has engaged in violations of law or regulation and unsafe or unsound practices by failing to comply with 12 U.S.C. § 1464(v), 12 C.F.R. §§ 160.160(a)(1) and (2), 163.170(c), 163.180(a) and (b), and 12 C.F.R. Part 162.

ARTICLE V

LEGAL BASES FOR REQUESTED RELIEF

(62) The Comptroller reasserts and realleges the allegations in paragraphs (4) through (61).

(63) As evidenced by the Bank's actions described in Articles II through IV above, the Bank has violated laws or regulations and has engaged in unsafe or unsound practices in conducting the affairs of the Bank.

(64) By reason of the Bank's actions, the Comptroller charges that legal grounds exist for the issuance of an Order to Cease and Desist because the Bank has violated 12 U.S.C. § 1464(v), 12 C.F.R. §§ 160.160(a)(1) and (2), 163.170(c), 163.180(a) and (b), and 12 C.F.R. Part 162 and has engaged in, and continues to engage in, unsafe or unsound banking practices.

OPPORTUNITY FOR HEARING

The Bank is directed to file an answer to this Notice of Charges within twenty (20) days from the date of service of this Notice of Charges in accordance with 12 C.F.R. § 109.19. The answer shall be filed with the Office of Financial Institution Adjudication, 3501 N. Fairfax Drive, Suite VS-D8113, Arlington, Virginia 22226-3500. The Bank is encouraged to file any answer electronically with the Office of Financial Institution Adjudication at ofia@fdic.gov. A copy of any answer shall also be filed with the Hearing Clerk, Office of the Chief Counsel, Office of the Comptroller of the Currency, Washington, D.C. 20219 and with the attorney whose name appears on the accompanying certificate of service. **Failure to answer within this time period shall**

constitute a waiver of the right to appear and contest the allegations contained in this Notice of Charges and shall, upon the Comptroller's motion, cause the Administrative Law Judge or the Comptroller to find the facts in this Notice of Charges to be as alleged and to issue an appropriate order.

PRAYER FOR RELIEF

The Comptroller prays for relief in the form of the issuance of a Cease and Desist Order that is substantially similar to the Proposed Cease and Desist Order attached hereto as Exhibit A, requiring the Bank to cease and desist from the unsafe or unsound practices set forth in this Notice of Charges and, further, to take affirmative action to correct the conditions resulting from such practices.

The Comptroller, by his duly authorized designee, issues this Notice of Charges on this 9th day of May, 2012.

_/s/James G. Price___________
James G. Price
Associate Deputy Comptroller
Southern District Office