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

In the Matter of:	)	
	)	AA-EC-02-03
Peoples National Bank	)	
Paris, Texas	)	

NOTICE OF CHARGES FOR ISSUANCE OF AN ORDER TO CEASE AND DESIST

TAKE NOTICE that on the _**17th**__ day of May, 2002, or such other date as determined by the Administrative Law Judge, a hearing will commence at 10:00 a.m. in Dallas, Texas, pursuant to 12 U.S.C. § 1818(b), concerning the charges set forth herein, to determine whether an Order to Cease and Desist should be issued against Peoples National Bank, Paris, Texas ("Bank"). The hearing afforded the Bank shall be open to the public unless the agency, in its discretion, determines that holding an open hearing would be contrary to the public interest.

After examination into the affairs of the Bank, the Comptroller is of the opinion that the Bank is engaging or has engaged in violations of law, rule or regulation; the Bank is engaging or has engaged in unsafe or unsound practices in conducting the affairs of the Bank; and such violations and/or unsafe or unsound practices are likely to weaken the condition of the Bank, and/or prejudice the interests of the Bank's depositors.

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

Article I

Jurisdiction

At all times relevant to the charges set forth below:

(1) The Bank was, and continues to be, a national banking association, chartered and examined by the Comptroller, pursuant to the National Bank Act of 1864, as amended, 12 U.S.C. §1 *et seq*.

(2) The Bank was, and continues to be, an "insured depository institution" within the meaning of 12 U.S.C. §1818(b).

(3) The Comptroller was, and continues to be, the "appropriate Federal banking agency" within the meaning of 12 U.S.C. §1813(q)(1) and for purposes of 12 U.S.C. §1818(b) to initiate and maintain an enforcement proceeding against a national banking association.

Article II

Unsafe or Unsound Practices

(4) Contrary to safe and sound banking practices, from on or about May 2001, to the present, the Bank has engaged or is engaging in unsafe or unsound practices by failing to measure, monitor, and control the risks associated with the Bank's operations and lending activities, and by failing to meet accepted standards of prudent banking operations.

(5) The Bank's unsafe or unsound practices are evidenced by the following facts:

Absence of the Requisite Policies, Procedures, Systems and Controls for Payday Loans

(6) The Bank initiated a high-risk, subprime Payday loan product without first ensuring the presence of the comprehensive array of policies, procedures, systems and controls needed to prudently engage in this high risk business.

(7) The Bank then grew the Payday lending product rapidly, during which time, the Bank still lacked the needed policies, procedures, systems and controls to prudently manage the associated risk, thereby increasing risk commensurate with the growth of the product. Specifically:

(a) between February 2001, when the product was initiated, and May 2001, a period of just three months, the Bank exponentially grew the product, until it approximated 120% percent of the Bank's capital, while failing to have the requisite policies, procedures, systems and controls, thereby placing the Bank, its depositors, and the federal deposit insurance fund at risk;

(b) between May 2001, and October 2001, the Bank more than doubled the product volume again, until it approximated 240% of the Bank's capital, while failing to have the requisite policies, procedures, systems and controls, thereby placing the Bank, its depositors, and the federal deposit insurance fund at risk;

(c) from approximately October 2001, until approximately January 2002, the Bank continued to imprudently permit the Payday loan product to approximate 240% or more of the Bank's capital, while failing to have all of the necessary policies, procedures, systems and controls, thereby placing the Bank, its depositors, and the federal deposit insurance fund at risk;

(d) from approximately January 2002, until the present, the Bank continues to imprudently permit the Payday loan product to approximate 130% of the Bank's capital, while failing to have all of the necessary policies,

procedures, systems and controls, thereby placing the Bank, its depositors, and the federal deposit insurance fund at risk; and

(e) the reduction in concentration to 130% of the Bank's capital was due in large part to the Bank's receipt of proceeds of a $3 million loan made to the Bank's parent company by the Bank's primary third-party vendor for the Payday loan product. In the absence of this indirect loan from the Payday loan vendor, the Bank's Payday loan product would approximate 180% of the Bank's capital.

(8) As of October 2001, 60% or more of the Bank's classified assets are delinquent Payday loans. Yet, the Bank has failed and fails to internally classify delinquent Payday loans, despite the fact that the primary source of repayment for these loans (the borrower) has failed to perform, and the loans consequently meet the criteria for a substandard classification. Failure to classify these loans is unacceptable, since the Bank is ultimately the party to bear the risk of loss.

Disregard of Bank Internal Limits on Payday Loan Volume

(9) Although the Bank's Board set a loan volume limit of $2.5 million, or 25% of capital when the Bank initiated the Payday lending product, the Bank quickly exceeded this self-imposed limit, and the Bank, Board and management failed and fail to prudently oversee the operations of the Bank, including ensuring adherence to Board-imposed limits. Specifically:

(a) over a period of approximately eight months, the Bank ignored its own Board-imposed limit, and increased the product more than seven-fold, at all times without the appropriate policies, procedures, systems and controls; and

(b) the Board failed and fails to establish and approve a new prudent limit on Payday loan volume, both as a dollar amount, and as a percentage of the Bank's capital, thereby subjecting the Bank to excessive and unmitigated risk, which is limited solely by the Bank's ability to fund the loans.

Excessive and Unacceptable Concentration of Credit Risk

(10) The Board has failed and continues to fail to set prudent risk limits and to establish a comprehensive monitoring process for Payday loan volume based on both the dollar volume of loans and as a concentration of capital. Specifically:

(a) from May 2001 until the present, outstanding Payday loans have exceeded the Bank's capital, and represent an excessive and unacceptably high concentration of credit risk, thereby subjecting the Bank, its depositors, and the federal deposit insurance fund to unacceptable risk.

Inadequate Supervision of the Payday Loan Product

(11) The Bank has failed to supervise, or is unwilling or incapable of supervising, its Payday loan product appropriately and effectively, as evidenced by:

(a) the implementation of the Payday loan program without a written strategic plan designed to address the Bank's increasing risks and resource needs of the Payday loan program;

(b) the implementation of the Payday loan program without the appropriate policies, procedures, systems and controls to prudently manage risk;

(c) the implementation and rapid growth of the Payday loan product at an excessive concentration of credit risk;

(d) the implementation and rapid growth of the Payday loan product without adequate capital support;

(e) the implementation and rapid growth of the Payday loan product without prudent and adequate underwriting standards for successive loans to one borrower;

(f) the implementation and rapid growth of the Payday loan product without obtaining and/or testing the contingency plans of the third-party vendors relied upon by the Bank to offer this product; and

(g) the fragmented supervision of its Payday loan program.

(12) Prior to initiating the Payday loan product, and after commencing Payday loan operations, the Bank failed to establish clear lines of authority with one individual responsible for comprehensive monitoring of:

(a) adherence with Board-established policies;

(b) legal and regulatory requirements;

(c) adequate financial safeguards, including prudent risk-control limits and prudent disaster contingency plans; and

(d) adequate financial and operational reports that assess risk, provide trend analysis, and facilitate monitoring of program goals and targets.

(13) Furthermore, the Bank has failed to classify delinquent Payday loans, and failed to institute a process to effectively manage the Bank's capital position and balance sheet.

Failure to Implement Prudent Underwriting Standards for Payday Loans

(14) The Bank has failed to implement, or is unwilling or incapable of implementing, prudent underwriting standards for Payday loans. Specifically, the Bank has permitted, and

continues to permit, successive Payday loans to be extended to borrowers without the concurrent update and verification of employment and income with each and every extension of credit, despite the extended length of time and number of loans that may be made to one borrower.

Three Million Dollar Loan from Third-Party Vendor to Reduce Concentration

(15) The Bank obtained an indirect $3 million loan from its primary third-party vendor for the Payday loan product, to bolster capital and reduce the concentration of Payday loans, though this loan increased risk to the Bank.

(16) The proceeds from this loan were obtained by the Bank's parent company from the Payday loan third-party vendor and injected into the Bank.

(17) The loan has a rapidly escalating interest rate and provides strong incentive for the Bank to maintain its Payday loan volume at an excessive level, or even increase this volume, in order for the Bank to have earnings sufficient to pay increasingly large dividends to the Bank's parent company, so that the parent company can repay the third-party vendor loan as contractually agreed.

(18) The Bank's indirect receipt of loan proceeds from its primary third-party vendor for the Payday loan product underscores the undue level of Bank reliance placed upon the Bank's third-party vendor, to wit, for marketing, underwriting, originating, disbursing, servicing and collecting these loans.

Failure to Obtain or Test Vendor Disaster Recovery Plans

(19) In offering the Payday loan product, the Bank exposed and continues to expose all of its capital, by relying on two third-party vendors in order to market, underwrite, originate, disburse, service and collect these loans, while failing to assure itself that these third-party vendors will be able to contractually perform as promised.

(20) The Bank failed to obtain the contingency plans of its Payday loan third-party vendors, and thus failed to assure itself of continuity of operations in the event of any unforeseen contingency(ies).

(21) The Bank failed to assure itself that its primary Payday loan third-party vendor possessed a comprehensive contingency plan.

(22) The Bank's primary third-party vendor failed to have a comprehensive contingency plan.

(23) After obtaining the third-party vendors' contingency plans, and/or requiring the primary third-party vendor to draft a comprehensive contingency plan, the Bank failed and continues to fail to test these contingency plans.

Inadequate Strategic Plan

(24) The Bank's strategic plan is inadequate because it fails to appropriately:

(a) consider or incorporate the Payday loan product;

(b) address the increasing risks and resource requirements of the Payday loan product, including the needed policies, procedures, systems and controls to engage in prudent Payday lending operations;

(c) project the amount of equity capital needed to support the Payday loan product, and appropriate sources for such capital; and

(d) address and limit concentration of Payday loans.

Significant Flaws in the Allowance for Loan Lease Losses Methodology

(25) The Bank's methodology for ensuring the adequacy of the Allowance for Loan Lease Losses ("ALLL") was significantly flawed, and resulted in an underfunded ALLL account,

as detailed in the Bank's most recent Report of Examination. Among other things, the Bank failed to:

(a) appropriately revise the ALLL process to ensure compliance with relevant OCC guidance and instructions for filing Consolidated Reports of Condition and Income (“Call Reports”); and

(b) allocate appropriate reserves for the Payday loan portfolio commensurate with recent Payday loan loss trends.

Inadequate and Unacceptable Audit Function

(26) The Bank’s audit function is unacceptable, and as set forth further below in Article III, this has resulted in a violation of a law, rule or regulation.

(27) Internal audit was not independent from external audit, since some of the staff of the Bank's audit firm were responsible for conducting both the internal and external audits, essentially reviewing and attesting to their own work, thereby compromising auditor independence.

(28) Auditors' lines of reporting to the Board are compromised, since audit reports are reviewed and responded to by an officer of the Bank before the Board is made privy to the audit findings, thereby compromising auditor independence.

(29) The Bank's audit firm determines the audit scope and sample criteria without consulting the Board, or receiving prior Board approval.

Inadequate Management Information Systems

(30) The Bank failed to obtain, or is unwilling or incapable of obtaining, all reports necessary to measure, monitor, and control the risks associated with the Payday loan program, and/or to confirm the accuracy and reliability of such reports.

(31) In approximately February 2001, the Bank failed to establish the type and frequency of MIS reports needed to supervise the Payday loan product in advance of implementing Payday lending.

(32) As the product was greatly expanded over the next eight months, the Bank continued to fail to establish the type and frequency of MIS reports needed to prudently supervise the Payday loan product, despite the greatly increased risk to the Bank with the increase in loan volume, concentration of credit risk, and lack of capital support.

(33) Despite the ongoing risk to the Bank, the Bank only proceeded to develop additional MIS reports upon the OCC's examination, and even this additional MIS was insufficient.

(34) Specifically, the Bank has failed to develop MIS for trend analysis and to provide data for risk control and adequate monitoring of Payday loan program goals and targets, including the following:

(a) an aging of past due accounts;

(b) a cumulative historical summary of delinquencies and losses;

(c) an analysis of customer complaints received, resolved, or in the process of resolution;

(d) the number of consecutive advances compared to default probability;

(e) the percentage of delinquent loans that become losses, by period originated;

(f) a listing of borrowers sorted by number of consecutive borrowings;

(g) a listing of borrowers sorted by number of borrowings during the past 12 months;

(h) the recovery percentage based on days of delinquency (to support charge-off timing);

(i) the number of customers stratified by number of consecutive advances; and

(j) applicant credit scores and other ancillary information correlated against average credit extended, loss rates, and renewal ratios.

(35) The failure, unwillingness or incapability of the Bank to meet the accepted standards of prudent banking operations, enumerated above, collectively and individually results in abnormal risk of loss to the Bank, and is likely to weaken the condition of the Bank, and/or prejudice the interests of the Bank's depositors.

Unsafe or Unsound Capital Levels

(36) Contrary to safe and sound banking practices, the Bank's capital is deficient in relation to the Bank's extremely high risk exposures, as further set forth in the Bank's most recent Report of Examination.

(37) The failure of the Bank to maintain appropriate capital at a level that is adequate to support the high levels of concentration, credit, transaction, compliance, reputation, legal and strategic risks results in abnormal risk of loss to the Bank, and is likely to weaken the condition of the Bank, and/or prejudice the interests of the Bank's depositors.

Article III

Violations of Law, Rule or Regulation Regarding Standards for Safety and Soundness

(38) From on or about February 21, 2001, to the present, the Bank has caused, brought about, participated in, counseled or aided or abetted violations of law, rule or regulation when the

Bank failed to comply with the Standards for Safety and Soundness promulgated at 12 C.F.R. Part 30 Appendix A (II). The facts supporting these violations are described below.

(39) As detailed in 12 C.F.R. Part 30 Appendix A (II)(A), the Bank has failed to have internal controls and information systems that are appropriate to the size of the institution and the nature, scope and risk of its activities, including effective risk assessment, and adequate procedures to safeguard and manage assets, as evidenced by the Bank's failure to:

(a) have an updated strategic plan:

(i) considering or incorporating the Payday loan product;

(ii) addressing the increasing risks and resource requirements of the Payday loan product, including the needed policies, procedures, systems and controls to engage in prudent Payday lending operations; and

(iii) projecting equity capital needed to support the Payday loan product, and appropriate sources for such capital;

(b) prudently underwrite successive Payday loans to one borrower;

(c) eliminate fragmented supervision of its Payday loan program;

(d) maintain its Payday loans at a level at or below its own established concentration limit of the lesser of $2.5 million in Payday loans, or 25% of the Bank's capital;

(e) obtain and test the contingency plans of the Payday loan third-party vendors in the event the third-party vendors are unable to continue to perform Payday loan services for the Bank; and

(f) obtain all reports necessary to measure, monitor, and control the risks associated with the Payday loan program.

(40) As detailed in 12 C.F.R. Part 30 Appendix A (II)(B), the Bank has failed to have an internal audit system that is appropriate to the size of the Bank and the nature and scope of its activities, which provides for adequate monitoring of the system of internal controls through an internal audit function, and independence and objectivity, as evidenced by the Bank's failure to:

(a) ensure internal audit was independent from external audit;

(b) ensure auditors' lines of reporting to the Board were and are not compromised; and

(c) ensure the Bank's audit firm determined and determines the audit scope and sample criteria after consulting the Board, and/or receiving prior Board approval.

(41) As detailed in 12 C.F.R. Part 30 Appendix A (II)(D), the Bank has failed to establish and maintain prudent credit underwriting practices that, among other things, are commensurate with the types of loans the institution will make and consider the terms and conditions under which they will be made; provide for consideration, prior to credit commitment, of the borrower's overall financial condition and resources, character, and willingness to repay as agreed; and take adequate account of concentration of credit risk. This is evidenced by the Bank's failure to:

(a) maintain its Payday loans at a level at or below its own internally-established concentration limit of the lesser of $2.5 million or 25% of capital;

(b) restrain its current concentration of credit, which far exceeds 100% of capital; and

(c) ensure adherence to prudent underwriting standards for successive Payday loans to one borrower, including:

(i) underwriting standards requiring the complete re-underwriting of successive Payday loans, such as obtaining documentation of employment or other source(s) of income, and bank statement, for each and every extension of credit; and

(ii) underwriting standards for successive Payday loans requiring the borrower's specific reason why the loan has been requested, identifying the source(s) of funds used to repay the preceding loan(s), if any, including whether these prior loan(s) have been repaid using other sources of credit, such as payday loans from different lender(s), and then the Bank's determination about the borrower's present ability to repay the Payday loan being sought without using borrowed funds.

(42) As detailed in 12 C.F.R. Part 30 Appendix A (II)(F), the Bank has failed to have asset growth that is prudent and considers the effect of growth on the Bank's capital, as evidenced by the Bank's:

(a) significantly increased volume of Payday loans without a corresponding increase in the level or quality of Bank resources to manage the Payday lending program, such as the appropriate policies, procedures, systems and controls;

(b) significantly increased volume of Payday loans without the requisite increase in the amount of capital needed; and

(c) significantly increased volume of Payday loans and consequent increase in the concentration of credit risk.

(43) As detailed in 12 C.F.R. Part 30 Appendix A (II)(G), the Bank has failed to have an asset quality system that is commensurate with the Bank's size and the nature and scope of its operations, as evidenced by the Bank's failure to:

(a) internally classify delinquent Payday loans;

(b) ensure the adequacy of the ALLL methodology, including:

(i) appropriately revise the ALLL process to ensure compliance with relevant OCC guidance, and instructions for filing Call Reports; and

(ii) allocate appropriate reserves for the Payday loan portfolio commensurate with recent Payday loan loss trends;

(c) obtain updated collateral valuations on problematic assets;

(d) maintain its Payday loans at a level at or below its own internally-established concentration limit of the lesser of $2.5 million or 25% of capital;

(e) obtain all reports necessary to measure, monitor, and control the risks associated with the Payday loan program; and

(f) consider the size and potential risks of material asset concentrations.

(44) The Bank's repeated failures, enumerated above, demonstrate that the Bank has violated the Standards set forth in 12 C.F.R. Part 30 Appendix A(II).

Article IV

Violation of Law and Unsafe or Unsound Banking Practices
Inaccurate and Material Misrepresentations of Financial Condition

(45) All national banks are required to file accurate Call Reports pursuant to 12 U.S.C. § 161. Call Reports must be filed 30 days after the close of each calendar quarter.

(46) The Bank caused, brought about, participated in, counseled or aided or abetted violations of 12 U.S.C. § 161 when the Bank filed inaccurate Call Reports for the quarters ending December 31, 2000, and March 31, 2001, as described below.

(47) Generally Accepted Accounting Principles ("GAAP") require financial institutions to account for certain investments in limited partnerships using the equity method of accounting.

(48) The Bank's Call Reports for the quarters ending December 31, 2000, and March 31, 2001, contained significant and material errors in Schedule RC, Report of Condition. As part of these Call Reports, the Bank incorrectly reported the value of Equipment Leasing Associates 1995-V Limited Partnership ("ELA 95-V").

(49) The Bank has a 90% ownership of Peoples Asset Management ("PAM"), a consolidated subsidiary. PAM's only asset is a 99% limited partner ownership interest in ELA 95-V. Because the limited partner ownership interest is more than 3 to 5 percent, this investment in ELA 95-V must be accounted for using the equity method of accounting. On a GAAP basis, ELA 95-V has a lease receivable and a lease obligation of a like amount for various computer equipment. Thus, the Bank's investment in ELA 95-V effectively represents an intangible asset.

(50) The economic substance of the transaction is that the Bank ostensibly acquired the right to approximately $7.4 million in tax deductions from 1996 to 2002 in exchange for a cash payment of approximately $887,000 plus approximately $27,000 in legal expenses. In addition

to the tax deductions, the Bank is entitled to receive contingent cash flows from the potential re-lease of the computer equipment.

(51) In accordance with GAAP, PAM's investment in ELA 95-V should have been accounted for using the equity method of accounting resulting in the investment being amortized over the life of the underlying lease obligation.

(52) The December 31, 2000, balance of the net recorded investment, reported at $772,000, should have been $209,000. This represents an overstatement of $563,000--more than 9% of the Bank's Tier 1 capital.

(53) The March 31, 2001, balance of the net recorded investment, reported at $771,000, should have been $169,000. This represents an overstatement of $602,000--more than 9% of the Bank's Tier 1 capital.

(54) The Bank became aware during the latter half of 2000 that the underlying computer equipment supporting the at-issue lease had been substituted for less valuable collateral. This substitution was viewed by the Bank as inappropriate, and precipitated a lawsuit by the Bank. This event should have also triggered a re-valuation of PAM's investment in ELA 95-V by no later than the December 31, 2000, Call Report.

(55) The Bank's failure to use the equity method of accounting and to amortize the PAM investment in ELA 95-V over the life of the underlying lease obligation in the December 31, 2000, and March 31, 2001, Call Reports, resulted in material misrepresentations of the Bank's true financial condition, overstating the Bank's assets and capital by more than nine percent. Such material misrepresentations are both violations of 12 U.S.C. § 161 and constitute unsafe or unsound banking practices.

(56) The Bank's failure to re-value the underlying asset in the December 31, 2000, and March 31, 2001, Call Reports, resulted in material misrepresentations of the Bank's true financial condition, by overstating the Bank's assets and capital. Such material misrepresentations are both violations of 12 U.S.C. § 161 and constitute unsafe or unsound banking practices.

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

The Bank is directed to file a written answer to this Notice within twenty (20) days from the date of service of this Notice in accordance with 12 C.F.R. § 19.19(a) and (b). The original and one copy of any answer shall be filed with the Office of Financial Institution Adjudication, 1700 G Street, N.W., Washington, DC 20552. A copy of any answer shall also be served with the Hearing Clerk, Office of the Chief Counsel, Office of the Comptroller of the Currency, Washington, DC 20219 and with the OCC 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, and shall, upon the OCC's motion, cause the administrative law judge or the Comptroller to find the facts in this Notice to be as alleged, upon which an appropriate order may be issued.**

PRAYER FOR RELIEF

The Comptroller prays for relief in the form of the issuance of a final Order Requiring Affirmative and Corrective Action, in substantial form to the attached proposed Order.

Witness, my hand on behalf of the Office of the Comptroller of the Currency, given at Washington, DC this _**15th**_day of March, 2002.

_____/s/__________________________
Leann Britton
Senior Deputy Comptroller
for Midsize/Community Bank Supervision