

Journal of Vincentian Social Action

Volume 3

Issue 2 *Journal of Vincentian Social Action*

Article 7

November 2018


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Recommended Citation

Agnello, Vincent; Winter, Joseph F.; and Ta, Hai (2018) "Case Study: Robin Hood or Criminal? The Case of a Bank Loan Officer," *Journal of Vincentian Social Action*: Vol. 3 : Iss. 2 , Article 7.
Available at: <https://scholar.stjohns.edu/jovsa/vol3/iss2/7>

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CASE STUDY: ROBIN HOOD OR CRIMINAL?—THE CASE OF A BANK LOAN OFFICER

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This case was prepared by the authors as a basis for classroom discussion. It has been used in three undergraduate courses (Auditing, Business Law and Legal & Ethical Environment of Business) and one graduate Strategic Accounting course. The case encourages students to consider such matters as internal control, bank fraud, leadership policy and ethical behavior.

Jimmy just received the dreaded phone call he was expecting. It was the Federal Bureau of Investigation (FBI) telling him to wait in his office until they got there; they had some questions to ask. Two hours earlier that same day, Jimmy was explaining the events that transpired over the past seven years to his manager, Morgan, the Executive Vice President (EVP) of First Star Bank. Even as Jimmy was explaining these facts, his only thought was why? Why did he do this?

Jimmy was the leading loan officer at First Star Bank, a large publicly traded federally chartered bank headquartered in his home town. In fact, he was First Star's top loan officer for the past five out of seven years. Based on his overall apparent performance along with his recognition within the bank, he was promoted to Regional Vice President (RVP) of Commercial Lending eleven months ago. He spent this morning explaining to the EVP that he started out by loaning money to the bank's customers that did not meet First Star Bank's rigid lending requirements. He provided loans to bank customers who started businesses such as coffee shops, gas stations, restaurants, bars, and small home repair contractors. These businesses were not the type of businesses the Bank was interested in lending its resources. The Bank considered these businesses as a high risk of failure.

Jimmy considered himself lucky. He found his

dream job in his hometown working for this major financial institution, First Star Bank. In fact, life treated him very well. He came from a working-class family. His father worked at the steel mill. He had one brother and one sister. Both of his siblings went to work at the mill once they graduated from high school. Jimmy wanted more and had no interest in a factory job. He was the first in his family to attend college. His high grades at a Catholic high school earned him a full scholarship to attend a local prestigious Catholic college. He majored in economics and graduated with honors. His department chair helped him secure a graduate assistant position at the local State University where he earned his MS in Finance. He was recruited by many firms and ultimately selected First Star Bank which evaluated Jimmy as a wonderful candidate for its Leadership Training Program. Secure in his future, he married his grade school sweetheart. The happy couple had three children, two in middle school and one in elementary school. Even though Jimmy enjoyed much success through hard work and long hours in his banking career, they still lived in a modest home in the suburbs that they purchased when they married.

When Jimmy's Leadership Training was complete, he was assigned to a local branch bank as a customer service representative. He opened and

closed accounts for customers and met most of their servicing needs. Jimmy had the authority to provide small personal installment loans and arrange for home equity lines of credit as long as the potential customer met the Bank's lending requirements. As time progressed and his performance was well documented, Jimmy was promoted to commercial lending at his branch. The bank's lending policies were stricter on commercial loans as compared to consumer lending. First Star Bank was known in the community and within the national banking industry to demand and require high quality credit standards, so it was not much of a risk taker. All commercial loans had to be fully secured and could only be given to First Star applicants with high credit ratings.

Certain business loans were automatically off limits to the Bank, regardless of how sound a business plan appeared. That was very upsetting to Jimmy personally. Jimmy considered some of these business people and inventors having solid-loan-worthiness business plans that were virtually guaranteed to be a success; they only needed some startup capital. After several years of rejecting his customers' loan requests, which he agonized and hated to do, he figured out a way to help. Having been at the First Star for more than seven years, Jimmy knew exactly what the Bank would check and what they would not check in terms of paperwork and due diligence. Once a loan is actually disbursed from First Star, no one at the Bank would routinely review loans unless they went delinquent and forced into a work-out phase. Jimmy decided to help these really nice customers. Why shouldn't they get a loan for a coffee shop or to start a home repair business? Consequently, Jimmy took an inspired approach, by giving several smaller personal loans to every adult in the home. At first it was just the parents, but later any child that had the same or similar name to the parent, regardless of age. He just used the same credit check that was used on the parent. No one at the Bank ever checked with follow up procedures.

After Jimmy was promoted to commercial loan

officer (CLO), he realized no one at the Bank ever checked or reviewed smaller commercial loans. By intentionally increasing the value of the collateral and adjusting the financial statements to increase the value of personal assets, he could confidently provide loans to customers without any red flags. All Jimmy had to do is work with his customers and he never met them at the Bank. He would visit them at their place of business, their homes, coffee shops, bars, restaurants, or other mutual meeting places. They were extremely grateful for this help and they soon became Jimmy's close friends. The Bank never questioned Jimmy about not being in the office simply because of the large growing loan portfolio. Jimmy was executing over the top customer service and through the assistance of modern technology, a virtual office environment predominately.

Furthermore, because of his success and emerging prominent role at the Bank, Jimmy was becoming quite well-known in the community. He was sought out and very active on several not-for-profit boards. He would hold seminars and promote First Star Bank to local chambers of commerce as well as network with leadership of these organizations to further enhance his brand and contacts. He was supportive and would often join any organization whose mission was to make the community a better place. He also served in several capacities at his place of worship. All of this volunteer work, along with word of mouth promotion by his Bank customers/friends, generated even more lending business for Jimmy. At the time of his promotion to CLO, his commercial loan portfolio exceeded \$150 million dollars.

Things were going really well for Jimmy until approximately the stock market crash of 2008, which was totally unexpected. Just about everyone was affected, some Bank customers more than others. Coffee shops, bars, restaurants, and home repair companies found it hard to maintain their customer base, as unemployment rose to record levels and those still working cut back on non-essential expenses. To help his friends through this rough patch, Jimmy needed to be more creative about supplying additional dollars to them. He

decided to raid unused lines of credit balances of his “well to do” customers and use the money to either pay off loans, extend additional credit, or just make payments to keep the loans to more riskier customers from default. Once he exhausted those funds, he turned to using collateral of these “well to do” businesses to guarantee new loans given to his other customers. He contacted these unsuspecting bank customers and told them that the Bank needed to have their files updated to meet new government regulations such as the Dodd-Frank Bill. These unsuspecting customers needed to sign new security instruments and collateral forms. In some cases, he had them sign new promissory notes. Again, Jimmy met them anywhere they wanted, except his office. He did not want to inconvenience them any more than necessary to get the forms signed. He always brought blank forms to sign and then told the customers that he grabbed the wrong file and/or would fill the forms in when he returned to the office. These customers did not suspect anything was wrong because they trusted Jimmy and he seemed to always be looking out for their best interests. Jimmy, however, created fictitious companies and used the collateral and financial guarantees of these “well to do” lending relationships. To avoid any problems, he had opened P.O. Boxes for each of these new fictitious companies at the several post office branches in the community. In some cases, he just forged names on documents. He also provided forged notaries when the documents required a notary.

While Jimmy was solving his own banking problems, First Star was facing a few challenges. The first was that the Bank was a major originator of loans underwritten by the U.S. Department of Housing and Urban Development (HUD) and Federal Housing Administration (FHA) which did not meet the government’s applicable requirements. The Bank ultimately agreed to a \$180 million settlement with the Department of Justice as a penalty in conjunction with this matter. However, on what appeared to be a positive note resulting from the stock market crash in 2008, First Star being a conservative and well run financial institution had the ability to acquire

weaker banks. They chose to make an offer on Blue Sky Bancorp, a smaller financial institution about one-fifth the size of the Bank and with a contiguous geographic footprint to First Star. In the process of putting forth an offer to acquire Blue Sky, First Star knew that it needed to enhance its internal audit department and strengthen its own internal controls especially revolving around foreign currency, loan authorizations and money laundering.

As First Star was enhancing its system wide internal audit and control procedures, standard year-end reporting processes would prove to be very problematic and stressful for Jimmy. For example, standard year-end techniques for compliance and tax reporting matters such as annual statements would be sent by First Star to their loan customers. The customers whom all called Jimmy their friend and trusted adviser at the Bank began to inquire that the loan balances were wrong or that there was some other problem on the disclosure form. Jimmy would meet with each at their home or business and assure them that the bank’s computer files were corrupted and that he would make sure that it was corrected. However, when a CFO, at a major client of the Bank, decided to do an end around Jimmy and contacted the Bank directly for answers, the questionable lending practices began to unfold. The Bank’s outside auditors and fraud examiners, who were already contracted for due diligence for the Blue Sky deal, had to also begin reviewing all of Jimmy’s files and uncovered major irregularities with his accounts. The independent professionals determined that the “well to do” Bank customers were scammed in the amount of approximately \$12 million dollars. The Bank was able to recover \$1.5 million that Jimmy had not yet disbursed. Throughout all the years that Jimmy was employed by First Star Bank, it was believed that he never requested a kickback from his customers, nor did he ever accept any gifts from them aside from small Christmas gifts of cookies and bottles of wine. He was honest with the Bank’s EVP when asked about his loans and now he would cooperate and repeat the same details to the FBI when they arrive.

QUESTIONS:

1. Describe Jimmy's actions.
 - a) Would any of them constitute fraud? Why or why not?
 - b) Would any of them constitute unethical behavior? Why or why not?
2. Regarding Jimmy's work activities did he violate any duties to his employers?
 - a) Which duty or duties? Explain your reasoning.
3. Were any of Jimmy's actions illegal? Explain your answer describing which activity and which crime.
4. Could Jimmy's actions be prosecuted for Bank Fraud?
 - a) What elements of proof are required to charge Jimmy with bank fraud?
 - i) If yes, would the prosecution be successful?
 - ii) If successful what punishment should the judge impose?
5. If Jimmy were convicted of a crime, should he receive probation or incarceration?
6. If Jimmy is not jailed, should the Bank keep him employed? In what capacity?
7. What culpability, if any, should be assessed against First Star Bank for Jimmy's actions?
 - a) Did First Star Bank act unethically? Explain your answer.
 - b) Was First Star Bank responsible for contributing or encouraging the loan officer's actions? If yes, how so?
 - c) What changes should the bank implement to prevent this type of fraud in the future?
8. Why did it take this publicly traded bank five years to discover the fraud?
9. What changes in policy and or procedures should the Board of Directors of First Star Bank implement to prevent problems in the future?

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