WHETHER YOU GET PUBLICLY OR PRIVATELY SLAPPED VARIES ALL OVER THE LOT

As most of you know, our firm has the opportunity to represent banks from Maine to Alaska. As a result, I am on the road close to 300 days a year (at least lately). One issue has jumped out at me recently, and that is the inconsistency of regulation, not just between the agencies, but between regions within the same agency. This primarily deals with troubled institutions.

Where it begins

My general benchmark for dealing with troubled institutions, i.e., when somebody calls me and indicates they have just had an exam, is for me to ask, “What is your ratio of classifications to capital?” For example, if your bank has $10 million in capital and $5 million in classified loans, your classifications to capital is 50%.

The general regulatory benchmarks for classifications to capital, at least in the current aggressive regulatory environment, has been that if your bank is over 40%, you’re looking at an informal enforcement action, at the least. If your bank has over 70% classifications to capital, you’re probably looking at a formal enforcement action.

However, that’s not necessarily going to be the case for every bank.

I have had some banks that have been as low as 60% classifications to capital which have been hammered with a formal enforcement action. And I recently had a bank that was “north” of 142% where the regulators were proposing a only a Memorandum of Understanding.

In my experience across the nation, there is very little consistency in regulation or approach to troubled institutions. The greatest discrepancies are seen among banks supervised by FDIC (the federal agency with the most banks). Different regions treat their banks totally differently. Granted, classifications to capital are not the only thing that drives enforcement actions, but they are certainly an indicator of the health of the institution. It is hard to justify a bank with 67% classifications to capital “needing” a formal enforcement action and a bank with 140% plus being okay with an informal action. Often, the difference is management, but that management differential would be hard to justify.

This needs fixing

My suggestion is that the agencies get their act together and at least have some consistent standards.

Standards would be appropriate—not a bright-line test, just guidelines—within both formal and informal enforcement actions.

For example, when does a bank get a board resolution instead of an MOU? When does a bank receive a formal agreement instead of a consent order? The regulators are big on “progressive” regulation. Where does the progression start? Although bright-line tests with no discretion are virtually always inappropriate, some regulatory guidance and some consistency between the regions would be appropriate.

As many of you know, the regulators have many different alternatives. The FDIC now, thank goodness, has moved to the Consent Order and away from the Cease and Desist Order, unless the bank contests the matter. (See my earlier article for more about that. http://www.ababj.com/blog/375.html.) Board Resolutions and Memorandums of Understanding, neither of which are public or enforceable, are always great choices.

Know what you’ve been hit with—and consider more negotiation

What never ceases to amaze me is the need of the regulators to have some “public paper”—just to have it. It is highly unlikely that an enforceable action is going to help the bank raise capital or clean up its assets, any more than an unenforceable commitment through a memorandum or resolution will.

Keep in mind that although a Memorandum of Understanding looks like something that is an enforceable Written Agreement, it is not. It is also not public. It seems to me that would be a good substitute for a lot of what is going on lately.

Even though the Federal Reserve’s Written Agreement, the OCC’s Formal Agreement, and now the FDIC’s Consent Order are much more user-friendly as it relates to public relations and potential liquidity issues than they have been in the past, my recommendation is to push for a Memorandum of Understanding. It makes sense, provides a moral commitment for the bank, and yet it is not public.

If the regulators cannot collectively back down to informal enforcement actions, it would certainly be helpful to have some guidance as to when formal actions are triggered. It would probably help the regulators, as well, because there are a lot of banks out there with north of 100% of their capital classified that do not understand why they are being subjected to something formal and public.

About the Author

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