

## THIRTY DAYS TO A BETTER LIFEâ€™NOT!

Regulators seem to impose capital plans like they want them to flop

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Many community banks are searching for capital. For some, the goal is to take advantage of the multitude of opportunities that are, and will become, available. For most, however, the quest is the result of consenting to an enforceable regulatory agreement or order that contains a capital requirement. Unfortunately, for those who are really "desperate" to raise capital and are subject to a Prompt Corrective Action Directive requiring them to raise capital, there is a total disconnect between a regulator's issuance of the Prompt Corrective Action Directive and the ability of the troubled institution to raise capital.

The regulators' CYA mode requires them to issue a Prompt Corrective Action Directive (so does the statute) when the bank gets to Less than Adequately Capitalized or Undercapitalized status. What the statute does not require is that the PCA Directive have a short trigger. Yet many of the recent PCA Directives have had a 30-day trigger. As a practical matter, the regulators' desire for CYA, and that they not be subject to an ugly Inspector General's Report if the bank fails, simply makes it more difficult for the bank to raise capital.

To put this in a real world context, when a bank fails to maintain a Tier 1 leverage ratio of 4.0% or greater, a Tier 1 risk-based capital ratio of 4.0% or greater, and a total risk-based capital ratio of 8.0% or greater, the regulators are required by statute to order the bank to create a Capital Restoration Plan. This is generally done by sending the bank a "Directive." We have dutifully created numerous Capital Restoration Plans as required by the Directive for our community bank clients and submitted them to the appropriate regulator. The regulator, in every circumstance, has summarily rejected the Capital Restoration Plans because none were accompanied by a check (or an escrow account) for the requested amount of capital.

Under the statute and regulations, once the regulators reject a Capital Restoration Plan (the rejection of which is not public), the regulator is required to send the bank a Prompt Corrective Action Directive, directing the bank not to just come up with a plan, but to either raise capital or find a merger partner within some reasonable period of time. The problem is, the regulators' definition of "reasonable time" and the bank's definition rarely coincide.

In many of these Prompt Corrective Action Directives, the regulators' definition of a "reasonable period of time" is as short as 30 days. Think about the impact on a bank already trying to raise capital when that PCA Directive hits the airwaves. If the bank's holding company is a public company, then the holding company is required virtually immediately to file an 8-k, letting the world know that the bank allegedly has 30 days to raise capital.

To say this throws the holding company's potential investors into a dither is an understatement. The investors all think the bank is going to fail at the end of 30 days, which, in reality, it is not.

Recently, I received a call from the CEO of one of our community bank clients at 9:00 p.m. The CEO had just opened his mail and was the not-so-proud recipient of a PCA Directive which required the bank to raise about \$30 million in capital in 30 days. My advice to him: "Go get a good night's sleep. Nothing is going to happen in 30 days absent a liquidity crisis."

If the bank receiving the PCA Directive is a private company, then the Directive is still published on the regulators' website, according to their normal publication guidelines, and at that point, the announcement throws the potential investors into a dither because they think the bank is going to close (or they view it as an opportunity simply to wait for the bank to close).

The reality is that the regulators' issuance of a PCA Directive is about as counterproductive for a bank trying to raise capital as anything that could be imagined.

Most of the uninitiated potential investors (and I include some of the larger investment banks that do banking work in that group) think the bank is going to close in 30 days.

The reality is that to date, that has never happened. Some banks receiving PCA Directives eight months ago are still open and operating.

The regulators' desire for CYA through a PCA Directive and the bank's goal to raise capital and keep the doors open intersect in a bad way in this environment.

About the Author

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