

## DOES P.C.A. REALLY MEAN, "PROBABLY CAN'T ACHIEVE"?

A bank holding company can't pledge what isn't there

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Prompt Corrective Action ("PCA"), or as I like to say, "Probably Can't Achieve," was put into the law in the Federal Deposit Insurance Corporation Improvement Act of 1991. A Prompt Corrective Action designates certain capital categories from "well-capitalized" all the way down to "critically undercapitalized," with stops along the way of "adequately capitalized" and "significantly undercapitalized."

It's not a fun trip. But I've put together a "map" for those who may have to take it, and those who want to know where not to go.

### PCA theory versus reality

When a bank becomes less than "adequately capitalized" (basically less than 6% Tier 1 leverage ratio or less than 10% total risk-based capital under the Prompt Corrective Action requirements, it is obligated by the direction of its primary federal regulator to submit a capital plan reflecting how it intends, in its weakened condition, to restore its capital to an adequately capitalized position.

The capital plan has to be a realistic, viable plan that the regulators can accept. It also must contain a guarantee from the bank's holding company that it will comply with the plan and provide appropriate assurances of performance.

Our firm has assisted dozens of troubled banks across the nation to formulate and submit capital plans. I am firmly convinced that no capital plan will be acceptable to the federal regulator unless it has a check representing the amount of capital to be injected pursuant to the plan or the account number for the escrow account which is full of the money required.

Also, I encountered a surprising situation with one of the federal regulators the other day with respect to a PCA capital plan. The bank had submitted the plan, which was to raise equity or sell the bank. The bank indicated that the holding company would guarantee the execution of the plan, as is required.

That, apparently, was not enough for this federal regulator.

The regulator indicated that the holding company guarantee must be accompanied by a pledge of all holding company assets. (To whom the assets should be pledged, I was not exactly sure and neither was the regulator. I suppose they could be pledged directly to the federal regulator (or his parents or children) and the Deposit Insurance Fund?)

### Parsing a PCA order

Now, think this through with me.

The typical bank holding company (the one in question was a holding company under \$500 million) has a balance sheet

that reflects generally two things on the asset side.

The first is a small amount of cash.

The second is "investment in bank," i.e., the holding company's primary asset is the stock in its subsidiary bank.

On the other side of the balance sheet, the holding company reflects its liabilities, which could be to the government under TARP; to holders of the company's trust-preferred securities; and in this particular situation, to the bank stock lender who was secured by 100% of the bank stock, i.e., the only asset on the holding company's balance sheet truly pledgable.

Exercise in futility?

Notwithstanding the facts, the federal regulator insisted that there be some type of collateral pledged to the guarantee. (Frankly, I really think this particular regulator (not the Federal Reserve) did not understand holding company structure and balance sheet issues.)

There was really nothing to pledge.

I did offer, however, to allow them to participate in the equity offering if they would like, or to take a seat on the board. I suppose that will occur soon enough.

Prompt Corrective Action, and its tentacles, literally means "Probably Can't Achieve," particularly when the demands are unreasonable.

About the Author

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