

LIFE UNDER AN ENFORCEMENT ORDER, PART TWO

"Abandon all hope, ye who enter here," might be a bit strong. But maybe not

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You can also read Parts One and Three , the conclusion.

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Life as a community bank these days, in many states, is not much fun.

But life under a Consent Order can be a living hell.

A glimpse beyond Hell's gates

Once a bank is under a Consent Order it has virtually no leverage in dealing with its primary regulator.

Consider operating under a few of the standard Consent Order provisions. These standard provisions include commitments to:

Increase the participation of the Board in the supervision of the bank.

Provide management acceptable to the regulators.

Maintain capital (or increase it to) at a certain level for the life of the Order.

No dividend payments without permission of the regulators.

How does a Board know it has increased its participation in the bank's affairs?

What is acceptable management?

What does the bank do if it cannot raise capital?

What happens if the bank would like or needs to pay a dividend?

How can your Board comply once you're under an Order?

Rulebook: Most of the regulators will tell you that a Consent Order provides a "corrective program" for the bank. It is not designed to be "punitive."

Reality: It is often tough to tell the difference between a punitive program and a "corrective" program.

Going to the question of increased board participation, for instance. Does that mean instead of meeting monthly the Board is supposed to meet weekly? Does that mean the Board is supposed to begin micro-managing the institution? Does that mean the Board should use additional outside resources?

And does "increased board participation" mean the same thing for every bank?

I have had several clients who, when looking at that provision, indicated that they could not possibly have the Board more involved in the affairs of the bank.

In other words ... this is a boilerplate provision gone mad.

The Management element of the Order ... and the Board's role

How do you know if management is acceptable to the regulators?

The usual discussion by the regulators on this particular paragraph of the Consent Order is that, if we (the regulators) thought your management ought to be removed, we have ways to do that.

That is frankly not a whole lot of help.

How do the board members know they are not in violation of the Order the minute it is issued? The answer is, they don't.

The issue about management being acceptable to the regulators will only be tested the next time the regulators come in. If the examiners think that management is making progress toward compliance with the Order, then it will probably be deemed acceptable. If they are not, then, who knows what will happen?

This is about as baffling as having managers who have been in the bank for 20 years and has always been rated a CAMELS 1, go to a 5 because asset quality has deteriorated. If it is the same management, then either they were improperly rated for the last 19 years and properly rated this year, or properly rated for the last 19 years and improperly rated this year.

Capital ideas ... yours, and the regulators'

What about the capital paragraph of the Order? This is a paragraph that requires the bank to maintain a certain level of capital over the life of the Order.

Here we have fact and fiction at play.

What about the bank that knows it cannot raise a single dime of capital? Does the bank's leadership consent to an Order knowing they will be in violation the minute they agree to it?

At least one of our clients has said "no"-which is the only reported decision by the FDIC in the past 12 months.

So, say you've gone ahead and signed, and sworn. What if you attempt and fail to raise the capital? Are you still in violation of the Order? Technically, yes.

The regulators will give you their standard stump speech about how if you act in "good faith" they will not come after you for civil penalties. In order words, "trust us."

Also, the little-focused-on provision of the standard Order says that capital, for purposes of the Order, will be calculated pursuant to Part 325 of the FDIC's Regulations. Part 325 basically says that if the state or federal examiners come in in an exam or visitation and classify some loss, it gets charged off. The bank could easily be in a position where the Board believed it had 9% Tier 1 capital and 12% total risk-based, and as soon as the exam gets halfway through, the bank is now down to 6% Tier 1 and 8% total risk-based, and in violation of the Order, with no time under the Order to correct the violation.

What do you do then?

And what about the dividend restriction?

The dividend restriction is fairly consistent throughout all of the agencies in connection with their enforcement actions.

The federal agencies want to conserve capital, understandably. Unfortunately, some of the decisions made under the dividend restriction can only be characterized as idiotic.

I recently had a client who, for the past couple of years, had paid a nominal dividend to its shareholders: One penny a share. This totaled a whopping \$22,000.

This is a \$300+ million bank with "well-capitalized" status. The bank just entered into a fairly typical Consent Order, which my firm helped it negotiate. It has a capital requirement and it has a dividend restriction.

For the last two quarters, before the bank consented to the Consent Order, it had applied for and received permission to pay the whopping \$22,000 one penny per share dividend. The bank also applied to pay the third quarter dividend.

Now that the Consent Order is in effect, the regulators decided to disapprove the dividend.

The payment of a \$22,000 dividend will impact this bank's capital less than 1 basis point.

The bank is likely to make \$3 million this year.

Is this punitive?

You be the judge.

Editor's Note: We invite bankers, board members, examiners, and anyone else who has had involvement in the examination or regulatory order processes to share their thoughts and experiences here. If you have questions of a general nature—not regarding specific banks or events—please email them to scocheo@sbsub.com for consideration for answering in future blogs.

About the Author

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