

You can fight proposed enforcement actions (April 8, 2009)

Many boards cave in quickly to examiner orders, but you have rights

By Jeffrey C. Gerrish, chairman, Gerrish McCreary Smith Consultants, LLC, and a member of the Memphis-based law firm of Gerrish McCreary Smith, PC, Attorneys jgerrish@gerrish.com

[This article was posted on April 8, 2009 on the website of ABA Banking Journal, www.ababj.com, and is copyright 2009 by the American Bankers Association.]

A regulatory enforcement action. Sounds pretty ominous! The regulators euphemistically call them "corrective programs." If your bank has not had the opportunity to participate in this exercise in the past, you are likely, in the next 12 to 24 months, to have the opportunity to consider some type of an enforcement action by the regulators. It seems that the regulatory strategic initiative (written or not) is to put virtually every bank in the country under some type of "corrective program."

You will be in good company. Not that that will make it any more fun.

Classifying regulatory orders

Regulatory enforcement actions fall into two distinct categories: those that are enforceable by the regulators and those that are not. The latter are generally referred to as "informal actions"—Memoranda of Understanding, Agreements, or Board Resolutions, as detailed below.

Those that are enforceable are labeled (depending on which regulator) as Formal Agreements, Written Agreements, or Cease-and-Desist Orders and are enforceable with civil money penalties, and in some cases, by the Federal District Court.

The civil penalties, according to the statute, cannot exceed approximately \$1.2 million per day, per infraction, per director of bank, or other institution-affiliated party. No big deal!

The secret about enforcement actions

One fundamental principle in the enforcement arena that is not well understood is that the board of directors of the bank is in control as it relates to the proposed enforcement action by the regulators, formal or informal.

Fortunately, we live in the U.S. Guantanamo Bay is in the process of being closed and the new Administration has outlawed torture, however you define that. As such, the bank regulators are unable to force a board of directors to agree to any type of enforcement action.

If the board refuses to agree to an informal enforcement action, then the only alternative the regulators have is to initiate an administrative proceeding. The goal of that is a formal enforcement document. If the board declines to consent to a proposed formal enforcement document then the regulators really have no alternative but to initiate an administrative proceeding to try and obtain that document.

Regulators do not like to go through the administrative proceeding process because it takes too much time. It also ties up their resources. In addition, during the time the regulators are attempting to impose some type of enforcement order on the bank, the bank is not under any kind of enforcement action and is basically unfettered in its activities. (The exception is some emergency powers the regulators have if you are really dissipating the assets of the bank).

The bottom line of all this is that the board of directors is in control.

The practical result of this dynamic is that regulators regulate by intimidation when it comes to enforcement actions. There are some regions of the country where our clients have literally experienced the "screaming regulators." This is where the regulator assigned to your bank will literally scream at the CEO, trying to intimidate the board into consenting to an enforcement action.

Some are more subtle. But all realize that if they cannot get the board to voluntarily do what they want, then there is a long process they must go through to give the bank its day in court. This process involves the appointment of an administrative law judge; the issuance of a Notice of Charges (similar to a civil complaint); the bank's opportunity to answer; the conduct of discovery for documents on both sides; an administrative hearing before the judge; recommended decisions to the agency; and the like.

It's a very long and laborious process—possibly as long as a year—during which the agency has no enforceable corrective program for the bank without its consent.

The board can voluntarily agree to consent; the board can agree not to consent and go through the administrative hearing; or the board can, through its advisors, negotiate and consent pretty much anywhere along the way. The board is in control.

A order by any other name…

As noted above, enforcement actions, formal and informal, come in all shapes and sizes. Interestingly, there is no uniformity between the three major bank regulatory agencies with respect to formal enforcement actions. The Federal Reserve uses what is called a Written Agreement. The OCC uses a Formal Agreement. The FDIC uses a Cease-and-Desist Order. The authority for each one of these actions emanates from the same section of the Federal Deposit Insurance Act.

Why the difference in the regulatory agreements? Because that is the way they have always done it.

As far as the boilerplate provisions of the formal enforcement action are concerned, the Federal Reserve's Written Agreement is the least offensive. It simply says that the bank and the Fed have agreed to the following corrective program.

The OCC's Formal Agreement is a step up in the "offensiveness" category, in that it recites that the bank has engaged in unsafe and unsound practices and the like and has agreed to the following corrective program.

FDIC's Cease-and-Desist Order is the most offensive and the greatest risk to the bank's liquidity and reputation. It recites in the boilerplate all kinds of horrible things the bank has done, from operating with hazardous management to lax collection policies to inadequate capital, etc., and that the bank and the agency have agreed to a corrective program.

One major issue with enforcement actions of the formal type is that they are all public. This is required by statute unless an agency determines there is good reason not to make the agreement public, which the agencies never do.

Now that you're in control…

So, the board has a lot to think about when having received an exam in which the bank is rated 2, 3, 4 or 5, and having been proposed an enforcement action, either formal or informal. Issues include the following:

- Do we consent?

- Do we negotiate toward a consent?

- Do we force the regulators to move through their administrative proceeding, which will garner us the time to correct the problems?

- Do we force the regulators to go through the administrative proceeding and then negotiate a consent?

- Can we stand the publicity that results from a formal action?

- Can the bank and the board stand the risk of civil money penalties associated with a violation of an order which the board acknowledged on the front end would be impossible to comply with?

These are all real issues when dealing with a formal enforcement action in particular.

Implications to consider

The landscape is changing dramatically in the enforcement arena. The banks need to know their rights and know their options. They also need to know the regulators's rights, options and strategies.

Do not think that consenting to an enforcement action is "no big deal."

It is a big deal. The consent to an unwarranted and inappropriate enforcement action with content you cannot comply with will not only subject the bank and its directors, officers, and other institution-affiliated parties to the potential of civil money penalties, but will also prohibit the bank from taking advantage of virtually any expansion or other opportunities for a two-to-three-year time period.

Do not go it alone. Get professional advice, from your advisors of choice. BJ

[This article was posted on April 8, 2009 on the website of ABA Banking Journal, www.ababj.com, and is copyright 2009 by the American Bankers Association.]