

UPDATE

News of Developments in the Financial Sector and Related Areas

* *IN THIS ISSUE* *

Regulatory Enforcement Actions

Regulatory Enforcement Actions

Although the number of banks on the FDIC's problem list has declined, the banking industry continues to see regulatory enforcement actions with banks experiencing loan portfolio problems resulting in inadequate capital and unresolved compliance issues. One of the concerns facing banks will be the ability to remain in compliance with regulatory capital requirements.

Bank regulatory agencies have a variety of enforcement actions available to them ranging from *informal actions*, such as memorandums of understanding and voluntary board resolutions, to *formal actions*, such as written agreements and cease and desist orders. Informal actions are not available to the public, while formal orders are available to the public. Informal enforcement actions provide a bank with explicit guidance and direction and evidence the commitment of the board of directors of the bank to correct identified problems, such as set forth in an examination report, before they adversely affect the bank's performance or cause further decline in the

bank's condition. Informal actions are generally viewed as voluntary corrective administrative actions and represent an alternative to formal agreements or actions. Formal actions which have the most impact on a bank are available to the public and in most cases are accessible on the website of the regulatory agency having supervisory responsibility over a bank.

Enforcement actions by bank regulatory agencies are issued for unsafe and unsound conditions or violations of law and regulations. These actions will typically direct the bank to insure the safety of its insured deposits, preventing unsafe and unsound banking practices and violations of law, insuring minimum capital levels and requiring adequate compliance programs. Depending on the circumstances, an enforcement agreement or order will require (i) a bank to maintain an approved capital plan and minimum capital, (ii) board monitoring committees, (iii) retention of outside experts and professionals to prepare and revise bank policies and procedures, (iv) a written plan for reduction in classified assets, (v) a management plan, (vi) a strategic plan, (vii) limitations on the hiring of new management personnel, (viii) prior approval for payment of dividends, (ix) prior approval for changes in directors and (x) periodic progress reports to supervisory bank regulatory agencies.

In those situations where a bank fails to achieve compliance with an informal enforcement action, a formal enforcement action will generally follow to address the

outstanding deficiencies. A cease and desist order can be issued with consent of the bank through its board of directors or following an administrative hearing. In either case, whether by consent or through an administrative hearing, a cease and desist order is legally indistinguishable in its effects. Formal orders that require a bank to meet and maintain certain capital levels will no longer be *well capitalized* under the Prompt Corrective Action regulations regardless of what the actual capital ratios may be. A formal order will generally prohibit a bank from accepting or renewing brokered deposits without prior regulatory approval.

In those situations where a bank has failed to achieve compliance with a formal enforcement action, additional enforcement actions are available, such as the assessment of civil money penalties against the board of directors, enforcement of the action by a federal court or a requirement for the sale, merger or voluntary liquidation of the bank.

Regulatory bank enforcement actions increase the operating costs of a bank, while at the same time, revenues and funding sources may decline as a result of customer and credit concerns. Civil money penalties may be substantial for failure to comply with an agreement or order once it is entered which is a substantial reason for addressing an enforcement action aggressively and effectively in order to resolve the underlying issues.

It is important for a bank to retain the services of legal counsel when facing the possibility of a regulatory enforcement action. Formal enforcement orders will generally require an opinion by counsel for the bank that the order is valid and binding on the bank. Experienced legal counsel will be able to assist the board of directors of a bank as to the terms and conditions of a proposed formal order. Once the formal

order has been agreed upon, a meeting between the board of directors and supervisory regulatory agencies is generally required. Once a regulatory action becomes known, a bank must be prepared to address concerns of its employees, shareholders, customers and creditors. Depending on the terms of credit agreements between the bank and its lenders, funds for liquidity may no longer be available, or alternatively, have to be immediately repaid. It is imperative that a bank be prepared to deal with these concerns and issues prior to regulatory enforcement actions becoming available to the public.

Once a formal order is entered, it will be available on the website of the primary federal regulatory agency. Although an informal order is not available to the public, it may have to be disclosed when the bank is attempting to raise capital through a securities offering. If an informal order contains material restrictions or conditions such as a limitation on the payment of dividends, securities law would require disclosure of those conditions that are material to an investor making an investment decision regarding a bank.

Both informal and formal orders will generally stay in place until the bank is examined again and found to be in compliance. Once a bank receives either an informal or formal order, its parent holding company should be prepared to expect a similar enforcement action either following the entry of the action at the bank level or when the holding company is examined. A bank should not rely on the statements or understandings of examiners during an examination regarding matters relating to enforcement actions. Decisions within supervisory regulatory agencies regarding enforcement actions are made at higher levels.

It is important to work with legal counsel who have experience in regulatory

enforcement actions and dealing with bank regulatory agencies. Our firm has extensive experience in representing financial institutions before federal and state banking and securities agencies and is available to assist and answer questions involving regulatory enforcement actions.