ENFORCEMENT ACTIONS, PART II

by Steve Brown

Yesterday in our "Winding Down" discussion, we covered formal and informal enforcement actions, so we pick up there as we begin by exploring the world of the prompt corrective action (PCA). The PCA is usually selected instead of an enforcement action when banks are found to be undercapitalized, significantly undercapitalized or critically undercapitalized and regulators are concerned the bank's problems could develop into serious issues that threaten its own viability. Perhaps surprising to some, regulators also have the flexibility to impose even more severe limitations than a bankÃ¢Â€Â™s capital category would require. These include reclassifying a well-capitalized bank as adequately capitalized; requiring an adequately capitalized bank to comply with requirements of an undercapitalized bank; or requiring an undercapitalized bank to take actions applicable to significantly undercapitalized banks. The key is a determination by regulators whether or not the bank is already in an unsafe or unsound condition or is engaging in unsafe or unsound practices. The overriding driver of PCA behind the scenes is its purpose, which is to resolve the problems of problem institutions at the least possible long-term cost to the deposit insurance fund. So, in short, if regulators break out the PCA stick, you can bet even money the bank's time clock has probably wound nearly all the way down. In fact, regulators will place banks into receivership nearly automatically when the bank has tangible equity capital of less than 2%.

The PCA is triggered by capital categories, but regulators have other options and can even initiate an early resolution under certain circumstances. The most common include banks that are losing capital; have no realistic prospects for recapitalization; are engaging in practices likely to increase losses to the FDIC fund in the future; are engaging in unsafe and unsound practices that have a substantial negative effect on the bank; or suffer from critical management failures. In general, enforcement actions of all varieties are a tool regulators will use to ensure bank boards and management focus on rehabilitating the bank before things become too ugly and resolution is required.

There are some things bankers can do specifically to avoid an enforcement action. These are beyond staying on top of laws, rules and regulations or ensuring you have proper controls and procedures. Regulators tip toward formal enforcement actions when banks have serious problems or weaknesses in systems, controls, internal audit programs, operating policies, methods of operations or management information systems. They are also usually triggered when serious insider abuse surfaces (involving members of senior management or the board) or there are compliance problems or substantial violations of law. Finally, they can be triggered when banks respond inappropriately to prior supervisory efforts; do not maintain the books & records; attempt to limit what and how examiners review; or do not comply with informal enforcement actions. Doing these is about as smart as a broken clock - it will be right 2x per day, but will still be broken.

It is important to understand that even regulators have rules they must follow. That is one reason why formal actions are made public, PCA directives are disclosed and banks that receive an informal or formal order are assessed for compliance every 6 months. It is also why regulators check to be sure banks have done everything in their action and it has been verified through the examination process. It is also why actions are not terminated until the bank has complied with all of the articles.

The balance between regulator and banker can be uncomfortable at times, but it is nonetheless a symbiotic relationship that spans the ages. Our industry is one of rules and rules must be followed by both groups. Overreaching can occur, but the rules over time also bring order and process to the industry. Perhaps that is one reason why time is critical to any enforcement process and why time must also pass if we are to heal the industry and get everyone back to lending again.

BANK NEWS

Deleveraged

The latest Fed data shows investment and other US banks have decreased their ratio of debt to assets from 36 to 1 at the highest levels in 2007 to 7 to 1 in Oct. As an aside, MF Global was about 33 to 1 before it collapsed making bad bets on the European crisis.

Unlikely Cut

Fitch Ratings said it was unlikely to cut the US credit rating from AAA in 2012, even if the European debt crisis deepens. Fitch said it would give the new US government that will come into office in 2013 several months to come up with a credible deficit-reduction plan before deciding on the rating.

QE3

A recent Bloomberg survey of economists at Primary Dealers show that 76% foresee another quantitative easing program from the Fed.

IPO

November was one of the busiest of the year for initial public offerings with 13 new deals coming to market.

French Rating

Moody's is warning that a deteriorating market climate and weaker growth prospects could lead to a downgrade of France from its AAA rating. We say "bienvenue."

Strange Bedfellows

Citizens Bank opens their 2nd branch inside a Cambridge, MA, Dunkin Donuts.

US Bank

The Bank extends its "SinglePoint" web portal to mobile devices for its business clients. Clients can now access a menu of basic treasury and account management services.

Housing

Largely driven by falling asset prices and lower interest costs, the cost of owning a home is now the lowest in 15Ys. Homeownership is now less expensive than renting in a number of cities.