

## Failure Spurs Questions on Timing of Enforcement Orders

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By Joe Adler and Cheyenne Hopkins

WASHINGTON — The failure last week of the Kansas community bank Columbian Bank and Trust Co. could be Exhibit A in a growing number of experts' argument that the system for giving enforcement actions to banks is flawed.

The agreement between the Federal Reserve Bank of Kansas City and Columbian Financial Corp. of Overland Park, Kan. — requiring the holding company to raise capital and restricting its transactions with affiliates — was signed only two weeks before the bank collapsed. It was not released to the public until Monday, three days after the bank's failure.

Critics said this scenario is becoming all too common. Regulators do not take action until it is too late to save an institution, and sometimes include requirements that are unrealistic given current market circumstances, these critics said. They said regulators also appear to hold back on releasing the orders until after its failure out of fear they will hurt a bank's chances to save itself.

"That's ... like ordering plastic surgery for someone who has just died," said V. Gerard Comizio, a partner at Paul, Hastings, Janofsky & Walker LLP, and a former deputy general counsel at the Office of Thrift Supervision. "It's kind of just mopping up the operation by formally declaring that there were violations of safety and soundness rules. ... I'm not sure what the point is."

Columbian was the fourth consecutive failure in which regulators took enforcement actions close to the institution's collapse and did not release the order until afterward. In other situations no formal enforcement action was taken at all. The OTS had not issued a public action against IndyMac Bancorp before it failed July 11.

This raises serious questions about the enforcement order process, observers said.

"I don't think it's broken, but I think it's taken too long" to get orders out, said Nicholas Ketcha, a former director of the Federal Deposit Insurance Corp.'s supervision unit and

now a managing director at the bank consulting firm FinPro. "For it to be effective, it should be issued a lot sooner after the exam."

Regulators defend the process by saying public enforcement actions are not indicative of the work examiners are doing behind the scenes to right an institution.

Scott Polakoff, the OTS' deputy director, said examiners tell bank managers to fix problems as soon as they detect them, and the formal enforcement actions are just a document putting it all in one place.

"There's a difference between the document and the action management is taking," Mr. Polakoff said in an interview. "Very frequently, the regulators will say to management, 'Here's the action you must take,' and management is responsive to the regulators' demands. But there's a big difference between putting those demands in place verbally ... and crafting a public document."

Regulators frequently take informal actions that can help save a bank but that the public will never see, Mr. Polakoff said.

In those cases, "There's a regulatory action in place to have management address the regulatory deficiencies well before any document is finalized and released to the public."

Mr. Polakoff acknowledged, however, that lately institutions have collapsed much faster than in the past, so there is not as much time between an enforcement order and a failure.

"Recently, a number of institutions, regardless of charter, have ... really increased their risk profile between examinations, and frequently that's the result of economic stresses more than management actions during that period of time," he said.

That may contribute to the growing lists of orders that ask banks to accomplish tasks they may not be able to complete. In several cases — including First Priority Bank in Bradenton, Fla., which failed Aug. 1, and two western banks owned by First National Bank Holding Co. in Arizona, which failed a week earlier — the banks were asked to raise capital within a short time frame. But market conditions — and the banks' condition — made that unlikely if not impossible.

"You can tell a troubled bank that they need more capital, but they may be entirely unable to raise capital," said Ann Graham, a professor at Texas Tech University Law School and a former FDIC regional counsel in Dallas.

The Aug. 7 written agreement between Columbian and the Fed asked the holding company to create a new capital plan within 60 days and to focus on the "adequacy of the bank's capital, taking into account the volume of classified credits, concentrations of credit, adequacy of loss reserves, current and projected asset growth and projected retained earnings."

But in just a quarter of the allotted time, regulators shuttered the bank. (See related [story](#).)

"The regulators can try to be effective, but in some cases they just can't go out and raise the capital for the institution if no one will put money into the place," Mr. Comizio said. "Slapping them with a cease-and-desist order may make everyone feel good that the regulators have kind of done that, but it doesn't get to the real problem."

Some critics argue regulators wait too long to crack down on an institution, letting problems multiply at banks while they try to work them out through an informal process. By the time a formal action comes, it can be too late.

"Regulators give the benefit of the doubt to the bank," said Karen Shaw Petrou, the managing partner of Federal Financial Analytics Inc. "It's embedded in the culture of the agencies, this work-it-out culture."

For enforcement orders to be effective, they must be issued promptly, when a bank's managers can still correct problems, she said. "Until you've embarrassed" the board or the CEO, "you can't get change. That doesn't mean you need to drive them out, but you sure need to focus their attention."

To be sure, not every regulator is alike. Observers say the FDIC — concerned about an institution's effect on its Deposit Insurance Fund — has been more aggressive in using and calling for enforcement actions, while chartering agencies show more of a willingness to have a more informal exchange with an institution about its problems.

"The chartering agency, be it state or federal, might be inclined to work with the institution more before instituting the action, where the FDIC is pushing harder for putting formal or informal action in place," Mr. Ketcha said.

"The chartering agency historically has tried to work with the institutions. The FDIC comes from the position, 'We have to protect the fund.' That little bit of difference determines a lot of times who is going to be more aggressive or not."

The FDIC took action against Columbian Bank and Trust three weeks before the Fed targeted its holding company. But the July 15 cease-and-desist order has still not been made public.

While enforcement orders are up, they are still low by historical standards. The FDIC said it has issued 31 cease-and-desist orders in the first half of 2008. Last year, the agency handed out 48 such orders. In 1991, the agency issued 158 cease-and-desist orders.

"While each order is unique to a particular bank, the number of enforcement actions generally rise and fall with the business cycle," an FDIC spokesman said. "This correlation with the business cycle is not unreasonable considering the fact that the FDIC

has certain evidentiary burdens to meet before bringing a formal enforcement action against a bank."

Other agencies showed more varied numbers. The Fed issued 13 enforcement actions against institutions so far in 2008, which include cease-and-desist orders, civil money penalties, and other written agreements. That compares with 22 in all of last year.

The Office of the Comptroller of the Currency issued 38 orders last year and has issued 13 so far this year. The OTS issued 30 in 2007 and has issued 22 this year.

If enforcement actions are lagging, however, many observers said they expect more to come soon. "In this environment, if they don't act quickly enough they will be open to criticism that the matter got away from them," said Ralph Sharpe, a partner at Venable LLP and former deputy comptroller at the OCC. "That's going to be a very strong motivation to not only act sooner, but take more rigorous action when they get there."