

# ARTICLES

## Administrative and Judicial Review of Prompt Corrective Action Decisions by The Federal Banking Regulators\*

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## INTRODUCTION

The convulsion in the banking<sup>1</sup> industry<sup>2</sup> has subsided now as banks and savings and loan associations (S&Ls) have returned to profitability.<sup>3</sup>

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1. "Banking" is used in this report as a term of convenience to refer to the savings and loan (S&L or thrift) and commercial banking industries.

2. The federal deposit insurance funds for both industries have required extensive recapitalization after depletion by the massive round of S&L and bank failures. While the causes of failure for each industry are complex and not identical, the combined effect generated a common political response, both in Congress and in the Administration. See *infra* notes 6-12, 31-41 and accompanying text (describing congressional and administration response to S&L crisis).

3. The Federal Deposit Insurance Corporation (FDIC) has reported that federally-insured commercial banks "recorded their four highest-ever quarterly profits in 1992, resulting in record annual earnings of \$32.2 billion." FDIC, *Assessments*, 58 Fed. Reg. 17,533, 17,534 (1993). The FDIC also reported that the number of "problem banks"

Perhaps the causes of the recent crisis have been arrested, or maybe the spate of bank and S&L failures was just one episode symptomatic of deeper problems that threaten to destabilize the banking industry. Such a determination is difficult to make at this stage. Clearly, the relationship between banking institutions and regulators has changed significantly.

Peering into the fog of the recent past, at the commentary of jurists in the late 1950s, we can measure the magnitude of the transformation.<sup>4</sup> The cooperative style of supervision by the banking regulators once was celebrated by distinguished academicians and the Supreme Court, which attributed the "virtual disappearance of bank failures"<sup>5</sup> to the continuous and close, yet largely informal, system of banking regulation. During the past five years, however, these vestiges of the associational ideal have been vilified in the storm of public criticism and recrimination that accompanied the painful need to recapitalize the federal deposit insurance funds for banks and thrifts. Two major statutes in 1989<sup>6</sup> and 1991<sup>7</sup> have reconstituted the terms upon which the four principal federal banking regulators now may interact with the industries under their jurisdiction.<sup>8</sup> In the Financial Institutions Reform, Recovery, and En-

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dropped to the "lowest year-end level since 1983." *Id.* at 17,534. As for federally-insured S&Ls, the FDIC reported that "much of the industry has shown consistent improvement over the past year," although it also noted that "a number of problem institutions remain." *Id.* at 17,539. *See also BIF-Insured Commercial Banks Pull in Record Profits in 1992*, 60 Banking Rep. (BNA) 327, 334 (1993); *Thrifts Earn \$1.12 Billion in Fourth Quarter 1992, For Record Year*, OTS Says, 60 Banking Rep. (BNA) 346 (reporting improvements in financial condition of thrift industry).

4. *See, e.g.*, 1 KENNETH C. DAVIS, ADMINISTRATIVE LAW TREATISE § 4.04, 247-48 (1958) (describing highly informal regulatory system as "superior in its efficiency" and "one of the most successful" systems of federal regulation); ADMINISTRATIVE PROCEDURE IN GOVERNMENT AGENCIES, MONOGRAPH OF THE ATTORNEY GENERAL'S COMM. ON ADMIN. PROCEDURE, pt. 9, Federal Reserve System, S. Doc. No. 186, 76th Cong., 3d Sess. 31-32 (1940) (describing procedure followed in administrative rulemaking); *id.*, pt. 13, Federal Control of Banking: Comptroller of the Currency and Federal Deposit Insurance Corporation, at 18 (urging federal banking agencies, as special case, require less procedural formality in administrative process).

5. *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 330 (1963).

6. Financial Institutions Reform, Recovery, and Enforcement Act, (FIRREA), Pub. L. No. 101-73, 103 Stat. 183 (1989) (amending Federal Deposit Insurance Act (FDI Act), 12 U.S.C. § 1811 (1988)).

7. Federal Deposit Insurance Corporation Improvement Act, (FDICIA), Pub. L. No. 102-242, 105 Stat. 2236 (1991) (amending FDI Act, 12 U.S.C. § 1811 (1988)).

8. The regulatory structure is as follows: the Board of Governors of the Federal Reserve, an independent Federal Government agency, has primary federal responsibility for the regulation of all bank holding companies, state-chartered banks that belong to the Federal Reserve System, and foreign banks, branches, and offices. *See* 12 U.S.C.

forcement Act of 1989 (FIRREA),<sup>9</sup> Congress conferred upon the banking agencies massive new enforcement powers and ordered the banking agencies to use these powers "aggressively."<sup>10</sup> In 1991, Congress passed the Federal Deposit Insurance Corporation Improvement Act (FDICIA).<sup>11</sup> Through this Act, Congress forced the agencies to take early and decisive action against troubled banking institutions, their owners, directors, and employees.<sup>12</sup> This Article focuses on FDICIA.

FDICIA introduced, as one of the central strategies designed to prevent further bank failures, the requirement that the federal banking regulators take "prompt corrective action to resolve the problems of federally-insured depository institutions."<sup>13</sup> The purpose of the prompt corrective action (PCA) system is "to resolve the problems of insured depository institutions at the least possible long-term loss to the deposit insurance fund."<sup>14</sup> Bank regulators must take PCA to preempt the failure of

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§ 248 (Supp. IV 1992) (stating enumerated powers of Board); the Federal Deposit Insurance Corporation, also an independent federal agency, administers the Bank Insurance Fund (for commercial banks) and the Savings Association Insurance Fund (for S&Ls), has primary responsibility for the federal regulation of all state-chartered, nonmember, federally insured banks, and has secondary regulatory authority over all other federally-insured banks and thrifts, *see* FDI Act §§ 1, 8(t), 12 U.S.C. §§ 1811, 1818(t) (Supp. IV 1992) (defining duties and authority of FDIC); the Office of the Comptroller of the Currency (OCC), a bureau within the U.S. Department of the Treasury and headed by the Comptroller of the Currency, charts and supervises all national banks, *see* 12 U.S.C. § 26 (1988) (defining Comptroller's duties and authority); and the Office of Thrift Supervision (OTS), another bureau in the Treasury Department, charts all federally chartered S&Ls and supervises all S&L holding companies and state and federally chartered, federally insured savings associations, *see* 12 U.S.C. §§ 1463 (1988 & Supp. IV 1992) (defining powers of OTS).

9. Pub. L. No. 101-73, 103 Stat. 183 (codified at scattered sections of 12 U.S.C.) (Supp. IV 1992).

10. CONFERENCE REPORT TO ACCOMPANY H.R. 1278, FINANCIAL INSTITUTIONS REFORM, RECOVERY, AND ENFORCEMENT ACT OF 1989; H.R. CONF. REP. No. 222, 101st Cong., 1st Sess. 440 (1989), *reprinted in* 1989 U.S.C.C.A.N. 432. The Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act, which was enacted as part of the Crime Control Act of 1990, Pub. L. No. 101-647, 104 Stat. 4789 (1990), further augmented these powers.

11. Pub. L. No. 102-242, 105 Stat. 2236 (codified at scattered sections of 12 U.S.C.) (Supp. IV 1992).

12. FDICIA § 131(a) (adding FDI Act § 38, 12 U.S.C. § 1831o (Supp. IV 1992)).

13. *Id.* (adding FDI Act § 38(a)(2), 12 U.S.C. § 1831o(a)(2)).

14. *Id.* (adding FDI Act § 38(a)(1), 12 U.S.C. § 1831o(a)(1)). For reviews of the history and rationale behind concept of prompt corrective action, *see* Richard Scott Carnell, *A Partial Antidote to Perverse Incentives: The FDIC Improvement Act of*

the institution or, if failure is likely or inevitable, to seize the institution early enough to ensure that the remaining assets sufficiently cover the institution's losses.<sup>15</sup> Regulators have a wide range of early intervention responsibilities<sup>16</sup>—depending on the capital classification of each institution, the PCA legislation imposes a number of restrictions on depository institutions and individuals associated with them.<sup>17</sup>

Although FDICIA created a provision for limited procedural protection for an individual dismissed from office as a result of a PCA directive, no direct provision exists for administrative review of PCA decisions. Moreover, FDICIA does not expressly provide for, or preclude, judicial review of PCA determinations. Agencies have developed some administrative procedures,<sup>18</sup> but have restricted severely the scope of administrative review in cases involving the most important of the PCA powers. In these cases, the institutions and individuals cannot be certain of the availability of judicial review.

This Article will identify principles upon which administrative and judicial review should be based and will conclude that Congress should make express provision for limited administrative and judicial review of basic PCA "capital classification" decisions. With regard to administrative review, recent reforms instituted by the Comptroller of the Currency provide a promising model.<sup>19</sup> Judicial review also should be made

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1991, 12 ANN. REV. BANKING L. 317 (1993); George G. Kaufman and George J. Benston, *The Intellectual History of the Federal Deposit Insurance Corporation Improvement Act of 1991*, in ASSESSING BANK REFORM; FDICIA ONE YEAR LATER 19 (George G. Kaufman and Robert E. Litan eds., 1993).

15. FDICIA § 131(a) (adding FDI Act § 38, 12 U.S.C. § 1831o (Supp. IV 1992)).

16. FDICIA §§ 111-112, 131(a) (adding to and amending FDI Act §§ 10, 36, 38, 12 U.S.C. §§ 1820, 1831m, 1831o).

17. *Id.* § 131(a) (adding FDI Act § 38, 12 U.S.C. § 1831o).

18. The Federal banking agencies have incorporated some administrative procedures into the rules implementing the PCA powers (PCA Rules or Final Rules), as well as other relevant, though limited, administrative review provisions. Department of the Treasury, Federal Reserve System, Federal Deposit Insurance Corporation, *Prompt Corrective Action; Rules of Practice for Hearings*, 57 Fed. Reg. 44,866 (1992) (amending scattered sections of 12 C.F.R. §§ 6, 19, 208, 263, 308, 325, and adding 12 C.F.R. § 565). See *infra* pp. 535, 539 Charts 1A and 1B and accompanying text (summarizing examination review and appellate process).

Neither FDICIA nor the PCA Rules, however, make express provision for either administrative or judicial protection against possible misuse of some of the most basic and far-reaching of the PCA powers.

19. See *infra* notes 160-69 and accompanying text (describing new OCC national bank appeals process).

available to persons who have been dismissed as a result of PCA directives, and to the institutions that are actually seized. Furthermore, all four relevant banking agencies should apply uniform provisions governing such judicial review procedures. In all other cases involving the exercise of PCA powers, the administrative procedures already supplied by the Federal banking agencies in the PCA Rules offer sufficient protection and correctly preclude judicial review.

## I. THE CHANGING CONTEXT OF FEDERAL BANKING REGULATION

FIRREA and FDICIA, enacted amidst a multitude of economic conditions that have contributed to the vulnerability and fragility of depository institutions, have transformed the regulatory landscape for banking. Two basic, yet distinct, models have shaped the particular matrices of federal banking regulation. One commentator has termed them *prophylactic* and *prudential* regulation.<sup>20</sup> The prophylactic model dominated the earlier phases of banking regulation, from the inception of national banking in 1863 to about the early 1970s.<sup>21</sup> Prophylactic bank regulation primarily followed a pattern of a series of barriers or prohibitions, designed to control entry into banking and to channel banks and thrifts into certain activities.<sup>22</sup> At the same time, Congress barred these institutions from other activities deemed *inherently* unsafe, no matter how well positioned any individual bank might have been to engage in that activity.<sup>23</sup> During the relatively tranquil period from the enactment of the Glass-Steagall Act in 1933 until the late 1970s, banks and thrifts operated happily under the network of prophylactic constraints erected by Congress and the regulators, despite the wooden character of these constraints. To the extent that it enjoyed immunity from non-bank competition in certain protected activities, the banking industry effectively con-

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20. HELEN A. GARTEN, *WHY BANK REGULATION FAILED DESIGNING A BANK REGULATORY STRATEGY FOR THE 1990S* xvi-xvii (1991).

21. *Id.*

22. *Id.*

23. The classic example of such a prohibition has been the Glass-Steagall Act, aptly described by two authors as a "legal Maginot Line." JONATHAN R. MACEY & GEOFFREY P. MILLER, *BANKING LAW AND REGULATION* 496 (1992). Cf. *Securities Industry Association v. Board of Governors of the Fed. Reserve Sys.*, 468 U.S. 137, 157 (1984) (stating that "[Glass-Steagall's] prophylactic prohibition on underwriting reflects Congress' conclusion that the mere existence of a securities operation, 'no matter how carefully and conservatively run, is inconsistent with the best interests' of the bank as a whole" (citing a quote made by Sen. Bulkley in his remarks during the passage of Glass-Steagall)).

stituted a government-sponsored cartel, receiving in exchange for strict operating restrictions a reasonably stable stream of profits.<sup>24</sup>

Prophylactic regulation was not, of course, the exclusive form of banking regulation, even during this period. Banks failed under poor management or through misfortunes. Hence, prudential regulation also played a role in federal banking regulation, particularly with the inception of federal deposit insurance in 1933.<sup>25</sup> Safety and soundness (S/S) regulation became an important aspect of regulatory supervision. Such regulation, however, assumed a highly informal and cooperative character. Bank examiners, and even their superiors in the regional offices and in Washington, tended to rely heavily on discussion, persuasion, and other non-adversarial methods for deterring the institutions under their supervision from imprudent activities.<sup>26</sup> Such informal regulation worked because it tied into a fabric of tough prophylactic regulation.

New forces emerged in the late 1960s and began to destabilize the regulatory matrix.<sup>27</sup> Banks and thrifts began to experience increasing competition from other segments of the financial services industry.<sup>28</sup> Technological and competitive innovation made more attractive substitutes available to bank customers, and depository institutions experienced large-scale disintermediation.<sup>29</sup> Unable to compete, either because of

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24. Geoffrey P. Miller, *Anatomy of a Disaster: Why Bank Regulation Failed*, 86 NW. U. L. REV. 742, 746-47 (1992) (reviewing HELEN A. GARTEN, *WHY BANK REGULATION FAILED DESIGNING A BANK REGULATORY STRATEGY FOR THE 1990S* (1991)).

25. From 1933, regulators had the power to implement safety/soundness regulations in order to prevent violations of law or unsafe and unsound practices. See Banking Act of 1933, 48 Stat. 193 (codified at 12 U.S.C. § 227 (1988) (also known as Glass-Steagall Act) (empowering Comptroller of Currency to certify directors or officers of national banks to Federal Reserve Board for institution of removal proceedings for persistent violations of law or unsafe or unsound practices).

26. Bank regulators did not possess the power to take injunctive formal enforcement action until 1966 when banking regulators were given cease-and-desist powers. Financial Institutions Supervisory Act, Pub. L. No. 89-695, 80 Stat. 1028 (1966) (codified as amended at 12 U.S.C. § 1464(d) (1988)).

27. See NATIONAL COMMISSION ON FINANCIAL INSTITUTION REFORM, RECOVERY AND ENFORCEMENT, ORIGINS AND CAUSES OF THE S&L DEBACLE: A BLUEPRINT FOR REFORM (A REPORT TO THE PRESIDENT AND CONGRESS OF THE UNITED STATES), 23-28 (1993) [hereinafter BLUEPRINT] (examining events leading to S&L industry's collapse). For another recent and brief analysis, see William B. Stevenson, *Current Problems in the Financial System May be Laid Directly at Feet of Politicians*, Am. Banker, May 3, 1993, at 4. See also *infra* note 34 and accompanying text (describing origins of S&L and banking crisis).

28. BLUEPRINT, *supra* note 27, at 7-8.

29. *Id.* and Stevenson, *supra* note 27, at 4. Disintermediation occurs when interest



restrictions on activities or because they did not meet interest-rate ceilings, banks and thrifts clamored for deregulation in order to survive.<sup>30</sup> State governments and Congress responded during the early 1980s by loosening the restrictions on their activities and breaking down the barriers between banks and thrifts themselves.<sup>31</sup> Prophylactic regulation receded as new activities and opportunities opened up to banks and thrifts. These institutions, in many cases, could then decide for themselves whether and to what extent they should compete with money market mutual funds, invest in real estate ventures, or engage in other forms of financial services and investments.

With increased opportunities came increased risk, exacerbated by an enhancement of the moral hazard<sup>32</sup> of deposit insurance that had evolved as a result of congressional steps to increase the limits of such insurance quite dramatically in 1980.<sup>33</sup> The banking industry might have expected to see efforts at tougher prudential regulation by banking agencies to offset increased dangers of abuse and bank failures caused by the decline in prophylactic regulation. Such intensification, however, did not occur. Instead, some state governments and the Federal Government, *cut back on S/S* regulation to reduce government expenditure and to bring regulatory "forbearance" to a thrift industry experiencing steadily increasing difficulties in adverse regional economic climates across the country.<sup>34</sup> By the late 1980s, when the cost of the spate of thrift

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rates from a depository institution's interest-bearing accounts fall below market rates on competing investments. GLENN G. MUNN ET AL., 1 *ENCYCLOPEDIA OF BANKING & FINANCE* 276 (9th ed. 1991).

30. Stevenson, *supra* note 27, at 4.

31. See Depository Institutions Deregulation and Monetary Control Act of 1980, (DIDMC Act), Pub. L. No. 96-221, 94 Stat. 132 (codified as amended in scattered sections of 12 U.S.C.) (mandating phase out of interest rate controls and permitting banks and thrifts to offer NOW accounts); Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (codified as amended in scattered sections of 12 U.S.C.) (increasing amounts of loans that banks and thrifts could make to one borrower and allowing thrifts to engage in agricultural and commercial lending, accept demand deposits, offer money market accounts, and increase amounts of consumer loans).

32. BLUEPRINT, *supra* note 27, at 5. The term refers to the phenomenon that risky behavior increases as the risk of loss is placed elsewhere—the higher the insurance, the riskier the behavior. *Id.*

33. DIDMC, Pub. L. No. 96-221, 94 Stat. 132, 147 (codified as amended in scattered sections of 12 U.S.C.) (1988). Federal deposit insurance was increased from \$40,000 to \$100,000. *Id.*

34. Although the now-defunct Federal Home Loan Bank Board (FHLBB), which exercised forbearance instead of closing failing and dead thrifts, received the blame

and bank failures began to dawn on the public, Congress and the Bush Administration faced a situation where *both* prophylactic and prudential regulation of banking had been substantially impaired.

Congress and the Bush Administration responded by intensifying many forms of prudential regulation.<sup>35</sup> Intensification changed the *character* of the regulation that the agencies performed, replacing informality with more formal regulation. FIRREA provided sanctions, even where regulators lacked the capacity to perform the type and volume of supervision needed, designed to deter risky banking practices and to induce self-restraint on the part of depository institutions and their participants.<sup>36</sup> FIRREA also accelerated the trend toward formalism by exposing enforcement proceedings, which, until 1989, almost always had remained confidential, to the glare of publicity and aggregate monitoring.<sup>37</sup>

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for this policy, Congress actually partly authorized the board, and members of Congress, representing the interests of their constituents, encouraged it. For more on the power granted to the FHLBB, see: DEPARTMENT OF THE TREASURY, MODERNIZING THE FINANCIAL SYSTEM: RECOMMENDATIONS FOR SAFER, MORE COMPETITIVE BANKS 120, 137-38 (1991); LAWRENCE J. WHITE, THE S&L DEBACLE: PUBLIC POLICY LESSONS FOR BANK AND THRIFT REGULATION 139-42 (1991); MARTIN MAYER, THE GREATEST-EVER BANK ROBBERY: THE COLLAPSE OF THE SAVINGS AND LOAN INDUSTRY 156 (1990); EDWARD J. KANE, THE S&L INSURANCE MESS: HOW DID IT HAPPEN? 51-57 (1989); MARTIN E. LOWY, HIGH ROLLERS: INSIDE THE SAVINGS AND LOAN DEBACLE 269 (1991) (describing forbearance).

35. See FDICIA § 303(a) (adding FDI Act § 24, 12 U.S.C. § 1831a (Supp. IV 1992)) (containing restrictions on ability of state chartered depository institutions to engage in activities not permitted to their federally chartered counterparts without FDIC approval).

36. FIRREA, Pub. L. No. 101-73, 103 Stat. 183 (codified in scattered sections of 12 U.S.C.) (Supp. IV 1992)). In the years since the enactment of FIRREA, Congressional insistence on expeditious, forthright, and decisive regulatory supervision has produced a marked shift from informality to formality and has led to regulatory supervision intruding deeply into the entrepreneurial preserves of the banking industry. Where banks and thrifts have had difficulties or have failed, the effect has been to bring many of the business decisions of their management to scrutiny through the enforcement process, thereby producing a kind of "entrepreneurial state" in which discretionary business decisions have become the subject matter of agency enforcement determinations. See Lawrence G. Baxter, *Judicial Responses to the Recent Enforcement Activities of the Federal Banking Regulators*, 59 FORDHAM L. REVIEW 193, 232-35 (1991) (discussing "entrepreneurial state").

37. FIRREA § 913(a) (amending FDI Act § 8(u), 12 U.S.C. § 1818(u) (Supp. IV 1992)) (requiring public hearings in enforcement actions and public disclosure by federal banking agencies of final enforcement orders, underlying records, and, subject to limited exceptions, informal settlement agreements, as well as filing of quarterly

The enactment of FDICIA two years later<sup>38</sup> further solidified the character of prudential regulation. Through FDICIA, Congress required regulators to develop generally applicable S/S standards, rather than merely to use ad hoc discretion with respect to the activities of individual institutions.<sup>39</sup> FDICIA introduced the PCA system to ensure that agencies not only act to prevent and deter unsafe and unsound conduct, but also that they act *in particular ways*.<sup>40</sup> At certain points in the process, regulators must take certain actions including outright seizure of the institutions concerned.<sup>41</sup>

As a result of these developments, the atmosphere in which the agency/industry interaction takes place has greater formality than ever before. While broad or unconfined agency discretion might lead to regulatory expedition and convenience, the severity of the powers the regulators wield, and the pressures under which they must wield them, counsel strongly in favor of providing appropriate protection against the potential abuse of these powers. It is against this background that the adequacy of procedural protections for institutions and individuals subject to these

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report on enforcement decisions with Congress). See also FDI Act § 8(t)(5), 12 U.S.C. § 1818(t)(5) (Supp. IV 1992) (requiring agencies to make semi-annual reports to Congress on their disposition of requests from regional offices for formal enforcement action).

38. FDICIA § 132(a) (adding FDI Act § 39, 12 U.S.C. § 1831p-1 (Supp. IV 1992)) (transferring provisions from § 1831s).

39. *Id.* See Lawrence G. Baxter, *The Rule of Too Much Law? The New Safety/Soundness Rulemaking Responsibilities of the Federal Banking Agencies*, 47 CONSUMER FIN. L. Q. REP. 210 (1993) (describing congressional requirement of generally applicable standards of S/S).

40. See Richard Scott Carnell, *The Culture of Ad Hoc Discretion*, in ASSESSING BANK REFORM, *supra* note 14 at 113 (describing agency-forcing philosophy behind PCA and S/S reforms).

41. *Id.* Also, to ensure that agencies observe scrupulously the dictates of the statute, Congress included in FDICIA a provision for an "inquest," Carnell, *supra* note 14, at 330, under the supervision of the relevant agency's inspector general whenever an insured depository institution causes "a material loss" to the insurance fund. FDICIA § 131(a) (adding FDI Act § 38(k)(1), 12 U.S.C. § 1831o(k)(1) (Supp. IV 1992)). FDICIA defines "material loss" as the greater of \$25 million or two percent of the institution's total assets at the time the FDIC initiated financial assistance to the institution or assumed control as its receiver. *Id.* § 131(a) (adding FDI Act § 38(k)(2)(B), 12 U.S.C. § 1831o(k)(2)(B)).

The inspector general's report is to be made public. *Id.* (FDI Act § 38(k)(4), 12 U.S.C. § 1831o(k)(4)). It is to be followed by a General Accounting Office review and spot-check audit. *Id.* (adding FDI Act § 38(k)(5), 12 U.S.C. § 1831o(k)(5)). The obvious intention behind these provisions: make the agencies even more accountable to Congress and the public.

actions should be assessed.

## II. THE NEW PROMPT CORRECTIVE ACTION REGULATORY SYSTEM

### A. The FDICIA "Tripwire" System

The PCA framework arises from a "tripwire" approach popular with reformers by the beginning of 1991. Basically, the banking regulators should have the power to take increasingly severe action, on a stage-by-stage basis, against a depository institution as the capital and soundness of the institution declines (i.e. as the institution crosses certain objectively defined capital and S/S tripwires).<sup>42</sup> As finally formulated in FDICIA, the system relies upon three mechanisms for assuring early regulatory resolution of troubled banking institutions: capital measures;<sup>43</sup> objective standards for measuring safety and soundness;<sup>44</sup> and uniform, stringent accounting requirements.<sup>45</sup>

#### 1. Capital Classifications and Restrictions

##### a. Capital Classifications

*Capital-to-Asset Ratios.* Under FDICIA's capital classification system, the regulators must adopt two separate *capital standards* for depository institutions under their supervision.<sup>46</sup> The first is a *leverage limit* (LR), which measures the ratio of an institution's equity to its total assets. The second is a *risk-based capital requirement* (R-BR), which measures the ratio of an institution's capital to its total assets *after* adjustment for risk.<sup>47</sup> The agencies also may establish or rescind other relevant capital measures.<sup>48</sup> In their Final Rules, the agencies adopted an additional, *Tier 1 risk-based capital ratio* (T1 R-BR).<sup>49</sup>

42. See GENERAL ACCOUNTING OFFICE, DEPOSIT INSURANCE: A STRATEGY FOR REFORM 61 (Mar. 4, 1991) (advocating power for regulators to take increasingly severe action as capital and soundness of institution decline).

43. See FDICIA § 131(a) (adding FDI Act § 38, 12 U.S.C. § 1831o (Supp. IV 1992)) (establishing capital categories and standards).

44. See *id.* § 132(a) (adding FDI Act § 39, 12 U.S.C. § 1831p-1 (transferred from § 1831s)) (establishing standards for S/S).

45. See *id.* § 121(a) (adding FDI Act § 37, 12 U.S.C. § 1831n) (establishing accounting objectives and standards).

46. *Id.* § 131(a) (adding FDI Act § 38(c)(1)(A), 12 U.S.C. § 1831o(c)(1)(A)).

47. *Id.*

48. FDICIA § 131(a) (adding FDI Act § 38(c)(1)(B), 12 U.S.C. § 1831o(c)(1)(B)).

49. See 12 C.F.R. § 325.103(a)(2) (1993) (describing agencies' adopting Tier 1

*Capital Measures.* These capital measures comprise the criteria for defining five categories of institutions:<sup>50</sup> well capitalized institutions;<sup>51</sup> adequately capitalized institutions;<sup>52</sup> undercapitalized institutions;<sup>53</sup> significantly undercapitalized institutions;<sup>54</sup> and critically undercapitalized<sup>55</sup> institutions.<sup>56</sup>

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risk-based capital ratio).

50. FDICIA § 131(a) (adding FDI Act § 38(b)(1), 12 U.S.C. § 1831o(b)(1) (Supp. IV 1992)). The specific levels enumerated in the text are those stipulated in the agencies' Final Rules. See 12 C.F.R. § 325.103 (a)-(b) (1993) (outlining capital maintenance standards).

51. FDICIA § 131(a) (adding FDI Act § 38(b)(1)(A), 12 U.S.C. § 1831o(b)(1)(A) (Supp. IV 1992)). These are institutions that "significantly exceed[] the required minimum level for each relevant capital measure." *Id.* Minimum level is set at or greater than R-BR 10.0%; and T1 R-BR 6.0%; and LR 5.0%. 12 C.F.R. § 325.103 (a)(3)(b)(1) (1993).

52. FDICIA § 131(a) (adding FDI Act § 38(b)(1)(B), 12 U.S.C. § 1831o(b)(1)(B) (Supp. IV 1992)). These are institutions meeting "the required minimum level for each relevant capital measure." *Id.* Minimum level is set at or greater than R-BR 8.0%; and T1 R-BR 4.0%; and LR 4.0% or 3.0% if composite CAMEL rating of 1 and no significant growth experienced or anticipated. 12 C.F.R. § 325.103(a)(3)(b)(2) (1993). See *infra* note 138 (describing CAMEL).

53. FDICIA § 131(a) (adding FDI Act § 38(b)(1)(C), 12 U.S.C. § 1831o(b)(1)(C) (Supp. IV 1992)). These are institutions that "fail[] to meet the required minimum level for any relevant capital measure." *Id.* Minimum level is set at less than R-BR 8.0% or T1 R-BR 4.0% or LR 4.0% or LR 3.0% and not experiencing or anticipating significant growth. 12 C.F.R. § 325.103(a)(3)(b)(3) (1993).

54. FDICIA § 131(a) (adding FDI Act § 38(b)(1)(D), 12 U.S.C. § 1831o(b)(1)(D) (Supp. IV 1992)). These are institutions that are "significantly below the required minimum level for any relevant capital measure." The minimum level is set at less than R-BR 6.0%; or T1 R-BR 3.0%; or LR 3.0%. 12 C.F.R. § 325.103 (a)(3)(b)(4) (1993).

55. FDICIA § 131(a) (adding FDI Act § 38(b)(1)(E), 12 U.S.C. § 1831o(b)(1)(E) (Supp. IV 1992)). This category is subject to a number of related qualifications and currently comprises institutions with a "ratio of tangible equity to total assets that is equal to or less than 2.0%." 12 C.F.R. § 325.103 (a)(3)(b)(5) (1993).

56. Recent statistics regarding capital classifications are as follows:

TYPE OF INSTITUTION	WELL CAPITALIZED	ADEQUATELY CAPITALIZED	UNDERCAPITALIZED (TOTAL-ALL CATEGORIES)	CRITICALLY UNDERCAPITALIZED
BIF-insured (12/31/92) (Commercial & Savings banks)	11,051	550*	210*	18**
TOTAL: 11,875 (11,461 COMMERCIAL BANKS; 414 SAVINGS BANKS)**				
SAIF-insured (6/30/92) (S&Ls)	1,523*	341*	172*	11**
TOTAL: 1,855**				

Sources: \* FDIC, *Assessments*, *supra* note 3, at 17,538 (Table 4) (as of 12/31/92), 17540 (Table 6) (as of 6/30/92);

*S/S Reclassifications.* Where the appropriate agency determines that an institution is in an *unsafe or unsound condition*;<sup>57</sup> or where it deems the institution to be engaging in an *unsafe or unsound practice* because the institution has received a less-than-satisfactory rating for asset quality, management, earnings, or liquidity, which it has failed to correct,<sup>58</sup> the agency may, regardless of the institution's actual capital level, reclassify a well-capitalized institution as adequately capitalized and use its powers relating to undercapitalized institutions against the institution even if it is actually adequately capitalized. Moreover, the agency may use its specific PCA powers for a significantly undercapitalized institution where the institution is actually merely undercapitalized.<sup>59</sup> In other words, an institution may have its capital rating downgraded as a result of S/S factors, even if its capital otherwise would justify a higher rating. The downgrading will then expose the institution to regulatory control normally reserved for institutions with lower capital.<sup>60</sup>

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\*\* 60 Banking Rep. (BNA) 334 (Mar. 15, 1993) (as of 3/9/93).

Separate statistics regarding significantly undercapitalized institutions were unobtainable.

A more recent report indicates that the number of BIF-insured institutions exposed to PCA has declined further. See Barbara A. Rehm, "Prompt Action" *Specter Fades: Upturn Made Plans for Early Intervention Irrelevant*, AMERICAN BANKER (Aug. 9, 1993) at 17 (indicating that, at date of report, 11,352 banks were well capitalized, 286 were adequately capitalized, 49 were undercapitalized, 38 were significantly undercapitalized, and 13 were critically undercapitalized).

57. FDICIA § 131(a) (adding FDI Act § 38(g)(1), 12 U.S.C. § 1831o(g)(1) (Supp. IV 1992)).

58. *Id.*; read with FDICIA § 131(c) (amending FDI Act § 8(b)(8), 12 U.S.C. § 1818(b)(8)). Section 8(b)(8) reads:

If an insured depository institution receives, in its most recent report of examination, a less-than-satisfactory rating for asset quality, management, earnings, or liquidity, the appropriate Federal banking agency may (if the deficiency is not corrected) deem the institution to be engaging in an unsafe or unsound practice for the purpose of this subsection [i.e., for cease-and-desist order purposes].

*Id.* See *infra* notes 135-49 and accompanying text (describing examination ratings).

59. FDICIA § 131(a) (adding FDI Act § 38(g)(1)(A)-(C), 12 U.S.C. § 1831o(g)(1)(A)-(C) (Supp. IV 1992)).

60. *Id.* (adding FDI Act § 38(g)(1), 12 U.S.C. § 1831o(g)(1)). It is difficult to estimate the significance of the S/S criteria in the classification process. The number of banks on regulators' "problem lists" might provide some indication. FDIC, *Assessments*, *supra* note 3, at 17,534. The FDIC recently reported that 787 commercial banks and 76 savings banks remain on the agency's "problem list." *Id.* While these banks represent less than ten percent of the total number of banking institutions, the numbers suggest that S/S reclassifications will constitute a significant threat for many institutions.

The same trend appears valid for thrifts. Although the FDIC reported that a

## b. PCA Restrictions and Directives

The capital categorization system is used in FDICIA to benefit as well as to sanction depository institutions. Well capitalized institutions are allowed to accept brokered deposits<sup>61</sup> and, if "well managed" and below a certain size, are subject to less frequent on-site examinations.<sup>62</sup> In addition, these institutions are permitted to continue conducting insurance activities under certain circumstances.<sup>63</sup> The capital categories, however, are used principally for defining restrictions that must be imposed on institutions in each category. Further, the categories are used to identify a range of actions that the regulators must take in regard to each category of institution.

Some restrictions apply to every category.<sup>64</sup> Most restrictions, however, focus on the undercapitalized institutions. The restrictive intensity increases as institutions move from the undercapitalized to the critically undercapitalized categories.<sup>65</sup> All undercapitalized institutions are subject to increased monitoring<sup>66</sup> and restrictions on growth, branching, and new business.<sup>67</sup> All undercapitalized institutions must develop and implement capital restoration plans acceptable to their regulators.<sup>68</sup> In ad-

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number of "problem" SAIF-insured thrifts still existed, *id.* at 17,539, it did not give specific figures. Separately, however, the OTS reported that at the end of the fourth quarter, 1992, 330 thrifts had a MACRO rating of "3" and 200 had a MACRO rating of "4" or "5," indicating that about 530 thrifts were exposed to S/S reclassification. *See Thrifts Earn \$1.12 Billion in Fourth Quarter 1992, For Record Year, OTS Says*, 60 Banking Rep. (BNA) 346 (1993) (discussing current status of thrift industry); *infra* notes 133-42 and accompanying text (describing significance of such ratings).

61. FDICIA § 301(a) (amending FDI Act § 29(a), 12 U.S.C. § 1831f(a) (Supp. IV 1992)); *see also* FDIC, *Unsafe and Unsound Banking Practices*, 57 Fed. Reg. 23,933-01 (1992) (implementing, as 12 C.F.R. § 337, FDICIA § 301).

62. FDICIA § 111(a) (adding FDI Act § 10(d)(4), 12 U.S.C. § 1820(d)(4) (Supp. IV 1992)).

63. *Id.* § 303(a) (adding FDI Act § 24(d)(2)(B), 12 U.S.C. § 1831a(d)(2)(B)).

64. *Id.* § 131(a) (adding FDI Act § 38(d), 12 U.S.C. § 1831o(d)). For example, no institution may distribute dividends or pay management fees where the effect would be to cause the institution to become undercapitalized. *Id.* (adding FDI Act § 38(d)(1)(A), 12 U.S.C. § 1831o(d)(1)(A)).

65. *See id.* (adding FDI Act § 38(c)-(i), 12 U.S.C. § 1831o(c)(i)) (establishing restrictions and requirements for undercapitalized institutions, significantly undercapitalized institutions, and critically undercapitalized institutions).

66. FDICIA § 131(a) (adding FDI Act § 38(e)(1), 12 U.S.C. § 1831o(e)(1) (Supp. IV 1992)).

67. *Id.* (adding FDI Act § 38(e)(3)-(4), 12 U.S.C. § 1831o(e)(3)-(4)).

68. *Id.* (adding FDI Act § 38(e)(2), 12 U.S.C. § 1831o(e)(2)). Companies having

dition, regulators may exercise far-reaching discretionary powers where the regulators deem such actions to be necessary.<sup>69</sup> Under these powers, the agencies may, for example:<sup>70</sup>

- require the institution to be recapitalized through a share issue, merger, or acquisition;<sup>71</sup>
- restrict transactions with affiliates irrespective of any exemptions permitted under the Federal Reserve Act;<sup>72</sup>
- restrict the rate of interest the institution pays on deposits;<sup>73</sup>
- restrict the rate of growth of the institution's assets;<sup>74</sup>
- restrict any of the institution's, or its subsidiary's, activities that pose "excessive risk to the institution";<sup>75</sup>
- improve management by requiring the election of a new board of directors, the dismissal of directors or senior executive officers, or the employment of qualified senior executive officers approved by the agency;<sup>76</sup>
- require divestiture, either by the depository institution of its subsidiary or by the parent company, of the depository institution or an affiliate;<sup>77</sup>
- require the depository institution to "take any other action that the agency determines will better carry out the purpose of this section than any of the actions" already specified;<sup>78</sup>
- place the institution into conservatorship or receivership if it "has no reasonable prospect of becoming adequately capitalized," "fails to become adequately capitalized when required to do so," fails to submit a capital restoration plan, or materially fails to implement an approved capital restoration plan.<sup>79</sup>

While these powers may be used against all undercapitalized institutions, one or more of them *must* be used against a significantly under capitalized institution or an institution that fails to submit or implement its

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control of such institutions are required to guarantee compliance with such plans. *Id.* (adding FDI Act § 38(e)(2)(C)(ii), 12 U.S.C. § 1831o(e)(2)(C)(ii)). Liability can amount to 5% of the institution's total assets. *Id.* (adding FDI Act § 38(e)(2)(E), 12 U.S.C. § 1831o(e)(2)(E)).

69. FDICIA § 131(a) (adding FDI Act § 38(e)(5), 12 U.S.C. § 1831o(e)(5) (Supp. IV 1992)).

70. *Id.* (adding FDI Act § 38(e)(2), 12 U.S.C. § 1831o(e)(2)).

71. *Id.* (adding FDI Act § 38(f)(2)(A), 12 U.S.C. § 1831o(f)(2)(A)).

72. *Id.* (adding FDI Act § 38(f)(2)(B), 12 U.S.C. § 1831o(f)(2)(B)).

73. *Id.* (adding FDI Act § 38(f)(2)(C), 12 U.S.C. § 1831o(f)(2)(C)).

74. FDICIA § 131 (adding FDI Act § 38(f)(2)(D), 12 U.S.C. § 1831o(f)(2)(D) (Supp. IV 1992)).

75. *Id.* (adding FDI Act § 38(f)(2)(E), 12 U.S.C. § 1831o(f)(2)(E)).

76. *Id.* (adding FDI Act § 38(f)(2)(F), 12 U.S.C. § 1831o(f)(2)(F)).

77. *Id.* (adding FDI Act § 38(f)(2)(I), 12 U.S.C. § 1831o(f)(2)(I)).

78. *Id.* (adding FDI Act § 38(f)(2)(J), 12 U.S.C. § 1831o(f)(2)(J)).

79. FDICIA § 133(a) (adding FDI Act § 11(c)(5)(K), 12 U.S.C. § 1821(c)(5)(K) (Supp. IV 1992)).



capital restoration plan.<sup>80</sup>

More severe activity restrictions automatically apply to critically undercapitalized institutions.<sup>81</sup> For example, the institution must refrain from: making payments on subordinated debt,<sup>82</sup> engaging in unusual business transactions,<sup>83</sup> extending highly leveraged financing, engaging in covered transactions with affiliates,<sup>84</sup> or "paying excessive compensation or bonuses."<sup>85</sup>

Most importantly, critically undercapitalized institutions can be placed in conservatorship or receivership within ninety days, unless their primary regulators *and* the Federal Deposit Insurance Corporation (FDIC) agree that an alternative action would be more appropriate under section 38 of the Federal Deposit Insurance Act (FDI Act).<sup>86</sup> The institution *must* be seized and placed in receivership if, on average, it remains critically undercapitalized during the calendar quarter beginning 270 days after the institution first falls into that condition.<sup>87</sup>

The general conservatorship and receivership powers, along with the other responsibilities of the federal banking agencies, have been revised extensively to make PCA more effective.<sup>88</sup> First, Congress added critical undercapitalization to the general discretionary grounds for appointing a conservator or receiver.<sup>89</sup> Another capital condition referred to as

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80. *Id.* (adding FDI Act § 38(f)(1)-(2), 12 U.S.C. § 1831o(f)(1)-(2) (Supp. IV 1992)). In addition, the regulators are required to favor the first three specified actions: restricting share distributions; restricting transactions with affiliates; and restricting interest rates. *Id.* (adding § 38(f)(3), 12 U.S.C. § 1831o(f)(3)). Various other restrictions, such as executive compensation limits, also may be imposed. *See id.* (adding FDI Act § 38(f)(4), 12 U.S.C. § 1831o(f)(4)) (stating that institutions must get approval before awarding bonuses to executives).

81. *Id.* (adding FDI Act § 38(h), 12 U.S.C. § 1831o(h)).

82. FDICIA § 131(a) (adding FDI Act § 38(h)(2), 12 U.S.C. § 1831o(h)(2) (Supp. IV 1992)).

83. *Id.* (adding FDI Act § 38(i)(2)(A), 12 U.S.C. § 1831o(i)(2)(A)).

84. *Id.* (adding FDI Act § 38(i)(2)(B) & (E), 12 U.S.C. § 1831o(i)(2)(B) & (E)).

85. *Id.* (adding FDI Act § 38(i)(2)(F), 12 U.S.C. § 1831o(i)(2)(F)).

86. *Id.* (adding FDI Act § 38(h)(3)(A), 12 U.S.C. § 1831o(h)(3)(A)).

87. FDICIA § 131(A) (adding FDI Act § 38(h)(3)(C), 12 U.S.C. § 1831o(h)(3)(C) (Supp. IV 1992)). The mandatory imposition of receivership after 270 days is subject to a very narrow exception: where the agency determines, with the concurrence of the FDIC, that other action is appropriate, given the condition of the depository institution, and the heads of both agencies certify that the institution is "viable and not expected to fail." *Id.* (adding FDI Act § 38(h)(3)(C)(ii), 12 U.S.C. § 1831o(h)(3)(C)(ii)).

88. *See infra* notes 115-116 and accompanying text (describing conservatorship and receivership powers in relation to agency enforcement choices).

89. FDICIA § 133(a) (amending FDI Act § 11(c)(5)(L)(i), 12 U.S.C. §

"substantially insufficient capital" was added as well.<sup>90</sup> Second, the appropriate federal banking regulators are allowed, after consulting with the proper state banking authority, to appoint the FDIC as sole conservator or receiver under the following circumstances:<sup>91</sup> the institution is critically or "substantially insufficiently" undercapitalized; the institution is undercapitalized and has no reasonable prospect of becoming adequately capitalized; the institution has failed to submit a satisfactory capital restoration plan; or the institution has submitted such a plan, but has failed to implement it satisfactorily *and* the federal agency determines that the appointment is necessary to carry out the purposes of section 38 of FDICIA.<sup>92</sup>

Third, the FDIC has independent authority, after consultation with any other appropriate federal or state banking agency, to appoint itself sole conservator or receiver of an insured depository institution if it determines that grounds for appointing a conservator or receiver exist and that the appointment is necessary to reduce the amount of loss to the federal insurance funds.<sup>93</sup> Finally, other federal banking agencies may not place an institution into conservatorship without first giving the FDIC the opportunity to appoint itself as receiver for the institution.<sup>94</sup>

## 2. *Enhanced Safety and Soundness Regulation*

*S/S Standards.* The second prong of the early resolution system created by FDICIA, adding a new section 39 to the FDI Act (section 39), is the requirement that the banking agencies promulgate "regulations" establishing general standards for safety and soundness.<sup>95</sup> Congress classified the S/S standards to be adopted into three categories: *operational and managerial controls*,<sup>96</sup> *asset quality, earnings and stock valuation standards*,<sup>97</sup> and *compensation standards*.<sup>98</sup>

1821(c)(5)(L)(i) (Supp. IV 1992)).

90. *Id.* (amending FDI Act § 11(c)(5)(L)(ii), 12 U.S.C. § 1821(c)(5)(L)(ii)).

91. *Id.* (amending FDI Act § 11(c)(9), 12 U.S.C. § 1821(c)(9)).

92. *Id.* (amending FDI Act §§ 11(c)(5)(K)-(L), (9)(A)(i), 12 U.S.C. §§ 1821(c)(5)(K)-(L), (9)(A)(i)).

93. *Id.* (amending FDI Act § 11(c)(10), 12 U.S.C. § 1821(c)(10)).

94. FDICIA § 133(a) (amending FDI Act § 11(c)(11), 12 U.S.C. § 1821(c)(11) (Supp. IV 1992)).

95. *Id.* § 132(a) (adding FDI Act § 39, 12 U.S.C. § 1831p-1 (transferred from § 1831s)).

96. *Id.* (adding FDI Act § 39(a), 12 U.S.C. § 1831p-1(a)).

97. *Id.* (adding FDI Act § 39(b), 12 U.S.C. § 1831p-1(b)).

98. *Id.* (adding FDI Act § 39(c), 12 U.S.C. § 1831p-1(c)). The regulations identi-

*S/S Restrictions.* After the S/S standards have been implemented, failure by an institution to meet those standards will trigger the early intervention provisions of FDICIA.<sup>99</sup> An institution that fails to meet the S/S standards will be required to submit to its primary regulator a plan indicating how it will correct the deficiency.<sup>100</sup> If the institution fails to submit or implement a plan, the agency can impose specific requirements and restrictions upon the institution, including a prohibition against growth, restrictions on the payment of interest rates on deposits, and the election of a new board of directors.<sup>101</sup> If this stage is reached, FDICIA expressly triggers the intervention powers contained in section 38 of the FDI Act.<sup>102</sup>

### 3. Examination, Accounting and Audit Requirements

The third part of the early intervention system insures that regulators receive more accurate data concerning the financial condition of the depository institutions under their control.<sup>103</sup> Prompted primarily by a General Accounting Office report,<sup>104</sup> FDICIA provided for more frequent examinations,<sup>105</sup> annual reports to regulators of condition, inter-

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fying these standards were meant to be in effect by December 1, 1993, but at the time this article went to press, the agencies are still in the process of formulating the rules for their implementation. In mid-1992 they published a joint advance notice of proposed rulemaking for public comment. See Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System, *Joint Advance Notice of Proposed Rulemaking: Standards for Safety and Soundness*, 57 Fed. Reg. 31,336 (1992) (announcing rulemaking). In December 1993, the agencies then published a joint notice of proposed rulemaking. Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System, *Proposed Rules: Standards for Safety and Soundness*, 58 Fed. Reg. 60,802 (1993) (to be codified at scattered sections of 12 C.F.R.) (proposed Nov. 18, 1993) [hereinafter *Standards for Safety and Soundness*]. At the time this article went to press, the agencies had not yet adopted final rules.

99. FDICIA § 132(a) (adding FDI Act § 39(e)(2), 12 U.S.C. § 1831p-1(e)(2) (Supp. IV 1992)).

100. *Id.* (adding FDI Act § 39(e)(1), 12 U.S.C. § 1831p-1(e)(1)).

101. *Id.* (adding FDI Act § 39(e)(2)-(3), 12 U.S.C. § 1831p-1(e)(2)-(3)).

102. *Id.* (adding FDI Act § 39(e)(2)(B)(iii), 12 U.S.C. § 1831p-1(e)(2)(B)(iii) (referring to 12 U.S.C. § 1831o(f)(2)(c)).

103. *Id.* § 111(a) (amending FDI Act § 10, 12 U.S.C. § 1820).

104. GENERAL ACCOUNTING OFFICE, FAILED BANKS: ACCOUNTING AND AUDITING REFORMS URGENTLY NEEDED, (Apr. 23, 1991).

105. FDICIA § 111(a) (amending FDI Act § 10(d), 12 U.S.C. § 1820(d) (Supp. IV 1992)).

nal control evaluations, greater independence and comprehensiveness in auditing,<sup>106</sup> and the adoption of uniform principles of accounting, consistent with generally accepted accounting principles.<sup>107</sup>

### B. Enforcement

The PCA and S/S provisions are partially self-executing because certain restrictions are triggered automatically once an institution falls over one of the tripwires identified in FDICIA.<sup>108</sup> In the PCA context, for example, an institution can be directed to restrict excessively risky activities or to dismiss a senior executive officer.<sup>109</sup> In the S/S context, an institution can be ordered to divest itself of a subsidiary or to elect a new board of directors.<sup>110</sup> PCA and S/S orders can be enforced if the agency applies to a federal district court for judicial enforcement of the agency's directive or order.<sup>111</sup>

The ability to enter PCA and S/S directives that are judicially enforceable adds an important new weapon to the banking agencies' enforcement arsenal. The FDI Act does not require the agencies to take formal enforcement action to formulate and enforce their PCA and S/S orders and directives. At the same time, the agencies have authority to take regular, formal enforcement action under the Act.<sup>112</sup> An agency,

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106. *Id.* § 112(a) (adding FDI Act § 36(a)-(c), 12 U.S.C. § 1831m(a)-(c)).

107. *Id.* § 121(a) (adding FDI Act § 37, 12 U.S.C. § 1831n)).

108. *See supra* notes 42-45 and accompanying text (describing FDICIA tripwires).

109. *See supra* notes 61-94 and accompanying text (describing PCA enforcement powers).

110. *See supra* notes 95-102 and accompanying text (describing S/S enforcement powers).

111. FDICIA § 131(c)(2) (amending FDI Act § 8(i)(1), 12 U.S.C. § 1818(i)(1) (Supp. IV 1992)). Initially, FDICIA also attempted to render an individual or institution subject to a PCA directive liable for civil penalties under section 8(i)(2), but a drafting error originally made the FDICIA Amendment unintelligible. *See* FDICIA § 131(c)(2)(B), Pub. L. No. 102-242, 105 Stat. 2266 (purportedly amending FDI Act § 8(i)(2)(A)(ii)). As to S/S enforcement, FDICIA originally made no express provision for judicial enforcement or civil money penalty liability under section 8(i) of the FDI Act. These errors were corrected in 1992, and section 8(i) was amended to provide for judicial enforcement and enforcement by way of civil money penalties. *See* the Housing and Community Development Act of 1992, § 1603(d)(3), Pub. L. No. 102-550, 106 Stat. 4080 (1992) (codified as amended in scattered sections of 12 U.S.C.) (amending FDICIA for technical errors).

112. Under section 8 of the FDI Act, 12 U.S.C. § 1818 (which provides for cease-and-desist orders, removal, prohibition order, and civil money penalties) is fully preserved.

The two sections are also careful to preserve the power of the banking agen-

therefore, has a *choice* between taking formal judicial enforcement action or taking PCA or S/S action.<sup>113</sup> This option creates a danger that agencies might abuse their discretion to exert unfair pressure on the institutions under their supervision.<sup>114</sup>

Conservatorship and receivership also offer potential enforcement options. Under PCA, the regulatory agencies may (and in some cases must) use seizure as a means of enforcement. As already has been noted, the conservatorship and receivership provisions relating to banks have been amended extensively to ensure early seizure of institutions with weak capital.<sup>115</sup> But the appointment of a conservator or receiver can now also be used as an enforcement device before an institution has become critically undercapitalized. Thus, in the case of *any* undercapitalized institution, the appropriate agency has the power to appoint a conservator or receiver if the institution does not have a reasonable prospect of becoming adequately capitalized, fails to comply with a capital directive, or fails to submit or materially implement a capital restoration plan.<sup>116</sup>

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cies to take other authorized action in addition to actions allowable under those sections. FDICIA § 131(a) (adding FDI Act §§ 38(m), 39(g), 12 U.S.C. §§ 1831o(m), 1831p-1(g) (Supp. IV 1992)).

113. The regulators are clearly aware of the difficulties posed by the interrelationship between their PCA powers and their formal enforcement powers. See *Regulators Outline Incorporation of FDICIA into the Examination, Enforcement Process*, 3 Reg. Compliance Watch (American Banker) 2 (Jan. 18, 1993) (quoting senior counsel in resolutions section of FDIC's legal division, as stating that: "[regulators] are now struggling with developing a policy for issuing PCA directives within the context of their existing discretionary policy").

Indeed, there is an express linkage between sections 8 and 38 in the case of unsafe and unsound conditions or practices leading to less-than-satisfactory examination ratings. See *supra* notes 35-41 and accompanying text (describing amendments to FIRREA and FDICIA).

114. For more on fear that PCA and S/S actions could be taken as a substitute for formal enforcement action, see *FDICIA Well-Capitalized Banks May Be Exposed To Prompt Corrective Action Provisions*, 59 Banking Rep. (BNA) 237-38 (Aug. 24, 1992); *Threat of Reclassification Will Be Used by Regulators; Curbing Unsafe Practices*, 2 Thrift Reg. (American Banker) 1 (July 13, 1992).

The director of the OCC's Enforcement and Compliance Division has confirmed that the S/S reclassification power will be used against well and adequately capitalized institutions to subject them to the restrictions otherwise applicable only to lower-category institutions where the regulators deem this to be appropriate. See *Reclassification Under Prompt Corrective Action System May Be Coming, OCC Official Says*, 60 Banking Rep. (BNA) 527 (1993) (describing application of reclassification power by OCC).

115. See *supra* notes 89-94 and accompanying text (describing amendments to conservatorship and receivership provisions).

116. FDICIA § 133(a) (amending FDI Act § 11(c)(5)(K), 12 U.S.C. §

### C. Fundamental Importance of Basic "Capital" Classifications

The entire PCA framework is indexed to the basic capital categories described above.<sup>117</sup> Each of the categories, well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, serves as a trigger for agencies to use new coercive powers against, and to impose new operating restrictions on, insured depository institutions, their officers and their directors.<sup>118</sup> The capital classifications also serve to define the scope of certain other, non-PCA restrictions and privileges.<sup>119</sup> Only well capitalized institutions may receive brokered deposits. Additionally, well-capitalized institutions are subject to less frequent on-site examinations, and they enjoy broader insurance powers than their less capitalized counterparts.<sup>120</sup>

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1821(c)(5)(K) (Supp. IV 1992)). See *supra* note 79 and accompanying text (describing conservatorship and receivership power).

Here, too, anomalous situations might arise if the agencies are subject to procedural differences according to whether they choose the seizure option as opposed to the formal enforcement or the PCA-directive options. The judicial protections applicable to appointment of conservators and receivers are not treated consistently by the statutory provisions governing each of the four banking agencies, nor are the procedures prescribed by statute as generous as the administrative and judicial protections available in the other enforcement situations. *Infra* notes 324-34 and accompanying text.

117. See *supra* notes 46-60 and accompanying text (describing capital categories).

118. See Julius L. Loeser, *The FDIC Improvement Act Errs Badly in Placing So Much Emphasis on Capital*, AM. BANKER, Apr. 5, 1993, at 4 (criticizing Congress's excessive reliance on capital classifications).

119. FDICIA §§ 301(a), 111(a), 303(a) (amending and adding FDI Act §§ 29(a), 10(d)(4), 24(d)(2)(B), 12 U.S.C. §§ 1831f(a), 1820(d)(4), 1831a(d)(2)(B) (Supp. IV 1992)).

120. See *supra* notes 61-63 and accompanying text (describing advantages of well capitalized institutions). Capital classifications also serve as primary nonexclusive criteria for the FDIC's new risk-related insurance assessment system, and the Federal Reserve's new regulation governing limitations on interbank liabilities is keyed to risk-based capital levels. FDIC, *Assessments*, 57 Fed. Reg. 45,263-64 (1992). The difference in insurance premiums can be very substantial: for example, an "A"-rated, well capitalized bank currently pays only 23 basis points for its federal insurance, whereas a "C"-rated, undercapitalized institution pays 31 basis points. *Id.* at 45,282 and 12 C.F.R. § 327.13 (1993); and FDIC, *Assessments*, *supra* note 3, at 17,538 (Table 4). Even for a relatively-small institution with, say, \$100 million in insured deposits, the difference would mean extra premiums of \$80,000 per annum. See Federal Deposit Insurance Corporation, *Differences in Capital and Accounting Standards Among the Federal Banking and Thrift Agencies: Report to Congressional Committees*, 58 Fed. Reg. 4996, 4997 (1993) (describing risk-based capital frameworks set up by banking agencies); Federal Reserve System, *Report to Congressional Committees Regarding*

The capital determination also has corresponding implications for the examination process of which it is the result. Until 1991, the banking agencies were entitled to take the capital condition of an institution, or its composite MACRO or CAMEL<sup>121</sup> rating, into consideration when deciding to take either informal or formal enforcement actions. Their power to do so was entirely discretionary, and it has long been the practice of examiners, regional supervisors, and even the Washington offices to engage in informal discussion, persuasion, and negotiation with the institution concerned before resorting to more coercive, formal enforcement action.<sup>122</sup> If an agency chose formal action, the banking institutions were given the opportunity for formal hearings and judicial review in a U.S. court of appeals.<sup>123</sup> If, on the other hand, an agency chose to place an institution into conservatorship or receivership, its

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*Differences in Capital and Accounting Standards Among the Federal Banking and Thrift Agencies*, 58 Fed. Reg. 3019, 3020 (1993) (describing differences in risk-based capital requirements for differently defined banking institutions).

The new S/S standards jointly proposed by the Federal banking agencies indicated that the agencies' "basket loan" concept, designed to stimulate increased credit availability, will apply only to well and adequately capitalized institutions. See *Standards for Safety/Soundness*, *supra* note 98, at 60,804 (explaining that interagency policy requiring less rigorous loan documentation for so-called "basket" loans will continue to apply. Under interagency policy statement jointly released by four agencies, in response to pressure on President to restore due process, *infra* note 158, well-run, well capitalized and adequately capitalized institutions are permitted to establish a "basket" of small business loans that will not be subject to normal loan-documentation requirements).

It is also likely that any future reforms relating to nationwide bank branching or new securities powers will be linked by Congress to the capital status of the institutions affected. See The Comprehensive Deposit Insurance Reform and Taxpayer Protection Act of 1991, S. 543 (as reported out of the U.S. Senate Committee on Banking, Housing and Urban Affairs, Rep. 102-167 (1991)), §§ 302 & 303 (conditioning permission for national and state banks to branch nationwide on requirement that banks be "adequately capitalized and adequately managed"); *id.* § 715 (conditioning approval for bank holding companies to establish securities affiliates on adequate capitalization for holding company and requirement that each of holding company's insured depository subsidiaries be well capitalized).

The determination by the appropriate federal banking agency of an insured depository institution's capital classification, therefore, has very broad implications, both positive and negative, for the institution concerned as well as for its affiliates.

121. See *infra* note 138 (explaining MACRO and CAMEL acronyms).

122. Ralph A. Mock, *Informal Enforcement Process*, in *BANKS AND THRIFTS: GOVERNMENT ENFORCEMENT AND RECEIVERSHIP* 8-1 at 8-9 to 8-16 (Barry Stuart Zisman ed. 1992) [hereinafter Zisman].

123. See *infra* notes 317-19 and accompanying text (describing results of agency's choosing formal action).

decision would be (and still is) subject to an *ex post* challenge in a U.S. district court.<sup>124</sup>

FDICIA did not add to the regulators' ultimate arsenal of coercive powers, except, perhaps, in the case of pre-insolvency seizures; but, FDICIA did dramatically change the *environment* in which those powers must be exercised. In the first place, section 38 of the FDI Act provides for the use of coercive powers against institutions and individuals *outside* of the procedural format created by section 8 of the FDI Act.<sup>125</sup> Second, the regulators have been stripped of their discretion to use capital levels and S/S ratings as merely *relevant factors* in their overall assessment of what enforcement or seizure action (if any) to take against troubled institutions. Instead, capital levels and S/S ratings have been transformed into *triggers* for the mandatory action by the regulators.<sup>126</sup> In other words, FDICIA has greatly intensified the importance of capital levels and S/S ratings, while simultaneously reducing (or even bypassing) the procedural protections formerly available to troubled institutions and their directors and officers.

The changes brought about by FDICIA have rendered the traditional tone of informality surrounding the examination process obsolete. Much more now than ever before, this process now turns on the decisions of examiners. This transformation of the supervisory landscape has exposed the deficiency, from the viewpoint of banks and their directors and officers, of the current procedures for securing review of examiners' decisions.

### III. ADMINISTRATIVE AND JUDICIAL REVIEW UNDER THE CURRENT PCA SYSTEM

PCA involves a substantial range of agency actions and procedures. Depository institutions and individuals subject to PCA not only will be presented with various forms of agency intervention, from mild coercion to substantial intrusion, but they also will become involved with a variety of procedures, from the simple and informal to the complicated and

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124. See *infra* notes 324-34 and accompanying text (describing results of agency's placing institutions into conservatorship or receivership).

125. FDICIA § 131(a) (adding FDI Act § 38, 12 U.S.C. § 1831o (Supp. IV 1992)).

126. See *supra* notes 42-45 and accompanying text (describing triggers for mandatory action). At the same time, capital levels have become *qualifying* determinants for the exercise by insured depository institutions of their corporate powers. *Id.*; *supra* notes 61-63.



fairly formal. While section 38 of the FDI Act contains few procedural requirements,<sup>127</sup> the agencies have developed a number of procedural protections that are now contained in their Final Rules.<sup>128</sup>

Even before any of the PCA procedures are initiated, however, the agencies' decisions concerning prompt corrective action rely heavily on the information acquired during their regular supervisory activities. It is, therefore, important to understand how the agencies gather the depository institution information to assess the adequacy of the procedures adopted to implement section 38 requirements.

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127. The only express procedural provisions are contained in sections 38(g) and 38(n). FDICIA § 131(a) (adding FDI Act § 38(g), (n), 12 U.S.C. § 1831o(g), (n) (Supp. IV 1992)). Section 38(g) provides for "notice and an opportunity for a hearing" before a banking agency determines that an insured institution is in an unsafe or unsound condition, while section 38(n) provides for an "administrative review of dismissal orders." *Id.* In the latter case, an apparent concern for the constitutional rights of directors and senior executive officers prompted Congress to provide for a limited administrative due process hearing before the relevant banking regulator whenever the latter orders a PCA dismissal of a director or senior executive officer. *Id.* As far as other PCA actions are concerned, Congress left it to the banking agencies to formulate appropriate procedures through the rulemaking process.

Earlier versions of the legislation did make general provision for judicial review in the court of appeals of any actions taken under the prompt corrective action provisions. For an example, see Financial Institutions Safety and Consumer Choice Act of 1991, S. 713, 102d Cong., 1st Sess. (1991) (bill sponsored by Treasury to reform federal deposit insurance system and recapitalize Bank Insurance Fund). Various more restrictive alternatives were explored in staff drafts in the Senate Committee on Banking, Housing and Urban Affairs (which formulated the PCA provisions as they appear in FDICIA). All reference to judicial review, however, was removed from the Committee Print that went to markup in the Senate Committee. The provision was reinserted in the version that passed the Senate, but was eventually dropped by the Senate conferees in the face of objections by House staff who believed that PCA determinations would not be reviewable under present law in any event. *See* Carnell, *supra* note 14, at 349 (describing original Senate bill); Richard Scott Carnell, *Prompt Corrective Action under the FDIC Improvement Act of 1991*, LITIGATING FOR AND AGAINST THE FDIC AND THE RTC 1992 (Practicing Law Institute) 27, 38-40 (1992) (illustrating difference between versions of bill).

Except insofar as enforcement is concerned, no reference to judicial review remains in the amended version of the FDI Act. FDI Act § 8(i)(1), 12 U.S.C. § 1818(i)(1) (Supp. IV 1992). The result is that the default provisions of the Administrative Procedure Act (APA) relating to judicial review will apply. 5 U.S.C. §§ 554-557 (1988).

128. *See infra* notes 129-49 and accompanying text (providing detailed analysis of provisions).

### A. The Monitoring Process

The federal banking agencies obtain the information concerning the condition and activities of the institutions under their supervision in two ways. First, the institutions are required regularly to file various reports with their primary regulator;<sup>129</sup> and second, the institutions are subject to regular and special on-site examinations by the agencies' examiners.<sup>130</sup>

#### 1. Monitoring

The most important reports that depository institutions must file are reports of condition<sup>131</sup> ("call reports"), reports of income,<sup>132</sup> and, since the enactment of FDICIA, annual reports of condition and management.<sup>133</sup> The information from these reports is computer-monitored on a continuing basis and, where the analysis of the information indicates cause for concern, the agency may decide to seek more information or to conduct a special on-site examination or visitation.<sup>134</sup>

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129. FDICIA § 112(a) (adding FDI Act § 36(a), 12 U.S.C. § 1831m (Supp. IV 1992)).

130. *Id.* § 111(a) (adding FDI Act § 10(d)(4), 12 U.S.C. § 1820(d)(4)).

131. *Id.* (amending FDI Act § 7(a)(1), 12 U.S.C. §§ 1817(a)(1), 161, 324)).

132. *Id.*

133. *Id.* § 112 (adding FDI Act § 36, 12 U.S.C. § 1831m). This statute was effective with respect to fiscal years beginning after December 31, 1992. *Id.*

Reports of condition and income must be filed at the request of the appropriate agency and at least four times a year. *See* 12 U.S.C. § 161 (1988) (requiring reports of condition and income for national banks); *Id.* § 324 (requiring reports of condition and income for state member banks); FDICIA § 111(a) (amending FDI Act § 7(a)(1), 12 U.S.C. § 1817(a)(1)) (requiring reports of condition and income for federally insured state nonmember banks); and 12 U.S.C. § 1464(v) (requiring reports of condition and income for thrifts). *See also*, FDICIA § 111(a) (amending FDI Act § 7(a)(3), 12 U.S.C. § 1817(a)(3) (Supp. IV 1992)) (providing reporting rules).

In practice, commercial banks file reports every quarter (with the Fed, FDIC or OCC), savings associations (thrift financial reports) every month (with the OTS), and bank holding companies (with the Fed) every quarter. *See generally* Joseph P. Daly, *Enforcement Process*, in Zisman, *supra* note 122 at 4-1, 4-42 - 4-43 (describing entire examination process) [hereinafter Daly]. The FDIC has full access to these reports and is authorized to require, in agreement with the other relevant agency, additional reports when these are needed for insurance purposes. FDICIA § 111(a) (amending FDI Act § 7(a)(2), 12 U.S.C. § 1817(a)(2) (Supp. IV 1992)).

134. Daly, *supra* note 133, at 4-43.

## 2. Examinations

An on-site examination is the agencies' most important information gathering technique. Each federal banking agency has clear authority to conduct on-site examinations as deemed necessary.<sup>135</sup> The Federal Financial Institutions Examination Council has devised a uniform rating system (UFIRS) that all four federal banking regulators have adopted.<sup>136</sup> The system distinguishes between two types of ratings: one for each so-called "*key performance dimension*"<sup>137</sup> of the institution under examination, and a separate "*composite rating*" that attempts to make a global assessment of the institution's condition and performance based upon the five key performance dimensions and other relevant factors.<sup>138</sup>

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135. See, e.g., 12 U.S.C. § 481 (1988) (giving OCC authority over national banks); *Id.* § 248(a) (giving Federal Reserve authority over state member banks); FDI Act § 10(b), 12 U.S.C. § 1820(b) (1988 & Supp. IV 1992) (giving FDIC authority over all federally insured state nonmember banks, banks filing applications for deposit insurance, insured depository institutions in default, and any other insured depository institution where FDIC Board deems special examination necessary); and 12 U.S.C. § 1464(d)(1)(B) (giving OTS authority over all federally insured thrifts). See generally Daly, *supra* note 133, at 4-8 - 4-10 (describing examination process).

136. FEDERAL DEPOSIT INSURANCE CORPORATION, LAW REGULATIONS RELATED ACT, UNIFORM FINANCIAL INSTITUTIONS RATING SYSTEM, at 5079-80.01 (June 6, 1980).

137. FDIC DIVISION OF BANK SUPERVISION, MANUAL OF EXAMINATION POLICIES 1.1-1 (1993) [hereinafter FDIC MANUAL].

138. *Id.* at 1.1 to 1-3. The key performance dimensions are capital adequacy (C), asset quality (A), management (M), earnings (E), and liquidity (L), and they are commonly referred to by the acronym "CAMEL" (or, in the case of institutions supervised by the OTS, "MACRO"). See *id.* at 1.1-1 (explaining CAMEL classifications); Daly, *supra* note 133, at 4-13 - 4-23 (explaining acronym and definitions used in classifications). The MACRO acronym stands for management, asset quality, capital adequacy, risk management, and operating results. See generally Daly, *supra* note 133, 4-24 - 4-31 (explaining definitions used in MACRO classifications).

Examiners and reviewers are not precluded from considering other factors if, in their judgment, these other factors are relevant to an accurate assessment of the overall condition and soundness of a particular bank. See FDIC MANUAL, *supra* note 137 at 1.1-2 (explaining composite ratings system). A scale of "1" to "5" is used to express the evaluation for both the key performance dimensions and the composite rating. "1" indicates the highest evaluation and least degree of supervisory concern, and "5" indicates the lowest rating and greatest degree of concern. The performance ratings are described as follows:

RATING "1" — Indicates strong performance, significantly higher than average.

RATING "2" — Reflects satisfactory performance, which is average or above; this includes performance that adequately provides for the safe and sound opera-

The intensity level of the examination conducted by the agency's examiner varies according to the result of an institutional risk analysis performed prior to the examination. Additionally, the intensity level is based on information from previous examinations as well as other sources. For example, the FDIC distinguishes between Tier I, II, and III examinations.<sup>139</sup> A Tier I examination is the most thorough as far as the number of assets reviewed and depth of analysis is concerned. Tier II examinations are somewhat less detailed and are used to determine "whether an institution poses more than a normal risk to insurance funds."<sup>140</sup> Tier III examinations focus primarily on making an overall assessment of an institution's condition to keep the FDIC's Division of Supervision informed of changes and trends that might jeopardize the insurance funds.<sup>141</sup> Tier III examinations are highly flexible, small-scale

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tion of the bank.

RATING "3" — Represents performance that is flawed to some degree and as such is considered fair. It is neither satisfactory nor unsatisfactory but is characterized by performance that is [average] or below-average quality.

RATING "4" — Refers to marginal performance, significantly below average. If left unchecked, such performance might evolve into weaknesses or conditions that could threaten the viability of the institution.

RATING "5" — Considered unsatisfactory; performance that is critically deficient and in need of immediate remedial attention. Such performance, by itself or in combination with other weaknesses, threatens the viability of the institution.

*Id.* at 1.1-1.

The composite rating, while it normally should bear a fairly close relationship to the rankings of the individual CAMEL components, is not derived merely by computing an arithmetic average of those individual rankings. It is "quite conceivable," for example, for an institution that has a "1" rating for capital adequacy, management, earnings, and liquidity to have an "excessive volume of adversely classified assets," therefore meriting an overall composite rating of "3" as an indication that a "remedial program to address these asset weaknesses" should be incorporated into informal supervisory action against the institution. *Id.* at 1.1-2.

139. FDIC MANUAL, *supra* note 137, at 1.1 - 9-10. Tier I examinations are used "to ascertain the extent of problems that pose more than a normal risk to the deposit insurance funds" and are conducted for deteriorating 3-rated as well as 4- and 5-rated institutions. *Id.* at 1.1-9.

140. *Id.* at 1.1-10. Tier II examinations are conducted in the case of all 1- and 2-rated institutions and "should be seriously considered for stable and improving 3-rated institutions." *Id.* Tier III examinations are less detailed: for example, the volume of loans reviewed in a Tier II examination "can be dramatically reduced from the Tier I level" and should normally not exceed 25% of the dollar volume of loans. *Id.* at 1.1-12.

141. FDIC MANUAL, *supra* note 137, at 1.1-13. Tier III examinations are used for all institutions, whatever their rating, to: "(a) confirm existing UFIR and [monitoring system] ratings; (b) determine if an institution's risk profile has changed and whether

assessments, which tend to focus on the adequacy of the institution's policies and procedures, using, for example, a small sample of assets.<sup>142</sup>

At the conclusion of the examination, the examiner compiles a report that contains comments and conclusions, a detailed statement of the financial condition of the institution, a detailed analysis of the examiner's treatment of the institution's performance dimensions, and the institution's composite rating.<sup>143</sup> Although shared with the bank itself, the examiner's report is considered highly confidential and is exempt from disclosure under the Freedom of Information Act.<sup>144</sup>

Before finalizing the report, the examiner will meet with the institution's management in an "exit interview," where problems highlighted in a "pencil draft" of the report will be reviewed.<sup>145</sup> The meeting is an extremely important aspect of the continuing relationship between the institution and the examiner.<sup>146</sup> At the conclusion of the interview, the examiner finalizes the report and appends certain confidential schedules for disclosure to the agency. The confidential portion of the report discloses factual information supporting the rating assigned to the management and, if appropriate, may recommend supervisory action.<sup>147</sup> The examiner's report is then reviewed in the regional office prior to the formal issuance of the Report of Examination to the institution. The Report is issued with a request for a response to its conclu-

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such changes will pose an undue insurance risk . . . ; (c) determine progress in correcting previously noted deficiencies or monitor compliance with corrective programs and orders; and (d) evaluate other trends and situations." *Id.* at 1.1-10.

142. *Id.* at 1.1-14.

143. Daly, *supra* note 133, at 4-39 n.2. The examiner's individual performance dimension ratings are not disclosed to the institution. FDIC MANUAL, *supra* note 137, at 10.1-1.

The comments and conclusions are the most important aspect of the report and examiners are encouraged to give time and thought to their formulation. FDIC MANUAL, *supra* note 137, at 1.1-15. The report is directed first and foremost at the institution's board of directors, although it is also intended to inform the examiner's regional supervisor and, ultimately, the Washington office. *Id.*

144. 5 U.S.C. § 552(b)(8) (1988).

145. Mock, *supra* note 122, at 8-17. Ideally, the institution's management will undertake to make corrections as a result of the discussion that has transpired with the examiner, but the examiner also may be persuaded that a particular assessment, for example a loan classification, is wrong and should be upgraded. *Id.* at 8-16.

146. *See id.* at 8-16 - 8-18 (outlining importance of ongoing relationship with examiner).

147. *See* FDIC MANUAL, *supra* note 137, at 10.1-29 (listing contents of report).

sions and any corrective action that is required.<sup>148</sup> If the institution refuses to comply with a request for corrective action, it is possible for the agency to take further informal, or formal, enforcement action.<sup>149</sup>

### 3. *Review of Examinations*

Institutions have opportunities to appeal the adverse aspects of the Report of Examination, that can effect directly the capital and supervisory status of the institution. Under procedures instituted in early 1992, the four banking regulators each permit an institution to seek review by a superior officer of their examiners' decisions.<sup>150</sup> The matters that are reviewable on appeal include the most important issues of dispute that are likely to appear in the Report of Examination. These include appraisal values assigned to loans and collateral, classifications of loans, and conclusions concerning issues of safety and soundness. There are minor differences of detail between each agency as far as the procedure and direction of the appeal are concerned; most agency rules are tailored

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148. See Daly, *supra* note 133, at 4-41 (describing internal FDIC procedure).

149. See Zisman, *supra* note 122, chs. 8 and 9 (outlining subsequent informal and formal enforcement actions).

150. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, 1 FEDERAL RESERVE REGULATORY SYSTEM, EXAMINATIONS AND INSPECTIONS - RESOLVING DIFFERENCES BETWEEN BANKERS AND EXAMINERS, at 3-1532.1 (Trans. 138) (Aug. 1992) [hereinafter BOARD OF GOVERNORS, EXAMINATIONS AND INSPECTIONS]; Procedures for Requesting Review of Supervisory Decisions, in Memorandum from Paul G. Fritts, Executive Director, Office of Executive Director, Federal Deposit Insurance Corporation (Feb. 7, 1992) [hereinafter FDIC, Procedures for Requesting Review of Supervisory Decisions]; OFFICE OF THE COMPTROLLER OF THE CURRENCY, POLICIES AND PROCEDURES MANUAL, EXAMINATION REVIEW PROCESS, at 5000-28 (rev) (Feb. 26, 1992) [hereinafter OCC, EXAMINATION REVIEW PROCESS]; Supervisory Review Process, in Memorandum from John F. Downey, Deputy Director for Regional Operations, Office of Thrift Supervision (Apr. 6, 1992) [hereinafter OTS, Supervisory Review Process].

In addition, the Competitive Equality Banking Act of 1987 (CEBA) imposed upon the Federal Home Loan Bank Board (now the OTS) a requirement that institutions could secure review by the agency's principal supervisory agents (PSAs) of the decision of examiners or supervisory agents relating to the appraisal value of loans and collateral, loan classifications, and loan write-downs. Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 407(d), 101 Stat. 617 (codified at 12 U.S.C. § 1442a (1988)).

Under this provision, the PSA must take into account the report of an independent arbiter or panel of arbiters before approving, modifying or setting aside the decision under review. 12 U.S.C. § 1442a(b) (1988). Independent arbiters are appointed under the provisions of subsection (c). *Id.* § 1442a(c).

to the specific organization of each agency and the kinds of institutions they supervise. While all of these procedures are in the process of being revamped, only those of the Office of the Comptroller of the Currency (OCC) had been finalized by the time this Article went to press.<sup>151</sup> Those procedures for review of examinations that were still applicable at the FDIC, OTS and Federal Reserve are represented in the following chart:

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151. For more on the new OCC procedures, see *infra* notes 159-69 and accompanying text.

Chart 1A: Current Examination Review Processes - FDIC, OTS and Fed

	FDIC <sup>13</sup>	OTS <sup>13</sup>	OTS <sup>14</sup> 12 USC § 1442a	FED <sup>15</sup>
<b>Subject matter reviewable</b>	- "significant supervisory decisions" (including classifications, exam findings)  → Division of Supervision (DOS) Regional Office → DOS Director, D.C.	- final supervisory findings & decisions - not enforcement actions - not OTS policies  → OTS, D.C. (Deputy Director, Regional Operations)	- appraisal value of loans & collateral - classification of loans - reserve requirements  → principal supervisory agent (PSA)	- significant errors in examinations and related to safety/soundness, operation, management or financial standing of inst'n, or having a material impact on the regulator's supervision of the institution  → senior Reserve Bank officials; or → Reserve Bank President <sup>16</sup> - Reserve Bank president or designee can also decide whether to resolve the issue in a manner that is confidential from the examiner involved
<b>Appeal to</b>				
<b>Power on appeal</b>	FDIC/D.C. can override ("will resolve or recommend a resolution of the issues")	OTS/D.C. can override	PSA must: - consider independent arbiter's report - act on basis of supervisory agent's review of facts and applicable regulations	Reserve Bank president can override examiner
<b>Procedures</b>	- must be requested with the knowledge of the institution's board - written submission describing details of the dispute - consultation between DOS Director (or designee) and lower staff	- S&L board must resolve to request review - 5 pages of written information (plus relevant excerpts from exam reports, etc.)	- provision for report by independent arbiter(s) - balance to be established by agency: RB4	- should be authorized by the state member bank's board of directors - "request for review" (no indication of whether this must be in writing)
<b>Time limits</b>	"timely" submission	within 30 days of receipt of document transmitting regional office's final determination	25-day arbiter review 20-day PSA review	within a "reasonable time"
<b>Creates rights?</b>	No (review also discretionary)	No	No	No



None of these procedures, however, created any further rights of administrative or judicial review and indeed, expressly foreclose such a possibility.<sup>157</sup> The appeal provisions just described fail to provide genuine, independent review of the examiner's determinations and are claimed to lead to retributive action on the part of examiners in subsequent examinations.<sup>158</sup>

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152. All information presented in this section is from FDIC, Procedures for Requesting Review of Supervisory Decisions, *supra* note 150, at 1-2.

153. All information presented in this section is from OTS, Supervisory Review Process, *supra* note 150, at 1.

While this Article was in the press, the OTS announced a new examination appeal process that provides for a more formal appeal from the regional office to the deputy director of regional operations in Washington. See *OTS Informs Thrifts of Formal Process for Appealing Adverse Examination Results*, 61 Banking Report (BNA) 521 (1993) (describing new appeal process).

154. All information presented in this section is from 12 U.S.C. § 1442a (1988).

155. All information presented in this section is from BOARD OF GOVERNORS, EXAMINATIONS AND INSPECTIONS, *supra* note 150, at 1-2.

While this Article was in the press, the Federal Reserve issued a letter restating and slightly modifying its policy on examination appeals. See *Fed Sends Reserve Bank Presidents Letter Restating Appeal Policy*, 60 Banking Report (BNA) 913 (1993) (describing guidance contained in letter). The letter does not appear to affect significantly the information provided in this chart.

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These officials have the discretion to decide whether the circumstances of the particular situation, including the views of the bank involved, suggest that the matter should be resolved by individuals who did not participate directly in the particular decision or examination finding under review . . . in these situations, while the examiner might be consulted, the examiner would generally not be involved in making the final determination.

BOARD OF GOVERNORS, EXAMINATIONS AND INSPECTIONS, *supra* note 150, at 2.

157. See 12 U.S.C. § 1442a(f)(2)-(3) (1988); OTS Supervisory Review Process, *supra* note 150 (stating that "this review process is discretionary and does not confer any legal rights").

158. See Fred R. Bleakley, "Regulators from Hell" Frighten Some Banks But Also Win Praise, WALL ST. J., Apr. 27, 1993, at A14 (reporting fear by some bankers and analysts that "retribution will follow any complaint about regulators").

The absence of any meaningful forms of appeal was strongly protested in a joint letter to the President-elect and signed by the leading industry associations last December. Letter from the American Bankers Association, Independent Bankers Association of America, Association of Reserve City Bankers, Association of Bank Holding Companies, Consumer Bankers Association, and Savings & Community Bankers of America, to the President-elect, Bill Clinton, (Dec. 7, 1992). The organizations urged the President-elect to "restore due process" by creating an appeal process against examination results that "are used to levy significant money penalties or enforcement actions against officers and directors, even for technical infractions such as inadvertent

The OCC has taken the lead in addressing these concerns. As with the other banking agencies, the OCC provided an appeal structure that allowed all national banks to seek higher review of all examination findings and supervisory actions with the exception of formal enforcement actions.<sup>159</sup> Banks were given the option of seeking review before their immediate higher-level supervisors or directly from the Office of the Chief National Bank Examiner. Acknowledging that this system failed to address the bank's fear that they might suffer retribution for seeking to bypass their regional supervisors, the Comptroller instituted a new review process in June 1993.<sup>160</sup>

The new OCC review system adopts an ingenious technique for reconciling the demand for independent review of examination disputes with the need for maintaining as much informality and flexibility in the supervisory process. There is now an Office of Ombudsman, located in the Washington, D.C. office,<sup>161</sup> to which national banks are permitted to appeal all agency decisions, with certain exceptions,<sup>162</sup> either through the regular supervisory hierarchy or directly.<sup>163</sup> The Office of the Ombudsman has plenary jurisdiction, with the prior consent of the Comptroller, to override any decisions or actions taken by the agen-

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addition errors on regulatory reports." *Id.* at 1-2 (accompanying recommendations).

The President and the agencies have responded by announcing that the agencies will devise new appeals and complaints processes. *See* Remarks by the President on Policy to Alleviate the Credit Crunch, at 3 (Office of the Press Secretary) (Mar. 10, 1993) (describing agency coordinator); OFFICE OF THE COMPTROLLER OF THE CURRENCY, FEDERAL DEPOSIT INSURANCE CORPORATION, FEDERAL RESERVE BOARD, OFFICE OF THRIFT SUPERVISION, INTERAGENCY POLICY STATEMENT ON CREDIT AVAILABILITY, at 4 (Mar. 10, 1993) (describing actions to improve appeals process). In their joint release, the agencies state that each agency will "take appropriate steps to ensure that its appeals process is fair and effective. In particular, each agency will ensure that its process provides a fair and speedy review of examination complaints and that there is no retribution against either the bank or the examiner as a result of an appeal." *Id.* At the time this Article went to press, the FDIC, OTS and Federal Reserve were still in the process of formulating their new procedures. For the new OCC procedures, *see infra* notes 159-69 and accompanying text (describing appeals process).

159. OCC, EXAMINATION REVIEW PROCESS, *supra* note 150.

160. OFFICE OF THE COMPTROLLER OF THE CURRENCY, BANKING ISSUANCE, NATIONAL BANK APPEALS PROCESS, BC-272 at 1 (June 11, 1993) (superseding EXAMINATION REVIEW PROCESS, *supra* note 150) [hereinafter OCC, NATIONAL BANK APPEALS PROCESS].

161. *Id.* at 1-2.

162. *See infra* p. 539, Chart 1B (describing OCC appeals process).

163. OCC, NATIONAL BANK APPEALS PROCESS, *supra* note 160, at 1-2.

cy.<sup>164</sup> Where any disagreement cannot be resolved informally, the examiner involved in the dispute is directed specifically to “encourage the national bank to seek a further review of the OCC decisions or actions that are in dispute,”<sup>165</sup> and the Ombudsman is required to review all the materials and contact the bank “to ensure that the OCC is in possession of all relevant materials.”<sup>166</sup>

The full process is presented in the following chart:

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164. *Id.* at 1.

165. *Id.*

166. *Id.* at 3-4.

Chart 1B: New OCC National Bank Appeals Process<sup>10</sup>

	<i>Supervisory Office Appeals</i>	<i>Ombudsman Appeals</i>
<b>Subject matter reviewable</b>	<ul style="list-style-type: none"> <li>- all agency decisions except:               <ul style="list-style-type: none"> <li>- appointments of receivers and conservators</li> <li>- preliminary examination conclusions<sup>10a</sup></li> <li>- enforcement-related matters</li> <li>- other decisions subject to specific appeal procedures<sup>10b</sup></li> </ul> </li> </ul>	
<b>Appeal to</b>	<p><i>Community and regional banks:</i></p> <ul style="list-style-type: none"> <li>- district administrator or district deputy comptroller</li> </ul> <p><i>Multinational banks:</i></p> <ul style="list-style-type: none"> <li>- deputy comptroller for multinational banking, D.C.</li> </ul> <p><i>Banks in special supervision programs:</i></p> <ul style="list-style-type: none"> <li>- deputy comptroller for special supervision, D.C.</li> </ul>	<p><i>All banks</i></p> <ul style="list-style-type: none"> <li>- direct appeal to OCC Ombudsman, Washington, D.C.</li> <li>- "second-tier appeal" from district administrator or deputy comptroller to Ombudsman, D.C.</li> </ul>
<b>Power on appeal</b>	<ul style="list-style-type: none"> <li>- can reverse or amend prior decision</li> </ul>	<ul style="list-style-type: none"> <li>- Ombudsman, with prior consent of Comptroller, can "supersede any agency decision or action"</li> </ul>
<b>Procedures</b>	<ul style="list-style-type: none"> <li>- written submission by bank</li> <li>- OCC officer "not connected with the matter in dispute" discusses appeal and related issues with bank officials and prepares written or oral information concerning the basis of the appeal</li> <li>- written response from OCC within 20 calendar days (in "absence of any extenuating circumstances")</li> <li>- copies of all relevant materials forwarded to Ombudsman in D.C. "immediately after response is issued"</li> </ul>	<p><i>Direct appeals:</i></p> <ul style="list-style-type: none"> <li>- written submission by bank fully describing the matter in dispute</li> <li>- Ombudsman contacts OCC management officials involved in the dispute</li> <li>- latter submit written materials &amp; documents within 10 calendar days</li> <li>- further contact with bank &amp; meeting if bank so requests</li> <li>- written response to appeal within 30 calendar days of filing of appeal (absent "extenuating circumstances")</li> </ul> <p><i>Second-tier appeals:</i></p> <ul style="list-style-type: none"> <li>- written notice by bank within 15 calendar days</li> <li>- Ombudsman reviews all material and contacts bank</li> <li>- meeting with bank if latter so requests</li> <li>- written response within 15 calendar days of filing of appeal (absent "extenuating circumstances")</li> </ul>
<b>Effect of appeal</b>	<ul style="list-style-type: none"> <li>- general rule: stays "all agency decisions and actions"</li> <li>- Ombudsman has discretion to put agency decision or action into effect "in appropriate circumstances"</li> </ul>	
<b>Creates rights?</b>	Unclear	Unclear

### B. Administrative Review of PCA Determinations

The procedures directly applicable to PCA determinations are governed by statute<sup>170</sup> and by formal and informal agency regulations.<sup>171</sup> These procedures can be broken down into capital classifications, reclassifications based on non-capital considerations, capital restoration plans, and PCA directives and dismissals.

#### 1. Capital Classifications

As far as PCA is concerned, there are no additional statutory procedural requirements in the case of a classification based on the actual capital condition of the institution concerned.<sup>172</sup> As a result, the procedures already described provide the basis for the initial classification and any reclassifications that might follow. In other words, the agencies rely on their regular monitoring and examination processes, as well as on voluntary reporting by the institutions themselves, for the information that the agencies use to classify each institution into its PCA capital category. After an agency's assessment of an institution's capital status has been made, the institution is notified of the capital category into which it has been placed.<sup>173</sup> Beyond those procedures already described for challenging the conclusions in reports of examination, no procedures exist by which the institution can challenge this basic category determination. The situation currently applicable is represented in the following chart:

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167. All information presented in Chart 1B is from *id.* at 1-5.

168. Preliminary examination conclusions are made prior to final Report of Examination or other written communication. OCC, NATIONAL BANK APPEALS PROCESS, *supra* note 160, at 4.

169. Decisions subject to an existing appeals process "designed specifically for the issue in dispute" are appealable to the Ombudsman when final. *Id.* at 4-5.

170. FDICIA § 131(a) (adding FDI Act § 38, 12 U.S.C. § 1831o (Supp. IV 1992)).

171. 12 C.F.R. §§ 308.200-204, 320.101-105 (1993).

172. Notice and hearing procedure is required where an institution is reclassified as a result of non-capital considerations. *See infra* notes 186-204 and accompanying chart and text (describing agency procedures when institutions are reclassified based on non-capital classification). The agencies also have not provided any procedural additions in their Final Rules, although their joint discussion of the Final Rules indicates that the agencies do contemplate some kind of informal opportunity for an explanation of information adverse to the institution. *See Prompt Corrective Action; Rules of Practice for Hearings, supra* note 18, at 44,874 (stating agencies' position on informal review of agency actions).

173. 12 C.F.R. § 325.103(b) (1993).

Chart 2: Capital-Based Capital Classification Procedure

<i>Basis for Calculation</i>	<i>Agency Procedure</i>	<i>Moment of Implementation</i>
1) Self-monitoring by institution	<p>Institution must supply information w/in 15 days of any material event that would cause the institution to be assigned to a lower capital category.<sup>174</sup></p> <p>Institution can also seek reclassification to a higher category.<sup>175</sup></p> <p>Review of information supplied by management.<sup>176</sup></p> <p>Agency analysis of data</p>	<p>Institution deemed to have been notified of new capital category on most recent date of:-</p> <ul style="list-style-type: none"> <li>- call report due;</li> <li>- final report of examination filed to bank; or</li> <li>- date of notice to bank under § 325.102(c) or § 325.103(d).<sup>177</sup></li> </ul>
2) Call Reports. <sup>178</sup>	Agency analysis of data	Deemed notified of capital levels and capital category at date that call report is required to be filed with the FDIC. <sup>179</sup>
3) Information obtained in examination or inspection	<p>Examination process</p> <p>Informal statutory review process applicable to OTS.<sup>180</sup></p> <p>Informal internal appeal process or supp. review.<sup>181</sup></p> <p>Analysis of data</p>	Date final examination report is delivered. <sup>182</sup>
4) "Other information obtained by the agency from any source." <sup>183</sup>	Notification in writing of the calculation and the information used as a basis for the capital calculation. <sup>184</sup>	Date of written notice by FDIC. <sup>185</sup>

## 2. *Reclassifications Based on Non-Capital Considerations*

Section 38(g) of the FDI Act provides for the reclassification of an institution's capital category on a basis other than its capital condition.<sup>186</sup> Being concerned that "factors other than capital should in certain circumstances be used to assess the financial condition of an institution,"<sup>187</sup> Congress authorized the agencies, irrespective of an institution's actual capital status, to downgrade the institution's classification where (a) the agency has determined, "after notice and an opportunity for hearing," that the institution is in an unsafe or unsound condition, or (b) the agency has deemed the institution to be engaging in an unsafe or unsound practice because the institution has received a less than satisfactory rating for asset quality, management, earnings, or liquidity.<sup>188</sup> Once again, therefore, the examination process is very im-

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174. *Id.* § 325.102(c)(1).

175. *Prompt Corrective Action: Rules of Practice for Hearings*, *supra* note 18, at 44,874. Agency review of information supplied by management, together with any explanations, is used to determine whether adjustment is appropriate. 12 C.F.R. § 325.102(c)(2) (1993).

176. 12 C.F.R. § 325.102(c)(2) (1993).

177. *Id.* § 325.102(b), (c), (d).

178. A Call Report is a Consolidated Report of Condition and Income that banking institutions must file with the FDIC. *Id.*

179. *Id.* § 325.102(b)(1).

180. 12 U.S.C. § 1442a (1988).

181. *See supra* pp. 535, 539, Charts 1A and 1B (summarizing appeals process at FDIC, OTS, Federal Reserve, and OCC).

182. 12 C.F.R. § 325.102(b)(2) (1993).

183. The other information includes: data provided by the institution on a voluntary basis; information obtained in connection with an application; calculations based on reports other than Call reports; or "adjustments that are appropriate based on publicly announced events that may affect an institution's capital." *Prompt Corrective Action*, 57 Fed. Reg. 29,662, 29,668 (1992) (to be codified at 12 C.F.R. §§ 308, 325) (proposed July 6, 1992).

184. It is unclear whether 12 C.F.R. § 325.102(c) applies.

185. 12 C.F.R. § 325.102(b)(3) (1993).

186. FDICIA §131(a) (adding FDI Act § 38(g), 12 U.S.C. § 1831o(g) (Supp. IV 1992)).

187. *Prompt Corrective Action: Rules of Practice for Hearings*, *supra* note 18, at 44,876.

188. *Id.* *See supra* notes 57-60 and accompanying text (describing safety or soundness reclassifications). In practice, a less than satisfactory rating would occur wherever the institution received a rating of "3" or lower for one of its non-capital key performance dimensions. *See supra* notes 137-38 and accompanying text (describing "key

portant for the PCA capital classification of an institution.<sup>189</sup>

The statute requires the agencies to provide "notice and an opportunity for a hearing" for a reclassification based on unsafe or unsound *condition*,<sup>190</sup> but is silent concerning procedural requirements for a reclassification based on unsafe and unsound *practice*.<sup>191</sup> The agencies have adopted a procedure that permits automatic introduction of written submissions and oral argument, but requires prior express permission from the FDIC or presiding office.<sup>192</sup> The procedures for reclassifications based on both unsafe and unsound condition and practice are presented in the following chart:

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performance dimensions").

189. As the agencies observe in their joint discussion of the Final Rules, "[t]he examination rating . . . serves as the trigger for reclassification." *Prompt Corrective Action; Rules of Practice for Hearings*, *supra* note 18, at 44,877.

190. FDICIA § 131(a) (adding FDI Act § 38(g)(7), 12 U.S.C. § 1831o(g)(1) (Supp. IV 1992)).

191. *Id.* In the proposed rules, the agencies interpreted this silence as requiring no procedural protection for the institution, but, in response to adverse comments, the agencies revised their position and adopted the same notice and hearing requirements for both forms of classification. *See Prompt Corrective Action; Rules of Practice for Hearings*, *supra* note 18, at 44,876-77 (stating agencies' intent to require notice and comment for each form of classification). The agencies did, however, reject comments calling for the adoption of a formal adjudicatory process.

Relying on judicial decisions that have interpreted the triggering requirements for formal adjudication under the APA very strictly, the agencies concluded that a less formal notice and hearing requirement would be sufficient, particularly given that the reclassification will follow upon an examination process that "involves substantial participation by the affected institution." *Prompt Corrective Action; Rules of Practice for Hearings*, *supra* note 18, at 44,877. The agencies cite *United States v. Florida East Coast Railroad Co.*, 410 U.S. 224, 240 (1973) and *Independent U.S. Tanker Owner Comm. v. Lewis*, 690 F.2d 908, 922 n.63 (D.C. Cir. 1982).

192. 12 C.F.R. § 308.202(a)(7) (1993).



Chart 3: Reclassifications Based on Non-Capital Considerations

Basis for Reclassification	Procedures
1) Unsafe & unsound condition <sup>193</sup>	<p style="text-align: center;"><b>PCA Procedures</b></p> <p>Notice and informal, oral hearing; no formal adjudication<sup>194</sup></p> <ul style="list-style-type: none"> <li>- bank's response (within 14 days, unless FDIC determines shorter period is appropriate)<sup>195</sup></li> <li>- failure to file response<sup>196</sup></li> <li>- request for hearing &amp; presentation of oral testimony or witnesses must be made<sup>197</sup></li> <li>- order for informal hearing (within 30 days)<sup>198</sup></li> <li>- oral argument and written submissions (allowed to submit relevant written submissions during hearing and within reasonable period after hearing)<sup>199</sup></li> <li>- recommendation of presiding officers (within 20 days)<sup>200</sup></li> <li>- time for decision (within 60 days)<sup>201</sup></li> </ul>
	<p style="text-align: center;"><b>General Enforcement Procedures</b></p> <p>Formal adjudication procedures and sanctions under FDI Act<sup>202</sup></p>
2) Unsafe & unsound practice resulting in less-than-satisfactory CAMEL or MACRO rating <sup>203</sup>	<p>Initial examination process leading to rating</p> <p>Notice and informal hearing as in 1) above; no formal adjudication</p>
<p style="text-align: center;"><b>Applicable to both</b></p> <p style="text-align: center;">Request for rescission of reclassification<sup>204</sup></p>	

193. FDICIA § 131(a) (adding FDI Act § 38(g)(1), 12 U.S.C. § 1831o(g)(1) (Supp. IV 1992); 12 C.F.R. § 325.103(d)(1) (1993)).

194. 12 C.F.R. § 308.202 (1993).

195. *Id.* § 303.202(a)(2)(iii).

196. *Id.* § 308.202(a)(4).

197. *Id.* § 308.202(a)(5).

198. *Id.* § 308.202(a)(6).

199. 12 C.F.R. § 208.202(a)(7) (1993).

200. *Id.* § 308.202(a)(8).

201. *Id.* § 308.202(a)(9).

202. 12 U.S.C. § 1818(i) (Supp. IV 1992); 12 C.F.R. § 308.204 (1993).

203. FDICIA § 131(a) (adding FDI Act § 38(g)(1), 12 U.S.C. § 1831o(g)(1) (Supp. IV 1992), read with *id.* § 131(c)(2) (adding FDI Act § 8(b)(8), 12 U.S.C. § 1818(b)(8)); 12 C.F.R. § 325.103(d)(2) (1993).

204. 12 C.F.R. 308.202(b) (1993).

### 3. Capital Restoration Plans

Once an institution has been classified as less than adequately capitalized, where the classification was based on the capital condition of the institution,<sup>205</sup> it must develop and implement a capital restoration plan that is acceptable to its federal regulator.<sup>206</sup> The agency may enforce this requirement by means of appropriate PCA directives<sup>207</sup> and, ultimately, by seizing the institution.<sup>208</sup>

Although the statute provides no procedures for the submission and approval or rejection of a capital restoration plan, the agencies have developed procedures that provide for an informal "paper hearing." An institution that is significantly or critically undercapitalized must submit a written plan, guaranteed by the controlling company,<sup>209</sup> for review and approval by the appropriate agency.<sup>210</sup> If the institution has been reclassified only because of an unsafe or unsound condition or practice, the institution must provide a description of the steps it will take to remedy the deficiencies<sup>211</sup> but there is no general requirement that it submit a capital plan unless required by the agency.<sup>212</sup>

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205. Obviously an institution that was reclassified on the basis of non-capital considerations would not be subject to this requirement. Instead, it would be subjected to an appropriate PCA directive or be required to correct the condition or practice that led to the reclassification. Cf. FDICIA § 132(a) (adding FDI Act § 39(e)(1), 12 U.S.C. § 1831p-1(e)(1) (Supp. IV 1992) (transferred from § 1831s)) (requiring submission of plan for correcting deficiencies in compliance with applicable safety/soundness standards).

206. *Id.* § 131(a) (adding FDI Act § 38(e)(2), 12 U.S.C. § 1831o(e)(2)).

207. *Id.* (adding FDI Act § 38(e)(5), 12 U.S.C. § 1831o(e)(5)).

208. *Id.* § 133(a) (amending FDI Act § 11(c)(5)(K), 12 U.S.C. § 1821(c)(5)(K)); see *supra* notes 70-80 and accompanying text (describing regulators' broad powers).

209. 12 C.F.R. § 325.104(h) (1993). A plan cannot be approved unless the controlling company provides a guarantee of performance. The regulators establish the guarantee amount, duration, collection procedures, and the sanctions for failure to provide the guarantee or to perform. *Id.*

210. *Id.* § 325.104(a)(1). The written capital restoration plan must be filed within 45 days of notice. *Id.* Additional or revised plans are required only when the FDIC notifies the bank that a new or revised plan is required. 12 C.F.R. § 325.104(a)(2) (1993). The agency has 60 days to review the plan, and if the plan is rejected, a new plan must be submitted within a time period specified by the agency. *Id.* § 325.104(d). Failure to submit or implement a plan can lead to an institution being treated as "significantly undercapitalized." *Id.* § 325.104(e)-(f). The contents of the plan are specified. FDICIA § 131(a) (adding FDI Act § 38(e)(2)(B), 12 U.S.C. § 1831o(e)(2)(B) (Supp. IV 1992)). The plan can be amended only after notice to and approval by the agency. *Id.* (adding FDI Act § 38(g), 12 U.S.C. § 1831o(g)).

211. *Id.*

212. The agencies make this decision on a case by case basis. See *id.* (adding

Chart 4: Capital Restoration Plans

Institution	Procedures
1) Institutions that are: <sup>213</sup> - undercapitalized - significantly undercapitalized - critically undercapitalized	Written plan required to be filed for review and approval/disapproval by agency <sup>214</sup> - written capital restoration plan to be filed within 45 days of notice or deeming (not including reclassified institutions) <sup>215</sup> - additional or revised plan required only when FDIC notifies bank that new/revised plan is required <sup>216</sup> - contents of plan <sup>217</sup> - review by agency within 60 days (can extend the time) <sup>218</sup> - disapproval of plan; new plan must be submitted within time specified by agency <sup>219</sup> - failure to submit plan (falls into "significantly undercapitalized" net) <sup>220</sup> - failure to implement plan (falls into same net) <sup>221</sup> - amendment of plan permitted after prior written notice to and approval by agency <sup>222</sup>
2) Controlling institutions <sup>223</sup>	Plan cannot be approved unless controlling company provides a guarantee of performance; approval on case-by-case basis <sup>224</sup> - limitation on amount of guarantee <sup>225</sup> - limitation on duration <sup>226</sup> - collection on guarantee <sup>227</sup> - failure to provide guarantee <sup>228</sup> - failure to perform guarantee <sup>229</sup>
3) Reclassified institutions (unsafe/unsound condition or practice)	Description of steps to be taken to address deficiencies <sup>230</sup> No requirement to submit capital plan, unless agency decides (case-by-case) <sup>231</sup>

FDI Act § 38(g), 12 U.S.C. § 1831o(g)) (presenting agencies' optional proceedings).

213. See 12 C.F.R. § 325.103 (1993) (defining undercapitalized and other categories).

214. *Id.* § 325.104(a)(1); FDICIA § 131(a) (adding FDI Act § 38(e)(2)(A), 12 U.S.C. § 1831o(e)(2)(A) (Supp. IV 1992)).

215. 12 C.F.R. § 325.104(a)(1) (1993).

216. *Id.* § 325.104(a)(2).

217. *Id.* § 325.104(b).

218. *Id.* § 325.104(c).

219. *Id.* § 325.104(d).

220. 12 C.F.R. § 325.104(d) (1993).

221. *Id.* § 325.104(f).

222. *Id.* § 325.104(g).

223. 12 U.S.C. § 1841(a)(2) (Supp. IV 1992).

224. 12 C.F.R. § 325.104(h) (1993).

225. *Id.* § 325.104(h)(1)(i).

226. *Id.* § 325.104(h)(1)(ii).

227. *Id.* § 325.104(h)(1)(iii).

228. *Id.* § 325.104(h)(2).

229. 12 C.F.R. § 325.104(h)(3) (1993).

230. FDICIA § 131(a) (adding FDI Act § 38(g), 12 U.S.C. § 1831o(g) (Supp. IV 1992)).

231. *Id.*

#### 4. PCA Directives

No procedures are prescribed by the statute for directives issued under section 38(f).<sup>232</sup> The agencies, however, have developed informal notice and hearing procedures in their Final Rules. In addition, the FDIC has delegated specifically the power to issue and modify these directives to its deputy regional directors<sup>233</sup> and has subjected the directive process to regulations providing for reconsideration of decisions by those directors.<sup>234</sup>

All institutions subject to PCA directives can request rescission or modification,<sup>235</sup> and FDIC-regulated institutions can request reconsideration under FDIC regulations.<sup>236</sup> In addition, an institution subject to a PCA written notice can have an informal "written" hearing, but is not entitled to an oral hearing.<sup>237</sup> Notice of the written hearing must be given by the agency.<sup>238</sup> The institution must respond within a specific time,<sup>239</sup> and the agency must consider this response before reaching its final determination.<sup>240</sup> The agency also may take summary action in certain circumstances, in which case the institution is entitled to a written "appeal" and a final agency determination within sixty days.<sup>241</sup> The directive remains in effect during the period of review unless stayed by the FDIC. An institution that consents to a PCA directive has none of the above procedural rights.

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232. See *supra* notes 61-94 and accompanying text (outlining circumstances when directive may be used).

233. See FDIC, *Applications, Delegations of Authority, Capital Maintenance, Prompt Corrective Action*, 58 Fed. Reg. 8210, 8213 (1993) (describing delegation of authority to deputy regional director level).

234. 12 C.F.R. § 303.6(e) (1993).

235. *Id.*

236. *Id.* § 308.303.6(e).

237. *Id.* § 308.201(a)(1).

238. *Id.* § 308.201(a)(1).

239. 12 C.F.R. § 308.201(a)-(c) (1993).

240. *Id.* § 308.201(d).

241. *Id.* § 308.201(a)(2).

Chart 5: PCA Directives

<i>Form of Directive</i>	<i>Procedure</i>
1) Action on written notice	Written notice Informal "written" hearing; no oral hearing <sup>242</sup> <ul style="list-style-type: none"> <li>- written notice by FDIC<sup>243</sup></li> <li>- contents of notice &amp; date for response<sup>244</sup></li> <li>- timing &amp; content of response (within 14 days, unless agency extends)<sup>245</sup></li> <li>- FDIC consideration of response &amp; determination<sup>246</sup></li> <li>- failure to file response<sup>247</sup></li> </ul>
2) Summary action	Immediate directive & written "appeal" <sup>248</sup> <ul style="list-style-type: none"> <li>- immediate action, if found to be necessary by FDIC</li> <li>- submission of written appeal w/in 14 days, unless FDIC allows longer period</li> <li>- FDIC determination w/in 60 days</li> <li>- directive remains in effect during this period unless FDIC stays</li> </ul>
3) Action by consent	Agency not required to follow any of the above procedures or time limits
<p style="text-align: center;"><b>Applicable to all</b> Request for rescission or modification<sup>249</sup></p> <p style="text-align: center;"><b>Applicable to FDIC-regulated institutions</b> Opportunity to petition for reconsideration of a denied application, petition, or request<sup>250</sup></p>	

### 5. PCA Dismissals

As a practical matter, the banking agencies always have been able to cajole an institution into replacing its management as part of an agreement designed to restore the institution to a sound condition.<sup>251</sup> Since

242. *Id.* § 308.201(a)(1).

243. *Id.*

244. *Id.* § 308.201(b).

245. *Id.* § 308.201(c).

246. 12 C.F.R. § 308.201(d) (1993).

247. *Id.* § 308.201(e).

248. *Id.* § 308.201(a)(2).

249. *Id.* § 308.201(f).

250. *Id.* § 303.6(3). See also *Applications, Delegations of Authority, Capital Maintenance, Prompt Corrective Action*, *supra* note 233, at 8213 (noting availability of § 303.6 review).

251. This is the practical result of the agencies' extensive background enforcement

1933 (in the case of the Federal Reserve, with regard to national banks), and generally since 1966,<sup>252</sup> the federal banking agencies also have been able to institute formal enforcement proceedings to suspend and permanently remove bank and thrift directors, officers, and other affiliated parties from their positions.<sup>253</sup> In the case of a permanent removal order not based on indictment for a crime involving dishonesty,<sup>254</sup> the respondent has a right to an on-the-record agency adjudication<sup>255</sup> and subsequent judicial review in a U.S. court of appeals.<sup>256</sup>

Section 38, on the other hand, authorizes the federal banking agencies to order, as one of the PCA actions against an institution classified as less than adequately capitalized, the dismissal of directors or senior executive officers who have held office with the institution for more than 180 days immediately before the institution became undercapitalized.<sup>257</sup> Such a removal is quite distinct from any enforcement removal

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powers. As the court in *Miami Beach Fed. Sav. & Loan Ass'n v. Callander*, somewhat obviously observed, the threat of more serious sanctions enables the regulator to order that the institution "clean house," and it would be difficult to hold that such a request would constitute an abuse of power by the agency. 256 F.2d 410, 414-15 (5th Cir. 1958) (quoted with approval in *United States v. Gaubert*, 499 U.S. 315, 333 (1991)).

252. Financial Institutions Supervisory Act of 1966, Pub. L. No. 89-695, 80 Stat. 1028 (1966) (codified as amended in scattered sections of 12 U.S.C.).

253. FDI Act § 8(e), (g), 12 U.S.C. § 1818(e), (g) (1988 & Supp. IV 1992). The agencies are able to order suspensions without advance notice; if such enforcement action is taken, the respondents have an opportunity to seek a stay of an immediate suspension order in a U.S. district court. *See id.* § 8(e)(3) (permitting immediate suspension under certain circumstances) and *id.* § 8(f) (establishing procedure to obtain stays of suspension orders pending administrative review).

The constitutional sufficiency of this "post-dismissal" hearing is not clear: the Supreme Court considered (and upheld) the constitutional adequacy of the post-dismissal hearing provided for a party removed by the agency, under § 8(g), after indictment for a serious crime involving dishonesty. *FDIC v. Mallen*, 486 U.S. 230, 240-41 (1988). But the strict constitutional requirements for summary action may be easier to satisfy when the predicate for the action is an independent, serious allegation of criminal wrongdoing than when it is based on non-criminal factors. *Cf. id.* (discussing safeguards that accompany proceedings brought under § 8(g)).

254. Where removal is based on such an indictment, the FDI Act provides for a less formal post-removal hearing. *See* FDI Act § 8(g)(3), 12 U.S.C. § 1818(g)(3) (1988 & Supp. IV 1992) (outlining procedures for a post-suspension hearing).

255. *Id.* § 8(h)(1), 12 U.S.C. § 1818(h)(1).

256. *Id.* § 8(h)(2), 12 U.S.C. § 1818(h)(2).

257. FDI Act § 38(f)(2)(E)(ii), 12 U.S.C. § 1831o(f)(2)(E)(ii) (Supp. IV 1992). This action can be taken against any significantly undercapitalized institution and any undercapitalized institution that fails to submit and implement an acceptable capital

by the agency under section 8 of the FDI Act.<sup>258</sup> A PCA removal is subject to certain procedures stipulated in the section 38(n), which permits the director or officer dismissed to obtain review of the decision to order his or her dismissal on written petition for reinstatement.<sup>259</sup>

Congress made provision for this limited notice and hearing procedure out of a concern that a PCA dismissal order might implicate a property interest protected by the due process clause of the Fifth Amendment.<sup>260</sup> Yet the hearing provided for is extremely limited, not so much because it is informal and does not provide the right to present witnesses and introduce oral testimony, but because Congress also has stipulated a burden of proof that is almost impossible to discharge.<sup>261</sup>

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restoration plan. In addition, the agency can require the employment of new senior executive officers approved by the agency. *Id.* § 38(f)(2)(E)(iii), 12 U.S.C. § 1831o(f)(2)(E)(iii).

258. *See id.* § 38(f)(E)(ii), 12 U.S.C. § 1831o(2)(E)(ii) (stating that "dismissal under this clause shall not be construed to be a removal under section 1818 of this title").

259. *Id.* § 38(n)(1), 12 U.S.C. § 1831o(n)(1). The statute provides that the director or officer dismissed may submit written materials in support of the petition, and appear for reinstatement with the appropriate Federal banking agency, no later than 10 days after receiving notice of the dismissal, personally or through counsel before the agency, one or more of its members, or one of its designees. *Id.* § 38(n)(2)(A)(i)-(ii), 12 U.S.C. § 1831o(n)(2)(A)(i)-(ii).

In their Final Rules, the agencies interpreted these requirements not to include the right to introduce oral testimony and present witnesses without the permission of the hearing officer. 12 C.F.R. § 203(d) (1993). *See also Prompt Corrective Action; Rules of Practice for Hearings, supra* note 18, at 44,875 (outlining general procedures adopted for issuing directives under § 38). The procedures now available are represented *infra* p. 552, Chart 6 and accompanying text.

260. The author relies on personal knowledge acquired while working for the staff of the United States Senate Committee on Banking, Housing, and Urban Affairs during the markup for S. 543, the Senate vehicle for FDICIA. As the Supreme Court in *Mallen*, acknowledged "it is undisputed that appellee's interest in the right to continue to serve as president of the bank and to participate in the conduct of its affairs is a property right protected by the Fifth Amendment Due Process Clause." 486 U.S. at 240.

*See also Meyer v. Fidelity Sav.*, 944 F.2d 562, 572-75 (9th Cir. 1991) (holding that thrift employee possesses sufficient property interest in employment contract to trigger requirement of due process hearing prior to dismissal, despite strong public interest in expeditious liquidation of failed savings and loan associations), *cert. granted sub nom. FDIC v. Meyer*, 113 S. Ct. 1576 (1993).

261. The statute requires that the dismissee "shall bear the burden of proving that [his or her] continued employment would materially strengthen the insured depository institution's ability . . . (A) to become adequately capitalized . . . [or] (B) to correct the unsafe or unsound practice" that led to the downgrading of the institution in the

first place. FDI Act § 38(n)(3), 12 U.S.C. § 1831o(n)(3) (Supp. IV 1992).

Given that anyone who is subject to dismissal under section 38 must have held office for at least 180 days before the institution was classified as undercapitalized, it is difficult to imagine how a dismissee could discharge the statutory burden of proof. When the causes of an institution's difficulties are so complicated that the agency is unable to find enough evidence to bring a separate formal enforcement action against the individual, it is unlikely that the individual would be able *affirmatively to prove* that his or her *continued employment* would improve the institution's condition. Such "proof" is likely to be a matter of pure speculation. Moreover, it is conceivable that no one in the institution, not even the regulators themselves, could discharge the harsh burden of proof.

More curiously, the congressional drafters appear to have adopted the provisions of section 8(g)(3) of the FDI Act as their model. This subsection governs hearings in cases where an institution-affiliated party is suspended or removed because he or she has been charged with a crime involving dishonesty or breach of trust that is punishable by imprisonment for a term exceeding one year. FDI Act § 8(g)(3), 12 U.S.C. § 1818(g)(3) (Supp. IV 1992). The hearing provided for under section 8(g)(3) is more restrictive than one that would be available in the case of other removal actions. *Id.* This is perhaps not remarkable because the individual concerned already will have received a full judicial trial on the underlying charge. A similarly restricted hearing in the context of PCA dismissal cannot be so justified. Not only will the PCA dismissal be unconnected with any criminal charge, but the basis for the dismissal need not even be as serious as might constitute grounds for removal on other, less serious, grounds under section 8. In other words, to gain the full benefit of a formal, on-the-record agency hearing and judicial review in a court of appeals, one should not conduct oneself so reprehensibly as to attract serious criminal charges, but one should conduct oneself badly enough to attract formal removal proceedings! The limitations on the hearing requirements of section 38(n) are so substantial that at least one study has concluded that they are constitutionally inadequate. Howard N. Cayne & Michael Caglioti, *The FDICIA Dismissal Authority: What Process is Due?* (Constitutional Rights Task Force, American Association of Bank Directors 1993). For official acknowledgement that the PCA dismissal provisions might be constitutionally deficient, see *Agencies May Face Due Process Claims, Depending on How Bankers Are Dismissed*, 60 Banking Rep. (BNA) 587 (Apr. 26, 1993) (reporting remarks by OCC's Director of Enforcement and Compliance).

Apart from the problem of the burden of proof, it might be argued that even if the procedure prescribed in § 38(n) is constitutionally adequate on its face, it could be applied unconstitutionally where a hearing officer refuses to permit the presentation of oral witnesses and the introduction of oral evidence. See *Mallen*, 486 U.S. at 247 (suggesting that such refusal in circumstances where "oral testimony is essential to enable the hearing officer to make a fair appraisal of the impact of a suspended officer's continued service on the bank's security and reputation" might constitute denial of due process).



Chart 6: PCA Dismissals

Action	Procedure
Dismissal of director or senior executive officer <sup>262</sup>	<p>Summary dismissal, but informal post-dismissal hearing for reinstatement; no absolute right to oral hearing<sup>263</sup></p> <ul style="list-style-type: none"> <li>- notice of dismissal (to institution &amp; individual)<sup>264</sup></li> <li>- right to petition for reinstatement (within 10 days)<sup>265</sup></li> <li>- individual must give reasons for requested reinstatement, request oral hearing, &amp; give notice of witnesses<sup>266</sup></li> <li>- order for informal written &amp; oral hearing &amp; deadlines (30 days)<sup>267</sup></li> <li>- hearing procedures (oral presentation &amp; witnesses only with authorization of FDIC or presiding officer)<sup>268</sup></li> <li>- standard for review &amp; burden of proof<sup>269</sup> (&amp; cannot challenge capital classification)<sup>270</sup></li> <li>- recommendation of presiding officer (w/in 20 days)<sup>271</sup></li> <li>- final decision w/in 60 days &amp; reasons if denied<sup>272</sup></li> </ul>

### C. Possibilities for Judicial Review

Section 38 makes no express provision for judicial review of PCA determinations and, therefore, the availability of judicial review is uncertain. While it is possible that judicial review has been precluded either by the FDI Act itself or by operation of the APA, the FDI Act does provide various vehicles by which judicial review might be available, and the APA itself may provide for judicial review. Judicial review also might be mandated by the U.S. Constitution.<sup>273</sup> The following sections examine these various possibilities.

262. FDI Act §§ 38(f)(2)(F)(ii), 38(n), 12 U.S.C. §§ 1831o(f)(2)(F)(ii), 1831o(n) (Supp. IV 1992); 12 C.F.R. § 308.203 (1993).

263. 12 C.F.R. § 308.203(a) (1993).

264. *Id.*

265. *Id.* § 308.203(b)(1).

266. *Id.* § 308.203(b)(2).

267. *Id.* § 308.203(c).

268. 12 C.F.R. § 308.203(d) (1993).

269. FDI Act § 38(n)(3), 12 U.S.C. § 1831o(n)(3) (Supp. IV 1992).

270. 12 C.F.R. § 308.203(e) (1993).

271. *Id.* § 308.203(f).

272. *Id.* § 308.203(g).

273. A damages action based on the negligence of the regulator in implementing PCA, which might have presented a further avenue of review, is effectively precluded by the "discretionary function" exception of the Federal Tort Claims Act, 28 U.S.C. § 2680(a) (1988). *See United States v. Gaubert*, 499 U.S. 315 (1991) (holding that discretionary function exception applies in cases where agency must use element of judgment or make choice based on public policy considerations).

## 1. Possible Bases for Judicial Review

### a. Full Judicial Review Under APA Section 702

In the absence of any reference in section 38 to judicial review, the first possibility is that the default provision in section 702 of the APA will apply.<sup>274</sup> Section 702 provides that, with the exception of actions involving money damages (in which case the Federal Tort Claims Act<sup>275</sup> and Tucker Act<sup>276</sup> apply), “[a] person suffering legal wrong because of agency inaction, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof.”<sup>277</sup> If this default right-to-review provision does indeed apply, then the general standard of review would be governed by the APA section 706,<sup>278</sup> which permits a reviewing court to set aside a PCA decision if it were “[a]rbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.”<sup>279</sup>

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274. 5 U.S.C. § 702 (1988).

275. 28 U.S.C. §§ 1346(b), 2671 (1988).

276. *Id.* §§ 1346, 1491.

277. 5 U.S.C. § 702 (1988).

278. *Id.* § 706.

279. *Id.* § 706(2)(A). The “substantial evidence” provision of § 706(2)(E) probably would not be available because the agencies are not required by section 38 (or section 39) to engage in formal adjudication on the record within the meaning of §§ 554-57 of the APA. *See, e.g.,* *United States v. Florida East Coast Ry.*, 410 U.S. 224 (1973) (finding formal evidentiary hearing by ICC to set nationwide rail prices unnecessary); *U.S. Tanker Owner Comm’n v. Lewis*, 690 F.2d 908, 922 n.63 (D.C. Cir. 1982) (concluding that adjudication should be informal when act does not require hearing on record); *Chemical Waste Management Inc. v. E.P.A.*, 873 F.2d 1477 (D.C. Cir. 1989) (holding informal adjudication sufficient when statute merely requires “public hearing”); *United States Lines, Inc. v. Federal Maritime Comm’n*, 584 F.2d 519, 536 (D.C. Cir. 1978) (finding that formal hearing is not required unless specified by statute).

Although APA § 706(2)(F) also contemplates the possibility of a trial *de novo* on the facts, this option probably will not be available because the agencies have developed procedures for PCA factfinding. *See* *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 415 (1971) (determining that *de novo* review is appropriate only when action is adjudicatory in nature and agency factfinding inadequate); *but see* the critical analysis of *Overton Park* by John C. Deal, *Banking Law is Not for Sissies: Judicial Review and Capital Directives*, 12 J.L. & COM. 185 (1993) (arguing that *Overton Park* decision is inconsistent with legislative intent behind APA § 706(2)(F)).

b. Complete or Partial Preclusion of Review?

i. Implied Preclusion of Judicial Review  
Under APA Section 701(a)(1)

It might be argued that the language, structure, and history of section 38 indicates an intention on the part of Congress to completely or partially preclude review.<sup>280</sup> Section 38 makes no provision in its language for review, and the specific provision for judicial enforcement under the FDIC Act section 8(i)(1) that FDICIA provided (section 131(c)(2)) might be taken to suggest that Congress intended judicial enforcement to provide the only court involvement in the PCA process.<sup>281</sup>

On the other hand, the Supreme Court has emphasized a strong presumption in favor of reviewability.<sup>282</sup> Because the legislative history underlying section 38 is sparse, no other provision is made for judicial relief from action taken under section 38, and the cross reference to section 8(i)(1) in that section is made solely for enforcement purposes, the ambiguities surrounding the absence of any reference to judicial review in section 38 probably would be insufficient to overcome the presumption in favor of judicial review.

ii. Partial Preclusion of Judicial Review  
Under APA Section 701(a)(2)

A more likely basis for concluding that there is no judicial review is to be found under the "committed to agency discretion" provision of APA section 701(a)(2).<sup>283</sup> At the risk of some oversimplification, two

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280. As far as the legislative history is concerned, there is evidence that Congress considered the possibility of full or partial judicial review and decided against making provision for it. *See supra* notes 108-16 and accompanying text (discussing enforcement actions when determining basic capital classifications).

281. FDICIA § 131(c)(2) (amending FDI Act § 8(i)(7), 12 U.S.C. § 1818(i)(7) (Supp. IV 1992)).

282. *See, e.g.,* McNary v. Haitian Refugee Ctr., 498 U.S. 479, 491-93 (1991) (presuming limited review of statute even where Congress had appeared to preclude review); Bowen v. Michigan Academy of Family Physicians, 476 U.S. 667, 670-73 (1986) (upholding presumption that Congress intends judicial review of agency actions); Abbott Laboratories v. Gardner, 387 U.S. 136, 141 (1967) (finding judicial review of agency action appropriate absent clear congressional intent to contrary).

283. This provision, which creates linguistic tension with the "abuse of discretion" language of § 706(2)(A), has been the subject of great judicial and scholarly contro-

broad strands of judicial doctrine address this narrow exception to review. The first holds that agency decisions are unreviewable when they are made under statutory mandates that are so broadly discretionary that there is "no law to apply"<sup>284</sup> and where strong policy arguments counsel against review.<sup>285</sup> The second strand of doctrine focuses on whether the decision under review falls within an area that *traditionally* has been regarded as inappropriate for judicial review.<sup>286</sup> In other words, the question is whether the decision being challenged is the kind of decision that the courts in the past have tended to leave alone.

In a decision that may provide some indication of judicial attitudes toward PCA reviewability, the Fifth Circuit in *Federal Deposit Insurance Corp. v. Bank of Coughatta*<sup>287</sup> invoked the first strand of "committed to agency discretion doctrine," holding that the decision to issue a capital directive against a bank and its directors was authorized by a statutory mandate so broad and general as to constitute a decision "committed to agency discretion by law" that is therefore unreviewable.<sup>288</sup>

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versy in recent years. See *Heckler v. Chaney*, 470 U.S. 821, 829 (1985) (holding that agency decisions not to take action presumptively unreviewable unless Congress provides guidelines limiting agency discretion). See generally Ronald M. Levin, *Understanding Unreviewability in Administrative Law*, 74 MINN. L. REV. 689 (1990) (arguing that undue emphasis is placed on whether court *can* review decision, when focus should be whether court *should* review decision). Its implication is that if a reviewing court were to regard a PCA classification, determination, or directive as "committed to agency discretion by law" the PCA action would be unreviewable. *Id.*

284. *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 410 (1971). But see 5 KENNETH C. DAVIS, *ADMINISTRATIVE LAW TREATISE* § 28:8 at 290-97 (2d ed. 1984) [hereinafter DAVIS] and *id.* §§ 28:1-6 to 28:1-7, at 500-03 (Supp. 1989) (criticizing basis and reasoning of "no law to apply" of *Overton Park* doctrine).

285. See *Heckler v. Chaney*, 470 U.S. at 831-32 (refusing to review decision by agency not to take enforcement action because decision involved number of considerations peculiarly within agency's expertise, including allocation of resources).

286. The Supreme Court never has chosen clearly one of these strands over the other. In its recent unanimous decision in *Lincoln v. Vigil*, for example, the court invoked *both* lines of analysis to reach the conclusion that an agency's decision to terminate a health program was unreviewable. 113 S. Ct. 2024, 2030-31 (1993).

287. 930 F.2d 1122 (5th Cir. 1991), *cert. denied*, 112 S. Ct. 170 (1991).

288. See also *TransOhio Sav. Bank v. Director, Office of Thrift Supervision*, 60 U.S.L.W. 2138 (D.D.C. 1991), *aff'd on other grounds*, 967 F.2d 598 (D.C. Cir. 1992) (finding that Congress intended to preclude judicial review of process by which Office of Thrift Supervision sets appropriate capital levels). For criticism of the *Coughatta* decision, see Deal, *supra* note 279 and Thomas M.L. Metzger, *FDIC Capital Directive Procedures: The Unacceptable Risk of Bias*, 110 BANKING L.J. 237 (1993).

In *Coughatta*, the FDIC had issued a directive requiring a bank and its board to restore the bank's capital-to-assets ratio to a minimum level set by the agency, to

The Sixth Circuit more recently has applied the *Coushatta* holding in a somewhat different context. In *United Liberty Life Ins. Co. v. Ryan*,<sup>289</sup> an investor in a failed thrift brought suit seeking to hold the relevant banking agencies responsible for failing to enforce a net worth maintenance agreement entered into by the purchaser of the thrift at the behest of the Federal Home Loan Bank Board (FHLBB). The district court granted summary judgment in favor of the defendants, and the court of appeals affirmed. The panel held, with respect to the failure to enforce the agreement, that the agencies' inactions could not be challenged because of the "committed to agency discretion" language of section 701(a)(2).<sup>290</sup> The statutory provisions under which the FHLBB and OTS might have acted<sup>291</sup> were, in the court's view, couched in highly discretionary terms.<sup>292</sup> In addition, the action complained of was an alleged *failure to enforce* which, as the Supreme Court has made clear, is almost always covered by the section 701(a)(2) exception.<sup>293</sup>

On the basis of the *Coushatta* decision (and presumably also the decision in *United Liberty Life*, some regulators have taken the view that PCA directives will not be reviewable.<sup>294</sup> On the other hand, the

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further enhance the capital by at least \$725,000, and to submit a plan within 30 days for achieving the required capital level. When the bank failed to comply, the FDIC filed an *ex parte* letter in a federal district court seeking enforcement of its directive under the FDI Act, against the bank and its board. See Deal, *supra* note 279, at 190 (describing this *ex parte* proceeding). Mr. Deal represented the Bank of Coushatta in its appeal to the Fifth Circuit.

The court issued the requested order, and the bank and its board appealed. On appeal, the Fifth Circuit emphasized the broad discretionary language of the governing statute. *Coushatta*, 930 F.2d at 1125-26. The court also concluded that, although the statute did not evince a sufficiently clear intention to overcome the presumption in favor of judicial review, the decision to issue a directive was exempt from the judicial review provisions of the APA because it fell within the "committed to agency discretion" exception of the APA's section 701(a)(2). *Id.* at 1128-29.

289. 985 F.2d 1320 (6th Cir. 1993).

290. *Id.* at 1325-27.

291. See 12 U.S.C. § 1464(s)(1)(B) (1988) (authorizing agencies to impose capital requirements); *id.* § 1818(i)(1) (authorizing agencies to seek enforcement of capital directives in federal district court); and *id.* § 1464a(g)(5)(B) (authorizing agencies to seek judicial enforcement against savings and loan holding companies).

292. *United Liberty Life*, 985 F.2d at 1326-27.

293. Heckler v. Chaney, 470 U.S. 821 (1985) (applied by Sixth Circuit Court of Appeals in *United Liberty Life*, 985 F.2d at 1326).

294. See FDIC Official Gives Bankers a Glimpse of Final Prompt Corrective Action Rules, 58 Banking. Rep. (BNA) 763 (1992) (outlining agency regulations to implement prompt corrective action scheme).

statutory authority under which the capital directive in *Coushatta* was issued, the International Lending Supervision Act (ILSA) of 1983,<sup>295</sup> speaks in very general language about the goal of minimum capital adequacy that was the subject of the directive.<sup>296</sup> Section 38 and its implementing regulations, by contrast, contain considerable detail concerning the capital measures, classification processes and PCA options that must be pursued against banks. It may be that a court considering action under section 38 would conclude that there was "sufficient law to apply."<sup>297</sup>

As can be seen from the charts in Part III(B) above, the range and variety of PCA actions, and the factual premises upon which they must be based, are considerable.<sup>298</sup> If the "no law to apply" doctrinal strand prevails, a reviewing court could well take the position that it is only

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295. 12 U.S.C. § 3907 (1988).

296. For the language regarding the minimum capital goals see 12 U.S.C. § 3907, which states in relevant parts:

(a) (1) Each appropriate Federal banking agency shall cause banking institutions to achieve and maintain adequate capital by establishing minimum levels of capital for such banking institutions and by using such other methods as the . . . agency deems appropriate.

(2) Each . . . agency shall have the authority to establish such minimum level of capital for a banking institution as the . . . agency, in its discretion, deems to be necessary or appropriate in light of the particular circumstances of the banking institution.

(b) (1) Failure of a banking institution to maintain capital at or above its minimum level . . . may be deemed by the . . . agency, in its discretion, to constitute an unsafe or unsound practice within the meaning of section 8 of the [FDI] Act.

(2)(A) . . . the . . . agency may issue a directive to a banking institution that fails to maintain adequate capital at or above its required level . . . .

(B)(i) Such directive may require the banking institution to submit and adhere to a plan acceptable to the . . . agency . . . .

(ii) Any such directive . . . , including plans submitted pursuant thereto, shall be enforceable under the provisions of section 8(i) of the [FDI] Act to the same extent as an effective and outstanding order issued pursuant to section 8(b) of the [FDI] Act [i.e., a cease-and-desist order] which has become final.

*Id.* See also Metzger, *supra* note 288, at 239-43 (describing procedures followed by FDIC in implementing provision).

297. See Board of Trustees of Knox County (Indiana) Hosp. v. Sullivan, 965 F.2d 558, 561-63 (7th Cir. 1992) (distinguishing *Coushatta* on ground that statute under consideration was considerably more detailed than ILSA). See also Deal, *supra* note 279, at 201-03 (extensively criticizing this aspect of *Coushatta*).

298. See *supra* pp. 541, 544, 546, 548, and 552, Charts 2-6 (outlining PCA actions).

the most intensely discretionary aspects of the PCA determination process that are immune from review, and that errors regarding factual determinations, for example, are fully within the court's reviewing power.

### iii. Full Preclusion of Review Under APA Section 701(a)(2)

The second strand of doctrine relating to the "committed to agency discretion by law" exception focuses on the "by law" facet of section 701(a)(2).<sup>299</sup> In his partial dissent in *Webster v. Doe*,<sup>300</sup> Justice Scalia articulated a view of the exception to review that could well preclude all judicial review of PCA decisions and directives.<sup>301</sup> He argued that the "no law to apply" criterion was unworkable because there is almost always *some* law to apply (as is clearly the case in the PCA context).<sup>302</sup> Instead, he opined, it is not only statutory "law" that the courts must consider but also the common law tradition of unreviewability, because section 701(a)(2) "operates to keep certain categories of agency action *out of* the courts."<sup>303</sup>

### iv. Importance of Context

The problem with either of the approaches just described is that, taken on their own, they tend to treat the question of reviewability as if one could reach a uniform answer about every agency action. This ig-

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299. 5 U.S.C. § 701(a)(2) (1988).

300. 486 U.S. 592, 606 (1988) (Scalia, J., dissenting).

301. *Id.* at 607.

302. *Id.* at 608.

303. *Id.* at 610. If the Scalia view were to gain acceptance, it is possible that a court might conclude that all PCA determinations and actions are unreviewable. The Court, however, would have to do so on the basis of policy arguments and not "tradition," which is hardly appropriate in the novel realm of PCA.

Cf. *Lincoln v. Vigil*, 113 S. Ct. 2024, 2031 (1993) (stating that "over the years, . . . [the Court has] read § 701(a)(2) to preclude judicial review of certain categories of administrative decisions that courts have traditionally regarded as 'committed to agency discretion'"); *Panama Canal Co. v. Grace Line, Inc.*, 356 U.S. 309, 317 (1958) (concluding that decision by government agency whether to initiate proceedings for setting new tolls for use of Canal was not subject to review and stating that "the present conflict rages over questions that at heart involve problems of statutory construction and cost accounting . . . . These are matters on which experts may disagree; they involve nice issues of judgment and choice . . . which require the exercise of informed discretion").

nores the great range and variety of circumstances in which disputes might occur.<sup>304</sup>

The importance of the context within which reviewability should be considered, therefore, cannot be minimized. The law relating to reviewability, even though codified in the APA, is largely the product of judicial elaboration.<sup>305</sup> In the absence of clear and convincing congressional intent to preclude review, it is unrealistic to assume that one or two cases will settle the question of reviewability for all contexts.<sup>306</sup> It is, therefore, also important to consider the diverse situations in which judicial review will arise.

## 2. *Potential Vehicles for Judicial Review*

Whatever the scope or basis for review, it is clear that there are many potential circumstances in which a judicial challenge to PCA or PCA-related action might arise.

### a. Default Federal Jurisdictional Provisions

If judicial review were to take place under the APA's section 702, it would take place in a federal district court, as there is no specific jurisdictional statute.<sup>307</sup> Any remedy would be sought under the APA,<sup>308</sup>

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304. For example, a dispute concerning the allocation of a bank's loan loss reserves and the number and amount of its classified assets would bear very different characteristics from a dispute concerning the specific actions that need to be taken to improve the bank's capital ratio. The former relates to identifiable and quantifiable assets; although the quality of those assets might be subject to differing judgments, their evaluation will fall within a relatively manageable range of possibilities that can be tested through expert evidence and subsequently evaluated for reasonableness by a reviewing court. The latter, on the other hand, will involve more speculative predictions concerning the comparative feasibility and success of many different strategies that might be available; while even this kind of judgment should be informed by competent and experienced judgment, the range of reasonable possibilities is likely to be greater and less manageable, and the scope of obstructive argumentation may be a good reason for restricting review.

305. See generally, DAVIS, *supra* note 284, §§ 28:4-6, at 266-83 (outlining APA and judicial law relating to reviewability).

306. See *id.* § 28:2, at 257-59 (discussing meanings of both "reviewable" and "unreviewable"). Even in the *Panama Canal* case, Justice Douglas acknowledged that "[w]here the matter is peradventure clear, . . . then judicial relief is often available." 356 U.S. at 318.

See also STEVEN G. BREYER & RICHARD B. STEWART, *ADMINISTRATIVE LAW AND REGULATORY POLICY* 1021 (3d ed. 1992) (arguing that "whether you obtain review depends very much on *what type of claim* you are making").

307. 28 U.S.C. § 1331 (1988).



and, if necessary, the declaratory and injunctive relief statutes.<sup>309</sup>

b. Review in Judicial Enforcement Proceedings

PCA determinations made in terms of section 38 can be enforced under the judicial enforcement provision in section 8(i)(1) of the FDI Act.<sup>310</sup> This latter provision permits the agency to seek enforcement of its PCA orders in a federal district court.<sup>311</sup> Section 8(i)(1) also denies any court "jurisdiction to affect by injunction or otherwise . . . or to review, modify, suspend, terminate, or set aside" any order or notice under section 38, "except as otherwise provided under this section or under section" 38.<sup>312</sup>

At first sight, section 8(i)(1) might seem to preclude review of the underlying validity of PCA determinations and orders in the enforcement proceedings.<sup>313</sup> The wording, however, is by no means clear on this point.<sup>314</sup> Indeed, the APA itself contemplates the possibility of review in civil and criminal enforcement proceedings,<sup>315</sup> and as John Deal forcefully argues, "[n]either the APA nor the Supreme Court's jurisprudence under 5 U.S.C. section 701(a) prevents a court from performing its normal judicial functions when its jurisdiction is invoked by an Executive Branch agency to enforce an action of the agency."<sup>316</sup>

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308. 5 U.S.C. § 700(1), (2) (1988).

309. 28 U.S.C. §§ 2201, 2202 (1988).

310. FDI Act § 8(i)(1), 12 U.S.C. § 1818(i)(1) (Supp. IV 1992).

311. *Id.*

312. *Id.*

313. *Coushatta*, 930 F.2d at 1126.

314. For example, § 8(i)(1) does not state that the *enforcing* court cannot review the validity of the determination or order: it merely indicates that a litigant must use avenues of litigation otherwise available under section 8 (review in the court of appeals following formal enforcement orders) or under section 38. FDI Act § 8(h)(2), 12 U.S.C. § 1818(h)(2) (Supp. IV 1992). Deal, *supra* note 279, at 194-95.

315. 5 U.S.C. § 703 (1988).

316. Deal, *supra* note 279, at 210 (noting that section 703 of APA, 5 U.S.C. § 703, expressly contemplates this possibility by providing that "[e]xcept to the extent that prior, adequate, and exclusive opportunity for judicial review is provided by law, agency action is subject to judicial review in civil . . . proceedings for judicial enforcement"). For more on the APA's treatment of judicial review, see Administrative Conference of the United States, *FEDERAL ADMINISTRATIVE PROCEDURE SOURCEBOOK* 208 (2d ed. 1992); U.S. Department of Justice, *ATTORNEY GENERAL'S MANUAL ON THE ADMINISTRATIVE PROCEDURE ACT* 99-100 (1947).

c. Review in Connection with a Related Formal Enforcement Action

Some form of judicial review is also possible if a banking regulatory agency chooses to take formal enforcement action in circumstances to which PCA action is also relevant. This can occur in one of two ways.

First, the agency's PCA determinations and violations of its S/S standards can be sanctioned by means of civil money penalties.<sup>317</sup> If the agency chooses this course of action, it must afford the individual or institution affected a formal agency hearing before making a final assessment of penalties.<sup>318</sup> The agency's final decision is thereafter subject to judicial review in a U.S. court of appeals, and the decision is reviewed under the standards prescribed in chapter 7 of the APA.<sup>319</sup>

Second, if the capital classification of an institution has been downgraded as a result of a less than satisfactory MACRO or CAMEL rating, the condition or conduct giving rise to the unsatisfactory rating also may form the predicate for formal enforcement under section 8 of the FDI Act.<sup>320</sup> The agency may decide to take targeted enforcement action instead of, or in addition to, using its PCA powers. If the agency chooses to do so, the respondent will be entitled to formal administrative adjudication and judicial review in a U.S. court of appeals.<sup>321</sup>

In either of these circumstances, "[r]eview of such proceedings shall be had as provided in chapter 7 of [the APA],"<sup>322</sup> and it is possible that the reviewing court may treat certain aspects of the agency's decision as nonreviewable under section 701.<sup>323</sup> This is by no means certain, however, for at least two reasons. First, it is common for examiners to testify in formal enforcement proceedings. They often are subjected to vigorous cross-examination. Hence, the difficulty of reviewing the actions of examiners will not be as great where formal enforcement proceedings have occurred. Second, the evidence that formed the basis of the enforcement action will be part of a formal record before the court and will, therefore, be easily accessible for review. A reviewing court is

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317. FDI Act § 8(i)(2)(ii), 12 U.S.C. § 1818(i)(2)(ii) (Supp. IV 1992).

318. *Id.* § 8(i)(2)(H), 12 U.S.C. § 1818(i)(2)(H), and FDI Act § 8(h)(1), 12 U.S.C. § 1818(h)(1).

319. *Id.* § 8(h)(2), 12 U.S.C. § 1818(h)(2).

320. FIRREA § 902-04, 12 U.S.C. § 1818 (Supp. IV 1992) (amending FDI Act § 8).

321. FDI Act, § 8(h), 12 U.S.C. § 1818(h) (Supp. IV 1992).

322. *Id.* § 8(h)(2), 12 U.S.C. § 1818(h)(2).

323. See *supra* notes 280-303 and accompanying text (discussing preclusion of judicial review under APA § 701).

likely to review the evidence underlying the enforcement action, and that evidence will be the same evidence that underlies PCA actions.

#### d. Conservatorship and Receivership Review

Where the availability of judicial review is concerned, the requirement in section 38 that, with limited exceptions, the agency should place a critically undercapitalized institution into conservatorship or receivership within a fixed time creates an anomalous situation.<sup>324</sup> If section 38 is interpreted to preclude judicial review, this conclusion would run counter to the *express* provision for judicial review of the agencies' general powers to appoint conservators and receivers. The decision to appoint a *conservator* for an insured depository institution is subject to judicial review in the case of national banks,<sup>325</sup> federally insured state banks,<sup>326</sup> and federally insured S&Ls.<sup>327</sup> The same provisions apply to

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324. FDICIA § 131(a) (amending FDI Act § 38(h)(3), 12 U.S.C. § 1831o(h)(3)(c) (Supp. IV 1992)).

325. See FIRREA § 801, 12 U.S.C. § 203(b)(1) (Supp. IV 1992) (allowing review in U.S. district court within 20 days of appointment, according to "arbitrary, capricious . . . abuse of discretion . . ." standard of review).

326. *Id.* § 212(a) (amending FDI Act § 11(c)(7), 12 U.S.C. § 1821(c)(7) (Supp. IV 1992)) (providing for review in U.S. district court within 30 days "upon the merits"). Judicial review is provided for even where the FDIC appoints itself receiver because the institution concerned is undercapitalized or critically undercapitalized "as defined in section 38(b) of the FDI Act." FDICIA § 133(a) (amending FDI Act §§ (c)(5)(K) & (L), 12 U.S.C. §§ 1821(c)(5)(K) & (L) (Supp. IV 1992)).

It seems fairly settled that the "upon the merits" language, which also is used with regard to judicial review of thrift seizures, is intended to trigger the "arbitrary, capricious or an abuse of discretion" standard of review. Some U.S. district courts have interpreted the "merits" language as indicating a more intrusive standard of review, but the courts of appeal have been in accord in interpreting the language to conform to the less exacting, more deferential, standard. See *Franklin Sav. Ass'n v. Director, Office of Thrift Supervision*, 934 F.2d 1127, 1141-42 (10th Cir. 1991) (applying arbitrary and capricious standard for reviewing appointment of conservator), *cert. denied*, 112 S. Ct. 1475 (1992); *Woods v. Federal Home Loan Bank Bd.*, 826 F.2d 1400, 1407 (5th Cir. 1987) (rejecting *de novo* review of bank board's action and restricting review to the record), *cert. denied*, 485 U.S. 959 (1988); *Guaranty Sav. & Loan Ass'n v. Federal Home Loan Bank Bd.*, 794 F.2d 1339, 1342 (8th Cir. 1986) (rejecting *de novo* review in favor of review on record). For more on *de novo* review, see Paul W. Grace, *Regulatory Seizure of Institutions*, in Zisman, *supra* note 122, 12-1, 12-27 to 12-30.

327. See FDICIA § 133 (amending Home Owners' Loan Act § 5(d)(2), 12 U.S.C. § 1464(d)(2)(B) (Supp. IV 1992)) (permitting review in U.S. district court within 30 days "upon the merits").

the appointment of *receivers* for federally insured state banks<sup>328</sup> and federally insured S&Ls.<sup>329</sup> The provision for judicial review of the appointment of conservators and receivers for state member banks,<sup>330</sup> and the appointment of receivers for national banks,<sup>331</sup> is much less clear,<sup>332</sup> it is possible that limited judicial review would be available in these situations as well,<sup>333</sup> and it may be that some form of judicial or

328. FIRREA § 212(a), 12 U.S.C. § 1821(c)(7) (Supp. IV 1992).

329. FDICIA § 133, 12 U.S.C. § 1464(d)(2)(B) (Supp. IV 1992).

330. *See id.* § 133(f) (adding § 11(p) to Federal Reserve Act § 11, 12 U.S.C. § 248(o)) (permitting Board to appoint FDIC as conservator or receiver). The legislative history indicates no more than that Congress merely intended to ensure that all four federal banking regulators would have effective power to implement the PCA program; there is no reference to the reasons for not subjecting the Federal Reserve to the same requirements of judicial review as are applicable to the other banking regulators. The Senate Banking Committee's report, for example, merely prefaces its description of the conservatorship and receivership reforms ultimately enacted in FDICIA with the words "[t]o facilitate prompt corrective action." S. REP. NO. 102-167, 102d Cong., 1st Sess. 42 (1991).

331. FDICIA Act § 133(b), § 1, 12 U.S.C. § 191 (Supp. IV 1992) (amending Act of June 30, 1976 § 1, and redesignated as National Bank Receivership Act § 2 by Housing and Community Development Act of 1992 § 1603(d)).

332. FDICIA is silent on the question of judicial review, stating only that "[t]he Board may appoint the [FDIC] as conservator or receiver for a State member bank under section 11(c)(9) of the [FDI] Act." *Id.* § 133 (amending Federal Reserve Act § 11, 12 U.S.C. § 248(o) (Supp. IV 1992)).

The National Bank Receivership Act § 2 provides that the Comptroller of the Currency may appoint the FDIC as receiver "if the Comptroller determines, in the Comptroller's discretion," that any of the grounds specified in section 11(c)(5) of the FDI Act exist. 12 U.S.C. § 191 (1988). These specified grounds are common to the appointment of conservators or receivers in the case of all federally insured banks and savings associations, but the National Bank Act makes no express provision for judicial review. The use of the phrase "in the Comptroller's discretion" has been interpreted by some courts to indicate that no right to review exists. *See, e.g.,* JOSEPH JUDE NORTON & SHERRY CASTLE WHITLEY, *BANKING LAW MANUAL* 3A-23 at n.2 (1989) (asserting that no right to judicial review exists). *But see infra* notes 333-34 (discussing post-seizure judicial review).

333. Although some courts have assumed that the Comptroller's decisions to appoint receivers are not subject to judicial review and that such decisions are not subject to *pre-seizure* judicial review and injunctive relief, several courts have acknowledged the possibility that *post-seizure* judicial review might be available. *See, e.g.,* *American Bank v. Clarke*, 933 F.2d 899, 904 (10th Cir. 1991) (denying pre-closure review but acknowledging possibility of post-closure review); *United States Sav. Bank v. Morgenthau*, 85 F.2d 811, 814 (D.C. Cir. 1936) (finding that "the court will not substitute its judgment for the judgment of the Comptroller, unless it appears by convincing proof that the Comptroller's action is plainly arbitrary and made in bad faith"), *cert. denied*, 299 U.S. 605 (1936); *In re American City Bank & Trust Co.*,

administrative review is constitutionally required.<sup>334</sup>

If the judicial review provisions more generally applicable to conservatorship and receiverships are held to apply to PCA conservatorships and receiverships as well—and there is nothing in these provisions that suggests otherwise—there is the potential for challenging in court the underlying PCA determinations that led to the imposition of a conservatorship or receivership.

### 3. *Judicial Review Mandated by the Constitution*

Under prevailing doctrine, judicial review of a PCA order would be available where the claim is based on a charge of unconstitutionality.<sup>335</sup> It is clear that some form of *post*-seizure, if not *pre*-seizure, hearing would be required in a case where PCA action led to the seizure of the bank;<sup>336</sup> an effort by an agency to avoid this requirement could provide the basis for judicial review even if the statute were interpreted as impliedly precluding judicial review.<sup>337</sup>

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N.A., 402 F. Supp. 1229, 1231 (E.D. Wis. 1975) (finding that there is authority that such action by Comptroller is entirely discretionary and, thus, not subject to judicial review. Better view, however, is that Comptroller's judgment is final unless clearly arbitrary and taken in bad faith. (citing *Morgenthau*, 85 F.2d at 814)). For more on the standard of review of Comptroller action, see Grace, *supra* note 326, at 12-17 to 12-18.

334. The Supreme Court held that due process does not require a pre-seizure hearing before a conservator could be appointed by the FHLBB. *Fahey v. Mallonee*, 332 U.S. 245 (1947). It did so, however, on the basis that such appointments were likely to be based on the need for emergency action, so that compelling interests permitted the government to avoid the usual due process requirement that a pre-deprivation hearing be granted. *Id.* at 253-54. The Court did not, however, suggest that an adequate *post*-seizure hearing need not be granted. *Id.* The courts appear to have accepted that due process is satisfied if a post-seizure hearing is supplied in the form of the right to judicial review of the conservatorship or receivership appointment. See *Haralson v. Federal Home Loan Bank Bd.*, 837 F.2d 1123, 1126 (D.C. Cir. 1988) (stating that post-seizure hearing does not render review unconstitutional). Cf. also *Mallen*, 486 U.S. at 230 (providing post-termination hearing for bank official).

335. See *supra* note 19 and *infra* notes 336-37 and accompanying text (discussing constitutionally required judicial review).

336. See *supra* notes 88-94 and accompanying text (discussing PCA actions leading to bank seizure).

337. See, e.g., *McNary*, 498 U.S. at 479 (permitting judicial review of policies that were alleged to be unconstitutional); *Webster v. Doe*, 486 U.S. 592 (1988) (holding that nothing in § 102(c) of National Security Act precludes judicial review of colorable constitutional claim); *Johnson v. Robison*, 415 U.S. 361 (1974) (permitting challenges to constitutionality of veteran's benefits legislation). Even outside the context

This avenue of review, however, would be restricted to *constitutional* challenges to PCA determinations and orders and, as such, would have limited utility in most situations. For example, disputes revolving around the substantive appropriateness of the agency action in question would not be resolved in this manner.

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of full-scale seizures, it is possible that constitutional arguments can be made. For example, it might be argued that the dismissal procedure in section 38(n) of the FDI Act (and the implementing regulations) deny the employee or director procedural due process because the burden of proof is almost insurmountable. *See Executives Fired by FDIC Would Face Uphill Struggle; Due Process in Doubt*, 2 FDIC Watch (American Banker) 1 (Sept. 14, 1992) (reporting views doubting constitutionality of dismissal provision).

It might even be possible to argue that the capital classification process requires a due process hearing before adverse consequences could attach to an agency's capital classification of an institution. John C. Deal and Thomas Metzger take the position that the Due Process Clause actually would trigger the formal adjudication requirements of the APA, §§ 554-57. Deal, *supra* note 279, at 191-92 and Metzger, *supra* note 288, at 249. These authors rely on *Wong Yang Sung v. McGrath*, 339 U.S. 33, 50 (1950), in which the Supreme Court ruled that the formal hearing requirements of the APA can be triggered, not only by "statute" (5 U.S.C. § 554(1)), but also by the Constitution. *Id.* The orthodox view among administrative lawyers is that *Wong Yang Sung* has been all but overruled, and it certainly has been largely ignored since it was decided. For example, the Court later determined that Congress could act constitutionally in expressly overruling the effect of *Wong Yang Sung* by providing for a lesser form of hearing than that prescribed by the APA. *Marcello v. Bonds*, 349 U.S. 302 (1955). *See also* *Ardestani v. I.N.S.*, 112 S. Ct. 515, 518-19 (1991) (upholding immigration proceedings to be on record after hearing pursuant to Immigration and Naturalization Act and not in conformity with APA); and *see generally* ALFRED C. AMAN, JR. & WILLIAM T. MAYTON, *ADMINISTRATIVE LAW* 203-04 (1993) (discussing implications of *Wong Yang Sung*). It appears that procedural due process analysis follows a separate and more flexible track than that ordained by § 554 of the APA. *Id.* at 204-05.

Nevertheless, Mr. Deal argues strongly that the drafters of the APA actually did intend the result reached in *Wong Yang Sung*, and that a faithful application of the APA would lead to a similar result in the context of capital directives. Deal, *supra* note 279, at 190-192. He also asserts that this is most clearly the case where an administrative sanction, including a capital directive, is subject to judicial review. *Id.*

Assuming that there is some merit in these arguments, there is little doubt that a due process claim could be brought in court, even if section 38 were construed to have precluded review. *See supra* note 260 and accompanying text (describing due process requirements for judicial review).

## IV. PRINCIPLES FOR REFORM

A. *Shortcomings of the Present Processes*

The preceding review highlights a series of unsatisfactory and anomalous features in the PCA process. Four features seem to be particularly important: absence of clear protection against improper classification decisions; uncertainty regarding the availability of judicial review; the anomalous coexistence of PCA and formal enforcement powers; and anomalous inconsistencies between PCA and conservatorship/receivership powers.

1. *Absence of Clear Protection Against Improper Classification Decisions*

The basic capital classification of an insured depository institution is extremely important to the continuing operation of the institution.<sup>338</sup> The capital category into which an institution is placed determines not only many of the rights the institution can or might enjoy, but also forms the basis for any PCA action that may be directed towards the institution or its officers and directors. Although the statute and the agencies' final rules make provision for some limited procedural protections in the case of safety/soundness reclassifications<sup>339</sup> and the implementation of PCA directives<sup>340</sup> and dismissal orders,<sup>341</sup> no specific procedural protections are provided in the case of the basic capital classification decisions themselves.<sup>342</sup> Institutions can rely only upon the highly informal and discretionary policies for review of examination decisions that are currently provided by the agencies.<sup>343</sup>

These review policies are the product of the historical relationship between the agencies and the institutions under their charge. The review

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338. See *supra* notes 117-26 and accompanying text (discussing fundamental importance of basic capital classifications).

339. See *supra* notes 95-102 and accompanying text (outlining safety/soundness regulations in § 39 of FDI Act).

340. See *supra* notes 186-273 and accompanying text (discussing procedures for issuing directives under § 38).

341. See *supra* notes 251-73 and accompanying text (discussing procedures for PCA dismissals).

342. See *supra* note 191 and accompanying text (discussing basic procedural protections under sections 38(g) and (n) but determining that such protections are limited).

343. See *supra* p. 535, Chart 1A and accompanying text (outlining current review process).

policies assume a highly informal and continuous relationship between the institutions and regional supervisory officials, including the examiners, and are designed to resolve disputes with the minimum of adversary friction. The policies also presuppose a complete absence of judicial review regarding the results of examinations. Unfortunately, the conditions necessary for the success of these review policies have eroded<sup>344</sup> and have been replaced by a growing concern on the part of depository institutions, and their representatives, that the examination process can be potentially capricious and that the protections against abuse of agency power in the examination process are inadequate.<sup>345</sup>

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344. See *supra* note 155 and *infra* note 345 (discussing erosion of trust necessary for success of review policies).

345. See *supra* note 155 (describing joint letter from major banking industry representatives to President-elect).

If there were complete trust in the examination process in the past, this trust seems to have diminished; whether this is because now more turns on the results of the examination or because of an alienation between many institutions and their supervisory agencies is hard to determine. The erosion of trust, which evidently has been accepted by the President himself, was expressed by some leading banking lawyers (both inside and outside banks) in letters and verbal comments to the author in response to earlier drafts of this study.

Nor is the decline in trust merely the reflection of subjective perceptions in an industry that has been the recent subject of unexpectedly intensified regulation. Indeed, some relatively objective data available seems to suggest that the examination process can lead to quite arbitrary results, depending on which agency's examiners are making the evaluations. Even before the creation of the PCA process, courts sometimes accepted that the banking agencies were capable, in particular cases, of acting arbitrarily. See *Biscayne Fed. Sav. & Loan Ass'n v. Federal Home Loan Bank Bd.*, 720 F.2d 1499 (11th Cir. 1983) (characterizing Board's conduct as "'outrageous, outlandish, egregious, and wrapped in a shroud of deception.'", *cert. denied*, 467 U.S. 1215 (1984); *id.* at 1502, (quoting from trial court findings); see also *MCorp v. Clarke*, 755 F. Supp. 1402, 1408 (N.D. Tex. 1991) (finding that claim by MCorp that FDIC plotted with Comptroller to engineer insolvency of entire banking family to secure better post-seizure sale price for package of institutions was supported by sufficient evidence to survive motion for summary judgment).

The General Accounting Office recently released a study reporting its review of the agency examination process. Among its conclusions was a finding by the GAO that out of 20 thrift examinations reviewed where the FDIC and the OTS each had performed examinations, the two agencies reached *different* safety and soundness ratings in nine of the examinations. GENERAL ACCOUNTING OFFICE, THRIFT EXAMINATION QUALITY: OTS EXAMINATIONS DO NOT FULLY ASSESS SAFETY AND SOUNDNESS 36 (1993). See also Metzger, *supra* note 288, at 254 (citing another example of seemingly arbitrary examination classifications given by former bank examiner); Bleakley, *supra* note 158, at A14 (reporting that bankers complain that regulation is subjective and inconsistent).



Even if the reforms proposed in this Article regarding judicial review are not adopted, judicial review of the capital classification of an institution sometimes will be available, if only in the context of receivership review and review of enforcement actions.<sup>346</sup> Yet, review without a meaningful record, even when confined to the arbitrary and capricious or abuse of discretion standards of review, is extremely difficult, if not impossible.<sup>347</sup> Unless judicial review is to be precluded altogether, or is to be a mere chimera, some kind of coherent record of the process leading to the final decision in dispute is appropriate.

For these reasons, it is proposed below that a uniform, record-creating appeal process be instituted for all the federal banking agencies to apply in all cases where an institution's capital classification is determined or changed.

## 2. *Uncertainty Regarding the Availability of Judicial Review*

Considerable doubt exists as to whether a reviewing court may probe into disputes relating to PCA classifications and determinations.<sup>348</sup> Even if judicial review is regarded as inappropriate in the PCA context, this uncertainty is likely to generate exploratory litigation. Given the differing views on the factors that should determine whether the exception to judicial review applies,<sup>349</sup> it is likely that courts will reach a variety

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This finding is hardly surprising, given the extremely broad and subjective range of factors that examiners and their supervisors must consider when determining their final ratings. It also indicates, however, the scope for potential error in situations where precision and consistency is becoming increasingly important. Cf. MACEY & MILLER, *supra* note 23, at 585 (asking:

[H]ow scientific do the CAMEL ratings seem to you? Given that the bank examiner can give variable weighing to the five factors in determining the composite rating, and may consider factors other than the five specifically mentioned, isn't there a high level of subjectivity in the examination process? Are the ratings even logical? How can a bank's performance be "neither satisfactory nor unsatisfactory"?).

346. See *supra* notes 317-23 and accompanying text (discussing review and related formal enforcement action).

347. See *Camp v. Pitts*, 411 U.S. 138 (1973) (finding it possible to review record comprised of few lines of letter from regulator).

348. See *supra* notes 272-336 and accompanying text (discussing possible bases for judicial review). Although a court might conclude that some or all forms of PCA action are actions "committed to agency discretion by law," this result is by no means certain. 5 U.S.C. § 701(a)(2).

349. See *supra* notes 299-303 and accompanying text (discussing full preclusion of review under APA).

of conclusions, depending on the precise issues involved and the gravity of the particular decisions in dispute.

Certainty regarding judicial review is important, and the PCA decisions that are subjected to potential judicial review should be distinguished from those that are of lesser importance and, correspondingly, that are less susceptible to review. The conclusion is that basic capital classification decisions, safety/soundness reclassifications, and PCA dismissals have such grave consequences for the institutions and individuals concerned that they should be subject to judicial review. The variety of PCA action, such as day-to-day decisions regarding the issuance, form and content of individual PCA directives, or the approval and supervision of capital restoration plans, are so highly discretionary and require such varying responses to fluctuating conditions, that they should not be subject to judicial review, and in these cases, judicial review should be expressly precluded to remove any uncertainty.

### *3. The Anomalous Coexistence of PCA and Formal Enforcement Powers*

A clear danger arising from the side-by-side coexistence of both formal enforcement powers and the PCA system is the possibility that an agency might choose to use its PCA powers instead of its formal enforcement powers. This could occur in a situation where the predicates or procedures for the use of the latter are thought by the agency to be "too much trouble."<sup>350</sup> Individuals who are subject to PCA dismissal deserve judicial protection from arbitrary agency orders. It is anomalous that individuals would enjoy such protection when they are charged with specific violations of banking laws or regulations and have formal enforcement action taken against them that may even result in their removal from office,<sup>351</sup> yet they might not enjoy similar protection when subject to the same sanction, removal, under a PCA dismissal order. This is increasingly problematic when the PCA dismissal might have resulted merely because their employer depository institution suffered

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350. It could be very tempting, for example, for an agency desiring to get rid of a troublesome, yet perfectly law-abiding director, officer, or, for that matter, the entire management of an institution, simply to issue a series of PCA dismissal orders to avoid having to prove its complaints according to the standards prescribed for formal removals.

351. See FDI Act § 8(e)-(g), 12 U.S.C. § 1818(e)-(g) (Supp. IV 1992) (discussing removal and prohibition authority, stay of suspension, and/or prohibition of institution affiliated party and suspension or removal of institution affiliated party charged with felony).

economic misfortune that has driven it into a capital category allowing PCA dismissals.<sup>352</sup>

Similarly, merely for the sake of convenience and increased leverage, an agency could threaten PCA-based seizure of an institution in circumstances where less severe enforcement action would be more appropriate if properly based on the predicates of section 8. A PCA-based receivership might be easier to impose than formal enforcement action, and the threat would be so severe that, without safeguards, it would be overwhelming even to an institution that had a legitimate objection to the agency's demands.

The proposals in this Article for the introduction of a uniform, record-generating classification review process and the backup safeguard of judicial review are intended, in part, to provide a safeguard against the inappropriate selective use of PCA powers in situations where other actions, including possible formal enforcement action, should be taken instead.

#### 4. *Anomalous Inconsistencies Between PCA and Conservatorship/Receivership Powers*

The most glaring anomaly is the disparity between the agencies regarding the availability of judicial review in the case of temporary or permanent seizure of an institution. Presently, if the Federal Reserve appoints a conservator or receiver for a state member bank, the law contains no apparent provision for judicial review.<sup>353</sup> If the Comptroller of the Currency appoints a conservator for a national bank, however, this decision is subject to judicial review.<sup>354</sup> If the Comptroller decides instead to appoint a receiver, there may be no judicial review and, even if there is, there is no statutorily prescribed time limitation.<sup>355</sup> If, on the other hand, the Comptroller or the Federal Reserve intends to appoint a conservator and the FDIC, after having been given notice of this intention, decides instead to appoint a receiver, the decision *will* be subject to review!<sup>356</sup>

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352. See *supra* notes 251-72 and accompanying text (discussing PCA dismissals generally).

353. FDICIA § 133(f), 12 U.S.C. § 248(o) (Supp. IV 1992).

354. FIRREA § 801, 12 U.S.C. § 203(b)(1) (Supp. IV 1992).

355. FDICIA § 133(b), 12 U.S.C. § 191 (Supp. IV 1992).

356. *Id.* There are further anomalies as between the agencies, including varying time limits within which review must be sought. See *supra* notes 325-27 and accompanying text (outlining some time limits for review of agency action).

Judicial review in the case of the appointment of both conservators and receivers is desirable. In the past, most receiverships were appointed when institutions were almost certainly insolvent. In such circumstances, judicial review was rarely worthwhile because there was nothing left for the owners of the seized institution to fight about. The situation now has changed substantially: FDICIA *mandates* the seizure of an institution *that is still insolvent*.<sup>357</sup> Indeed, if the PCA system is working properly, the institution *ought* to be solvent when it is seized. FDICIA also permits the seizure of institutions that are quite possibly still *substantially capitalized*.<sup>358</sup> For example, an institution that is classified as "undercapitalized" and has a capital leverage ratio of 3.9%<sup>359</sup> may be subject to seizure if, in a dispute with its regulator over the means or the necessity of raising capital, the regulator believes that it has "fail[ed] to become adequately capitalized when required to do so."<sup>360</sup> If the institution has assets of \$1 billion, and therefore an excess of assets over liabilities, at least in theory, of \$39 million, the seizure of the institution certainly will leave something to fight over.

This example highlights the need for some independent protection against arbitrary seizure for the institution's owners. PCA seizures constitute a very drastic deprivation of value from the institutions' owners. While drastic action might be justified to protect the deposit insurance funds from loss, it seems imperative that an external safeguard be provided to protect owners from abusive government action. This principle has long been recognized by Congress in the case of other, non-PCA seizures where, ironically, an institution is more likely to be insolvent and worthless to its owners.<sup>361</sup>

There is also no apparent reason for the discrepancies between the agencies regarding the availability of review. Hence, the judicial review provisions in the event of the appointment of conservators and receivers

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357. See FDICIA § 131(a) (amending FDI Act § 38(h)(3)(c), 12 U.S.C. § 1831o(h)(3)(c) (Supp. IV 1992)) (requiring appointment of receiver if other actions fail to restore capital).

358. See *id.* § 133(a) (amending FDI Act § 11(c)(5), 12 U.S.C. § 1821(c)(5) (Supp. IV 1992)) (discussing additional grounds for appointing conservator or receiver).

359. See *supra* note 53 (discussing undercapitalization).

360. FDICIA § 133(a) (amending FDI Act § 11(c)(5)(K), 12 U.S.C. § 1821(c)(5)(K) (Supp. IV 1992). See *supra* note 79 and accompanying text (discussing when agency may place institution in conservatorship or receivership).

361. See *supra* notes 354-56 and accompanying text (describing review of Comptroller's seizure of institution).

by the federal banking agencies should be rendered uniform.

### B. Finding the Right Balance

#### 1. Interests of Depository Institutions, their Directors and Officers, and Borrowers

The importance of judicial review, from the point of view of an affected institution or individual, is obvious. Under section 38, individuals can be dismissed from office;<sup>362</sup> institutions can be forced to divest themselves of lucrative subsidiaries;<sup>363</sup> holding companies can be required to guarantee the capital performance of their bank or thrift subsidiaries;<sup>364</sup> and critically undercapitalized *though still solvent* institutions can and must be placed into receivership.<sup>365</sup>

PCA determinations represent, therefore, the most intrusive forms of intervention by any agency into the realm of economic entrepreneurship. The drastic nature of PCA action prompts a concern for protecting individuals and institutions against arbitrary agency action.<sup>366</sup> It is not only banks and bankers whose protection is important. Their anxieties translate, in turn, into unduly conservative lending practices, which, as the President and the four banking agencies have acknowledged, have contributed to the recent shortage of credit availability, particularly from small and medium-sized banking institutions.<sup>367</sup> In other words, borrowers may be paying the price for an examination system that is perceived by bankers to be unpredictable and arbitrarily severe.<sup>368</sup>

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362. FDICIA § 131(a) (amending FDI Act § 38(f)(2)(F), 12 U.S.C. § 1831o(f)(2)(F) (Supp. IV 1992)).

363. FDICIA § 131(a) (adding FDI Act § 38(f)(2)(I), 12 U.S.C. § 1831o(f)(2)(I) (Supp. IV 1992)).

364. *Id.* § 131(a) (adding FDI Act § 38(f), 12 U.S.C. § 1831o(f)).

365. *Id.* § 133(a) (adding FDI Act § 11(c)(5), 12 U.S.C. § 1821(c)(5)).

366. This concern is heightened by the fact that virtually all subsequent redress against an agency in the form of recovery in a tort suit for damages appears to be cut off by the "discretionary function exception" in the Federal Tort Claims Act. *See supra* note 273 (outlining "discretionary function exception"). Unless an arbitrary or obviously inappropriate PCA determination can be enjoined or reversed at an early stage, individuals and institutions who suffer injury as a result will be entirely without remedy.

367. *See* Remarks by the President on Policy to Alleviate the Credit Crunch, *supra* note 158, at 3 (outlining new appeals and complaint processes); and INTERAGENCY POLICY STATEMENT ON CREDIT AVAILABILITY, *supra* note 158, at 1 (specifying forms of some agency appeal processes).

368. Embraced by these general considerations are some less obvious but equally important ones that already have been voiced in the context of the existing examina-

The agencies seem, with their examination review processes, to have made a serious and commendable attempt to provide "head-office" relief. The OCC, for example, provided in its 1992 procedures a separate avenue of alternative relief directly to the Washington office,<sup>369</sup> the availability of which was emphasized to the author during his inquiries.<sup>370</sup> Unfortunately, the efforts by the agency head offices may not resolve the underlying objections that the industry has to the existing review process: the concern of bankers also stems from a fear of retribution *in subsequent examinations* when the determinations of an examiner or regional supervisor are challenged.<sup>371</sup> This concern threatens to

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tion review process. First, bankers question the objectivity of the examination and the examination review processes. This was the reason for the imposition by CEBA of an independent arbiter process for thrifts. *See supra* note 150 (discussing CEBA § 1442(c)).

The problem has been voiced again publicly by industry representatives and privately to the author. *See supra* note 158 (describing joint letter to President-elect). In part, the concern is for impartial decisionmaking as a remedy for the possible predilections and biases of individual examiners in cases where relations between the institution and the supervisors have become difficult. In part, the complaints also seem to be based on an anxiety about the potentially exaggerated impact that national political controversy might have on regional offices. *See* Bleakley, *supra* note 158, at A14 (reporting complaints that ratings by field examiners are sometimes inappropriately downgraded by supervisors in reaction to political accusations of earlier laxity).

369. *See supra* p. 539, Chart 1B (discussing new OCC national bank appeals process).

370. Letter from Robert B. Serino, Deputy Chief Counsel, OCC, to Professor Lawrence G. Baxter, (Apr. 9, 1993). The Acting Comptroller of the Currency also has emphasized that the new appeal process currently being developed will include an official reporting directly to the Comptroller who, "[a]bove all, . . . would make sure there was no retribution for anyone involved in an appeal." *Acting Comptroller Steinbrink Fills in Some Gaps of Clinton Credit Crunch Plan*, 60 Banking Rep. (BNA) 367 (1993). The Federal Reserve's 1992 procedures also attempted to ensure that someone independent from the examiner would be involved in making the final decision on review. *See supra* note 158 (discussing pressures on President to create new appeals process and subsequent new appeals and complaints process).

The Federal Reserve and the OTS more recently have made additional efforts to address the problem of potential retribution. *See OTS' New Outreach Program Addresses Thrift's Complaints over Appeals Process*, 61 Banking Rep. (BNA) 59 (1993) (describing new system of examination oversight management designed to ensure that early action is taken to resolve potential rifts between examiners and institutions); *Fed Sends Reserve Bank Presidents Letter Restating Exam Appeal Policy*, 60 Banking Rep. (BNA) 913 (1993) (describing letter of guidance from Federal Reserve to Bank Presidents urging more sensitive handling of examination disputes).

371. The apprehension was perhaps best expressed in a letter to the author from a leading and widely respected in-house banking counsel:

taint *any* internal agency review process, even if it is conducted at the Washington level, although the new Ombudsman remedy instituted by the OCC offers a promising method for overcoming the bankers' fears.<sup>372</sup>

One possible benefit of formalizing and standardizing the examination review process is that examiners might become more willing to accept appeal as a perfectly normal aspect of the supervisory process. In addition, the Washington, D.C. agency offices might be more able to enforce proper respect for the review process more easily if it were written into formal agency practice.

Another concern is the lack of a record upon which to base any judicial challenge to agency examination determinations. In particular, the inability to secure meaningful explanations of particular agency conclusions regarding such matters as asset classifications is a source of some frustration. On the other hand, written appeal procedures would themselves be insufficient: given the highly discretionary nature of the determinations involved, oral presentations, perhaps even at the Washington level, may be essential to a meaningful appeal process.<sup>373</sup> These concerns are understandable, yet they make strong demands on any pro-

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I would be less than candid . . . if I did not voice the cynicism that most bankers I know share as to the efficacy of any intra-agency appeals process, the fear being that exercise of any appeal right risks retribution by the examiner or regional director at a later examination. When I was a regulator in Washington, I was convinced that such retribution would never occur; however, my experience in the industry is that it does occur. While former Treasury Secretary Brady tried to establish a mechanism that would preclude retribution, my sense is that few bankers trust it and have availed themselves of it, and I fear that even the best of intentions of President Clinton and his advisors (with whom we have worked on his credit crunch alleviation program) can overcome the practical problems of preventing later retribution.

My sense is that, in theory, an appeal to Washington, D.C. agency headquarters does yield a fair review of the particular matter; it is the fact of seeking such an appeal that seems to bode ill later for banks availing themselves of the opportunity.

Letter from Julius L. Loeser, Senior Vice President, First Interstate Bancorp, to Lawrence G. Baxter (Mar. 26, 1993) (on file with author).

372. See *supra* p. 539, Chart 1B (outlining new OCC National Bank Appeals Process).

373. Letter from Patrick B. Augustine, Executive Vice President and General Counsel, First United Bancorporation, to Professor Lawrence G. Baxter (Apr. 6, 1993) (on file with author) (asserting that "in matters involving 'judgment' which is somewhat subjective, personal meetings/appeals whereby parties can observe the interchange between the parties is helpful to a resolution of the matter").

posed appeal process, and a compromise is necessary in this regard if the agencies take the view that the efficient discharge of their PCA responsibilities requires that they determine whether proceedings should take an oral form.

Banks and commentators are also concerned that the review procedures are entirely discretionary and that they do not stay continuing enforcement or PCA action by the agencies concerned.<sup>374</sup> In view of the potentially severe infringement on the value of the institution that a capital classification might entail, these concerns are hardly surprising and must be addressed. Once again, however, some compromise is necessary, and the recommendations in this Article take this into account.

## 2. Agency Concerns

The banking regulatory agencies have been directed by Congress to intervene rapidly to prevent further losses to the deposit insurance funds. Rapid intervention is the primary purpose of the PCA system, and it inevitably entails making difficult, entrepreneurial decisions in a volatile world made all the more complicated by the fact that the agencies will be dealing with ailing institutions buffeted by unfavorable economic forces. The notion of drawn-out judicial wrangling seems inimical to the whole concept of *prompt* corrective action.

The concern for rapid response to the emergencies that might confront a troubled institution is a powerful one. For this reason, it is difficult to see how one could reasonably require an agency to stay its hand in every situation where it is in dispute with the institution over the quality of the institution's assets, or the detailed form of PCA that the institution should be required to take. On the other hand, it does not follow that the agencies should always be able to rely on "urgency" as a justification for denying effective relief to the institution. As the procedures adopted in the final rules seem to contemplate, some disputes can be settled over a substantial period of time.<sup>375</sup>

Other, sometimes important, arguments might be made against a more formal examination appeal process and against judicial review. First, it might be argued that the processes devised by the agencies in their Final Rules already provide significant safeguards for the individuals and

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374. See *supra* notes 150-69 and accompanying text (discussing institution's ability to review agency examination).

375. See *supra* p. 544, Chart 3 (describing procedures allowing 14-day response time before adverse safety/soundness reclassifications are implemented), and *supra* p. 548, Chart 5 (describing 14-day response procedure before PCA directive is finalized).



institutions affected. This argument (in relation to the procedures accompanying capital directives) carried considerable weight with the court in *Coushatta*.<sup>376</sup> As an argument against judicial review, however, it tends to prove too much, because it also could be used against the availability of judicial review in the case of formal adjudications under the APA, where full judicial review always has been provided for and been thought appropriate.

Second, the banking agencies might be concerned that more formal internal review processes, and subsequent judicial review of PCA issues, would inevitably "put the examiners on trial," which might have the effect of inhibiting examiners who might be inclined to make decisions adverse to ailing institutions or individuals. At the same time, however, it should be noted that it is quite common for examiners to be "put on trial" in the formal enforcement process, where respondents are usually able to cross examine them fairly intensively.<sup>377</sup> Furthermore, examiners and their agencies enjoy substantial deference from reviewing courts<sup>378</sup> and, at least in theory, examiners should not anticipate that they will be second-guessed where their determinations do not appear to be arbitrary.<sup>379</sup>

A third concern is that the kinds of records underlying PCA orders often would be unsuitable for judicial review because they involve highly discretionary, on-site judgments, and the record, therefore, would not reflect the real reasoning behind the determinations giving rise to the orders. Asset classifications might provide a good example: the appraisal of assets is a matter involving sensitive judgments informed by local experience that is hard to articulate.<sup>380</sup>

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376. 930 F.2d 1122 (5th Cir. 1991), *cert. denied*, 112 S. Ct. 170 (1991). See also *supra* notes 287-93 and accompanying text (discussing *Coushatta* decision).

377. In anticipation of this examination, agency manuals advise examiners to prepare careful records. See FDIC MANUAL, *supra* note 137, at 1.1-15 to 1.1-16 (providing guidance on requisite level of detail and style for examiner's reports).

378. See *Franklin Sav. Ass'n v. Director, Office of Thrift Supervision*, 934 F.2d 1127 (10th Cir. 1991) (repeatedly emphasizing need for reviewing court to show deference to examiner and banking agency), *cert. denied*, 112 S. Ct. 1475 (1992); *Sunshine State Bank v. FDIC*, 783 F.2d 1580, 1583 (11th Cir. 1986) (ruling that FDIC Board's remedies were not abuse of discretion).

379. See *Sunshine State Bank*, 783 F.2d at 1584 (finding that "[u]nless shown to be arbitrary or capricious or outside a zone of reasonableness, the ALJ, the Board, and the courts must give significant deference to these experts [i.e. the examiners].").

380. *Chicago, Burlington & Quincy Ry. Co. v. Babcock*, 204 U.S. 585, 597 (1907) (describing such decisions as expressing "an intuition of experience which outruns analysis and sums up many unnamed and tangled impressions; impressions

Judicial review may be suitable *in some situations* because of the highly discretionary nature of the decisions. This supports a conclusion that certain decisions, at least, have been "committed to agency discretion by law." It is also evident, however, that many other areas of PCA decisionmaking do not involve such finely tuned judgments. In fact, the agencies themselves have argued at times that aspects of the examination process involve mere computations,<sup>381</sup> and examiners are urged by the agencies to provide "factually objective" comments in their reports.<sup>382</sup> Where standards are relatively well understood, there is no reason to assume that a court could not tell when the standards have been disregarded arbitrarily.

### 3. *Demands and Limitations of Judicial Review*

Subjecting PCA determinations to judicial review inevitably would entail some risk to the efficiency and integrity of the PCA system. The ultimate task is striking the right balance between the demand for some judicial protection against arbitrary agency action and the need for the agencies to discharge their responsibilities efficiently and without strategic obstruction by institutions and individuals who are subject to the agencies' actions. Two problems seem particularly important: the effect of judicial review on the continuing relationship between the regulatory agencies and the institutions, and whether the type of decisions needed, because of the inherent discretionary nature of the decisions, can be reviewed intelligently at all.

#### a. *The Continuing Supervisory Relationship*

Even though bankers have expressed some frustration with the role of examiners, the bank supervisory system is dependent on these officials. Notwithstanding the trend to increase formality that has been spurred by FIRREA and FDICIA, it is likely that the examination process will remain, and should remain, highly informal in the great majority of examinations. Any restrictions imposed by the availability of judicial review should, therefore, be limited as far as possible so as not to undermine the responsibilities and authority of examiners.

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which lie beneath consciousness without losing their worth.").

381. See Brief for the FDIC at 23, *FDIC v. Bank of Coughatta*, 930 F.2d 1125 (5th Cir. 1991) (arguing against reviewability by asserting that "[a]ll that is even arguably left for review is the arithmetic by which the agency establishes the current [capital] level"), *cert. denied*, 112 S. Ct. 170 (1991).

382. FDIC MANUAL, *supra* note 137, at 1.1-15 to 16.

The standard of judicial review of the discretionary elements of capital classifications and safety/soundness reclassifications should be restricted to the most basic, default standard currently available under the APA, namely, the "arbitrary, capricious, or an abuse of discretion" standard.<sup>383</sup> This standard, coupled with the deference that the courts already accord the evaluations of examiners,<sup>384</sup> should reassure examiners that their decisions will not be second-guessed in the ordinary course of events. At the same time, the mere availability of judicial review, even under the arbitrary and capricious standard, would provide a backup safeguard for institutions that believe themselves to be the subject of truly abusive agency action.

b. Reviewing the Unreviewable?

A conceptual problem with judicial review of PCA determinations is the possibility that examination ratings and capital classifications might be *inherently* unreviewable. As was observed earlier, many of the standards examiners must apply are highly subjective.<sup>385</sup> Yet many of the standards that must be applied, some of which are clearly stipulated by the PCA statute and Final Rules, are also quite objective and probably capable of independent evaluation. Furthermore, while it is true that some of the examination assessments are highly discretionary, it does not necessarily follow that the mere presence of discretion—even complex discretion—will render the final result absolutely unreviewable. As it was put by a prominent banking lawyer with extensive personal experience in these matters: "[t]o a country lawyer like me it is not clear that the problems the federal banking agencies deal with are more difficult to understand or more dangerous to the public than those dealt with by the Nuclear Regulatory Commission, the Food and Drug Administration, or the Federal Aviation Administration."<sup>386</sup>

This observation is a powerful one: there seems to be no obvious reason why banking determinations should be regarded as unreviewable merely because they are *complicated*. There may be many reasons (including the complexity of the decisions under review as well as others

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383. 5 U.S.C. § 706(2)(A) (1988).

384. See *supra* note 379 and accompanying text (describing deference shown to examiners).

385. See *supra* notes 137-42 (describing examination procedures) and 323-24 (describing reviewability concerns under APA § 701).

386. Memorandum from John C. Deal, Esq., to Professor Lawrence G. Baxter (Mar. 30, 1993) (on file with author).

presented in this Article) for restricting the *depth* or *standard* of review, and the time limits relating to judicial relief, but these are not reasons for denying judicial relief *altogether*.

#### 4. *Crafting Realistic Protection*

The preceding discussion suggests that a balance needs to be struck, both as far as the provision of internal, agency remedies and the availability of judicial protection are concerned. The following proposals attempt to strike the necessary compromises.

### V. PROPOSALS FOR ENHANCING ADMINISTRATIVE AND JUDICIAL PROTECTIONS<sup>387</sup>

#### A. *Recommendations*

##### 1. *Administrative Appeals of Classification Decisions*

A. In formulating an appeal process for independent internal review of classification decisions, the federal banking agencies should promulgate rules providing for an appeal to a senior official by a depository institution. The institution could appeal a decision of an examiner or regional director that results in an adverse capital classification of the institution, including a decision to assign the institution a less-than-satisfactory rating for asset quality, management, earnings, or liquidity.

B. The appeal procedures should provide that:

(1) the affected institution is given immediate notice of its right to appeal;

(2) the institution is provided with a written report stating the reasons, including the factual bases, for the adverse classification or rating;

(3) the institution has an opportunity to supply further facts and information, make written representations, and, in the agency's discretion, present oral testimony and argument; and

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387. The Administrative Conference of the United States, for whom the report upon which this Article is based was prepared, adopted the substance of nearly all of the recommendations that follow. See Administrative Conference of the United States, *Administrative and Judicial Review of Prompt Corrective Action Decisions by the Federal Banking Regulators*, (Recommendation 93-2, adopted June 10, 1993), 1 C.F.R. § 305.93-2 (1993) (detailing appeals process). The improvements made by the Conference to the formulation of the original recommendations have been adopted in this Article. One of the recommendations made in the original report and in this Article was not adopted. See also *infra* note 397 and accompanying text (specifying recommendation not adopted).

(4) the agency's final decision is issued within a specified time.

C. The agencies also should specify in their rules whether an adverse classification decision ordinarily will be stayed pending completion of the internal appeal, or ordinarily will be stayed pending completion of the internal appeal process and, in either event, provide for exceptions where special circumstances justify departure from regular practice.

## 2. *Judicial Review of Final Agency Decisions*

A. Congress should amend section 38 of the Federal Deposit Insurance Act<sup>388</sup> to permit a depository institution that has suffered an adverse capital classification, or a person who has been dismissed pursuant to section 38(n) of the Act,<sup>389</sup> to seek judicial review of the federal banking agency's final decision in a federal district court. Therefore,

(1) A party affected by an adverse capital classification or a PCA dismissal should be required to seek review within ten days of receiving notice of the agency's final decision.

(2) The court should review the agency's decision under the standards of judicial review set forth in section 10(e) of the APA.<sup>390</sup>

(3) Whether the agency's ruling is stayed pending judicial review should be determined by the court under the usual standards for granting stays.

B. Congress should amend section 38 of the Federal Deposit Insurance Act<sup>391</sup> to clarify that it does not preclude judicial review of decisions to appoint a conservator or receiver under the terms of section 38(h)(3).<sup>392</sup>

(1) In addition, Congress should amend section 2 of the National Bank Receivership Act<sup>393</sup> to provide for judicial review of decisions to appoint receivers for national banks, and section 11(p) of the Federal Reserve Act<sup>394</sup> to provide for judicial review of decisions by the Board of Governors of the Federal Reserve System to appoint conservators and receivers for state member banks.

(2) Congress should also amend the provisions relating to judicial review of decisions by all the federal banking agencies to appoint con-

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388. FDI Act § 38, 12 U.S.C. § 1831o (Supp. IV 1992).

389. *Id.* § 38(n), 12 U.S.C. § 1831o(n).

390. 5 U.S.C. § 706 (1988).

391. FDI Act § 38, 12 U.S.C. § 1831o (Supp. IV 1992).

392. *Id.* § 38(h)(3), 12 U.S.C. § 1831o(h)(3).

393. 12 U.S.C. § 191 (1988).

394. *Id.* § 248.

servators and receivers so as to provide for:

(a) a consistent standard of review in accordance with section 10(e) of the APA;<sup>395</sup> and

(b) consistent time limits within which judicial review should be sought after a conservator or receiver has been appointed.

C. Congress should amend section 38 of the Federal Deposit Insurance Act<sup>396</sup> to preclude judicial review in the case of all other prompt corrective action decisions and directives made by the federal banking agencies.<sup>397</sup>

### B. Commentary

The net effect of these proposed recommendations would be to introduce a limited element of formality into the examination process that governs federally insured depository institutions, to leave the procedures already developed by the federal banking agencies for the exercise of their PCA powers in their current form, and to establish clarity and consistency regarding the availability and standard of judicial review by providing for a limited form of expedited judicial review at the "triggering" stages of prompt corrective action. As such, the proposals attempt to strike a compromise between the competing interests of both the agencies and those affected by their actions.

#### 1. Administrative Appeals

*Recommendation 1* would change the present, highly informal, examination process by providing a right on the part of an institution to a somewhat more formal appeal than is currently available in the case of classifications based on capital condition alone.<sup>398</sup> The upgrading of the capital classification appeal process is essential given that the FDICIA has changed substantially the framework in which examinations take place.<sup>399</sup>

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395. 5 U.S.C. § 706 (1988).

396. FDI Act § 38, 12 U.S.C. § 1831o (Supp. IV 1992).

397. ACUS did not adopt this recommendation.

398. On the other hand, the right to appeal proposed in this report does not differ substantially from the right of appeal now provided for in the case of reclassifications based on non-capital considerations (i.e., based on unsafe or unsound conditions or practices). See *supra* p. 544, Chart 3 (outlining reclassifications based on non-capital considerations).

399. See *supra* notes 38-41 and accompanying text (discussing formalization of regulations after FDICIA).

In addition, this recommendation would structure the internal examination review process by adding a formal right to agency review, requiring a written record, and imposing deadlines for final decision.<sup>400</sup> The proposed review process also would operate *in addition to* the existing informal avenues of review that the agencies have provided, so that earlier opportunities to resolve a dispute orally and perhaps amicably still would remain.

The new OCC Ombudsman appeal procedures<sup>401</sup> may well have succeeded in incorporating all the principles underlying this recommendation in a manner that ingeniously maintains a substantial degree of flexibility and reviewer independence. They provide, perhaps, a commendable model for the other three agencies.

*Recommendation 1(C)* is designed to provide clarity as to when an agency's reclassification determination will take effect.<sup>402</sup> The proposal leaves to the agency's discretion the moment of effectiveness: this permits the agency to act quickly if the circumstances demand prompt action. On the other hand, the proposal also would require the agency to be clear about its intentions. Clarity is important because the legal consequences of reclassifying the institution can be automatic<sup>403</sup> and the practical impact of a dismissal, whether final or pending, is immediate. Clarity is also important for identifying when the classification or dis-

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400. The CEBA provision imposes two deadlines: arbiter review must be completed within 25 business days and review by the PSA must be completed within a further 20 days. 12 U.S.C. § 1442a(e) (Supp. IV 1992).

The recommendation does not require, however, the establishment of an independent arbiter system like the one provided by CEBA. *See supra* notes 150-51 and accompanying text (describing review of examinations). The institution pursuing the appeal, however, could submit the testimony of outside arbiters as part of its evidence. Given the availability of judicial review under *Recommendations 2(A)* and *(B)*, independent arbitration does not seem to be essential for safeguarding the institution's rights. The right to present oral testimony and introduce oral evidence would not be available as a right, but an agency would be expected to permit such evidence where the circumstances clearly demand it, and this decision ultimately would be subject to judicial review where a party could demonstrate that the opportunity was denied arbitrarily.

401. *See supra* p. 539, Chart 1B (outlining New OCC National Bank appeals process).

402. *Id.* (discussing new OCC procedures providing for stay of agency action pending outcome of appeal).

403. For example, the institution, if downgraded from well capitalized, can no longer receive brokered deposits. *See supra* note 60 and accompanying text (discussing effects of downgrading).

missal is "final" for the purpose of judicial review.<sup>404</sup>

## 2. Judicial Review of "Basic" Decisions

The availability of judicial review of PCA actions is unclear. *Recommendation 2* would remedy this lack of clarity by making specific provision for judicial review in the case of the most serious of the PCA determinations and by expressly precluding judicial review in the case of the more highly discretionary, "secondary" PCA directives.

### a. Classification Decisions and PCA Dismissals

The most serious of all the PCA determinations are those relating directly to capital classifications, dismissal of directors or officers, and seizure of institutions. In the case of the latter two forms of PCA determination, judicial review ordinarily would be available were the agencies to take identical action under other statutory provisions. Even in the case of capital classifications, the decisions of examiners are sometimes the subject of judicial review as part of an enforcement action under review or a challenge to a seizure. If *Recommendation 1* were to be adopted, review of capital classifications would be rendered more feasible because there would be a written record concerning the issues in dispute.

*Recommendation 2(A)* places judicial review in a U.S. district court. This is consistent with the provisions relating to judicial review of receiverships and conservatorship. Judicial review in a district court seems appropriate because the record concerning the supervisory decisions underlying capital classifications and PCA dismissals and seizures is likely to be somewhat informal, there having been no formal agency hearing.

*Subrecommendation 2(A)(1)* places a ten-day limit on a party seeking judicial review. This time limit accords with the time limits governing judicial review of temporary orders under section 8.<sup>405</sup> PCA actions are likely to become necessary in a "crisis environment" where time is of the essence.

Under proposed *Subrecommendation 2(A)(2)*, the standard of judicial review of the discretionary elements of the agency's decision is the

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404. 5 U.S.C. § 704 (1988).

405. See FDI Act § 8(c)(2), 12 U.S.C. § 1818(c)(2) (Supp. IV 1992) (providing for temporary cease-and-desist orders), and FDI Act § 8(f), 12 U.S.C. § 1818(f) (providing for suspension and prohibition orders).



narrowest standard normally applicable in administrative law.<sup>406</sup> Review of the agency's decisions on matters of fact and policy would be confined to the "arbitrary, capricious, or abuse of discretion" standard of section 706(2)(A) of the APA.<sup>407</sup> Because the agency decision would not be based on formal, on-the-record adjudication, the substantial evidence standard would not apply.<sup>408</sup> This seems appropriate in a situation where considerable deference toward the agency is necessary in a highly discretionary area of administrative decisionmaking.<sup>409</sup> And because there would be no formal agency record or prior adjudicative hearing, alternative, possibly more intrusive, standards for review, such as the "substantial evidence" standard, would be inappropriate.

*Recommendation 2(A)(3)* addresses whether a banking agency's classification determination, decision to order a dismissal, or decision to impose a conservatorship or receivership, should be stayed pending judicial review. The recommendation does not *require* a stay of agency action pending judicial review. Given the promptness with which the agencies must act in some of the situations contemplated by section 38, a mandatory stay requirement seems unduly inflexible. The banking agencies do enjoy a discretionary power to stay their action,<sup>410</sup> and it seems appropriate that this decision should remain initially in their hands.<sup>411</sup> As *Recommendation 2(A)(3)* is formulated, a court would not be prevented from ordering a temporary stay to preserve the petitioner's rights pending completion of review proceedings.<sup>412</sup> It would be expected, howev-

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406. 5 U.S.C. § 706(2)(A) (1988).

407. *Id.* § 706(2)(A).

408. The substantial evidence standard applies only to on-the-record decisionmaking. *See* 5 U.S.C. § 706(2)(E) (1988) (limiting substantial evidence standard).

409. *Cf.* *Franklin Sav. Ass'n v. Director, Office of Thrift Supervision*, 934 F.2d 1127 (10th Cir. 1991), *cert. denied*, 112 S. Ct. 1475 (1992).

410. *See* 5 U.S.C. § 705 (1988) (outlining relief available pending review). I am grateful to Professor William Funk for drawing my attention to the significance of § 705 in the PCA context.

411. Permitting the agencies to retain discretion in this regard could give rise to serious hardship. By refusing a stay, the agency's seizure of an institution may render subsequent judicial review either futile or inadequate as a remedy. Yet it is easy to imagine a situation in which an agency may simply *have* to take irreparable action—say, seizing a critically undercapitalized institution within days of the determination that it is critically undercapitalized to prevent even greater possible harm occasioned by further delay. It is difficult to see how the agency could be enjoined from action without simultaneously undermining the agency's statutory responsibilities.

412. *Cf.* 5 U.S.C. § 705 (1988) (providing for grant of stay by reviewing court in case of irreparable injury). *But cf.* FDI Act § 8(i)(1), 12 U.S.C. § 1818(i)(1) (Supp.

er, that the court's discretion to issue a stay would be exercised sparingly, with the presumption against interfering with the agency's right to take immediate action being a heavy one.<sup>413</sup>

#### b. Conservatorship and Receiverships

*Recommendation 2(B)* seeks to eliminate the present uncertainty and anomaly regarding the right to judicial review in the case of conservatorship and receiverships imposed under section 38. The inconsistency between the legislative provisions providing for a right to judicial review in the case of state member bank and savings association receiverships, on the one hand, and national and state nonmember bank receiverships, on the other, already has been noted.<sup>414</sup> The all-purpose provision stipulating the grounds upon which a conservatorship or receivership may be imposed by the FDIC, OTS, and the OCC, namely section 11(c)(5) of the FDI Act, clearly contemplates conservatorship and receiverships imposed as a result of the capital condition of the institution concerned.<sup>415</sup> In the same subsection, a provision is made for judicial review of decisions by the FDIC to impose a conservatorship or receivership under section 11(c)(5),<sup>416</sup> and a similar provision for judicial review also is made where it is the OTS that makes the appointment.<sup>417</sup> No express provision is made, however, either in section 38 or in the National Bank Receivership Act, for judicial review where the appointment of a receiver is made by the Comptroller of the Currency.<sup>418</sup> Furthermore, no provision is made for judicial review of decisions by the Federal Reserve to appoint conservators or receivers for state member banks.<sup>419</sup> This inconsistency lacks any principled justification.

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IV 1992) (precluding any injunctive relief not provided for in FDI § 38).

413. To ensure that courts do not intervene lightly, the amendment to section 38 could require the institution or individual seeking the stay to demonstrate that the grant of a stay would not create a danger of further dissipation of the assets of the insured depository institution or threaten losses to the deposit insurance fund.

414. See *supra* notes 324-33 and accompanying text (describing conservatorship and receivership review).

415. FDI Act §§ 11(c)(5)(K) & (L), 12 U.S.C. §§ 1821(c)(5)(K) & (L) (Supp. IV 1992).

416. *Id.* § 11(c)(7).

417. See *supra* note 153 and accompanying text (describing OTS's current examination review process).

418. See *supra* note 332 and accompanying text (describing appointment of receiver by Comptroller of Currency).

419. See *supra* note 330 and accompanying text (describing judicial review for state member banks).

The opportunity also should be taken to introduce consistency regarding the standard of judicial review. The Bank Conservation Act clearly states the standard from which courts have had to deduce the more obscure language used in the case of state nonmember banks and thrifts.<sup>420</sup> The provision relating to appointments by the Federal Reserve states no standard at all. A uniform application of the arbitrary and capricious standard would be consistent with the appropriate level of deference, the state of the record, and the apparent desires of Congress in at least the case of national bank conservatorship.

Finally, there seems to be no reason for different time limits for judicial challenge.<sup>421</sup> These could be rendered uniform for all four agencies.

### 3. *Preclusion of Judicial Review in Other PCA Situations*

*Recommendation 2(C)* would expressly preclude judicial review in all other cases involving PCA action, with the important exception of PCA seizures.

Although the Administrative Conference of the United States has decided not to make a specific recommendation in this regard,<sup>422</sup> the author believes that this proposed subrecommendation is important because it acknowledges the highly discretionary nature of PCA directives and the need on the part of the agencies to be able to act quickly to respond to the difficulties faced by a troubled institution. The agencies already have established internal procedures for the review or reconsideration of their PCA directives, and, while judicial review would seem theoretically to follow from this process, the delaying consequences of the judicial process has the potential to undermine the entire PCA enterprise. An express preclusion of judicial review would serve to reduce the possibility of strategic litigation without the need for the development of a body of judicial precedent concerning the limits of the "committed to agency discretion" exception to reviewability.

## VI. REMAINING QUESTIONS

This Article leaves some related questions unanswered. In particular, no recommendations are offered with respect to the standard, under

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420. See *supra* notes 25 and 332 (discussing Bank Act).

421. See *supra* notes 325-27 and accompanying text (describing varying time limits within which review must be sought).

422. See *supra* note 397 (indicating ACUS's position).

section 38, that a director or officer who is dismissed must satisfy to secure reversal of his or her dismissal.<sup>423</sup> Nor does the Article consider whether the lack, on the part of such a director or officer, of any right to an oral administrative hearing or the right to present witnesses<sup>424</sup> is unfair and should be remedied.

Issues arising out of the development and implementation of safety/soundness standards under section 39 of the FDI Act<sup>425</sup> are also likely to have an impact on the way in which PCA powers are exercised. Because the final rules relating to these standards have not yet been finalized, however, an investigation of this dimension of the PCA regime seems premature at this stage.

Finally, it may be that the federal banking agencies should develop clear, understandable principles regarding the way in which they will make choices between proceeding under sections 38 and 39 of the FDI Act, on the one hand, and sections 8 and 11 of the Act, on the other. PCA, safety/soundness standard-setting, formal enforcement, and conservatorship/receivership issues all have become closely intertwined since the enactment of FDICIA and the emergence of a climate that favors aggressive agency action to prevent losses to the deposit insurance funds. At this point, however, it may be appropriate to allow time for the accumulation of agency experience and judicial evaluation before attempting to identify what should be the fairest principles governing the agency choice of powers.

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423. See FDI Act § 38(n)(3), 12 U.S.C. § 1831o(n)(3) (Supp. IV 1992) (finding that "[t]he petitioner shall bear the burden of proving that the petitioner's continued employment would materially strengthen the insured depository institution's ability (A) to become adequately capitalized . . . [or] (B) to correct the unsafe or unsound condition or unsafe or unsound practice"). See *supra* notes 257-59 and accompanying text (describing § 38 dismissals).

424. See *supra* p. 552, Chart 6 (outlining PCA dismissals).

425. See *supra* notes 95-98 and accompanying text (discussing development of safety/soundness standards).