Recommendation 93-2

Administrative and Judicial Review of Prompt Corrective Action Decisions by the Federal Banking Regulators

(Adopted June 10, 1993)

In the wake of the recent crises in the banking industry, Congress has passed two major statutes affecting the relationship among the four principal banking regulators (the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision) and the industries they supervise.[1] In 1989, the Financial Institutions Reform, Recovery and Enforcement Act gave the banking agencies extensive new enforcement powers. The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) went further, authorizing the federal banking agencies to take "prompt corrective action to resolve the problems of federally insured depository institutions," and to do so "at the least possible long-term loss to the deposit insurance fund." 12 USC 1831o(a)(1) and (2). Underlying the FDICIA scheme is Congress' belief that by acting quickly at the earliest sign of problems, the banking agencies may be able to prevent the failure or further deterioration of regulated institutions.

FDICIA added a new section 38 to the Federal Deposit Insurance Act, which requires banking regulators to take prompt corrective action (PCA) to preempt the possibility that a bank or savings association will fail or, if failure appears likely, to seize the bank early enough to ensure that there remain assets within the institution sufficient to cover its liabilities. The PCA framework is premised on a "tripwire" approach, under which banking regulators may take increasingly severe action, on a stage-by-stage basis, against a depository institution as the capital and soundness of the institution decline. FDICIA creates a system of five capital classifications, ranging from well capitalized to critically undercapitalized, within which bank regulators place institutions based on the application of capital standards. Downgrading of an

[1] The Board of Governors of the Federal Reserve System is an independent federal agency with primary federal responsibility for the regulation of all bank holding companies, state-chartered banks that are members of the Federal Reserve System, and foreign banks. 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 savings and loans, has primary federal responsibility for the regulation of all state-chartered federally insured banks that are not members of the Federal Reserve System, and has secondary regulatory authority over all other federally insured banks and thrifts. The Office of the Comptroller of the Currency, located within the Treasury Department, charters and supervises all national banks. The Office of Thrift Supervision, also located within the Treasury Department, charters all federally chartered savings and loans and supervises all savings and loan holding companies and federally insured savings associations.

institution's capital classification not only subjects it to increasing intervention by regulators, but also automatically triggers certain restrictions on the institution's activities (e.g., loss of authority to accept brokered deposits or to make payments on subordinated debt). In addition to considering capital standards, regulators may reclassify the institution based on a determination that it is in an unsafe or unsound condition or is engaging in an unsafe or unsound practice.

Before passage of FDICIA, the banking agencies took coercive action through the formal enforcement provisions of section 8 of the Federal Deposit Insurance Act, which provides extensive procedural protections. The new section 38, on the other hand, accommodates the need for banking agencies to respond quickly to developing problems by permitting exercise of functionally similar powers outside the formal procedural framework of section 8. Moreover, although FDICIA dramatically increased the importance of capital classifications, and the standards on which they are based, in the regulatory scheme, the bank examination process in which these determinations are made is very informal, with limited opportunity for review. Specifically, while section 38 makes provision for limited procedural protection for an individual who is dismissed from office as a result of a PCA directive, as well as for an institution subject to a determination that it is in an unsafe or unsound condition, it does not provide for administrative review of PCA decisions, nor does it expressly provide for -- or preclude -- judicial review of PCA determinations.

The Administrative Conference believes that, in light of the significance of prompt corrective actions, greater procedural protection is appropriate. On the other hand, since time will often be of the essence in meeting FDICIA's goals of avoiding bank failures and minimizing the drain on the bank insurance funds, any procedural requirements must permit expeditious action and must be limited to those situations where agency actions have the severest impact. Moreover, any scheme for expanded review of PCA decisions must take into account the broad discretion Congress has afforded the banking agencies in determining and applying standards in this area.

The Conference believes administrative review should be available for decisions that have an adverse effect on an institution's capital classification. These decisions, which are ordinarily made in the context of a bank examination rather than in a PCA directive, form the basis for any PCA action that may be taken against an institution. The highly informal and discretionary mechanisms for review of examination decisions that are currently provided by the banking agencies were designed for use in an atmosphere of trust and close working relationships between bankers and examiners. In the current environment, a somewhat more structured

administrative review by a higher-level reviewing authority within the agency would promote fairness and more consistent results.

Providing a more effective administrative review mechanism is particularly important here where, because of the broad discretion afforded agencies to interpret fairly general statutory standards and the subjective nature of some of the determinations that must be made in the examination process, judicial review may be of limited effectiveness. Moreover, the proposed review process would provide a more meaningful record for judicial review in those cases where it can be effective. Paragraph 1 of this recommendation proposes a uniform, record-creating appeal process for decisions by all federal banking agencies in which an institution's capital classification is determined or changed. The banking agencies' rules should make clear whether changes in capital classification will ordinarily go into effect while administrative review is pending or will not become final until after administrative review; in either case, agency rules should provide for exceptions from ordinary practice in appropriate circumstances.

In addition, judicial review should be available for some of the most crucial PCA decisions. Institutions that have suffered adverse capital classifications and persons who have been dismissed as a result of PCA directives should be able to seek judicial review of those decisions, and the provisions governing judicial review in these cases should be made uniform across all the relevant federal banking agencies.

Similarly, any action to appoint a conservator or receiver for an institution should be judicially reviewable. Some such actions are already reviewable under existing law, though section 38 may be interpreted to preclude such review. Congress should clarify that review is available for all such decisions made by every federal banking agency and should provide for uniform standards of review and time limits for review of these decisions. The Conference recognizes the need for flexibility in determining whether an adverse capital classification or prompt corrective action decision should take effect pending judicial review and concludes that stays of agency action should be discretionary rather than automatic.

Recommendation

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 of 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

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

c. The agencies also should specify in their rules whether or not an adverse capital classification decision will ordinarily 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[2]

a. Congress should amend section 38 of the Federal Deposit Insurance Act, 12 U.S.C. 1831o, 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, 12 U.S.C. 1831o(n), to seek judicial review of the federal banking agency's final decision in a federal district court.

(1) A party affected by an adverse capital classification should be required to seek review within 10 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 5 U.S.C. 706.

[2] In making these recommendations related to judicial review of decisions by federal banking agencies, the Administrative Conference takes no position on whether and to what extent judicial review of these decisions is available under current law.

(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, 12 U.S.C. 1831o, 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), 12 U.S.C. 1831o(h)(3).

(1) In addition, Congress should amend section 2 of the National Bank Receivership Act, 12 U.S.C. 191, to provide for judicial review of decisions to appoint receivers for national banks, and section 11(p) of the Federal Reserve Act, 12 U.S.C. 248(p), 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 conservators and receivers so as to provide for:

(i) A consistent standard of review in accordance with 5 U.S.C. 706; and

(ii) Consistent time limits within which judicial review must be sought after a conservator or receiver has been appointed.

Citations:

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