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Statement by  
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Board of Governors of the Federal Reserve System  
before the  
Committee on Financial Services  
U.S. House of Representatives

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## **Introduction**

Chairman Bachus, Ranking Member Frank, and members of the Committee, thank you for the opportunity to discuss the Federal Reserve's enforcement program. Authority to take enforcement actions is one of the important tools Congress has provided the Federal Reserve to require financial institutions under its jurisdiction to address serious problems or risks that are found during the course of the supervisory process.

The Federal Reserve has supervisory authority over state member banks, bank holding companies, savings and loan holding companies, and subsidiaries of these holding companies, as well as foreign banks that operate branches, agencies, and certain other offices in the United States. The Federal Reserve's basic supervisory responsibility is to oversee the financial soundness of these institutions and their adherence to applicable banking laws. To this end, we monitor the largest of these institutions on a continuous basis and routinely conduct inspections and examinations of all of these firms to encourage their safe and sound operation. The vast majority of the Federal Reserve's supervisory actions address unsafe and unsound banking practices and are integrated into our supervision and examination process.

Over the past ten years, the Federal Reserve has taken nearly 1,000 formal, public enforcement actions, which includes the issuance of more than 600 written agreements and 100 cease-and-desist orders against the institutions and individuals subject to our jurisdiction. During this same period, in response to some of the more serious banking practices and suspected violations of law, the Federal Reserve has assessed more than 100 civil money penalties and restitution payments totaling more than \$1.2 billion. Moreover, our investigations of insiders have led to the permanent ban of more than 80 individuals from the banking industry, including untrustworthy loan officers and traders, directors, and other banking officials.

## **Enforcement Tools**

The statutory scheme established by Congress confers on the Federal Reserve and the other bank regulators a broad array of both informal and formal enforcement tools to be exercised at appropriate points throughout the course of the supervisory process. The primary means for addressing supervisory concerns at regulated financial institutions is informally during the ordinary course of the routine examination process.

The Federal Reserve examines, on a regular basis, institutions for which we have been granted supervisory authority by Congress and, through that authority, has complete and unfettered access to an institution's most sensitive financial information and processes, including information that would otherwise be privileged and not subject to public disclosure. Thus, many problems are identified and corrected during the examination process while examiners are still on site. These types of informal actions are well suited to address safety and soundness deficiencies or violations of law that bank supervisors believe can be readily corrected by the institution's management.

Enforcement measures may escalate depending on the severity or difficulty of the problem. Problems that cannot be corrected immediately will be formally reported to the institution in the examination report or in a supervisory letter as matters requiring management's attention and corrective action. These matters are presented to the institution's board of directors, which is charged with ensuring that management addresses and corrects them. Supervision staff will subsequently follow management's actions to ensure that the problem is corrected. If a problem requires a more detailed resolution or is more pervasive at an institution, the Federal Reserve may enter into a memorandum of understanding with the financial

institution in which the board of directors commits to specific actions to correct potentially unsafe and unsound banking practices or possible violations of laws or regulations.

Unsafe and unsound practices and violations of banking laws found during the course of the supervisory process are usually resolved using the informal methods described above; however, an institution's failure to remedy an unsafe or unsound practice or comply with banking laws can subject the institution to the formal enforcement measures provided by Congress to the Federal Reserve and our fellow federal banking regulators. For example, in instances where a financial institution's management is recalcitrant in addressing a supervisory issue or the condition of the bank has become less than satisfactory, the Federal Reserve may enter into a formal written agreement, which is statutorily enforceable by assessing civil money penalties or imposing other sanctions.

On occasion, the Federal Reserve has also confronted situations where a financial institution's management either refuses to correct an unsafe or unsound practice or to comply with applicable laws or regulations, or where the practice or alleged violation is so widespread or so serious that normal recourse to informal supervisory methods is not appropriate or sufficient. In these cases, the Federal Reserve will commence more formal types of enforcement action against the regulated financial institution and its institution-affiliated parties.

These more formal remedies include, among other things, imposing orders directing the financial institution or its institution-affiliated parties to cease and desist from engaging in the improper or prohibited conduct, directing the firm to take certain actions to return to safe and sound banking practices, and, where appropriate, requiring the firm to make restitution or provide reimbursement, indemnification, or guaranty to third parties harmed by the wrongful

conduct.<sup>1</sup> The Federal Reserve may also remove an institution-affiliated party from the banking institution and prohibit the party from participating in banking at other financial institutions.<sup>2</sup> Finally, we may determine that the assessment of civil money penalties is appropriate against either the offending institution or an institution-affiliated party.<sup>3</sup>

The Federal Reserve may commence a formal investigation to determine whether more stringent enforcement action is appropriate. This investigative authority, which complements our statutory examination authority, empowers designated Federal Reserve staff to issue subpoenas to take sworn witness testimony and compel the production of relevant documents necessary to establishing a factual basis for the alleged misconduct. These investigations usually involve circumstances where relevant information cannot readily be obtained through the normal supervisory process and that are more likely to result in a contested action.

### **Resolving Enforcement Actions**

The vast majority of the Federal Reserve's formal enforcement actions are resolved upon consent, which is fully consistent with the goal of resolving supervisory concerns with bank management quickly and firmly. In crafting enforcement actions that are entered by consent, the Federal Reserve typically sets out summary recitations of the relevant facts in "Whereas" clause provisions; however, like our fellow banking regulators, it has not been our practice to require formal admissions to the misconduct addressed in our enforcement orders given the remedial nature of our enforcement program. Requiring admissions of fact and legal conclusions as a condition of entering into a consent action is likely to have a deleterious effect on our supervisory efforts by causing more institutions and individuals to challenge the requested relief

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<sup>1</sup> 12 U.S.C. 1818(b)

<sup>2</sup> 12 U.S.C. 1818(e)

<sup>3</sup> See 12 U.S.C. 1818(i)

in contested administrative proceedings, which typically take years to reach final resolution, and which could delay implementation of necessary corrective action.

The enforcement authority of the Federal Reserve and the other banking agencies is different in significant respects from that of some other federal financial institution regulators. For example, in order to foster the soundness and stability of financial institutions and the nation's financial system, bank regulatory agencies must act quickly and effectively to address safety and soundness issues as well as potential violations of law. Moreover, safety and soundness concerns typically do not give rise to third-party claims and often require remedial action by banking institutions to address risks and conditions that are subjective in nature. Thus, the effectiveness of the regulatory framework established for financial institutions does not depend on actions brought by third parties to enforce their rights under the regulatory scheme.

Where an enforcement action cannot be resolved by consent, the Board may issue a formal notice of charges, which sets forth the factual basis for the remedy sought by the Board. The respondents named in the notice of charges in these cases are accorded the opportunity to answer the charges and request a formal hearing before an administrative law judge. Administrative hearings may be public and entitle the respondent to full and complete discovery of the information that forms the basis for the Federal Reserve's charges as well as the opportunity to present evidence at a formal trial-like hearing presided over by an administrative law judge. At the conclusion of the hearing, the administrative law judge will prepare a recommended decision including findings of fact and conclusions of law that is then presented to the Board for final adjudication and issuance of a final decision. Respondents may appeal the Board's decision to a federal court of appeals.

Only 11 of the nearly 1,000 enforcement actions taken by the Federal Reserve in the last decade were not resolved by consent. The Federal Reserve sought removal from banking of current or former institution-affiliated parties in eight of these contested cases, and sought compulsory cease-and-desist relief in the remaining three cases. Seven of the 11 cases went through the full administrative hearing process, while the remaining four were settled upon consent just prior to the scheduled administrative hearing. In the cases where a consent settlement was not reached, the contested action typically required an additional six months to two years to reach final resolution.

To the extent that there is noncompliance with one of our enforcement orders, we are statutorily authorized to apply to the appropriate federal district court for enforcement of the order.<sup>4</sup> The Federal Reserve also takes past conduct into account in determining both the level of enforcement action we will take and the type of corrective or punitive action we will require. Individuals who knowingly fail to comply with one of our final enforcement orders suspending them from office or prohibiting them from participation in the banking industry may be referred for criminal prosecution by the Department of Justice.<sup>5</sup>

### **Coordinating State and Federal Enforcement**

In the exercise of our enforcement authority, the Federal Reserve works closely with other state and federal banking regulators, as well as other state and federal law enforcement agencies, on enforcement matters that raise issues within their respective jurisdiction. These efforts have led to many successful coordinated enforcement actions with these agency counterparts.

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<sup>4</sup> 12 U.S.C. 1818(i)

<sup>5</sup> 12 U.S.C. 1818(j)

The Federal Reserve refers matters that come to our attention during the supervisory process to other appropriate federal and state agencies, including law enforcement authorities.<sup>6</sup> We also provide technical assistance to other federal and state law enforcement authorities where violations of criminal or other laws may occur within their jurisdiction involving our regulated institutions.

### **Conclusion**

The Federal Reserve's enforcement program serves the important purpose of addressing serious problems found in the normal course of our supervision and regulation of the financial institutions under our jurisdiction. It is a critical component of our authority to ensure safe and sound banking practices and enforce compliance with the banking laws.

Thank you for the opportunity to provide this information to the Committee. I would be happy to answer any questions you may have.

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<sup>6</sup> Historically, fair lending matters have been referred to the Department of Justice and fair housing violations have been referred to the Department of Housing and Urban Development. Now, most consumer law matters will be referred to the Consumer Financial Protection Bureau as provided by statute.