



**BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM**

WASHINGTON, D. C. 20551

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 90-36 (FIS)

November 29, 1990

**TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK**

**SUBJECT: Formal Enforcement Action Statement of Purpose and
Guidelines**

Background

A Task Force on Enforcement Actions, which was composed of representatives from the Federal Reserve Banks of New York, Minneapolis, Dallas and Atlanta, the Board's Legal Division and this Division, last year examined various issues relating to the Federal Reserve System's formal enforcement activities. Among other matters, the Task Force reviewed the outstanding written guidelines for formal enforcement actions that were described in a 1979 SR Letter (SR-512) and the way that the Federal Reserve has conducted its formal enforcement activities since the issuance of that SR Letter. The members of the Task Force concluded that the enforcement action policies set forth in SR-512 should be updated in order to describe more accurately the manner in which the Federal Reserve currently conducts its enforcement activities. The findings of the Task Force have subsequently been evaluated over the past year by the staffs of the Federal Reserve Banks, who were responsible for their Districts' enforcement actions, and reviewed by the Enforcement Section of this Division and the Board's Legal Division. The findings were also discussed and supported during the course of the recent enforcement action conference, which was held at the Board in September 1990.

Based on the work of the Task Force and subsequent staff efforts, updated guidelines for formal enforcement actions (the "Guidelines") and a recommended Statement of Purpose for such actions have been prepared. The Statement of Purpose and the Guidelines, which are more consistent with the current practices of the Division's Enforcement Section and the Federal Reserve Banks, are described below.

Statement of Purpose

Consistent with the Board's statutory authority to undertake formal enforcement actions, the Federal Reserve should use its enforcement powers, in a legally supportable manner, to (1) prevent

and, where possible, stop financial institutions and individuals subject to the Board's jurisdiction from engaging in unsafe or unsound practices or violations of applicable laws, rules and regulations; (2) ensure that appropriate corrective action programs are developed and used by problem financial institutions; (3) deter unsafe or unsound banking practices and law violations; (4) minimize losses to financial institutions and the Federal deposit insurance funds; (5) ensure that commitments made to the Federal Reserve and all Federal Reserve policy statements are complied with to the fullest extent possible by financial institutions and individuals; and (6) with respect to institution-affiliated parties, ensure that those who engage in abusive insider practices or misconduct or law violations are permanently barred from the banking industry, or fined, or both, for their malfeasance.

Guidelines for Formal Enforcement Actions Against State Member Banks, Bank Holding Companies, Other Financial Institutions and Institution-Affiliated Parties Subject to the Board's Jurisdiction

The current policy of determining, in significant part, whether informal (e.g., a memorandum of understanding) or formal (e.g., a written agreement or a cease and desist order) enforcement action should be undertaken against a State member bank or bank holding company based on the CAMEL or BOPEC rating of the institution is clarified by the Guidelines that are described below.

- (1) While a financial institution's less than satisfactory CAMEL or BOPEC rating could be a determinative factor, the following criteria should be used to determine whether a formal enforcement action recommendation is warranted, notwithstanding the financial condition of the bank or bank holding company and its composite rating:
 - (a) Formal enforcement action referrals to the Division's Enforcement Section by the Federal Reserve Banks should be made in all instances where examiners uncover instances of insider abuse or misconduct, or significant violations of laws, rules or regulations by institution-affiliated parties.
 - (b) Formal enforcement action referrals to the Division's Enforcement Section by the Federal Reserve Banks should be made in all instances where examiners find that the management of a financial institution is seriously deficient and the financial institution has unsatisfactory policies or procedures, or inadequate internal controls or recordkeeping systems in important areas of operations and the Federal Reserve Bank staff believes that the institution cannot be operated in a safe or sound manner or in compliance with applicable laws, rules or regulations. The lack of independent directors on the institution's board of directors or the failure of the board to monitor adequately the management of the bank or bank holding company should also be considered in connection with any analysis of management or directorate deficiencies.
 - (c) A formal enforcement action may, at the option of the Federal Reserve Bank, be referred to the Division's Enforcement Section and, with the appropriate Board staff approvals, be initiated in those instances where, even though the management and directorate of a financial

institution have voluntarily undertaken certain necessary corrective steps, the Federal Reserve Bank staff is of the opinion that a formal enforcement action focused only on those areas needing additional improvement or attention will benefit the financial institution by requiring some other corrective procedures or actions.

- (d) For financial institutions rated CAMEL or BOPEC composite "4" or "5", formal enforcement action recommendations do not necessarily have to be made to the Division's Enforcement Section if the problems of the institution were caused by losses or economic conditions beyond the control of the bank or bank holding company, or the management of either, an examination of the bank or an inspection of a holding company did not uncover any unsafe or unsound practice or violation of a law, rule or regulation, and the financial institution has already taken all of the types of prudent steps that the Federal Reserve Bank staff believes are necessary to correct or address all major problem areas. When a formal enforcement action is not being recommended for a composite "4" or "5" rated institution, supporting reasons should be discussed in the confidential section of an examination or inspection report.

(2) Formal enforcement actions against shell bank holding companies will normally not be required if the following four factors are evident:

- (a) The Federal or state regulator of the company's subsidiary bank has caused the bank to address its problems and has sufficiently insulated the bank.
- (b) The holding company has not engaged in any abusive transactions with its subsidiary bank, such as extracting excessive dividends or major violations of law (e.g., section 23A of the Federal Reserve Act).
- (c) The holding company has not issued any short-term obligations, such as commercial paper, to the public.
- (d) A complementary formal enforcement action would not further aid in effecting an appropriate corrective program for the subsidiary bank.

Notwithstanding the foregoing, significant or repetitive violations of the Bank Holding Company Act of 1956, as amended, or any other applicable law or regulation, or commitments made to the Federal Reserve should be addressed regardless of the fact that a violator is a shell bank holding company.

Conclusion

The foregoing Statement of Purpose and Guidelines concerning formal enforcement actions are meant to provide the staffs of the Federal Reserve Banks and the Board with a flexible framework for developing and processing recommendations for formal enforcement actions against financial institutions and individuals under the provisions of the Federal Deposit Insurance Act, as amended,

and the Bank Holding Company Act of 1956, as amended. These are internal guidelines for the use of the Federal Reserve System. They do not create or confer any substantive or procedural rights on third parties, which would be enforceable, in any manner, in an administrative or civil proceeding.

In the event that you have any questions concerning the Guidelines or the Statement of Purpose, please contact Herbert A. Biern, Assistant Director, at 202-452-2620.

signed by
Frederick M. Struble
Associate Director

Supersedes SR 79-512