An Assessment of Banking Agency Discretion
Under FDICIA's Prompt Corrective Action Provisions

Lori B. Morgan
J.D., Harvard Law School, 1994
Student I.D. 103858140

107 Holden Green
Cambridge, MA 12038, or
118 Elm Street
Birmingham, AL 35213

Presented to Professor Howell Jackson
In Fulfillment of the Written Work Requirement
at Harvard Law School

April 25, 1994
An Assessment of Banking Agency Discretion
Under FDICIA's Prompt Corrective Action Provisions

I. Introduction

In 1991, the United States Congress passed the Federal Deposit Insurance Corporation Improvement Act (FDICIA)\(^1\) in response to the crisis state\(^2\) of the federal insurance fund. Recognizing the need "to resolve the problems of insured depository institutions at the least possible long-term loss to the deposit insurance fund,"\(^3\) Congress created a new regulatory authority for banking agency\(^4\) enforcement actions to be taken against ailing institutions at the first sign of weakness.\(^5\) This system for early agency intervention, termed Prompt Corrective Action (PCA), forces the federal bank regulatory agencies to undertake certain measures to boost capital of troubled institutions. Thus, it is hoped that PCA will limit banks' risk of insolvency and the resulting insurance

\(^1\)Section 131 of FDICIA amended section 38 of the Federal Deposit Insurance Act, the primary legislation that governs regulatory enforcement actions against banking institutions. Federal Deposit Insurance Corporation Improvement Act, Pub. L. 102-242, Dec. 19, 1991.


\(^3\)12 U.S.C. 1831o(a)(1).

"The "appropriate federal banking agency" (AFBA) for national banks is the Comptroller of the Currency (OCC); for state banks that are members of the Federal Reserve system, the AFBA is the Federal Reserve Board (FRB); the FDIC regulates state banks that are not members of the Federal Reserve; and the Director of the Office of Thrift Supervision (OTS) regulates thrift institutions. 12 U.S.C. 1813q (Supp. II 1990).

fund exposure and taxpayer expense.\footnote{See Prompt Corrective Action, Rules of Practice for Hearings, 57 Fed. Reg. 44866, 44874 (1992) ("The system enacted in section 38 is based on Congress’s belief that prompt action must be taken to resolve problems at insured depository institutions at an early enough stage to minimize costs to the federal deposit insurance funds, and ultimately the taxpayer.").}

By establishing self-executing provisions to control capital outflow from troubled institutions, the PCA framework provides a certain measure of protection. By requiring mandatory agency actions once capital levels fall, PCA ensures a minimum level of agency response. The statutory mandate of agency action has drawn criticism from banking experts that agency discretion has been limited in favor of forced regulation.\footnote{See, e.g., Thomas P. Vartanian, et al., FDICIA Has Important Implications For Bank and Thrift Board Rooms, Banking Policy Rep. Vol. 11 No. 6 at 1, 13 (1992) (stating that "Congress, apparently dissatisfied with the agencies’ approach to supervising troubled depository institutions, has largely stripped regulators of their discretion for dealing with such institutions.").} In fact, the nature of agency actions newly authorized by PCA authority allows broad agency discretion. PCA provisions allowing swift action and informal, internal decision-making represent a departure from the procedural requirements of other agency enforcement actions, a change that grants drastic powers to regulators.

This paper will attempt to assess the activities of the federal banking agencies under the radical prompt corrective action provisions of FDICIA as compared to traditional federal enforcement
Morgan, Banking Agency Discretion Under PCA

procedures against financial institutions.\(^8\) The analysis will focus on the nature of the actions permitted under prompt corrective action, the degree of agency discretion involved, and the agencies' interpretations of their jurisdiction, in light of varying judicial authority and procedural differences between prompt corrective action and the old administrative structure.

Part II will provide an overview of traditional agency enforcement authority, summarizing informal and formal mechanisms for agency control over financial institutions. Parts III and IV will explain the new PCA system of capital categories and corresponding agency actions that are triggered by capital levels, assessing the degree to which enforcement depends upon agency interpretation and initiative. Part V will focus on the procedural

\(^8\)Only a few scholarly works have examined aspects of PCA. See Howell E. Jackson, The Expanding Obligations of Financial Holding Companies, 107 Harv. L. Rev. 507, 536 (discussing holding company guarantee of capital restoration plans under PCA); Lissa Lamkin Broome, Redistributing Bank Insolvency Risks: Challenges to Limited Liability in the Bank Holding Company Structure, 26 U.C. Davis L. Rev. 935 (1993); Stuart D. Root, Bank Capital, Asset Liquidation, and the Credit Crunch, 1993 Colum. Bus. L. Rev. 169 (addressing depressed asset values and credit crunch resulting from "liquidation" approach of PCA).

Most treatments of PCA have been directed toward practitioners or institutions. Their approach has been primarily to summarize the law rather than to analyze it. See, e.g., FDIC Improvement Act of 1991: What Banks and Thrifts Need to Know Now (PLI, 1992) [hereinafter What Banks and Thrifts Need to Know Now] (collecting articles or outlines by practitioners or, in a few instances, by regulators); The New Implementing Regulations Under FDICIA (William P. Bowden, et al., eds., P-H 1992) (same); Litigating For and Against the FDIC and the RTC 1992 (Howard N. Cayne & Michael S. Helfer, eds. 1992) (same); Civil and Criminal Liability of Bank Directors, Lawyers and Accountants in the 1990s (Warren L. Dennis & Faith S. Hochberg, eds. PLI, 1992) (same).
aspects of PCA decision-making, considering various criticisms of its informality.

Following this overview of traditional and PCA enforcement, Part VI contrasts actions under the PCA framework with some corresponding traditional enforcement activities, concentrating on the level at which decisions are made, the timing of agency action, and the availability of review. Part VII will address some overarching concerns from constitutional and administrative law arguments for protections against radical agency action. In conclusion, Part VIII will suggest the appropriate limits of agency authority to take prompt corrective action.

II. Traditional Enforcement Mechanisms as a Backdrop for Prompt Corrective Action

The prompt corrective action provisions of FDICIA became effective in December, 1992⁹ against the backdrop of traditional enforcement authority, previously fortified by the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) in 1989.¹⁰ Because FDICIA's PCA scheme supplements existing agency authority rather than replacing it,¹¹ a review of the FDIA

⁹See Pub. L. 102-242 s 131(f).


¹¹See 12 U.S.C. s 1831o(m) (Other authority not affected) ("[t]his section does not limit any authority of an appropriate Federal banking agency, the Corporation, or a state to take action in addition to (but not in derogation of) that required under this
enforcement mechanisms, as strengthened by FIRREA, is an appropriate starting point for analysis of FDICIA PCA authority.

Generally, agency enforcement activity against financial institutions falls into two categories based on the degree of formality of the agency action and any agreement that results. Informal agency actions may prove to be quite powerful controls on institutions because of the speed and the flexibility of implementation and the obvious lack of procedural safeguards. Informal agency enforcement commonly occurs when regulators force institutions seeking agency approval for some activity\textsuperscript{12} to comply with agency mandates, which may be unrelated to the needed approval. Agencies also force compliance more overtly by requiring board resolutions, commitment letters, memoranda of understanding, and other written memorializations of corrective measures or commitments to future compliance with agency demands or with statutory requirements. These informal actions may address a range of supervisory concerns quickly and quietly, at times enabling agencies to win more concessions\textsuperscript{13} than in formal public section.

\textsuperscript{12}An institution may seek agency approval for chartering or for opening a new branch or a new line of business. See Jonathan R. Macey & Geoffrey R. Miller, Banking Law and Regulation 591 (1992).

\textsuperscript{13}For a discussion of relative bargaining leverage of banking agencies and institutions, see Alfred C. Aman, Jr., Bargaining for Justice: An Examination of the Use and Limits of Conditions by the Federal Reserve Board, 74 Iowa Law Rev. 837 (1989).
Morgan, Banking Agency Discretion Under PCA

proceedings.\textsuperscript{14} Formal enforcement mechanisms are those provided by statutory authority. The most common of enforcement tools is the cease and desist order under 12 U.S.C. 1818(b). These are formal, written orders that may be negotiated by consent or instituted by formal proceedings in which the agency files a notice of charges and the respondents may invoke a right to an agency hearing before an Administrative Law Judge (ALJ). The ALJ may make findings and issue a recommendation to the agency, which may then issue a cease and desist order.\textsuperscript{15} The agency's decision is reviewable by a federal Court of Appeals under the standards set forth in the Administrative Procedure Act (APA).\textsuperscript{16} Cease and desist orders require institutions to cease actions such as extension of further credit to insiders in violation of the law and violation of consumer protection laws. They may also require institutions to take actions such as charging off assets classified as losses, adopting written loan policies, raising new capital, discharging managers and hiring new management under agency approval,

\textsuperscript{14}Even informal written agreements are powerful enforcement tools. They draw the attention of an institution's top management to its commitments. Violation of these written agreements provides an independent basis for a formal cease and desist order, see Macey and Miller, supra note 12, at 593, and may even subject bank officers to removal actions under 12 U.S.C. 1818(c).

\textsuperscript{15}See 12 U.S.C. 1818(b).

\textsuperscript{16}See 5 U.S.C. 706.
rectifying unsafe or unsound practices, or taking any actions designed to remedy violations of law.\textsuperscript{17}

Even before a cease and desist order is issued, if a banking agency determines that an institution's conduct is "likely to cause insolvency or significant dissipation of assets or earnings of the bank, or is likely to weaken the condition of the bank or otherwise prejudice the interests of its depositors," a temporary cease and desist order may be effected immediately, without a prior hearing.\textsuperscript{18} The temporary order remains effective until the completion of permanent cease and desist proceedings or until the order is limited or set aside by a federal district court upon application by the institution.\textsuperscript{19}

Agencies also exert enforcement authority over institutions by exercising control over personnel in informal\textsuperscript{20} and formal actions.

\textsuperscript{17}12 U.S.C. 1818(b)(6) - (8); see Macey and Miller, supra note 12, at 596.

\textsuperscript{18}12 U.S.C. 1818(c). While a temporary order may force an institution to take any affirmative relief, including any preventive or corrective action within conventional cease and desist power under 12 U.S.C. 1818(b)(6), recent disputes over temporary cease and desist authority have concerned the successful freezing of assets of institution-affiliated parties at the commencement of enforcement proceedings. See, e.g., Paul v. OTS, 763 F.Supp. 568 (S.D. Fla. 1990), Aff'd without opinion, 948 F.2d 1297 (11th Cir. 1991) (enforcing OTS temporary order).

\textsuperscript{19}12 U.S.C. 1818(c).

\textsuperscript{20}Informal agency authority over institutions may be exercised by an agency's refusing to grant a charter unless an individual is excluded from management or by an agency's preventing the hiring of an individual. See Macey & Miller, supra note 12, at 605.
Morgan, Banking Agency Discretion Under PCA

Formal proceedings for supervision, removal, and prohibition from office of institution-affiliated parties, including directors, officers, and other employees, may be instituted under 12 U.S.C. 1818(e). Generally, the appropriate agency will act to remove and prohibit an institution-affiliated party from further participation in the affairs of any insured institution if the agency finds 1) activity in violation of law, regulation, or agreement; participation in an unsafe or unsound practice; or breach of fiduciary duty; 2) resulting financial loss or other damages, and 3) personal dishonesty or willful or continuing disregard for the institution's safety and soundness.\(^{21}\) Upon this agency determination, the agency must issue a notice of charges and hold an administrative hearing. The findings of the ALJ may be appealed to a full agency hearing and are ultimately subject to judicial review in a federal Court of Appeals.\(^{22}\) While an order is in effect, an affected individual may not participate in the affairs of an insured depositary institution.\(^{23}\) Related actions include a temporary suspension or removal order\(^{24}\) of an IAP and suspension

\(^{21}\)12 U.S.C. s1818(e)(1).

\(^{22}\)12 U.S.C. 1818(h)(2).

\(^{23}\)12 U.S.C. 1818(e)(1).

\(^{24}\)12 U.S.C. 1818(e)(3) provides for emergency suspension of an IAP, effective on service of written notice until the agency disposes of the underlying charges.
of persons charged with certain felonies.\textsuperscript{25} Agency leeway to control personnel is permitted because fraud, mismanagement, and insider abuse are recognized factors in bank failures and because the agencies are considered to be well-qualified to judge the potential performance of individuals.\textsuperscript{26} Thus, the agencies have greater ability to regulate institutions in order to protect depositors and the insurance funds.

To further this enforcement goal, FIRREA expanded the agencies' authority to impose civil money penalties (CMPs) upon financial institutions and IAPs. A three-tier penalty structure in 12 U.S.C. 1818(i)(2) divides offenses punishable by CMPs into violations of law or agreement invoking maximum penalties of $5000 per day; violations that are part of a pattern of misconduct, cause loss to the institution or gain to the individual invoking maximum penalties of $25,000 per day; and knowing violations that cause substantial loss to the institution or gain to the individual invoking a maximum penalty of $1 million per day.\textsuperscript{27} The process for assessing a CMP begins under agency practice of issuing a "15-day letter" requesting information from the affected party within

\textsuperscript{25}12 U.S.C. 1818(g)(1)(A) provides for suspension of persons charged with federal felonies involving "dishonesty or breach of trust..." Individuals so charged have a right to an administrative hearing in 30 days, and a non-reviewable agency decision within 60 days after the hearing. 12 U.S.C. s1818(g)(3).

\textsuperscript{26}Macey & Miller, supra note 12, at 605.

\textsuperscript{27}12 U.S.C. 1818(i)(2).
Morgan, Banking Agency Discretion Under PCA

15 days.\textsuperscript{28} The agency gives written notice of the penalty, which becomes an order if the respondent does not request an administrative hearing. The agency decision is reviewable by a federal Court of Appeals.\textsuperscript{29} Agencies have released CMP "matrices" and policy statements regarding determination of CMPs and the impact of various factors in agency determinations,\textsuperscript{30} emphasizing overall the deterrence rationale for CMP policy.

A more corrective measure is the capital directive authority from the International Lending Supervision Act of 1983 (ILSA).\textsuperscript{31} Section 3907 allows an AFBA to establish minimum levels of capital for institutions\textsuperscript{32} and to enforce these levels by issuing directives often requiring infusion of capital or a plan for achieving capital levels.\textsuperscript{33} Directives are enforceable under the

\textsuperscript{28}This represents informal agency practice and is not found in statute. See Michael S. Helfer & Stuart Cane, Enforcement Actions Against Banks and Thrifts in FDIC Improvement Act of 1991: What Banks and Thrifts Need to Know Now, supra note 8, at 197.

\textsuperscript{29}12 U.S.C. 1818(h) provides for judicial review of "any hearing provided for in" section 1818, necessarily including the agency hearing explicitly provided in 12 U.S.C. 1818(i).

\textsuperscript{30}See OCC Banking Circular BC-253, Civil Money Penalties and Attachments (Apr. 8, 1991); OCC Policies and Procedures Manual 5000-7; Office of Thrift Supervision Regulatory Bulletin RB 18-3 (June 18, 1990), reprinted in What Banks and Thrifts Need to Know Now, supra note 8, at 237 - 78.

\textsuperscript{31}12 U.S.C. s3907.

\textsuperscript{32}12 U.S.C. s3907(a)(1).

\textsuperscript{33}Id. s(B)(i).
provisions of section 1818(i) in federal district court. \textsuperscript{34} Before issuing a directive, an AFBA must issue a notice detailing its intent and the data used in its determination. \textsuperscript{35} An institution may respond within 14 days, explaining why a directive should not issue and including any relevant evidence. \textsuperscript{36} The AFBA makes a final determination based on these written submissions and may direct the bank to raise capital before a certain date, to submit a plan for achieving minimum capitalization, or to take other action. \textsuperscript{37} In spite of only minimal procedural protections, these orders have been upheld by courts. \textsuperscript{38}

Perhaps the harshest penalty for an ongoing banking business is FDIC ability to suspend or withdraw deposit insurance may be the "death knell" of an institution. The FDIC Board of Directors may commence the process of terminating deposit insurance under 12 U.S.C. 1818(a)(2) if it finds unsafe or unsound practices in conducting the business of the institution, that the institution is in an unsafe or unsound condition, or a violation of law,

\textsuperscript{34} 12 U.S.C. s3907(b)(2)(B)(ii).

\textsuperscript{35} See 12 C.F.R. s325.6(c)(1) (FDIC).

\textsuperscript{36} Id. s (c)(2).

\textsuperscript{37} Id. s (c)(3).

\textsuperscript{38} See FDIC v. Bank of Coushatta, 930 F.2d 1122 (5th Cir. 1991) (holding that agency decision was not reviewable because it was committed to agency discretion by statute).
regulation, or agreement. After first alerting an institution's regulating agency of the violation so that it may attempt to enforce the correction of the violation, the FDIC may issue a notice and conduct a hearing by the Board of Directors or its designee, pursuant to APA procedure and subject to judicial review. If an order issues against an institution, subsequent deposits to new and existing accounts are not insured, and current deposits are insured for a limited period of time.

Other agency actions that may function as enforcement tools for deterrent or corrective effect are civil litigation, commonly conducted by the agency as receiver acting for the institution against parties that have contracted with the institution and criminal penalties against IAPs. Overall, this range of agency enforcement tools has been adapted through recent decades to combat specific supervisory problems. It provides a setting for the following discussion of the new PCA framework.

44 This period may vary from six months to two years at the discretion of the FDIC Board of Directors. 12 U.S.C. 1818(a)(7).
45 See Macey & Miller, supra note 12, at 620 - 22.
46 See id. at 623 - 24 (listing statutory prohibitions).
III. Prompt Corrective Action: A Capital-Based Approach

Building on these pre-existing enforcement authorities, the Prompt Corrective Action (PCA) system sets out specific agency actions triggered by an institution's capital levels. Part III of this paper examines some aspects of the capital-based system, including the interplay between the statutory and agency treatment of capital categories and some criticisms of the capital-based approach. Recognizing that capital was a principal indicator of weakness, Congress provided by statute that institutions be placed in five capital categories, from well-capitalized to significantly undercapitalized.\textsuperscript{47}

FDICIA section 131(c)(2) required each Federal banking agency to designate capital measures, including a leverage limit and a risk-based capital requirement,\textsuperscript{48} and to establish minimum capital levels for each category,\textsuperscript{49} leaving the agencies with considerable license to shape the system. While the statute does specifically limit the agencies' discretion to set leverage limits,\textsuperscript{50} other

\textsuperscript{47}12 U.S.C. 1831o(b)(1).

\textsuperscript{48}12 U.S.C. s1831o(c)(1).

\textsuperscript{49}12 U.S.C. 1831o(c)(2).

\textsuperscript{50}Each agency must specify a ratio of "tangible equity" to total assets at which an institution will be critically undercapitalized, requiring tangible equity in an amount not less than two per cent of total assets but not greater than 65 per cent of the "the required minimum level of capital under the leverage limit," and absent FDIC consent, not less than that specified for
Morgan, Banking Agency Discretion Under PCA

required measures and even the introduction of new measures are left to agency discretion. In fact, the statute states that

an appropriate Federal banking agency may, by regulation (i) establish any additional relevant capital measures to carry out the purpose of this section; or (ii) rescind any relevant capital measure required...upon determining (with the concurrence of the other Federal banking agencies) that the measure is no longer an appropriate means for carrying out the purpose of this section. 51

This latitude to add or discard capital measures, while it may never be exercised, gives a powerful license to the agencies. As the federal banking agencies are subject to perennial economic and political pressures, 52 the power to regulate capital measures gives agencies an ability to control the volume of institutions that will fall into the lower capital categories and thus become subject to agency sanctions. As certain statutory measures under PCA are automatic, and require no agency action, 53 any regulatory changes that establish more stringent capital measures would affect institutions, even in an environment of regulatory forbearance. Of course, agencies could also bow to political winds to abandon certain capital measures. It is certain that capital measures will

state member banks by the FDIC. 12 U.S.C. 1831o(c).

51 12 U.S.C. 1831o(c)(1)(b).


53 See Part IV.A. infra.
be reexamined as industry and regulatory conditions change.\textsuperscript{54}

In addition to agency power over the capital measures instituted by PCA, a more basic regulatory authority allows bank examiners to control the measured capital of the institution by "writing down" loans that examiners consider to be doubtful. Thus, if examiners take an aggressive stance, the capital of the bank will be lower for purposes of determining PCA capital categories. While the individual examiners are not the agency personnel who will be responsible for guiding PCA enforcement actions, their participation in an aggressive regulatory environment will have a fundamental determinative effect on the capital category status of institutions. One commentator has noted that dependence on supervisory decisions on asset classifications renders the objectivity of the capital categories "illusory."\textsuperscript{55}

While agency latitude to set and reset capital measures and levels seems broad, the agencies' final rules adopt the categories currently used under agency capital adequacy guidelines.\textsuperscript{56} Thus,

\textsuperscript{54}See 57 Fed. Reg. 44866, 44870. The Final Rules state that "[t]he agencies intend to lower or eliminate the leverage capital component from the definitions of 'well-capitalized,' 'adequately capitalized,' and 'undercapitalized'" after risk-based capital standards have been revised to accommodate interest-rate risk as required by FDICIA "and after experience has been gained with such standards." Id. Commenters on the proposed rules reportedly supported such reconsideration. Id.


\textsuperscript{56}See, e.g., 12 C.F.R. s3.1 et seq., (OCC).
Morgan, Banking Agency Discretion Under PCA

under current regulations, an institution will be assigned to one of the following capital categories:

1. **well-capitalized** if the institution has a total risk-based capital ratio of 10 percent or greater, a Tier 1 risk-based capital ratio of 6 percent or greater, and a leverage ratio of 5 percent or greater, and the institution is not subject to an order, written agreement, or capital directive, or prompt corrective action directive to meet and maintain a specific capital level for any capital measure;

2. **adequately capitalized** if the institution has a total risk-based capital ratio of 8 percent or greater, a Tier 1 risk-based capital ratio of 4 percent or greater, and a leverage ratio of 4 percent or greater (or a leverage ratio of 3 percent or greater for composite 1 rated institutions that are not anticipating significant growth), and the institution does not meet the definition of well-capitalized;

3. **undercapitalized** if the institution has a total risk-based capital ratio that is less than 8 percent, a Tier 1 risk-based capital ratio that is less than 4 percent, or a leverage ratio that is less than 4 percent or greater, (or a leverage ratio that is less than 3 percent for composite 1 rated institutions that are not anticipating significant growth);

4. **significantly undercapitalized** if the institution has a total risk-based capital ratio that is less than 6 percent, a Tier 1 risk-based capital ratio that is less than 3 percent, and a
Morgan, Banking Agency Discretion Under PCA

leverage ratio that is less than 3 percent;
5. critically undercapitalized if the institution has a ratio of
tangible equity to total assets that is equal to or less than 2 percent.\textsuperscript{57}

It is true that commenters supported strongly the adoption of
capital levels like those in capital adequacy guidelines as a means
of reducing the burden and complexity of the system,\textsuperscript{58} which
depends in some aspects on institutions' awareness of their capital
level designation.\textsuperscript{59} While the certainty in applying a familiar
system comforts institutional leaders, the replication of current
capital adequacy standards in the PCA framework subjects it to the
common criticisms of the capital adequacy guidelines.\textsuperscript{60} In
particular, the common complaint against a capital-dependent
enforcement system, that capital is a lagging indicator of

\textsuperscript{57}See, e.g., 12 C.F.R. s6.4 (OCC). Cf. 12 C.F.R. s3.1 et seq.,
(OCC) (capital adequacy guidelines).

\textsuperscript{58}57 Fed. Reg. 44866, 44870 - 71.

\textsuperscript{59}See, e.g., 12 C.F.R. s6.3 (OCC). The regulations state that
the effective date of determination of a capital category is the
date that the bank is notified of, or is deemed to have notice of
its capital category. A bank is deemed to be notified as of the
most recent date that a Consolidated Report of Condition and Income
(Call Report) is required to be filed by the OCC or written notice
is provided by the OCC to the bank. Banks must give written notice
of adjustment of reported capital levels within 15 days of a
material event that would cause the bank to be placed in a lower
capital category.

\textsuperscript{60}See Macey & Miller, supra note12, at 284 - 88 (discussing
problems of defining capital ratios and controversy over which
capital ratios to apply for various institutions).
institutional weakness,\textsuperscript{61} casts doubt on the entire PCA structure, which is aimed at the earliest possible detection and correction of problems. At any rate, the capital-based system allows agencies to determine fundamental aspects of the triggers to agency action, rather than just determining appropriate action once the agency is alerted to a problem.

Capital measures purportedly serve as the trigger to agency action, yet the statute allows the agencies to dispense with the capital basis for their action. While on a macro level the agencies set the measurements for capital levels, even after supposedly empirical capital categories are established, agencies have authority to treat an institution as though it were in a lower capital category. In the case of a well-capitalized institution, the statute allows reclassification to the adequately capitalized category.\textsuperscript{62} For adequately capitalized or undercapitalized institutions, the statute basically allows agency treatment as if the institution were in the next lower category.\textsuperscript{63} The impact is

\textsuperscript{61}See Carnell, \textit{supra} note 52, at text accompanying n.109, 175.

\textsuperscript{62}12 U.S.C. \textsection1831o(g)(1)(A).

\textsuperscript{63}12 U.S.C. \textsection1831o(g)(1)(B) (stating that the agency may "if the institution is adequately capitalized (but not well capitalized), require the institution to comply with 1 or more provisions of subsections (d) and (e) of this section [specifying actions against all institutions and undercapitalized institutions], as if the institution were undercapitalized"); \textit{id}, \textsection1831o(g)(1)(B) (stating that the agency may "if the institution is undercapitalized, take any one or more actions authorized under subsection (f)(2) of this section [Provisions applicable to significantly undercapitalized institutions and undercapitalized

18
Morgan. Banking Agency Discretion Under PCA

most significant for adequately capitalized institutions subject to downgrade, as agencies may reach the sanctions applicable to a lower level only through this reclassification process.\textsuperscript{64} This downgrade in treatment is appropriate where the AFBA "determines (after notice and an opportunity for hearing) that an insured depository institution is in an unsafe or unsound condition or, pursuant to [12 U.S.C. s1818(b)(8)] deems the institution to be engaging in an unsafe or unsound practice."\textsuperscript{65} Section 1818(b)(8) was amended by FDICIA to provide that an institution may be deemed to be engaged in an unsafe or unsound practice if the institution has received a less-than-satisfactory rating in its most recent examination report for assets, management, earnings, or liquidity,\textsuperscript{66} and the institution has not corrected the

---

\textsuperscript{64}There is no general authority to take actions against adequately capitalized institutions that are available for lower categories. For institutions that already fall in the undercapitalized category, discretionary authority to take actions reserved for lower categories when the AFBA determines that those actions are necessary to carry out the purposes of PCA. See Julie L. Williams, The New Prompt Corrective Action Supervisory System 5, n.17, in The New Implementing Regulations Under FDICIA, supra note 8, at 355, 360. See also infra Part IV.B.

\textsuperscript{65}12 U.S.C. s1831o(g)(1).

\textsuperscript{66}For savings associations, the relevant categories are the management, assets, risk, and operations components of the MACRO rating. See 57 Fed. Reg. 44866, 44876 n.10.
deficiency.\textsuperscript{67}

While the statutory language suggests that an opportunity for hearing is required only for findings of an unsafe or unsound condition, agency regulations do provide for informal hearings for findings on institutional condition and specific practices.\textsuperscript{68} Agency discretion to use this vehicle for prompt corrective action is thus limited by separate legislation and by administrative precedent on safety and soundness.\textsuperscript{69}

Under one reading of the statute and regulations, internal agency restraint is evident, as is a suggestion of forbearance: the agencies recognize that "reclassification of an institution based on an examination rating is not an automatic result of receiving an unsatisfactory rating. Instead, each agency retains discretion to initiate the procedures for reclassification and will do so based on the facts of each case."\textsuperscript{70} Furthermore, the agencies have characterized the statute as stating that agencies \textit{may} take actions authorized for lower capital categories, but does not mandate the


\textsuperscript{68}57 Fed. Reg. 44866, 44877. \textit{See} Part V.C. \textit{infra}.


\textsuperscript{70}57 Fed. Reg. 44866, 44877.
actions once an institution is reclassified. 71 Thus, forbearance is possible.

Under another reading of the statute, the agency position reflects confusion: it seems illogical that the reclassification procedure would exist if it did not trigger sanctions, particularly the mandatory ones. One may ask why the agencies would assert that mandatory measures would not enter into effect automatically, as they do when capital levels fall. If the reclassification procedure is separate from the agency decision to take measures, even "mandatory" ones, the real penalty for institutions comes after a reclassification, when agencies decide whether sanctions are to apply. The statute and rules, of course, give no guidance for this decision, so agency discretion reigns. While it seems counter-intuitive that agencies would not want sanctions to apply automatically, this interpretation may actually give agencies greater leverage to extract consent for certain measures from institutions, as it increases uncertainty for institutional leaders, who may fear the unknown.

Successful agency reclassification of an institution based on supervisory criteria other than capital has far-reaching effects,

71 Id. The final rules state that "no restrictions or requirements become effective automatically as a result of reclassification. As commenters noted, section 38 does not make institutions that are reclassified immediately subject to the mandatory provisions of section 38. Instead, section 38 authorizes the appropriate agency, in its discretion, to impose requirements or proscriptions contained in section 38." Id.
as the range of PCA mandatory and discretionary sanctions grows dramatically through the lower capital categories. It is worth noting that the corrective sanctions available under the PCA framework may be unrelated to, and may reach far beyond, the practice or condition that prompted reclassification. Thus, the reclassification authority has potential as a threat or a club for agency enforcement.

In sum, there are obvious dangers inherent in the PCA capital approach. Its reliance on a capital-based system may neglect other factors in bank failures, treating the symptom rather than the cause of problems. Its specific supervisory actions become available only after capital levels fall, facilitating prompt action only after problems have damaged the capital structure of the institution. Further, the system may be overinclusive, forcing or enabling regulators to take harsh actions that may not be warranted in all cases. Congress’s attempt to describe a general system of capital categories has paved avenues for potential agency manipulation and abuse.

IV. Agency Actions based on capital categories.

The five capital categories, as the primary basis of agency enforcement decisions under the prompt corrective action framework, trigger specific actions designated by statute. Many actions have a fundamental effect on institutional structure and business practices, raising concerns over agency implementation of the
statutory system. Generally, agency regulations merely affirmed the applicability of the substantive actions listed in the statute, leaving few questions of agency freedom in interpreting the substance of the statutory provisions. Nevertheless, the harshness of measures authorized by statute raises concerns over when agencies will seek to apply them and how agency actions will be pursued. Part IV details, for each capital level, the mandatory or discretionary actions available, considering the degree to which enforcement depends on agency discretion or initiative.

A. Statutory Provisions Applicable to All Institutions.

The PCA framework imposes some strictures on the activities of all depository institutions. By statute, no institution\(^\text{72}\) may make a capital distribution,\(^\text{73}\) including payment of dividends, or pay a management fee\(^\text{74}\) to a person in control\(^\text{75}\) of an institution if, 

\(^{72}\)Institution means insured depository institution.

\(^{73}\)A capital distribution is defined as a distribution of cash or property to an owner, including redemptions, but not including a stock dividend. 12 U.S.C. 1818o(b)(2)(B).

\(^{74}\)Management fees include payments for management services or advice other than as compensation as an officer or employee of the institution. They do not include payments for non-managerial services such as property management. See 57 Fed. Reg. 44866, 44881.

\(^{75}\)A person with control of an institution is defined as one who owns or controls 25 percent or more of the institution's voting securities, controls the institution's board, or otherwise exercises controlling influence over management or policies. 12 U.S.C. 1841(a)(2).
after the payment, the institution would be undercapitalized, falling into one of the lower three capital categories.\textsuperscript{76} Notwithstanding the general prohibition on capital distributions, the AFBA, in consultation with the FDIC, may authorize a redemption of shares or ownership interest made in connection with the issuance of additional shares which reduces the institution's financial obligation or otherwise improves the financial condition of the institution.\textsuperscript{77} As an institution is deemed to be aware of its own capital level\textsuperscript{78} and hence of the amount of permissible distributions before reaching the undercapitalized levels, this subsection functions as a guideline for preventative institutional self-enforcement.

B. Statutory Provisions Applicable to Undercapitalized Institutions

Any institution that becomes undercapitalized\textsuperscript{79} is immediately subject to certain agency sanctions by statute. The agencies have recognized these as "mandatory supervisory actions,"\textsuperscript{80} designating them as ones that agencies must take as minimum corrective action.

\begin{footnotes}
\item[76] 12 U.S.C. 1818o(d)(1), (d)(2).
\item[77] 12 U.S.C. 1818o(d)(1)(b).
\item[78] See, e.g., 12 C.F.R. s6.3 (OCC).
\item[79] Undercapitalized institutions include significantly and critically undercapitalized institutions.
\item[80] E.g., 12 C.F.R. s6.6(a)(2) (OCC).
\end{footnotes}
Of course, while the agencies must enforce these provisions, a fact that likely appeases those who fear regulatory forbearance, there remains much leeway in the degree of intrusiveness of agency action.

First, the institution becomes subject to increased monitoring by the AFBA, which must closely monitor the institution's condition, closely monitor compliance with capital restoration plans or prompt corrective action requirements, and periodically review the institution's efforts to restore its capital.81 Regulations offer guidance on agency review of institutions subject to special monitoring.82

Second, an undercapitalized institution must submit a capital restoration plan that meets statutory requirements and agency approval.83 The plan must detail the institution's activities and efforts to become adequately capitalized and to comply with prompt corrective action demands, setting forth the institution's projected capital level for each year of the plan.84 The statute has attempted to guide agency decisions on accepting a plan,

81 12 U.S.C. 1831o(e)(1)(A) - (C).
82 Monitoring will include review of institutional reports, periodic examinations, and "informal discussions" between regulators and the institution. The agencies may discuss revisions of an institution's capital plan, and "elimination of restrictions that are no longer needed as an institution" improves. 57 Fed. Reg. 44866, 44881.
83 See 12 C.F.R. s6.5 (OCC).
84 12 U.S.C. s1831o(e)(2)(B).
Morgan, Banking Agency Discretion Under PCA

dating that the AFBA may not approve a plan unless it determines that the plan: (a) is based on realistic assumptions and is likely to succeed,85 (b) would not appreciably increase the institution's risk exposure,86 and (c) provides for guarantees by "each company having control of the institution."87 These criteria are necessarily subjective: the agencies must even judge the "realism" of a plan and its chances for success. As institutions are advised to consult with agencies while they are developing their proposed plans,88 it is likely that agencies will use this opportunity to negotiate restrictive plans. Institutions will be loath to submit any plan that has not received tacit approval, and their opportunity for "back and forth" negotiations and exchanges with the agency will be bound by the time constraints for their official

---

85 Id. at (e)(2)(C)(ii).

86 Id. at (e)(2)(C)(iii).

87 Id. at (e)(2)(C)(ii). See id. at (e)(2)(E) (guarantee liability limited); see also 57 Fed. Reg. 44879 (clarifying control company liability and specifying that control company liability under PCA is independent of liability under 12 U.S.C. 1818e and does not supersede any capital maintenance agreement). The issue of a control company guarantee is reportedly a current topic of discussion at the agencies. Telephone interview with OCC personnel (Mar. 24, 1994).

88 See 57 Fed. Reg. 44866, 44878 (stating that "it is important that an undercapitalized institution discuss the development of its capital restoration plan with the appropriate banking agency during the period that the plan is being developed").
Morgan. Banking Agency Discretion Under PCA

submission.\textsuperscript{89}

An authority affirms that "[a]pproval of a plan is one of the most crucial exercises of regulatory judgement" under PCA.\textsuperscript{90} While agencies will presumably use their experience with institutional risk factors in determining whether a plan should be accepted, it is possible that here, as in any agency decision, an individual or a group of decision-makers biased by some policy or experience will make a decision on a subjective basis.

This problem is amplified because the costs to an institution of submitting an unacceptable plan are great: an undercapitalized institution that fails to submit an acceptable plan is subject to the mandatory restrictions on a significantly undercapitalized institution, thus adding a restriction on an institution’s ability to pay bonuses or salary increases to senior executive officers.\textsuperscript{91} Even more alarming, the agency may subject the institution to discretionary actions available against significantly undercapitalized institutions. Indeed, the agencies have stated that they are permitted to take, and must consider taking, a number of additional discretionary actions in connection with the institution [that fails to submit an acceptable capital restoration plan]. In determining whether to exercise its

\textsuperscript{89}An institution must file a written capital restoration plan within 45 days of becoming undercapitalized. \textit{E.g.} 12 C.F.R. s6.5 (OCC).

\textsuperscript{90}Carnell, \textit{supra} note 52, at text accompanying n.127.

\textsuperscript{91}12 U.S.C. 1831o(f).
discretion to take additional supervisory actions, the agencies believe that they may consider...factors...including events that have occurred after submission of the original plan, the efforts of management to devise a realistic and acceptable plan, and other factors.\textsuperscript{92}

The agencies' apparent willingness to negotiate once an institution has failed to submit an acceptable capital restoration plan in the allowed time frame and their appreciation of management efforts to cooperate appear to be designed to appease critics.\textsuperscript{93} In fact, they underscore the degree of informality and agency leeway in the determination of an acceptable plan. They reflect and, indeed, perpetuate agency leverage over troubled institutions. Institutions are also compelled to implement an accepted plan, even if it was crafted and forced on them by an agency: failure to implement approved plan subjects the bank to civil money penalties pursuant to sec. 8(i)(2)(A) of the FDI Act. The agencies' leverage is complete.

Third, undercapitalized institutions are subject to restrictions on growth of the institution's total assets, requiring consistency with an accepted plan and certain ratios of tangible equity to assets,\textsuperscript{94} and restrictions on acquisitions, branching, and new lines of business without prior AFBA approval.\textsuperscript{95} Thus,

\textsuperscript{92}57 Fed. Reg 44866, 44879.

\textsuperscript{93}See id. (commenters' reported concerns).

\textsuperscript{94}12 U.S.C. s1831a(e)(3).

\textsuperscript{95}Id. at (e)(4).
basic institutional operations become subject to specific agency approval and are not possible without an institution's first receiving approval for a capital restoration plan. Ultimately, an institution's need for approval for asset growth or new activities may provide added leverage for an agency's negotiating a restrictive capital restoration plan.

Finally, an AFBA may take actions against an undercapitalized institution that are available against a significantly undercapitalized institution\(^96\) "if the agency determines that those actions are necessary to carry out the purpose of this section."\(^97\)

The statute and regulations give no guidance as to when such a determination may be warranted. Because there is no tie to the reclassification provisions of the statute, this provision should be considered a separate license for regulators. This general provision gives agencies discretion to impose additional sanctions at will, presumably notwithstanding an accepted capital restoration plan. This power to impose sanctions usually reserved for lower categories would be available even when formal reclassification was not possible. In an aggressive regulatory climate, this provision would allow agencies to ignore the distinctions between capital levels or the procedures for downgrading treatment. This license eviscerates the limitations on agency activity that capital

\(^{96}\)See 12 U.S.C. 1831o(f); Part IV.C., infra.

\(^{97}\)12 U.S.C. 1831o(e)(5).
categories and recategorization procedures impose, leaving institutions that are not formally considered "significantly undercapitalized" open to the actions described below,\textsuperscript{98} subject to the whim of regulators.\textsuperscript{99}

C. Statutory Provisions Applicable to Significantly Undercapitalized Institutions

In addition to being subject to the same mandatory supervisory actions as for undercapitalized institutions, significantly undercapitalized institutions are subject to the mandatory requirement of prior written agency approval before paying bonuses and raising to senior executive officers if the institution has submitted a capital restoration plan. No such payments are allowed if no capital restoration plan has been submitted.\textsuperscript{100} Many other actions are available at agency discretion. In fact, statutory authority states that the agency "shall...take one or more of the following actions,"\textsuperscript{101} and provides a lengthy list of available

\textsuperscript{98}Part IV.C, infra.

\textsuperscript{99}Observers surmise that it is possible for both types of downgrades to be applied concurrently, as an otherwise well-capitalized institution that is deemed to be in an unsafe or unsound condition is reclassified as an undercapitalized institution, and then becomes subject to discretionary sanctions available against a significantly undercapitalized institution. See John L. Douglas, \textit{et al.}, \textit{Prompt Corrective Action}, at 12 (Nov. 17, 1992), reprinted in \textit{The New Implementing Regulations Under FDICIA}, supra note 8, at 504, 518.

\textsuperscript{100}12 U.S.C. 1831o(f)(4).

\textsuperscript{101}12 U.S.C. 1831o(f)(2).
enforcement measures to be instituted by the issuance of a PCA directive.\textsuperscript{102} Among the available actions, the statute states a presumption that certain actions will be taken, "unless the agency determines that the actions would not further the purpose of this section."\textsuperscript{103} Thus, it is presumed that the agency will do the following: require the institution to recapitalize (usually by selling enough additional shares to become adequately capitalized),\textsuperscript{104} restrict affiliate transactions,\textsuperscript{105} and restrict interest rates paid on deposits to rates paid on comparable deposits in the region.\textsuperscript{106} Other discretionary actions allow the agencies to enforce sanctions that affect the institution’s operations, including measures to restrict asset growth or reduce total assets,\textsuperscript{107} to require the institution or a subsidiary to terminate or alter activities that the agency determines pose excessive risk to the institution,\textsuperscript{108} to require the institution

\textsuperscript{102}See discussion of PCA directives in Part V, infra.

\textsuperscript{103}12 U.S.C. s1831o(f)(3). See 57 Fed. Reg. 44866, 44869 (affirming agency presumption: "the agency must impose each of these actions unless the agency determines that the action would not further the purpose of section 38.").

\textsuperscript{104}Id. s (f)(2)(A)(i).

\textsuperscript{105}Id. s (f)(2)(B)(i).

\textsuperscript{106}Id. s (f)(2)(C).

\textsuperscript{107}Id. s (f)(2)(D).

\textsuperscript{108}Id. s (f)((2)(E).
Morgan, Banking Agency Discretion Under PCA

to hold a new election of the board of directors,\textsuperscript{109} to require the institution to dismiss any director or senior executive/office\textsuperscript{110} and to employ new officers who may be subject to agency approval,\textsuperscript{111} to prohibit the acceptance of deposits from corresponding depository institutions,\textsuperscript{112} and to prevent a holding company from paying a dividend without prior FRB approval.\textsuperscript{113} Further discretionary actions addressing institutional structure allow the agency to require merger or divestiture of the institution by its parent company,\textsuperscript{114} to require the institution to divest or liquidate any subsidiary that is in danger of becoming insolvent or that is likely to cause significant dissipation of the agency's assets or earnings,\textsuperscript{115} or to require a company which controls the institution to divest or liquidate non-bank affiliates.\textsuperscript{116} The agency may also require any other action that the agency determines would better carry out the purposes of

\begin{itemize}
\item $\text{Id.} \ s \ (f)(2)(F)(i)$. \textsuperscript{109}
\item $\text{Id.} \ s \ (f)(2)(F)(ii)$. \textsuperscript{110}
\item $\text{Id.} \ s \ (f)(2)(F)(iii)$. \textsuperscript{111}
\item $\text{Id.} \ s \ (f)(2)(G)$. \textsuperscript{112}
\item $\text{Id.} \ s \ (f)(2)(H)$. \textsuperscript{113}
\item $\text{Id.} \ s \ (f)(2)(I)(ii)$. \textsuperscript{114}
\item $\text{Id.} \ s \ (f)(2)(I)(i)$. \textsuperscript{115}
\item $\text{Id.} \ s \ (f)(2)(I)(ii)$. \textsuperscript{116}
\end{itemize}
Morgan, Banking Agency Discretion Under PCA

PCA,\textsuperscript{117} or even impose restrictions available against critically undercapitalized institutions if the "agency determines that those restrictions are necessary to carry out the purpose of this section."\textsuperscript{118} The array of tools available to regulators allows the agencies to control the structure and operations of institutions. Their control becomes ever more invasive as capital drops.

D. Provisions Applicable to Critically Undercapitalized Institutions

Agency intervention becomes even more comprehensive for critically undercapitalized institutions. The AFBA must place a critically undercapitalized institution in conservatorship or receivership within 90 days unless the AFBA and the FDIC concur that another action is more appropriate.\textsuperscript{119} After 270 days below the critically undercapitalized level, there is a presumption that a receiver will be appointed unless the AFBA and the FDIC make a finding of viability.\textsuperscript{120} After 60 days, the institutions may make no payment of principal or interest on subordinated debt without

\textsuperscript{117}Id. s (f)(2)(J).

\textsuperscript{118}Id. s (f)(5).

\textsuperscript{119}12 U.S.C. 1831o(h)(3)(A).

\textsuperscript{120}Id. s (h)(3)(c).
prior agency approval. In addition, the FDIC must restrict the activities of the institutions to prohibit the following activities without agency approval: "material transactions" other than in the course of business, extending credit for any highly leveraged transaction, amending charter or bylaws unless forced by law, making any material change in accounting methods, engaging in transactions with affiliates, paying excessive compensation or bonuses, or paying interest above prevailing rates in the area. Obviously, more aggressive agency action is allowed against these most troubled institutions, but the agency does have discretion to "rescue" the institution, by raising it out of its category through loans, or by taking the least aggressive sanctions within the category. Yet FDIC concurrence is required to keep an institution out of receivership or conservatorship, so the agencies cannot forebear and watch an institution deteriorate. In fact, observers point out that, as of July 1993, banking agencies must prepare written reports when an institution's failure results in a material loss to the FDIC. They add that an agency will wish to avoid this report, which will expose the agency to criticism and "congressional second-guessing" of decisions not to close

\[121\] Id. s (h)(2). Carnell explains that "this prohibition seeks to increase discipline by subordinated debtholders by enforcing their subordination to the insurance fund." Carnell, supra note 52, at text accompanying n.153.

\[122\] 12 U.S.C. 1831o(i)(2)(A) - (G).

\[123\] 12 U.S.C. 1831o(k).
critically undercapitalized institutions. Thus, the agency may not exercise discretionary authority to keep a critically undercapitalized institution open.\footnote{124}{See John L. Douglas, \textit{et al.}, \textit{Prompt Corrective Action 10}, in \textit{The New Implementing Regulations Under FDICIA} 504, 516 (William P. Bowden, \textit{et al.}, eds., P-H 1992).}

V. Procedural Mechanisms of PCA

While the substantive provisions of PCA give banking agencies a choice of discretionary corrective actions and some hand in guiding the situations in which these actions will be applied, the procedural framework of PCA allows great agency discretion in the application of corrective measures. In fact, the PCA procedures allow swift and sweeping agency enforcement with only minimal protections for the institutions and affiliated parties. In a declared attempt "to comply with the statutory mandate that the agencies take prompt corrective action to resolve the problems of troubled institutions while also providing affected institutions, companies, and persons the opportunity to be heard in a meaningful time and in a meaningful manner,"\footnote{125}{57 Fed. Reg. 44866, 44874 (1992).} the agencies' final rules establish procedures to govern four types of agency action. These actions are issuing prompt corrective action directives, reviewing dismissal of directors or senior executive officers, reclassifying an institution due to non-capital supervisory criteria, and
Morgan, Banking Agency Discretion Under PCA

enforcement of directives and imposition of civil money penalties. This section will detail these procedural provisions, discussing the agencies' aggressive stance with respect to criticisms of agency overreaching.

A. Issuing PCA Directives to Impose Discretionary Supervisory Requirements

After an agency has decided to take one of the available discretionary actions against an undercapitalized institution,\textsuperscript{126} it must undertake the procedure for issuing a prompt corrective action directive.\textsuperscript{127} Under the pre-issuance notice procedure, the agency provides written notice to the institution before issuing the directive to describe the action contemplated by the agency.\textsuperscript{128} Generally, the institution may respond within 14 days by submitting written arguments and evidence. According to the regulations, the response should also include "an explanation why the action proposed by the [agency] is not an appropriate exercise of discretion under section 38."\textsuperscript{129} Failure to respond constitutes consent to the issuance and a waiver of the opportunity to appeal.\textsuperscript{130} The agency will consider the submissions in

\textsuperscript{126} Including significantly undercapitalized and critically undercapitalized institutions.

\textsuperscript{127} See, e.g., 12 C.F.R. s6.21 - .23 (OCC).

\textsuperscript{128} 12 C.F.R. s6.21(a)(1) (OCC).

\textsuperscript{129} 12 C.F.R. s6.22(b) (OCC).

\textsuperscript{130} 12 C.F.R. s6.22(c) (OCC).
determining whether and in what form to issue the directive.\textsuperscript{131} An alternative issuance procedure allows the agency to issue a directive immediately, without notice, "to carry out the purposes of section 38."\textsuperscript{132} The institution has 14 days in which to submit a written appeal for modification or rescission on an expedited basis. The agency must consider the appeal within 60 days of receiving it.\textsuperscript{133}

After issuance under either mechanism, an institution that is subject to a directive may, "upon a change in circumstances" according to agency regulations, request modification or rescission of the directive.\textsuperscript{134} There is no stated agency procedure or format for such a request. In an interview with the author, agency personnel explained that an institution would likely claim compliance with a directive and request its rescission. The agency has no mandate to entertain such a request, and a "pretty one-sided" negotiation would likely ensue. The agency would judge compliance and, if compliance was not deemed complete, would direct the institution to correct deficiencies and to try again at a later date.\textsuperscript{135} Thus, the agency has total leverage once a directive

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{131} 12 C.F.R. s6.23 (OCC).
\item \textsuperscript{132} 12 C.F.R. s6.21(a)(2) (OCC).
\item \textsuperscript{133} Id.
\item \textsuperscript{134} 12 C.F.R. s6.24 (OCC).
\item \textsuperscript{135} Telephone interview with OCC personnel (March 24, 1994).
\end{itemize}
\end{footnotesize}
Morgan, Banking Agency Discretion Under PCA

issues.

Criticisms of the procedure for issuance of directives reveal commenters' fears of an agency's acting without the participation of institutional parties. Specifically, commenters protested that the lack of an oral hearing before issuance of a directive was unfair to institutions. Agency response stated broadly that PCA at the first sign of trouble is mandated by Congress, justifying speedy issuance without an oral hearing. Further, the agencies point out that Congress specified in the statute where an oral hearing is required, but did not provide one here. The agencies cite court decisions holding that written submissions afford parties an ample opportunity to be heard in a meaningful time and manner. The agencies also offered court precedent on when there is prompt post-directive administrative review, claiming that the post-issuance hearing provided under the regulations satisfies these demands.

---


140 57 Fed. Reg. 44866, 44875; Mallen, supra; Soranno's Gasco, Inc. v. Morgan, 874 F.2d 1310, 1317 - 18 (9th Cir. 1989).
Morgan, Banking Agency Discretion Under PCA

While Congress did not provide for an oral hearing for PCA directives in the statute so that agency provision of a hearing is not mandated,\textsuperscript{141} the fact remains that agencies have the ability to take drastic action in the face of mere written exchanges. This grant of power is striking, given the breadth of potential measures to be implemented by directives and the pervasive effects of these measures. Further, the ease of agency issuance of directives, which implement specific sanctions, may reflect Congress's full reliance on and endorsement of its capital-based system.

B. Dismissal of Directors or Senior Executive Officers

The agencies have adopted a post-dismissal hearing procedure whereby an individual has 10 days to file a petition for reinstatement with the agency.\textsuperscript{142} An agency hearing is mandated within 30 days,\textsuperscript{143} at which the individual may submit written materials and appear in person.\textsuperscript{144} Within 20 days of the closing

\textsuperscript{141}It is interesting to note that the agencies arguably created an informal hearing for reclassification on the basis of unsafe or unsound practice, a finding that would enable -- but not force -- agencies to take harsher actions against an institution, but did not provide one for issuance of directives, where a specific sanction will result from the procedure.

\textsuperscript{142}12 C.F.R. 19.231(b).

\textsuperscript{143}12 C.F.R. 19.231(c).

\textsuperscript{144}12 C.F.R. 19.231(d).
of the hearing record, the presiding officer\textsuperscript{145} must make a recommendation to the agency,\textsuperscript{146} and the agency must issue a decision within 60 days after closing the hearing record.\textsuperscript{147}

Several criticisms focus on the one-sided burden on the individual which may make this hearing a mere formality. In short, the statute and regulations combine to make it very difficult for an individual to win. Agency personnel speaking in an informal interview expressed skepticism that an individual would ever request a hearing, because of the near impossibility of meeting the statutory standard.\textsuperscript{148} The statutory burden of proof on the officer or director seeking reinstatement is a difficult one: the individual must "bear the burden of demonstrating that his or her continued employment by or service with the bank would materially strengthen the bank's ability (1) to become adequately capitalized, to the extent that the directive was issued as a result of the bank's capital level or failure to submit or implement a capital restoration plan; and (2) to correct the unsafe or unsound condition or unsafe or unsound practice, to the extent that the

\textsuperscript{145} An OCC official indicated that a planned (but aborted) hearing scheduled with the OCC was to be conducted by high ranking agency personnel. Telephone Interview with OCC personnel (Mar. 24, 1994).

\textsuperscript{146} 12 C.F.R. 19.231(f).

\textsuperscript{147} 12 C.F.R. 19.231(g).

\textsuperscript{148} Telephone interview with OCC personnel (Mar. 24, 1994). No hearings have been requested at the OCC.
directive was issued as a result of classification of the bank based on supervisory criteria other than capital, pursuant to 12 U.S.C. 1831o(g).\textsuperscript{149} Citing inability to change the statutory burden of proof, the agencies’ final rules reject the requirement (as suggested by commenters) that the agency identify a connection between the conduct of the officer or director and the financial deficiencies of the institution,\textsuperscript{150} in spite of the appeal to fairness that is inherent in such a demand. Furthermore, despite the urging of commenters, the agency has declared that the officer or director may not challenge the capital category of the institution in order to argue that agency action was improper,\textsuperscript{151} demonstrating once again the capital-dominated system that allows leeway in categorization only for agency advantage.

Agency procedures as represented in the regulations and the final rules provide for an informal hearing to review the dismissal order. The statute states under the subheading, "(A) Hearing required," that "[t]he agency shall give the petitioner an opportunity to (i) submit written materials in support of the petition [for reinstatement]; and (ii) appear, personally or through counsel, before one or more members of the agency or its

\textsuperscript{149} 12 C.F.R. 19.231(e) (OCC).

\textsuperscript{150} 57 Fed. Reg. 44866, 44875 - 76.

\textsuperscript{151} 57 Fed. Reg. 44866, 44875 - 76.
designated employees of the agency."\textsuperscript{152} The regulations make clear that an informal hearing will be provided, and that "[n]either the provisions of the Administrative Procedure Act governing adjudications required by statute to be determined on the record nor the Uniform Rules of Practice and Procedure ... of this part apply to an informal hearing under this section unless the OCC orders that such procedures shall apply."\textsuperscript{153} While the agencies' final rules do not belabor the matter of the "informal" hearing requirement for review of personnel dismissal orders, their position on this matter is likely identical to their position on the informality of hearings required for reclassification of an institution's capital category due to non-capital criteria.\textsuperscript{154} In this informal hearing, there is no absolute right to present oral testimony or witnesses at hearing. Rather, the permission of the presiding officer is required. In an interview, agency personnel declined to speculate as to whether such permission would be granted if an individual were to request a hearing, but stated a preference for a "hearing on the record," presumably meaning one only on paper submissions.\textsuperscript{155} The regulations serve to formalize

\textsuperscript{152}12 U.S.C. 1831o(n)(2).

\textsuperscript{153}12 C.F.R. 19.231(d) (OCC).

\textsuperscript{154}See Part VIII.C., \textit{infra} (explaining the agency position that only an informal hearing, rather than a hearing on the record with APA protections, is required in reclassification proceedings).

\textsuperscript{155}Telephone interview with OCC personnel (Mar. 24, 1994).
the agencies' stance, specifying that "a Respondent shall have the right to introduce relevant written materials and to present oral argument. A Respondent may introduce oral testimony and present witnesses only if expressly authorized by the OCC or the presiding officer(s)." Because no hearings have been conducted by the agencies, no information based on actual practice was available.

C. Corrective Actions Based on Non-capital Supervisory Criteria: Reclassification or Downgrade in Treatment

Once the agency believes that statutory requirements are met for reclassification or downgrade in treatment of an institution, the regulatory procedure begins when the agency

156 12 C.F.R. 19.231(d) (OCC).

157 Telephone Interview with OCC personnel (Mar. 24, 1994).

158 For a discussion of the standards for reclassification or downgrade, see Part II, infra. In the case of a well-capitalized institution, the statute allows reclassification to the adequately capitalized category. 12 U.S.C. 1831o(g)(1)(A). For adequately capitalized or undercapitalized institutions, the statute basically allows agency treatment as if the institution were in a lower category. This treatment is appropriate where the AFBA "determines (after notice and an opportunity for hearing) that an insured depository institution is in an unsafe or unsound condition or, pursuant to [12 U.S.C. s1818(b)(8)] deems the institution to be engaging in an unsafe or unsound practice." Id. s1831o(g)(1). Section 1818(b)(8) was amended by FDICIA to provide that an institution may be deemed to be engaged in an unsafe or unsound practice if the institution has received a less-than-satisfactory rating in its most recent examination report for assets, management, earnings, or liquidity, and the institution has not corrected the deficiency. Id. s1818(b)(8).

While the statutory language suggests that an opportunity for hearing is required only for findings of an unsafe or unsound
Morgan, Banking Agency Discretion Under PCA

provides written notice to the institution to describe the intention to reclassify.\textsuperscript{159} Generally, the institution may respond within 14 days by submitting a written appeal and a request for a hearing. According to the regulations, the response should also include "an explanation why the bank is not in unsafe or unsound condition or otherwise should not be reclassified."\textsuperscript{160} Failure to respond constitutes consent to the reclassification and a waiver of the opportunity to appeal.\textsuperscript{161} The agency must hold a hearing within 30 days of receiving a request.\textsuperscript{162} A party must request permission in writing to present oral testimony or witnesses. This right is waived if a party does not request it.\textsuperscript{163} The statutory provision speaks of enforcement after an agency "determines (after notice and opportunity for hearing) that an insured depository institution is in an unsafe or unsound condition or, pursuant to section 1818(b)(8) of this title, deems the institution to be engaging in an unsafe or unsound practice."\textsuperscript{164}

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{159}12 C.F.R. s19.221(a)(2) (OCC).
\item \textsuperscript{160}12 C.F.R. s19.221(c)(1).
\item \textsuperscript{161}12 C.F.R. s19.221(d).
\item \textsuperscript{162}12 C.F.R s19.221(f).
\item \textsuperscript{163}12 C.F.R. s19.221(e).
\item \textsuperscript{164}12 U.S.C. s1818o(g)(1).
\end{enumerate}
\end{footnotesize}
Morgan, Banking Agency Discretion Under PCA

While the statute arguably suggests differing procedural treatment for findings on condition versus practice,\textsuperscript{165} -- perhaps only due to poor drafting -- the agencies' final rules provide an informal hearing on either ground for reclassification.\textsuperscript{166} The regulations state again that "[n]either the provisions of the Administrative Procedure Act (5 U.S.C. 554 - 557) governing adjudications required by statute to be determined on the record nor the Uniform Rules of Practice and Procedure ... of this part apply to an informal hearing under this section unless the Board orders that such procedures shall apply."\textsuperscript{167}

Regarding the provision for an agency hearing, the agencies' final rules explain the agencies' position as to why the statutory mandate for "notice and opportunity for hearing" does not require a formal hearing. While commenters to the proposed rules

\textsuperscript{165}See supra Part III.

\textsuperscript{166}One may question whether this failure to differentiate between the two constitutes impermissible legislation by the agencies. The proposed agency regulations did not provide an informal hearing on findings of unsafe or unsound practices, but only on conditions. Nevertheless, because the provision for informal hearing for practices (where no hearing was explicitly required by statute) will raise no complaints from parties to such hearings, this agency action will not likely be the subject of controversy. It does, however, suggest concerns over the agencies' giving protections to troubled institutions greater than those intended by Congress, promoting regulatory delay or forbearance. The agencies could, of course, merely desire to avoid controversy or constitutional challenge, and believe that the value of such avoidance balances the additional administrative burden of providing hearings on reclassifications based on institutional practices.

\textsuperscript{167}12 C.F.R. s263.202(a)(7)(i) (FRB).
Morgan, Banking Agency Discretion Under PCA

reportedly argued that Congress intended that a full administrative hearing be provided and that "principles of fundamental fairness" so required,\textsuperscript{168} the agencies asserted that the statutory language "notice and opportunity for hearing" does not require a formal hearing\textsuperscript{169} and that absent the phrase "hearing on the record" and Congressional intent to provide for a formal hearing,\textsuperscript{170} an informal hearing will meet statutory requirements.\textsuperscript{171} Further, the final rules seem to assert that an informal hearing "meets any requirement of fundamental fairness or due process when viewed in context," as any reclassification results from an examination process that involves institutional participation in providing relevant information to the examiner, meeting with the examiner, and even appealing the examiner's findings to agency review.\textsuperscript{172} The larger issues of protection in the administrative hearing context and questions of fundamental fairness or due process will be addressed in Part VII.

\textsuperscript{168}57 Fed. Reg. 44866, 44876.

\textsuperscript{169}Id. (citing United States v. Florida East Coast Ry., 410 U.S. 224, 240 (1973)). The relevant language states that the use of the word hearing in a statute "does not necessarily embrace either the right to present evidence orally and to cross-examine opposing witnesses, or the right to present oral argument to the agency's decision-maker."

\textsuperscript{170}For this proposition, the agencies cited Independent U.S. Tanker Comm. v. Lewis, 690 F.2d 908, 922 n.63 (D.C. Cir. 1982).

\textsuperscript{171}57 Fed. Reg. 44866, 44876.

\textsuperscript{172}Id. at 44877.
VI. Comparing PCA to Traditional Enforcement: Agency Advantages Under PCA

The prompt corrective action framework gives regulators some distinct procedural advantages over other enforcement authority. These advantages are the product of agency decision-making involving few agency personnel, speeded timing of enforcement from agency initiation to final decision, and agency final decisions that may be enforced without delay or second-guessing from judicial review. This section will discuss these advantages, drawing contrasts between PCA actions and substantively similar actions under pre-existing enforcement authority.

First, formal involvement of many agency personnel is minimized under PCA procedures, promoting agency efficiency, but perhaps discounting measured decision-making. For instance, PCA directives may be issued after a small group of agency personnel have coordinated a decision to send out a notice of intent to issue a directive.173 Written submissions are reviewed by unspecified officers, likely the personnel who have determined that the notice of intent was necessary, and the decision by the agency appears to be concluded with the issuance of the directive. While a party may request modification or rescission of a directive if circumstances

173 An interview with OTS personnel revealed that early PCA actions were commenced only with the authorization of senior agency decision-makers, but that this authority is no longer required within the agency. Now junior enforcement personnel in charge of PCA actions may initiate proceedings. Agency personnel attribute this shift to experience gained over time and practice under PCA. Telephone interview with OTS personnel (Apr. 1994).
change, no appeal to a higher decision-maker or a court is possible. In contrast to the PCA directive process, issuance of a cease and desist order under 12 U.S.C. 1818(b),\textsuperscript{174} which may institute various sanctions similar to those available through a PCA directive, requires more active agency involvement at a number of levels. C&D action involves enforcement personnel, ALJs, and reviewing agency personnel, all of whom must document their findings and reasons supporting them. This burden on agencies will likely cause them to use the less strenuous PCA actions where they are available.\textsuperscript{175}

In contrast to a PCA directive, the decision to issue a cease and desist order is also subject to judicial review in a federal Court of Appeals, forcing the agencies to spend more time and resources to document the initial case, to conduct formal hearings, and to prepare to defend an appeal. When PCA is available, the simple PCA procedure allows the agencies to dispense with much of the efforts formerly devoted to cease and desist proceedings.\textsuperscript{176}

Ease of administration and swift conclusion of PCA actions, while they promote agency efficiency and swift imposition of

\textsuperscript{174}See supra Part II.

\textsuperscript{175}The streamlined processes under PCA are also evident when swift, nonreviewable PCA dismissals of officers and directors are contrasted with removal actions under 12 U.S.C. 1818(e) and (g). See supra Part II.

\textsuperscript{176}See infra Part VII (discussing lack of judicial review for PCA).
agencies' desired sanctions, leave institutions at a disadvantage. Their bargaining position is distinctly lower than for other enforcement actions with longer times for settlements. Parties do not receive any benefit of the agencies' need to balance efficient administration with enforcement goals, because administration is not a burden on the agencies. Generally, the short time period in which these procedures take place leaves no institutional leverage for negotiating sanctions more tailored to the individual problems of an institution. This problem is particularly keen in the highly discretionary, agency-approved capital restoration plan. Indeed, there is less agency incentive to identify real problems: the agencies do not need consent for actions in order to speed up enforcement -- enforcement is already quick. In the case of measures imposed by the immediate issuance of a PCA directive without notice, enforcement is swift indeed. Regulators have no reason to allow institutions to "plea bargain," or to consent to enforcement in exchange for less harsh measures: enforcement is easy without parties' consent, and procedural impediments are weak. If a consent agreement is not reached early, regulators need make no concessions to speed resolution because hearings will happen quickly, and agencies can certainly impose desired sanctions. This advantage for the agencies makes the imposition of harsh enforcement measures easier and more likely.

VII. Agency Discretion and Fairness: Administrative Law and
Morgan, Banking Agency Discretion Under PCA

Constitutional Issues

A. Unfettered Agency Action: Inapplicability of the APA and Lack of Judicial Review

Common administrative constraints on agency action are seemingly absent under PCA. Where Congress has required some form of hearing for PCA actions, in the procedures for reviewing dismissal of officers or directors under 12 U.S.C. s1831o(e)(5) and (f)(2)(F)(ii), and for downgrading capital treatment for unsafe or unsound condition under 12 U.S.C. s1831o(g)(1)(A) - (B), agency final rules interpret the statute to require only informal agency hearings. The provision of an informal hearing only and the declared inapplicability of the APA\textsuperscript{177} deprives institutions of significant administrative protection of the APA for formal hearings on the record.

Generally, agencies must provide trial-type procedures for formal agency adjudications, that is, only those adjudications "required by statute to be determined on the record after opportunity for an agency hearing."\textsuperscript{178} The necessary protections in formal agency adjudications include "each of the elements of a judicial trial," including notice and an oral evidentiary hearing.\textsuperscript{179} Courts have interpreted the requirement of a formal

\textsuperscript{177}See sections V.B and C., supra.

\textsuperscript{178}Administrative Procedure Act, 5 U.S.C. s554(a).

Morgan, Banking Agency Discretion Under PCA

hearing -- and the agencies have asserted it -- to be inapplicable when a statute does not employ the phrase "hearing on the record" and there is no legislative intent for a formal hearing.¹⁸⁰ Where a statute merely provides for a hearing on an agency decision, an informal hearing will suffice.¹⁸¹ If an agency adjudication does not qualify as a formal hearing, the APA provides lesser protections,¹⁸² requiring that an agency (1) allow a party to be represented by an attorney or other qualified representative,¹⁸³ (2) allow a person who submits data or evidence to obtain a copy or a transcript from the agency,¹⁸⁴ issue a subpoena when necessary,¹⁸⁵ and (4) issue prompt notice of denial of a party's


¹⁸²APA s555. See Davis & Pierce, supra at s 8.2 (stating that "[r]elatively few classes of agency adjudications are governed by statutes that require 'determination on the record after notice and opportunity for an agency hearing,' though a high proportion of statutes require determination based on a hearing").

¹⁸³APA s555(b).

¹⁸⁴APA s555(c).

¹⁸⁵APA s555(d).
Morgan, Banking Agency Discretion Under PCA

request and provide a brief statement of the grounds for denial.\textsuperscript{186} In addition to affecting the procedural protections at a hearing, the informal nature of agency adjudications affects the nature of agency findings in support of an order issued in an informal adjudication. Simply, because APA section 555(e) requires merely "a brief statement of the grounds for denial," and only when an agency denies "a written application, petition, or other request made in connection with any agency proceedings,"\textsuperscript{187} no statement of findings or reasons is explicitly required when most orders are issued.\textsuperscript{188} Thus, it is uncertain whether any record of banking agency reasoning would be required for PCA findings. Authorities on administrative law have illustrated the "critical link between an agency's stated reasons for acting and judicial review to determine whether an agency action is arbitrary and capricious or whether it is 'in accordance with law.'"\textsuperscript{189} Davis and Pierce explain that the "Court has not adopted a consistent position on the need for an agency statement of reasons in an informal

\textsuperscript{186}APA s555(e). The protection offered by APA sec. 555 are reflected in the agencies rules for hearings for reclassification and for reinstatement of personnel. See, e.g., 12 C.F.R. ss19.231(g), 19.331(d) (OCC).

\textsuperscript{187}APA s555(e).

\textsuperscript{188}See Davis & Pierce, supra at s8.5.

\textsuperscript{189}Id.
adjudication," but has recently clarified the issue, stating that APA section 706(2)(A), "which directs a court to ensure that an agency action is not arbitrary and capricious or otherwise contrary to law, imposes a general 'procedural' requirement of sorts by mandating that an agency take whatever steps it needs to provide an explanation that will enable the court to evaluate the agency's rationale at the time of decision." Agency failure to provide sufficient reasons to permit a court to understand agency rationale will not overturn the agency's decision, but merely prompt the court to "remand to the agency for additional investigation or explanation." Davis and Pierce conclude that "[a]s a practical matter, then, an agency is required to state reasons for any action taken in an informal adjudication only if the action is subjected to judicial review."

Thus, only if PCA actions are taken pursuant to "a written application, petition, or other request...made in connection with any agency proceedings" under APA section 555(e) or if judicial review is available will the agencies be compelled to provide a written statement of reasons for their order. While the

\[190\] Id. (citing Camp v. Pitts, 411 U.S. 138 (1973) (holding that OCC was not required to state its reasons for action in an informal adjudication)).

\[191\] Id. (citing PBGC v. LTV Corp., 110 S.Ct. 2668 (1990)).

\[192\] Id. (citing LTV Corp. at 2680).

\[193\] Id.
availability of judicial review of PCA orders is questionable, it appears that banking agencies will, in most instances, escape the requirement of written statements of reasoning supporting their orders. The laxity of the APA procedural protections for informal adjudications and the probable lack of written reasons for agency actions give great freedom to agency decision-makers. Affected parties have little recourse: submission of written arguments and oral testimony (with witnesses and testimony at the whim of regulators), or informal requests for termination after an action is taken. These routes offer little protection from agency personnel under congressional mandate to take prompt action, who may mechanically apply harsh corrective measures whether or not these are tailored to the causes of the institution’s weakness. The lack of procedural safeguards and the lack of judicial review have alarming implications: there is a danger that since agencies have to comply with few rules and have no one looking over their shoulder, their reasoning may be less careful. And since they do not have to justify their reasoning later, they may not be as fair in the first instance. Agencies could deprive parties of their few hopes for "being heard." It is possible that the agencies won’t permit oral testimony, for instance, because it is easier to

194See infra.

195It is interesting to note that there is no basis for challenging PCA sanctions on the grounds that they do not address the particular problems of an institution in a given situation.
control and administer a hearing without it, and they will not have to explain why they did not permit it. In short, agency control is complete.

The problems of unfettered agency discretion and freedom from procedural restrictions in adjudications are compounded by the fact that these adjudications will likely not be subject to judicial review. The APA and judicial doctrine have created a presumption of reviewability for agency action. APA sections 701(a)(1) and (a)(2) create exceptions to reviewability in two instances. First, review is not available "to the extent that...statutes preclude judicial review," demonstrated by five types of evidence: specific statutory language, specific legislative history, contemporaneous judicial construction followed by congressional acquiescence, import of the judicial and legislative history of the statute, and inferences drawn from the statutory scheme as a whole. Second, a statute is unreviewable under APA section 701(a)(2) "to the extent that...agency action is committed to

---


197 APA §701(a)(1).

198 See Block v. Community Nutrition Institute, 467 U.S. 340, 349 (1984). See also Davis & Pierce, s17.8. Davis and Pierce explain that Congress may also implicitly preclude review under 701(a)(1). Id. Some courts have held that mere absence of a statutory provision authorizing judicial review supports an inference of Congressional intent to preclude judicial review. See, e.g., Langevin v. Chenango Court, Inc., 447 F.2d 296 (2d Cir. 1971).
discretion by law." The Court has relied on the legislative history of the APA to identify the scope of this exception, deeming that an action is committed to agency discretion when the statute provides no legal standard that a court could apply to decide the substantive issue. The "no law to apply" standard has proved difficult. Davis and Pierce report that, nevertheless, many statutes have been determined to commit actions to agency discretion, and these statutes share typical features, including broad statutory language, no evidence of congressional intent to review, "contexts that are complicated and difficult for generalist judges to understand," and "contexts in which judicial review would have the potential to create serious unintended problems, such as delay, imposition of heavy burdens on agencies and on reviewing courts, and high risk of judicial errors in the process."

A recent circuit court decision suggests how the issue of PCA reviewability might be resolved under the "committed to agency

199 APA § 701(a)(2).

200 The legislative history of the Administrative Procedures Act indicates that it is applicable except in those rare instances where "statutes are drawn in such broad terms that in a given case there is no law to apply."


201 Davis & Pierce, § 17.6.

202 Id. (collecting decisions).
discretion" standard. In *FDIC v. Bank of Coughetta*, the court ruled that the FDIC's issuance of a capital directive under the International Lending Supervision Act of 1983 (ILSA) was an action committed to agency discretion by law, unreviewable under APA section 701(a)(2). The court first found that APA section 701(a)(1) was not decisive because ILSA contained no statutory prohibition of review, nor any procedure for review -- unlike final cease and desist orders, the court noted -- and no review is allowed in the district court proceeding to enforce the capital directive under 12 U.S.C. 1818(i)(1). In its examination under APA section 701(a)(2), however, the court gave great weight to the legislative history of section 3907, which was enacted to counteract judicial interference with enforcement of capital requirements. The court also considered the language of the section 3907, mentioning the FDIC's assertions that the statutory

---


*Coughetta*, 930 F.2d at 1129.

*Id.* at 1128.

*Id.* at 1128. See S.Rep. No. 98-122, 98th Cong., 1st Sess. 16 (explaining Congressional purpose behind s3907 to assert the authority "of the bank regulatory agencies to exercise their independent discretion in establishing and requiring the maintenance of appropriate levels of capital" in response to a Fifth Circuit decision setting aside a portion of a cease and desisted order requiring maintenance of a capital ratio, citing *Bellaire v. Comptroller of the Currency*, 697 F.2d 674 (5th Cir. 1983)).

57
Morgan, Banking Agency Discretion Under PCA

use of the words "discretion" and "deem" forecloses review.\textsuperscript{208} The court concluded, in short, that the law created no standard to apply in review and that the decision to issue the capital directive was not reviewable.\textsuperscript{209} The U.S. Supreme Court denied certiorari in 1992.\textsuperscript{210}

This decision sheds light on the issue of PCA reviewability. While section 1831o does give some detailed standards for such issues as the reinstatement of dismissed directors and officers, its overall scheme is a general one that requires much agency decision-making on factors not outlined in the statute. Decisions on these factors are certainly left to agency discretion. In addition, the enforceability of PCA orders is governed by section 1818(i)(1), which dictates that agencies may apply to district court for enforcement of orders or notices under section 1831o, but that except as otherwise provided in [section 1818] or under section 1831o...no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under any such section, or to review, modify, suspend, terminate, or set aside any such notice or order.\textsuperscript{211}

This mandate, along with the strong Congressional purpose for swift corrective action, may cause a court to judge that review is

\textsuperscript{208}Id. at 1128.

\textsuperscript{209}Id. at 1129.

\textsuperscript{210}112 S.Ct. 170 (1992).

\textsuperscript{211}12 U.S.C. s1818(i)(1).
precluded.

The legislative history of section 38's PCA provisions has interesting implications for the issue of judicial review. The version that was originally passed by the Senate would have explicitly restricted judicial review of agency action under that section, including preclusion of injunctions, but allowing certain actions to be reviewed under the arbitrary and capricious standard.\textsuperscript{212} The Senate reportedly omitted this provision due to pressure from the House Banking Committee staff, who claimed that express restriction was unnecessary because the agency actions in the statute would be unreviewable.\textsuperscript{213} Thus, it appears that the Senate declined to make explicit a system for judicial review because the law was written, they surmised, in a way that would render it unreviewable under administrative law doctrine committing the decision to agency discretion. This reasoning is illogical, as the Senate could have shaped a system for judicial review to fit its intent. If the Senate desired that to preclude judicial review, an explicit provision would have been the most efficient -- and obvious -- way to do so.

Even if agency action under PCA is committed to agency discretion by law, judicial review of constitutional claims will be


\textsuperscript{213}\textit{See} Carnell, \textit{supra} note 52, at text accompanying n.165.
Morgan, Banking Agency Discretion Under PCA

available because there is no explicit intent to preclude them.\textsuperscript{214}

B. Constitutional Concerns

While constitutional issues may be framed in the PCA context, and may even have an intuitive appeal, it appears unlikely that constitutional challenges would be successful. Conceivable challenges might include that PCA requirements constitute excessive delegation of legislative power by Congress to the banking agencies, that PCA allows intrusive actions that constitute regulatory takings, or that the enforcement of the current PCA regime violates substantive or procedural due process requirements.\textsuperscript{215}

1. Violation of Non-Delegation Doctrine

Delegation of legislative power by Congress may violate Article 1 of the Constitution. PCA indeed grants broad rulemaking powers to the banking agencies, but the prospect of a successful constitutional challenge is extremely unlikely for two reasons. First, delegations of power to agencies, when accompanied by


\textsuperscript{215}The framework for this section of the paper was suggested by Lawrence G. Baxter’s analysis of the constitutionality of safety and soundness legislation of section 132 of FDICIA, now section 39 of the FDI Act. See Lawrence G. Baxter, The Rule Of Too Much Law? The New Safety/Soundness Rulemaking Responsibilities of the Federal Banking Agencies, 47 Consumer. Fins. Law. Q. 210, notes 52 - 79 and accompanying text.
Morgan, Banking Agency Discretion Under PCA

"intelligible principles" guiding the exercise of agency power, have been allowed by the Supreme Court.\textsuperscript{216} Because PCA statutory authority provides guidance as to how agencies are to "fill in the gaps" and to implement statutory standards, even if this guidance is haphazard or vague, a current federal court would probably view the statute as sufficiently detailed to guide agency action.\textsuperscript{217}

Second, the Court has accepted Congress's delegation of broad power to regulate banking institutions on such grounds as safety and soundness.\textsuperscript{218} A non-delegation attack on PCA, even if successful, would likely be unfavorable to institutions: Congress, rather than the banking agencies, would be forced to detail the PCA framework, leaving institutions in less familiar, and perhaps less friendly, hands.


\textsuperscript{217}Cf. Baxter's comparison of FDI section 39, which contains the kind of voluminous (albeit conflicting) guidance that was quite validly supplied to the U.S. Sentencing Commission for the development of the Federal Sentencing Guidelines, and is likely to be regarded as sufficiently detailed on this account alone.

See Baxter, supra note 69, text accompanying notes 55 - 56 (citing Mistretta v. United States, 488 U.S. 361 (1989) (upholding the delegation of power to the U.S. Sentencing Commission to formulate Sentencing Guidelines)).

\textsuperscript{218}Id. at text accompanying notes 57 - 59 (discussing court’s rejection of non-delegation argument in Fahey v. Mallonee, 322 U.S. 245 (1947)). See also Farmers State Bank, Kanawa v. Bernau, 433 N.W. 2d 734, 741 (Iowa 1988).
2. Regulatory Takings

An argument might be outlined to cast PCA regulation as a regulatory taking, "in the form of regulatory restrictions so severe as to deprive the owners of banks of the value of their banks." The Supreme Court has recently confirmed that "while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." Nevertheless, federal regulatory power over the banking industry is pervasive. Indeed, its general intent to improve banks makes it unlikely that courts will view banking regulation as a deprivation of property. In addition, Lawrence Baxter points out that bank owners are unlikely to be able to satisfy particular statutory requirements of takings doctrine, particularly as participants in insured depository institutions could hardly claim "reasonable investment-backed expectations" of compensation in the event of stricter regulation. Given Congress's unquestioned power over the banking industry, finding a regulatory taking in this context is next to impossible.

219 Baxter, supra note 69, at text accompanying n.60.


221 Baxter, supra note 69, at text accompanying n.64. Baxter also discusses the view that directors and officers subject to compensation restrictions by new standards would be "highly unlikely...to be regarded as having employment contracts that validly embrace" an expectation of compensation from the government "in the event of regulatory impairment." Id. nn.65 - 66.
3. Due Process Challenges

Similarly, constitutional doctrine and decisions in the banking context make a successful due process challenge against PCA very unlikely. A conceivable substantive due process challenge might assert that PCA provisions constitute an oppressive or arbitrary government imposition on private property and liberty interests. But because current substantive due process doctrine recognizes only certain fundamental individual rights, excluding banking or economic interests, a court would find little basis for rejecting the legislative rationale for PCA as a violation of substantive due process. Baxter suggests a second "dimension" to a substantive due process challenge that may apply to the PCA structure: some regulations, particularly restrictions on payments to affiliates or other shareholders, might be argued to constitute an impairment of contracts, as the Contracts Clause of the U.S. Constitution is considered to be incorporated against the federal government via the Due Process clause of the Fifth Amendment. Again, the character of the heavily regulated,

---

222 Cf. Baxter, supra note 69, at text accompanying nn. 67 - 70.

223 U.S. Const., art. 1, sec. 10.

224 The Contracts Clause has been regarded as applicable against the federal government as a matter of due process. See Lynch v. United States, 292 U.S. 717, 733 (1934) (cited in Baxter, supra note 69, at n.67.) Baxter asserts that this argument "will not avail the baking industry." Id.
federally insured banking industry may make it clear that any individual who invests in the industry or who is employed in it is aware of federally mandated conditions on employment or ownership interests, conditions that negate the argument of defeated expectations. This aspect of substantive due process has little chance of prevailing.

Procedural due process arguments apply to agency actions in enforcing PCA against institutions and individuals. Procedural due process dictates that "some form of hearing is required before an individual is finally deprived of a property interest," in particular, "the opportunity to be heard at a meaningful time and in a meaningful manner." Courts have applied a three-factor test articulated in Matthews v. Eldridge, examining the private interest to be affected by the government action; the risk of erroneous deprivation of the private interest through the procedures used and any probable value of additional or different procedural safeguards; and the government interest, including the function involved and the fiscal or administrative burdens of additional or substitute procedures.

While the private interests subject to PCA enforcement, including loss of ownership interests in banks and required capital infusions, are indeed substantial, the weak procedural requirements

---


226 424 U.S. at 335; see Coushatta, 930 F.2d 1122, 1130 (applying Matthews test).
Morgan, Banking Agency Discretion Under PCA

of PCA would likely be deemed to meet current procedural demands. For instance, there is ample precedent supporting judgement on written submissions, as is allowed for issuance of PCA directives,\textsuperscript{227} rather than requiring oral argument, presentation of witnesses and oral testimony. There is also precedent for the failure to provide a pre-issuance hearing for immediately effective PCA directives, analogous to issuance of temporary cease and desist orders, where a post-issuance hearing is deemed to meet due process requirements. Further, because PCA reclassification on the basis of unsafe or unsound condition or practice follow bank examination and informal oral hearings on reclassification, a court would likely rule that due process was satisfied, as the Fifth Circuit did in Coushatta for the issuance of a capital directive under ILSA. The Coushatta court noted that the risk of erroneous deprivation of the bank's interest was "minimal,"\textsuperscript{228} as the bank had an opportunity to respond to the bank's notice of intent and to the examination report. The court emphasized that a decision was made "only after several deliberative steps and through documentation, including a bank examination, presentation of the examination report to a bank, and consideration of any written response."\textsuperscript{229} Because this court put a premium on the bank

\textsuperscript{227}See discussion supra Part V.A.

\textsuperscript{228}930 F.2d at 1131.

\textsuperscript{229}Id.
Morgan, Banking Agency Discretion Under PCA

examination procedures as a separate protection, their combination with a hearing in the reclassification procedures would surely pass muster. Finally, court recognition of a significant government interest in prompt implementation of capital directives in *Coushatta* presages judicial acceptance of PCA’s justifications of prompt action to protect the insurance fund, as Congress’s mandate for capital-based regulation is clearer than ever under PCA.

C. Prior Practice and Expectations: Fairness Issues

Calls for due process may be formalistic demands for simple fair treatment. Even if a due process violation would be difficult to prove, there is an intuitive appeal to arguments against invasive, abrupt agency actions that go against institutions’ expectations from the regulatory relationship. Parties are protected from agency overreaching by certain legal constructs: consider that an agency action on appeal to a federal court will be deemed arbitrary and capricious if it represents an unexplained departure from the agency’s prior policies and precedents.

---

230 The agencies' Final Rules mention the examination as alleviating the need for more procedure and more institutional participation in reclassification proceedings. 57 Fed. Reg. 44866, 44877.

231 930 F.2d at 1131.

232 Atchison, Topeka & Sante Fe R. Co. v. Wichita Board of Trade, 412 U.S. 800, 808 (1973).
Morgan, Banking Agency Discretion Under PCA

Under PCA, however, where Congress has mandated this radical new authority, the agencies' departure from prior practice is explained. This lack of protection for parties from the change in the enforcement system does nothing to lessen the fact that institutions' and parties' expectations, including interests in employment or ownership, have been defeated, a claim that is intrinsically appealing. The fairness of the existing system, however, can only be improved by transparent enforcement by agencies or by new, clearer standards from Congress.

VIII. Conclusion: Limits on Agency Discretion

This paper has attempted to identify and evaluate agency freedom under PCA. It has described a questionable capital-dependent system that triggers agency action within an extraordinarily broad range of discretionary sanctions with few procedural safeguards. Overall, the capital category designation appears to be the determining factor for the fate of institutions under PCA.

It follows that perhaps Congress made the system unfairly dependent on the initial determination of capital categories, as agencies gain dominion over institutions whose capital levels fall. The agencies have full authority to punish or dismember institutions. Agencies need only give a nod to minimal procedural requirements, and they may impose any of a range of sanctions by PCA directives.
Morgan, Banking Agency Discretion Under PCA

Several schemes might serve to lessen the danger of agency discretion after capital-based enforcement is triggered. Congress could separate the capital category determination from the agency action in several ways, which would have varying benefits and costs. Congress could take control of the capital category designation by legislating new, specific standards for capital and determination of capital levels, including examination procedures and documentation. Alternatively, Congress could retain its present statutory guidelines for capital measures and categories, but separate the category determination from the sanctions by forcing separate bureaus within agencies for capital determinations and enforcement; by creating a separate body outside the current banking agencies to make initial findings on capital; or by keeping the present structure but allowing institutions to challenge their capital category designation to an unbiased decision-maker.

These proposals that address the capital category determination nevertheless leave agencies with great discretion in enforcement. This regime can only be altered if Congress curbs their discretion with new legislation providing clearer enforcement standards and judicial review of agency action. This change, though it would be difficult and costly, would provide a necessary, if weak, limit on agency freedom.