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presents

Bank Enforcement Actions: Trends and Developments for 2010

Negotiating and Complying With Enforcement Orders, Meeting Disclosure Requirements

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:

Konrad Alt, Managing Director, **Promontory Financial Group**, San Francisco

Sanford M. Brown, Partner, **Bracewell & Giuliani**, Dallas

T. J. Mick Grasmick, Partner, **Manatt Phelps & Phillips**, Los Angeles

Thursday, May 20, 2010

The conference begins at:

1 pm Eastern

12 pm Central

11 am Mountain

10 am Pacific

You can access the audio portion of the conference on the telephone or by using your computer's speakers. Please refer to the dial in/ log in instructions emailed to registrations.

Banking Law @ manatt

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Is There a New Three Strikes Rule for Some California Banks?

Authors: Harold P. Reichwald | T.J. Mick Grasmick

Community bankers did not design or market subprime mortgages nor did they devise or promote credit default swaps. Community bankers did make many loans to longtime customers whose businesses, employees and communities have been hurt by a historic economic downturn that few foresaw, resulting, in many cases, in dramatic losses in loan portfolio values. The ensuing examination and enforcement spiral seems to leave many community banks with few growth options and all too often a demoralizing message from their regulators: Raise capital or face failure.

Through it all, community banks are being pressured by government officials to restart the economy through small business lending.

At Manatt, we fear a new type of "Three Strikes Rule" has emerged for many California banks that in the scheme of things should be given more time to "right the ship and resume course."

- *Strike One* is the harsh examination so many have endured resulting in a public enforcement action requiring changes throughout the bank, often including senior management, and capital increases to well above well capitalized ratios.
- *Strike Two* is a regulatory rejection of capital plans as insufficient or rejection of private equity joint venture proposals designed to quickly infuse meaningful capital, all with an apparent "Just Say No" attitude emanating from Washington.
- *Strike Three* will be the upcoming round of follow up examinations and audits with even more blunt public enforcement directives: Immediately meet unattainable capital ratios, pursue a sale or merger and consent to outsiders doing due diligence in anticipation that the bank will be closed and its assets and deposit franchise sold by the FDIC in a receivership.

We also are now seeing the post-failure phase begin with litigation by the FDIC and creditors seeking to hold former bank executive officers and directors liable for gross negligence or reckless misconduct alleged to have led to unsafe and unsound conditions. Look for civil money penalties and debarment orders that will damage reputations and hinder future opportunities in banking.

Banks have scrambled to make the proper disclosures of their problems and their plans and

Newsletter Editors

Katerina Hertzog Bohannon
Partner
kbohannon@manatt.com
650.812.1364

Harold P. Reichwald
Partner
hreichwald@manatt.com
310.312.4148

Our Practice

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emphasize the positive. In many cases institutions took TARP funds which they intended to use to make prudent loans when receiving TARP funds was considered a sign of stability and regulator support. Since then additional deterioration in loans and increased loan loss reserves have vaporized earnings and eroded bank capital. For many, paying any dividends, including paying the Treasury dividends on its TARP investment, and payments on trust preferred securities, have been put on hold by the regulators in enforcement actions until new capital is raised and earnings resume.

It is in this climate that Boards and management have also been directed to reconstruct and improve much that examiners often previously said was working and not broken before the economic downturn: Strategic Plans, Risk Management, Credit Underwriting, Loan Loss Policy, Liquidity Policy, Collection Practices and the adequacy of management and the Board itself. The result has the ring of a self-fulfilling prophecy to it:

- Investment bankers take on capital raise engagements with optimism only to return pessimistic on raising capital on anything other than pricey and severely dilutive terms.
- Potential private equity investors, often embarked on a steep learning curve with respect to bank regulation and the prospective regulation of them as well, further distract management and staff attention from tending to the business of banking. Time (and money) spent with consultants and regulatory counsel often increases exponentially as does the need to respond to anxious deposit customers, press inquiries and inaccuracies, analysts' questions and the rating agencies.
- The Board and management, in effect, are told to raise new capital and remake the bank in a matter of months and, at the same time, to profitably manage the bank and make new loans.

With so many banks now formally in a "troubled condition" with orders to raise capital and take extensive corrective action, is it fair to wonder if there is another agenda? The Chair of the FDIC has spoken openly about a "culling process" that will reduce the number of banks in the United States. If that is now a policy objective of the regulators, the banking industry and bank customers deserve to know.

At Manatt, we have too often seen detailed proposals rejected as inadequate, requests for short extensions summarily denied and reasonable actions scolded as unsafe and unsound and subject to civil money penalties. It may be hyperbolic to suggest that some banks' futures have already been determined and scheduled by unidentified FDIC planners. Still, there are banks that would appear to have a reasonable chance to recover with franchises worth saving, thereby lessening the losses for the Deposit Insurance Fund. Why the rush to receivership? Why the denigrating and punitive attitude after the bank is in the penalty box? Why the regulatory disinterest in new and available sources of capital?

The voices of those in the industry have not been heard on these and similar issues. Perhaps the time for speaking out is at hand.

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For additional information on this issue, contact:

Harold P. Reichwald Mr. Reichwald is a highly experienced banking and finance attorney whose career encompasses domestic and international matters for banks and specialty finance institutions. His experience comprises a broad range of matters including: governance matters, sophisticated financial transactions such as asset securitization, LBOs, project finance, corporate lending and restructuring; representation of a variety of domestic and foreign financial institutions before the FDIC, Comptroller of the Currency, the Federal Reserve Board and other bank regulatory agencies in connection with new product development, chartering new banks and branches, issues arising out of the bank examination process and enforcement actions demanded by regulatory authorities.

T.J. Mick Grasmick Mr. Grasmick's practice focuses on mergers and acquisitions, non-banking activities, formation of new banks, interstate and other expansion by banks, bank holding companies and other financial institutions and the requirements and restrictions on expansion of state and federal bank regulatory agencies; bank supervision and examination, and general banking corporate matters and regulatory and legislative developments.