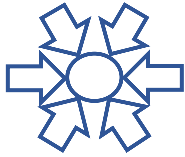

Financial Services Management

Enforcement Policy

Cite
OCC, Policy and Procedures Manual, Bank Enforcement Actions and Related Matters

Recommended Distribution:
CRO, Audit/Examination, Policy, Legal, Government Relations

Website
https://www.ots.treas.gov/news-issuances/bulletins/2023/ppm-5310-3.pdf

Impact Assessment

- Although announced as a program focused only on larger banks, much in the new manual governs all federal charters.
- The OCC may now issue enforcement actions regardless of a bank's CAMELS ratings and/or financial condition, increasing the odds for early intervention as well as additional legal/reputational risk.
- Formal enforcement actions are possible for violations of requirements otherwise under the CFPB's authority.
- Formal actions are also possible when the OCC thinks it essential to reduce resolution costs or if the OCC thinks the public is at risk for reasons not made clear in the new policy manual.
- The manual stresses the OCC's authority to order resolution regardless of imminent or actual insolvency.
- Unless the Fed and/or FDIC follow suit, banks may consider charter conversions as long as they are not under a formal OCC enforcement order, when this is barred.

Overview

Following a speech earlier this year by the Acting Comptroller arguing that some banks are "too big to manage" and the furor caused by recent failures, the OCC has significantly revised its enforcement policy. The new framework requires examiners promptly to intervene if any of a bank's CAMELS scores slips to 3 for unsatisfactory or if the bank is what CFPB Director Chopra would call a "repeat offender" of law, rule, or express supervisory actions or found deficient in practices necessary to ensuring safety and soundness. The new policy also includes an array of presumptions for stringent OCC action designed to end forbearance of the sort evident at SVB and Signature Bank,[1] along with

[1] See *Client Report* **REFORM224**, May 16, 2023.

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toughening the OCC's formal policy as to when it can order receivership, conservatorship, merger, or other resolution action.

Although an appendix to the policy focuses on banks over $50 billion or those that are large and complex found to have "persistent weaknesses," these particularly stringent sanctions may apply to any federal charter if the OCC deems it necessary. Further, while the persistent-weakness section creates an express prompt corrective action (PCA) construct for targeted banks, much in the general policy also gives the OCC scope to intervene regardless of a bank's capital ratio, earnings, or the indicators that have previously insulated banks from enforcement action until their condition significantly weakens. This would sharply accelerate supervisory intervention, with the new policy aiming to end forbearance also by new deadlines for bank follow-up and examiner escalation.

Impact

This new policy is a radical rewrite of the OCC's current approach to supervisory policy. This was issued in 2018 at a time when the Comptroller called federally-chartered institutions his "customers" and all of the agencies were pivoting to what some since have called "light-touch" enforcement. In sharp contrast, Acting Comptroller Hsu believes that examiners must address any deficiency that poses safety-and-soundness concerns along with violations of law, rule or prior supervisory requirements in order to ensure timely action by a bank's board to ensure rapid remediation of identified weaknesses or violations. The agency also intends its enforcement actions to prepare a bank for resolution at the lowest cost to the FDIC in the event its conditions are irremediable, with the policy making clear that the OCC may order resolution well before technical insolvency – a practice that poses additional franchise-value risk but is likely to reduce resolution costs.

While aspects of the policy repeat prior standards, much in it is new in terms of the additional criteria on which enforcement actions may be based, the speed with which banks are expected to respond, and the rapid-fire approach examiners are to take should this not occur. A significant feature of the new policy is the approach to "repeat offenders," with the manual making it clear that the agency will ramp up enforcement if matters brought to the bank's attention – perhaps including those from other agencies such as the CFPB – remain unaddressed. Indeed, regardless of a bank's CAMELS ratings or its financial condition, the policy now has a presumption of a public enforcement action if the bank has a CAMELS 3 composite rating or a 3 for management, shows deteriorating trends, is a repeat offender, has failed quickly to remediate critical deficiencies, or – a new factor – the bank's actions threaten customers, the FDIC, or "the public."

This policy thus addresses a concern identified by the FRB with regard to Silicon Valley Bank – i.e., examiner reluctance to intervene when earnings are strong,[2] making it clear that the OCC intends not to do so and thereby removing one buffer many national banks have long believed insulate them from legal and reputational risk. However, neither the Fed nor the FDIC has laid out what it plans to do to revise supervisory protocols to reflect this lesson or those germane

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2 See *Client Report* **REFORM221**, May 1, 2023.

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to the lengthy periods of time between supervisory identification of concerns, notification to banks, bank response, and supervisory intervention of heightened force. Even if these other agencies revise their policies to include stiffer standards for problem banks regardless of CAMELS or earnings, it is unclear if they will also adopt the OCC's approach to incorporating consumer protection, resolvability, and public welfare into express grounds for informal and formal enforcement actions. The "repeat-offender" construct in whole or part may also remain unique to the OCC.

Should this be the case, some federal banks, thrifts, and foreign-bank branches or agencies may reconsider a state charter in light of heightened legal and reputational risk that could quickly translate into the entity's franchise value. Federal charters engaged in interstate finance may be reluctant to do so despite this risk, but those active across state lines by virtue of fintech or similar "partnerships" may reconsider these arrangements in light of the OCC's authority spelled out in this policy also to undertake formal enforcement actions related to third-party or outsourced activities. However, a national bank subject to a formal enforcement action could not convert its charter at that point due to prohibitions against doing so in the Dodd-Frank Act.[3]

What's Next

As with a replacement approach to designating SIFIs, this new methodology was unanimously proposed by the FSOC on April 21. Comments are due sixty days after *Federal Register* publication.

Analysis

The new enforcement policy was issued on May 25 and is effective immediately.

A. Enforcement Context

1. Definitions

The manual describes the range of OCC enforcement actions – i.e., formal and informal – and when these are likely to apply. Informal actions are appropriate if a bank is sound but has failed to correct identified problems or if developments warrant a more formal citation of a matter requiring immediate attention (MRIA). When a bank's deficiencies are severe, uncorrected, repeat, unsafe or unsound, or negatively affect the bank's condition, the OCC may use formal bank enforcement actions, which are more likely to be made

[3] See **FHC19**, *Financial Services Management*, July 29, 2010.

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public and are enforceable in federal courts as well as create grounds for a civil-money penalty.

Examiners are told to consider the following in determining whether to issue a formal enforcement action and what action to impose:

- component or specific CAMELS ratings;
- risk profile and trends;
- nature, severity, and extent of deficiencies;
- the extent of unsafe or unsound practices;
- board/management willingness and ability to repair identified problems in a timely fashion;
- potential adverse implications for customers, the FDIC, or "the public;"
- compliance progress; and
- other concerns.

2. Presumptions

The agency now states that, regardless of the CAMELS ratings or a bank's financial condition, the agency has a presumption in favor of a formal enforcement action when deficiencies are severe or there is "considerable insider abuse," systemic or significant violations of law, management/board disregard of prior informal actions, or violations of law or other requirements. The relevant supervisory officer – not the comptroller – is responsible under a process detailed in the policy for determining the enforcement action based on the bank's ratings, deficiency severity, level of risk, and board and management ability and willingness to correct the deficiencies within an appropriate time frame.

In addition to the presumptions of action noted above, the new policy has a presumption of very strong and public action for CAMELS 4 or 5 banks. In general, examiners are to review the extent to which a bank has acted within 180 days, escalating interventions as warranted. Stringent requirements must be met before an enforcement action is officially terminated.

3. Resolutions

The policy notes the OCC's authority to terminate a federal charter for reasons that include falling below a two percent tangible capital level but also may include other rationales not detailed in the policy, noting also that resolution may be required prior to technical insolvency or a drop below two percent tangible capital.

B. Sanctions

The policy manual includes appendices providing additional detail on the sanctions that may be imposed in OCC enforcement actions. For informal actions, these may include but are not limited to:

- an order for the bank to increase capital, which may be appealed. A higher mandatory capital ratio does not affect PCA thresholds, but failure to comply may

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be deemed an unsafe or unsound action which must generally be declared within thirty days; and

- a mandatory operating plan detailing how unsafe or unsound practices are to be remediated.

In formal enforcement actions, the OCC may require remediation such as:

- a public capital directive, which may be appealed but for which violations may be addressed via civil money penalties. However, a failure to comply with a capital directive is not on its own grounds for receivership; or
- imposition of a C&D order requiring restitution, restricting asset growth, requiring divestitures of loans or other assets, and ordering contractual recission or employment of qualified officers or directors. Restrictions may also be imposed on a bank's activities, with the manual spelling out the process for these orders and a bank's rights upon receipt.

C. Persistent Weaknesses

Key to the OCC's new policy is the additional sanctions applicable to banks with "persistent weaknesses" that are over $50 billion, are otherwise large and complex, or present heightened bank-wide risk. Persistent weaknesses are defined to cover:

- composite or management ratings of 3 or worse for more than three years;
- failure to comply in a timely manner with a formal enforcement action; or
- multiple enforcement actions outstanding or executed against the bank in a three-year period.

When persistent weaknesses are observed and the OCC thinks the bank's profile warrants additional restrictions, the policy includes a presumption of additional sanction. These include:

- civil money penalties;
- a mandatory board-set enterprise-risk management plan to ensure prompt remediation;
- restrictions on overall or specific kinds of growth;
- dividend restrictions;
- requirements for additional investments to enhance risk management;
- mandatory capital or liquidity increases;
- actions against institution-affiliated parties, including with regard to third-party activities and/or outsourcing; or
- divestiture of identified activities or business unit.

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