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United States General Accounting Office
Washington, DC 20548

January 31, 2001

The Honorable Richard H. Baker
Chairman, Subcommittee on Capital
Markets, Insurance, and
Government Sponsored Enterprises
Committee on Financial Services
House of Representatives

Subject: Comparison of Financial Institution Regulators' Enforcement and Prompt Corrective Action Authorities

Dear Mr. Chairman:

This letter responds to your October 10, 2000, request that GAO review and compare the legal authorities available to the federal bank regulators, the Office of Federal Housing Enterprise Oversight (OFHEO), and the Federal Housing Finance Board (FHFB) (collectively referred to as financial institution regulators) for taking actions when issues arise regarding the capitalization and safety and soundness of the institutions they supervise. The federal bank regulators, OFHEO, and FHFB are responsible for ensuring that the institutions they supervise are in a safe and sound condition and that the activities of the regulated institutions and their managing officials do not raise safety and soundness concerns. To fulfill this responsibility, each financial institution regulator has an array of statutory supervisory authorities, regulatory powers, and enforcement tools. In your request letter, you expressed concern that OFHEO and FHFB may not have the same supervisory and enforcement powers as the bank regulators. As agreed, our objective was to describe the types of supervisory and enforcement authorities (including prompt corrective action provisions) available to financial institution regulators and highlight distinctions between the specific authorities of the bank regulators, OFHEO, and FHFB. Enclosure I provides a detailed side-by-side analysis of the respective enforcement and prompt corrective action authorities of the bank regulators, OFHEO, and FHFB.

To respond to this request, we reviewed relevant statutes, legislative histories, agency opinions, and secondary sources relating to the supervisory and enforcement authorities of the financial institution regulators. We also met with agency officials from OFHEO and FHFB. We conducted our work at OFHEO and FHFB headquarters between October and December 2000.

Results in Brief

The financial institution regulators have similar types of powers and authorities, but they are not identical. Each financial institution regulator administers its own statutory scheme that contains authority to address unsafe and unsound conditions and practices, as well as certain violative conduct. The tools generally available to these regulators include informal supervisory actions; formal enforcement actions involving notice to the affected institutions, the opportunity for a hearing, and, if warranted, the imposition of sanctions such as a cease and desist (C&D) order or civil money penalties; and capital-based actions and restrictions generally referred to as prompt corrective action (PCA) provisions.

Based on each regulator's powers and authorities, it appears that each regulator has statutory tools available to address significant safety and soundness concerns. However, because of differences in existing authorities and regulatory discretion, it is likely that these regulators may approach similar concerns differently. For example, some differences appear to exist between OFHEO and the bank regulators regarding the grounds for issuing C&D orders. In addition, in contrast to the bank regulators and FHFB, OFHEO lacks authority to remove officers and directors, place an enterprise into receivership, or bring suit on the agency's behalf (OFHEO must rely on the Attorney General). These differences, in certain cases, may cause OFHEO to rely on less direct measures.

In addition to these general enforcement authorities, the bank regulators and OFHEO are required, or in certain instances authorized, to take specified supervisory actions based on an institution's capital under the PCA provisions.[1] Supervisory actions based on the PCA provisions differ from formal enforcement actions in that they do not typically involve notice and an opportunity for hearing. In addition, certain of the PCA provisions are mandatory, thereby eliminating the regulator's discretion in deciding whether or how to act.

Although FHFB's enabling statute requires FHFB to ensure that the Federal Home Loan Banks (FHLB) remain adequately capitalized, it does not contain provisions specifying particular supervisory actions that the Board must or may take in response to an FHLB's undercapitalized condition, as is the case for the bank regulators and OFHEO. The capital provisions of FHFB's enabling statute do place certain restrictions directly on the FHLBs linked to the statutorily prescribed capital requirements. FHFB officials pointed out that they can use their other statutory tools to take the discretionary actions found in the bank regulators' or OFHEO's PCA provisions; however, they are not required to take such actions.

Although the classifications triggering PCA actions are the same for both the bank regulators and OFHEO, the capital requirements underlying these classifications are different. Certain differences also exist between the bank regulators and OFHEO's PCA provisions. For example, it appears that OFHEO's PCA scheme, in some

[1] Each agency is required to ensure that the institutions it regulates comply with capital requirements established by statute or regulation. As noted later, OFHEO is in the process of adopting risk-based capital rules. FHFB adopted final rules implementing a new risk-based capital structure for the FHLBs that includes a statutory minimum capital standard.

instances, may provide for regulatory action at a lower level of capital classification than the bank regulators' PCA scheme, has fewer required actions imposed, and provides OFHEO more discretion in determining specifically what action to take. In addition, OFHEO's PCA provisions contain more notice and comment provisions for the enterprises. These statutory notice and comment requirements, which are absent from the bank regulators' PCA provisions, may result in a longer PCA process for OFHEO.

Background

Four federal regulators oversee federally insured banks and thrifts and are referred to in this report as the bank regulators. The Comptroller of the Currency regulates nationally chartered banks; the Board of Governors of the Federal Reserve System (FRS) regulates state-chartered banks that are members of FRS, bank holding companies, and financial holding companies; the Federal Deposit Insurance Corporation (FDIC) regulates state-chartered, nonmember banks; and the Office of Thrift Supervision regulates all federally insured thrifts, regardless of charter type, and their holding companies. The bank regulators have a wide array of supervisory authorities (including their examination and application review functions), regulatory powers, and enforcement tools to monitor the safety and soundness of the institutions they regulate. Under the Federal Deposit Insurance Act, each of these regulators is charged with taking supervisory and enforcement actions based on safety and soundness concerns, including capital-related concerns.

OFHEO is an independent regulator, within the Department of Housing and Urban Development (HUD), whose primary mission is to oversee the financial safety and soundness of Fannie Mae and Freddie Mac (collectively referred to as the enterprises).[2] It was established by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Safety and Soundness Act).[3] OFHEO's primary means of fulfilling its mission include establishing and ensuring compliance with capital standards for the enterprises, conducting on-site examinations to assess their management practices and financial condition, rulemaking, and taking enforcement actions as authorized under the Safety and Soundness Act.

FHFB is an independent federal agency created by the Financial Institutions Reform Recovery and Enforcement Act of 1989.[4] FHFB administers the Federal Home Loan Bank Act (FHLB Act), under which its primary duty is to ensure the safety and soundness of the FHLBs.[5] FHFB also is responsible for mission oversight. FHFB supervises the FHLBs by, among other things, ensuring that they satisfy capitalization requirements established pursuant to the act and maintain the ability to raise funds in the capital markets. FHFB is authorized to promulgate and enforce such regulations and orders that it determines are necessary to carry out the provisions of the FHLB Act. The Federal Home Loan Bank System Modernization Act of 1999 specified

[2] The statute separately designates HUD as having oversight over the enterprises' mission. This report does not address HUD's oversight function.
[3] 12 U.S.C. § 4511.
[4] 12 U.S.C.§ 1422a(a)(1)(2000).
[5]12 U.S.C. § 1422a.

FHFB's administrative enforcement powers with respect to safety and soundness matters.[6]

A Range of Enforcement Tools Is Available to Financial Institution Regulators

The tools available to financial institution regulators include informal supervisory actions; formal enforcement actions involving notice to the affected institution, the opportunity for a hearing, and, if warranted, the imposition of sanctions, including civil money penalties; and PCA. Although there are statutory, regulatory, and procedural differences among the financial institution regulators, we have used these three basic categories of enforcement tools for ease of description in this report.

Informal Supervisory Actions

The most frequent and informal means by which financial institution regulators address a safety and soundness or other supervisory concern occurs in connection with a regulator's exercise of its general supervisory function, such as examinations or reviews of reports. For example, in the course of an examination, an agency might become aware of a condition or conduct that it considers relevant to the institution's safety and soundness or that raises other supervisory concerns. In such a case, the agency typically will notify the institution of its determination and give the institution an opportunity to correct the problem to the regulator's satisfaction. This interaction is characterized as "suasion."

On the basis of the prevalence and severity of the circumstances and other considerations, the regulator may require an action in which the institution formally acknowledges the problem and commits to correct it. This type of action may be a board of directors' resolution, a commitment letter, or a memorandum of understanding.[7] An institution's failure to make a commitment or honor the commitment it undertakes may justify a more formal enforcement action.

The bank regulators, OFHEO, and FHFB rely most often on these types of supervisory actions.[8] In fact, to date, OFHEO has relied exclusively on these types of supervisory actions. OFHEO officials pointed out the enterprises' willingness to

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[6] The Modernization Act is contained in Title VI of the Gramm-Leach-Bliley Act, Pub. L. No. 106-102; 12 U.S.C. § 1422b.

[7] See Jackson, Howell E. and Symons, Edward L., *Regulation Of Financial Institutions* 334-335 (1999). The board of directors' resolution involves a commitment by the institution to respond to the deficiency in a way approved by the regulator. The commitment letter is often used with respect to institutions that are in good condition but have minor problems in isolated areas of activity. It is prepared by the regulator and sent to the institution for execution. The written memorandum of understanding reflects an agreement between the regulator and the institution on what actions are to be taken. Typically, it also is prepared by the regulator and contains provisions requiring the institution to establish a business plan to correct the problems identified by the regulator.

[8] FHFB has a mechanism for achieving compliance with a supervisory determination that operates in the context of the supervisory process, but which can have the same effect as a formal enforcement proceeding. Under FHFB's regulations, a supervisory determination requiring mandatory actions, such as a finding in an examination report, order, or directive, as well as any FHFB order or directive concerning a safety and soundness or compliance matter, is final unless the affected FHLB petitions FHFB for a review of the determination. The determination remains in effect while the petition is pending. 12 C.F.R. part 907 (2000). In December 2000, FHFB approved additional regulations governing formal enforcement actions, such as C&D proceedings.

resolve issues early and expeditiously. Under the Safety and Soundness Act, the Director of OFHEO is required to provide Congress with an annual report that includes a description of any actions taken by the Director, as well as the results of enterprises' examinations. These disclosure provisions may encourage early resolution of issues to avoid disclosure of OFHEO's concerns. The bank regulators and FHFB do not have such a disclosure requirement.

Formal Enforcement Actions

In the event informal action is ineffective or inappropriate, each financial institution regulator has more formal enforcement tools available. Formal enforcement actions may include the formal written agreement, the issuance of C&D orders, the suspension or removal of officers and directors (except for OFHEO as discussed below), and civil money penalties. A formal written agreement sets forth the specific corrective and remedial measures that the regulator determines are necessary to return the institution to a safe and sound condition.[9] A C&D order may require an institution to halt specified conduct or to take affirmative action to correct conditions resulting from the conduct.

Based on the respective statutory authorities of the bank regulators, OFHEO, and FHFB, each appears to have statutory tools available to address significant safety and soundness concerns. For example, all can issue written agreements and C&D orders and impose civil money penalties. However, there are differences between the bank regulators' authorities and those of OFHEO regarding aspects of their C&D authorities; removal and prohibition authorities applicable to officers and directors; and receivership and litigation authorities, as highlighted below. These differences, in certain cases, may cause OFHEO to rely on less direct measures.

Cease and Desist Authorities

The Safety and Soundness Act specifically provides OFHEO with authority to issue a C&D order and impose civil money penalties based on (a) conduct having an adverse effect on capital; (b) misconduct by an executive officer or director resulting in unjust enrichment or actual or likely substantial loss to the enterprise; (c) conduct in violation of the Safety and Soundness Act and the enterprises' charter acts, as well as conduct in violation of any order, rule, or regulation under those laws (enforcement of HUD established housing goals is excepted); and (d) the violation of any written agreement between the enterprise and OFHEO.[10] The Federal Deposit Insurance Act (FDI Act) provides that the bank regulators may issue a C&D order and impose civil money penalties based on (a) an unsafe or unsound practice; or (b) a violation of a law, regulation, or any condition imposed in writing by the agency or any written

[9] The formal written agreement, which must be signed by the institution's board of directors, is used to address situations that may be serious, but in which the regulator has confidence that the institution's management can and will correct the problem by performing the agreed-upon measures. The agreement has the effect of a consent order in that it obviates the need for a notice and hearing to determine whether the condition or conduct at issue violated any legal standard. An institution's breach of the agreement can serve as grounds for issuance of a C&D order. Although an institution cannot be forced to enter into a formal written agreement, it has an incentive to do so because failure to enter such an agreement might raise the potential for a more formal enforcement proceeding.

[10] 12 U.S.C. § 4631 (2000).

agreement entered into with the agency.[11] FHFB also has specific authority to issue a C&D order based on safety and soundness grounds or violative conduct.

A few differences exist in these authorities. First, the OFHEO C&D provision does not specifically list an unsafe and unsound practice as grounds for issuing an order (the bank regulators and FHFB have this ground listed). However, OFHEO maintains that unsafe and unsound practices are violations of the Safety and Soundness Act and, therefore, fall within the third listed ground for issuing a C&D order. Second, the bank regulators can issue a C&D order to any institution–affiliated party (IAP), which includes an institution's directors, officers, controlling stockholders, and independent contractors.[12] OFHEO may issue such an order only against an enterprise or its affiliates, an executive officer, or director.[13] Similar to OFHEO, FHFB may issue a C&D order against an FHLB, an executive officer, or director. Finally, in contrast to the bank regulators and FHFB, there is no specific statutory authority for OFHEO to issue a C&D order if an enterprise were to violate conditions imposed in writing. Often, bank regulators issue approvals of some action subject to conditions. Violations of conditions that a bank regulator imposes in writing may be grounds for a C&D order and may even subject bank officers to removal. Although OFHEO lacks this explicit authority, it typically does not issue the type of conditional approvals that the bank regulators issue.

Removal and Prohibition Authority

OFHEO does not have the same direct removal and prohibition authorities applicable to officers and directors as the bank regulators and FHFB have. The bank regulators may remove officers, directors, and other specified parties or prohibit them from participating in the affairs of the institution if the agency determines that the affected individual or entity violated a law or regulation, a final C&D order, or a written condition or agreement; or if it engaged in an unsafe or unsound practice; or breached a fiduciary duty. The conduct must adversely affect the institution's financial condition or have other specific consequences and must involve either personal dishonesty or a willful disregard of the institution's safety and soundness.[14] Under its statute, FHFB may take a similar action if it determines that cause exists. OFHEO does not have similar explicit removal or prohibition authorities. Rather, OFHEO, in connection with the issuance of a C&D order, can, among other actions, direct

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[11] 12 U.S.C. § 1818(c) (2000).

[12]Under the FDI Act, an IAP is any director, officer, employee, or controlling stockholder of an insured institution, other than a bank holding company; any person who has filed or is required to file a change-in-control notice as required under 12 U.S.C. 1817(j); any shareholder (other than a bank holding company) or other person who participates in the conduct of the affairs of the institution; and any independent contractor who knowingly or recklessly participates in a violation of any law or regulation, any breach of fiduciary duty, or any unsafe or unsound practice, where such conduct caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the institution.

[13] The Safety and Soundness Act defines "executive officer" of an enterprise to mean the chairman of the board; the chief executive officer; chief financial officer; president; vice chairman; any executive vice president; and, any senior vice president in charge of a principal business unit, division, or function. It also provides that affiliates of Fannie Mae and Freddie Mac are considered to be parts of the enterprise. Except as provided by OFHEO, an affiliate is any entity that controls, is controlled by, or is under common control with an enterprise. 12 U.S.C § 4502 (2000).

[14] 12 U.S.C. § 1818(e) (1994). In addition, an IAP may be suspended, removed, or prohibited from participating based on a final judgment, conviction, or plea agreement (and suspended as a result of specified criminal charges).

the affected enterprise to hire a new employee to perform the job of the officer or director at issue.[15] This action appears to be a less direct measure than the removal authority afforded the bank regulators.

Litigation Authority

Finally, in connection with the implementation of these formal enforcement actions through the court system, only OFHEO must rely on the Attorney General to bring suit on the agency's behalf. The bank regulators and FHFB have independent litigation authority, which allows them to bring suit on behalf of the respective agency.

Prompt Corrective Action

In addition to authorizing the use of formal enforcement proceedings, Congress established PCA schemes for both the bank regulators and OFHEO (and not for FHFB, as discussed below) to mandate early regulatory intervention for institutions having capital adequacy problems. The purpose of PCA is to ensure that regulatory action is taken at the time an institution becomes financially troubled in order to prevent a failure or minimize resulting losses.[16] Under the PCA scheme applicable to the bank regulators, the regulator is required to have regulations specifying capital levels at which an institution is to be classified as well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized. OFHEO's PCA scheme does not provide for the well-capitalized classification. With respect to both the bank regulators and OFHEO, a PCA action is triggered by an institution's classification as undercapitalized, significantly undercapitalized, or critically undercapitalized. However, although the classification names triggering PCA actions are the same for both the bank regulators and OFHEO, the definitions of these classifications are different.[17] For example, as OFHEO officials noted, an undercapitalized bank does not become significantly undercapitalized until its capital diminishes by 25 percent below the levels at which a bank becomes undercapitalized. Under the OFHEO PCA scheme, an undercapitalized enterprise becomes significantly undercapitalized as soon as the capital falls beneath the minimum capital standard. Furthermore, the stringency of the capital standards differs because it reflects, in large part, the difference in capital structures and risks of the regulated institutions. Certain of the regulators' respective capital standards are specified in statute, while others are set forth in regulation. In conjunction with its PCA scheme, OFHEO is required to adopt risk-based capital requirements and is in the process of doing so.[18]

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[15] 12 U.S.C. § 4631(d) (2000).

[16] See Macey, Jonathan R. and Miller, Geoffrey P., *BANKING LAW AND REGULATION*, 294-296 (2d. ed. 1997); See also Jackson, Howell E. and Symons, Edward L., *Regulation Of Financial Institutions* (1999). These publications contain informative discussions of the enforcement and supervisory authorities of the federal banking agencies.

[17] The minimum capital standards for financial institutions are set forth in both statute and/or required to be set forth in regulation. In the case of the enterprises (unlike banks), the risk-based capital component as set forth in statute is a forward-looking measure with a 10-year time horizon. The required risk-based capital regulations, which have been proposed, have not yet taken effect.

[18] OFHEO's minimum capital rule is set forth at 12 C.F.R. pt. 1750 (2000). OFHEO's most recent proposed rules for risk-based capital were published in April 1999 (64 Fed. Reg. 18083). In December 2000, a final rule had not been promulgated, although OFHEO announced that the final rule had been

Certain differences, in addition to different capital requirements underlying the classifications, exist between the bank regulators and OFHEO's PCA provisions. Generally, the bank regulators' PCA provisions require the regulator to take more actions at an earlier classification point.[19] For example, all banks (including adequately capitalized ones) are generally barred from making capital distributions if doing so would leave the institution undercapitalized.[20] In the case of OFHEO, the statute does not explicitly impose this restriction until the enterprise is undercapitalized, and the distribution restriction is limited to those distributions that would result in the enterprise being reclassified downward. However, the enterprises must secure approval for any dividend that would leave them less than adequately capitalized. In addition, the bank regulators are required to take more actions against an undercapitalized institution than OFHEO is. Specifically, a bank regulator is required to (1) increase its monitoring and periodic review of the institution's efforts to restore capital (2) have the undercapitalized institution submit a capital restoration plan acceptable to the regulator (3) restrict its asset growth unless its growth falls within specified exceptions and (4) provide prior approval of any acquisition, branching, and new lines of business. The statute does not require that the institution receive a notice or hearing in connection with any of these required actions.[21] OFHEO does not have the same range of required (or discretionary) actions in connection with an undercapitalized enterprise. Instead, under OFHEO's PCA provisions, only two actions are to be imposed upon an undercapitalized enterprise– the submission of an acceptable capital restoration plan and the capital distribution restriction set forth above.[22]

Similarly, the bank regulators are required to take a defined set of actions against significantly undercapitalized institutions. For example, in such cases, the bank regulator must (1) require the sale of shares or obligations sufficient to become adequately capitalized, or in specified instances, require the merger or combination of the institution; (2) restrict affiliate transactions; (3) restrict interest rates paid on deposits; and (4) restrict senior executive officers' compensation.[23] In addition, the bank regulators are provided the authority to take numerous other discretionary actions.[24] In response to a significantly undercapitalized enterprise, OFHEO is

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sent to the Office of Management and Budget for clearance. On December 20, 2000, FHFB approved final rules implementing a new risk-based capital structure for the FHLBs that includes a statutory minimum capital standard.

[19] This letter does not evaluate the distinctions (or their effect) between the classification categories.

[20] This provision contains an exception that would allow an institution to repurchase, redeem, retire, or otherwise acquire its own shares if (1) an equivalent amount of shares or obligations are issued concurrently, and (2) the transaction improves the institution's financial condition.

[21] In addition, the bank regulators have discretion to take additional actions relating to an undercapitalized institution normally applicable to significantly undercapitalized institutions if the regulator determines that those actions are necessary to carry out the purpose of the PCA provisions.

[22] This provision governing supervisory actions applicable to undercapitalized enterprises (12 U.S.C. § 4615(c)) has an effective date of one year later than the date of the risk-based capital regulations, which is later than the effective dates of OFHEO's other PCA provisions (which take effect upon the first capital classification of the enterprises). Because these regulations are not yet effective, this provision is also arguably not yet effective.

[23] The first three actions are mandatory unless the regulator determines that they would not further the purpose of the section.

[24] In response to a significantly undercapitalized classification, a bank regulator can take one or more actions prescribed by regulation for institutions that are critically undercapitalized if necessary to

required to take the same two actions as described above–requiring an acceptable capital restoration plan and ensuring compliance with capital distribution restrictions. In addition, OFHEO has discretion to (1) limit the increase in or order the reduction of the enterprise's obligations, (2) limit or prohibit growth of assets or require a contraction of assets, (3) require acquisition of new capital, (4) restrict activities, (5) reclassify the enterprise as critically undercapitalized under certain circumstances, and (6) appoint a conservator should certain financial conditions exist.

Receivership Authority

With respect to critically undercapitalized institutions, the bank regulators must appoint a receiver, appoint a conservator with FDIC's concurrence, or take other action with FDIC's concurrence if it would better serve PCA purposes. Under OFHEO's PCA provisions, OFHEO may appoint a conservator for a significantly undercapitalized enterprise and, after appropriate notice, generally must appoint one for a critically undercapitalized enterprise.[25] Unlike the bank regulators, OFHEO lacks the authority to place an enterprise into receivership. FDIC, as receiver, is empowered to take over the assets and operate an insured depository institution, assuming all of its powers and conducting all of its business. It may place the failed institution into liquidation and sell its assets. A conservator, on the other hand, is typically appointed to conserve (not dispose of) the assets of the entity. Under OFHEO's conservatorship authority, it may terminate the conservatorship if it is in the public interest and may be safely accomplished and permit the institution to resume its operations. FHFB has the statutory authority to liquidate or reorganize an FHLB "whenever [FHFB] finds that the efficient and economical accomplishment of the purposes of the [FHLB Act] will be aided by such action…."[26] To date, neither OFHEO nor FHFB has had to rely on these provisions.

Capital Reclassification Authority

In addition, both the bank regulators and OFHEO have authority to reclassify an institution downward, into a lower capital classification category, for statutorily prescribed reasons. In the case of a bank, reclassification can occur if the regulator (1) determines that the institution is in an unsafe or unsound condition, or (2) deems the institution to be engaging in an unsafe or unsound practice. Notice and a hearing are required in connection with the first type of discretionary reclassification action.[27] Further, an undercapitalized institution is treated as a significantly undercapitalized institution if it fails to submit or implement an acceptable capital plan. OFHEO has discretion to reclassify an enterprise downward if (a) the enterprise engages in conduct that could result in a rapid depletion of core capital, (b) there are significant

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carry out the purposes of PCA. These actions include activities restrictions and requiring regulatory approval of: (a) any material transaction other than in the normal course of business, such as investments, expansion, acquisitions, and asset sales; (b) extending credit for highly leveraged transactions; (c) amendments to the charter or bylaws; and (d) material changes in accounting methods and other matters listed by statute. See 12 U.S.C. § § 1831o(f)(5) & 1831o(i) (2000).

[25] OFHEO's conservatorship authority is not limited to the PCA regime.

[26] 12 U.S.C. § 1446.

[27] Notice and an opportunity for a hearing are not required if a reclassification action is in response to the banking agency's having deemed an institution to be engaging in an unsafe or unsound practice based upon a less-than-satisfactory rating for asset quality, management, earnings, or liquidity.

declines in housing prices, or (c) the enterprise fails to submit or comply with an acceptable capital restoration plan. Although these bases for reclassification are different, both sets of regulators are afforded broad authority to reclassify their regulated institutions.

PCA Notice and Comment

The bank regulators are authorized to take all but two types of PCA actions (dismissal of certain directors or officers and reclassification based on an unsafe or unsound condition) without giving the subject institution notice and an opportunity to respond to the action. OHFEO, on the other hand, must provide the affected enterprise a notice and comment period in connection with a number of its PCA actions. Specifically, OFHEO may not reclassify an enterprise or take any discretionary PCA-type action, including the appointment of a conservator, without first notifying the enterprise of the proposed action. The enterprise has 30 days from the date it receives the notice to comment on the proposed action. OFHEO has authority to shorten (or extend) the comment process.[28] After the comments are received or the comment period expires, OFHEO must consider and respond to the comments. Because of the statutory notice and comment requirements contained in OFHEO's PCA provision, it may take OFHEO longer than the bank regulators to implement many of its PCA actions.

Lack of Specific FHFB PCA

FHFB's enabling statute does not contain provisions specifying particular supervisory actions that the Board must or may take in response to a FHLB's undercapitalized condition, as is the case for the bank regulators and OFHEO. The capital provisions of FHFB's enabling statute do place certain restrictions directly on the FHLBs linked to the statutorily prescribed capital requirements. Specifically, the FHLB Act (a) restricts an FHLB from redeeming its capital stock if, following the redemption, the bank would fail to satisfy any minimum capital requirements; (b) restricts an FHLB from making any distribution of its retained earnings unless, following the distribution, the FHLB would continue to meet all applicable capital requirements; and (c) requires each FHLB's capital plan to provide for continuing FHLB review and adjustment of the minimum investment required of each member of the FHLB to ensure that the FHLB remains in compliance with the minimum capital requirements, and for prompt compliance with such adjustments by each member.[29] The FHLB Act also requires FHFB to ensure that the FHLBs remain adequately capitalized and provides FHFB with authority to enforce its capital regulations. In addition to these prohibitions and authorities, FHFB officials maintain that they can use their statutory supervisory and enforcement tools to take the discretionary actions found in the bank regulators' or OFHEO's PCA provisions; however, they are not required to take such actions. The PCA provisions applicable to bank regulators specifically state that PCA does not limit their authority to take action in addition to (but not in derogation

[28] The timing and comment procedures are different in connection with the appointment of a conservator.

[29] These restrictions and requirements do not specify particular actions for FHFB to take when a FHLB becomes undercapitalized at a particular classification level, unlike the case with the bank regulators and OFHEO.

of) actions required under PCA. Similar language is found in OFHEO's PCA provisions.[30]

Conclusions

The bank regulators, OFHEO, and FHFB each have an array of statutory supervisory and enforcement powers for ensuring that the institutions they supervise are in a safe and sound condition. Each regulator has its own statutory scheme that contains specific authorities to address unsafe and unsound conditions and practices, as well as certain violative conduct. Although it appears that each regulator has statutory tools available to address significant safety and soundness concerns, differences do exist in their authorities and OFHEO lacks certain authorities afforded the bank regulators. For example, differences exist between OFHEO and the bank regulators regarding the grounds for issuing a C&D order; and OFHEO lacks authority to remove officers and directors and does not have receivership or independent litigation authority. It is difficult to determine the impact of these differences, particularly since OFHEO, to date, has not had to take formal enforcement actions.

In connection with PCA authority, FHFB's enabling statute does not contain provisions specifying actions to be taken should an institution become undercapitalized, as is the case for the bank regulators and OFHEO. OFHEO's PCA scheme differs in certain respects from that of the bank regulators. OFHEO's PCA scheme, as compared to the bank regulators', may provide for regulatory action later (in terms of capital classification) than the bank regulators' PCA scheme, has fewer required actions imposed, and provides OFHEO more discretion in determining specifically what action to take. In addition, OFHEO's PCA provisions contain more opportunity for notice and comment than the provisions applicable to the bank regulators. In light of these differences, as well as the different capital requirements imposed on the various regulated institutions, it is difficult to ascertain the impact of the variations in the two PCA schemes.

Agency Comments and Our Evaluation

We obtained oral comments from FHFB and OFHEO on a draft of this letter. FHFB's Managing Director and General Counsel and OFHEO's General Counsel provided a number of technical comments, which we incorporated where appropriate. The FHFB officials stated that in their view, certain FHFB authorities were similar to PCA provisions. Specifically, they stated that the capital provisions of FHFB's enabling statute do place certain restrictions directly on the FHLBs linked to the statutorily prescribed capital requirements. We revised our discussion to clarify the restrictions cited by the FHFB officials.

As agreed with your office, we plan no further distribution until 30 days from the date of this letter unless you publicly release its contents earlier. We will then send copies to the Ranking Minority Member of the Subcommittee on Capital Markets, Insurance,

[30] See 12 U.S.C. § 4616(b).

and Government Sponsored Enterprises; Representative Michael Oxley, Chairman, and the Ranking Minority Member, House Committee on Financial Services; Senator Phil Gramm, Chairman, and Senator Paul Sarbarnes, Ranking Member, Senate Committee on Banking, Housing, and Urban Affairs; Armando Falcon, Jr., Director of OFHEO; Allan I. Mendelowitz, Chairman of FHFB; and Mel Martinez, Secretary of HUD. The letter will also be available on GAO's home page at http://www.gao.gov.

If you have any questions, please contact Thomas J. McCool at (202) 512-8678, Lynn H. Gibson at (202) 512-8153, or William B. Shear at (202) 512-8678. Key contributors to this letter were Rosemary Healy and Paul G. Thompson.

Sincerely yours,

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Managing Director
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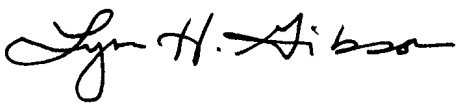

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Enforcement and Prompt Corrective Action Authorities

A. Formal Enforcement Authority

	Bank Regulators	OFHEO	Finance Board
Formal Agreement	Implied from general supervisory powers and enforcement authorities.	Implied from general supervisory and enforcement authorities.	Implied from general supervisory and enforcement authorities.
C&D Order	Against: insured depository institutions (IDI) and institution-affiliated parties (IAP).[1] Specified Grounds: (1) unsafe or unsound practice;[2] (2) violation of any law, rule, regulation, written condition imposed in connection with granting an application or request, or any written agreement. C&D order may include affirmative order to correct conditions resulting from violations and practices and limitation on activities or functions of an institution or IAP.	Against: enterprises (includes affiliates), their executive officers, and directors. Specified Grounds: (1) potential impact of conduct on core capital (separate provisions for adequately capitalized and undercapitalized enterprises)--conduct that either "threatens significant depletion" (undercapitalized) or is "likely to result in material depletion" (undercapitalized); (2) misconduct by an officer or director resulting in unjust enrichment or actual or likely substantial loss to the enterprise;	Against: a Federal Home Loan Bank (FHLB), any executive officer or director. Specified Grounds: (1) unsafe or unsound practice; (2) violation of any law, order, rule, or regulation, any written condition imposed in connection with granting any application or other request, or any written agreement. C&D may include affirmative order to correct conditions resulting from violations and practices and limitation of activities and functions of FHLBs or

[1] Under the Federal Deposit Insurance Act (FDI Act), an IAP is any director, officer, employee or controlling stockholder of an insured institution, other than a bank holding company; any person who has filed or is required to file a change-in-control notice as required under 12 U.S.C. 1817(j); any shareholder (other than a bank holding company) or other person who participates in the conduct of the affairs of the institution; and any independent contractor who knowingly or recklessly participates in a violation of any law or regulation, any breach of fiduciary duty, or any unsafe or unsound practice, where such conduct caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the institution.

[2] In addition to a firm's capital status and practices relating directly to its financial health, factors indicative of safety and soundness include the safety and soundness standards set forth in 18 U.S.C. § 1831p-1 for federal banking agencies to promulgate in regulations or guidelines. These standards relate to operational and managerial matters such as, but not limited to, internal controls, loan documentation, credit underwriting, interest rate exposure, asset growth, asset quality, earnings and stock valuation standards, and compensation.

		3) conduct that violates the Safety and Soundness Act or enterprise charter acts (except for provisions pertaining to HUD housing goals), or any order, rule or regulation under those laws, or any written agreement with OFHEO. C&D order may include affirmative order to correct conditions resulting from violations and practices and an order limiting activities or functions of the enterprise or any executive officer or director.	IAP.
Removal and Prohibition	Removal or prohibition action can be taken against any IAP. Grounds: violation of law, regulation, final C&D order, written condition, or written agreement, engagement in unsafe or unsound practice or breach of fiduciary duty, where the conduct relates to actual or probable financial loss or other damage or has other specified consequences and involves dishonesty or mental culpability. Suspension or prohibition can be taken against any IAP if necessary to protect institution or interests of depositors. Additional grounds for removal or prohibition relate to certain officers, directors and IAP for culpable violations of specific statutes related to banking. Additional grounds exist for IAP suspension or removal based on	No specific authority, but authority exists to require enterprises to hire qualified officers or directors to remedy conditions resulting from conduct or violations upon which a C&D order has been entered.	May remove or suspend "for cause" a director, officer, employee, or agent of an FHLB or joint office.

	criminal proceedings: Suspension or prohibition pending outcome of criminal charges against IAP for crime of dishonesty or violation of specified statutes; removal or prohibition for conviction or plea agreement involving same offenses.		
Civil Money Penalties	First tier: violation of law, regulation, final enforcement order, written condition or agreement or temporary C&D order; violation of removal, suspension, or prohibition order; violation of monetary transaction and report requirements. Amount: Not more than $5,000 for each day the violation continues. Second tier: any violation of law, etc., reckless unsafe or unsound practice, or breach of fiduciary duty, that is part of a pattern of misconduct, causes more than a minimal loss, or results in pecuniary gain or benefit. Amount: Not more than $25,000 for each day the violation, practice, or breach continues. Third tier: knowing violation of law, etc., engagement in unsafe or unsound practice, breach of fiduciary duty and knowingly or recklessly causes substantial loss or substantial pecuniary gain or benefit. Amount:	Grounds: (1) violation of the Safety and Soundness Act, the charter acts (except for provisions relating to housing goals) and any order, rule, or regulation under any such act; (2) violation of any final or temporary PCA-type order or final or temporary C&D order; (3) violation of written agreement; or (4) conduct that causes or is likely to cause a loss to the enterprise. First tier (available against enterprises only): may be imposed only for violations described in paragraphs (1) through (3), above. Amount: not more than $5,000 for each day of the violation. Second tier: any violation or conduct constituting grounds for CMP that is part of a pattern of misconduct or involved recklessness and caused or likely would cause a material loss. Amount: Against an officer or director – no more than $10,000 for each day	Same as OFHEO, but with respect to the pertinent statutes, regulations, etc.

	(1) persons other than IDI – not more than $1,000,000 for each day the violation, practice of breach continues; (2) IDI--not to exceed the lesser of $1,000,000 or 1 percent of total assets per day the violation, practice, or breach continues.	that the violation or conduct continues; against an enterprise–not more than $25,000 per each day the violation or conduct continues. Third tier: any violation or conduct constituting grounds for CMP if it was knowing and caused or would likely cause a substantial loss to the enterprise. Amount: Against an officer or director--not more than $100,000 for each day the violation or conduct continues; against an enterprise–not more than $1,000,000 per each day the violation or conduct continues.	
Termination of Insurance	FDIC may terminate deposit insurance based on (1) unsafe or unsound practice by the IDI, its directors, or trustees; (2) unsafe or unsound condition to continue operations; (3) violation by institution, directors, or trustees of any applicable law, regulation, order, written condition imposed by FDIC or written agreement between the IDI and FDIC.	N/A	N/A

B. PCA Provisions

	Bank Regulators	**OFHEO**	**Finance Board**
Undercapitalized	Mandatory: (1) timely submission of acceptable capital restoration plan (CRP); (2) close monitoring of condition and compliance with CRP;	Mandatory: (1) timely submission of acceptable CRP; (2) statutory prohibition on capital distribution if it would make undercapitalized enterprise	FHFB's enabling statute does not contain provisions specifying particular supervisory actions that the Board must or may take in response to a FHLB's

	(3) statutory restrictions on asset growth; (4) agency approval of acquisitions, branching, and new business lines. Discretionary: regulator has discretion to take actions applicable to significantly undercapitalized institutions, if necessary.	significantly or critically undercapitalized. Discretionary: reclassification if (a) enterprise fails to submit a timely CRP "substantially in compliance" with statutory requirements for CRP or OFHEO does not approve CRP; or (b) enterprise failed to make, in good faith, reasonable efforts necessary for compliance and fulfill the compliance schedule approved by OFHEO.	undercapitalized condition, as is the case for the bank regulators and OFHEO. The capital provisions of FHFB's enabling statute do place certain restrictions directly on the FHLBs linked to the statutorily prescribed capital requirements. Specifically, the FHLB Act (a) restricts an FHLB from redeeming its capital stock if, following the redemption, the bank would fail to satisfy any minimum capital requirements; (b) restricts an FHLB from making any distribution of its retained earnings unless, following the distribution, the FHLB would continue to meet all applicable capital requirements; and (c) requires each FHLB's capital plan to provide for continuing FHLB review and adjustment of the minimum investment required of each member of the FHLB to ensure that the FHLB remains in compliance with the minimum capital requirements, and for prompt compliance with such adjustments by each member. The FHLB Act also requires FHFB to ensure that the FHLBs remain adequately capitalized and provides FHFB with authority to enforce its capital regulations. In addition to these prohibitions and authorities, FHFB officials maintain that they can

			use their statutory supervisory and enforcement tools to take the discretionary actions found in the bank regulators' or OFHEO's PCA provisions.
Significantly Undercapitalized or Undercapitalized and fails to submit or materially implement CRP.	Mandatory: regulator shall take the following actions unless they do not serve PCA purposes: (1) require sale of shares or obligations sufficient to become adequately capitalized or, if one or more grounds exist for appointing a conservator or receiver, require institution to be acquired by an insured depository institution holding company or combine with another institution; (2) restrict transactions with affiliates; and (3) restrict interest rates paid on deposits. Also, agency approval is required for bonuses or increased compensation to senior executive officers. Discretionary (or mandatory use of at least one of the following, if agency determines combined actions (1) through (3), above, would not further PCA purposes): (1) recapitalization; (2) restrict affiliate transactions; (3) restrict amounts of interest paid on deposits; (4) restrict asset growth; (5) restrict activities by institution or subsidiary posing excessive risk to the institution; (6) require improvement of management (including dismissal of	Mandatory: (1) require timely submission of an acceptable CRP; (2) prohibit any capital distribution that would result in reclassification as critically undercapitalized and require OFHEO approval for any other capital distribution. Discretionary: OFHEO may (1) limit increase or order reduction of obligations of enterprise; (2) limit or prohibit asset growth or require contraction of assets; (3) require acquisition of new capital in form and amount determined by OFHEO; (4) require termination, reduction, or modification of any activity determined to create excessive risk; (5) reclassify as critically undercapitalized if (a) CRP is not in substantial compliance with statutory requirements or is not approved, or (b) enterprise failed to make in good faith reasonable efforts to comply with CRP (same as reclassification standards for undercapitalized); (6) appoint conservator subject to statutory standards if OFHEO determines core capital to be less than statutory	See above.

	directors and senior executive officers); (7) prohibit deposits from correspondent banks; (8) require prior approval by the Federal Reserve Board of capital distribution by controlling holding company; (9) require divestiture actions under certain circumstances; (10) require any other action the agency determines to serve PCA purpose better than those listed, including actions specifically applicable to critically undercapitalized institutions. Discretion to impose additional restrictions if necessary: agency may impose one or more activities restrictions prescribed by FDIC regulation for critically undercapitalized institutions.	minimum capital and alternative remedies are unsatisfactory. (Statutory standards include written determination that enterprise (a) is not likely to pay obligations in the normal course of business, (b) has incurred or faces substantial depletion of core capital and timely replenishment is unlikely, (c) concealed or refused inspection of material books and records, or (d) willfully violated or is in violation of a final C&D order.)	
Critically Undercapitalized	Statutory requirements: (A) compliance with FDIC-prescribed (by order or regulation) activities restrictions and prohibitions against the following: (1) entering material transactions outside the normal course of business; (2) extending credit for highly leveraged transactions; (3) amending charter or by-laws (unless necessary to comply with	Statutory requirement: Conservator to be appointed unless OFHEO, with concurrence of Treasury, determines that appointment would have serious adverse effects on economic condition of national financial markets or the financial stability of the housing finance market and the public interest would be better served by taking some other authorized enforcement action.	See above.

	requirements); (4) material change in accounting methods; (5) engaging in covered transactions with affiliates (as defined in 12 U.S.C. § 371c(b) (Section 23A of the Federal Reserve Act); (6) paying excessive compensation or bonuses; (7) paying interest on new/renewed liabilities above prevailing rates; (B) stop payments of principal and interest on subordinated debt; (C) agency must appoint a receiver or FDIC-approved conservator or take other FDIC-approved action if it better achieves PCA purposes; (D) receiver must be appointed if institution remains critically undercapitalized for 270 days unless agency and FDIC see improvement and certify the institution is not expected to fail.		
Reclassification	If an agency determines an institution to be in unsafe or unsound condition after notice and an opportunity for hearing, or deems the institution to be engaging in an unsafe or unsound practice based on a less-than-satisfactory examination rating for asset quality, management, earnings, or liquidity, the agency may: (1) reclassify a well capitalized institution as adequately capitalized; (2) treat an adequately capitalized institution as undercapitalized; (3) subject an undercapitalized institution	Based on conduct or asset values OFHEO may reclassify an enterprise one grade lower if (a) conduct not approved by OFHEO could result in a "rapid depletion of core capital"; or (b) the "value of the property subject to mortgages held or securitized by" the enterprise has decreased significantly (OFHEO may reclassify adequate–to undercapitalized, under-to significantly undercapitalized, and significantly–to critically undercapitalized.) (Reclassification also may be based on	See above.

	to one or more actions authorized for significantly undercapitalized institutions.	undercapitalized or significantly undercapitalized classifications if statutory requirements for capital restoration plans are not satisfied.)	
Conservatorship, or Receivership, Closure	Authority to appoint a receiver or conservator; receiver required if other action fails to restore capital. See PCA based on "critically undercapitalized" classification.	Authority only to appoint a conservator. See PCA based on "significantly undercapitalized," or "critically undercapitalized" classifications.	FHFB may liquidate or reorganize a FHLB if it finds that the efficient and economical accomplishment of the purposes of the FHLB Act will be aided by such action.

C. Ancillary Authorities

	Bank Regulators	**OFHEO**	**Finance Board**
Independent litigation authority	Have independent litigation authority.	Has no independent litigation authority. OFHEO may request Attorney General to bring judicial enforcement action with respect to "any effective notice or order" issued in formal enforcement proceedings or pursuant to its PCA-type authority. Judicial enforcement of CMP by Attorney General or by OFHEO under direction and control of Attorney General.	Has independent litigation authority.
Subpoena authority	Has subpoena authority in connection with administrative enforcement proceedings.	Same as bank regulators.	Same as OFHEO.

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