

Dealing with Weak or Problem Banks

WB/IMF/FRB Seminar

for Senior Bank Supervisors of Emerging Economies

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October 24, 2019

Disclaimer

The opinions expressed here are my own and may not reflect the opinions of the Federal Reserve Bank of New York or the Board of Governors of the Federal Reserve System.

Supervisors

- Determine local regulatory minima for financial indicators
- Want safe and sound institutions, individually and collectively
- Create the opportunity for improvement

- Protect depositors, borrowers, financial markets, and ...owners
- Maintain confidence in the financial system
- Ensure credit availability

Supervisory Questions

What is the Source of Our Concern?

What is the Root Cause of Our Concern?

What is the Severity of Our Concern?

What is the Speed of Our Concern?

What is the Source of Our Concern?

A Bank

or

A Group of Banks

Supervisory Model for Individual Institutions

- Ongoing, regular Supervision
 - Financial condition and trend
 - BAU and Stress
 - Managerial behavior
 - [Annual] Rating Processes
 - CAMELS
 - LFI - Capital, Liquidity, Governance & Controls
 - RFI – Risk Management, Financial Condition, Impact
 - Multiple Supervisory Authorities
- Monitoring/Surveillance
 - Formal/Informal
 - Peer Analyses
 - Market Indicators: Funding Spreads/Composition, Credit Spreads, CDS, Debt/Equity Pricing

Supervisory Model for Multiple Institutions

- Stress Testing (for large institutions)
 - CCAR and CLAR
 - Annual and quarterly processes
 - Scenarios
 - Sensitivity Analyses
- Resolution Planning (for large institutions)
 - What does an orderly wind-down look like?
- Financial Stability?

Enhanced/Heightened Supervision

- Tailored Approach
 - Fact and Circumstance-Dependent
 - Plan, Design, Implementation, and Sustainability
- Supervisory Time and Resources
 - Planning
 - Execution
- Realistic Remediation Horizon
 - Confirmation
 - Two Challenges
 - Compliance/Non-Compliance
 - Expectations through Time

Supervisory Role Continuum

- Expectation Setter?
- Expectation Evaluator?
- Advisor?
- Consultant?
- Approver?

..... depends on supervisor's legal and statutory authority and its ability and willingness to use it

Supervisory Role – A Model

- The Problem/Concern
 - Impact to Safety and Soundness
- The Remediation Plan and Accountabilities
 - People, Milestones, and Budget
 - Timeline
 - Contingencies/Dependencies
- The Monitoring Plan
- The Confirmation of Remediation/Corrective Action
 - Thresholds
 - Third Parties?

What is the Root Cause of Our Concern?

Idiosyncratic

(event-driven, a decision, series of decisions, expansion, concentration)

or

Macroeconomic

(business sector, geography, client set)

What is the Severity and Speed of Our Concern?

Credit Decisions

Trading Decisions

Operational Event

Compliance Issue

Cyber Event/Vendor Failure

....How fast is capital and/or liquidity deteriorating?

....How culpable is management?

The U.S. Enforcement Action Spectrum

- Periodic feedback from examination activity
 - “Nudging”/Moral Suasion
 - Formal Feedback – MRIAs, MRAs
 - Requires response and action
- Typical Issues:
 - Improve practices – capital planning, compliance, operational risk, controls
 - Increase board/senior management involvement
 - Enhance credit underwriting, risk management, and administration

The U.S. Enforcement Action Spectrum

Informal Enforcement Actions

- Supervisory/Commitment Letter
 - Least severe form of enforcement action; typically used to correct minor problems
- Board Resolution
 - Represent a number of voluntary commitments made by directors on behalf of the institution that are incorporated into the corporate minutes
- Memorandum of Understanding
 - Structured documents that are signed by both the regulator and the institution

These actions are not legally enforceable and are not publically disclosed

The U.S. Enforcement Action Spectrum

Formal Enforcement Actions

- Written Agreements
 - Issued by consent
- Cease and Desist Orders
 - Generally issued by consent against institutions, individuals, or institution-affiliated parties
 - Can be issued by a regulatory agency without consent
- Civil Money Penalties
 - Assessed for violations of law or unsafe and unsound practices (i.e., BSA/AML)
 - Amounts determined by statute, based on the number of and severity of violations or practices
 - Requires action (e.g., restitution, changes, restrictions)

These actions are legally enforceable and are publically disclosed

The U.S. Enforcement Action Spectrum

Statutory Enforcement Actions

- 4(m) agreements
 - Occurs when institution is considered not “well capitalized” or “well managed”
 - Limits the ability of the company to expand or acquire
- Prompt corrective action directives
 - Issued when capital ratios fall to certain levels proscribed by legislation
 - Restricts funding sources and capital distributions
 - Removed when institution returns to “well-capitalized”

Questions?