

Board of Governors of the Federal Reserve System

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# The Board Can Enhance Its Internal Enforcement Action Issuance and Termination Processes by Clarifying the Processes, Addressing Inefficiencies, and Improving Transparency



**Office of Inspector General**  
Board of Governors of the Federal Reserve System  
Bureau of Consumer Financial Protection



## Office of Inspector General

Board of Governors of the Federal Reserve System  
Bureau of Consumer Financial Protection

Executive Summary, 2019-SR-B-013, September 25, 2019

# The Board Can Enhance Its Internal Enforcement Action Issuance and Termination Processes by Clarifying the Processes, Addressing Inefficiencies, and Improving Transparency

## Findings

We found that the Board of Governors of the Federal Reserve System (Board) and the Reserve Banks have implemented some effective practices to support the enforcement action issuance and termination processes; however, we identified opportunities for the Board to enhance these processes.

Specifically, we found that the Board can clarify certain aspects of these internal processes, such as the steps in these processes, the Board stakeholders' roles and responsibilities, and the Board members' involvement. In addition, we found that the Board can (1) improve the timeliness and efficiency of its enforcement action issuance and termination processes and (2) increase transparency with respect to the status of ongoing enforcement actions.

## Recommendations

Our report contains recommendations designed to enhance the efficiency and effectiveness of the Board's enforcement action issuance and termination processes. In its response to our draft report, the Board concurs with our recommendations and outlines actions to address each recommendation. We will follow up to ensure that the recommendations are fully addressed.

## Purpose

We conducted this evaluation to assess the efficiency and effectiveness of the Board's and the Reserve Banks' enforcement action issuance and termination processes and practices. This evaluation focused on enforcement actions against institutions within the community banking organization and the large and foreign banking organization portfolios. Specifically, our scope included certain types of formal and informal enforcement actions that address safety and soundness or Bank Secrecy Act/Anti-Money Laundering matters.

## Background

The Board plays a significant role in supervising and regulating U.S. financial institutions. It delegates to each Reserve Bank the authority to supervise certain financial institutions, such as community banking organizations and large and foreign banking organizations, within the Reserve Bank's district. The Board's Division of Supervision and Regulation oversees the Reserve Banks' execution of these responsibilities. If the Board or a Reserve Bank identifies significant concerns through the supervisory process or other means, supervision staff can use various enforcement tools to compel an institution's management to address the issues.



**Office of Inspector General**

Board of Governors of the Federal Reserve System  
Bureau of Consumer Financial Protection

Recommendations, 2019-SR-B-013, September 25, 2019

## The Board Can Enhance Its Internal Enforcement Action Issuance and Termination Processes by Clarifying the Processes, Addressing Inefficiencies, and Improving Transparency

### Finding 1: The Board Can Clarify Certain Aspects of Its Processes for Issuing and Terminating Enforcement Actions

Number	Recommendation	Responsible offices
1	Issue internal guidance on the enforcement action issuance and termination processes that <ol style="list-style-type: none"><li>defines the general steps to take when issuing and terminating each type of enforcement action.</li><li>clearly defines the roles and responsibilities of the parties involved in the processes.</li><li>reflects any structural or process changes that result from recommendations 3 and 4.</li></ol>	Division of Supervision and Regulation and Legal Division
2	Consult with the Board members to determine the circumstances that necessitate their involvement in approving enforcement matters. Based on the consultation, define and communicate these circumstances in the new guidance.	Division of Supervision and Regulation and Legal Division

### Finding 2: The Board Can Improve the Timeliness and Efficiency of Its Enforcement Action Issuance and Termination Processes

Number	Recommendation	Responsible offices
3	Evaluate potential solutions to reduce overlap between the S&R Enforcement section and the Legal Division, such as restructuring the groups or assigning distinct roles and responsibilities to the existing groups. Ensure that the guidance developed in response to recommendation 1 reflects the chosen solution.	Division of Supervision and Regulation and Legal Division
4	Evaluate the current approach to documenting concurrence with enforcement proposals and determine whether more expeditious alternatives for evidencing concurrence may be beneficial. If a more efficient alternative is identified, implement the new approach.	Division of Supervision and Regulation and Legal Division
5	Conduct an assessment to identify stages or points in the processes for which implementing interim targets for the expected time or range of time allotted would be feasible. Establish interim targets based on the results of the assessment as appropriate.	Division of Supervision and Regulation and Legal Division

### Finding 3: The Board Can Better Communicate Enforcement Action Status

Number	Recommendation	Responsible offices
6	Develop internal processes and procedures requiring that Board staff provide periodic updates to the Reserve Banks regarding the status of enforcement actions following the Reserve Bank's recommendation for issuance or termination. In developing this guidance, S&R and the Legal Division should consider including requirements for <ol style="list-style-type: none"><li data-bbox="391 457 1084 506">a. notifying the Reserve Bank of the Board attorney(s) assigned to the case.</li><li data-bbox="391 512 1101 537">b. relaying updates that provide specificity about the status of the case.</li></ol>	Division of Supervision and Regulation and Legal Division



**Office of Inspector General**

Board of Governors of the Federal Reserve System  
Bureau of Consumer Financial Protection

## MEMORANDUM

**DATE:** September 25, 2019

**TO:** Michael S. Gibson  
Director, Division of Supervision and Regulation  
Board of Governors of the Federal Reserve System

Mark E. Van Der Weide  
General Counsel  
Board of Governors of the Federal Reserve System

**FROM:** Michael VanHuysen   
Assistant Inspector General for Audits and Evaluations

**SUBJECT:** OIG Report 2019-SR-B-013: *The Board Can Enhance Its Internal Enforcement Action Issuance and Termination Processes by Clarifying the Processes, Addressing Inefficiencies, and Improving Transparency*

We have completed our report on the subject evaluation. We conducted this evaluation to assess the efficiency and effectiveness of the Board's and the Reserve Banks' processes and practices for issuing and terminating enforcement actions.

We provided you with a draft of our report for review and comment. In your response, you concur with our recommendations and outline actions that have been or will be taken to address our recommendations. We have included your response as appendix B to our report.

We appreciate the cooperation that we received from the Board and the Reserve Banks in our sample during our evaluation. Please contact me if you would like to discuss this report or any related issues.

cc: Richard Ashton  
Patrick Bryan  
Jason Gonzalez  
Jennifer Burns  
Todd Vermilyea  
Barbara Bouchard  
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# Contents

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<b>Introduction</b>	<b>9</b>
Objective	9
Background	9
Enforcement Tools	10
Delegations of Authority for Enforcement Actions	11
Processes for Issuing, Monitoring, and Terminating Enforcement Actions	12
Formal Enforcement Action Data	15
<b>Commendable Actions: The Board and the Reserve Banks Have Implemented Some Effective Practices to Support Issuing and Terminating Enforcement Actions</b>	<b>17</b>
The Board’s Biweekly Enforcement Action Meetings Have Enhanced Communication and Coordination Among Board Stakeholders	17
The Sample Reserve Banks Have Employed Some Effective Practices to Aid in Issuing and Terminating Enforcement Actions	18
<b>Finding 1: The Board Can Clarify Certain Aspects of Its Processes for Issuing and Terminating Enforcement Actions</b>	<b>20</b>
The Board’s Guidance Does Not Include Defined Steps for Issuing and Terminating Enforcement Actions	20
The Board’s Guidance Does Not Appear to Clearly Describe the Roles and Responsibilities of Certain Board Stakeholders in the Enforcement Action Issuance and Termination Processes	21
The Board’s Guidance Does Not Describe the Board Members’ Roles in Approving the Issuance and Termination of Enforcement Actions	22
Conclusion	22
Recommendations	22
Management Response	23
OIG Comment	23
<b>Finding 2: The Board Can Improve the Timeliness and Efficiency of Its Enforcement Action Issuance and Termination Processes</b>	<b>24</b>
The Board’s Enforcement Processes Involve Multiple Groups and Chains of Command and Overlap Between Groups	24
The Board’s Processes for Preparing and Reviewing Supporting Enforcement Documentation May Involve Redundancies	25

The Board Has Not Established Expected Process-Related Time Frame Targets for Issuing or Terminating Enforcement Actions	26
Conclusion	27
Recommendations	27
Management Response	27
OIG Comment	28
<b>Finding 3: The Board Can Better Communicate Enforcement Action Status</b>	<b>29</b>
Reserve Banks Do Not Always Have Insight Into the Status of an Enforcement Action During the Board’s Review Process	29
Defining Communication Expectations for Enforcement Actions Against Institutions Could Enhance Transparency	30
Recommendation	31
Management Response	31
OIG Comment	31
<b>Appendix A: Scope and Methodology</b>	<b>32</b>
<b>Appendix B: Management Response</b>	<b>33</b>
<b>Abbreviations</b>	<b>37</b>



# Introduction

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## Objective

Our objective for this evaluation was to assess the efficiency and effectiveness of the Board of Governors of the Federal Reserve System's (Board) and the Federal Reserve Banks' processes and practices for issuing and terminating enforcement actions.<sup>1</sup> This evaluation focused on enforcement actions within the community banking organization (CBO) and the large and foreign banking organization (LFBO) portfolios. Specifically, our scope included certain types of formal and informal enforcement actions that address safety and soundness or Bank Secrecy Act/Anti-Money Laundering (BSA/AML) matters.<sup>2</sup>

## Background

The Board plays a significant role in supervising and regulating U.S. financial institutions. In its oversight, the Board seeks to ensure that the institutions under its authority employ safe and sound business practices and comply with all applicable federal laws and regulations.<sup>3</sup> Within the Federal Reserve System, which encompasses the Board and the Reserve Banks, the Board delegates to each Reserve Bank the authority to supervise certain financial institutions, such as CBOs and LFBOs, located within the Reserve Bank's district. The Board's Division of Supervision and Regulation (S&R) oversees the Reserve Banks' execution of these responsibilities and issues supervisory policy and guidance to assist the Reserve Banks in executing that authority.

S&R groups its oversight activities into multiple supervisory portfolios that are generally based on the total asset size of the institution. S&R's portfolio sections are responsible for overseeing each of these portfolios.

- The CBO portfolio includes institutions with less than \$10 billion in total consolidated assets.
- The regional banking organization portfolio includes institutions with \$10 billion to \$100 billion in total consolidated assets.
- The LFBO portfolio includes domestic institutions with more than \$100 billion in total consolidated assets and foreign institutions regardless of size that are supervised by the Board but not subject to Large Institution Supervision Coordinating Committee portfolio supervision.

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<sup>1</sup> We are conducting a separate evaluation assessing the effectiveness of the Board's and the Reserve Banks' practices for monitoring open enforcement actions against supervised financial institutions.

<sup>2</sup> Our scope did not address enforcement actions against institution-affiliated parties or enforcement actions pertaining to consumer compliance matters.

<sup>3</sup> By law, the Board is responsible for supervising and regulating the following segments of the financial industry: state member banks; bank holding companies; savings and loan holding companies; nonbank subsidiaries of bank holding companies and of savings and loan holding companies; Edge Act and agreement corporations; branches and agencies of foreign banking organizations operating in the United States and their parent banks; financial market utilities; and officers, directors, employees, and certain other categories of individuals associated with the above banks, companies, and organizations.

- The Large Institution Supervision Coordinating Committee portfolio includes the largest and most systemically important domestic and foreign financial institutions supervised by the Board.

Under S&R's oversight, Reserve Bank examiners supervise these institutions through onsite examinations and inspections and offsite monitoring. After completing an examination or inspection, Reserve Bank examiners complete a report of examination or inspection that summarizes the findings, ratings, and required actions.<sup>4</sup> If the Board or a Reserve Bank identifies significant concerns through the supervisory process or other means, supervision staff can use various enforcement tools to compel the institution's management to address the issues.

## ***Enforcement Tools***

Enforcement tools consist of formal and informal actions. By law, the Board may issue formal enforcement actions against supervised financial institutions for violations of laws, rules, or regulations; unsafe or unsound practices; violations of final orders; and violations of conditions imposed in writing. Alternatively, the Board may use a variety of informal enforcement tools to address less severe issues, such as deficiencies that are relatively small in number, have a less immediate effect on the safety and soundness of the institution, and can be corrected by management. An institution's failure to implement corrective measures required by an enforcement action may result in further enforcement actions.

### **Formal Enforcement Actions**

If an institution engages in an unsafe or unsound practice or does not comply with federal banking laws or regulations, the Board may issue a formal enforcement action, which may compel an institution to take, or refrain from taking, specific actions and which can be enforced in court or through additional enforcement actions. Formal enforcement actions may include the following:

- Cease and desist (C&D) orders—A C&D order may require the financial institution to cease and desist from practices or violations or take affirmative action to correct the violations or practices.
- Written agreements—A written agreement is signed by the institution and the Reserve Bank on behalf of the Board and may direct the institution to take certain actions to operate more consistently with regulatory expectations.
- Civil money penalties—A civil money penalty may be assessed against an institution for certain types of unsafe and unsound practices or violations of the law; the amount of the monetary penalty varies depending on the nature and severity of the underlying issues.

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<sup>4</sup> For full-scope examinations, examiners assign state member banks a composite rating and component ratings addressing the bank's capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk (CAMELS). For bank holding companies, examiners assign a composite rating and ratings addressing the company's risk management, financial condition, and potential effect on affiliated depository institutions (RFI/C(D)). Ratings range from 1 to 5, with 1 indicating the least regulatory concern and 5 indicating the greatest concern. In February 2019, the Board announced a new rating system for the supervision of large financial institutions. This rating system, referred to as the LFI rating system, is composed of three components: capital planning and positions, liquidity risk management and positions, and governance and controls. Each component is rated on a four-point nonnumeric scale.

- Prompt corrective action directives<sup>5</sup>—A prompt corrective action directive requires insured depository institutions to promptly resolve capital deficiencies.
- Removal and prohibition orders—A removal and prohibition order removes an institution-affiliated party from the institution and prohibits the party from participating in banking at other financial institutions.

In each case, the Board considers whether the relevant legal standards for seeking the proposed remedy are supported by the facts and circumstances. Formal enforcement actions are required by law to be made public; the Board publishes the issuance or termination of these actions through press releases and posts the actions to its public website.

## Informal Enforcement Actions

The Board or a Reserve Bank may issue informal enforcement actions for less significant deficiencies that the Board or the Reserve Bank believes an institution’s management can correct without the need for more-extensive intervention. Informal enforcement actions include the following:

- Memorandums of understanding (MOUs)—An MOU is signed by an institution’s board of directors and the Reserve Bank and states the specific remedial actions the institution has agreed to take. An MOU is generally used when an institution has multiple deficiencies that the Reserve Bank believes management can correct.
- Board resolutions—A board resolution generally represents a number of commitments made by an institution’s board of directors and is incorporated into the institution’s corporate minutes.
- Commitment letters—A commitment letter outlines the actions an institution’s management will take to correct minor problems.

These types of informal actions are not legally enforceable in court. Further, the Board does not post informal enforcement actions to its website or otherwise make these actions publicly available.

## ***Delegations of Authority for Enforcement Actions***

Under the Board’s Rules Regarding the Delegation of Authority, the Board has delegated responsibility for certain formal enforcement actions to the Board’s General Counsel with the concurrence of the Director of S&R.<sup>6</sup> The Board’s internal guidance describes this delegation and notes that the joint delegation reflects the fact that the General Counsel has authority for all legal aspects of enforcement activity while the Director of S&R is responsible for all supervisory elements. These delegations of authority apply to the issuance and termination of certain formal enforcement actions, such as C&D orders and written agreements. In an internal memorandum dated October 13, 2017, the General Counsel delegated his authority to approve these enforcement actions to the Deputy General Counsel for Litigation, Enforcement, and System Matters or to the Deputy General Counsel’s designee. Similarly, the Director of

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<sup>5</sup> 12 U.S.C. 1831o.

<sup>6</sup> 12 C.F.R. § 265.6.

S&R delegated his authority to approve these enforcement actions to a Senior Associate Director in the division.

Acting under their general examination authority, the Reserve Banks may issue informal enforcement actions against certain institutions, which do not require Board approval. However, according to the Board's internal guidance, Board staff must review draft MOUs pertaining to institutions with over \$50 billion in total consolidated assets and to foreign banking organizations to promote consistent treatment of supervisory issues at these institutions.

## ***Processes for Issuing, Monitoring, and Terminating Enforcement Actions***

### **Enforcement Action Issuance**

The Board or a Reserve Bank will typically issue an enforcement action as a result of an onsite bank examination or a bank holding company inspection.<sup>7</sup> The Board or a Reserve Bank may also issue an enforcement action when it becomes aware of a problem at an institution that warrants immediate attention and corrective action.<sup>8</sup> Based on our interviews and review of available documentation, we understand the process for issuing certain types of formal and informal enforcement actions that stem from supervisory activities to be generally as follows:

- Once Reserve Bank staff have determined that an enforcement action is warranted and have vetted this decision internally with Reserve Bank management, the Reserve Bank must submit a recommendation memorandum and relevant supporting documentation to the Board.<sup>9</sup> According to the Board's internal guidance, the Reserve Bank should submit its recommendation simultaneously to S&R and to the Legal Division to further these divisions' efforts to work more closely together on enforcement matters and to allow the Legal Division to begin its review as early in the process as possible.
- The S&R Enforcement section, which is responsible for providing S&R and the Reserve Banks with specialized legal advice and assistance regarding enforcement actions, then initiates the Board's review process. Specifically, the S&R Enforcement section consults with the relevant S&R portfolio section regarding the recommended action and begins its review of the Reserve Bank's recommendation and supporting documentation.<sup>10</sup> The S&R Enforcement section may follow up

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<sup>7</sup> As noted earlier, the Reserve Banks may issue informal enforcement actions, which do not require Board approval, against certain institutions.

<sup>8</sup> The Federal Reserve may also commence a formal investigation to determine whether an enforcement action is appropriate when the information needed to evaluate an institution's conduct cannot be readily obtained through the normal examination process.

<sup>9</sup> The Reserve Bank's recommendation memorandum typically includes background on the institution, a description of the weaknesses identified, and suggested provisions for the recommended action. The Reserve Bank also submits supporting documentation, such as the report of examination or inspection.

<sup>10</sup> The S&R Enforcement section has primary S&R responsibility, in consultation with the appropriate portfolio sections and, as applicable, the BSA/AML section within the division, for all proposed enforcement actions that require Board approval.

with the Reserve Bank or the S&R portfolio section, as necessary. Subsequently, the S&R Enforcement section drafts the action and supporting memorandums and sends these materials to the Legal Division.

- The Legal Division reviews the materials to ensure that the enforcement case has sufficient evidence to meet relevant legal requirements and to promote consistency in the Board's enforcement actions. The Legal Division makes these determinations on a case-by-case basis depending on the unique record of each enforcement action. During its review, the Legal Division may follow up with the Reserve Bank or S&R, as necessary, and then edits and finalizes the enforcement action document and supporting memorandums. Subsequently, the Legal Division may send the relevant information pertaining to the proposed action to the Vice Chair for Supervision or the Committee on Supervision and Regulation (CSR) for review.<sup>11</sup>
- Once all relevant parties have approved the proposed action, Board staff communicates the approval to the Reserve Bank, and the Board or the Reserve Bank issues the action.<sup>12</sup>

The process for issuing informal enforcement actions that do not require Board approval may vary by Reserve Bank; however, the process generally begins following the completion of an onsite examination or inspection. The Reserve Bank holds internal vetting discussions and decides on the appropriate type of informal enforcement action. Subsequently, Reserve Bank staff drafts the informal enforcement action and submits it to Reserve Bank management for approval. Once approved, the Reserve Bank issues the informal enforcement action.

While the enforcement action issuance process generally involves the steps outlined above, certain factors, such as the following, may contribute to variation within the process and the overall timelines required to issue the action:

- The type of action—Certain formal enforcement actions may require additional steps. For example, the Secretary of the Board is required to sign C&D orders, whereas Reserve Banks can sign written agreements through delegated authority following Board approval.
- The subject matter or sensitivity of the action—The process may differ depending on the underlying subject matter. For example, enforcement actions pertaining to BSA/AML matters undergo additional review by S&R's BSA/AML section.<sup>13</sup> Further, enforcement actions addressing more-complex subject matter or potentially precedent-setting issues may require additional time for Board stakeholders to review. An enforcement action addressing a high-profile matter may require more vetting but also may be expedited through the process.
- The stakeholders involved—Some actions require the involvement of additional stakeholders at the federal or state level. For example, joint enforcement actions with a state regulator will

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<sup>11</sup> The CSR is the Board's oversight committee for issues related to bank and bank holding company supervision. This committee is currently composed of the Vice Chair for Supervision and two additional Board members.

<sup>12</sup> The Reserve Banks issue written agreements after receiving approval from the Board, whereas the Board issues C&D orders.

<sup>13</sup> S&R's BSA/AML section promotes quality and consistency in the Board's and the Reserve Banks' approach to supervising BSA/AML compliance by assisting supervision staff in understanding the issues and compliance exposures of their assigned institutions.

require additional vetting with the appropriate state regulatory agency. Further, an enforcement action against a bank holding company may involve vetting with the subsidiary bank's primary federal regulator.<sup>14</sup> In addition, the enforcement action process may involve discussions or negotiations with the institution's counsel pertaining to the language in the enforcement action.

Following the issuance of an enforcement action, the Board and the Reserve Banks use their examination authority to monitor an institution's compliance with the action.

## Enforcement Action Monitoring

Each Reserve Bank is responsible for monitoring all actions within its district's purview to assess compliance with the underlying commitments or necessary corrective actions.<sup>15</sup> Enforcement actions generally require an institution to develop and implement acceptable plans, policies, and programs to remedy the safety and soundness or compliance deficiencies that resulted in the action. The Reserve Bank monitors compliance through reviewing submissions from an institution, performing examination or inspection activities, and completing offsite analyses.

## Enforcement Action Termination

Once the Reserve Bank determines that an institution has demonstrated "substantial sustained compliance," the Reserve Bank recommends termination of the action.<sup>16</sup> Typically, the Reserve Bank arrives at this conclusion as a result of its onsite examination or inspection activities. The Reserve Bank then holds an internal vetting discussion to ensure that all internal parties agree with the decision to terminate the action.

For terminations that require Board approval, the Reserve Bank must submit a recommendation to the Board following the Board's internal guidance. Subsequently, S&R and the Legal Division must approve the proposed termination under delegated authority.<sup>17</sup> If approved, Board staff then notifies the Reserve Bank that the action may be terminated, and the Reserve Bank staff informs the institution of the termination.

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<sup>14</sup> The primary federal regulator for an insured depository subsidiary of a bank holding company depends on its charter and whether it is a member of the Federal Reserve System. For bank holding companies that own insured depository subsidiaries other than state member banks, the primary federal regulator for the insured depository is either the Federal Deposit Insurance Corporation or the Office of the Comptroller of the Currency. The Federal Deposit Insurance Corporation is the primary federal regulator for insured depository institutions with a state charter that are not members of the Federal Reserve System, including state nonmember banks, and the Office of the Comptroller of the Currency is the primary federal regulator for insured depository subsidiaries with a national bank charter.

<sup>15</sup> As noted earlier, we are conducting a separate evaluation assessing the effectiveness of the Board's and the Reserve Banks' practices for monitoring open enforcement actions against supervised financial institutions.

<sup>16</sup> Under the standards for terminating an enforcement action that requires remedial action, the institution must show at least substantial sustained compliance with the corrective actions required by the enforcement action, among other factors. Whether this standard is met is determined on a case-by-case basis, depending on the specific facts relating to the institution's compliance record.

<sup>17</sup> The Vice Chair for Supervision or the CSR may review the proposed termination prior to Board officials' approval under delegated authority. In some cases, enforcement action terminations are approved by a vote of the Board.

For terminations that do not require Board approval, the Reserve Bank may terminate the action following its internal vetting discussion. The Reserve Bank typically will communicate the termination in the transmittal letter of the report of examination or report of inspection.

## **Formal Enforcement Action Data**

The volume of formal enforcement actions that the Board and the Reserve Banks issue fluctuates over time. From January 2015 through April 2018, the Board and the Reserve Banks issued 88 formal enforcement actions against institutions. During this period, the issued written agreements and C&D orders pertaining to safety and soundness or BSA/AML matters within the CBO portfolio varied from zero to seven for a given year. Similarly, within the LFBO portfolio, these types of actions varied from two to six for a given year during the same period (table 1).

**Table 1. Total Issued Written Agreements and C&D Orders for Institutions in the CBO and LFBO Portfolios, January 2015–April 2018**

Portfolio	2015	2016	2017	2018 <sup>a</sup>	Total
CBO	7	6	3	0	16
LFBO	6	2	3	3	14

Source. OIG analysis of Board data. The Board provided us with data on formal enforcement actions issued from January 2015 through April 2018.

Note. The totals represent the issued written agreements and C&D orders pertaining to safety and soundness or BSA/AML matters.

<sup>a</sup> The numbers for 2018 only include data through April 30, 2018.

The average duration of time from the relevant Reserve Bank’s recommendation through the issuance date was roughly 180 days for actions against institutions within the CBO portfolio and 261 days for actions against institutions within the LFBO portfolio.<sup>18</sup> As noted, certain factors may contribute to variation within the issuance process and overall timelines. We acknowledge that the recommendation date to issuance date is highly variable and dependent on the unique circumstances of each case. As a result, one case with extenuating circumstances may affect the overall average duration.

Similar to the issuance of formal enforcement actions, the volume of terminated formal enforcement actions fluctuates over time. From January 2015 through April 2018, the Board and the Reserve Banks terminated 175 formal enforcement actions against institutions. During this period, the terminated written agreements and C&D orders pertaining to safety and soundness or BSA/AML matters within the CBO portfolio varied from 7 to 50 for a given year. Similarly, within the LFBO portfolio, these types of actions varied from 1 to 4 for a given year during the same period (table 2).

<sup>18</sup> In certain instances, parties other than the Reserve Banks may initiate the enforcement action process. Because there is no Reserve Bank recommendation date for these cases, we excluded them from our duration analysis.

**Table 2. Total Terminated Written Agreements and C&D Orders for Institutions in the CBO and LFBO Portfolios, January 2015–April 2018**

Portfolio	2015	2016	2017	2018 <sup>a</sup>	Total
CBO	50	43	28	7	128
LFBO	1	1	4	3	9

Source. OIG analysis of Board data. The Board provided us with data on formal enforcement actions terminated from January 2015 through April 2018.

Note. The totals represent the terminated written agreements and C&D orders pertaining to safety and soundness or BSA/AML matters.

<sup>a</sup> The numbers for 2018 only include data through April 30, 2018.

The average duration of time from the relevant Reserve Bank’s recommendation through the termination date was roughly 87 days for the actions against institutions within the CBO portfolio and 135 days for the actions against institutions within the LFBO portfolio.<sup>19</sup> We acknowledge that, similarly to issuance, one case with extenuating circumstances may affect the overall average duration from the relevant Reserve Bank’s recommendation date to the termination of the action.

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<sup>19</sup> We acknowledge that the average duration of time for the termination of actions against institutions within the LFBO portfolio is based on the small number of written agreements and C&D orders that were terminated within this portfolio during this period.



# Commendable Actions: The Board and the Reserve Banks Have Implemented Some Effective Practices to Support Issuing and Terminating Enforcement Actions

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We found that the Board and the Reserve Banks have implemented some effective practices to support issuing and terminating enforcement actions. In recent years, Board stakeholders began holding biweekly meetings to discuss enforcement action matters, which has improved the communication and coordination among these stakeholders. The sample Reserve Banks—the Federal Reserve Bank of Richmond (FRB Richmond), the Federal Reserve Bank of Chicago (FRB Chicago), and the Federal Reserve Bank of New York (FRB New York)—have also implemented some effective practices to aid their enforcement action issuance and termination processes. Each of these Reserve Banks has established centralized enforcement teams and issued thorough policies and procedures that outline expectations for issuing and terminating enforcement actions. Further, interviewees from a sample of supervised institutions provided generally positive feedback regarding their interactions with the Reserve Banks during the enforcement action processes.

## The Board’s Biweekly Enforcement Action Meetings Have Enhanced Communication and Coordination Among Board Stakeholders

The Board’s biweekly meetings provide a forum for the Legal Division, the S&R Enforcement section, and the S&R portfolio sections to discuss enforcement action matters.<sup>20</sup> Interviewees indicated that attendees provide updates on the docket of enforcement actions to be issued and terminated at each meeting. Board staff and officials remarked that these biweekly meetings have increased coordination among Board stakeholders and increased transparency at the Board regarding the status of the actions. A Board official also noted that these meetings create discipline: Attendees must regularly provide updates on the status of enforcement cases, which is an impetus to move cases forward. Another Board interviewee noted that the biweekly meetings are helpful because the attendees discuss enforcement cases across all portfolios, which helps to promote consistency.

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<sup>20</sup> Other Board stakeholders that might attend the meetings include personnel from the S&R BSA/AML section.

# The Sample Reserve Banks Have Employed Some Effective Practices to Aid in Issuing and Terminating Enforcement Actions

The sample Reserve Banks have employed some effective practices to aid in issuing and terminating enforcement actions. For example, FRB Chicago, FRB New York, and FRB Richmond each have established centralized enforcement teams. These Reserve Banks describe their respective enforcement teams as follows:

- FRB Chicago notes that the primary responsibility of its Enforcement Unit is to formulate, in coordination with the supervisory teams, a program of prompt supervisory action for problem institutions with material deficiencies. This unit coordinates all communication with the Board for enforcement action matters.
- FRB New York describes its Enforcement Analyst Team as a centralized unit that is responsible for managing the enforcement action process for regional, community, and foreign institutions. Among other activities, the team ensures open communication and collaboration between relevant stakeholders throughout the enforcement action process and acts as the central point of contact for the institution on enforcement-related matters.
- FRB Richmond notes that its Enforcement Unit provides a centralized and consistent approach to enforcement matters pertaining to institutions throughout the life cycle of the enforcement action. Further, this unit serves as the central point of contact for communications with Board enforcement staff.

Several Reserve Bank interviewees identified having a centralized Reserve Bank enforcement function as a leading practice and described benefits associated with this approach. Interviewees indicated that these enforcement functions (1) process enforcement actions routinely and provide technical expertise to supervisory staff, (2) provide a horizontal view of enforcement actions within the respective Reserve Banks, (3) effectively challenge the supervision groups to better inform decisionmaking, and (4) have effective relationships with key Board stakeholders.

Further, each sample Reserve Bank has issued thorough policies and procedures that outline expectations for issuing and terminating enforcement actions. These policies and procedures include an outline of the roles and responsibilities of Reserve Bank stakeholders, process maps, and specific steps to take when recommending the issuance or termination of an action. Interviewees noted the benefits of their respective Reserve Banks' policies and procedures. For example, one interviewee expressed that having an enforcement handbook that describes the nuances of what staff should consider when issuing and terminating actions helps staff that may be working on an enforcement matter for the first time. Another interviewee noted that the respective Reserve Bank's procedures have been helpful in providing insight into the enforcement function's roles and into the Reserve Bank's enforcement action processes.

In addition, interviewees from a sample of supervised institutions provided generally positive feedback regarding their interactions with the respective Reserve Banks during the enforcement action processes. For example, an interviewee from one institution noted that the Reserve Bank provided that institution with a good understanding of the measures that the institution needed to take to remediate the issues

identified in the action. Further, an interviewee from another institution expressed appreciation for the help and guidance that the respective Reserve Bank provided during the process.



# Finding 1: The Board Can Clarify Certain Aspects of Its Processes for Issuing and Terminating Enforcement Actions

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We found that there is a lack of clarity around certain aspects of the processes for issuing and terminating enforcement actions once the Reserve Bank submits its recommendation to the Board. Interviewees indicated that they were unclear about the Board's steps in these processes, the Board stakeholders' roles and responsibilities, and the Board members' involvement. We attribute this lack of clarity to the Board not having formally defined policies and procedures that communicate the steps in the issuance and termination processes and define the roles and responsibilities of the key Board stakeholders involved in these processes. Although we acknowledge that the process steps may vary for different types of actions or other circumstances, we believe that defining the general steps for issuing and terminating each type of enforcement action may help the Board more effectively manage expectations with Reserve Bank stakeholders and help Reserve Banks better communicate with the supervised institutions. Further, defining the process steps, the Board stakeholders' roles and responsibilities, and the Board members' involvement may help enhance transparency in the processes.

## The Board's Guidance Does Not Include Defined Steps for Issuing and Terminating Enforcement Actions

We identified opportunities for the Board to define the steps for issuing and terminating an enforcement action. Interviewees expressed a need for clarity concerning these steps. For example, several Reserve Bank interviewees described the Board's process as a "black hole" or "black box" once a Reserve Bank submits its recommendation to the Board. One Reserve Bank interviewee indicated that it would be helpful for Board personnel to communicate the steps in the process and where a given action is within the process steps. A Reserve Bank official noted that it is not transparent as to what is being done or where the recommendation is in the process. Further, another Reserve Bank official noted that knowing more about how the enforcement process works would provide comfort to the Reserve Bank supervision teams. This official added that having structured training to educate the supervision teams on the general expectations of the enforcement processes could be helpful and would make the supervision team feel they are more aware of the expectations.

For informational purposes, we sought to understand other federal financial regulatory agencies' practices for issuing and terminating enforcement actions. We obtained information on the guidance that these agencies provide to supervision staff regarding their respective enforcement processes. One of the federal financial regulatory agencies issued guidance that includes a detailed procedures manual that provides sequential steps, assigns responsibility for each step, and explains what happens at each step in the process for each type of enforcement action. The agency's manual noted that these detailed procedures seek to promote uniformity in processing enforcement actions.

We found that the Reserve Banks in our sample had thorough policies and procedures outlining expectations for the respective Reserve Bank when issuing and terminating enforcement actions. These policies and procedures include process maps and specific steps to take when recommending the issuance or termination of an action. We determined that the Board has various Supervision and Regulation Letters, Advisory Letters, supervision manuals, and other guidance documents describing aspects of the enforcement action issuance and termination processes. However, the Board's guidance does not appear to define the Board's specific steps in the processes.

## **The Board's Guidance Does Not Appear to Clearly Describe the Roles and Responsibilities of Certain Board Stakeholders in the Enforcement Action Issuance and Termination Processes**

In addition to not defining the Board's specific steps in the processes, the Board's guidance does not appear to clearly describe the roles and responsibilities of certain key Board stakeholders involved in these processes, specifically for those in the Legal Division and the S&R Enforcement section. During our interviews with both Board and Reserve Bank personnel, several interviewees shared a range of descriptions of each group's roles:

- Certain Board interviewees indicated that the S&R Enforcement section is responsible for enforcement actions against institutions while the Legal Division is responsible for enforcement actions against bank insiders or institution-affiliated parties.
- Other Board and Reserve Bank interviewees noted that the S&R Enforcement section provides a supervision or safety and soundness perspective and the Legal Division provides a legal perspective.
- Interviewees also indicated that the S&R Enforcement section's clients are the S&R portfolio sections and the Reserve Banks, whereas the Legal Division's client is the Board.
- Some interviewees expressed that they viewed the S&R Enforcement section as the primary drafter of the enforcement action provisions and the Legal Division as the reviewer. For example, one Board interviewee noted that their understanding was that the S&R Enforcement section drafts the enforcement action but the Legal Division has the ultimate approval.

Further, several Board interviewees, including personnel from the Legal Division and the S&R Enforcement section, could not clearly distinguish the roles and responsibilities between the two groups. For example, a Board interviewee indicated there is confusion about the roles of the S&R Enforcement section and the Legal Division and that it is sometimes unclear which group to contact. Another interviewee indicated that they were not clear as to what determines the handoff from one group to the other. Several Reserve Bank interviewees also could not clearly distinguish the roles and responsibilities of the two groups. For example, a Reserve Bank official noted that it would be helpful if the Board could clarify the enforcement action framework, including the roles and responsibilities of those involved in the enforcement action processes.

# The Board's Guidance Does Not Describe the Board Members' Roles in Approving the Issuance and Termination of Enforcement Actions

During our review of Board documentation, we did not identify any written guidance pertaining to the Board members' roles in approving the issuance and termination of enforcement actions. Further, many Board and Reserve Bank interviewees indicated that they were unclear as to when the CSR or the Vice Chair for Supervision must approve enforcement actions. For example, interviewees indicated that they did not know if there are specific criteria for which enforcement actions undergo review by the Board members and that they defer to the Legal Division to shepherd this aspect of the process.

We heard that the Board members' involvement in these processes has evolved over the years. Interviewees indicated that in the past, as a result of the financial crisis and other factors, certain Board members preferred reviewing recommended actions. Consistent with this prior practice, Legal Division personnel noted that they currently route enforcement actions to the Vice Chair for Supervision for review. Certain interviewees had an awareness of this practice but did not have insight into the rationale for the approach. For example, a Reserve Bank official noted that there has been a general trend in the last few years toward more enforcement actions undergoing review by the Board members. This official noted that it would be useful to understand whether this shift was the result of a decision by the Board members or whether it has just evolved over time.

## Conclusion

We determined that the lack of clarity in certain aspects of the issuance and termination processes stems from the Board not having formally defined or communicated the steps for issuing and terminating an enforcement action or key Board stakeholders' roles and responsibilities. We acknowledge that the process steps may vary for different types of actions or other circumstances. However, we believe that defining the general steps for issuing and terminating each type of enforcement action and defining key Board stakeholders' roles and responsibilities may help the Board more effectively manage expectations with Reserve Bank stakeholders and help them better communicate with the supervised institutions. Further, defining the process steps, the Board stakeholders' roles and responsibilities, and the Board members' involvement may help enhance transparency in the processes.

## Recommendations

We recommend that the Director of S&R and the General Counsel

1. Issue internal guidance on the enforcement action issuance and termination processes that
  - a. defines the general steps to take when issuing and terminating each type of enforcement action.
  - b. clearly defines the roles and responsibilities of the parties involved in the processes.
  - c. reflects any structural or process changes that result from recommendations 3 and 4.

2. Consult with the Board members to determine the circumstances that necessitate their involvement in approving enforcement matters. Based on the consultation, define and communicate these circumstances in the new guidance.

## Management Response

In its response to our draft report, the Board concurs with our recommendations. The Board notes that S&R, the Legal Division, and Reserve Bank staff are participating in a business process review of the Board's internal enforcement processes. The Board also notes that the goals of the business process review are to describe and better understand current practices, processes, systems, and structures for initiating and terminating formal and informal enforcement actions on banking institutions and to identify and implement improvements.

Specifically, in response to recommendation 1, the Board notes that one outcome of the business process review will be to identify and implement internal guidance that defines the general steps to take when issuing and terminating each type of enforcement action and clearly defines the roles and responsibilities of the parties involved in the processes through cross-functional future-state mapping. The agency further notes that the S&R Enforcement section and the Legal Division are concurrently working on defining the legal bases for which terminations are appropriate and that the Legal Division has recently implemented internal procedures that describe the procedural steps Legal Division attorneys should follow when handling enforcement matters.

In response to recommendation 2, the Board notes that the Legal Division, in conjunction with the S&R Enforcement section, has begun the process of seeking guidance from Board members to clarify the circumstances requiring consultation with the Board on approving enforcement matters. Further, the Board notes that the business process review will also consider the specific processes involved in approving or terminating an enforcement action under delegated authority.

## OIG Comment

The actions described by the Board appear to be responsive to our recommendations. We will follow up to ensure that the recommendations are fully addressed.



## **Finding 2: The Board Can Improve the Timeliness and Efficiency of Its Enforcement Action Issuance and Termination Processes**

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We found that the Board can enhance the timeliness and efficiency of its enforcement action issuance and termination processes. We acknowledge that it may be difficult for the Board to address all the contributing causes of potential delays, such as those associated with the involvement of external stakeholders or other factors outside the Board’s control. However, we identified factors specific to the Board that may be contributing to inefficiencies and delays in the enforcement action issuance and termination processes. These factors include (1) the involvement of multiple groups and chains of command and overlap between groups, (2) redundancies in preparing and reviewing supporting documentation pertaining to enforcement decisions, and (3) the lack of formal process-related targets for the expected time allotted to certain aspects of the enforcement action processes. We believe that addressing these factors may improve the timeliness and efficiency of the enforcement processes. Timely issuance of enforcement actions more promptly conveys the significance of the necessary corrective actions to the institutions. Further, once determining that an institution has demonstrated substantial sustained compliance with the enforcement action provisions, more-efficient processing of terminations may allow an institution to resume or pursue certain types of business activities more quickly after satisfying the enforcement action terms.

### **The Board’s Enforcement Processes Involve Multiple Groups and Chains of Command and Overlap Between Groups**

Under the Board’s Rules Regarding the Delegation of Authority, the Board has delegated responsibility for approving certain formal enforcement actions to the Board’s General Counsel with the concurrence of the Director of S&R. Prior to these officials’ approvals, multiple Board stakeholders are involved in processing these enforcement actions. A Board interviewee noted the responsibility for enforcement is dispersed across several groups. The interviewee added that each group pushes enforcement matters through their respective management chains of command and processes for review, which results in time lags and bottlenecks. Specifically, after the Reserve Bank vets the proposed action internally, the materials supporting the enforcement proposal are reviewed by the management chains within the relevant S&R portfolio section; the S&R BSA/AML section, if applicable; the S&R Enforcement section; and the Legal Division as well as the CSR or the Vice Chair for Supervision.

During our analysis of a sample of enforcement actions, we identified instances in which the number of Board stakeholders and the levels of review may have contributed to delays in issuing or terminating enforcement actions. A Board interviewee noted that one might question why there are so many steps in the review process. The interviewee added that it is difficult to detect a big difference between the legal

review process conducted by the S&R Enforcement section and the Legal Division. Further, interviewees in the Legal Division and the S&R Enforcement section acknowledged that there is duplication between their groups and they were not always able to distinguish between their respective responsibilities.

In addition, the Board has identified duplication of efforts between the Legal Division and the S&R Enforcement section. In 2017, Board divisions reviewed existing functions and operations to identify potential redundancies and opportunities to enhance efficiency and effectiveness. As a result of this exercise, both the Legal Division and S&R identified overlap in the enforcement activities between the Legal Division and S&R's Enforcement section.

During our evaluation, interviewees shared perspectives on options to address the duplication between the S&R Enforcement section and the Legal Division, including restructuring the groups or clarifying the roles and responsibilities of the existing groups:

- One interviewee noted that integrating the two enforcement groups would provide more efficiency and allow for more-consistent legal advice to the Reserve Banks. Other interviewees also questioned whether two enforcement groups were necessary. For example, an S&R interviewee described the current structure as overlapping and redundant and noted they did not see a compelling reason for two enforcement groups and that the enforcement unit in the Legal Division was sufficient. Certain Board and Reserve Bank interviewees, however, noted that the S&R Enforcement section is important in that it provides a supervision perspective to enforcement matters.
- Some interviewees indicated that it would be helpful if the Board clarified the existing groups' respective roles. For example, a Board interviewee noted that sometimes the S&R Enforcement section and the Legal Division "bump into one another" and expressed that the Board needs to be more transparent about these stakeholders' roles in the process to ensure that everyone has a clear understanding of their responsibilities. This interviewee added that the Legal Division and the S&R Enforcement section need to then be careful to respect the "lines" to reduce the risk of redundancy.

Further, certain interviewees questioned whether Board members need to be involved in approving all enforcement cases. Although we acknowledge that decisions pertaining to enforcement actions are important and require careful consideration, we believe that the multiple levels of review across various groups and overlap between groups may contribute to extending the timeline for issuing or terminating an enforcement action. Moreover, while the volume of enforcement actions fluctuates over time, an increase in the volume could place additional pressure on the processes and decrease process throughput.

## **The Board's Processes for Preparing and Reviewing Supporting Enforcement Documentation May Involve Redundancies**

We determined that the Board's processes for preparing and reviewing supporting documentation pertaining to enforcement decisions may involve redundancies. We learned that Board analysts from the

relevant S&R portfolio section typically participate in the Reserve Bank's vetting discussions regarding the examination or inspection results and any enforcement matters. Interviewees noted that during those sessions, S&R portfolio section personnel typically indicate whether they concur with the Reserve Bank's proposed enforcement course of action. Subsequently, the Reserve Bank submits a detailed recommendation memorandum and supporting documentation when proposing to issue or terminate an action. The relevant S&R portfolio section may also prepare a concurrence memorandum, typically for terminations, or provide its concurrence by email. Multiple interviewees identified this concurrence memorandum as an area of duplication within the processes. For example, one Board interviewee noted that the relevant S&R portfolio section often writes a concurrence memorandum that states generally the same thing as the Reserve Bank's recommendation memorandum, adding time to the process. A Reserve Bank interviewee also identified this practice as duplicative and added that the Board could create a standardized approach to produce one memorandum to expedite the process and reduce duplication.

## **The Board Has Not Established Expected Process-Related Time Frame Targets for Issuing or Terminating Enforcement Actions**

We determined that the Board has not established formal process-related targets for the expected time allotted to certain aspects of the enforcement action processes. Some Board and Reserve Bank interviewees indicated that it may be challenging for the Board to establish process-related targets given certain factors in the enforcement action processes, such as the involvement of external stakeholders, while others believed such targets would be beneficial. A Reserve Bank official expressed concern around the Board not having any process-related targets or milestones. Another Reserve Bank official indicated that process-related targets at the Board would help manage the Reserve Bank's expectations around how long certain aspects should take. A third Reserve Bank official expressed that establishing interim timelines for stages or key milestones would help create a structure around the enforcement process or its substeps, which currently does not seem to exist or is not evident. Further, a Reserve Bank interviewee noted that accountability would be better defined if the Board would establish general time frames or a suggested range for the time frames. This interviewee acknowledged that the expected time frames could vary if more stakeholders, such as other regulators, are involved.

We sought to understand other federal financial regulatory agencies' practices for issuing and terminating enforcement actions against their supervised institutions, including whether they use targets to track the time allotted for their enforcement processes. One agency has adopted an informal milestone for presenting formal and informal actions to a supervised institution following the completion of an examination. Further, another agency has established a formal target for presenting proposed enforcement actions to a supervised institution following the commencement of an examination whenever possible.

We acknowledge that other federal financial regulatory agencies' structures and approaches for issuing and terminating enforcement actions may not be comparable to the Board's structures and approaches. We also acknowledge that it may be challenging for the Board to establish targets addressing all aspects of these processes. However, we believe that stakeholders could benefit if the Board conducted an assessment to identify stages or points in the processes that lend themselves to the establishment of interim targets for the expected time or range of time allotted. For example, the Board could determine

the expected amount of time to allot a given party to complete an initial review of a Reserve Bank recommendation memorandum, barring extenuating circumstances. We acknowledge that these targets may be aspirational in nature as opposed to hard targets and may evolve over time based on actual results. We believe that establishing process-related targets for certain aspects of the enforcement action processes may enhance the Board's ability to manage expectations, promote accountability, and reduce delays.

## Conclusion

As outlined above, many factors can lead to inefficiencies and delays in the enforcement action issuance and termination processes. Although we acknowledge that it may be difficult for the Board to address factors outside its control, we believe that focusing on certain aspects within these processes may enable the Board to more efficiently issue or terminate enforcement actions. Further, doing so also may enable the Board to be better prepared in the event of increased volumes of enforcement matters. Timely issuance of enforcement actions more promptly conveys the significance of the necessary corrective actions to institutions. In addition, once determining that an institution has demonstrated substantial sustained compliance with the enforcement action provisions, more efficient processing of enforcement action terminations may allow a firm to resume or pursue certain types of business activities more quickly after satisfying the enforcement action terms.

## Recommendations

We recommend that the Director of S&R and the General Counsel

3. Evaluate potential solutions to reduce overlap between the S&R Enforcement section and the Legal Division, such as restructuring the groups or assigning distinct roles and responsibilities to the existing groups. Ensure that the guidance developed in response to recommendation 1 reflects the chosen solution.
4. Evaluate the current approach to documenting concurrence with enforcement proposals and determine whether more expeditious alternatives for evidencing concurrence may be beneficial. If a more efficient alternative is identified, implement the new approach.
5. Conduct an assessment to identify stages or points in the processes for which implementing interim targets for the expected time or range of time allotted would be feasible. Establish interim targets based on the results of the assessment as appropriate.

## Management Response

In its response to our draft report, the Board concurs with our recommendations. In response to recommendation 3, the agency notes that the business process review will consider potential solutions to reduce overlap between the S&R Enforcement section and the Legal Division, and the Board will incorporate the selected solution into internal guidance, as appropriate. In response to recommendation 4, the agency notes that the business process review will consider whether more-expeditious alternatives for evidencing concurrence may be beneficial and will consider any changes for implementation and incorporation in internal guidance. In response to recommendation 5, the agency notes that the business

process review will include an assessment to identify stages or points in the processes for which implementing interim targets for the expected time or range of time allotted would be feasible.

## **OIG Comment**

The actions described by the Board appear to be responsive to our recommendations. We will follow up to ensure that the recommendations are fully addressed.



## Finding 3: The Board Can Better Communicate Enforcement Action Status

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Reserve Bank interviewees indicated that once the Board’s review activities begin, Reserve Bank staff lack transparency regarding the status of enforcement actions. We attribute this lack of transparency to the Board not having a formal approach for communicating status updates to the Reserve Banks. We believe formalized policies and procedures that include an approach for the Board to better communicate enforcement action statuses may enable Reserve Bank supervision teams to more effectively communicate with supervised institutions.

### Reserve Banks Do Not Always Have Insight Into the Status of an Enforcement Action During the Board’s Review Process

Interviewees from each sample Reserve Bank noted that they do not always have insight into the status of an enforcement action requiring Board approval once the Reserve Bank sends the Board its recommendation to issue or terminate an action. Many interviewees indicated that the Board does not proactively communicate an action’s status and the Reserve Bank must reach out to the Board to obtain this information. We also heard that it would be helpful for the Board to notify the Reserve Banks of the Board attorney(s) assigned to the case to enable Reserve Bank staff to request status updates.

We learned that Reserve Bank personnel have developed their own norms and methods for obtaining updates on enforcement actions.

- Interviewees expressed that they rely on their relationships with Board personnel to obtain updates. For example, Reserve Bank supervision staff may contact their Board analysts in S&R for information regarding the status of the action. Further, Reserve Bank enforcement staff often turn to the S&R Enforcement section for these updates, while Reserve Bank Legal staff may contact the Board’s Legal Division. One Reserve Bank official described the enforcement action process as more people dependent than process dependent, which could be problematic for new Reserve Bank employees who do not have established relationships. Another Reserve Bank official expressed that the effectiveness of communication during the process depends on relationships, which could place those with infrequent involvement with enforcement actions at a disadvantage. In addition, while many interviewees noted that they are able to communicate with their preferred Board contacts, these contacts may not always have insight into the status of the action. For example, a Reserve Bank official noted that communications can be opaque if the Board analyst does not have deep roots or good connections within the Board. In addition, Reserve Bank interviewees noted that in response to their outreach, the Board often replied that the action was under review without providing additional specificity.

- FRB New York has implemented regular conference calls with Board staff to discuss enforcement matters for institutions within its district. These conference calls serve as a method for obtaining status updates.
- An FRB Richmond interviewee indicated that the Reserve Bank tracks enforcement actions and uses time triggers to follow up with the Board 1 month after submitting its recommendation to determine where the action stands in the Board’s review process.
- An FRB Chicago interviewee noted that they follow up with the Board 4 to 6 weeks after FRB Chicago submits its recommendation to request a status update. Another FRB Chicago interviewee noted that they follow up with Board staff if the recommendation sits with the Board for too long.

Despite these efforts, Reserve Bank interviewees expressed that there is a lack of transparency about the status of enforcement actions following their submission of recommendations to the Board. We attribute Reserve Bank interviewees’ comments regarding the lack of transparency to the Board not having established formal policies and procedures that include an approach for providing periodic status updates to the Reserve Banks.

Reserve Bank interviewees expressed that their lack of clarity regarding the status of an enforcement action can put them in a difficult position as they are on the front lines interfacing with an institution’s management, who may have questions about the action. Further, an interviewee from a supervised institution noted that the Reserve Bank examiners were responsive to the institution’s inquiries regarding the status of the enforcement action, but it seemed that the examiners did not have insight into the specific status of the action while under the Board’s review. We believe formalized policies and procedures that include an approach for the Board to better communicate enforcement action statuses may enable Reserve Bank supervision teams to more effectively communicate with supervised institutions.

## **Defining Communication Expectations for Enforcement Actions Against Institutions Could Enhance Transparency**

During our reviews of the failure of Allied Bank and Fayette County Bank, we identified opportunities to enhance communication following a Reserve Bank’s recommendation for an enforcement action pertaining to a supervised institution’s insiders.<sup>21</sup> As a result, a Legal Division official noted that the division planned to implement an approach to provide the referring Reserve Banks with quarterly updates on ongoing enforcement cases. In October 2018, the Legal Division issued guidance regarding expected communications between Board and Reserve Bank staff following the submission of a formal enforcement action recommendation concerning bank insiders or institution-affiliated parties. This letter required periodic communications between the Board’s Legal Division staff and Reserve Bank designees.

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<sup>21</sup> Office of Inspector General, *Review of the Failure of Allied Bank*, [OIG Report 2018-SR-B-007](#), March 19, 2018; Office of Inspector General, *Review of the Failure of Fayette County Bank*, [OIG Report 2018-SR-B-016](#), September 26, 2018.

Because this guidance is specific to enforcement actions against bank insiders or institution-affiliated parties, we believe that it would be beneficial for the Legal Division and S&R to issue guidance establishing communication expectations for enforcement actions against institutions.

## Recommendation

We recommend that the Director of S&R and the General Counsel

6. Develop internal processes and procedures requiring that Board staff provide periodic updates to the Reserve Banks regarding the status of enforcement actions following the Reserve Bank's recommendation for issuance or termination. In developing this guidance, S&R and the Legal Division should consider including requirements for
  - a. notifying the Reserve Bank of the Board attorney(s) assigned to the case.
  - b. relaying updates that provide specificity about the status of the case.

## Management Response

In its response to our draft report, the Board concurs with our recommendation. The Board notes that the business process review will consider the most efficient and effective method to provide periodic notice to the Reserve Banks regarding the status of enforcement action issuance and termination. Further, the agency notes that it will develop internal guidance based on the business process review recommendations.

## OIG Comment

The actions described by the Board appear to be responsive to our recommendation. We will follow up to ensure that the recommendation is fully addressed.



# Appendix A: Scope and Methodology

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We initiated this evaluation to assess the efficiency and effectiveness of the Board’s and the Reserve Banks’ processes and practices for issuing and terminating enforcement actions. The scope of our evaluation included formal and informal enforcement actions addressing safety and soundness or BSA/AML matters. Our evaluation addressed enforcement actions within the CBO and LFBO portfolios. We focused on two types of formal enforcement actions, written agreements and C&D orders, and two types of informal enforcement actions, MOUs and board resolutions. Our scope did not address enforcement actions pertaining to institution-affiliated parties or consumer compliance matters. In addition, we did not assess the substance of enforcement actions or whether enforcement actions were warranted.

We selected a nonrandom sample of three Reserve Banks that issued or terminated enforcement actions against supervised institutions in recent years—FRB Chicago, FRB New York, and FRB Richmond. We then selected a nonrandom sample of formal enforcement actions pertaining to institutions supervised by these Reserve Banks that were issued or terminated from January 2015 through April 2018.

To accomplish our objective, we reviewed relevant Board policies and procedures, such as Supervision and Regulation Letters, Advisory Letters, and supervision manuals. We also reviewed other relevant documentation, such as the Board’s Rules Regarding the Delegation of Authority, enforcement action data, management reports, and documentation and correspondence associated with the sample enforcement actions. In addition, we reviewed the sample Reserve Banks’ relevant policies and procedures, informal enforcement action data, management reports, documentation and correspondence associated with the sample enforcement actions, and other relevant materials. We also reviewed documentation pertaining to the enforcement action processes of a sample of other federal financial regulatory agencies for informational purposes.

We interviewed 71 officials and staff at the Board and at the sample Reserve Banks to gather their perspectives on the efficiency and effectiveness of the enforcement action issuance and termination processes. Specifically, at the Board, we interviewed personnel in the Legal Division; the Office of the Secretary; and S&R, including the S&R Enforcement section, BSA/AML section, and the relevant portfolio sections. At each Reserve Bank, we interviewed the head of supervision; senior supervision officers; key supervision team members; and key personnel involved in the enforcement processes, such as enforcement analysts and attorneys. In addition, we interviewed personnel from a sample of financial institutions that were previously under enforcement actions to gather their perspectives on the efficiency and effectiveness of these processes.

We conducted our fieldwork from May 2018 through May 2019. We performed our evaluation in accordance with the *Quality Standards for Inspection and Evaluation* issued in January 2012 by the Council of the Inspectors General on Integrity and Efficiency.

# Appendix B: Management Response



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

September 16, 2019

Michael VanHuysen  
Assistant Inspector General  
for Audits and Evaluations  
Board of Governors  
of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington DC, 20551

Dear Mr. VanHuysen:

Thank you for the opportunity to comment on your draft report, *The Board Can Enhance Its Internal Enforcement Action Issuance and Termination Processes by Clarifying the Processes, Addressing Inefficiencies, and Improving Transparency*. We appreciate the effort that the Office of Inspector General ("OIG") has put into this report and the recommendations it has provided for enhancing the efficiency and effectiveness of the Board's enforcement action issuance and termination processes. The evaluation focused on enforcement actions within the community banking organization and large and foreign banking portfolios that were entered into by consent and that address safety and soundness or Bank Secrecy Act/Anti-Money Laundering issues. The recommendations did not include informal actions taken by the Federal Reserve Banks without review by Board staff.

The report found that the Board of Governors of the Federal Reserve System ("Board") and the Reserve Banks have implemented some effective practices supporting the issuance and termination of enforcement actions, but identified opportunities where the Board can enhance these processes.

The Division of Supervision and Regulation ("S&R") and the Legal Division agree with the conclusions in the report and have already begun action to enhance the efficiency and effectiveness of the Board's enforcement action issuance and termination processes. Notably, S&R, Legal Division, and Reserve Bank staff are participating in a

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business process review (“BPR”) of the Board’s internal enforcement process. The goals of the review are to describe and better understand current practices, processes, systems and structures for initiating and terminating formal and informal enforcement actions on banking institutions and to identify and implement improvements. The BPR is reviewing the same types of enforcement actions as covered by the OIG report. A current state assessment was recently completed. It is anticipated that the review will identify opportunities to improve transparency, collaboration, and efficiency by September 30, 2019, improvement plans will be developed and are projected to be completed by October 31, 2019, and improvements are estimated to be implemented by December 31, 2019. The adopted improvements will include controls and reporting to allow management to monitor the efficacy of the processes and make changes as needed. Improvements implemented in response to the BPR will be comprehensive to this report’s findings.

In the report, the OIG makes the following six recommendations:

1. Issue internal guidance on the enforcement action issuance and termination processes that:
  - a. defines the general steps to take when issuing and terminating each type of enforcement action.
  - b. clearly defines the roles and responsibilities of the parties involved in the processes.
  - c. reflects any structural or process changes that result from recommendations 3 and 4.

*Management Response 1:* The S&R and Legal Divisions will address this recommendation as part of the BPR. One outcome of the review will be to identify and implement internal guidance that defines the general steps to take when issuing and terminating each type of enforcement action and clearly defines the roles and responsibilities of the parties involved in the processes through cross functional future state mapping. In addition, S&R Enforcement and the Legal Division are concurrently working on defining the legal bases for which terminations are appropriate. The Legal Division has recently implemented internal procedures that describe the procedural steps Legal Division attorneys should follow when handling enforcement matters.

2. Consult with the Board members to determine the circumstances that necessitate their involvement in approving enforcement matters. Based on the consultation, define and communicate these circumstances in the new guidance.

*Management Response 2:* The Legal Division, in conjunction with S&R Enforcement, has begun the process of seeking guidance from Board members to clarify the circumstances requiring consultation with the Board on approving enforcement matters. The BPR will also consider the specific processes involved in approving or terminating an enforcement action under delegated authority.

3. Evaluate potential solutions to reduce overlap between S&R Enforcement and the Legal Division, such as restructuring the groups or assigning distinct roles and responsibilities to the existing groups. Ensure that the guidance developed in response to recommendation 1 reflects the chosen solution.

*Management Response 3:* Potential solutions to reduce overlap between the S&R Enforcement section and the Legal Division will be considered and discussed as part of the BPR. The selected solution will be incorporated into internal guidance as appropriate.

4. Evaluate the current approach to documenting concurrence with enforcement proposals and determine whether more expeditious alternatives for evidencing concurrence may be beneficial. If a more efficient alternative is identified, implement the new approach.

*Management Response 4:* The BPR will consider whether more expeditious alternatives for evidencing concurrence may be beneficial. Any changes will be considered for implementation and incorporation in internal guidance.

5. Conduct an assessment to identify stages or points in the processes for which implementing interim targets for the expected time or range of time allotted would be feasible. Establish interim targets based on the results of the assessment as appropriate.

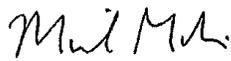
*Management Response 5:* An assessment to identify stages or points in the processes for which implementing interim targets for the expected time or range of time allotted would be feasible is included as part of the BPR. The S&R and Legal Divisions appreciate the OIG's recognition that external factors can cause delays in the enforcement action issuance and termination processes.

6. Develop internal processes and procedures requiring that Board staff provide periodic updates to the Reserve Banks regarding the status of enforcement actions following the Reserve Bank's recommendation for issuance or termination. In developing this guidance, S&R and the Legal Division should consider including requirements for
  - a. notifying the Reserve Bank of the Board attorney(s) assigned to the case.
  - b. relaying updates that provide specificity about the status of the case.

*Management Response 6:* The BPR will consider the most efficient and effective method to provide periodic notice to Reserve Banks regarding the status of enforcement action issuance and termination. Internal guidance will be developed based on the BPR recommendations.

As is clear in our response, the BPR is integral to addressing the recommendations resulting from your review and to enhancing the sustainability and timeliness of the Board's enforcement process to support strong execution of its supervisory responsibilities.

Regards,



Michael S. Gibson  
Director  
Division of Supervision and Regulation



Mark Van Der Weide  
General Counsel  
Legal Division



# Abbreviations

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<b>Board</b>	Board of Governors of the Federal Reserve System
<b>BSA/AML</b>	Bank Secrecy Act/Anti-Money Laundering
<b>CBO</b>	community banking organization
<b>C&amp;D</b>	cease and desist
<b>CSR</b>	Committee on Supervision and Regulation
<b>FRB Chicago</b>	Federal Reserve Bank of Chicago
<b>FRB New York</b>	Federal Reserve Bank of New York
<b>FRB Richmond</b>	Federal Reserve Bank of Richmond
<b>LFBO</b>	large and foreign banking organization
<b>MOU</b>	memorandum of understanding
<b>OIG</b>	Office of Inspector General
<b>S&amp;R</b>	Division of Supervision and Regulation

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### Hotline

Report fraud, waste, and abuse.

Those suspecting possible wrongdoing may contact the OIG Hotline by mail, [web form](#), phone, or fax.

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