**Could the Feds shut you down in 1999?**
Cocheo, Steve
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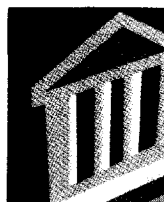
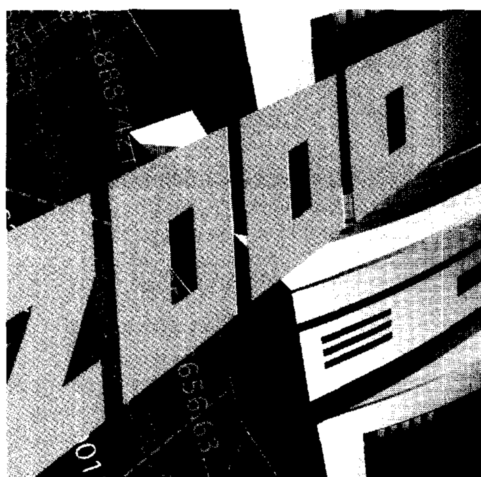


YEAR 2000 REPORT

# Could the Feds shut you down in 1999?



During the 1980s, the spectacle of bank closings by federal and state regulators became so commonplace that it grew uncomfortably familiar. In the healthy years since then, closings have become quite rare. But as the Year 2000 issue has moved toward the center of regulators' radar screens, the specter of a new trend of bank closures has been hinted at, this time because of inability to handle post-2000 processing, rather than traditional insolvency issues.

Case in point: The controversial *Money Magazine* article that ran earlier this year, which all but said that depositors should switch their savings to big banks out of fear that community banks won't be ready on time for Year 2000 processing—the implication being that the small banks might not be with us. Though somewhat less controversially, *BusinessWeek* raised similar worries with an January article entitled "Will your bank live to see the millennium?"

Not only magazines and other media are raising the issue: In the electronic bulletin-board section of a popular bank-related Year 2000 site on the World Wide Web, a banker raises the issue of federal regulators shutting down noncompliant banks, keeping them operating just long enough to pass them on to a Year 2000-compliant acquirer.

The question is, can federal regulators really shut your bank's doors because of the Year 2000 deadline? Or is this just one of those myths that seem to develop?

The short answer to the first question is "yes"—federal regulators are indeed framing plans for closures and takeovers because of Year 2000 problems.

The longer answer is, well, longer.

### Plans are no matter of speculation

Rumors of plans to close *lots* of banks are "a garbled version of what we've been saying," says Mark O'Dell, director of the bank technology division at the Comptroller's Office and overall head of that agency's Year 2000 efforts. "It's our *intent* that all of our banks be ready for the Year 2000. The direct answer is that there is no plan to take over large numbers of institutions."

But if there was any doubt in anyone's mind that closure was a possible consequence of not getting moving on the Year 2000 challenge, such uncertainty was put to rest in testimony given before the Senate Banking Committee's Subcommittee on Financial Services and Technology. Michael J. Zamorski, deputy director of FDIC's Division of Supervision and chairman of its Year 2000 oversight committee, testified (emphasis added):

"Although the FDIC's supervisory approach is designed to minimize the potential for disruptions at financial institutions resulting from Year 2000 problems, we recognize that *some* institutions may encounter problems achieving Year 2000 readiness. The FDIC will, therefore, be ready to intervene should an institution's viability be threatened by an inability to maintain accurate books and records.

"At this time we do not expect numerous failures, *if any*. However, we are developing contingency plans to prepare for the possibility.... We have made an aggressive start in developing plans that address deposit insurance issues and failed bank resolutions and receiverships in the context of institution failures caused by technological rather than capital deficiencies.

"Along with the other federal financial institution regulatory agencies, we have repeatedly emphasized to depository institutions that they must prepare their own contingency plans to contain potential damage resulting from the inability to achieve the milestones set out in their formal Year 2000 plans."

The regulators, working together, are looking at many facets of closure of banks over Year 2000 issues. This ranges from the conditions under which a bank would be placed into receivership and how this would be administered; how data management would be handled while the institution was under regulatory control; how the closure would ultimately be re-

*By Steve Cocheo, executive editor*

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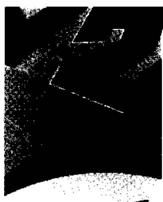



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solved; and how deposit insurance claims would be handled, particularly since the bank's own records would be suspect, unreadable, or even nonexistent.

It is important, Zamorski points out in an interview, to understand that not having 100% compliance throughout your bank does not automatically make it a candidate for closure. The issue hinges solely on those systems that regulators and bank managers and directors have identified as "mission critical." Even then, a bank would have to be in pretty bad compliance shape, and, at this juncture the vast majority of banks don't appear to be headed for such straits.

### But can they really do it?

FDIC's Zamorski notes that the national banking laws don't deal specifically with insolvency based on technological problems, focusing instead on credit and capital issues.

"Our answer to that is that we're looking at what remedies we could use under existing law," says Zamorski. One concern is that whatever solutions that are found be fair, yet also expeditious. "While we certainly are all for due process" of law, says Zamorski, "we won't have time to get tied up in an extensive procedure."

Overall, Zamorski says, the regulators have a great deal of work left before they will know with certainty how they will handle hopeless cases.

Legal precedent is very much on the regulators' side, notes Mike Crotty, ABA's deputy general counsel for litigation. He notes that, in general, even when seizures of banks haven't been clearly a matter of solvency, regulators have been upheld by the courts.

Furthermore, regulators not only have legal precedent, but also a significant array of helpful law in the form of the FDIC Improvement Act of 1991.

Because the law passed when most of the problems of the 1980s were ending, many tools handed to regulators by that law have never really been tested under real-world conditions, notes attorney Brian Smith of Mayer, Brown & Platt's Washington, D.C., office.

"Regulators were given enormous power in the FDIC Improvement Act," says Smith, whose past service includes a stint as chief counsel at OCC. As an example, Smith points out that the additional grounds for appointing a conservator or receiver for a bank contained in FDICIA's Section 133 are quite broad.

"'Substantial dissipation'," Smith quotes from one of the enumerated grounds. "What does that even mean?"

Surprisingly, as Smith points out, nothing that the regulators have published thus far about the Year 2000 issue has had the clear force of regulation. There have been supervisory letters, advisories, what have you, but not one actual reg or rule.

However, Smith says these materials, in conjunction with such laws as FDICIA, will "bootstrap" regulators into all the working room they need to close banks that aren't cutting it.

### Keeping your perspective

It's important, in considering the possibility that some banks could be closed over Year 2000 noncompliance, to recognize that federal bank technology specialists aren't going to be swooping down on noncompliant banks like Elliott Ness. Such images make for drama, but they belie reality.

"For regulators to walk in and take over an institution, they'd have to be pretty certain that the bank won't be able to balance," says Jim McLaughlin, director of the regulatory and trust affairs section of ABA's government relations group. "Long before that would happen, the regulators would find that these banks are having trouble and would start putting the screws to them."

McLaughlin believes regulators will generally work through the typical progress of enforcement steps long before getting anywhere near considering shutting a bank down: jawboning, "15-day" letters, cease-and-desist orders, on up to civil money penalties on board members.

As the turn of the century draws near, any banks that remain noncompliant after regulators exhaust their other options would probably be candidates for closure.

But McLaughlin suggests that understanding the significance of such a move by the regulators is critical. The small number of banks that would ever be targeted for such treatment would have to be in serious danger of failing, he points out. Though the initial cause of trouble would be technology related, says McLaughlin, a bank would quickly pass through all the stages of prompt corrective action, and be closed, very likely, for bread-and-butter insolvency reasons.

Consequences could be troublesome for individuals connected with the bank. During a recent convention, FDIC Director of Supervision Nick Ketcha warned officers and directors not to forget the huge number of D&O suits his agency filed during the 1980s and early 1990s. Failure to make sure your bank can handle the Year 2000, he suggested, was as ripe for pursuit as failing to oversee a bank's loan function. ***BJ***

## Key Y2K Dates

**June 30, 1998**. At this point, regulators expect to have completed on-site examinations of every bank to determine how well they are coming along with Year 2000 compliance. After these exams, progress will be monitored quarterly. Banks are expected to have developed their testing strategies by this date.

**June 30, 1998**. By this date, banks must set a process for managing Year 2000 risks posed by customers.

**July 1998 through late 1999.** In its role as payments system central, the Federal Reserve will run a program for banks to test payments and settlements over its FedWire service. Details were to be sent to banks during March 1998.

**Sept. 30, 1998**. By now, assessment of customers' risks should be completed.

**Dec. 31, 1998.** Regulators expect banks to have completed programming changes and hardware upgrades and to have testing well under way for critical systems.

**1999.** Banks' last opportunity to make corrections based on test results and to re-test systems.

**Sept. 9, 1999.** A date regulators want banks to test for, as some systems use a string of 9s to represent exception items.

**Jan. 1, 2000**. "D-Day"



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