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STATEMENT OF

RICHARD J. OSTERMAN, Jr.
DEPUTY GENERAL COUNSEL
FEDERAL DEPOSIT INSURANCE CORPORATION

on

EXAMINING THE SETTLEMENT PRACTICES OF U.S. FINANCIAL REGULATORS

before the

COMMITTEE ON FINANCIAL SERVICES

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Chairman Bachus, Ranking Member Frank, and members of the Committee, thank you for the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) about our settlement practices. In my testimony, I will discuss the FDIC's approach to enforcement and the tools we have available, as well as the public interest benefits derived from our enforcement policies and practices.

The core mission of the FDIC is to maintain stability and public confidence in the nation's banking system. As recent events have reminded us, the financial condition of banks influences the economy in direct, substantial and often immediate ways and, mindful of this, the FDIC is robust in its supervision of insured depository institutions and in correcting unsafe and unsound practices, violations of law, and breaches of fiduciary duty.

Among banking regulators, the combination of the FDIC's responsibilities as insurer, supervisor, and receiver is unique. As supervisor, the FDIC is the primary federal regulator for state banks that are not members of the Federal Reserve System, as well as state chartered savings associations. Presently, the FDIC directly supervises 4,115 insured state nonmember banks and 444 insured state-chartered savings associations, and by statute, in its role as insurer, has back-up enforcement authority for the rest of the over 7,000 FDIC-insured depository institutions. In addition, the FDIC acts as receiver for all failed insured depository institutions and, under the Dodd-Frank Act, has substantial responsibilities for large complex financial companies that may pose a systemic risk to the financial system.

The FDIC, like the other federal banking agencies has been given strong enforcement powers under section 8 of the Federal Deposit Insurance Act (FDI Act). These powers are used by the FDIC when corrective action is needed to protect consumers, the banking industry, and the financial institution itself from harm.

The FDIC's highly-trained examiner corps regularly examines FDIC-supervised depository institutions to ensure they are operated in a safe and sound manner in compliance with state and federal banking laws and regulations, including all consumer protection laws. When FDIC examiners find violations of law, breaches of fiduciary duty, or unsafe and unsound practices, including mismanagement and insider abuses, the FDIC requires corrective action, notably through removal and prohibition orders, the assessment of civil money penalties or cease-and-desist orders which may also include restitution.

From 2007 through 2011, the FDIC issued approximately 1,000 Cease-and-Desist Orders and 377 Removal and/or Prohibition Orders, as well as 753 Civil Money Penalties. These individual enforcement actions were based on a wide range of harm or risks caused to insured depository institutions and consumers.

Enforcement Process

Many of the FDIC's enforcement orders are issued based upon a stipulation between the FDIC and the respondent in which the respondent neither "admits nor denies" the allegations. Such consent orders are issued only after a thorough evaluation of the pertinent evidence to ensure that the FDIC's case against the respondent meets all of the statutory factors required to initiate an action and sustain a *prima facie* case. Consideration is given, among other things, to the particular facts and evidence in the case, the likelihood of success should the case proceed to litigation, the best way to meet our objectives and obtain the recommended relief, as well as how long it would take to get relief if the case did not settle.

The timeframe from obtaining the stipulation to issuance of an order is relatively quick, and the resulting final agency order is usually effective and enforceable immediately. Some stipulated orders, particularly cease-and-desist orders that seek quick correction of bank practices, are issued pursuant to delegated authority by appropriate managers in the FDIC's regional and area offices. Those involving restitution, civil money penalties, and removal and prohibition actions against individuals are carefully reviewed for both legal sufficiency and nationwide consistency, and then issued by the Washington office pursuant to delegated authority.

Should a respondent choose not to stipulate -- in other words, agree -- to an action, the FDIC prepares a Notice of Charges to initiate a case. While Notices of Charges seeking cease-and-desist orders are normally issued by the FDIC's Regional Offices under delegated authority, Notices to remove an individual from banking, require restitution, or impose civil money penalties are reviewed by the FDIC's Case Review Committee[1] before being issued. Once a case is filed, the procedures are governed by the

[1] The Case Review Committee is a standing committee of the FDIC Board, and serves to review in advance and approve the initiation under delegated authority of certain

FDIC's formal Rules of Practice and Procedure. Specifically, a hearing is held before an administrative law judge (ALJ) and the ALJ's recommended decision is reviewed by the FDIC's Board of Directors which then issues a final decision and order. Stipulated final orders and those entered after a hearing are both published, which provides notice to the industry and to the public of a bank's practices and individuals' misconduct and its consequences.

Removal and Prohibition and Civil Money Penalty Orders

As noted earlier in the testimony, one of the corrective actions for which Congress granted the FDIC authority is the removal and prohibition from the business of banking, found in section 8(e) of the FDI Act. The FDIC has issued hundreds of removal and prohibition orders against institution-affiliated parties who were determined to have dishonestly or recklessly engaged in violations of law, unsafe or unsound practices or breaches of fiduciary duty and caused losses to the institution they were meant to serve or benefited themselves at the institution's expense. An 8(e) order prohibits the individual from participation in any manner in banking under a lifetime, industry-wide ban. This powerful tool serves to address past conduct while also protecting the industry as a whole.

Appropriately, the statutory requirements to bring a removal or prohibition action are quite stringent. The FDIC must determine that the respondent has engaged in violations of law, unsafe or unsound practices or breaches of fiduciary duty that resulted

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enforcement actions.

in a benefit to them or a loss to the institution or prejudice to depositors. In addition, the FDIC must determine that the conduct involved personal dishonesty or willful or continuing disregard for the safety and soundness of the institution.

Although most FDIC removal and prohibition action orders are issued on consent, the orders specifically state that a determination has been made by the agency that a respondent's actions meet each of the foregoing statutory elements. Thus, while a respondent who stipulates to an order does not technically admit the conduct, it is clear to the public and the industry that the FDIC has determined it can make a *prima facie* case that the respondent has engaged in egregious actions that the FDIC believes warrant the imposition of a very severe and immediate remedy—a lifetime bar from banking.

In the context of removal and prohibition, stipulated orders serve the public interest in several ways. Our experience has been that the time between initiation of the case and the final decision effecting a remedy is often two to three years, given the time frames for response, discovery and litigation of a contested case before an ALJ, including review of the ALJ's recommended decision by the FDIC's Board of Directors and issuance of a final decision and order. During this time, respondents still employed in the banking industry may remain in their positions with the possibility of committing more harm. In contrast, a person subject to a stipulated removal and prohibition order is precluded from participating in banking *immediately* upon the order's issuance.

The FDIC believes that requiring a respondent to specifically admit the alleged conduct in a settlement may have the unintended consequence of frustrating its goals. Many respondents would be hesitant to admit the conduct, and respondents' attorneys cannot reasonably support settlements that require admissions if their clients are potentially exposed to additional civil liability, or criminal action. Thus requiring admission of liability is likely to reduce the number of settlements, and to push the parties in remaining cases toward settling based on admission of the absolute minimum necessary to sustain a case. Furthermore, insisting on an admission of liability is likely to result in protracted negotiations regarding settlement, thus precluding a principal benefit of settlement—obtaining prompt relief. Additionally, given finite agency resources, if there are fewer settlements it would mean that, in total, we would be able to pursue fewer cases overall.

Stipulated civil money penalty orders often accompany removal and prohibition actions, as a means of further deterrence. The FDIC uses its enforcement authority to assess civil money penalties against institutions and institution-affiliated parties when we have found violations of law, unsafe or unsound practices or breaches of fiduciary duty, with a progressive increase in penalty amount as the egregiousness of the conduct increases. In considering the civil money penalty amount, the FDIC must take into account statutorily-mandated factors, including the size of the financial resources and good faith of the respondent, the gravity of the violation, and the history of previous violations. Civil money penalties collected are paid to the U.S. Treasury.

Cease-and-Desist Orders

Cease and desist orders are used by the FDIC as an enforcement tool for corrective action in several significant contexts. One of those contexts is when banks are in a troubled condition. As noted, since 2007, the FDIC has issued approximately 1,000 cease-and-desist orders to halt and correct violations of law and unsafe or unsound banking practices and to strengthen the capital position of the institutions it supervises, and thus to achieve better health of the industry overall. Most of these are orders against institutions that are in troubled condition, with many of them posing an elevated risk of failure if their problems are not corrected. Such orders set forth a detailed corrective plan, a virtual "road map" for the institution to follow to correct practices and to raise capital to return the institution to a safe and sound condition. While the institution neither admits nor denies the unsafe or unsound practices or violations that are the subject of the cease and desist order, the order does recite that the FDIC has reason to believe the requisite statutory elements[2] are present, and each corrective action that is ordered is based upon a specific examination finding.

Prompt action in such cases is essential to avoid the loss to the insurance fund, and the cost to communities and the economic system as a whole, that arise when a bank fails. Without the ability to settle a case quickly, the length of time to obtain relief in a contested case could, in many cases, render the relief ineffective. Additionally, the FDIC has the power through cease-and-desist actions to order affirmative relief, including ordering an insured depository institution or institution-affiliated party who was unjustly enriched to make restitution.

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[2] Cease-and-desist actions require that the FDIC have a reason to believe that an institution or institution-affiliated party is engaging or has engaged, or is about to engage, in unsafe or unsound practices; or is violating, has violated or is about to violate law, rule or regulation, or any condition imposed in writing by the agency in connection with any action on an application, notice or other request, or any written agreement entered into with the agency. For restitution, the FDIC must prove the party was unjustly enriched in connection with such violation or practice or acted in reckless disregard of the law, applicable regulations or prior order of the agency.

The power to seek restitution can be particularly important when an institution or institution-affiliated party violates consumer protection laws and regulations, such as Section 5 of the Federal Trade Commission Act (prohibiting unfair or deceptive acts and practices), the Truth in Lending Act, the Truth in Savings Act, the Real Estate Settlement Procedures Act, among others. Where material violations of these consumer protection provisions are identified, FDIC seeks remedies that typically include cease-and-desist orders as well as restitution and civil money penalties. Depending on the severity of the violation and the extent of consumer harm, the amount of restitution sought for consumers can be substantial. In these consumer cases, orders for restitution are vehicles for consumer redress. Therefore, the FDIC has that additional interest in issuing such orders as quickly as possible.

Additionally, when violations involve fair lending laws, such as the Equal Credit Opportunity Act and the Fair Housing Act, the FDIC first determines whether the institution or institution-affiliated party engaged in a "pattern or practice" violation. If so, the FDIC will refer the case to the United States Department of Justice. If the violation is not a pattern or practice violation, or if the Department of Justice returns a case to the FDIC, the FDIC can pursue the enforcement remedies outlined above, assuming the statutory elements are met.

Professional Liability Cases

The FDIC also brings professional liability cases on behalf of the receiver of banks that have been closed by federal or state regulators. These cases serve a very different purpose than enforcement cases brought by the FDIC and the other banking agencies. Professional liability cases are civil tort and contract actions that seek recovery for damages caused to failed banks by their officers and directors, and by professionals working for the failed banks such as lawyers and accountants. Recoveries are used to pay claims against the receivership estate in accordance with statutory priorities set out by Congress, which provide first for payment of the receiver's administrative expenses, second for any deposit liability and third for general creditor claims.

The FDIC, consistent with its responsibilities as receiver, uses the most cost-effective approach available to obtain the maximum monetary relief in professional liability cases, whether this proves to be litigation or settlement. The FDIC has litigated certain cases for many years, including through appeal, when it has determined that it is cost-effective to do so. But most professional liability cases—like most civil litigation by other parties—settle, and the money is paid to the FDIC without a concession by the defendant regarding culpability.

SEC v. Citigroup Global Markets

The FDIC is aware of both the District Court and the Second Circuit decisions in the *U.S. Securities & Exchange Commission v. Citigroup Global Markets, Inc*. case. The FDIC is not a party to the case, does not have all of the facts, and thus is not in a position to express an opinion regarding the merits of the decisions. In response to the Committee's request for comment on the matter, we would note that the case is still before the Second Circuit, and that the Circuit has stayed the proceedings below, pending a decision on appeal regarding the order rejecting the settlement.

By statute, FDIC administrative enforcement actions, if not settled, proceed to hearing before an administrative law judge, and ultimately to final decision and order by the FDIC's Board of Directors, rather than trial in district court. As a consequence, we are very unlikely to be in the same position the SEC is in the *Citigroup* case. As indicated elsewhere in our testimony, it has been our experience that we are better able to accomplish the purposes of our statute by agreeing to 'neither admit nor deny' language in our settlements, which ultimately results in our imposing regulatory consequences on respondent's actions without the delays, resource costs, and litigation risks that would be involved if we insisted on admissions of liability as a condition to accepting a settlement.

Conclusion

In conclusion, we believe that the FDIC's process accomplishes its statutory responsibilities and purpose, while ensuring that the actions it takes serve the public interest and are prompt, effective and cost-efficient.