

CURRENT LEGISLATION

BANKING

THE FINANCIAL INSTITUTIONS SUPERVISORY ACT OF 1966

Federal regulation of federally insured banks and savings and loan associations¹ is divided among five agencies—the Federal Home Loan Bank Board (FHLBB), the Federal Savings and Loan Insurance Corporation (FSLIC), the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (FDIC)²—whose common objective is to maintain sound financial institutions.³ Their primary approach in attaining this objective is to insure that the management of these institutions operate prudently and in accordance with specific laws, rules, and regulations.⁴ They have relied heavily upon the supervisory process as the method for implementing this approach.⁵ The supervisory authorities, however, have not been able to secure prompt correction of unsatisfactory practices on their own terms, because the sanctions provided to support supervision were not adaptable to the problems.⁶ Congress passed the Financial Institutions Supervisory Act of 1966⁷ (here-

¹ Very few financial institutions do not carry federal insurance. See, e.g., 1965 FDIC Ann. Rep. 116.

² The Federal Home Loan Bank Board has jurisdiction over federal savings and loan associations. Home Owners' Loan Act of 1933, § 5(a), 48 Stat. 132, 12 U.S.C. § 1464(a) (1964). The members of this Board are the trustees of the Federal Savings and Loan Insurance Corporation. National Housing Act § 402(a), 48 Stat. 1256 (1934), as amended, 12 U.S.C. § 1725(a) (1964). The Board thereby controls state savings and loan associations and cooperative banks which carry the Corporation's insurance. National Housing Act § 403(a), 48 Stat. 1257 (1934), as amended, 12 U.S.C. § 1726(a) (1964).

The jurisdiction of the federal agencies in charge of banking overlaps in many areas. By informal agreement, the responsibility for supervision of management is allocated in the following manner: the Comptroller of the Currency—national banks; the Board of Governors of the Federal Reserve System—state banks which are members of the system; the Federal Deposit Insurance Corporation—state nonmember banks which carry that Corporation's insurance. See Welman, Jr., Allocation of Supervisory Responsibility Today, in Bank Supervision 11, 18 (Federal Reserve Bank of St. Louis pub. 1963). The Financial Institutions Supervisory Act recognizes this allocation of responsibility. FISA § 201, 80 Stat. 1046, 12 U.S.C.A. § 1813(q) (Supp. 1966).

³ Wyrick, The General Nature of Bank Supervision, in Bank Supervision 1, 2 (Federal Reserve Bank of St. Louis pub. 1963).

⁴ Id. at 2-3. See, e.g., 12 C.F.R. § 563.17 (1963).

⁵ 1 Davis, Administrative Law § 4.04 (1958). See Heisler, Regulations Versus Administrative Decisions, 18 Bus. Law. 240 (1962).

⁶ S. Rep. No. 1482, 89th Cong., 2d Sess. 5 (1966).

⁷ 80 Stat. 1028, [codified in scattered sections of 12 U.S.C.A. (Supp. 1966)], amending the following acts: Home Owners' Loan Act of 1933, § 5(d), as amended, 68 Stat. 634 (1954), 12 U.S.C. § 1464(d) (1964); National Housing Act §§ 401(b), 405(a), 407, 48 Stat. 1255, 1259, 1260 (1934), as amended, 12 U.S.C. §§ 1724(b), 1728(a), 1730 (1964); National Housing Act § 408(c), added by 73 Stat. 692 (1959), 12 U.S.C. § 1730a(c) (1964); Federal Deposit Insurance Act §§ 3, 7(i), 8, 9, 10(b), (c), 11(a), (i), 64 Stat. 873, 879, 881, 882, 884, 886 (1950), as amended, 12 U.S.C. §§ 1813, 1817(i),

inafter referred to as FISA) to correct these deficiencies by strengthening the formal sanctions.⁸

The purpose of this comment is to analyze the act's effect on the resolution of conflicts between the agencies and management, and, more specifically, to consider whether it remedies the previous deficiencies in the formal sanctions and whether, at the same time, it contains adequate safeguards against misuse of its provisions. The comment will first describe control by supervision. Second, an examination will be made of the new sanctions found in the act: (1) cease-and-desist orders; and (2) suspension, removal, and prohibition orders. Finally, the comment will discuss the problems which will face management as it seeks to secure an adjudication of its rights.

I. BACKGROUND: CONTROL BY SUPERVISION

A description of control by supervision is essential to an understanding of why FISA was passed and to appreciate the scope and effect of the act. Supervision is a three-step process involving fact-finding, appraisal, and correction of unsatisfactory practices. The first step, fact-finding, involves a yearly examination of every aspect of the institution's operations.⁹ The examiner will list and appraise loans, investments, and fixed assets, and also will analyze such items as deposit, income, expense, reserve, and capital accounts. Then, from the results in these areas, he will evaluate the quality of management. Finally, the examiner will draft a report containing relevant statistics, a notation of unusual activities, other comments, and criticisms.

The second step is an appraisal of these findings by the examiner, the regional supervisor, and eventually the central office to determine whether any practices disclosed by the report are unsatisfactory and in need of correction.¹⁰ Despite the fact that a large number of statutory provisions, rules, and regulations circumscribe management conduct, the supervisory authorities have great leeway in making this determination. Many of these provisions are phrased in such imprecise terms that their interpretation and application depend on supervisory judgment. For example, the regulations provide that state banks which are members of the Federal Reserve

1818, 1819, 1820(b), (c), 1821(a), (i) (1964). FISA also repealed: Federal Deposit Insurance Act § 7(j)(6), added by 78 Stat. 941 (1964), 12 U.S.C. § 1817(j)(6) (1964); Banking Act of 1933, § 30, 48 Stat. 193, 12 U.S.C. § 77 (1964). The act also increased the federal insurance limit from \$10,000 to \$15,000. FISA §§ 301-03, 80 Stat. 1055 [codified in scattered sections of 12 U.S.C.A. (Supp. 1966)]. Except for the increase in the insurance limit, the act expires June 30, 1972. FISA § 401, 80 Stat. 1056 (1966).

⁸ See S. Rep. No. 1482, *supra* note 6, at 1, 4-6.

⁹ For a description of examination methods, see H.R. Rep. No. 447, 88th Cong., 1st Sess. 43-46 (1963); 1965 FDIC Ann. Rep. 17-18; Chapin, *Techniques of Bank Examination*, in *Bank Supervision* 21-26 (Federal Reserve Bank of St. Louis pub. 1963); Fox, *Supervision of Banking by the Comptroller of the Currency*, in *Public Administration and Policy Formation* 120, 158-63 (Redford ed. 1956). National banks are examined approximately twice a year. Federal Reserve Act § 21, 38 Stat. 271 (1913), as amended, 12 U.S.C. § 481 (1964).

¹⁰ See Isbell, *Review and Appraisal*, in *Bank Supervision* 27-31 (Federal Reserve Bank of St. Louis pub. 1963). These three levels of authority are found in each agency and are generally referred to in this comment as the "supervisory authorities."

System must maintain adequate capital.¹¹ What factors are to be considered in determining whether the institution has adequate capital and has taken proper steps to maintain that capital, in addition to the relative weight to be assigned to each factor, are left to supervisory judgment.¹² Furthermore, even when there is an unambiguous regulation governing management conduct, the supervisory authorities may determine that a practice conforming to the regulation is unsatisfactory, if, under the circumstances, it might involve an abnormal risk.¹³ For example, the Federal Home Loan Bank Board sets a maximum rate of return on regular deposits; generally the current rate is 4.75 per cent.¹⁴ The supervisory authorities could determine that a rate of return within this limit is unsatisfactory if the association's earnings and its opportunities for investment were insufficient to justify such a rate.¹⁵

The third step is correction.¹⁶ The process begins in earnest when the regional supervisor transmits a covering letter and the examiner's report to the board of directors. The supervisory letter will note deviations from the norm and demand correction of unsatisfactory conditions. Because so many of the supervisory authorities' demands depend upon their own appraisal of the facts, and because the area of criticism is so broad, the probability of conflict between the agency and management is high. In an effort to resolve any conflict, the regional supervisor and management will meet informally to discuss the report and criticisms.

The supervisor's ability to resolve controversies and secure corrections on his own terms hinges upon the risk to management of noncompliance with the supervisory authorities' demands. The components of this risk are the severity of the sanctions to which management is subject and the probability that a particular sanction will be imposed. Consequently, in analyzing the efficacy of the supervisory process, an examination will be made of three categories of sanctions, the first two of which were unaltered by FISA: (1) state sanctions; (2) federal informal sanctions; and (3) federal formal sanctions.

The majority of federally insured financial institutions are state chartered¹⁷ and, thus, subject to both state and federal control. Therefore, in these instances the federal agency can supplement its power by making use of state sanctions. There are, however, several difficulties with this approach.

¹¹ 12 C.F.R. §§ 208.6(c), .7(2) (1963). For a case upholding this requirement, see *Continental Bank & Trust Co. v. Woodall*, 239 F.2d 707 (10th Cir.), cert. denied, 353 U.S. 909 (1957).

¹² In determining adequacy, capital is compared to the volume of marginal and inferior quality assets, of deposits, and of risk assets. In determining the adequacy of protection, the supervisory authorities examine dividend policies, expense control, and earnings retention. Isbell, *supra* note 10, at 30.

¹³ Crosse, *General Bank Supervision and Regulation*, in *The Bankers' Handbook* 1036, 1040 (Baughn & Walker ed. 1966).

¹⁴ 31 Fed. Reg. 16763 (1966).

¹⁵ See 112 Cong. Rec. 25416 (daily ed. Oct. 13, 1966) (FHLBB memorandum on unsafe or unsound practices).

¹⁶ See Isbell, *supra* note 10, at 31-33.

¹⁷ See, e.g., 1965 FDIC Ann. Rep. 99.

First, in a given situation, state officials may be unwilling to act, either because they apply a less strict standard to the facts or because, while applying essentially the federal standard, they interpret the facts differently.¹⁸ Second, state officials are more subject to the influence of pressure groups, since they have a smaller constituency than federal officials. Therefore, they may be more hesitant to act, simply out of fear of antagonizing such groups.¹⁹ Finally, even if the state officials are willing to act, they may not have sufficient power. For example, in several states, the state agency does not have authority to remove officers or directors²⁰ or to issue enforceable cease-and-desist orders.²¹ Thus, in many instances, state control will have no effect on the federal agency-management dispute.

Management is subject to a number of informal federal sanctions. If management seeks to borrow money from a Federal Home Loan Bank or a Federal Reserve Bank, it may, as a condition precedent to the loan, be forced to make corrections or at least sign an agreement giving assurances that it will comply with the directions of the responsible agency.²² Also, if the institution desires to merge or branch, management may have to take the same action before approval will be granted.²³ These pressures, however, are of limited usefulness, since they are only available when management requires "favors" from the agencies.

Another informal sanction involves the agency's use of its authority to order additional, *i.e.*, "special," examinations.²⁴ The force of special examinations stems from the fact that the agency can charge examination costs to the institution²⁵ and the fact that the examination disrupts daily business. It would seem, however, that in many instances, these nuisance effects will be outweighed by the expected benefits from the criticized practice and, therefore, will not be sufficient to secure corrections. On the other hand, in small communities, where the examiner's presence is readily noticeable, special examinations have a more forceful effect.²⁶ management will fear

¹⁸ See Crosse, *supra* note 13, at 1048.

¹⁹ See Hearings on S. 3158 Before a Subcommittee of the Senate Committee on Banking and Currency, 89th Cong., 2d Sess. 128 (1966) [hereinafter cited as Senate Hearings].

²⁰ *Id.* at 67.

²¹ *E.g.*, Alabama and Idaho.

²² See Fox, *supra* note 9, at 171.

²³ *Ibid.*

²⁴ *E.g.*, Federal Reserve Act § 9, 40 Stat. 232 (1917), as amended, 12 U.S.C. § 326 (1964). FISA broadens the permissible scope of the examination of savings and loan associations and state nonmember banks by the FHLBB, the FSLIC, and the FDIC to include the affairs of affiliates to whatever extent they may affect the institution. FISA §§ 102(a)(m)(1), 203(b), 80 Stat. 1044, 1053, 12 U.S.C.A. §§ 1730(m)(1), 1820(b) (Supp. 1966). Thus, the power to harass by examination is increased. The Board of Governors and the Comptroller of the Currency already had a similar power. Banking Act of 1933, §§ 5(c), 28(b), 48 Stat. 162, 194, as amended, 12 U.S.C. §§ 338, 481 (1964).

²⁵ The Board of Governors may charge the expense of special examinations against the individual bank. Federal Reserve Act § 9, 40 Stat. 232 (1917), as amended, 12 U.S.C. § 326 (1964). The Comptroller of the Currency must assess the expense against the institution. Federal Reserve Act § 21, 38 Stat. 271 (1913), as amended, 12 U.S.C. § 482 (1964).

²⁶ See Isbell, *supra* note 10, at 32.

that depositors may become alarmed at the frequency of examinations and begin a "run" on the institution. It is, however, contrary to the agency's interest to shake public confidence in the institution.²⁷ Therefore, in small communities the agency will not use frequent examinations as an instrument of coercion except in the most serious cases.²⁸

In light of the above discussion, it seems that both state sanctions and federal informal sanctions are unreliable tools with which to secure corrections. The remaining category to be considered in measuring the risk of noncompliance is federal formal sanctions. Before FISA, the primary formal sanctions and the agencies which could impose them were as follows: The Board of Governors of the Federal Reserve System and the Comptroller of the Currency could remove officers and directors of state member and national banks;²⁹ the FHLBB could seize federal savings and loan associations³⁰ and could issue correction orders to these associations;³¹ finally, the FDIC and the FSLIC could terminate insurance.³²

These sanctions, except for correction orders, were extremely severe. The removal of an officer deprived him of his livelihood.³³ Seizure deprived individuals of the right to manage their own property. Termination of insurance would eventually force the institution to either merge or dissolve, as few individuals would thereafter entrust their money to the institu-

²⁷ See Fox, *supra* note 9, at 124.

²⁸ For congressional criticism of the use of special examinations for coercive purposes, see H.R. Rep. No. 447, 88th Cong., 1st Sess. (1963).

²⁹ Banking Act of 1933, § 30, 48 Stat. 193. The Board of Governors has had the additional sanction of expelling, after hearing, banks from membership in the Federal Reserve System. Federal Reserve Act § 9, 38 Stat. 259 (1913), as amended, 12 U.S.C. § 327 (1964). Furthermore, upon such expulsion, federal insurance has been automatically terminated. Federal Deposit Insurance Act § 8(b), 64 Stat. 880 (1950), 12 U.S.C. § 1818(b) (1964). The sanction thus has had much the same defects as termination of insurance. The Board of Governors also has had the sanction of suspending from the credit facilities of the system member banks who unduly use their credit. Banking Act of 1933, § 3(a), 48 Stat. 163, as amended, 12 U.S.C. § 301 (1964).

³⁰ Home Owners' Loan Act of 1933, § 5(d)(2), as amended, 68 Stat. 635 (1954), 12 U.S.C. § 1464(d)(2) (1964).

³¹ Home Owners' Loan Act of 1933, § 5(d)(1), as amended, 68 Stat. 634 (1954), as amended, 12 U.S.C. § 1464(d)(1) (1964). It should be noted that the FHLBB has had authority to expel members from the Federal Home Loan Bank System, but this did not result in automatic termination of insurance. Federal Home Loan Bank Act § 6(i), 47 Stat. 279 (1932), as amended, 12 U.S.C. § 1426(i) (1964). FISA, however, provides that expulsion carries with it automatic termination of insurance. FISA § 102(a)(i), 80 Stat. 1041, 12 U.S.C.A. § 1730 (Supp. 1966). Consequently, when the Board now expels a member, that bank automatically loses its insurance.

³² Federal Deposit Insurance Act § 8, 64 Stat. 879 (1950), 12 U.S.C. § 1818 (1964); National Housing Act § 407, 48 Stat. 1260 (1934), as amended, 12 U.S.C. § 1730 (1964). It should be noted that termination was the only major formal sanction available against state chartered institutions which were not members of the Federal Reserve System. Such institutions comprise the largest segment of the industry. See, e.g., 1965 FDIC Ann. Rep. 99.

³³ Actually, this sanction did not effectively protect the public, because the removed officer could continue to exercise his deleterious influence through his stockholdings or deposits.

tion.³⁴ Moreover, in some states, an institution could not operate without federal insurance.³⁵ Finally, from the agencies' viewpoint, to seize an institution or terminate its insurance was to acknowledge, to some extent, that the agency had failed in that it was unable to keep financial institutions running smoothly.

The severity of seizure and termination was increased by the fact that imposition of either sanction would likely aggravate the institution's unsatisfactory condition. The sanctions could not practically be imposed without informing the public that the institution had been mismanaged. As the depository of private funds, the institution and the industry as a whole depend on public confidence in their soundness. Publicity of mismanagement would shake public confidence in the institution and raise doubts about the soundness of the entire industry, eventually resulting in a substantial increase in withdrawals.³⁶ These withdrawals could cause more damage than the practice sought to be corrected. Thus, in most instances, the agencies would be defeating their own purpose to impose such sanctions.

All the sanctions, except the FHLBB's summary seizure power, were unwieldy. Lengthy hearings were required before removal and termination orders could be issued. In the latter case, the agency had to give the institution 120 days to make corrections before hearings could be held. Issuing correction orders involved the most delay. Only after a full hearing could the FHLBB issue an order requiring a federal association to correct violations of law or regulation. Before such hearings could be held, however, the institution could bring suit in the appropriate district court to have that court decide the controversy. The Board invoked this authority twice, and both times the institution brought the controversy into court.³⁷ In one case, three years were spent in pretrial motions and discovery proceedings.³⁸ Such delay could be critical, since the institution's assets are easily transferable, and thus, dishonest or grossly incompetent management could ruin an institution before the agencies could gain control of the situation.³⁹

Thus, the pre-FISA formal sanctions could be categorized by their severity, by the likelihood that their imposition would further damage the institution, and by the fact that they were cumbersome to apply. Because of these

³⁴ Hearings on S. 3158 Before the House Committee on Banking and Currency, 89th Cong., 2d Sess. 31 (1966) [hereinafter cited as House Hearings].

³⁵ See, e.g., *Ariz. Rev. Stat. Ann.* § 6-412 (Supp. 1966).

³⁶ House Hearings 46-47; Fox, *supra* note 9, at 124. One sanction depends entirely on publicity: the FDIC may publish details of examination reports insofar as they relate to supervisory directives which management has failed to follow. Federal Deposit Insurance Act § 18(f), 64 Stat. 892 (1950), 12 U.S.C. § 1828(f) (1964). The Comptroller of the Currency has similar authority. Banking Act of 1933, § 28(a), 48 Stat. 192, as amended, 12 U.S.C. § 481 (1964). The agencies consider the sanction so drastic that it is rarely used. 1 Davis, *Administrative Law* § 4.04 (1958). In one instance, however, the Comptroller used the threat of this sanction to compel several New York City banks to reduce interest rates to within legal limits. Fox, *supra* note 9, at 172-73.

³⁷ Senate Hearings 12.

³⁸ *Id.* at 11.

³⁹ See *id.* at 16.

defects, the agencies were extremely reticent to resort to formal sanctions.⁴⁰ The only other use the agencies could make of the formal sanctions was to threaten to impose them. To be effective, however, the threat had to be used in circumstances in which the opposing party would consider it probable that the threat would be consummated. Since the agencies were so reluctant even to begin proceedings, their threat to impose sanctions would lack credibility in many instances. Therefore, the threat could be effectively employed only in the more serious problem cases.

Before FISA, the risk of noncompliance was therefore low, because it was unlikely that effective sanctions would be imposed. This low risk was brought into focus by two recent developments in the industry—rapid expansion and tight money.⁴¹ These changes lowered the quality of management and increased the pressures upon it to take greater risks. The agencies were less able to convince management of the validity of their judgments and, therefore, were forced to rely on a compulsion that was in fact inadequate to secure corrections. As an end result, the agencies were unable to secure prompt correction of many unsatisfactory practices⁴² and accepted less by way of corrections than they preferred.⁴³ An agency may have felt that an institution needed \$400,000 more capital; it would accept an increase of \$250,000. An agency may have felt that an executive officer was incompetent and should be replaced; it would accept a system whereby the directors would pass on all loans. The agencies also waited longer before demanding some corrections. Executive salaries may have been too high; an agency would wait until earnings were dangerously low before pressing the point. Furthermore, they let some unsatisfactory aspects, *e.g.*, inadequate separation between tellers and customers, pass with simple criticism. Thus, preventive supervision failed to realize its potential. This was demonstrated by an increasing number of bank failures, the most notorious of which was the failure of the San Francisco National Bank in 1965.⁴⁴ Congress sought to remedy this undesirable situation through revision of the formal sanctions.

⁴⁰ See *id.* at 51. To illustrate: the FDIC annually institutes termination proceedings against approximately five banks. See 1965 FDIC Ann. Rep. 19. Yet the cases which warrant serious supervisory concern are often twenty times that number. See Senate Hearings 72. When the FDIC does institute proceedings, it makes sure that it has a substantial case. Termination proceedings rarely proceed to the issuance of a termination order. In approximately 40% of the cases, the bank makes the demanded corrections. In approximately 54% of the cases, the bank merges or suspends operation before a termination date is set. Only in approximately 6% of the cases is a date set for termination of insured status. See 1965 FDIC Ann. Rep. 19.

⁴¹ Rapid expansion has created a shortage of capable, experienced management, particularly in small communities, and an increasing number of speculators and some criminal elements have filled the gap. See Senate Hearings 24, 33, 39-40. The rising cost of acquiring money has put a squeeze on earnings. Perhaps to maintain earning levels, management has increasingly tended to engage in high-risk, high-return ventures. *Id.* at 39.

⁴² S. Rep. No. 1482, *supra* note 6, at 4-6.

⁴³ See Senate Hearings 107, 110; House Hearings 31. The examples that follow in the text were obtained through interviews with agency representatives in Boston, Massachusetts, during January 1967.

⁴⁴ See 1965 FDIC Ann. Rep. 180-81. Between 1962 and 1966, there were twenty bank failures. See *id.* at 180; Senate Hearings 87.

The issue to be examined now is whether the formal sanctions provided by FISA increase the risks of noncompliance so that supervisory authorities can secure prompt correction of unsatisfactory practices on their own terms.

II. THE MAJOR FORMAL SANCTIONS UNDER FISA

A. *Cease-and-Desist Orders*

The cease-and-desist sanction will be the most useful tool by which the agencies will be able to prevent or correct unsatisfactory practices. Under FISA, whenever, in the opinion of the agency, the institution violates a law, rule, regulation, charter, or written agreement with the agency, or commits an unsafe or unsound practice, the agency may serve notice of intent to issue a cease-and-desist order.⁴⁵ If, after a hearing the proscribed conduct has been established, the agency may issue an order requiring the institution to conform and to take whatever affirmative action is necessary to correct the conditions resulting from such conduct.⁴⁶ The preventive nature of the remedy is underscored by the provision allowing the agency to begin proceedings if there are reasonable grounds to believe the institution "is about to engage in" an unsafe or unsound practice or "is about to violate" a law, rule, regulation, charter, or written agreement with the agency.⁴⁷

The sanction's utility depends upon whether it can be readily employed in the agency-management dispute, which in turn depends upon the construction of the words, "unsafe or unsound practice." These words have been in federal legislation for over thirty years;⁴⁸ yet, they have not been defined by either judicial opinion or official administrative pronouncement. The vagueness of the phrase troubled many members of Congress during debate over FISA. To meet their doubts, supporters of the act in both the House and the Senate offered the following definition:

Generally speaking, an "unsafe or unsound practice" embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.⁴⁹

Since there was no objection to this definition, it will probably be adopted by both the courts and the agencies.

A comparison of "unsafe or unsound practices," as defined above, with the practices typically criticized in letters from the regional supervisors reveals that substantially the same degree of harm is involved and is arrived at by the same process. Both branches criticize practices which are poten-

⁴⁵ FISA §§ 101(a)(2)(A), 102(a)(e)(1), 202(b)(1), 80 Stat. 1029, 1038, 1046, 12 U.S.C.A. §§ 1464(d)(2)(A), 1730(e)(1), 1818(b)(1) (Supp. 1966). Since the agency can require affirmative action, "cease and desist" is in a sense a misnomer.

⁴⁶ *Ibid.*

⁴⁷ *Ibid.*

⁴⁸ E.g., Banking Act of 1933, § 30, 48 Stat. 193.

⁴⁹ 112 Cong. Rec. 24022 (daily ed. Oct. 4, 1966) (House); 112 Cong. Rec. 25416 (daily ed. Oct. 13, 1966) (Senate).

tially harmful, *i.e.*, involve a greater than acceptable risk, and both base their decisions on an analysis of all relevant facts.⁵⁰ In addition, the scope of an "unsafe or unsound practice," like the scope of supervision, "touches upon the entire field of the operations of a financial institution."⁵¹ Thus, "unsafe or unsound" includes nearly all practices criticized in the initial supervisory letter. Therefore, the agency in nearly all cases will be able to institute cease-and-desist proceedings at the same time that it commences the correction process by issuing a supervisory letter.⁵²

An "unsafe or unsound practice" does not cover all initial criticisms because of the limitation that the practice be "contrary to generally accepted standards of prudent operation."⁵³ The agency, however, will not have to wait long before these other practices provide grounds for instituting proceedings. For example, since all lending is risk-taking, it is impossible to avoid making a few loans whose value will deteriorate because of subsequent changes in the borrower's ability to pay. Thus, having a few weak loans on the ledger will not be contrary to generally accepted standards.⁵⁴ When, however, such loans are discovered by the examiner, they will be criticized and corrective steps requested.⁵⁵ If management could improve the institution's position on these loans, *e.g.*, by requiring additional security, but fails to do so within a reasonable time, it would seem that such a failure would be contrary to generally accepted standards of prudent operation and would therefore be grounds for instituting corrective proceedings.

The fact that cease-and-desist proceedings may be instituted at the beginning of the correction process is not alone conclusive of the sanction's utility. The FHLBB had a similar sanction, but it was ineffective because it was unwieldy.⁵⁶ Under FISA, a permanent cease-and-desist order can only be issued after notice of charges, a hearing, and an administrative finding that grounds exist.⁵⁷ The order takes effect thirty days after service.⁵⁸ The time lapse between notice and an effective order will be approximately seven months.⁵⁹ During this interim the practice could cause serious damage.⁶⁰ To

⁵⁰ See *ibid.*

⁵¹ *Ibid.*

⁵² Previously, Congress spoke of *continued* unsafe or unsound practices. *E.g.*, Banking Act of 1933, § 30, 48 Stat. 193. Now the phrase is stated in the singular and without the qualifying adjective. This would seem to indicate a congressional intent that the sanction be available at an early point in the correction process, and, therefore, that the phrase should be interpreted liberally to achieve this end.

⁵³ Quare: what community's practices should serve as the standard? In the tort area, one recommended solution places the emphasis on the potential harm rather than on industrial practices. See *The T. J. Hooper*, 60 F.2d 737 (2d Cir. 1932).

⁵⁴ See Isbell, *supra* note 10, at 29.

⁵⁵ See *ibid.*

⁵⁶ See notes 37-39 *supra* and accompanying text.

⁵⁷ See FISA §§ 101(a)(2)(A), 102(a)(e)(1), 202(b)(1), 80 Stat. 1029, 1038, 1046, 12 U.S.C.A. §§ 1464(d)(2)(A), 1730(e)(1), 1818(b)(1) (Supp. 1966).

⁵⁸ FISA §§ 101(a)(2)(B), 102(a)(e)(2), 202(b)(2), 80 Stat. 1029, 1038, 1047, 12 U.S.C.A. §§ 1464(d)(2)(B), 1730(e)(2), 1818(b)(2) (Supp. 1966).

⁵⁹ See 112 Cong. Rec. 24508 (daily ed. Oct. 6, 1966) (letter from the Chairman of the Board of Governors, W. McC. Martin, Jr.).

⁶⁰ See Senate Hearings 16.

obviate this difficulty, the agency is permitted to issue a temporary order to take effect upon service and which remains in effect until the charges are dismissed or a permanent order becomes effective.⁶¹ The agency can only issue the order if the conduct "is likely to cause insolvency . . . or substantial dissipation of assets or earnings of the [institution] . . . , or is likely to otherwise seriously prejudice the interests of [depositors]. . . ."⁶²

How often the agency will be able to issue a temporary order hinges upon the construction of the words "is likely to otherwise seriously prejudice." The phrase "is likely" was substituted for "could" by the Senate Committee. They wished to make clear that the possibility of such consequences be a reasonable one; however, it was not intended to require a showing of definite probability.⁶³ A practice which involves the reasonable possibility of seriously prejudicing the interests of depositors must involve a lesser degree of harm than one which could possibly lead to insolvency or substantial dissipation of assets or earnings; otherwise, the additional words "seriously prejudice" would be meaningless. In determining how much less, the fact that the purpose of FISA is to enable the agencies to prevent loss in financial institutions should be accorded great weight. Since the assets of financial institutions are subject to rapid dissipation, the agencies must be able to act quickly to prevent loss. Therefore, a broad construction of the prerequisites for issuing temporary orders is most consistent with the underlying purpose of FISA. The proper construction would be to interpret "seriously prejudice" as equivalent to "unsafe or unsound" so that an agency could issue a temporary order whenever it discovered an unsafe or unsound practice. The definition of "unsafe or unsound" is stated in terms of the possibility of abnormal risk. If the objectionable practice involves the possibility of abnormal risk, it would be reasonable to hold that it also involves the possibility of seriously prejudicing the interests of depositors. Moreover, granting the agency such latitude would not make the words "seriously prejudice" meaningless, since a violation of a minor regulation would not fit within the phrase, inasmuch as it would not involve the possibility of abnormal risk.⁶⁴

Measured against pre-FISA defects, the cease-and-desist sanction is not unwieldy, since proceedings can be instituted at the beginning of the correction process, and since temporary orders can be issued in most cases at the same time. Furthermore, the issuance of a cease-and-desist order need not entail any harmful publicity, and thus should not aggravate the institution's financial condition; also, since the order does not require a change in management or a cessation of independent operation, it is not so severe as to inhibit its use. Consequently, the cease-and-desist sanction has none of the deficiencies of the pre-FISA sanctions. It can be readily employed at an early point in the agency-

⁶¹ FISA §§ 101(a)(3)(A), 102(a)(f)(1), 202(c)(1), 80 Stat. 1030, 1038, 1047, 12 U.S.C.A. §§ 1464(d)(3)(A), 1730(f)(1), 1818(c)(1) (Supp. 1966).

⁶² *Ibid.*

⁶³ S. Rep. No. 1482, 89th Cong., 2d Sess. 11, 22 (1966).

⁶⁴ To illustrate, if a federal savings and loan association, without prior approval, builds a drive-in facility 501 feet instead of 500 feet from a public entrance to the association, it would violate 12 C.F.R. § 545.14-1 (Supp. 1966), but its action, it would seem, would not seriously prejudice the interests of its savings-account holders.

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management dispute; in addition, it can be *effectively* employed, since the agency can immediately seek an injunction to enforce the order.⁶⁵

In terms of control by supervision, if management refuses to comply with supervisory directives, it is highly probable that the agency will force management to comply by employing the cease-and-desist sanction. Because of the negative psychological impact of being the party against whom a sanction is imposed, and because of the expense and time involved in contesting the imposition of the sanction, management will, in many instances, follow supervisory directives rather than force the agency to employ the sanction. Thus, the mere presence of the cease-and-desist sanction greatly facilitates control by supervision.

B. *Suspension, Removal, and Prohibition Orders*

A cease-and-desist order is not sufficient to deal with all supervisory problems. Some officers and directors exploit their positions for personal advantage,⁶⁶ and some controlling stockholders and large influential depositors run the institution from behind the scenes for the same purpose.⁶⁷ These individuals often have past records of ruining other institutions.⁶⁸ Because the institution's assets are readily transferable, such individuals can do substantial damage in a relatively short period of time.⁶⁹ If limited only by a cease-and-desist order as to one practice, they can always devise another scheme to exploit the institution.⁷⁰ The suspension, removal, and prohibition sanctions were drawn to meet these problems.⁷¹

Section 101(a)(4)(A) of the act⁷² provides three criteria for instituting proceedings against an officer or director for conduct with respect to the in-

⁶⁵ FISA §§ 101(a)(8), 102(a)(k)(2), 202(i), 80 Stat. 1034, 1042, 1051, 12 U.S.C.A. §§ 1464(d)(8), 1730(k)(2), 1818(i) (Supp. 1966). These sections are phrased generally and apply to any notice or order issued under the act. A largely duplicative provision states that the agency may seek an injunction against a threatened violation of a temporary cease-and-desist order. FISA §§ 101(a)(3)(C), 102(a)(f)(3), 202(d), 80 Stat. 1030, 1039, 1047, 12 U.S.C.A. §§ 1464(d)(3)(C), 1730(f)(3), 1818(d) (Supp. 1966). The section provides that if the threatened violation is established, "it shall be the duty of the court to issue such injunction." *Ibid.* Whether this was intended to, or constitutionally can, eliminate judicial discretion is uncertain. Cf. *The Hecht Co. v. Bowles*, 321 U.S. 321 (1944).

⁶⁶ See House Hearings 37.

⁶⁷ Senate Hearings 40.

⁶⁸ *Id.* at 25, 33, 40.

⁶⁹ *Id.* at 40.

⁷⁰ House Hearings 37.

⁷¹ The Senate Committee felt that it would be dangerous to give the sanctions of suspension, removal, and prohibition to one man. S. Rep. No. 1482, *supra* note 63, at 8-9. They, therefore, required the Comptroller of the Currency to certify the facts to the Board of Governors; the Board, with the Comptroller as a member (if he so desires), then decides whether to take action. FISA §§ 202(e)(2), (4), (6), (7), 80 Stat. 1048, 1049, 12 U.S.C.A. §§ 1818(e)(2), (4), (6), (7) (Supp. 1966).

⁷² FISA §§ 101(a)(4)(A), 102(g)(1), 202(e)(1), (2), (7), 80 Stat. 1030, 1039, 1047, 1048, 1049, 12 U.S.C.A. §§ 1464(d)(4)(A), 1730(g)(1), 1818(e)(1), (2), (7) (Supp. 1966). Each section has substantially identical counterparts to deal with the different agencies. In the text of this comment, the first section number is given to avoid confusion in the textual discussion. When a section number is mentioned in the text, the footnote citation is to each point in the act where the section is repeated.

stitution with which he is presently serving. First, an officer or director must have either committed a violation of law, rule, regulation, or a cease-and-desist order which has become final (*i.e.*, one from which there is no longer any right to appeal), or engaged or participated in an unsafe or unsound practice or breach of fiduciary duty. Second, his conduct must be such that it will probably cause substantial financial loss or other damage to the institution, or such that it could seriously prejudice the interests of account holders. Third, the conduct must involve personal dishonesty. If, in the opinion of the agency, the officer or director has committed such conduct, the agency may serve notice of intent to remove him after hearing.⁷³

Section 101(a)(4)(B)⁷⁴ provides somewhat less overlapping criteria for instituting proceedings against an officer or director who has mismanaged other financial or business institutions and is, therefore, likely to harm the institution with which he is presently serving. Whenever, in the opinion of the agency, an officer or director has evidenced personal dishonesty and unfitness by conduct with respect to another financial or other business institution, which resulted in substantial financial loss or other damage, the agency may serve notice of intent to remove him after hearing and/or prohibit him from further participation in the conduct of the institution's affairs. This section also covers any other person participating in the institution's affairs who has committed objectionable conduct with respect to that institution or any other business. Although apparently aimed at principal stockholders and influential depositors, this section is not thus limited as to class of persons.

Section 101(a)(4)(C) permits the agency to temporarily suspend and/or prohibit any of these individuals from participating in the institution's affairs pending completion of the administrative process.⁷⁵ The agency may issue temporary orders if it "deems it necessary for the protection of the [institution] . . . or the interests of its [depositors] . . ."⁷⁶

As drawn, these sections present a difficult problem of statutory construction. Section 101(a)(4)(A) is the only one which deals with dishonest conduct of an officer or director with respect to the institution with which he is presently serving. The only sanction mentioned in that section is removal. Therefore, one could argue that the agency, after hearing, can only *remove*

⁷³ This multiplicity of criteria was created when the Senate Committee added the prerequisite of personal dishonesty, S. Rep. No. 1482, *supra* note 63, at 7-8, but failed to redraft the section in that light. It is highly probable that if an officer or director has been dishonest in conducting the affairs of the institution, he will have either breached his fiduciary duty or committed an unsafe or unsound practice. Letter from Vice-Chairman Robertson of the Board of Governors, Dec. 2, 1966; letter from Paul E. McGraw, attorney for the FHLBB, Dec. 21, 1966. Furthermore, given the grave character of the conduct, it should not be difficult to show that the conduct could seriously prejudice the interests of depositors. Thus, in almost all cases, if personal dishonesty is established, the other prerequisites will be met.

⁷⁴ FISA §§ 101(a)(4)(B), 102(a)(g)(2), 202(e)(3), (4), (7), 80 Stat. 1031, 1039, 1048, 1049, 12 U.S.C.A. §§ 1464(d)(4)(B), 1730(g)(2), 1818(e)(3), (4), (7) (Supp. 1966).

⁷⁵ FISA §§ 101(a)(4)(C), 102(a)(g)(3), 202(e)(5), (6), (7), 80 Stat. 1031, 1039, 1048, 1049, 12 U.S.C.A. §§ 1464(d)(4)(C), 1730(g)(3), 1818(e)(5), (6), (7) (Supp. 1966).

⁷⁶ *Ibid.*

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the officer or director, and that such an individual cannot be permanently *prohibited* from participating in the institution's affairs in another capacity. Once having removed an officer or director, the agency could attempt to proceed under section 101(a)(4)(B), which deals with dishonest conduct with respect to the institution by any *other* person participating in its affairs and which authorizes prohibition orders. There are, however, two difficulties with this approach. First, the grounds for employing the second section are stricter: The agency must show that the conduct caused substantial damage, whereas in the first section the agency need only show that the interests of depositors "could be seriously prejudiced" by the conduct.⁷⁷ Second, it would lead to the absurd result of requiring two hearings involving the same facts and the same individual.

It would be equally absurd to hold that an officer or director may be temporarily prohibited from participating in the institution's affairs before the proscribed conduct is established at a hearing, but that after the conduct is established, the officer or director may not be thus prohibited. Such a holding would substantially impair the utility of these sanctions. Often, the officer or director will own substantial interests in the institution; thus removal would not end his ability to exercise his influence in a damaging manner.⁷⁸ It might be argued that an official should not be subject to double punishment, that he should only be subject to a permanent prohibition order if he has actually caused substantial damage, and, furthermore, that he can always be prohibited from further participation if he evidences dishonesty after being removed. However, the purpose of the sanctions is not to punish misconduct, but is to protect the public against the consequences of this misconduct. The public should not be required to bear the risk that an individual who has just been found to be dishonest will use his position as major stockholder or principal depositor to again exploit the institution.

This problem can be avoided by a properly broad construction of the section dealing with the orders which can be issued after hearing. Section 101(a)(4)(D) provides that the agency may "issue such orders of suspension or removal from office, and/or prohibition from participation in the conduct of the affairs of the [institution] . . . , as it may deem appropriate."⁷⁹ It would be reasonable to interpret this as a general grant of authority to deal with the established proscribed conduct in any manner suitable to protecting the in-

⁷⁷ It does not appear that Congress was consciously attempting to draw a distinction between the two sections. The reason for the divergence would seem to be that the second section as originally drafted only required that the individual be "unfit." To give this vague word meaning, the unfitness had to be demonstrated by conduct which actually caused substantial injury. When the Senate Committee added the prerequisite of personal dishonesty, S. Rep. No. 1482, *supra* note 63, at 8, it was no longer necessary that the concrete results of the conduct be proven, since personal dishonesty in itself would probably be sufficient evidence of unfitness. The Committee, however, neglected to redraft the section in the light of its amendment.

⁷⁸ This was the reason given by one Comptroller of the Currency for his reluctance to use the removal power granted by § 30 of the Banking Act of 1933. Fox, *Supervision of Banking by the Comptroller of the Currency, Public Administration and Policy Formation* 120, 173-74 (Redford ed. 1956).

⁷⁹ FISA §§ 101(a)(4)(D), 102(a)(g)(4), 202(e)(8), 80 Stat. 1031, 1040, 1049, 12 U.S.C.A. §§ 1464(d)(4)(D), 1730(g)(4), 1818(e)(8) (Supp. 1966).

stitution and the public. This construction is supported by the following reasoning. Section 101(a)(4)(A) states that the agency may serve notice of intent to remove. Section 101(a)(4)(B) states that the agency may serve notice of intent to remove and/or prohibit. Neither section speaks of notice of intent to *suspend*; yet the provision dealing with orders after hearing clearly authorizes the agency to issue a suspension order. If the agency can suspend after hearing without giving notice of intent to suspend, it should be able to prohibit after hearing without giving notice of intent to prohibit.

It might be argued, however, that because suspension is a lesser genre of removal, the notice of intent to suspend can be implied in the notice of intent to remove, but since prohibition is a different and more severe sanction than removal, notice of intent to prohibit cannot be implied in the notice of intent to remove. Therefore, since to impose a sanction without giving an individual warning deprives him of a fair hearing,⁸⁰ the section should not be construed as a general grant of authority to issue prohibition orders. This argument should be rejected. First, prohibition is not a more severe sanction than removal. Removal deprives an official of a source of income; prohibition places him in no worse position financially. If he has invested in the institution, he could still receive his dividends, and, at most, he will be denied his right to vote his stock. Second, the sanctions are of the same type because they all segregate the individual from the institution. Third, the officer or director has no greater burden of preparing a defense, since each sanction would be imposed on the grounds stated in section 101(a)(4)(A). Finally, like a defendant in a civil suit, the officer or director can be held to have notice that he is subject to any remedy justified by the facts litigated at the hearing.⁸¹

Admittedly, the suggested reasoning does not explain Congress' failure to provide for notice of intent to prohibit in section 101(a)(4)(A) while so providing in section 101(a)(4)(B). However, if an individual evidences a defect in character which makes him unfit to hold an office of public trust, leaving him in a position where he can control the "trustees," *i.e.*, management, subjects the public to grave risks. Given the important public interest that would be served by enabling the agencies to prohibit such individuals from further participation in the institution's affairs, the discrepancy should be considered a technical error in draftsmanship which in no way limits the agencies' ability to deal with personal dishonesty in any manner appropriate to fully protecting the public.

There is another possible solution to the problem of isolating a dishonest officer or director from the institution. If the FISA penalties section, section 101(a)(12)(A), is literally construed, any individual subject to a temporary suspension and/or prohibition order, or to a permanent suspension, removal, and/or prohibition order from which there is no longer any right of appeal, who participates in any manner in the conduct of the institution's affairs, is liable to a fine of not more than \$5,000 or imprisonment for not more than one year, or both.⁸² Thus, an officer subject to a temporary order or a final

⁸⁰ Cf. *Luacaw v. Fire Comm'r*, 214 N.E.2d 734, 735 (Mass. 1966); *Daley v. District Court*, 304 Mass. 86, 90-91, 23 N.E.2d 1, 5 (1939).

⁸¹ Cf. Fed. R. Civ. P. 54(c).

⁸² FISA §§ 101(a)(12)(A), 102(a)(p)(1), 202(j), 80 Stat. 1035, 1045, 1052, 12

order could not participate in any capacity even if the order only states that he is suspended or removed *from office*. This literal construction, however, is only a partial solution, because, during the time interval from the effective date of an order issued after hearing until the exhaustion of appeals, only the *specific* terms of the order are in effect. One could argue from this literal construction, however, that suspension or removal from office is to be defined as suspension or removal from participation in any manner. If an officer, for example, can be penalized for participating as a consultant even though the final order only states that he is removed from office, Congress must have intended to define removal from office as a proscription of participation in any manner. If removal is so defined, then participation as a consultant would violate the order, and the agency could seek an injunction to prevent such participation. Thus, an officer could be prevented from participation in any manner at all times. Both the literal interpretation of the penalties section and the construction of suspension or removal from office based thereon are difficult to accept. Suspension or removal from office is not commonly understood as including a proscription of participation in another manner.⁸³ If Congress intended to add a broader connotation to suspension or removal from office, it would not have done so abstrusely through a penalties section. Moreover, Congress would not have provided that prohibition orders could be issued in some instances against officers if suspension and removal were to have the same effect as prohibition. One might argue that prohibition orders refer only to persons other than officers or directors. However, the act states that the agency can issue temporary suspension *and/or* prohibition orders and permanent suspension, removal *and/or* prohibition orders against any person. If prohibition referred only to persons other than officers and directors, then the word "and" is superfluous. Finally, both constructions narrow the agencies' discretion. Under some circumstances, suspension or removal from office alone would be sufficient to protect the public. Yet, no matter how narrowly the suspension or removal order is worded, the individual would be subject to penalties at certain times, if he participated in any manner. In order to preserve the agencies' discretion the penalties should be interpreted as applicable only if the individual participates in a manner which violates the *specific* terms of the order as those terms are ordinarily understood. Ad-

U.S.C.A. §§ 1464(d)(12)(A), 1730(p)(1), 1818(j) (Supp. 1966). A second clause within the penalties section provides that a dishonest individual subject to a temporary or final order must obtain the prior approval of the issuing agency if he wishes to vote for a director, or serve as an officer, director, or employee not only of the institution with which he was affiliated before the order but also of any institution carrying the same federal insurance as that institution. If he does not obtain the approval before taking such action, he is subject to a fine of not more than \$5,000 or imprisonment for not more than one year or both. *Ibid.* As the second clause is drawn, it would not apply to such informal participation as acting as consultant without pay. Thus, an officer, prohibited from participating in X Savings and Loan Association, can informally participate in Y Savings and Loan Association without obtaining prior approval. Also, as the second clause is drawn, it would not apply to an individual who transfers to an institution carrying different federal insurance. Thus, an officer, removed from office in A Bank carrying FDIC insurance, can serve as an officer in B Savings and Loan Association carrying FSLIC insurance.

⁸³ See Fox, *supra* note 78, at 173-74.

mittedly, the agencies should be enabled to isolate a dishonest officer completely from the institution, but this can be achieved by allowing them to issue prohibition orders whenever the dishonest conduct of an officer or director merits it.

As originally introduced, the removal, suspension, and prohibition sections did not contain the requirement of personal dishonesty.⁸⁴ The Senate Committee was conscious, however, of the latitude allowed the agencies by such phrases as "an unsafe or unsound practice," "could be seriously prejudiced," and "unfitness."⁸⁵ They considered removal too severe a remedy to be applied as a matter of course.⁸⁶ Consequently, they made personal dishonesty a prerequisite to imposing these sanctions.⁸⁷

There was some controversy before the House Committee as to whether personal dishonesty included only conduct indictable under state and federal law or also conduct such as self-dealing.⁸⁸ Legislative history favors the broader construction. Senator Proxmire, one of the leading members of the Senate committee which added the phrase, defined "personal dishonesty" as conduct demonstrating a fundamental lack of "the integrity demanded by a position of public trust."⁸⁹ He further stated that the sanctions were meant to stop "the flow of losses through the hands of *self-seeking or* criminal elements."⁹⁰ (Emphasis added.)

As construed, the suspension, removal, and prohibition sanctions give the agencies effective means through which they can insulate financial institutions from dishonest individuals.⁹¹ By restricting the use of suspension, removal, and prohibition orders to cases of personal dishonesty, however,

⁸⁴ S. Rep. No. 1482, *supra* note 63, at 7-8.

⁸⁵ *Ibid.*

⁸⁶ *Ibid.*

⁸⁷ *Ibid.*

⁸⁸ Compare House Hearings 53 with House Hearings 135.

⁸⁹ 112 Cong. Rec. 19370 (daily ed. Aug. 22, 1966).

⁹⁰ *Ibid.* The fact that there is a separate provision for indictable conduct offers additional support for construing personal dishonesty to include more than criminal conduct. If any person participating in the institution's affairs is charged in any information, indictment, or complaint of a United States Attorney, with commission or participation in a felony involving personal dishonesty or breach of trust, the agency may issue a temporary suspension and/or prohibition order. If the individual is convicted and the conviction is no longer subject to judicial review, the agency can, without hearing, make the order permanent. Acquittal or other disposition, however, does not bar the agency from initiating proceedings under the other provisions. FISA §§ 101(a)(5)(A), 102(a)(h), 202(g)(1), 80 Stat. 1032, 1040, 1050, 12 U.S.C.A. §§ 1464(d)(5)(A), 1730(h), 1818(g)(1) (Supp. 1966). Permitting the agency to proceed under the other provisions is understandable; since suspension, removal, or prohibition is a civil sanction, the agency should not be held to the "beyond a reasonable doubt" burden of proof in criminal proceedings.

⁹¹ To aid the FHLBB and FSLIC to keep track of dishonest individuals, FISA requires institutions carrying FSLIC insurance to report changes in control to the Corporation. FISA § 102(a)(I), 80 Stat. 1042, 12 U.S.C.A. § 1730(I) (Supp. 1966). Banks carrying FDIC insurance have been subject to a similar provision since 1964. Federal Deposit Insurance Act § 7(j), added by 78 Stat. 940, 12 U.S.C. § 1818(7)(j) (1964). In one respect, the agencies seem to have too much authority. An individual could be excluded from an institution for dishonest conduct that took place years before. A statute of limitations should have been provided. See Senate Hearings 141.

Congress has deprived the agencies of any efficient remedy to meet another serious problem—grossly incompetent management.⁹² Previously, the agencies considered the maintaining of grossly incompetent management an unsafe or unsound practice;⁹³ such practices constituted grounds for imposing the pre-FISA sanctions.⁹⁴ Congress has unequivocally manifested its intent that personal dishonesty be a prerequisite to removal. Thus, an agency cannot issue a cease-and-desist order directing that hazardous management be replaced, nor can it seize an institution or terminate its insurance on the ground that it failed to replace hazardous management. True, hazardous management will probably be reflected in other unsafe or unsound practices, but to force the supervisory authorities to act on the peripheral results by requiring correction of each of these practices as they arise, instead of attacking the source of the problem, places an unwarranted burden on the supervisory process. It is urged that when Congress reconsiders the act,⁹⁵ it add gross incompetency as a ground for issuing suspension, removal, and prohibition orders.⁹⁶

⁹² The agencies are not totally without remedies. In *Reich v. Webb*, 336 F.2d 153 (9th Cir. 1964), the court held that the FHLBB could enforce by court action the common-law fiduciary duties of directors and officers of federal savings and loan associations. It would seem that the rationale of the decision would be equally applicable to the other agencies. However, court proceedings involve considerable delay and do not guarantee that the individual will refrain from further damaging conduct.

⁹³ See 1953 FDIC Ann. Rep. 12.

⁹⁴ See, e.g., Banking Act of 1933, § 30, 48 Stat. 193.

⁹⁵ Except for the raise in the federal insurance limit, the act expires in 1972. FISA § 401, 80 Stat. 1056 (1966).

⁹⁶ The act makes some minor changes in the termination-of-insurance sanction. FISA §§ 102(a)(b), 204, 80 Stat. 1036, 1054, 12 U.S.C.A. §§ 1730(b), 1818(a) (Supp. 1966). The insuring agency can shorten the correction period from 120 days to not less than 20 days if it feels that its insurance risk would be unduly jeopardized or if a state authority or other federal agency having jurisdiction requests it. Also, the insuring agency can now institute proceedings if it finds that a single unsafe or unsound practice has been committed. A new ground for instituting proceedings is that the insured is in an unsafe or unsound *condition* to continue operations. Since an unsafe or unsound *practice* is dealt with separately, an unsafe or unsound *condition* to continue operations must mean something different. A reasonable construction of the latter ground would be that it is applicable where the institution's financial condition is seriously impaired for reasons other than mismanagement, e.g., where the locality's major industry closes down. Since the insuring agency remains liable for two years on all amounts present at the effective date of the termination order (usually when all appeals have been exhausted), the agency, to protect itself, is authorized to use the cease-and-desist sanction as long as the institution has accounts covered by federal insurance. S. Rep. No. 1482, *supra* note 63, at 18.

The grounds for seizure of a federal savings and loan association by the FHLBB have also been modified. FISA § 101(a)(6)(A), 80 Stat. 1032, 12 U.S.C.A. § 1464(d)(6)(A) (Supp. 1966); S. Rep. No. 1482, *supra* note 63, at 13-14. The principal change is that the commission of an unsafe or unsound practice or violation of law, rule, or regulation is grounds for seizure now only if it has led to a substantial dissipation of assets or earnings. The criteria of an unsafe or unsound condition to continue operations is a new addition. Another ground for seizure is willful violation of a cease-and-desist order which has become final, i.e., one as to which judicial review is no longer available. FISA § 101(a)(13)(A)(1), 80 Stat. 1035, 12 U.S.C.A. § 1464(d)(13)(A)(1) (Supp. 1966). This lends added weight to cease-and-desist orders.

The modifications do not change the severity of the termination and seizure sanc-

III. ADJUDICATORY STANDARDS AND JUDICIAL CONTROL

FISA gives the agencies sanctions which can be readily and effectively employed to prevent objectionable management from ruining the institution. Although the act serves the public interest by establishing strong agencies, such agency power has other less desirable effects. First, since the presence of the sanctions, particularly the cease-and-desist provisions, substantially increases the risk to management of noncompliance with supervisory directives, the act permits too much emphasis on control by supervision. Some agency representatives have indicated that the agencies will take advantage of this new strength and issue fewer and less detailed regulations.⁹⁷ Thus, the agencies' supervisory branches will bear even greater responsibility for setting standards for the prudent operation of financial institutions. Second, these representatives have indicated that the agencies will delegate more responsibility to the lower ranks of authority within the supervisory branches.⁹⁸ In recent years the agencies have tended to defer to the judgment of regional supervisors and examiners in determining what aspects of the institution's operations were unsatisfactory.⁹⁹ They have also given these officials the primary responsibility for securing corrections.¹⁰⁰ Furthermore, management appeals from the regional to the central office have been infrequent, partly because the central office will usually support the determinations and directives of the lower ranks.¹⁰¹ Since the act places greater force behind the directives of regional supervisors and examiners, the agencies can safely delegate more authority to these officials. Third, because these officials will have greater leeway in determining what to correct and can now secure corrections on their own terms, they are likely to inject themselves even further into management decision making.¹⁰²

tions. Their use will be further restricted by the presence of other new sanctions in the act. The courts have required that the sanction imposed bear some reasonable relation to the practice found to exist. *Gilbertville Trucking Co. v. United States*, 371 U.S. 115, 129-31 (1962); *Jaffe, Judicial Control of Administrative Action* 268-71 (1965). Thus, if the lesser sanctions could clearly have remedied the situation, the courts are less likely to find that termination or seizure was reasonably related to the practice found to exist. Finally, strict control of the use of the termination and seizure sanctions would be consistent with legislative history. See S. Rep. No. 1482, *supra* note 63, at 14.

For severe congressional criticism of the FHLBB's use of the seizure power, see H.R. Rep. No. 2083, 86th Cong., 2d Sess. (1960) (seizure of the Long Beach Federal Savings and Loan Association). For cases in which it was alleged that the FHLBB threatened seizure unless management were replaced, see *Greater Del. Valley Fed. Savings & Loan Ass'n v. FHLBB*, 262 F.2d 371, 373 (3d Cir. 1958); *Miami Beach Fed. Savings & Loan Ass'n v. Callander*, 256 F.2d 410, 415 (5th Cir. 1958).

⁹⁷ Senate Hearings 19-20, 110-11.

⁹⁸ See *id.* at 69.

⁹⁹ 102 *Adm'r of Nat'l Banks Ann. Rep.* 93 (1965); 1965 FHLBB *Ann. Rep.* 74.

¹⁰⁰ See note 99 *supra*.

¹⁰¹ Interviews with agency representatives in Boston, Mass., Jan. 1967.

¹⁰² Senate Hearings 125. But cf. *id.* at 112. The act may also lead to increased agency action in a beneficial way. Some people have criticized the dual system of state and federally chartered institutions as leading to a "competition in laxity" between state and federal agencies to keep institutions within their jurisdiction. Fox, *supra* note 78, at 122. Since the act gives the federal agencies almost the same powers with regard to state and federal institutions, transfers of jurisdiction by the institution will be less

As a result of these developments, the supervisors and examiners of four different agencies¹⁰³ in approximately a dozen different regions¹⁰⁴ will be able to informally set and enforce their own standards of prudent operation. Since what is prudent, *i.e.*, not unsafe or unsound, is essentially a question of degree,¹⁰⁵ permitting so many individuals to informally make and enforce their own determinations of degree minimizes the role of agency heads in determining policy and maximizes the potential for arbitrary action, nonuniform application of standards, and undue interference with management decision making.¹⁰⁶

A clear definition of standards by the agency heads would obviate these dangers.¹⁰⁷ By defining standards, the agency heads could circumscribe their subordinates' action and assure themselves of their proper role in setting policy.¹⁰⁸ By publishing these definitions, the agency heads would lend consistency to the administrative process and leave themselves open to constructive criticism and review by other professionals, the industry as a whole, and the other branches of government.¹⁰⁹ Such criticism can be an effective safeguard against the potential dangers of the supervisory process.¹¹⁰

useful, and, therefore, federal agencies will have less need to lower standards in order to keep financial institutions within their sphere.

¹⁰³ The FHLBB and the FSLIC use the same regional officials. Interview with the FHLBB and FSLIC representative in Boston, Mass., Jan. 1967. See FISA § 102(a)(m)(1), 80 Stat. 1044, 12 U.S.C.A. 1730(m)(1) (Supp. 1966).

¹⁰⁴ The Comptroller of the Currency has fourteen supervisory districts. The FDIC and the Board of Governors each have twelve. Welman, Jr., Allocation of Supervisory Responsibility Today, in Bank Supervision 11, 19-20 (Federal Reserve Bank of St. Louis pub. 1963). The FHLBB and the FSLIC have eleven. See Senate Hearings 75.

¹⁰⁵ Questions of degree are apparent in the following categories of unsafe or unsound practices listed by the FHLBB:

1. Solicitation of capital on the basis of dividend rates in excess of the [institution's] . . . ability to pay except by resorting to high-risk loans
2. [O]verconcentration of loans to speculative builders . . . and lack of any systematic collection program.
3. [L]ax control of expenses; careless physical control of the assets; [and] excessive advertising or other costs beyond the ability of the [institution] . . . to absorb the expenses

112 Cong. Rec. 25416 (daily ed. Oct. 13, 1966) (FHLBB memorandum on unsafe or unsound practices).

¹⁰⁶ See H.R. Rep. No. 447, 88th Cong., 1st Sess. (1963); H.R. Rep. No. 2492, 87th Cong., 2d Sess. (1962); H.R. Rep. No. 2083, 86th Cong., 2d Sess. (1960).

¹⁰⁷ See Friendly, The Federal Administrative Agencies—The Need for Better Definition of Standards (1962) (especially 19-26).

¹⁰⁸ *Id.* at 24.

¹⁰⁹ 1 Davis, Administrative Law § 4.14 (Supp. 1965). Criticism would also be helpful in that it would lessen the tendency of agency heads to uphold the supervisory branch as a matter of course.

¹¹⁰ *Ibid.* FISA contains a built-in opportunity for professional criticism. Before instituting proceedings against state institutions, the federal agency must give to the appropriate state authority notice containing the grounds for the proposed action and setting a reasonable time limit for correction by that authority. S. Rep. No. 1482, 89th Cong., 2d Sess. 7 (1966). Only if the state authority does not secure satisfactory corrections within that time limit can the federal agency proceed. Management, however, cannot raise the failure to observe these requirements in attacking any notice or order. FISA §§ 102(a)(o), 202(m), 80 Stat. 1045, 1052, 12 U.S.C.A. §§ 1730(o), 1818(m) (Supp. 1966).

An agency can define standards formally by rule-making (*i.e.*, by issuing rules and regulations) and by adjudication (*i.e.*, by rendering reasoned decisions after adversary hearings). However, both the agencies and the industry have indicated that rule-making is undesirable.¹¹¹ Rules are often drawn to meet the problems presented by a small portion of the industry. Such rules are usually phrased in sufficient detail and with sufficient strictness to protect the public from the mistakes of the least sophisticated management within the entire industry. Thus, they tend to be overly restrictive in that capable management must also adhere to the rule drawn for the minority. In addition, detailed rules for every aspect of an institution's operations would severely limit management flexibility. On the other hand, adhering to specific rules does not safeguard management from supervisory criticism, because the supervisory authorities in a given situation may determine that the conduct violates the general proscription against unsafe or unsound practices.

Inasmuch as the first alternative is unsatisfactory, the necessary definition of standards could be supplied through adjudication. By focusing on an individual case, the agency can consider the many fact variables that are relevant to determining whether a practice is unsatisfactory. It might be argued that because so much depends on fact variables, no case will be precedent for any other. However, fact patterns in such a large industry should recur often enough to provide a basis for precedent which will circumscribe both agency and management conduct.¹¹² It might also be argued that adjudication requires considerable expenditures of time and money, but such inconveniences are outweighed by the need for definition of standards and the fact that increased rule-making is undesirable.

Definition by adjudication involves three steps: (1) the holding of hearings; (2) the publishing of opinions; and (3) the judicial review of these opinions. Various problems arise at each level which may forestall adjudication. As to the holding of hearings, if the regional supervisor convinces the agency to issue temporary orders, management will be forced to comply before it can contest the order at a hearing. The act allows the affected party to seek a stay of temporary orders in the district courts.¹¹³ Ruling upon the application for a stay, a district court is to be "guided by the traditional tests employed in actions for temporary or preliminary relief from administrative action when the public interest is involved."¹¹⁴ Professor Jaffe posits two criteria for obtaining a stay, namely that the administrative action will very likely be reversed on appeal, and that the private interest outweighs

¹¹¹ Senate Hearings 19-20, 110-11; Heisler, *Regulations Versus Administrative Decisions*, 18 Bus. Law. 240, 245 (1962).

¹¹² See Friendly, *op. cit.* supra note 107, at 18.

¹¹³ FISA §§ 101(a)(3)(B), (4)(E), 102(a)(f)(2), (g)(5), 202(c)(2), (f), 80 Stat. 1030, 1032, 1039, 1040, 1047, 1050, 12 U.S.C.A. §§ 1464(d)(3)(B), 4(E), 1730(f)(2), (g)(5), 1818(c)(2), (f) (Supp. 1966). A specific provision was necessary, because the courts, under the doctrine of exhaustion of administrative remedies, have refused in the absence of enabling provisions to review administrative action subject to review at an administrative hearing. *E.g.*, *Home Loan Bank Board v. Mallonee*, 196 F.2d 336 (9th Cir. 1952).

¹¹⁴ S. Rep. No. 1482, supra note 110, at 11, 22.

the possible harm to the public if the action is stayed.¹¹⁵ Whether a practice is unsafe or unsound depends to a great extent on an expert analysis of the facts; thus, the courts should give great weight to agency conclusions. Therefore, the difficulties of showing a substantial likelihood of obtaining a reversal of a cease-and-desist order based on such practice will be almost insuperable. However, when the issue is whether a party was personally dishonest, the courts need not afford the agencies great leeway, for this is essentially an ethical judgment requiring little expertise. Therefore, the affected party should find it easier to obtain a stay of a temporary suspension and/or prohibition order. As to Professor Jaffe's second criterion, the courts have been very conscious of the public interest and have frequently denied stays of administrative action in this area even when the action involved was an allegedly illegal seizure of an institution.¹¹⁶ The affected party should therefore find it most difficult to prove that the balance of public and private interests lies in its favor. Thus, management will be forced to first comply and will, in many instances, then lose the desire to contest the order at an administrative hearing.

The fear of harmful publicity is another major factor that may inhibit management from resorting to administrative hearings. Public knowledge that management has been cited for an unsafe or unsound practice or personal dishonesty can induce "runs" on the institution and seriously damage the business reputation of management, irrespective of the eventual determination of the controversy.¹¹⁷ Even though these results may not always follow from publicity, the possibility that they will occur is sufficient to raise a substantial fear of publicity in the minds of management. FISA creates a presumption in favor of private hearings, but the agencies may hold public hearings if they deem it necessary to protect the public interest.¹¹⁸ This leeway affords the supervisory authorities the opportunity to use the threat of a public hearing to coerce compliance with their directives.¹¹⁹ They are

¹¹⁵ See Jaffe, *op. cit.* supra note 96, at 689-97.

¹¹⁶ E.g., *Greater Del. Valley Fed. Savings & Loan Ass'n v. FHLBB*, supra note 96, at 374. In this case, the court refused the stay even though the complaint alleged that there was no emergency, which was a prerequisite to summary seizure under the pre-FISA provisions. See Jaffe, *op. cit.* supra note 96, at 691-92.

¹¹⁷ See H.R. Rep. No. 447, supra note 106, at 15; H.R. Rep. No. 2083, supra note 106, at 2, 4, 8-9. In one instance, the public began a "run" immediately upon learning that the president of an association had been indicted for embezzlement of \$250. The charge was dismissed for lack of evidence at the very beginning of the trial. H.R. Rep. No. 447, supra note 106, at 15.

¹¹⁸ FISA §§ 101(a)(7)(A), 102(a)(j)(1), 202(h)(1), 80 Stat. 1033, 1041, 1051, 12 U.S.C.A. §§ 1464(d)(7)(A), 1730(j)(1), 1818(h)(1) (Supp. 1966).

¹¹⁹ In *Graber Mfg. Co. v. Dixon*, 223 F. Supp. 1020 (D.C. Cir. 1963), the court pointed out the coercive effect of holding public hearings before the Federal Trade Commission:

[A] respondent may be quite reluctant to appear and defend, knowing that his confidential records will be open to the public. Further, with this sword of public disclosure held over the heads of alleged offenders, the Commission is in a position to coerce the signing of consent decrees, by threatening a lengthy and public complaint, and hearings. Thus, defending a complaint, even with a valid defense, may be more damaging than signing a consent decree.

Id. at 1022. Given the fact that mere rumor of mismanagement can prompt a "run" on

most likely to use the threat when an administrative hearing is most necessary, *i.e.*, when their directives rest on doubtful grounds. The supervisory authorities can use the threat often, without worrying about the possible damage to the institution if management accepts the risk and appears at the public hearing to contest the order. Since management has already been forced, by the temporary order, to comply with the directives, they will be reluctant to take the additional risk of contesting the order at a public hearing, and thus, they will rarely force the supervisory authorities to carry out the threat.

As noted above, the agency heads have a special interest in assuring that the administrative process is carried to completion; by defining standards through adjudication, they can control officials at all levels.¹²⁰ To protect this interest, they could prohibit their subordinates from using the threat of publicity as a club to induce compliance by issuing a regulation stating that all hearings shall be private except in a very few, specifically enumerated circumstances. If hearings are to be truly private, they must be held in such a location as to avoid attracting attention. The agency heads could, therefore, prescribe that hearings will be held in any reasonable location chosen by the party afforded the hearing if there is a danger that the public would otherwise be aware of the hearing. The best solution, of course, would be to amend the act to provide that unless the affected party requests a public hearing, all hearings shall be private, and that the affected party may, within reasonable limits, choose the location of the hearing to prevent publicity; but such an amendment is unlikely.

If the agencies or Congress are lax in providing management with the necessary protection of privacy, the judiciary can supply this protection. The Administrative Procedure Act provides for review by way of petitioning for an injunction against final agency action for which there is no other remedy in a court.¹²¹ It is submitted that the district courts, by way of injunction, can order that hearings be private. Appeal to the judiciary may itself involve harmful publicity, but if in a few cases, the courts, contrary to practice in other areas of administrative law, show a strong predilection for granting such injunctions, the supervisory authorities may be reluctant to use the threat of public hearings as a means of coercing compliance with directives.

The proposition that the courts can enjoin both the threat and the holding of public hearings might be attacked on several grounds. All of them, however, can be answered. First, the agency might argue that the threat of public hearings is not reviewable under *Greater Del. Valley Fed. Savings & Loan Ass'n v. FHLBB*,¹²² which held that the threat of seizure was

a financial institution, Fox, *supra* note 78, at 124, the coercive effect of threatening public hearings is even greater in this area. Under FISA, failure to appear at a scheduled hearing constitutes consent to the agency order. E.g., FISA § 101(a)(2)(A), 80 Stat. 1029, 12 U.S.C.A. § 1464(d)(2)(A) (Supp. 1966). Such consent bars judicial review. E.g., FISA § 101(a)(7)(B), 80 Stat. 1034, 12 U.S.C.A. § 1464(d)(7)(B) (Supp. 1966).

¹²⁰ For an allegation that the FHLBB has failed to exercise such control, see H.R. Rep. No. 2492, *supra* note 106, at 3.

¹²¹ Compare APA § 10(c), 5 U.S.C.A. § 704 (special pamphlet 1966), with APA § 10(b), 5 U.S.C.A. § 703 (special pamphlet 1966).

¹²² 262 F.2d 371 (3d Cir. 1958).

not reviewable under the doctrine of exhaustion of administrative remedies.¹²³ That doctrine, however, has no application to the threat of public hearings. In the case of seizure, an administrative hearing is provided to review the action, whereas under FISA, a hearing is not provided to review the decision to hold public hearings.

Second, the agency might argue that the decision to hold a public hearing is procedural and not final agency action, and, therefore, not subject to review until an order is entered after hearing.¹²⁴ Quite obviously, if the hearings are public, reversal of the eventual decision on this ground would provide small consolation; the damage would have already been done.¹²⁵ In other areas of administrative law, the courts have been willing to entertain suits seeking to enjoin publicity at the hearing level, albeit infrequently granting relief.¹²⁶ It is, therefore, likely that the decision to hold a public hearing, even if it is procedural, will be considered final agency action subject to review by way of injunction.

Third, FISA precludes review of agency action except as otherwise provided in the act.¹²⁷ The act provides only for a stay of temporary orders¹²⁸ and a review of permanent orders rendered after hearing.¹²⁹ Thus, the agency might argue that since review by way of injunction of decisions related to the conduct of hearings is not provided for, FISA precludes review by way of injunction of the decision to hold a public hearing, and, therefore, that the APA provision allowing review by petition for an injunction is inapplicable.¹³⁰ However, the reasonable construction of the preclusion provision is that it forbids review only of the *merits* of the complaint, except by way of appeal from orders issued after hearing or by way of application for a stay if a temporary order is issued.¹³¹ Under such a construction, since the decision to hold a public or a private hearing depends on considerations independent from the merits of the underlying controversy, the preclusion section should not be applicable.

Finally, the agency might argue that the decision to hold a public hearing is committed by law to its discretion, and, therefore, that APA's provisions for review are not applicable.¹³² FISA provides that "hearings

¹²³ *Id.* at 374.

¹²⁴ See APA § 10(c), 5 U.S.C.A. § 704 (special pamphlet 1966).

¹²⁵ *Continental Bank & Trust Co. v. Martin*, 303 F.2d 214 (D.C. Cir. 1962), held that an order which carried with it no penalty, fine, or sanction was not reviewable. Since public hearings can cause great damage, that case is distinguishable.

¹²⁶ See, e.g., *Utah Fuel Co. v. National Bituminous Coal Comm'n*, 306 U.S. 56 (1939); *Wolf Corp. v. SEC*, 317 F.2d 139 (D.C. Cir. 1963). But see *SEC v. Harrison*, 80 F. Supp. 226 (D.D.C. 1948).

¹²⁷ FISA §§ 101(a)(8), 102(a)(k)(2), 202(i), 80 Stat. 1034, 1041, 1051, 12 U.S.C.A. §§ 1464(d)(8), 1730(k)(2), 1818(i) (Supp. 1966).

¹²⁸ FISA §§ 101(a)(3)(B), (4)(E), 102(a)(f)(2), (g)(5), 202(c)(2), (f), 80 Stat. 1030, 1032, 1039, 1040, 1047, 1050, 12 U.S.C.A. §§ 1464(d)(3)(B), (4)(E), 1730(f)(2), (g)(5), 1818(c)(2), (f) (Supp. 1966).

¹²⁹ FISA §§ 101(a)(7)(B), 102(a)(j)(2), 202(h)(2), 80 Stat. 1034, 1041, 1051, 12 U.S.C.A. §§ 1464(d)(7)(B), 1730(j)(2), 1818(h)(2) (Supp. 1966).

¹³⁰ APA § 10(1), 5 U.S.C.A. § 701(a)(1) (special pamphlet 1966).

¹³¹ *Cf. Cappadora v. Celebrezze*, 356 F.2d 1, 5 (2d Cir. 1966).

¹³² APA § 10(2), 5 U.S.C.A. § 701(a)(2) (special pamphlet 1966).

shall be private, unless the [agency] . . . , in its discretion, after fully considering the views of the party afforded the hearing, determines that a public hearing is necessary to protect the public interest."¹³³ However, the issue of whether agency action is committed by law to its discretion does not depend on whether the statute contains such words as "in its discretion."¹³⁴ Rather it depends on the presence of standards by which a court can judge agency action and on the importance of the interests affected.¹³⁵ The agencies are required to weigh the private and public interests in deciding whether to hold public hearings. To strike a balance, the agencies must assign varying importance to different factors. By requiring such weighing, the act implicitly recognizes that standards do exist to govern the decision, or that standards can and should be formulated. Also, by creating a presumption in favor of private hearings, the act departs from the usual preference for public hearings, and thus recognizes that important private interests and, indirectly, public interests are involved in the decision. It would, therefore, seem that the decision to hold a public hearing is not "committed" by law to agency discretion.

Although, as submitted, the district courts have jurisdiction to enjoin public hearings, whether they will frequently grant relief is another question. In one respect, the public interest favors a public hearing, inasmuch as disclosure may provide a basis for suits against management for misconduct. On the other hand, public hearings may aggravate the institution's financial condition and may thus adversely affect the interests of borrowers, depositors, and stockholders. Moreover, if a public hearing is ordered, the affected party may be inhibited from contesting the order at the hearing, and, thus, the needed definition of standards will be forestalled. Finally, depriving the agencies of the weapon of publicity would not render them less able to fulfill their function, since the formal sanctions should be adequate to meet nearly all supervisory problems. Courts should accord great weight to the presumption for private hearings in assessing abuse of discretion.

Even if management is afforded the protection of private hearings, however, it may still be reticent to resort to adjudication, out of fear that it will be deprived of the privacy afforded at the hearings when adjudication reaches the second step—the publication of opinions. The Freedom of Information Act requires administrative agencies to make all opinions available to the public.¹³⁶ By specific exemption, the agencies need not make available any material related to examination, operation, or condition reports on financial institutions.¹³⁷ This material, however, provides the facts upon which opinions will be based, and thus, if the opinions are to have any value as precedent, such material must be included. Yet publication in the ordinary manner

¹³³ FISA §§ 101(a)(7)(A), 102(a)(j)(1), 202(h)(1), 80 Stat. 1033, 1041, 1051, 12 U.S.C.A. §§ 1464(d)(7)(A), 1730(j)(1), 1818(h)(1) (Supp. 1966).

¹³⁴ *Wong Wing Hang v. Immigration & Naturalization Serv.*, 360 F.2d 715 (2d Cir. 1966).

¹³⁵ *Id.* at 718; *Cappadora v. Celebrezze*, *supra* note 131, at 6.

¹³⁶ APA § 3(b), as amended, 80 Stat. 250 (1966), 5 U.S.C.A. § 1002(b) (Supp. 1966) (effective date July 5, 1967).

¹³⁷ APA § 3(e)(8), added by 80 Stat. 251 (1966), 5 U.S.C.A. § 1002(e)(8) (Supp. 1966).

involves the same drawbacks as holding public hearings. The Freedom of Information Act goes on to present a solution by providing that "to the extent required to prevent a clearly unwarranted invasion of personal privacy, an agency may delete identifying details when it makes available or publishes an opinion . . ."¹³⁸ The deletion of identifying details is not unfeasible, since cases could be indexed by number with names and locations stated by letters, and harmful publicity would be minimized. Thus, the question is whether it will be a "clearly unwarranted invasion of . . . privacy" for the agencies involved to publish any opinions without first deleting identifying details.

It seems that, on a policy basis, publication with identifying details should be held to be an invasion of privacy. By providing a specific exemption for material related to examination reports, the act recognizes the importance of privacy in this area. Moreover, one of the purposes of the act is to compel the agencies to inform interested groups of the standards by which the action of those subject to agency control will be judged.¹³⁹ Since the deletion of identifying details will encourage management to resort to their administrative remedies and, thereby, assist the definition of standards, it would further the purpose of the Freedom of Information Act to permit and, indeed, compel the agencies here involved to delete identifying details.

The third step in adjudicatory definition—judicial review of opinions rendered after hearing—should not play as significant a role in defining standards. Since it is impracticable for the courts to provide the same provisions for secrecy as the agencies, the party afforded the hearing would be unlikely to appeal administrative orders except where those orders so effect its vital interests as to outweigh detrimental publicity.¹⁴⁰ Within this limited area, the effectiveness of the judiciary in controlling agency action will depend on its approach to reviewing (1) findings of fact, and (2) the application of such standards as "unsafe or unsound" and "personal dishonesty" to established facts.

FISA provides that circuit courts are to review findings of fact according to the substantial-evidence test.¹⁴¹ This test has frequently been defined as the equivalent of the directed-verdict test in jury trials.¹⁴² Professor Davis has noted, however, that the thoroughness of review within this test varies considerably.¹⁴³ An insufficient number of cases have arisen in the area here

¹³⁸ APA § 3(b), as amended, 80 Stat. 250 (1966), 5 U.S.C.A. § 1002(b) (Supp. 1966).

¹³⁹ "No . . . opinion . . . may be relied upon, used or cited as precedent by an agency against any private party unless it has been indexed and either made available or published as provided by this subsection or unless that private party shall have actual and timely notice of the terms thereof." *Ibid.*

¹⁴⁰ It is probable that the first time FISA is applied, an appeal will be taken challenging its constitutionality. It seems, however, that attacks based on constitutional grounds will be rejected on the basis of *Fahey v. Mallonee*, 332 U.S. 245 (1947), and *Board of Governors of the Fed. Reserve Sys. v. Agnew*, 329 U.S. 441 (1947).

¹⁴¹ Compare FISA §§ 101(a)(7)(B), 102(a)(j)(2), 202(h)(2), 80 Stat. 1034, 1041, 1051, 12 U.S.C.A. §§ 1464(d)(7)(B), 1730(j)(2), 1818(h)(2) (Supp. 1966), with APA § 10(e), 5 U.S.C.A. § 706(2)(E) (special pamphlet 1966).

¹⁴² 4 Davis, *Administrative Law* § 29.02 (1958).

¹⁴³ *Id.* § 29.11.

involved upon which to base any judgment of how rigorously the courts will scrutinize findings of fact.¹⁴⁴

The approach to review of the application of law by the agency will also vary. Professor Davis lists several elements which influence a reviewing court, the primary one being the comparative qualification of the court and the agency to make the determination.¹⁴⁵ Accordingly, the court may consider the question of application to be one of fact, or uphold the judgment where there is a rational basis to support it, or it may view the question as one of law and freely substitute its judgment for that of the agency.¹⁴⁶ On the other hand, Professor Jaffe states that the proper approach is to treat the question as one of law and, where special knowledge is relevant, the court should evaluate the weight of the agency's expertise.¹⁴⁷ The determination of whether a practice is unsafe or unsound will involve knowledge of practices in the industry generally and their probable results—questions peculiarly within the competence of the agencies. The reviewing court is, therefore, unlikely to substitute its judgment. One court which adopted the Jaffe test stated that administrative judgment is entitled to great weight on the issue whether established conduct is unsafe or unsound.¹⁴⁸ Consequently, the affected party will find it difficult to overturn an administrative order based on such conduct.

In dealing with whether conduct involves personal dishonesty, however, agency expertise would seem to be irrelevant. The "integrity demanded by a position of public trust"¹⁴⁹ is an ethical judgment which a court is as competent to determine as an administrative agency.¹⁵⁰ It is, therefore, submitted that whether conduct involves personal dishonesty is a question of law as to which the courts may freely substitute their judgment for that of the agency. This approach is particularly beneficial; since the issuance of suspension, removal, and prohibition orders, for which personal dishonesty is a prerequisite, vitally affects the interests of management, they are more likely to appeal such orders. Thus, judicial review could be an effective check against the misuse of the suspension, removal, and prohibition sanctions.

IV. CONCLUSION

The underlying principle of FISA is that federal agencies should be able to set and enforce standards for the prudent operation of financial institutions without having either to depend on the vagaries of state authority or to resort to a war of nerves with management. By being given readily available sanctions adopted to recurring supervisory problems, the agencies will be able to achieve the maximum in preventive supervision. In one regard, however, the sanctions may prove deficient; Congress may find it necessary to amend the act to provide that suspension, removal, and prohibition orders may be issued against grossly incompetent management.

¹⁴⁴ Cf. *Beacon Fed. Savings & Loan Ass'n v. FHLBB*, 162 F. Supp. 350 (E.D. Wis. 1958) (reviewing facts under the weight-of-the-evidence test).

¹⁴⁵ 4 Davis, *op. cit.* *supra* note 142, § 30.14.

¹⁴⁶ *Ibid.*

¹⁴⁷ Jaffe, *Judicial Control of Administrative Action* 576-85 (1965).

¹⁴⁸ *Beacon Fed. Savings & Loan Ass'n v. FHLBB*, *supra* note 144, at 355.

¹⁴⁹ 112 Cong. Rec. 19370 (daily ed. Aug. 22, 1966) (remarks of Sen. Proxmire).

¹⁵⁰ See 4 Davis, *op. cit.* *supra* note 142, § 30.14.

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Finally, although the act promotes strong agencies, it does not contain adequate safeguards against misuse of power, because management is not guaranteed the full privacy necessary to encourage it to resort to adjudication. It is up to the agencies to provide the necessary privacy by enacting proper procedures for implementing the act, and thus strictly circumscribe agency action that would use the threat of publicity as a means of coercing consent.

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