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Federal Reserve Board Enforcement Action Raises Concerns as to Reach of Regulators' Jurisdiction

Key Takeaways

- The Federal Reserve Board issued a removal and prohibition order against a former bank employee based on alleged misconduct unrelated to her role at the bank, raising concerns about the scope of regulatory enforcement authority.
- The action relies on 12 U.S.C. § 1818(e), which allows regulators to impose industry bans for personal dishonesty or misconduct, even if it occurs outside of a banking institution, according to the regulators.
- While precedent for such actions is limited, the *Hendrickson v. FDIC* case provides an example of offsite conduct triggering a ban from the banking industry.
- Bank employees and affiliates should be aware that off-duty conduct, even in unrelated roles, may have lasting implications for future employment in the financial sector.

On July 3, 2025, the Federal Reserve Board (FRB) released a settled enforcement action against a former employee of Jonah Bank of Wyoming (the Bank). FRB Docket No. 25-013-E-1 (the Order). What makes this enforcement action different from typical enforcement actions is that the alleged misconduct of the former insider arguably had nothing to do with her performance or potential performance at the bank.

In the FRB Order, Respondent was a former employee of the Bank; however, the Order does not specify her position within the Bank. The Order details that while Respondent was an employee of the Bank, she also served as a bookkeeper for a nonprofit organization. The Order alleges that from March 6, 2018, through June 16, 2023, Respondent "embezzled a total of $33,212.84 from the nonprofit organization." The Order indicates that Respondent has "repaid the nonprofit in full," and that the alleged conduct "constituted violations of law or regulation and involved personal dishonesty."

The enforcement tool that the FRB brought against Respondent was a removal and prohibition action pursuant to 12 U.S.C. § 1818(e). Under this provision, the FRB may seek to impose an industry ban against an "institution-affiliated party" (IAP) of a bank or bank holding company if the FRB determines that the IAP has directly or indirectly: (1) violated any law, engaged in an unsafe or unsafe practice or committed any act, omission

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or practice which constitutes a breach of fiduciary duty (the "conduct" element); (2) the conduct caused loss to the "insured depository institution," the institution's depositors have been or could be "prejudiced," or the IAP received some financial gain from the conduct; and (3) such conduct involved personal dishonesty, willful unsafe or unsound practices or continuing unsafe or unsound practices. 12 U.S.C. § 1818(e). All directors, officers, employees or controlling stockholders are automatically IAPs, however third-party vendors, e.g., outside attorneys and accountants, must meet heightened standards to constitute an IAP. 12 U.S.C. § 1818(u). The effect of a removal and prohibition order, such as this one at issue in this case, is that the IAP/Respondent may have no greater relationship with any federally insured depository institution or its parent holding company, or any subsidiary of the holding company, beyond that of a typical customer, until the issuing agency terminates, stays or modifies the order.

Removal and prohibition orders are not new in the bank regulatory community. In fact, they constitute an important tool to protect the banking system from individuals whose conduct does or has the potential to tarnish the reputation of a depository institution, or threatens the safety and soundness of a depository or depository institution holding company. What makes this particular enforcement action different from "normal" removal and prohibition actions, is that the alleged misconduct giving rise to the enforcement action had nothing to do with Respondent's performance at the Bank. Instead, the Order alleges, she was banned from banking for conduct she allegedly committed at an entirely unrelated entity.

While there is some case law precedent for imposing the most several enforcement remedy, an industry ban, against a person for conduct they allegedly committed outside of the bank, such is sparse at best. The seminal case is *Hendrickson v. Federal Deposit Insurance Corporation*, 113 F.3d 98 (7th Cir. 1997). *Hendrickson* involved Stanley Hendrickson, who was working for Randolph County Bank of Winchester in 1985, when he left to work for his brother's precious metal dealership. While at the precious metal dealership, Mr. Hendrickson engaged in certain conduct for which he plead guilty to one count of willful failure to file a Form 8300 in violation of 26 U.S.C. § 7203. Mr. Hendrickson returned to the bank in 1992 as its president. In 1994, the FDIC initiated a removal and prohibition action, for which the FDIC was successful. Seventh Circuit Court Judge Flaum, in writing for the panel in *Hendrickson*, captured it best: "It may well be that Hendrickson never would have run into trouble had he stayed at the Bank." Id. at 100.

Without delving into a complicated review of the legislative history of § 1818(e), it is enough to say that the public policy purpose behind the removal and prohibition enforcement tool was likely to protect insured depository institutions and their regulated affiliates from persons who have demonstrated a history harming, or propensity to harm, the institution or its customers, or the banking system in general, due to the persons' misconduct. The question is how far regulators should be able to look to find the propensity evidence. In *Hendrickson*, the FDIC looked at actions that Mr. Hendrickson engaged in at a precious metal dealership, a regulated entity. In the Order related to Jonah Bank of Wyoming, the FRB looked at alleged embezzlement from a nonprofit organization.

This Order raises questions as to what the federal bank regulatory agencies (the FDIC, FRB, and Office of the Comptroller of the Currency all use the same statutory framework under 12 U.S.C. § 1818(e)) will view as conduct engaged in at a non-bank entity that warrants being banned from banking. Conduct that is similar to fraud, theft or embezzlement might be easier to accept. However, what about more technical violations of law or unsafe or unsound practices, that do not rise to the level of criminal conduct, but rather implicate regulatory violations? If a former bank employee is working in an unrelated regulated field, such as real estate brokering, food services, or pharmaceuticals

etc., and violates a regulatory requirement that harms the other entity, should that serve as the basis for a later ban from the banking industry?

We note that the Order at issue in the Jonah Bank of Wyoming action, and the *Hendrickson* case, both involved respondents who engaged in their off-site alleged misconduct after they already became bank employees. For people who have never been employed by a bank, but have a history of serious misconduct, such may also form the basis for preventing the person from working for a bank. Under 12 U.S.C. § 1829(a), "any person who has been convicted of any criminal offense involving dishonesty or a breach of trust or money laundering, or has agreed to enter into a pretrial diversion or similar program in connection with a prosecution for such offense, may not – (i) become, or continue as, an institution-affiliated party with respect to any insured depository institution; (ii) own or control, directly or indirectly, any insured depository institution; or (iii) otherwise participate, directly or indirectly, in the conduct of the affairs of any insured depository institution." Where a person violates § 1829, i.e., by becoming an employee of a bank while knowing that they are subject to the prohibitions under § 1829, such person may be fined up to $1 million for each day that the violation occurs, or imprisoned for not more than five years, or both.

In view of the foregoing, employees or former employees of banks must be mindful of how their offsite activities, and potential misconduct at such activities, might impact their future in the banking industry. Where the person is charged with a crime, careful negotiating of the remedy is crucial to any attempt to preserve the person's future ability to become employed in the banking industry. As for § 1829 actions, even if the person has never been employed by a bank or bank holding company, seemingly innocent youthful indiscretions can become impediments to future employment, where the crime involved fraud or dishonesty. For example, if a college fraternity member steals a horse and puts it into Dean Vernon Wormer's office (from "Animal House"), and the person later pleads guilty to misdemeanor theft, such may constitute a § 1829 predicate resulting in a prohibition from getting a job at a bank.

Consulting with counsel that is experienced in bank regulatory enforcement can help to navigate potential regulatory roadblocks to employment in the banking industry resulting from past misdeeds.