

Chapter 10 – Section 39 Actions

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Section 39 Actions

Section 39 of the FDI Act requires each FBA to establish certain safety and soundness standards for IDIs. This statute, which was created to meet the provisions of Section 132 of Federal Deposit Insurance Corporation Improvement Act, allowed the FBAs the option of adopting these standards by **regulation** or by **guideline**. The agencies adopted the standards as guidelines rather than regulations in order to grant each institution the flexibility of developing appropriate procedures based on the scope and nature of its activities.

The FDIC has established these standards for insured state nonmember institutions in Appendix A and Appendix B to Part 364 of the FDIC Rules and Regulations. Appendix A to Part 364 sets out the Interagency Guidelines Establishing Standards for Safety and Soundness. Appendix B to Part 364 sets out the Interagency Guidelines Establishing Information Security Standards.

The FDIC may, based upon an examination, visitation, or any other information that becomes available, determine that an institution is in nonconformance with the standards. The FDIC may request that an institution submit a plan describing the steps the institution will take to correct identified deficiencies under Section 39 of the FDI Act and 12 C.F.R. 308 Subpart R. Institutions that fail to submit an acceptable plan, or fail in any material respect to implement the submitted plan, will be subject to an order requiring correction of the deficiencies noted.

Specific operational guidelines and information security guidelines are established in Appendix A and Appendix B in the following areas:

- Internal controls and internal audit systems and information systems;
- Loan documentation;
- Credit underwriting;
- Interest rate exposure;
- Asset growth;
- Asset quality;
- Earnings;
- Compensation, fees, and benefits; and
- Security of customer information.

Grounds

Standards are designed to prompt an IDI to take steps that will help identify emerging problems and correct deficiencies before the safety and soundness of the institution becomes impaired.

The FDIC should consider both the size of the institution as well as the nature, scope, and risk of its activities when evaluating the adequacy of management's controls in each of the respective areas under Appendix A and when evaluating the information security program of the institution under Appendix B. An institution should not be viewed as being in nonconformance

with one of the standards due to an isolated error or inconsistency. Instead, the FDIC should assess the institution's overall practices and performance in each area when determining whether the institution satisfies the standards.

Section 39 actions may be initiated for non-problem institutions in which inadequate practices and policies could result in material loss to the institution, or management has not responded effectively to prior criticisms.

Corrective Programs

The enforcement power granted by Section 39 can be a useful means to effect corrective action in institutions that have significant operational problems. The FDIC may request an institution to submit a compliance plan that describes the steps the institution will take to correct identified deficiencies. Institutions that fail to submit an acceptable plan, or fail in any material respect to implement the submitted plan, will be subject to an order requiring correction of the deficiencies noted. Unless the FDIC determines that an order without notice is necessary, the FDIC first will issue a NOI to issue a safety and soundness order. The notice will identify the deficiencies in the plan or in its implementation and outline the provisions of a proposed order, including the effective dates for actions or prohibitions required by the proposed order. The notice will also give the institution a deadline (within 14 calendar days of the issuance of the notice, unless the FDIC permits a longer period) within which it may file a written response to the notice. If the institution fails to file a timely response, the institution will be deemed to have waived its opportunity to respond and will have consented to the issuance of the order (12 C.F.R. § 308.304).

After considering any response submitted by the institution, the FDIC may issue the proposed order or a modified order, seek additional information, or decide not to issue an order. If an order is issued, the FDIC may enforce it in federal district court. Further, the FDIC may assess a CMP against the institution or against an IAP or seek enforcement through any other remedies authorized by law for failure to comply with the order.

Other Concerns Not Specifically Addressed

Consultation with the Legal Division should assist in determining if authority exists to address a particular concern not specifically covered by the interagency standards for safety and soundness.

Other concerns not specifically addressed may include:

- Allowances for Loan and Lease Losses or Credit Losses,
- Budget/Profit Plans,
- Capital,
- Liquidity, and
- Violations of Laws and Regulations.

Section 39 vs. Other Formal Actions

The following criteria should be considered when determining whether to seek action under Section 39 or some other formal action.

Section 8(b)

A stipulated cease-and-desist order under Section 8(b) of the FDI Act potentially can be implemented and enforcement remedies can be available faster than an action under Section 39 of the FDI Act. Additionally, Section 8(b) has the advantage of allowing for a greater degree of regulatory flexibility in the areas of coverage.

Section 8(c)

Under Section 8(c) of the FDI Act, an immediate order can be issued, subject to a ten-day period for the institution to request injunctive relief. Section 8(c) orders can be challenged in federal district court.

Section 39 action

Proceedings under Section 39 have the advantages that:

- A compliance plan can be obtained within 30 days,
- Shorter time frames may be imposed,
- Order is enforceable in federal district court without the need for an administrative hearing, and
- Consent is not required.

However, once a Section 39 action is initiated, the FDIC lacks discretion to avoid issuing an order if the institution fails to submit, or to materially implement, an acceptable plan.

Section 39(e)(3) specifies mandatory restrictions for certain institutions.

There is a longer time frame to get an enforceable Section 39 order in place than a stipulated 8(b) order for the following reasons:

- If the institution's compliance plan is acceptable, time must be allowed for implementation.
- If the institution's compliance plan is unacceptable or not implemented, time may be needed to issue a notice and allow for a response before issuing the Section 39 order. Circumstances may dictate the immediate issuance of a final Section 39 order.

The deadlines for implementation of corrective actions contained in the Section 39 order will generally be later than the deadlines originally set out in the compliance plan.