

INTRODUCTION.....	2
Authorizations	2
Ratings	2
EXAMINATION CONSIDERATIONS	2
Evidence Required	3
Recommendations for Action.....	3
Reviewing Compliance with an Order	4
SECTION 8 – FDI ACT	4
Practices Deemed Unsafe or Unsound	4
Actions Deemed Unsafe or Unsound	5
Lack of Action Deemed Unsafe or Unsound	5
Conditions Considered Unsafe or Unsound	5
TERMINATION OF INSURANCE	5
Section 8(a)	5
CEASE AND DESIST ORDERS	6
Section 8(b).....	6
Types of Section 8(b) Orders	6
Section 8(c) - Temporary Cease and Desist Orders	7
REMOVAL AND PROHIBITION PROCEDURES	8
Section 8(e) - Removal and Prohibition	8
Section 8(g) - Suspension, Removal, and Prohibition....	8
ENFORCEMENT ACTIONS	9
Section 8(t) - Authority to Take Enforcement Action....	9
ANTI-MONEY LAUNDERING	10
Section 8(s) - Recordkeeping and Reporting.....	10
Section 8(w) - Terminating Insurance.....	10
INADEQUATELY CAPITALIZED INSTITUTIONS....	10
Section 38 - Prompt Corrective Actions.....	10
Reclassifying a Capital Category	10
Issuing Supervisory PCA Directive	11
Dismissing a Director or Senior Executive Officer..	11
Part 324 - Section 8 Powers	11
Part 324 - Capital Directives	12
SAFETY AND SOUNDNESS ORDERS.....	12

←
INTRODUCTION

Examiners must initiate corrective measures promptly if they identify excessive risks at financial institutions. Generally, examiners can use examination comments and supervisory recommendations or informal agreements to correct problems. However, various statutes and regulations authorize the FDIC to use formal enforcement actions, when necessary, to reduce risks and address deficiencies. This chapter discusses some of the main statutes and regulations that authorize formal actions, such as:

- Sections 8, 38, and 39 of the Federal Deposit Insurance (FDI) Act; and
- Part 324 of the FDIC Rules and Regulations.

Section 8 of the FDI Act provides the FDIC’s Board of Directors (FDIC’s Board) with broad enforcement powers. The FDIC’s Board has the power to:

- Terminate deposit insurance - Section 8(a),
- Issue cease and desist orders - Section 8(b),
- Invoke temporary (effective upon service) cease and desist orders - Section 8(c),
- Remove institution-affiliated parties (IAPs) or prohibit their participation in institution affairs - Sections 8(e) and (g),
- Assess Civil Money Penalties (CMP) – Section 8(i),
- Issue orders to cease and desist from violating certain anti-money laundering regulations - Section 8(s), and
- Terminate deposit insurance for certain money laundering offenses - Section 8(w).

Section 38 of the FDI Act and various sections of Part 324 of the FDIC Rules and Regulations authorize the FDIC to take prompt corrective actions (PCA) against institutions that fail to maintain certain capital levels.

Section 39 of the FDI Act authorizes the FDIC to take formal actions if an institution fails to submit and implement, upon FDIC request, an acceptable plan to achieve compliance with safety and soundness standards.

Authorizations

The FDIC’s Board has authority to implement various formal actions and has delegated to various levels within the Division of Risk Management Supervision (RMS), the authority to implement other actions. Parts 303 and 308 of the FDIC Rules and Regulations detail various rules and procedures relating to various types of formal actions.

Ratings

Formal action is generally initiated against an IDI with a composite rating of “4” or “5” if there is evidence of unsafe or unsound practices and/or conditions or concern over a high volume or severity of violations at the institution. However, initiation of formal action is not limited to these cases and may be justified in other situations as well, such as financially sound institutions with significant violations in their Anti-Money Laundering/Countering the Financing of Terrorism programs. Such formal action normally consists of an order to cease and desist under Section 8(b), and may also include an order of removal or prohibition against an IAP under Section 8(e), as well potential orders for restitution or orders to pay CMPs against an IDI or IAP under Section 8(b)(6) or 8(i). Under rare circumstances, formal actions may consist of a temporary cease and desist order under Section 8(c) or initiation of insurance termination proceedings under Section 8(a). Exceptions to the policy may be considered when the condition of the institution clearly reflects significant improvement resulting from an effective corrective program or where individual circumstances strongly mitigate against formal action.

Section 8(b) of the FDI Act authorizes the FDIC to deem that a state nonmember bank is engaging in unsafe or unsound practice if the institution receives less than satisfactory component ratings for asset quality, management, earnings, or liquidity. Examiners should assess all facts and circumstances to determine whether recommendation of Section 8(b) action is warranted under such circumstances.

←
EXAMINATION CONSIDERATIONS

The ROE often serves as the FDIC’s primary supporting evidence for formal actions. Comments must be factually correct, free of inconsistencies, and not contain gratuitous, editorial, or inflammatory statements. All comments, conclusions, and recommendations must be well supported. Primary examiner responsibilities include:

- Identifying practices or conditions that may result in excessive risk or loss to the institution or the Deposit Insurance Fund;
- Documenting such practices or conditions in accordance with instructions for the type of enforcement action recommended;
- Determining, in consultation with field- and regional-office management, if an enforcement action is necessary to address an unacceptable practice or condition;
- Ensuring that all credit classifications, component ratings, and composite ratings are accurate; and

- Submitting a memorandum to the regional director recommending an enforcement action.

Evidence Required

The FDIC must be able to prove that grounds for an action are based on facts and evidence and not merely based on suspicion. Consequently, FDIC examiners and staff must appropriately retain evidence such as:

- Copies of institution records needed to support charges;
- Documentation of all relevant meetings with management and the board;
- Documentation of all applicable recommendations made to management and the board; and
- Documentation of pertinent comments, requests, and commitments by management and the board.

Copies of institution records used as evidence should generally be complete copies of the records. And, whenever possible, at least two examiners should attend relevant meetings and sign or initial examiner notes taken during meetings.

Examiners should use special care not to make any charges on unsupported or inadequate grounds. Section 8 proceedings are within the purview of the Equal Access to Justice Act. The act provides that certain parties, who prevail in contested administrative or judicial proceedings against a federal government agency, may be able to recover litigation expenses if the position of the agency was not substantially justified. Examiners should also be mindful that all examiner writings, including but not limited to emails, notes, workpapers, and any memorandums to the regional director recommending formal actions might be a matter of record at any required hearing. Therefore, comments must be supported by substantive evidence and be able to withstand scrutiny in a hearing.

Recommendations for Action

A recommendation to pursue a formal order is not dependent upon completion of an ROE. If sufficient evidence is otherwise available, examiners should not wait for the completion of an examination or submission of the ROE before recommending a formal order.

Examiners are to consult with the regional office prior to discussing possible formal enforcement actions with the institution's board or management. Documentation of notification to the institution's board should be included in the memorandum to the regional director.

When examiners anticipate that Section 8(e) removal action may be appropriate, they should promptly consult with the regional office, including regional counsel, as directed. It is especially important that the ROE or other documentary evidence support all alleged practices or violations, particularly as they pertain to actions of the respondents.

Examiners that identify sufficient grounds for an action should submit, upon concurrence of regional office staff, a memorandum to the regional director recommending pursuit of an action. The memorandum, and ROE if available, should include as many details and documented facts pertaining to objectionable practices, unacceptable conditions, or apparent violations as reasonably possible.

The information required for inclusion in memorandums to regional directors varies based upon the type of proposed action. For proposed Section 8(b) actions, examiners should draft their memorandum to the regional director in accordance with the following guidelines:

- Detail each practice or condition regarded as unsafe or unsound;
- Identify any practice or condition that deviates from the institution's formal policies;
- Detail any apparent violations of law or regulations;
- Describe all relevant facts regarding each conclusion and recommendation;
- Include any institution director or officer statements that indicate disagreements, support charges, or show corrective actions;
- Describe issues or quote comments from previous examination reports or correspondence letters that support or refute promised corrective actions;
- Reference specific ROE schedules for additional details as necessary; and
- List items in order of importance and under appropriately descriptive subheadings.

The examiner's memorandum to the regional director should contain specific comments and recommendations relative to the adequacy of the institution's management. In some cases, existing management may be considered capable of solving the problems facing the institution, although a redirection or a clarification of authority may be necessary. If material management deficiencies are identified, the memorandum should address, as necessary, such matters as:

- The addition of independent outside directors;
- The addition of a chief executive officer, senior lending officer, or other senior officer;
- The establishment or modification of board committees, considering outside director representation;

- The addition or modification of board-approved policies;
- The implementation of board procedures to assure compliance with established directives and policies;
- The assessment of active management or the board by an independent committee or outside consultant;
- The establishment or modification of lines of authority;
- Restrictions on the authority of specific officers; and
- Any other managerial situations particular to the institution's circumstances.

For recommendations to pursue personal 8(b) actions and limitations on activities imposed against IAPs, examiners should identify any:

- Applicable misconduct;
- Necessary corrective measures;
- Deficiencies in an IAP's practices, skills, or competence; and
- Additional training or education requirements.

For all proposed Section 8(b) actions, examiners should include suggested measures and timeframes for correcting each practice or condition detailed in the memorandum to the regional director. The measures should be tailored to each specific issue and allow sufficient time for completion. Examination findings that are unrelated to issues being recommended to address in the proposed order should not be included.

The memorandum to the regional director should include the names and home addresses of any individuals to be named in a formal action to facilitate the service of a Notice of Charges. The memorandum and ROE should include facts that support why each named individual was included.

If the information needed to fully support the examiner's recommendations cannot be obtained through customary examination techniques, the regional office should be notified of the situation as soon as possible. If the matter remains unresolved, the examiner should so indicate in the memorandum and the regional director should consider using more formal investigative procedures authorized under Section 10(c) of the FDI Act.

Reviewing Compliance with an Order

Examiners are required to review management's compliance with any outstanding order during examinations. Orders typically require management to submit certain documents, including progress reports, to the regional office. Therefore, examiners should review all documentation submitted (since the prior examination) to the regional office to avoid requesting previously submitted

information. Examiners should also review any regional office responses to institution submissions and follow-up on any deficiencies or recommendations included in the responses.

Examiners should include a summary of outstanding formal enforcement actions in the Examination Conclusions and Comments section of the ROE. In the Compliance with Enforcement Actions section of the ROE, examiners must document, in a factual manner, the steps taken by management to comply with the provisions of the order. As part of this analysis, examiners should also determine the underlying reasons for an institution's failure to meet any provisions of an Order or improve the institution's condition over a reasonable time frame, and discuss with the regional office whether a new or revised Order would be appropriate. At the first examination after the issuance of an order, examiners should detail each provision and management's response. At subsequent examinations, examiners may summarize provisions and only detail items of a continuing nature and those that the institution had not complied with at the previous examination. Examiners should not use conclusory statements of opinion such as, "The institution is in compliance/noncompliance with this provision."

← SECTION 8 – FDI ACT

Section 8 of the FDI Act authorizes the FDIC to take certain formal enforcement actions when: (1) an institution or IAP: violates any law, regulation, or final order, (2) an IAP breaches a fiduciary duty; (3) an institution or IAP engages in an unsafe or unsound practices; or (4) where unsafe or unsound conditions are found to exist at an institution. However, the FDI Act does not define unsafe or unsound practices or conditions. The concept of unsafe or unsound practices or conditions touches upon an institution's entire operations, and a single definition would not capture the broad spectrum of activities or conditions included in the term.

The FDIC's Board has established examples of unsafe or unsound practices or conditions in previous Section 8 proceedings. However, examiners should understand that these examples of activities or conditions are not necessarily unsafe or unsound in every instance or when considered in light of all relevant facts pertaining to that situation.

Practices Deemed Unsafe or Unsound

Generally, an unsafe or unsound practice encompasses any action, or lack of action, by an institution or an IAP which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued,

would result in abnormal risk of loss or damage to an institution, its shareholders, or the Deposit Insurance Fund.

Actions Deemed Unsafe or Unsound

The FDIC's Board has found the following types of actions to be unsafe or unsound practices:

- Operating with inadequate capital for the type and quality of assets held;
- Engaging in hazardous lending and lax collection practices that include but are not limited to, extending credit that is inadequately secured, extending credit without first obtaining complete and current financial information, extending credit in the form of overdrafts without adequate controls, and extending credit with inadequate diversification of risk;
- Operating without adequate liquidity relative to the institution's asset and liability mix;
- Operating without adequate internal controls and an adequate audit program;
- Engaging in speculative or hazardous investment practices; and
- Paying excessive dividends in relation to the institution's capital position, earnings capacity, and asset quality.

Lack of Action Deemed Unsafe or Unsound

The FDIC's Board has found the following lack of actions to be unsafe or unsound practices:

- Failure to provide adequate supervision and direction over the officers of the institution,
- Failure to provide for an adequate allowance for loan and lease losses,
- Failure to keep accurate books and records,
- Failure to enforce programs for repayment of loans, and
- Failure to implement an adequate compliance management system.

Conditions Considered Unsafe or Unsound

An unsafe or unsound condition is a condition that, if continued, would result in abnormal risk of loss or damage to the institution or the Deposit Insurance Fund. An assessment of unsafe and unsound condition should be based on an assessment of virtually every aspect of the institution's operation and position. At a minimum, the institution's capital position, asset condition, management, earnings posture, and liquidity position must be carefully evaluated.

The FDIC's Board has found the following types of conditions to be unsafe or unsound:

- Maintenance of unduly low net interest margins,
- Excessive overhead expenses,
- Excessive volumes of loans subject to adverse classification,
- Excessive net loan losses, and
- Excessive volumes of nonearning assets.

←

TERMINATION OF INSURANCE

Section 8(a)

Section 8(a) provides the FDIC's Board with voluntary and involuntary termination of insurance powers. Voluntary termination of insurance actions under Section 8(a) are uncommon. Rather, voluntary termination of insurance actions are regularly done under Sections 8(p) and 8(q). Involuntary termination of insurance actions are also uncommon and generally used by the FDIC's Board only when other administrative actions have been ineffective.

The FDIC's Board may involuntarily terminate an institution's insured status under Section 8(a)(2) on the following grounds:

- An insured institution or its directors or trustees have engaged or are engaging in unsafe or unsound practices;
- An insured institution is in an unsafe or unsound condition; or
- An insured institution or its directors or trustees have violated any applicable law, rule, regulation, order, condition imposed in writing by the FDIC in connection with an application or other request by the institution, or any written agreement entered into with the FDIC.

Note: For the purposes of Section 8(a)(2), the term *written agreement* refers to a legally enforceable document, not an informal agreement such as a Memorandum of Understanding.

Before initiating formal proceedings to terminate an institution's deposit insurance, the FDIC must provide written notice to the institution's primary federal regulator or state authority. If the primary regulator or state authority fails to secure correction of the problems, the FDIC issues a *Notice of Intention to Terminate Insured Status, Findings, and Order Setting Hearing* to the institution. Unless the institution chooses not to litigate the matter, the FDIC has the burden of proving the allegations made in the Findings through the introduction of evidence at the hearing.

←
CEASE AND DESIST ORDERS

Section 8(b)

Section 8(b) of the FDI Act authorizes the FDIC to issue a cease and desist order against a state nonmember insured bank or an IAP when facts reasonably support that:

- The institution or IAP is engaging, or has engaged, in unsafe or unsound practices;
- The institution or IAP is violating, or has violated, a law, rule, or regulation; any condition imposed in writing by the FDIC with regard to the approval of a request or application; or a written agreement entered into with the FDIC; or
- There is reasonable cause to believe the institution or IAP is about to do either of the above.

The purpose of a cease and desist order is to remedy unsafe or unsound practices or violations, to correct conditions resulting from such practices or violations, and to prevent future unsafe and unsound practices or violations. Formal actions may be pursued before a violation or unsafe or unsound practice occurs in order to prevent a developing situation from reaching more serious proportions. Cease and desist orders generally contain provisions that require an institution or IAP to take, or prohibit an institution or IAP from taking, specific actions relating to inappropriate practices, violations, or conditions. Under certain circumstances, the enforcement action may require the institution or IAP to make restitution or provide indemnification against losses.

The failure of an institution to comply with any cease and desist order or consent order that has become final can be the basis for subsequent Section 8(a) termination of insurance action or 8(e) removal action against an IAP, as defined by Section 3(u) of the FDI Act. Such failure also can be the basis for the FDIC petitioning the U.S. District Court to enforce the order. Civil money penalties may also be imposed against the institution or any officer, director, employee or other person participating in the affairs of such institution that was responsible for such non-compliance.

Types of Section 8(b) Orders

The type of Section 8(b) order issued by the FDIC varies based on the institution or IAP’s response to an enforcement action. If an institution or IAP agrees to comply with an enforcement action (stipulates), the FDIC will issue a consent order. However, if an institution or IAP does not stipulate, the FDIC may pursue a cease and desist order. Both actions generally contain the same corrective provisions and are public documents.

Cease and Desist Order When an institution or IAP does not agree to stipulate to a proposed enforcement action, the FDIC may pursue a cease and desist order by issuing and serving the institution or IAP with a Notice of Charges. The Notice of Charges contains a statement of facts detailing alleged practices or violations and fixes a time and place for an administrative hearing. A hearing is held to determine whether an order to cease and desist should be issued against the depository institution or IAP. If the party or parties served with the Notice of Charges does not appear at the hearing, they may be deemed to have consented to the issuance of the cease and desist order.

The FDIC’s Board may issue a cease and desist order after the hearing. The action orders the institution and/or its IAPs to cease and desist from the unsafe and unsound practices or violations outlined in the order and to take affirmative actions to correct the conditions resulting from such a violation or unsafe or unsound practice. In certain cases, the cease and desist order may require the institution or IAP make restitution or provide indemnification against losses where the institution or IAP was unjustly enriched in connection the violations or unsafe and unsound practices or where the violation or practices involved a reckless disregard for the law or applicable regulations. A cease and desist order becomes effective 30 days after it is served upon the institution.

Consent Order Alternatively, if the institution or IAP agrees to a proposed enforcement action, the FDIC will issue a consent order. By stipulating, the institution or IAP waives its right to an administrative hearing. Eliminating the administrative hearing allows the institution or IAP to avoid lengthy and costly legal proceedings and allows the FDIC to address unsafe or unsound practices and violations more quickly. By stipulating to the action, the institution consents to the enforcement action without admitting or denying engagement in unsafe or unsound practices or violations. A consent order becomes effective at the time specified in the order, which is typically the date of issuance.

Personal 8(b) Orders The FDIC can seek 8(b) orders against IAPs under the same statutory authority and on the same statutory conditions as against an institution. The FDIC may pursue a personal 8(b) order when remedial action is warranted regardless of whether the elements could be met for a permanent prohibition of an IAP from the banking industry.

The FDIC may consider prioritizing possible 8(b) action against an IAP when facts reasonably support that an IAP. For example, when an IAP:

- Engaged in dishonest conduct;
- Was a director or officer;

- Had a substantial role in directing the misconduct;
- Engaged in repeated or large-scale misconduct;
- Received an FDIC supervisory letter, but continued the misconduct;
- Was identified in an ROE or other formal or informal enforcement action that detailed their misconduct, but continued the misconduct; or
- Was a director or officer who abdicated their fiduciary duties in an unsafe or unsound manner.

Examiners should assess IAPs' compliance with outstanding enforcement actions during examinations. Information on IAPs subject to personal enforcement actions may be available through regional offices. However, during the examination, examiners should also ask management to identify any IAPs subject to personal enforcement actions to ensure any recently hired IAPs appropriately notified the institution and to ensure management and the board are fulfilling their responsibilities to remain informed on the professional background and qualifications of directors, officers, and employees.

If an IAP appears to be in substantial compliance with all provisions of a personal cease and desist order (PC&D), examiners should detail their findings in the Confidential - Supervisory Section. However, if an IAP appears to be in substantive noncompliance with one or more provisions of an outstanding PC&D, examiners should describe their findings on the Compliance with Enforcement Actions page in a manner similar to evaluations of an institution's compliance with other enforcement actions. Examiners should carry forward a summary of their findings to the Examiners Conclusions and Comments page.

In general, a PC&D should have a time limit of five years and automatically expire at the end of that time. If the actions of the IAP were particularly egregious, compliance with a specific provision deemed critical, or another important supervisory reason can be articulated, the time limit can be greater than five years or eliminated completely. This decision will be made at the initiation of the PC&D. Justification for a time limit longer than five years should be included in the recommendation memo.

Termination prior to the end of five years, or termination of PC&Ds without a time limit should be based on satisfactory or full compliance with the provisions of the Order. When considering the issuance and provisions of a PC&D, the remedies set forth in a PC&D should lend themselves to measureable and verifiable compliance to permit a reasoned basis for termination.

In order to terminate a PC&D, regional directors should submit a memorandum to the appropriate Associate Director - Risk Management Supervision based upon an

IAP's satisfactory or full compliance with the provisions of the Order.

Section 8(c) - Temporary Cease and Desist Orders

If the FDIC cannot obtain an institution's stipulation and consent for a cease and desist order, the time required to complete the administrative proceedings and obtain a cease and desist order may result in additional damages to the institution. Section 8(c), therefore, authorizes the FDIC to issue a temporary cease and desist order to stop particularly dangerous practices, or take affirmative actions to remedy conditions, pending completion of the administrative proceedings. Temporary cease and desist orders are not meant to replace permanent orders and must be issued in conjunction with or subsequent to a Notice of Charges supporting an order.

The FDIC may issue a temporary order if a violation, threatened violation, or unsafe or unsound practice specified in the Notice of Charges is likely to cause insolvency or substantial dissipation of assets or earnings, weaken the condition of the institution, or prejudice the interests of depositors prior to the completion of the Section 8(b) action. The FDIC may also issue a temporary order if an institution's accounts and records are so inadequate that the FDIC cannot determine the institution's financial condition or cannot determine the details of a transaction that may have a material effect on the institution.

A temporary order, accompanied by a *Notice of Charges*, can be issued against the institution or IAP. The order becomes effective upon service and, unless set aside or limited by court proceedings, remains effective and enforceable pending completion of the administrative proceedings pursuant to a Section 8(b) action.

Within 10 days after service of a temporary cease and desist order, the institution or IAP may apply for an injunction setting aside, limiting, or suspending the enforcement, operation, or effectiveness of such order.

Due to the nature of temporary actions, recommendations for such actions are frequently developed without the benefit of a completed ROE. In those cases, a visitation report, memorandum, or letter will discuss the practices and violations and the effect, or anticipated effect, on the institution. Examiners should immediately contact the regional office to discuss the possible need for Section 8(c) action when a situation is discovered in which an apparent violation of law or unsafe or unsound banking practice is likely to cause insolvency or substantial dissipation of assets prior to the completion of proceedings under Section 8(b).

←
REMOVAL AND PROHIBITION PROCEDURES

Section 8(e) - Removal and Prohibition

Section 8(e) of the FDI Act authorizes the FDIC to order the removal of an IAP (director, officer, employee, controlling stockholder, etc.) from a state nonmember depository institution. It also allows the FDIC to prohibit the IAP from future participation in the conduct of the affairs of any insured depository institution. Removal and/or prohibition orders may be based upon conduct at the institution from which the individual is removed or upon conduct at another institution or affiliate.

The FDIC must establish three distinct and separate grounds to institute a removal and/or prohibition action:

1. **Misconduct** The IAP has directly or indirectly violated any law or regulation, any final cease and desist order, any condition imposed in writing in connection with the granting of an application or other request, or any written agreement; participated in any unsafe or unsound practice in connection with the depository or business institution; or engaged in an act, omission, or practice which constitutes a breach of fiduciary duty; and
2. **Effect of the Misconduct** Due to the misconduct, the insured depository institution or business institution has suffered or will probably suffer financial loss or other damage; the interests of the depositors have been or could be prejudiced; or the IAP has received financial gain or other benefit; and
3. **Culpability** The IAP’s acts or omissions involved personal dishonesty or demonstrated willful or continuing disregard for the safety and soundness of the insured depository or business institution.

If an IAP does not consent to the action, the FDIC may serve the IAP with a Notice of Intention to Remove from Office or to Prohibit from Further Participation. The Notice of Intention contains a statement of the facts and conclusions constituting grounds for an action and a place and time for a hearing.

Pending the hearing, the FDIC may order the temporary and immediate suspension or prohibition of an IAP if the IAP’s continued participation poses an immediate threat to the institution or to the interests of the institution’s depositors. Unless a court issues a stay, a temporary suspension or prohibition order remains effective until the FDIC dismisses the charges or until the effective date of the permanent removal or prohibition order.

Examiners should be alert for situations where Section 8(e) may be applicable and should promptly communicate concerns to the regional office. The examiner, regional director or designee, and regional counsel should consult as needed to determine whether to proceed with an investigation authorized under Section 10(c) of the FDI Act. The examiner, regional director or designee, and regional counsel should also determine what evidence should be collected during the course of the investigation. Upon completion of an investigation, examiners are required to submit a recommendation memorandum to the regional director outlining the alleged misconduct and evidence supporting the allegations. If the memorandum is submitted in conjunction with an ROE, the ROE should also support the allegations.

When an IAP’s acts support a removal/prohibition action and the alleged misconduct meets the criteria for filing a Suspicious Activity Report (SAR), the examiner should encourage the institution to file. If the institution refuses to file the SAR, the FDIC should file the SAR.

Section 8(g) - Suspension, Removal, and Prohibition

Section 8(g) of the FDI Act authorizes the FDIC to suspend an IAP charged with a felony and to remove an IAP convicted of a felony.

IAP Charged with a Felony Under Section 8(g)(1)(A), the FDIC may suspend an IAP from office or prohibit that IAP from participating in the conduct of any institution’s affairs if:

- An IAP is charged with a crime involving dishonesty or breach of trust that is punishable by imprisonment for a term exceeding one year under state or federal law (a felony) or is charged with a violation of section 1956, 1957, or 1960 of title 18 or section 5322 or 5324 of title 31; and
- Continued service or participation by the IAP may pose a threat to the interests of the institution’s depositors or may threaten to impair public confidence in the institution.

When determining the threat posed by the IAP’s continued service or participation, the FDIC must consider all relevant factors, including the nature of the charges in the indictment. If the indictment relates to alleged crimes against an institution or other financial institution, it may be that, the IAP’s continued service would pose a threat to the institution. The FDIC should also consider any potential impact to the institution from publicity that associates the institution with the criminal activity due to the IAP’s continued service or participation.

If the FDIC determines that the Section 8(g) criteria for suspension have been met, the regional office may notify the IAP of the contemplated recommendation for Section 8(g) action and offer the IAP the option of a voluntary suspension. Voluntary suspension is an IAP’s resignation from office and/or pledge not to participate in any manner in the affairs of the institution. A voluntary suspension is not a consent or stipulation to a formal action and it is not enforceable. When factors warrant a formal enforceable action, the FDIC will not offer a voluntary suspension.

If an IAP does not agree to voluntary suspension, the FDIC will serve a written notice of suspension upon the IAP and a copy of the notice upon the institution. The notice will suspend the IAP from office and/or prohibit his or her from further participation in the affairs of any institution. Such suspension or prohibition will remain in effect until the indictment or charge is finally disposed or until the notice is terminated. A finding of not guilty to a specific charge does not preclude the FDIC from instituting removal proceedings under Section 8(e).

IAP Convicted of a Felony Under Section 8(g)(1)(C), the FDIC may remove an IAP from office and/or prohibit an IAP from further participation in the conduct of the affairs of any depository institution without the prior written consent of the FDIC if:

- The IAP is convicted of a crime involving dishonesty or breach of trust which is punishable by imprisonment for a term exceeding one year under State or Federal law, or is convicted of a crime under section 1956, 1957, or 1960 of title 18 or section 5322 or 5324 of title 31,
- The judgment is not subject to further appellate review, and
- The FDIC determines that the IAP’s continued service or participation may pose a threat to the interest of the institution’s depositors or may threaten to impair public confidence in the institution.

Although the FDIC typically has the discretion to determine whether it is appropriate to issue a removal and/or prohibition order, Section 8(g) removes such discretion and requires the FDIC to issue a removal and/or prohibition order when an IAP is convicted of violating:

- 18 U.S.C. § 1956 (Laundering of Monetary Instruments),
- 18 U.S.C. § 1957 (Engaging in Monetary Transactions in Property Derived from Specified Unlawful Activities),
- 18 U.S.C. § 1960 (Prohibition of Unlicensed Money Transmitting Businesses),
- 31 U.S.C. § 5322 (Criminal Penalties), or

- 31 U.S.C. § 5324 (Structuring Transactions to Evade Reporting Requirement Prohibited).

Within 30 days of service of any notice of suspension or order of removal pursuant to Section 8(g), the IAP may request an opportunity to appear before the FDIC to show that continued service to the institution, or participation in its affairs, is not likely to pose a threat to the interests of an institution’s depositors or impair public confidence in the institution. Upon receipt, the FDIC shall schedule a hearing before agency personnel (not more than 30 days after receipt of the request). Within 60 days after such hearing, the party will be notified of the FDIC’s decision as to whether the prohibition or suspension will be continued, terminated, or modified, or whether an order of removal will be rescinded or modified.

←

ENFORCEMENT ACTIONS

Section 8(t) - Authority to Take Enforcement Action

Section 8(t) of the FDI Act authorizes the FDIC to take enforcement action under Section 8 of the FDI Act (among other Sections) against any insured depository institution, holding company, or IAP in certain circumstances.

When the FDIC is not the primary federal regulator, the FDIC may recommend to the appropriate federal banking agency that the agency take any enforcement action authorized under Section 8. If, within 60 days, the federal banking agency does not take the enforcement action recommended or provide a plan acceptable to the FDIC, the FDIC may take the recommended enforcement action if the FDIC’s Board determines:

- The insured depository institution is in an unsafe or unsound condition,
- The institution or IAP is engaging in unsafe or unsound practices and the recommended enforcement action will prevent the institution or IAP from continuing such practices,
- The conduct or threatened conduct (including any acts or omissions) poses a risk to the Deposit Insurance Fund or may prejudice the interest of the institution’s depositors, or
- The conduct or threatened conduct (including any acts or omissions) of the depository institution holding company poses a risk to the Deposit Insurance Fund. (Such authority may not be used with respect to a depository institution holding company in a generally sound condition and whose conduct does not pose a foreseeable and material risk of loss to the Deposit Insurance Fund.)

←
ANTI-MONEY LAUNDERING

Section 8(s) - Recordkeeping and Reporting

Section 8(s) of the FDI Act states the FDIC shall issue a cease and desist order if an institution:

- Has failed to establish and maintain the procedures to ensure compliance with the Bank Secrecy Act, or
- Has failed to correct any problems that were previously reported to the institution by the FDIC.

The FDIC shall issue the order in the same manner prescribed under Section 8(b) or 8(c) and shall require the institution to cease and desist from its violation of Section 8(s) or its prescribed regulations.

Section 8(w) - Terminating Insurance

Section 8(w) of the FDI Act states the FDIC Board shall issue a notice of intent to terminate deposit insurance when the Attorney General notifies the FDIC that an institution has been convicted of violating:

- 18 U.S.C. § 1956 (Laundering of Monetary Instruments), or
- 18 U.S.C. § 1957 (Engaging in Monetary Transactions in Property Derived from Specified Unlawful Activities).

Section 8(w) also authorizes the FDIC Board to issue a notice of intent to terminate deposit insurance when the Attorney General notifies the FDIC that a state institution has been convicted of violating 31 U.S.C. §§ 5322 (Violating Certain Provisions of 31 U.S.C. subch. II) or 5324 (Structuring Transactions to Evade Reporting Requirement Prohibited).

In determining whether to terminate insurance under Section 8(w), the FDIC’s Board shall take into account several factors, such as the extent of:

- Director or executive officer knowledge or involvement in the offense,
- Director or executive officer cooperation in the investigation,
- Existing institutional policies and procedures designed to prevent the offenses,
- Implementation of additional controls subsequent to the offense to prevent future money laundering offenses, and
- Adequate deposit and credit services in the local community if deposit insurance is terminated.

←
INADEQUATELY CAPITALIZED INSTITUTIONS

To promote capital adequacy, the FDIC is authorized, and in some instances obligated, to take action against institutions that are less than adequately capitalized. For example:

- Section 38 of the FDI Act grants the FDIC’s Board powers to take prompt corrective action against institutions that are less than adequately capitalized;
- Part 324 of the FDIC Rules and Regulations authorizes the FDIC, under certain conditions, to utilize Section 8(a), 8(b), or 8(c) powers against institutions that fail to meet certain capital levels; and
- Part 324 of the FDIC Rules and Regulation authorizes the FDIC to issue a capital directive to an institution that fails to maintain capital at or above the minimum leverage capital requirements under the generally applicable capital rules and the community bank leverage ratio (CBLR) framework.
- The CBLR framework does not affect the FDIC’s supervisory authority or ability to pursue formal enforcement actions when appropriate. Further, FDIC can recommend formal actions with a capital maintenance provision that requires a leverage ratio above the applicable CBLR requirement.

Section 38 - Prompt Corrective Actions

Section 38 of the FDI Act establishes a framework of supervisory actions to address issues at less than adequately capitalized financial institutions. The implementation of a PCA is intended to ensure early intervention at institutions experiencing problems and the timely closure of failing institutions.

Prompt corrective actions are based on an institution’s capital levels and become increasingly severe if an institution falls into a lower capital category. Some supervisory actions associated with PCAs are mandatory; that is, the actions immediately apply to the institution as it is classified in a particular category. Other actions are discretionary.

Reclassifying a Capital Category

Pursuant to Section 38(g) of the FDI Act (as implemented by Sections 324.403(d) and 308.202 of the FDIC Rules and Regulations), the FDIC may reclassify a well-capitalized, adequately capitalized, or under capitalized institution to the next lower capital category if:

- The FDIC determines, after notice and opportunity for hearing, that the institution is in an unsafe or unsound condition; or
- The FDIC determines, after notice and opportunity for hearing, that the institution has less than satisfactory asset quality, management, earnings, or liquidity.

With respect to the CBLR, electing institutions are considered to have met the well-capitalized ratio requirements mandated by section 38 of the FDI Act. However, if an electing institution is subject to a consent order with a condition to meet and maintain a specific capital level for any capital measure, it would be re-categorized as “adequately capitalized” for PCA purposes pursuant to section 324.403(b)(1)(i)(E) of the capital rule. The electing institution could remain in the CBLR framework as long as it meets the qualification standards.

Issuing Supervisory PCA Directive

Section 38 outlines supervisory actions applicable to an institution based on its capital category. Section 38 requires the FDIC to impose (by issuing a supervisory PCA directive) one or more of the following provisions on a significantly undercapitalized institution or an undercapitalized institution that failed to submit and implement a capital restoration plan:

- Require recapitalization,
- Restrict transactions with affiliates,
- Restrict interest rates paid,
- Restrict asset growth,
- Restrict activities involving excessive risk,
- Improve management,
- Prohibit deposits from correspondent institutions,
- Require prior approval for capital distributions by a bank holding company,
- Require the institution or holding company to divest of subsidiaries,
- Require a holding company to divest of the institution, or
- Require any other action the FDIC determines will resolve the problems of the institution.

Section 38 also authorizes the FDIC to take the following actions if the FDIC determines the action will resolve the problems of the institution at the least possible cost to the Deposit Insurance Fund:

- Impose upon an undercapitalized institution any of the discretionary provisions applicable to a significantly undercapitalized institution or an undercapitalized institution that failed to submit and implement a capital restoration plan; or

- Impose upon a significantly undercapitalized institution or undercapitalized institution that failed to submit and implement a capital restoration plan one or more of the restrictions placed upon critically undercapitalized institutions by Section 38 (i).

The FDIC must (except as described below) provide the institution with written notice prior to issuing a supervisory PCA directive that imposes any of the discretionary actions listed above. The notice provides the institution with an opportunity to respond to the proposed directive. Although a supervisory PCA directive does not entitle an institution to a hearing, the FDIC will consider the institution’s response prior to determining whether to issue a directive. The FDIC may issue a directive without prior notice if the FDIC deems it necessary to carry out the purposes of Section 38.

Dismissing a Director or Senior Executive Officer

Section 38 authorizes the FDIC to issue a supervisory PCA directive to require institutions to improve management in the case of significantly undercapitalized institutions and undercapitalized institutions supervised by the FDIC that fail to submit or implement acceptable capital restoration plans. The supervisory PCA directive may require the institution to dismiss from office any director or senior executive officer who held office for more than 180 days immediately before an institution became undercapitalized. Dismissal by a supervisory PCA directive is not construed as a removal under Section 8 of the FDI Act.

When the FDIC issues a directive to an institution requiring the dismissal of a director or senior executive officer, the FDIC also serves a copy of the relevant sections of the directive upon the person to be dismissed. If removed, the director or senior executive officer may file a request for reinstatement with the FDIC not later than 10 days after receiving notice of the dismissal. A post-dismissal hearing may be requested by the director or senior executive officer at which time the director or officer must demonstrate that continued employment would materially strengthen the institution’s ability to become adequately capitalized and to correct the unsafe or unsound conditions or practices.

Part 324 - Section 8 Powers

Section 324.4 of the FDIC Rules and Regulations defines certain capital levels as unsafe or unsound practices or conditions pursuant to Section 8 of the FDI Act.

Unsafe or Unsound Practice Any state nonmember bank that has less than its minimum leverage capital requirement is deemed to be engaged in an unsafe or unsound practice pursuant to Section 8(b)(1) and/or 8(c) of the FDI Act.

Exception: An institution is not deemed to be engaged in an unsafe or unsound practice if the institution has entered into and is in compliance with a written agreement with the FDIC, or the institution has submitted and is in compliance with a plan approved by the FDIC to:

- Increase its Tier 1 leverage capital ratio to such level as the FDIC deems appropriate, and
- Take such other action as may be necessary to be operated so as not to be engaged in such an unsafe or unsound practice.

Unsafe or Unsound Condition Any insured depository institution with a ratio of Tier 1 capital to total assets that is less than 2 percent is deemed to be operating in an unsafe and unsound condition pursuant to Section 8(a) of the FDI Act.

Exception: An insured depository institution is not deemed to be operating in an unsafe or unsound condition if, in the case of a state nonmember bank, it has entered into and is in compliance with a written agreement with the FDIC (or in the case of any other insured depository institution, has entered into and is in compliance with a written agreement with its primary federal regulator and to which agreement the FDIC is a party), to:

- Increase its Tier 1 capital ratio to such levels as the FDIC deems appropriate, and
- Take such other action as may be necessary to be operated in a safe and sound manner.

In most cases, capital levels may be a reflection of other supervisory concerns that have already resulted in Section 8(a), Section 8(b), or Section 8(c) enforcement actions. Institutions subject to enforcement actions that include a capital provision may meet the criteria for the exception from being deemed to be in or engaged in an unsafe or unsound condition or practice due to capital levels. However, when enforcement action has not been taken or is not warranted due to a lack of other supervisory concerns, the FDIC may choose to enter into a written agreement with the institution thereby providing the institution with an exception from the definition of unsafe or unsound practice or condition and precluding Section 8(a), Section 8(b), or Section 8(c) action solely based on capital levels.

It is important to note that the FDIC is not precluded from taking Section 8(a), Section 8(b), or any other enforcement action against an institution with capital levels that exceed those defined as unsafe or unsound in Section 324.4.

Part 324 - Capital Directives

Section 324.5 of the FDIC Rules and Regulations authorizes the FDIC’s Board to issue a directive against any insured state nonmember bank that fails to maintain capital at or above the minimum leverage capital requirement. A capital directive requires the institution to restore its capital to the minimum leverage capital requirement within a specified period. The directive may require the institution to submit a plan describing the means and timing by which it shall achieve the applicable minimum leverage capital requirement.

Prior to issuing a capital directive, the FDIC must provide the institution with written notice. The institution may submit a written response to the proposed directive. The FDIC will issue a written determination supporting any decision to issue or not to issue a directive after considering the response.

The key difference between a capital directive and PCA directive is the requirement that the FDIC may impose under each directive. Under a PCA directive, the FDIC can impose requirements ranging from recapitalization to restricting activities. However, under a capital directive, the FDIC is largely limited to requiring the institution to recapitalize and submit a capital restoration plan.



SAFETY AND SOUNDNESS ORDERS

Section 39 of the FDI Act requires the federal banking authorities to establish various safety and soundness standards. The Act allows the FDIC to request corrective plans from financial institutions that do not meet the standards, which are set forth in Part 364 and the interagency guidelines in Appendix A and Appendix B to Part 364.

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.

In addition, the FDIC may require by order, other corrective measures, such as restricted asset growth, higher capital levels, limits on deposit interest rates, or any other measure deemed necessary to effect corrective action.

Corrective programs for safety and soundness standards can also be incorporated into other types of formal and informal actions pursued against problem institutions. Section 39 actions may be considered for non-problem institutions having clearly inadequate safety and soundness practices and policies; however, this response will normally be limited to situations that could result in material loss to the

institution, or where management has not responded effectively to similar criticisms in prior examinations.

Examiners should consult with the regional office prior to discussing possible actions with the institution's board or management. If regional management determines Section 39 action is warranted, examiners should submit a recommendation memorandum to their regional director. The memorandum should detail any discussions with the institution's board or management regarding possible actions.

Note: Examiners and regional directors must exercise care to avoid requesting compliance plans if identified problems are correctable through standard examination practices.

References:

- Manual Section 13.1, Informal Actions
- Manual Section 14.1, Civil Money Penalties
- Manual Section 16.1, ROE Instructions