

INTRODUCTION.....2  
MEMORANDUMS OF UNDERSTANDING .....2  
    Memorandum Considerations .....2  
    Issuing Memorandums .....2  
    Monitoring Compliance with Memorandums .....2  
    Terminating Memorandums .....3  
SECTION 39.....3

## INTRODUCTION

Regulatory agencies may use formal or informal procedures to address weak operating practices, deteriorating financial conditions, or apparent violations of laws or regulations. A memorandum of understanding (MOU) is a common informal agreement used by the FDIC to obtain a commitment from a bank's board of directors to implement corrective measures. Other informal actions include board resolutions, letter agreements, and other forms of bilateral agreements or unilateral actions. Informal actions are not public information or legally enforceable. A financial institution's failure to implement the corrective measures detailed in an informal agreement may lead to formal corrective actions.

←

## MEMORANDUMS OF UNDERSTANDING

An MOU provides a structured way to correct problems at institutions that have moderate weaknesses, but have not deteriorated to a point requiring formal corrective actions. An MOU may be appropriate if examiners (after discussing examination findings with field- and regional-office personnel and the bank), determine that the board of directors and management are committed to, and capable of, implementing effective corrective measures.

An MOU may be used to address specific problems at institutions rated 1 or 2 and should, at a minimum, be considered for all institutions rated 3. An MOU may not be required at an institution rated 3 if the regional director or designee determines that the institution's financial condition improved significantly or that there are other strong mitigating circumstances. For example, a weak management team may have been replaced by a strong management team, or an acceptable action by a state authority might make an MOU unnecessary. However, the mere belief that management recognized its errors and will improve the bank's condition is generally not a sufficient reason to make an exception.

Examiners should consider recommending formal enforcement action pursuant to Section 8 of the Federal Deposit Insurance (FDI) Act for institutions rated 3 if management appears unwilling to take appropriate corrective measures, and for all composite 4- or 5-rated institutions.

### Memorandum Considerations

When determining whether to seek an informal (or formal) action, examiners should consider:

- Management's attitude towards complying with laws and regulations and correcting undesirable or objectionable practices;
- Whether violations or objectionable practices were intentional, repetitive, substantive, or numerous;
- The institution's history of violations and unsatisfactory practices;
- Management's history of instituting timely remedial or corrective actions;
- Whether management already initiated corrective actions;
- Whether management established procedures to prevent future deficiencies or violations;
- The extent of harm caused, or likely to be caused, by the violations or unsatisfactory practices; and
- Any other circumstances that warrant use of an informal action.

### Issuing Memorandums

Examiners considering the use of an MOU should contact their supervisory examiner, field supervisor, or regional reviewer (in accordance with regional policy) to discuss the possibility of issuing an MOU. When an institution is affiliated with a bank or holding company supervised by another federal regulatory agency, the regional reviewer should notify the agency of the proposed action. In all instances, state authorities should be notified of, and invited to join, proposed actions.

If an MOU is deemed appropriate, the examiner should draft a memorandum to the regional director recommending the MOU and detailing areas that the MOU should address. The examiner's memorandum to the regional director should include:

- A brief description of the examination findings, and
- Detailed recommendations for addressing each significant concern.

With the concurrence of the regional office, the examiner (and when appropriate, regional- or field-office representatives) should discuss the possible use of an MOU with management and the board at the exit and board meetings. Also, with regional- or field-office concurrence, the examiner should explain that the FDIC might consider implementing other actions if the MOU does not result in effective corrective actions.

### Monitoring Compliance with Memorandums

Monitoring an institution's progress in achieving the goals of an outstanding MOU may involve offsite monitoring, visitations, and examinations. Examiners should reflect

the adequacy of an institution's response to an MOU in the Management rating.

Examiners should include a summary of outstanding MOUs in the Examination Conclusions and Comments section of the Report of Examinations (ROE). Examiners should detail action provisions and the status of compliance with the provisions on the Compliance with Enforcement Actions page. Examiners should describe each provision and the status of compliance at the first examination after the issuance of an administrative action. At subsequent examinations, examiners may summarize provisions and only address requirements of a continuing nature and items that the institution had not complied with at the previous examination.

Examiner comments should sufficiently detail the institution's actions or inactions so readers can draw meaningful conclusions concerning the extent of compliance. Examiners should not use broad statements of opinion such as "compliance is noted," or "not in compliance." Comments should factually describe corrective efforts and indicate whether or not agreed upon time limits have expired. As part of this analysis, examiners should also determine the underlying reasons for an institution's failure to meet provisions of the MOU or improve the bank's condition over a reasonable time frame, and discuss with the Regional Office whether new or revised provisions, or a formal action, would be appropriate.

### Terminating Memorandums

Outstanding MOUs should be terminated promptly when:

- The institution has substantially complied with the terms of the MOU,
- The institution's condition has improved sufficiently and the action is no longer necessary,
- A new formal or informal action is issued that addresses all areas of concern, or
- The institution is merged or closed.

Regional office personnel should coordinate the termination of an MOU with any involved state or other federal authority.

←

### SECTION 39

Section 39 of the FDI Act requires federal banking agencies to prescribe various standards for insured depository institutions. Section 39 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. The standards provide financial institutions guidelines for overseeing activities relating to risk management and daily operations. Section 39 also provides banking agencies a tool to address weak risk management practices or operating weaknesses in otherwise financially sound institutions before deficiencies lead to capital deterioration. The standards relate to issues such as:

- Internal controls, information systems, and internal audit systems;
- Loan documentation and credit underwriting;
- Interest rate exposure;
- Asset growth;
- Compensation, fees, and benefits; and
- Other operational and managerial matters.

Section 39 also provides a tool for the banking agencies to address weak risk management practices or operating weaknesses in otherwise financially sound institutions before deficiencies lead to capital deterioration.

If an institution fails to meet these standards, the FDIC may pursue informal action under Section 39 by requesting management to submit a Safety and Soundness Compliance Plan. The plan must describe the steps the institution will take to correct identified deficiencies and the time frames for completing the steps.

If an institution fails to submit a requested plan or fails to adhere to a submitted plan, the FDIC will pursue formal enforcement action. Procedures for requesting submission of a compliance plan and issuing an enforceable order pursuant to Section 39 are detailed in Subpart R to Part 308 of the FDIC Rules and Regulations.

Examiners considering whether to request a Section 39 plan should contact their case manager to discuss the appropriateness of the request. If regional management determines supervisory action pursuant to Section 39 is warranted, examiners should submit a recommendation memorandum to their regional director.

*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 15.1, Formal Administrative Actions
- Manual Section 16.1, ROE Instructions
- Statement of Policy - Interagency Notification and Coordination of Enforcement Actions by the Federal Banking Regulatory Agencies