INTRODUCTION

While the use of reason and moral suasion remain the primary corrective tools of the FDIC, the Board of Directors has been given broad enforcement powers under Section 8 of the FDI Act. The Board has the power to terminate insurance (Section 8(a)), to issue Cease and Desist Actions (Section 8(b)) and, if deemed necessary, to immediately invoke a temporary Cease and Desist Action (Section 8(c)). In addition, the Board has been given the power to suspend or remove a bank officer or director or prohibit participation by others in bank affairs when certain criteria can be established (Sections 8(e) and (g)). Each of these powers and their scope and limitations are more fully discussed below.

The Board of Directors has delegated certain Section 8 actions, in accordance with Part 303 of the FDIC Rules and Regulations, to various levels within the Division of Supervision and has retained certain authorities for itself.

To assure greater uniformity of action and help assure that supervisory efforts are directed to banks most in need of them, the Division of Supervision has adopted a policy that presumes either a formal or informal administrative action will be taken on banks with Composite Uniform Bank Ratings of 3, 4 or 5 unless specific circumstances argue strongly to the contrary.

The composite 3 rating implies that a bank has weaknesses which, if not corrected, could worsen into a more severe situation. Remedial action is therefore appropriate. The Division's policy is that if formal administrative action under Section 8 of the FDI Act is not taken against insured State nonmember banks rated 3, the Regional Director shall generally (exceptions are allowed under certain circumstances) take action through use of a memorandum of understanding, an informal administrative action which is discussed in its own section of this Manual.

Banks with composite ratings of 4 or 5 will, by definition, have problems of sufficient severity to warrant formal action. Therefore, the policy of the Division of Supervision is that it shall take formal action pursuant to Section 8 of the FDI Act against all insured State nonmember banks rated 4 or 5, where evidence of unsafe or unsound practices is present. Such formal action will normally consist of either a Cease and Desist Order under either Section 8(b) or 8(c) or initiation of insurance termination proceedings under Section 8(a). Exceptions to the policy may be considered when the condition of the bank clearly reflects significant improvement resulting from an effective corrective program or where individual circumstances strongly mitigate the appropriateness or feasibility of this supervisory tool. For example, acceptable action by the State authority might preempt the need for FDIC action, or qualified new management might allow the use of an informal memorandum of understanding instead of a Cease and Desist Order. Mere belief that bank management has recognized the problems and will implement corrective action is not a sufficient basis to preclude action if the bank is still deemed to warrant a composite rating of 3, 4 or 5.

REPORTS OF EXAMINATION CONTAINING A BASIS FOR SECTION 8 CHARGES

Because of the seriousness of making Section 8 charges against a bank, it is mandatory that an examiner consult with the Regional Office before submitting a report of examination containing the basis for possible Section 8 charges. In preparation of a report where the examiner believes Section 8 action is or may be warranted, the following guidelines should be observed:

1. Only the FDIC's Board of Directors is authorized to make a finding of "unsafe or unsound". Therefore, examiners should avoid the use of the statutory words "unsafe or unsound" in the examination report. Synonyms and other descriptive terms such as "undesirable, unacceptable and objectionable practices" are permissible.

2. Examiners should present their findings in the report on the Examination Conclusions and Comments schedule in a manner and format consistent with the guidelines and instructions found in the Report of Examination Instructions. In a separate memorandum to the Regional Director, examiners should detail each specific "Undesirable and Objectionable Practice" regarded as unsafe or unsound, and the facts upon which that conclusion is based should be listed and discussed in the order of importance under appropriately descriptive subheadings and captions. Where violations of law or regulations are also present, they should be discussed under a separate subheading. All relevant facts concerning these areas should be addressed, and reference should be made to specific schedules in the report where full details are presented. In addition, the memorandum should include any statement made by the bank's directors and/or officers either supporting any charge made by the examiner or showing any corrective action. It is also valuable to quote the facts and circumstances from previous examination reports, letters from the Supervisory Authority to the bank, and letters of

inquiry regarding correction of criticisms from the Regional Director, so that examiners call attention to incomplete corrective promises of management. Examiners should also comment when the "Undesirable and Objectionable Practices" violate the provisions of the bank's board established formal policies.

3. Examiners should detail in the memorandum to the Regional Director their suggested measures to correct the "Undesirable and Objectionable Practices". Examples of corrective measures are offered under "UNSAFE OR UNSOUND PRACTICES" in this section. Such measures should be tailored to the situation and not impossible to perform within the given time frame. Care should be taken to ensure that recommended corrective actions are detailed for each "Undesirable or Objectionable Practice" reflected in the memorandum. Conversely, corrective measures which do not relate to the specific "Undesirable or Objectionable Practice" should not be recommended for inclusion in a corrective order.

4. The memorandum to the Regional Director should contain specific comments and recommendations relative to the existing management situation. In some cases, existing management may be considered adequate to solve the problems facing the institution, although a redirection or a clarification of authority may be necessary. If present management is not considered satisfactory, the examiner should comment upon such matters as

   a. the addition of independent outside directors and a chief executive officer, senior lending officer, or other appropriate senior officer with defined authority;
   b. the establishment of appropriate lines of authority, suitable board committees with outside director representation, and additional board policies for guidance of bank management;
   c. the implementation of board follow-up procedures to assure compliance with directives and established policies;
   d. the restriction of particular authorities of specific officers;
   e. the potential need for the directorate or an outside consultant to assess active management and/or the board; or
   f. any other managerial situations particular to the institution's circumstances.

5. The memorandum to the Regional Director should include the names and home addresses of any individuals the examiner believes should be named in a formal action to facilitate service on such individuals. The facts supporting the examiner's opinion should be provided in the memorandum as well as the Report of Examination.

6. If information needed to fully support the examiner's recommendations cannot be obtained through customary examination techniques, the Regional Office should be apprised of the situation as soon as possible; if the matter remains unresolved, the examiner should so indicate in the memorandum, and the Regional Director may consider possible use of the more formal investigative procedures under Section 10(c) of the FDI Act.

7. Examiners recommending Section 8 actions should be mindful that these 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 an agency of the Federal government may be able to recover their litigation expenses from the agency if the position of the agency in the proceeding was not substantially justified. Examiners should use special care not to charge any practice or violation on inadequate grounds. Examiners should also be mindful that the memorandum comments may be a matter of record at any required hearing. Comments and observations in the memorandum must be well-supported by substantial evidence and be able to stand up under cross-examination in a hearing.

8. The report of examination generally serves as the FDIC's primary evidentiary exhibit in Section 8 proceedings. Therefore, it should be both factually and statistically correct, free of inconsistencies, and should not contain inflammatory remarks nor personal comments or observations not pertinent to evaluation of the bank or its management. Gratuitous remarks are to be avoided. Criticisms and comments set forth in Examination Conclusions and Comments should be realistic and must be well-supported. Classifications should be reasonable, not arbitrary, and likewise well-supported. Classifications of related lines or lines dependent upon the same source of repayment or strength should be consistent. The same is true where action is recommended against related banks with participations in the same loans. Reports of examination containing the basis for Section 8 recommendations should receive special priority in terms of field examination work and Regional and Washington Office processing.

9. When it is anticipated Section 8(b) cease and desist action against a bank will be recommended, the

examiner should consult with the Regional Office prior to discussing the possibility with the bank's board. Documentation of notification to the bank's board of directors should be included in the memorandum to the Regional Director.

10. When it is anticipated Section 8(e) removal action may be taken, the examiner should consult with the Regional Office, including Regional Counsel, as directed. It is especially important that the report or other documentary evidence support the charges issuing the Notice, particularly as they pertain to actions of the respondents.

Upon receipt in the Regional Office of an examination report containing the basis for Section 8 charges, the Regional Director, if in agreement after giving consideration to the surrounding circumstances and the merits of the examiner's contentions, may take certain actions under delegated authority. If delegated authority does not exist, the Regional Director should forward the report, and the applicable memorandum from the examiner to the Washington Office with a separate letter or memorandum containing the Regional Director's recommendation and pertinent legal documents (Notice and Order).

UNSAFE OR UNSOUND PRACTICES

General

The concept of unsafe or unsound practices is one of general application which touches upon the entire field of operations of a banking institution. It would, therefore, be virtually impossible to catalog with a single all-inclusive or rigid definition, the broad spectrum of activities which are included by the term. Thus, an activity not necessarily unsafe or unsound in every instance may be so in a particular instance when considered in light of all relevant facts pertaining to that situation.

Like many other generic terms widely used in the law, such as "fraud", "negligence", "probable cause", or "good faith", the term "unsafe or unsound practices" has a central meaning which can and must be applied to constantly changing factual circumstances. 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 result in abnormal risk of loss or damage to an institution, its shareholders, or the insurance fund administered by the FDIC.

Practices Deemed "Unsafe or Unsound"

"Unsafe or unsound practices" can result from either action or lack of action by management. The FDI Act does not define the term "unsafe or unsound practices," but the FDIC's Board of Directors, in previous Section 8 proceedings, has established examples of such practices, some of which are listed below.

Lack of Action Deemed "Unsafe or Unsound"

1. Failure to provide adequate supervision and direction over the officers of the bank to prevent unsafe or unsound practices, and violation(s) of laws, rules and regulations.
2. Failure to make provision for an adequate allowance for loan losses.
3. Failure to post the general ledger promptly.
4. Failure to keep accurate books and records.
5. Failure to account properly for transactions.
6. Failure to enforce programs for repayment of loans.
7. Failure to obtain or maintain on premises evidence of priority of liens on loans secured by real estate.

Actions Deemed "Unsafe or Unsound"

1. Operating with an inadequate level of capital for the kind and quality of assets held.
2. Engaging in hazardous lending and lax collection practices which include, but are not limited to, extending credit which 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.
3. Operating without adequate liquidity, in light of the bank's asset and liability mix.
4. Operating without adequate internal controls including failing to maintain controls on official checks and unissued certificates of deposit, failing to segregate duties of bank personnel, and failing to reconcile differences in correspondent bank accounts.
5. Engaging in speculative or hazardous investment policies.
6. Paying excessive dividends in relation to the bank's capital position, earnings capacity and asset quality.

Conditions Considered "Unsafe or Unsound"

As in the case of unsafe or unsound practices, it is impossible to define precisely what constitutes an unsafe or unsound condition because the condition of the bank is dependent upon an analysis of virtually every aspect of the

bank's operation and position within a given time frame. At a minimum, the bank's capital position, asset condition, management, earnings posture and liquidity position must be carefully evaluated. While precise definition of unsafe or unsound condition is not possible, it is certain that a bank's condition need not deteriorate to a point where it is on the brink of insolvency before its condition may be found to be unsafe or unsound.

The following have been found to evidence unsafe or unsound conditions by the FDIC's Board of Directors:

1. Maintenance of unduly low net interest margins.
2. Excessive overhead expenses.
3. Excessive volume of loans subject to adverse classification.
4. Excessive net loan losses.
5. Excessive volume of overdue loans.
6. Excessive volume of nonearning assets.
7. Excessive large liability dependence.

Violations of Law, Regulation, Condition, or Order

Charges arising from violations of law, regulation, a written condition imposed by the FDIC in connection with a request by the bank or applicable Order are, as a general rule, definite and ascertainable and, therefore, generally more readily proven than charges based on unsafe or unsound practices.

Many violations are subject to legal interpretation, therefore, the term "apparent violation" is necessary to describe action or inaction which the examiner believes to be in contravention of law or regulation. Great care should be exercised in listing violations. The erroneous designation of conduct as a violation tends to discredit the report of examination and detract from its value as evidence. It may also tend to discredit the examiner on cross-examination at a hearing. If examiners are not reasonably certain a violation exists, they should promptly report the facts to the Regional Office and be guided by the advice received therefrom in the preparation of the report of examination.

Corrective Actions

In addition to setting forth the unsafe or unsound practices, conditions, and violations, the examiner should also detail in the memorandum to the Regional Director suggested measures, including appropriate time frames, to correct such practices, violations and conditions. These steps and the measurement of compliance therewith should be able to be accomplished within the time frames established. The requirements for compliance must be stated in unambiguous terms. Only those weaknesses requiring corrective action should be detailed in the memorandum to the Regional Director. It is generally not desirable to include provisions which require the Regional Director to make subjective judgments regarding correction. The following examples illustrate corrective measures for various unsafe and unsound practices, conditions, and violations:

1. If inadequate capital is evident, the amount of capital needed will be stated. This amount can be a ratio, e.g., Restore a _____% capital-to-asset ratio, or a dollar amount of new capital funds or a capital level, e.g., Increase capital and reserves to not less than ______and maintain. This particular corrective measure is one where precision in terminology mentioned immediately above may be illustrated. That is, should it be the desire to preclude the sale of preferred stock in an Order to sell new capital, the Order should indicate "sell new common stock" if that is what is actually intended.

2. If the bank has provided an inadequate allowance for loan losses, a requirement that the bank review the current balance of its allowance and make such entries as are necessary to provide an allowance that is adequate in light of the condition of the loan portfolio at that time will be included. The Board further requires that, in reviewing the adequacy of the allowance, consideration be given to the volume and severity of adverse loan classifications at the most recent examination. The bank's basis for adjustment to the allowance should be reduced to writing and provided to the regulatory authorities for review. Quarterly reevaluations are generally required. Except in unusual circumstances, Section 8(b) Orders should include some provision that the bank establish and maintain an adequate allowance for loan losses and that such allowance be established by charges to current operating income. In addition, a requirement that the bank provide accurate financial reporting prospectively and/or submit amended Reports of Condition or Income to correct previous inaccuracies should be included.

3. If the bank has operated with hazardous lending and collection policies, a requirement to cease and desist from such practices should be included. Such a requirement would normally establish a listing of conditions for extending credit. These might include: obtaining documents necessary to perfect the bank's lien and evaluate its priority; obtaining and maintaining current financial information on unsecured credits; and establishing a repayment

program consistent with the loan's purpose, security and source of repayment. In addition, development and implementation of formal lending policies have been required as have mandated reductions in the volume of classified assets.

4. If the bank was extending credit with inadequate diversification of risk, a requirement that credit extensions to any person or related interests of such person, be limited to % of the bank's Tier 1 capital should be included.

5. If the bank is operating without adequate liquidity, an order should contain a prohibition on the extension of credit, as defined in Section 215.3 of Federal Reserve Regulation O, during any month in total amounts exceeding __% of the total reduction in principal of outstanding loans during the month prior, unless the bank's total loans (exclusive of unearned income) are less than ______% of total deposits and the net cash, short-term and marketable assets exceed % of net deposits and short-term liabilities, calculated in accordance with current FDIC procedures. Establishment of formal asset-liability management policies has also been required.

6. If inadequate internal controls are evident, affirmative action to correct the specific weaknesses, hiring of a qualified operations officer, and contracting for an outside audit to include direct verification may be required.

7. If the bank is operating at a deficit, formulation and implementation of a comprehensive budget for two years for all categories of income and expense will be necessary. Also, appointment of a committee to supervise adherence to budgetary requirements and review items of bank expense has been directed.

8. If the institution is paying excessive dividends, prior written approval of the Regional Director before payment of dividends should be included. Similar prohibitions have frequently been established when a dollar amount of new capital funds is required.

9. If the board of directors is dominated by related individuals, officer directors, or directors whose dependence on the bank for credit compromises their effectiveness as directors, a requirement to change the composition of the board to a point which will reduce the impact of such individuals on the policies of the bank should be included. Each situation is unique; however, changes in the board to bring outside directors to at least 50% of the total board should be a goal. Furthermore, representation on influential committees should include a majority of outside directors.

As previously indicated, action under Section 8 constitutes a formal adversarial administrative action against the bank. The burden of proof for all charges rests with the FDIC. Examiners should be aware that lengthy time periods can elapse from completion of the examination to the date of a formal hearing. The examination report must contain all pertinent facts in support of each charge in order to better serve examiners should they be called as witnesses at a hearing. Examination workpapers may be used as evidence or to refresh the examiner's memory prior to giving testimony. Particular care should be taken to ensure that those workpapers are legible and consistent with the report. They should be stored under appropriate safeguards until the Order is lifted or the proceeding otherwise terminated.

SECTION 8(a) - TERMINATION OF INSURANCE

General

Section 8(a) provides an effective method by which the FDIC's Board of Directors can require insured banks to cease unsafe or unsound practices and violations and restore the bank to a safe and sound condition. The consequence of non-compliance, namely termination of insured status, is severe. The principal objective of Section 8(a), however, is to secure necessary corrections and not to terminate a bank's deposit insurance.

Authority to terminate a bank's insured status under Section 8(a) carries with it a grave responsibility. Deposit insurance is valuable and its loss would have serious adverse effects on any bank. National banks which lose their insured status must be closed, and many State banking codes contain similar provisions. Equity as well as logic mandate that, in any case, Section 8(a) be applied judiciously, with fairness, without haste or prejudice, and only after all other means for accomplishing correction have proven unsuccessful or where the condition of the institution is so severe as to preclude an attempt at correction through other means.

Outline of Section 8(a) and FDIC Procedure

In order for examiners to have a clear understanding of their part in cases involving Section 8(a), the applicable provisions of the FDI Act and an outline of the FDIC's procedures are offered.

Initiation of Proceedings - Section 8(a) provides that when the FDIC finds (1) an insured bank or its directors or trustees have engaged or are engaging in unsafe or unsound practices; (2) an insured bank or its directors or trustees have violated an applicable law, rule, regulation, order, or any condition imposed in writing by the FDIC in connection with the granting of any request by the bank, or any written agreement entered into with the FDIC; or (3) an insured bank is in an unsafe or unsound condition to continue operations as an insured bank, the FDIC, for the purposes of securing correction thereof, gives a notification regarding such practices, condition, or violations to the appropriate supervisory authority. Notification is provided to the Comptroller of the Currency in the case of a National or District bank, the relevant state authority having supervision over a bank or savings association in the case of a State-chartered institution, the Federal Reserve System in the case of a State member bank, and the Office of Thrift Supervision in the case of a savings association.

This "notification" specifies the violations, the unsafe and unsound practices, and conditions complained of in the form of findings; these are generally drawn from the reports of examination or a Report of Condition.

Such reports and the testimony of the examiners concerned constitute the bulk of evidence upon which the FDIC must rely to sustain the validity of the findings or charges made. Consequently, it is of the utmost importance that examination reports be accurate and that the facts are set out in detail and in clear, unambiguous form.

Should the decision be made that circumstances warrant termination of insurance, the FDIC gives the institution not less than 30 days written notice of its intention to terminate the institution's insured status and fixes a time and place for a hearing.

Hearing

Any hearing under Section 8(a) is a formal adversarial proceeding and held pursuant to the applicable provisions of the Administrative Procedures Act and Part 308 of FDIC Rules and Regulations. Failure of the bank to appear at the hearing is deemed as consent to the termination of its insured status. The hearing is presided over by an Administrative Law Judge and is comparable to a trial without a jury in U.S. District Court. Unless the bank chooses not to litigate the matter, the FDIC has the burden of proving the allegations made in the Findings through the production of evidence at the hearing. The FDIC's evidence generally consists of the reports of examination mentioned previously and the testimony of examiner personnel. However, any and all relevant evidence, such as the examiner's memorandum to the Regional Director, pertinent bank records and admissions made by directors, officers and other personnel of the bank, may be used as appropriate. The bank may be represented by counsel who has the right to cross-examine FDIC witnesses and present evidence in rebuttal or in mitigation of the FDIC's allegations. From the evidence adduced, the Administrative Law Judge recommends a decision to the Board of Directors. The Board of Directors then makes its final written findings and Order of disposition based upon the entire record of the evidence produced at the hearing. It should be noted this same procedure is utilized as regards hearings held under Section 8(b) of the FDI Act.

Bases for Section 8(a) Action

An institution's insured status may be terminated on the following grounds:

1. the institution or its directors or trustees have committed unsafe or unsound practices;
2. the institution or its directors or trustees have violated a law or regulation to which the bank was subject, a written condition imposed by the FDIC in connection with the granting of an application or other request of bank, or any written agreement entered into with the FDIC;
3. the institution is in an unsafe or unsound condition to continue operations.

Limiting the use of Section 8(a) powers as indicated is especially appropriate in light of the FDIC's intermediary enforcement powers now available under its cease and desist authority contained in Sections 8(b) and (c) of the Act.

Although the statutory language does not require it, Section 8(a) actions primarily occur when other available administrative remedies have proven unsuccessful in obtaining needed correction and/or when the bank's condition is unsafe or unsound. Section 8(a) charges are generally limited to those where immediate action is needed for the bank to continue as a viable entity. Other "unsafe or unsound practices" may be corrected through use of other administrative actions. Therefore, the Findings and Order for Section 8(a) actions are generally far more brief than those for Sections 8(b) or (c) actions.

CEASE AND DESIST PROCEEDINGS

General

As stated above, commencement of a proceeding to terminate the insured status of a bank should generally be used only after all other avenues have failed to induce an insured bank to discontinue unsafe or unsound practices or violations of law or regulation and restore the bank to a safe and sound condition. The severity of the ultimate penalty implicit in any 8(a) action limits its use as a remedial supervisory instrument.

Congress has given the FDIC and the other Federal bank supervisory agencies additional and intermediary powers with respect to banks engaging in or about to engage in, among other things, unsafe or unsound practices or violations of laws or regulations. This authority permits the use of "Cease and Desist" orders in situations where available facts and evidence reasonably support the conclusion that a bank is engaging in or about to engage in, an unsafe or unsound practice or violation of law. By ordering it to cease and desist from such practices and/or take affirmative action to remedy the conditions resulting therefrom, a bank's condition may be prevented from reaching such serious proportions as to require the more severe measures imposed by Section 8(a).

Section 8(b) Cease and Desist Proceedings

Section 8(b) provides that the FDIC may issue and serve a Notice of Charges upon a State nonmember insured bank in the following instances:

1. The bank is engaging, or has engaged, in unsafe or unsound practices;
2. The bank is violating, or has violated, a law, rule, or regulation, or 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
3. There is reasonable cause to believe the bank is about to do either of the above.

The Notice contains a statement of facts relating to the practices or violations and fixes a time and place for a hearing to determine whether a Cease and Desist Order shall be issued.

A Cease and Desist Order is issued after the hearing, if one is held. The Order becomes effective 30 days after it is served upon the bank, or at the time indicated if issued upon consent of the bank. It remains in effect, as issued, until modified or terminated by the FDIC, or stayed or set aside by a reviewing court. Such an Order can be issued against the bank or any director, officer, employee, agent or other person participating in the conduct of the affairs of such bank.

Section 8(b) permits the FDIC to order an insured bank and its directors, officers, employees, and agents to cease and desist from certain practices and violations and take affirmative action to correct the conditions resulting therefrom. The failure of a bank to comply with any Cease and Desist Order which has become final can be the basis for subsequent Section 8(a) termination of insurance action. 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 bank or any officer, director, employee or other person participating in the conduct of the affairs of such bank. (Refer to the Civil Money Penalties section of this Manual).

In preparing recommendations for Section 8(b) or Section 8(c) proceeding, notification should be made to the State authority and the other Federal regulatory agencies. The views of the State authority regarding the need for the action and the appropriateness of the corrective actions should be sought. Such a contact may be made telephonically; however, a written reply should be requested. Failure to advise the State authority does not affect the legality of action taken under either Section 8(b) or 8(c).

Evidence Required - Section 8(b) provides that the FDIC need only be of the opinion that an insured bank is engaging in, or has engaged in, any of the aforementioned practices or violations, or has reasonable cause to believe that the bank is about to engage in such activities. However, mere suspicion is not sufficient grounds to institute this enforcement proceeding. Any such action must rationally be based on facts and evidence, as the FDIC has the burden of proving formal charges set out in a Notice of Charges. Consequently, documentation in the files of requests made of management, promises by bank officials, and conferences with bank directors and/or officers is a primary necessity. Furthermore, if bank records are needed to establish any of the charges, copies of those records should be made and retained as part of the necessary documentation in the case. When used in connection with any Section 8(b) proceeding, the report of examination should be prepared in accordance with the instructions detailed under Section II.

Actual Commission of an Unsafe Act Not Required - An important aspect of the use of Section 8(b) proceedings is that it permits the FDIC to prevent the commission of an unsafe or unsound practice or violation. It may thus be used to prevent a developing situation from reaching serious proportions. Assume for example that four banks are owned or controlled by the same group of individuals and that the owners have, through various self-dealing

transactions, misused three of these banks but have not yet similarly abused the fourth bank. The FDIC in this situation could, through a Cease and Desist Order, likely ban all loans and fees to the ownership or controlling interest. This prohibition would apply not only to the three abused banks but also the fourth, even though no self-dealing had as yet transpired with regard to that institution. The basis for the Order against the fourth bank would rest on reasonably held belief by the FDIC that, because of the abusive self-dealing transactions committed by the owners with regard to the other related banks, similar unsafe or unsound practices would occur at the remaining bank.

Enforcement of Affirmative Corrective Acts - Under Section 8(b), the FDIC may both prohibit unsafe or unsound practices or violations of law and also require that affirmative steps be taken to correct the conditions resulting from previous violations or unsafe or unsound practices. For example, if the bank is being operated with an excessive amount of Substandard loans as a result of unsafe or unsound lending policies, a Cease and Desist Order issued pursuant to Section 8(b) could require the bank to take affirmative action to reduce the dollar volume of such loans to an amount specified in the Order.

Consent Cease and Desist Orders - Under Section 8(b), the FDIC attempts to obtain a Consent Cease and Desist Order in an effort to eliminate the need for time-consuming administrative hearings. The Consent Cease and Desist procedure is premised upon agreement to a stipulation between the representatives of the FDIC and the bank's board of directors whereby the bank agrees to the issuance of a Cease and Desist Order without admitting or denying that any unsafe or unsound practices and/or violations of law or regulation have occurred. The effect of this procedure is to reduce the time period between initial review of the case and the date on which an enforceable and binding Cease and Desist Order is issued. Concurrence of the State supervisor is sought; however, failure to obtain such concurrence is no reason to discontinue the pursuit of Section 8(b) action. The responsibility for negotiating a stipulation with the bank's board of directors is that of the Regional Counsel and other Regional Office representatives. The stipulation provides for waiver by the bank of its rights to a hearing and its consent to an agreed-upon Consent Cease and Desist Order. Once a stipulation is obtained, the Regional Counsel certifies in writing that the bank has been advised of its rights to a Notice of Charges and the directors or their chosen representative sign the stipulation. The Legal Division is responsible for certifying the legal sufficiency or for notifying the Division of Supervision of the legal insufficiency of the documents relating to Consent Cease and Desist Orders. After finalization of a stipulation, the FDIC issues the Order. If a satisfactory stipulation cannot be agreed upon, the FDIC gives notice of the time and place for a hearing.

Recommendation for Action - Recommendation for institution of Section 8(b) action is not necessarily dependent upon an examination of the bank or, if a bank is being examined, upon completion of a report of examination. If sufficient evidence is otherwise available, there is little or no reason to wait for an examination of the bank or completion of a report of examination before institution of Cease and Desist action. Care should be taken, however, to ensure that all unsafe or unsound practices evident have been addressed and are fully documented. Any report of examination and/or memorandum to the Regional Director should include as many detailed facts pertaining to the alleged practices or violations as is reasonably possible.

Determination of Compliance - The periods for compliance with the various provisions of a Cease and Desist Order are determined individually and may range from 30 days to 12 months, or more from the effective date of the Order. Virtually every Cease and Desist Order specifies intervals setting forth the form and manner of compliance with the substantive requirements of the Order. While reports prepared by the institution assist in monitoring progress with provisions, examinations will serve to determine compliance with the Order.

In the Compliance With Enforcement Actions schedule in the report of examination, the examiner must document in a factual manner and without statement of opinion the steps taken to comply with the Order. However, the examiner does not draw conclusions regarding the institution's compliance or noncompliance with the provisions of the Order. Refer to the Report of Examination Instructions for additional guidance.

Section 8(c) Temporary Cease and Desist Proceeding

The discussion of Section 8(b) actions reflects the FDIC's desire to obtain a Consent Cease and Desist Order to eliminate the need for time-consuming administrative hearings. The time frames involved in obtaining even a Consent Cease and Desist Order can be lengthy and may allow additional damage to be suffered by the bank from "unsafe or unsound practices". Section 8(c), however, provides the FDIC with the power to act with the utmost speed when the facts so dictate.

This portion of the Act provides that the FDIC may issue a Temporary Cease and Desist Order whenever the FDIC

determines the violations or threatened violations or unsafe or unsound practices specified in the Notice of Charges are likely to cause insolvency or substantial dissipation of assets or earnings of the bank, or otherwise seriously prejudice the interests of the depositors prior to the completion of action under Section 8(b).

Such an Order, accompanied by a Notice of Charges, can be issued against the bank or any director, officer, agent or other person participating in the conduct of the affairs of such bank. 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 Section 8(b) action.

Within 10 days after service of a Temporary Cease and Desist Order, the bank or such director, officer, employee, agent, or other person named may apply for an injunction setting aside, limiting or suspending the enforcement, operation or effectiveness of such Order. These actions will generally be held in U.S. District Court for the judicial district in which the home office of the bank is located or U.S. District Court for the District of Columbia.

Because of the nature of the action, recommendations for such actions and support thereof are frequently developed without benefit of a completed report of examination. In those cases, a visitation report, memorandum or letter will discuss the practices and violations and their probable effect on the bank. An examiner should immediately contact the Regional Office to discuss the possible need for Section 8(c) action when a situation is discovered in which a 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).

SUSPENSION AND REMOVAL PROCEDURES

Section 8(e)

Examiners should be alert for situations where Section 8(e) may be applicable and promptly communicate with the Regional Office for guidance. It is vital that the examiner, the Regional Director or designee, and the Regional Counsel communicate with each other so that the decision on whether to proceed with a Section 8(e) action can be made while the examiner is still in the bank. It is especially important that the report or other documentary evidence be supportive of charges, particularly as they may pertain to the actions of the respondent.

Section 8(e) gives the FDIC the power to order the removal of an institution-affiliated party (director, officer, employee, controlling stockholder, independent contractor, etc.) from office. It also allows the FDIC to prohibit the party from participating in the conduct of the affairs of any insured depository institution. Section 8(e) action may be taken only when it is determined, after notice and hearing, that

1. The institution-affiliated party has 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 institution; OR engaged in an act, omission or practice which constitutes a breach of fiduciary duty; AND
2. By reason of the violation, practice, or breach, the insured depository 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 party has received financial gain or other benefit; AND
3. The violation, practice or breach involves personal dishonesty on the part of the institution-affiliated party OR demonstrates willful or continuing disregard for the safety and soundness of the institution.

This section of the statute further permits removal or prohibition of an institution-affiliated party based on actions or consequences in connection with a business institution. More specifically, Section 8(e) proceedings may be based, in part, on participation of such party in an unsafe or unsound practice in connection with a business institution, actual or probable financial loss or other damage suffered by a business institution, or willful or continuing disregard by such party for the safety and soundness of a business institution. In addition, an institution-affiliated party can be immediately suspended or prohibited from participation in any manner in the conduct and affairs of the bank pending completion of proceedings regarding removal if the FDIC deems it necessary for the protection of the bank or the interests of the bank's depositors. Similar to proceedings under Section 8(c), an emergency suspension or order of prohibition remains effective pending completion of proceedings unless the person affected applies within 10 days for stay of such suspension and/or prohibition. Notification of anticipated Section 8(e) action should be made to the State authority and the opinion of the State authority regarding the appropriateness of the action should be sought. Failure to notify the State authority, however, does not affect the legality of the action taken under Section 8(e).

A notice of intention to remove a director, officer, or other person from office or to prohibit participation in the conduct of affairs of an insured bank contains a statement of the facts constituting grounds therefore and fixes a time and place for a hearing. This hearing must be held not earlier than 30 days nor later than 60 days after the date of service of such notice. Copies of the notice should also be served upon the bank of which the individual is a director, officer or associated person.

Within 10 days after any director, officer or other person has been suspended from office and/or prohibited from participation in the conduct of the affairs of an insured bank under Section 8(e)(3) (emergency suspension or order of prohibition), such director, officer, or other person may apply to the U.S. District Court for the judicial district in which the home office of the bank is located or the U.S. District Court for the District of Columbia for stay of such suspension and/or prohibition pending completion of the administrative proceedings.

For the purpose of enforcing any law, rule, regulation, or Cease and Desist Order in connection with an interlocking relationship, the term "officer" as used in this section has been defined as an employee or officer with management functions. The term "director" includes an advisory or honorary director, a trustee of a bank under the control of trustees, or any person who has a representative or nominee serving in such capacity.

Section 8(g)

Under Section 8(g), the FDIC may suspend an institution-affiliated party from office or prohibit that individual from participating in the conduct of the institution's affairs if such party is: (1) charged in any information, indictment or complaint authorized by a United States Attorney, with the commission of or participation in a crime involving dishonesty or breach of trust which is punishable by imprisonment for a term exceeding one year under State or Federal law; and (2) if continued service by the individual may pose a threat to the interests of the bank's depositors or may threaten to impair public confidence in the bank. The policy of the Division of Supervision regarding such actions is that the desirability of seeking removal or suspension will be considered on a case-by-case basis. Voluntary suspensions shall not be sought pending a decision that the FDIC is prepared to pursue formal suspension or removal under Section 8(g).

Examiners should notify the Regional Office immediately upon learning of the indictment of any director, officer, or other person participating the conduct of the affairs of an insured State nonmember bank. A copy of the indictment should be obtained and a determination made by Regional Counsel (or the Legal Division in Washington) that the indictment concerns a crime involving dishonesty or breach of trust punishable by imprisonment for a term exceeding one year under State or Federal law.

If the above determination is made, the Regional Director should review the threat posed by the individual's continued service. Relevant criteria may include the publicity expected to be generated by the case, the identification which exists between the individual and the bank, the nature of charges made in the indictment, or other relevant factors. It should be kept in mind that the FDIC must show only that an individual's continued service may threaten depositors or public confidence, but this finding must be supportable. Where the indictment relates to alleged crimes against a bank or other financial institution, it is expected that, except in rare instances, the second element of Section 8(g) will be met. Care should be taken to avoid any presumption of guilt or innocence in relation to the charges.

If it is determined that the relevant tests of Section 8(g) have been met, the individual(s) will be notified of the Region's contemplated recommendation for Section 8(g) action and offered the option of voluntary suspension. In those instances where there is voluntary suspension of the individual prior to the FDIC's learning of the indictment, the Regional Director will request a letter from the individual indicating resignation from office and/or a pledge of nonparticipation in any manner in the affairs of the bank.

Should formal action prove necessary, the FDIC will serve a written notice of the action upon the party and a copy of the notice upon the bank. The notice will suspend from office and/or prohibit the individual from further participation in bank affairs. Such suspension or prohibition will remain in effect until the indictment, etc., is finally disposed of or until the Order is terminated.

In the event of conviction and unavailability of further appellate review, the FDIC may serve an order removing the individual from office or prohibiting the individual from further participation in the conduct of bank affairs without the consent of the FDIC. A finding of not guilty, however, will not preclude the FDIC from removal proceedings under Section 8(e).

Within 30 days from service of any notice of suspension or order of removal, the involved person may request an opportunity to appear before the FDIC to show that continued service to the bank or participation in its affairs is not likely to pose a threat to the interests of a bank's depositors or threaten to impair public confidence in the

bank. Upon receipt, the FDIC shall establish a time for 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.

USE OF WRITTEN AGREEMENTS AND CAPITAL DIRECTIVES

The following are guidelines for implementing the requirements of the FDIC's capital regulation, Part 325 of the Rules and Regulation. In these guidelines, references to the "minimum capital requirements" for a bank mean either (a) a Tier 1 capital ratio of not less than 3.0% of total assets if the FDIC determines that the institution is not anticipating or experiencing significant growth and has well-diversified risk, excellent asset quality, high liquidity, good earnings, and, in general, is considered a strong banking organization, rated a composite 1 under the Uniform Financial Institutions Rating System or (b) a Tier 1 capital ratio of 3.0% of total assets plus an additional cushion of 100 to 200 basis points (a Tier 1 capital ratio of not less than 4% of total assets).

In addition to the minimum leverage capital standards, state nonmember banks are expected to maintain a minimum risk-based capital ratio of 8 percent, with at least one-half of that total capital amount consisting of Tier 1 capital.

Written Agreements

Part 325 states that any insured bank with a Tier 1 leverage capital ratio of less than 2% is operating in an unsafe or unsound condition. In such a case, the FDIC may, but is not required to, bring a Section 8(a) action against the bank. A bank with less than a 2% capital ratio will not be subject to Section 8(a) action because of its Tier 1 leverage capital ratio if it has entered into and is in compliance with a written agreement to increase its Tier 1 leverage capital ratio to the level deemed appropriate by the FDIC and to take whatever other action is necessary for the bank to be operated in a safe and sound condition. For an insured depository institution which is not a State nonmember bank, the written agreement must be between the bank and its primary Federal regulator with the FDIC a party to the agreement.

The use of a written agreement should normally be reserved for a bank whose problems are limited essentially to a capital deficiency that has not been caused by the unsafe and unsound practices of its management. Hence, within this narrow meaning of the term, a written agreement is not a substitute for other forms of enforcement action, but is intended to be used only when Section 8(a) or Section 8(b) action or a capital directive against a particular bank is not justified or practical. Thus, if the condition of a bank is so unsatisfactory that a termination of insurance action should be initiated, the FDIC should not seek to have the bank enter into a written agreement in lieu of taking a Section 8(a) action. Similarly, if Section 8(b) action and/or capital directive action would be called for on the basis of a bank's condition (including its capital ratios), it should be instituted by the primary Federal regulator against the bank.

When a bank's Tier 1 leverage capital ratio is less than the minimum levels and no Section 8 enforcement action or capital directive action is to be taken against the bank by its primary Federal regulator or the FDIC, as appropriate, the FDIC Regional Director should seek to cause the bank to enter into an acceptable written agreement between itself and its primary Federal regulator (with the FDIC as a party to it) or between itself and the FDIC. In the case of a State-chartered bank, the State authority should be invited to be a party to the written agreement.

Capital Directives

A capital directive is a final order issued by the FDIC to a State nonmember bank that fails to maintain capital at or above its minimum capital requirements. The FDIC does not have the authority to issue a directive to a national bank, a State member bank, or an FDIC insured Federal savings bank. The FDIC can issue a directive to a State nonmember bank. Such action can be taken in conjunction with a formal enforcement action or a memorandum of understanding or independent of other types of corrective action. A directive is to be used solely to correct a capital deficiency and it is not intended to address other weaknesses that may be present in a bank. Correction of such other weaknesses must be handled through some other form of action. Hence, in cases where it is possible to obtain a consent Cease and Desist Order that includes an appropriate capital provision, it is preferable to take Section 8(b) action instead of capital directive action. When a bank will be contesting the FDIC's Section 8(b) action, the Regional Directive may choose to also pursue a directive.

Upon determining that a directive should be issued to a State nonmember bank, the Regional Director should send a written notification of the intent to the bank. The State authority should be invited to join in this action. The

written notification to the bank should indicate the capital ratios that the bank will be required to attain and thereafter maintain and the dollar amount of capital the bank will be required to raise. The notice should also state the time period within which the bank should achieve the prescribed capital levels, a period which should generally not exceed 180 days following the issuance of the directive. After the bank has received the written notification, it has 14 days in which to mail a written response to the Regional Director indicating why the proposed directive should be modified or not issued. Within 30 days of receipt of this response and after the Region's analysis of it, the Regional Director should decide whether to proceed with the directive. If such action is to be taken, the Regional Director or Deputy Regional Director may issue the Directive.

If the bank does not respond to the written notification from the Regional Director within the prescribed 14 day period, it is deemed to have consented to the issuance of a directive. However, sufficient time should be allowed for the mailing of the notice to the bank and a response from the bank before concluding that the bank will not file a written response. The granting by Regional Directors of requests for extensions of the 14-day period for filing a response to a notice of intent is generally not contemplated. Such requests should be approved only for good cause and only when there are extenuating circumstances.

When circumstances warrant, the time period for achieving the capital requirement in a directive may be formally extended by the Regional Director or additional time to comply with a directive can be informally provided by postponing further enforcement action. The FDIC does have authority to seek enforcement of a directive in district court when appropriate.

PROMPT CORRECTIVE ACTION DIRECTIVE

Prompt corrective action is a framework of supervisory actions for insured depository institutions which are not adequately capitalized. These actions become increasing severe as an institution falls within lower capital categories. Some supervisory actions associated with prompt corrective action are mandatory; that is, the actions immediately apply to the institution as it classified in a particular category. Other supervisory actions associated with prompt corrective action are discretionary; in other words, they may be imposed by the FDIC. If the FDIC pursues discretionary supervisory action, administrative procedures defined in Section 308.2 of the FDIC Rules and Regulations must be followed.

Part 325 of the FDIC regulations automatically makes institutions subject to certain of the restrictions of the prompt corrective action provisions immediately upon receiving notice, or being deemed to have notice, that the institution falls into a particular PCA capital category. In addition, the FDIC may take further discretionary supervisory actions under PCA where such actions appear necessary to carry out the purpose of PCA.

Section 38(f)(2) of the FDI Act requires the appropriate Federal banking agency to take one or more of the actions listed in that section against institutions which are significantly undercapitalized or undercapitalized institutions which have failed to file or implement a capital restoration plan. The mandatory restrictions may be embodied in an action taken pursuant to section 8 of the FDI Act or in a PCA Directive. Regardless of the enforcement tool used to achieve the desired result, every Critically Undercapitalized institution, Significantly Undercapitalized institution, or Undercapitalized institution which has failed to file or implement an acceptable capital restoration plan, for which the FDIC is the appropriate Federal banking agency, must have a formal action in place or in process which covers the mandatory restrictions. Such formal action can only be avoided if the FDIC Board is able to make a determination that the action would not further the purpose of section 38.

ORDERS TO CORRECT SAFETY AND SOUNDNESS DEFICIENCIES

Section 39 of the FDI Act establishes a corrective program for banks that do not meet the safety and soundness standards set forth in Appendix A to Part 364 of the FDIC Rules and Regulations. Specific rules and procedures for initiating corrective action in banks that do not conform to the standards are delineated in Part 308, Subpart R of the rules and Regulations.

The FDIC may request a bank to submit a compliance plan describing the steps the bank will take to correct identified deficiencies. Banks that fail to submit a requested plan, or fail to adhere to the submitted plan, will be subject to an Order requiring correction of the deficiencies noted. In addition, the FDIC has the discretion to employ other corrective measures which are similar to those imposed by PCA provisions. These include growth restrictions, capital calls, limits on the rate of interest paid on deposits, or any other measure deemed necessary by the FDIC to effect corrective action.

The power to initiate supervisory action under Section 39 is discretionary; however, the discretion becomes limited

once a supervisory response has been introduced. Therefore, considerable care must be exercised so as not to begin a program that will result in overly harsh response to problems correctable by other means. Corrective programs for safety and soundness standards should normally be incorporated into formal and informal actions pursued against problem institutions. Such programs may also 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 bank, and/or where management has not responded effectively to similar criticisms in prior examinations.

CAPITAL PLANS

When a bank subject to FDIC supervision is determined to have capital ratios lower than those appropriate for the bank, the manner in which a capital plan is developed and submitted to the FDIC will depend largely on the nature of any other corrective measures (Section 8 action, capital directive, PCA directive, or memorandum of understanding) that will be taken. The Statement of Policy on Capital Adequacy, included in the Prentice-Hall volumes, provides interpretational and definitional guidance on how these corrective measures will be administered and enforced by the FDIC.

Those institutions which are deemed undercapitalized, significantly undercapitalized, or critically undercapitalized, as defined in Subpart B of Part 325 of the FDIC Rules and Regulations - Prompt Corrective Action, must submit a capital restoration plan to the appropriate Regional Director. This capital restoration plan must contain the following information:

- the steps the insured depository institution will take to become adequately capitalized;
- the levels of capital to be attained during each year the plan will be in effect;
- how the institution will comply with the restrictions in effect under prompt corrective action;
- the types and levels of activities in which the institution will engage; and
- other information as required.

Further, the FDIC may not accept a capital restoration plan unless the company having control of the institution has:

- guaranteed that the institution will comply with the plan until the institution has been adequately capitalized on average during each of four consecutive calendar quarters; and
- has provided appropriate assurances of performance.

This restoration plan must be filed within 45 days of the institution becoming undercapitalized.

Capital plans developed for any reason may describe the means and timing by which the institution will achieve its minimum capital requirements and may address one or more of the following areas: earnings, dividend policy, controlled growth, elimination of excessive risk, sale of common stock, sale of other forms of stock or debt, acquisition by new owners, merger, sale of branch offices, and other asset dispositions that do not reduce liquidity or increase risk.

Approved plans are expected to reflect a return to adequate capitalization within a reasonable time period. The time frame is to be determined on a case-by-case basis, taking into account the overall reasonableness of the plan and relevant factors such as the viability of the institution and whether it is fundamentally sound and well managed.

Institutions should be asked to submit capital restoration plans which are not merely a budget of projected operations, but the culmination of in-depth strategic planning on the part of the institution's directorate. Detailed information on the potential capital sources upon which the institution is relying should be provided. Plans which rely on an overly optimistic projected ability to sell stock may be rejected if not supported by objective data or reasonable assumptions. Institutions should provide an assessment of the likelihood of success of the plan and an explanation as to why particular strategies were selected over other alternatives. It may be appropriate to request an analysis of the effect of the capital restoration plan on the institution's risk profile, particularly in light of any planned sale of liquid assets, branch offices or other asset dispositions.

For additional information and guidance for all formal enforcement actions, please also refer to:

- The Division of Supervision and Consumer Protection **Formal and Informal Action Procedures Manual**, and
- The Division of Supervision and Consumer Protection **Case Managers Procedures Manual**.