

## INTRODUCTION

By definition, institutions which have been assigned a composite 3 rating pursuant to the Uniform Financial Institutions Rating System have overall strength and financial capacity sufficient to make failure only a remote possibility. However, their weaknesses are such that if not properly addressed and corrected, deterioration could concur. The memorandum of understanding is a means of seeking informal corrective administrative action from institutions considered to be of supervisory concern, but which have not deteriorated to the point where they warrant formal administrative action. It is the policy of the Division of Supervision that matters in need of corrective action within such institutions should be addressed in the form of a memorandum of understanding. This is in lieu of the use of letter agreements, board resolutions passed at the request of the Regional Director, or other forms of bilateral or unilateral agreements. As a general rule, and as a minimum, this informal administrative action is to be considered for all institutions rated a composite 3. General use of a memorandum of understanding for composite 3 rated institutions does not rule out recourse to formal enforcement action when it is believed management is unwilling to take necessary corrective action, nor does it prohibit use of a memorandum of understanding in situations where other than a composite 3 rating is assigned.

A memorandum of understanding is usually drafted at the Regional level and jointly signed by the Regional Director, Deputy Regional Director, or an Assistant Regional Director and the institution's board of directors. In all instances, the State authority should be invited to join in these actions. Contents of a memorandum of understanding should be uniquely fashioned to address the specific problems of an individual institution. It is important that the language used in the memorandum of understanding be precise so that all parties fully understand exactly what is agreed to and expected. Use of a memorandum of understanding, as opposed to more formal action, is particularly appropriate where the Regional Office believes the problems discussed with management and the board of directors of the institution has been adequately detailed and the institution, in good faith, will move to eliminate the problems. An institution's failure to comply with the provisions of a memorandum of understanding, or continued deterioration in the areas addressed in the memorandum of understanding, may facilitate implementation of more formal administrative action in the future. After consultation with the Regional Office, examiners should discuss fully with management and the directorate the probable use of a memorandum of understanding at all examinations where a composite 3

rating is recommended. Examiners should also inform management in these cases that, should the memorandum of understanding prove ineffective in correcting the deficiencies, consideration may be given to initiation of formal administrative action at a later date.

Exceptions, which are defined as not obtaining at least a memorandum of understanding from institutions rated a composite 3, will be considered by the Regional Director when the condition of the institution clearly reflects significant improvements or individual circumstances strongly mitigate the appropriateness or feasibility of this supervisory tool. For example, an acceptable action by the State authority might preempt the need for FDIC action. Mere belief that management has recognized its error and will improve is not generally a sufficient basis for granting an exception.

At the Regional Director's discretion, the memorandum of understanding may be drafted in the field and signatures of the directors obtained at the board meeting held at the conclusion of the examination. Termination of an outstanding memorandum of understanding should be considered when the institution's overall condition has improved significantly and the institution has substantially complied with its terms. The Regional Office will coordinate any terminations with the State authority if the latter is a party to the action. Flexibility is the keynote of this action. The goal is to obtain correction by sharply focusing on the institution's problem areas and defining responsibilities for ensuring that deficiencies are addressed.

Monitoring of adherence to an outstanding memorandum of understanding may be done by any combination of progress reports, visitations or examinations. The examiner should detail each provision of the memorandum of understanding and provide sufficient details regarding the institution's action (or inaction) to allow for meaningful conclusions concerning the extent of compliance. Such statements as "Compliance indicated" or "Not in compliance", without sufficient details, are to be avoided.

Please also refer to the **Formal and Informal Actions Procedures Manual** and the Division of Supervision and Consumer Protection **Case Managers Procedures Manual** for more information concerning policies, procedures and criteria for the issuance of these memoranda.