



### EM-1.4

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#### Introduction

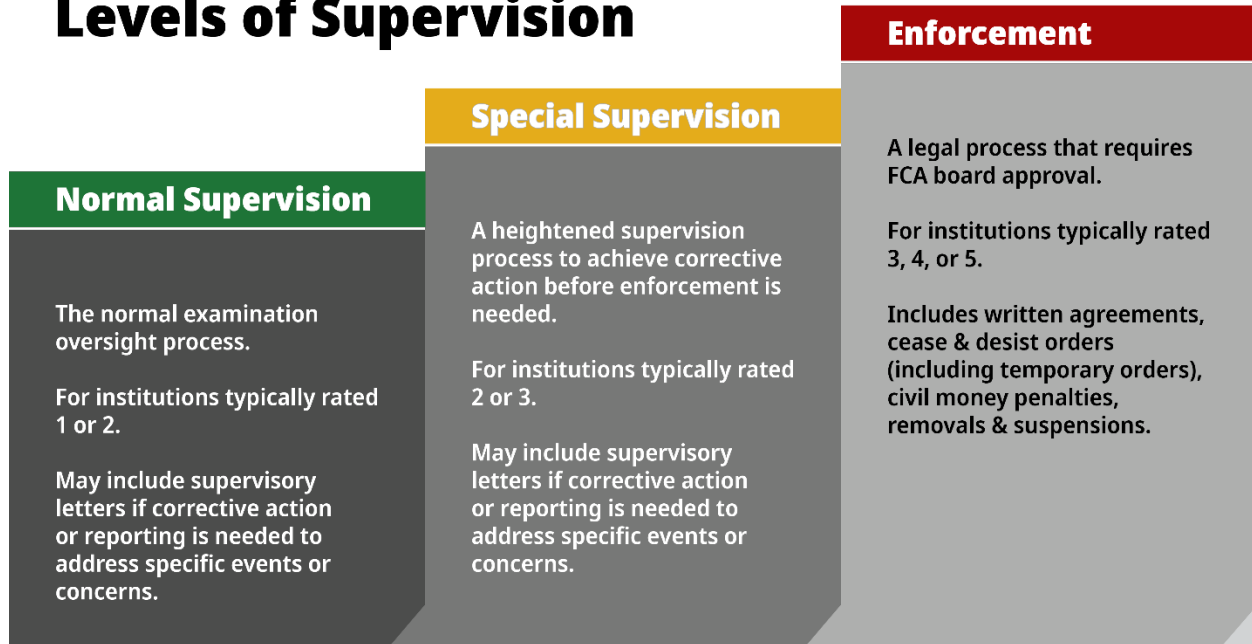
FCA's Office of Examination (OE) uses three supervision levels to differentiate its supervisory programs over Farm Credit System (System) institutions. The supervisory intensity increases commensurate with risk, unresolved corrective actions, and the board and management's willingness and ability to resolve unsatisfactory conditions, including their causal factors. Most institutions are typically under Normal Supervision; with Special Supervision and Enforcement Supervision used differentially as the risk profile increases and as FCA's confidence in the board's or management's abilities decreases. If enforcement supervision is needed, FCA has several types of enforcement authorities and other supervisory remedies available. This FCA Examination Manual section summarizes the supervision levels and each type of supervisory or enforcement action available.

*Note: All supervision and enforcement activities related to the Federal Agricultural Mortgage Corporation (Farmer Mac) are the sole responsibility of the Office of Secondary Market Oversight (OSMO). OSMO has supplemental procedures to define roles and responsibilities for supervision and enforcement activities related to Farmer Mac.*

#### Supervision Levels

OE uses three supervision levels to differentiate its supervisory programs: Normal Supervision, Special Supervision, and Enforcement Supervision. Institutions under Normal Supervision have a satisfactory risk profile and the board and management have demonstrated the ability to take corrective actions in the normal course of operations. OE uses Special Supervision to remediate weaknesses on institutions that have more significant weaknesses, but where the board and management are considered willing and able to effect corrective actions. Enforcement Supervision is used when the risk profile is unsatisfactory, and the board and management may be considered unable or unwilling to affect necessary corrective actions. Examination management and staff, in consultation with OE's Risk Supervision Division (RSD), recommends the supervision level and develop corresponding examination and supervision plans. RSD maintains primary responsibility for drafting and delivering supervisory documents. Each situation is unique and requires a customized supervisory solution. FCA Board policy, FCA Policy and Procedure Manual documents, and OE Directives or procedures provide additional guidance for examiners. The graphic on the next page highlights each supervision level.

# Levels of Supervision



## Normal Supervision

Institutions that operate under Normal Supervision are lower risk and the board and management have demonstrated they have preventive, detective, and corrective controls to resolve any identified weaknesses in the normal course of operations. These institutions generally exhibit the following characteristics:

- The Financial Institution Rating System (FIRS) composite rating is a “1” or “2”.
- The problems identified do not endanger the financial condition of the institution or materially impact its financial performance.
- The board and management are cooperative and considered willing and able to address problems in the normal course of business.

## Special Supervision

Special Supervision is used when the institution exhibits concerning conditions, but those conditions do not currently impair the institution’s safety and soundness. It is an OE process that is administered by RSD. This supervisory level allows the institution to correct negative conditions before deteriorating into an Enforcement Supervision situation. These institutions require more examination and supervisory oversight compared to institutions operating under Normal Supervision. Special Supervision is used when a board and management team are considered willing and able to correct weaknesses. The Special Supervision level may be applicable when any number of the following conditions exists:

- The FIRS composite rating is typically a “2” or “3”.
- The institution’s risk profile is considered weak and deteriorating, but its condition does not yet justify or require an enforcement action.

- Unsatisfactory conditions or practices exist that, if not promptly and sufficiently addressed, may warrant consideration of an enforcement action.
- The board and management recognize the identified safety and soundness or regulatory compliance weaknesses, are considered willing and able to correct them, and their actions are likely to resolve the concerns.
- The institution's financial profile borders at the lower end of a satisfactory range and is threatened by increasing risk.
- The institution is in default with its General Financing Agreement.

OE management, with concurrence from RSD, is responsible for determining when the institution operating under Special Supervision can be returned to Normal Supervision or recommended for Enforcement Supervision.

### **Enforcement Supervision**

Enforcement Supervision is applicable when an enforcement action is needed to correct unsafe or unsound conditions or practices or violations of law and regulations. It is a process that requires FCA Board approval. An enforcement action may include one or more supervisory actions as defined in the Farm Credit Act of 1971, as amended (the Act). These supervisory actions involve documents designed to address unsafe or unsound conditions or practices or violations of law, rule, or regulation. Generally, institutions that require Enforcement Supervision are those where any of the following conditions exist:

- The FIRS composite rating is a "3", "4", or "5".
- The institution or person is considered unable or unwilling to address a material unsafe or unsound condition or practice or violation of law or regulation.
- The institution or person is about to:
  - Engage in a material unsafe or unsound practice.
  - Commit a willful or material violation of law or regulation that exposes the institution to significant risk.
- Conditions meet the statutory criteria for the suspension or removal of a director or officer.
- Conditions meet the statutory criteria for assessing a civil money penalty (CMP) and the factors to be considered in determining the amount justify the imposition of the penalty.
- Conditions meet the statutory criteria to place the institution in conservatorship or receivership.
- An institution or person does not comply with an enforcement or supervisory document or is considered unwilling or unable to address a violation of a condition imposed in writing.

FCA will also consider other conditions not specifically defined above. Refer to [FCA Board Policy Statement 79](#) for specific criteria on when an enforcement action should be considered and referred.

## **Enforcement Authority**

Title V of the Act defines FCA's enforcement authority. Congress granted FCA enforcement authorities to ensure that System institutions, boards, management, and related parties comply with laws and regulations and operate in a safe and sound manner. These authorities enable FCA to impose rehabilitative or punitive enforcement measures on boards, officers, and other individuals. FCA may use these enforcement authorities when a violation of law, rule, or regulation exists. Likewise, they may be used when the institution, director, officer, or individual engages in an unsafe or unsound condition or practice. FCA may enter into Written Agreements, issue Cease and Desist Orders, assess CMPs, and remove, suspend, or prohibit officers, directors, and other individuals from participating in the affairs of a System institution. Each of these is discussed below.

### **Written Agreement**

A Written Agreement is a contract between FCA and the institution board or an individual. This contract commits the institution or individual to specific actions. FCA uses Written Agreements when weaknesses exist that rise to the level of unsafe or unsound conduct, but the board and management are considered willing and able to adequately address the weaknesses. The institution's board or specified individual executes the Written Agreement with an authorized FCA representative. If the institution or individual fails to comply with a Written Agreement, FCA may serve a Notice of Charges to initiate a cease and desist proceeding or other enforcement action, as appropriate.

### **Cease and Desist Proceedings** *(Section 5.25 of the Act)*

A Cease and Desist Order is issued to the institution or individual when problems are severe. It also may be used when the institution violates a Written Agreement or conditions that were imposed on the institution when granting an application (i.e., a merger or reorganization application). Under provisions of the 2018 Farm Bill, FCA may initiate a Cease and Desist Order action against current institution-affiliated parties (i.e., director, officer, employees, shareholder, agent, independent contractor, or any other person who participates in the conduct of the affairs of the institution) and former institution-affiliated parties up to 6 years after ceasing involvement with the institution. FCA may issue a Cease and Desist Order when either:

- The institution or person engaged, is engaging, or is about to engage in an unsafe or unsound practice.
- The institution or person violated, is violating, or is about to violate:
  - A law, rule, or regulation.
  - Any condition imposed in writing by FCA in connection with the granting of any application or other request by the institution or person.
  - Any Written Agreement entered into with FCA.

A Cease and Desist Order specifies affirmative actions to correct unsafe or unsound practices or conditions, or requires that activities be stopped, or both. All cease and desist proceedings begin with a Notice of Charges served on the institution or person. FCA asks the institution board or person to consent to the Cease and Desist Order. If an individual or a majority of board members, as defined in the institution's bylaws, agrees to consent, the Cease and Desist Order is effective. If the individual or board does not consent, the Notice of Charges requires the individual or institution to answer the charges within 20 days of service, and the matter continues to a formal hearing process before an Administrative Law Judge (ALJ) within 30 to 60 days of the date of the Notice.

The ALJ conducts a hearing and provides all parties an opportunity to present evidence. The ALJ provides the FCA Board its recommendation and the FCA Board ultimately decides whether to issue a Cease and Desist Order. The Cease and Desist Order may be appealed to the United States Court of Appeals. The Cease and Desist Order can be enforced in Federal District Court or a CMP action can be initiated if the institution or person does not comply. The Cease and Desist Order remains in effect until terminated by the FCA Board or a reviewing court.

**Temporary Cease and Desist Order** (Section [5.26](#) of the Act)

FCA may issue a Temporary Cease and Desist Order when a violation, threatened violation, or unsafe or unsound practice is likely to:

- Cause insolvency,
- Cause substantial dissipation of assets or earnings,
- Weaken the condition of the institution, or
- Prejudice the interests of investors or shareholders before completing a cease and desist proceeding.

The Temporary Cease and Desist Order can require the institution or person to stop the violation or practices described or take corrective action. This temporary order is effective immediately and remains in force until a Cease and Desist Order is issued, the charges are dismissed, or a court order terminates it.

**Removal, Suspension, and Prohibition** (Sections [5.28](#) and [5.29](#) of the Act)

FCA may remove or suspend directors or officers or prohibit their participation in the affairs of the institution. These actions are considered when a director or officer:

- Violated a law, rule, regulation, or Cease and Desist Order,
- Engaged in an unsafe or unsound practice, or
- Committed or engaged in any act, omission, or practice that constitutes a breach of fiduciary duty.

Sections [5.28](#) and [5.29](#) of the Act further define requisite conditions that must exist in order to take this enforcement action.

FCA initiates the removal, suspension, or prohibition process by serving a Notice of Intent. The Notice of Intent states the grounds for the action and the time and place of a formal administrative hearing before an ALJ. The FCA Board decides whether to take the specified action against the individual if the person does not consent to the action. This determination is based on a review of the hearing record and the ALJ's recommendations. A removal, suspension, or prohibition order may be reviewed by the appropriate United States District Court. FCA may suspend a director or officer pending completion of a removal proceeding, if necessary.

FCA can also remove, suspend, or prohibit a director or officer from participating in the institution's affairs when charged with a crime or convicted of a crime involving dishonesty or breach of trust punishable by imprisonment for more than 1 year. FCA must show that the person's continued service is a threat to the interests of the institution's shareholders or investors or threatens public confidence in the institution or the System. Within 30 days of service, the person may request an appearance before the FCA Board to modify or terminate the removal, suspension, or prohibition order. A suspension or prohibition order remains in effect until terminated by FCA or until the criminal charge is settled. When

the conviction is not subject to further appeal, FCA can order the individual's removal from office or prohibit the individual from further participation in the institution's affairs.

**Civil Money Penalty** (*Section 5.32 of the Act*)

A CMP action requires the institution or individual to pay a monetary penalty. Under provisions of the 2018 Farm Bill, FCA may initiate a CMP action against current institution-affiliated parties (i.e., director, officer, employees, shareholder, agent, independent contractor, or any other person who participates in the conduct of the affairs of the institution) and former institution-affiliated parties up to 6 years after ceasing involvement with the institution. This supervisory action may be used in coordination with other supervisory actions. A CMP can be assessed for violation of the Act, regulations issued under the Act, a final Cease and Desist Order, and certain other acts, including the Homeowners Protection Act and Flood Disaster Protection Act. For purposes of assessing a CMP, a directive issued under sections [4.3\(b\)\(2\)](#), [4.3A\(e\)](#), or [4.14A\(h\)](#) of the Act is also treated as a final order issued pursuant to section [5.25](#) of the Act. FCA staff consider 13 factors (referral criteria) when determining whether a violation warrants a CMP referral. These factors are cited in FCA's policy regarding CMP assessments, as published in the Federal Register (53 Fed. Reg. 27286 (1988)). CMP penalties include:

- **Final Orders** – FCA may assess the institution or person a CMP for violation of a final order. CMPs can be assessed for each day a violation continues. The maximum amount of each CMP within FCA's jurisdiction is adjusted in accordance with the Federal Civil Penalties Inflation Adjustment Act of 1990, as amended (28 U.S.C. 2461 note). Refer to FCA Regulation [622.61\(a\)\(1\)](#) for the current, inflation-adjusted CMP maximum.
- **Statutory or Regulatory Violations** – FCA may assess the institution or person a CMP for each violation of the Act or regulations issued under the Act. CMPs can be assessed for each day a violation continues. The maximum amount of each CMP within FCA's jurisdiction is adjusted in accordance with the Federal Civil Penalties Inflation Adjustment Act of 1990, as amended (28 U.S.C. 2461 note). Refer to FCA Regulation [622.61\(a\)\(2\)](#) for the current, inflation-adjusted CMP maximum.
- **Homeowners Protection Act** – FCA may assess a CMP under the Homeowners Protection Act of 1998 (the Private Mortgage Insurance Act [PMI Act]). The PMI Act (12 U.S.C. section 4909(b)(1)) provides that a violation of a requirement of the PMI Act is deemed a violation of the Act.
- **Flood Disaster Protection Act** – FCA may assess a CMP under the Flood Disaster Protection Act of 1973, as amended, by the National Flood Insurance Reform Act of 1994 (the Flood Act). The Biggert-Waters Act of 2012, which amended the Flood Act, sets the maximum penalty per violation with no calendar year cap on the total amount of penalties assessed against an institution that is found to have a pattern of committing violations of the Flood Act or applicable regulations promulgated under the Flood Act. The maximum amount of this CMP is also adjusted in accordance with the Federal Civil Penalties Inflation Adjustment Act of 1990, as amended (28 U.S.C. 2461 note). Refer to FCA Regulation [622.61\(b\)](#) for the current, inflation-adjusted CMP maximum.

As explained above, all CMP amounts are reviewed and adjusted periodically. FCA will consider the good faith of the institution or persons involved, gravity of the violation, history of previous violations, adequacy of financial resources, and such other matters as justice may require when determining actual assessment amounts.

The institution or individual subject to the CMP will have an opportunity to submit relevant information that addresses the violation. A Notice of Assessment will be served if FCA imposes a CMP. The individual or institution is afforded the same hearing procedures that apply to cease and desist proceedings. The institution or individual subject to the CMP can appeal to the appropriate United States Court of Appeals. FCA may refer the matter to the Department of Justice for collection if the individual or institution fails to pay the assessment after it becomes final. The forfeited monies are deposited in the United States Treasury and FCA receives no monetary benefits. FCA will inform the parties if it elects to not impose an assessment.

### **Disclosure of Enforcement Actions**

FCA issues a public disclosure whenever the FCA Board initiates, modifies, or terminates an enforcement action. [FCA Board Policy Statement 34](#) governs the disclosure content. Public disclosures reaffirm to the public, Congress, and the System that FCA is using its enforcement powers effectively through enforcement document issuance and the subsequent termination of such documents.

### **Other Supervisory Remedies Available**

FCA has other remedies and tools available to resolve significant concerns in addition to the specific types of enforcement actions described above. These remedies include:

- **Supervisory Letters** – Supervisory Letters may be used to communicate required corrective actions in both Normal Supervision and Special Supervision cases. OE uses this supervisory approach to resolve issues before a more extensive supervisory action may be necessary.
- **Directives** – The Act provides FCA authority to issue Capital Directives and Distressed Loan Restructuring Directives. Directives are enforceable consistent with the enforceability of a final Cease and Desist Order. Refer to sections [4.3](#) and [4.14A](#) of the Act, and the related implementing regulations, for additional details.
- **Conditions Imposed in Writing** – Conditions imposed in writing to address unsafe or unsound practices or violations of law, rule, or regulation are put in place by consent as part of approving the institution application request. The most common types of application requests are merger or reorganization requests. In these cases, the conditions imposed in writing are referred to as Supervisory Conditions of Merger or Reorganization. FCA can take enforcement actions for failure to comply with conditions imposed in writing.
- **Conservatorship or Receivership** – The FCA Board has exclusive power and jurisdiction to appoint, without notice, a conservator or receiver for the institution. The Act specifies the Farm Credit System Insurance Corporation will be the conservator or receiver. Refer to section [4.12](#) of the Act and the related implementing regulations for additional details.

### **Assessing Compliance with Enforcement Actions and Supervisory Letters**

OE will assess compliance with enforcement actions and Supervisory Letters during ongoing or special examination activities and provide the institution the results of its evaluation. Generally, OE will evaluate each requirement in the enforcement action or Supervisory Letter. OE will also assign a compliance rating according to the following ratings and definitions:

- **Compliance** – The institution appropriately responded to all material actions in the supervisory requirements and corrected the unsatisfactory condition(s) that prompted the need for the requirements. Required reporting must be maintained unless otherwise noted.
- **Substantial Compliance** – The institution is taking appropriate actions to comply with all material supervisory requirements. Accordingly, substantial evidence exists that the institution’s performance will eventually correct the unsatisfactory conditions that prompted the need for the requirements; however, additional performance and reporting are necessary to monitor and fully resolve the unsatisfactory conditions.
- **Partial Compliance** – The institution made a good faith effort to meet the supervisory requirements, but weaknesses are still evident or there are sufficient flaws in the actions taken to cast doubt on whether the unsatisfactory conditions will be resolved fully. Additional actions and oversight by the board or FCA are necessary.
- **Noncompliance** – The institution did not comply with any material supervisory requirements. Noncompliance may prompt the need for additional enforcement actions.
- **Not Determinable** – The supervisory requirements were not evaluated, or the institution was not able to comply with the requirements during the period examined, for valid reasons. This rating may also be used if required actions are not yet required to be completed.