Legal and Public Policy Research, LLC

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
Washington, DC 20219

Jennifer M. Jones
Deputy Executive Secretary
Attention: Comments—RIN 3064-AG16
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

December 29, 2025

Re: Unsafe or Unsound Practices, Matters Requiring Attention (Docket Nos.: OCC–2025–0174; FDIC RIN 3064-AG16)

Thank you for the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC) and Office of the Comptroller of the Currency's (OCC) (collectively, the agencies) Unsafe or Unsound Practices, Matters Requiring Attention Notice of Proposed Rulemaking.[1] My comment represents my personal views and not those of my employer. While the goals of providing "greater clarity and certainty regarding certain enforcement and supervision standards"[2] for purposes of unsafe or unsound practices and "establish[ing] uniform standards for purposes of [the agencies'] communication of certain supervisory concerns"[3] are admirable, the proposed rule fundamentally misses the mark. If finalized, it would be contrary to law, undermine supervision and enforcement, and tie the agencies hands absent a future rulemaking. For those reasons, the proposed rule should be withdrawn.

Under Section 8 of the Federal Deposit Insurance Act (FDI Act) (12 U.S.C. § 1818), "unsafe or unsound practices" has a specific meaning - the same one long used by the agencies' (and the Board of Governors of the Federal Reserve System's) (the Fed) and originally articulated by then-Federal Home Loan Bank Board (FHLBB) Chair John E. Horne and referred to herein as the Horne Definition:

"An unsafe or unsound practice includes any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds."[4]

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[1] 90 Fed. Reg. 48,835 (Oct. 30, 2025).
[2] 90 Fed. Reg. at 48,836.
[3] 90 Fed. Reg. at 48,836.
[4] *E.g., In re Adams,* OCC No. AA-EC-11-50, at 13 (Sept. 30, 2014), https://occ.treas.gov/topics/laws-and-regulations/enforcement-actions/comptroller-orders/adams-final-decision-09-30-14.pdf [hereinafter *Adams*]. The only possible modifications, sometimes made by courts and

The proposed rule introduces significant and novel deviations that are unlawful and would increase safety and soundness risks by foreclosing via regulation enforcement authorities Congress granted the agencies by statute. Moreover, the proposed rule neither fully acknowledges nor explains the changes in policy.

The problems with the proposed interpretation of "unsafe or unsound practices" also apply to the proposed approach to matters requiring attention (MRAs). The proposed rule would, in opposition to congressional intent, impose by regulation a higher standard for MRAs than the Horne Definition does for formal enforcement actions based on unsafe or unsound practices. It also would create a higher standard for MRAs for violations of law than Congress required by statute for formal enforcement actions. Both of these changes would have deleterious effects on supervision and enforcement.

The agencies could make these changes as a matter of policy without promulgating a new regulation. That course would provide flexibility to swiftly address the safety and soundness issues that almost certainly will arise if the proposed rule is finalized. Indeed, the proposed rulemaking raises a basic question: have the agencies considered the costs of implementing these shifts via regulation, which would require a new rulemaking to adjust, versus a change in policy? The agencies should explain that choice and provide an opportunity to comment on it.

This comment addresses each of these issues and consists of three parts:

1. This document, which addresses the main, but not all, problems with the proposed rule.
2. A working paper (Attachment A) on the meaning of "unsafe or unsound practices." It discusses the term in more depth, including why (1) potential modifications to the proposal other than the Horne Definition (e.g., the *Gulf Federal* interpretation) are flawed and unlawful and (2) the term "unsafe or unsound practices" encompasses macroeconomic risks even in the absence of microprudential risks to the bank engaged in the practice (or the bank with which an institution-affiliated party[5] (IAP) engaged in the practice is affiliated). It also highlights additional problems with the proposed rule. Please excuse the typos and the improperly formatted footnotes. It is a working draft.
3. The OCC enforcement action *In re Adams* (Attachment B), which offers a comprehensive explanation for the superiority of the Horne Definition as a matter of statutory interpretation. The FDIC and the Fed have each cited *Adams* in support of their use of the Horne Definition. The notice of proposed rulemaking

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the agencies themselves, are to replace "risk or loss" with "risk of loss" and replace "agencies administering the insurance funds" with "the Deposit Insurance Fund." Regarding the former potential modification, there is good reason to think the original phrasing was a typographical error. *See* Thomas L. Holzman, *Unsafe or Unsound Practices: Is the Current Judicial Interpretation of the Term Unsafe or Unsound?*, 19 Ann. Rev. Banking L. 425, 433 (2000). Some formulations drop the reference to the agencies or the DIF, but the change does not appear to be intentional.

[5] 12 U.S.C. § 1813(u).

surprisingly does not cite *Adams*, despite the latter's in-depth discussion in support of the Horne Definition, which the proposal would abandon. I respectfully request that the agencies identify and explain the rationale for each change from the *Adams* approach, and provide an opportunity to comment on the reasoning should they move forward with this rulemaking.

I. The Proposed Definition of "Unsafe or Unsound Practices"

The proposed definition of unsafe or unsound practices is unlawful, would increase safety and soundness risks, and would be a departure from previous policy without adequate recognition or explanation of the change.

A. The Proposed Definition of Unsafe or Unsound Practices Is Unlawful.

The proposed rule would define "unsafe or unsound practices" under 12 U.S.C. § 1818 as:

a practice, act, or failure to act, alone or together with one or more other practices, acts, or failures to act, that:
(1) Is contrary to generally accepted standards of prudent operation; and
(2)
(i) If continued, is likely to—
(A) Materially harm the financial condition of the institution; or
(B) Present a material risk of loss to the Deposit Insurance Fund; or
(ii) Materially harmed the financial condition of the institution.[6]

This proposed definition suffers from numerous flaws and would be unlawful.

1. The Agencies Do Not Have Discretion to Redefine "Unsafe or Unsound Practices."

Historically, the agencies have relied on *Chevron* and *Brand X* in support of their use of the unqualified Horne Definition even when some courts have added a restrictive gloss.[7] *Loper Bright* eliminated *Chevron* deference,[8] foreclosing that option. It appears that the agencies now intend to rely on the pre-*Chevron* case *Groos Nat'l Bank v. OCC*, 573 F.2d 889 (5th Cir. 1978) to claim broad authority to define "unsafe or unsound practices" how they see fit.[9] That approach would be misguided.

Loper Bright did not end all forms of discretion and deference. If the best reading of a statute is that it delegates discretion to an agency, "courts must respect the delegation, while ensuring

[6] 90 Fed. Reg. at 48,849.
[7] *See Adams* at 8, 13.
[8] *See Loper Bright Enterprises v. Raimondo*, 603 U.S. 369, 412 (2024).
[9] *See* 90 Fed. Reg. at 48,837 n.5.

that the agency acts within it,"[10] and deference continues to be warranted in the cases of mixed questions of law and fact, or "factbound determinations."[11]

Twelve U.S.C. § 1818 authorizes the agencies to determine if an unsafe or unsound practice has occurred, but it does not provide discretion to define the term. There is no explicit delegation.[12] There is also is no implicit delegation to "fill up the details" or define the term "subject to the limits imposed by a term or phrase that leaves agencies with flexibility, such as 'appropriate' or 'reasonable.'"[13] Instead, 12 U.S.C. § 1818 entitles the agencies to deference on the factbound determination of whether a specific practice is unsafe or unsound. It is a question of "specific application of a broad statutory term," leaving "the reviewing court's function . . . limited."[14] The meaning of "unsafe or unsound practices" (*i.e.*, the standard against which factbound determinations of whether a specific practice is unsafe or unsound are made), however, is a different matter and a "pure legal question."[15]

Groos and similar cases did not deal with the general meaning of "unsafe or unsound practices" but with the term's application to specific facts.[16] By favorably citing the misguided limitations set by *Gulf Federal*,[17] the agencies nevertheless correctly recognize that they do not have unbounded authority to define the term.

Entitled to no deference and without a grant of discretion to interpret "unsafe or unsound practices," the agencies nonetheless proposed to redefine "unsafe or unsound practices." For the most part, the agencies justify their changes on policy, not legal, grounds, even though the meaning of "unsafe or unsound practices" is a question of statutory interpretation. But "In the business of statutory interpretation, if [an interpretation] is not the best, it is not permissible."[18] As further detailed below, the agencies' proposed definition includes multiple shortcomings and is inferior to the Horne Definition. Indeed, because the Horne Definition is the best interpretation, the agencies cannot issue a regulation that deviates from it by raising the standard, as the proposal would, any more than they could lower it, by, for example, defining prudent practices as unsafe or unsound.

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[10] *Loper Bright*, 603 U.S. at 413.
[11] *Id.* at 389.
[12] *Compare* 12 U.S.C. § 1818 *with* 12 U.S.C. § 2271(5)(a).
[13] *Loper Bright*, 603 U.S. at 395.
[14] *NLRB v. Hearst Publications, Inc.*, 322 U. S. 111, 131 (1944).
[15] *Loper Bright*, 603 U.S. at 389.
[16] *Groos Nat. Bank v. Comptroller of Currency*, 573 F.2d at 897; *Independent Bankers Ass'n v. Heimann*, 613 F. 2d 1164, 1168-69 (DC Cir. 1979) (discussing and upholding a specific regulation); *Investment Co. Institute v. FDIC*, 815 F. 2d 1540, 1550 (DC Cir. 1987) (upholding an FDIC rule against challenge that it permitted unsafe or unsound practices). *See also Adams* at 16 ("the Fifth Circuit did not adopt a definition of [unsafe or unsound practices], but indicated that courts should be deferential to the practical implementation of the term by the banking agencies").
[17] 90 Fed. Reg. at 48,838 n.17, 48,839 n.28-29.
[18] *Loper Bright*, 603 U.S. at 400.

2. The Proposed Rule Offers a New Definition of "Unsafe or Unsound Practices" that Ignores the Legislative History, the Courts, and Decades of Agency Precedent.

The proposed rule departs from longstanding agency precedent and, as far as I am aware, has never been offered by any court, any federal banking agency (FBA),[19] or anyone.[20] The agencies are offering a novel interpretation almost 60 years after enactment of the Financial Institutions Supervisory Act (FISA) amended the FDI Act, to add flexible enforcement powers when the agencies identify an "unsafe or unsound practice"[21] and even longer since "unsafe or unsound practices" first authorized enforcement actions.[22] Asserting that now, decades later, the agencies finally have figured out the best definition, strains credulity and affords the agencies' judgment little weight.[23]

The additional powers granted by FISA prompted Congress to consider the meaning of "unsafe or unsound practices."[24] The Horne Definition is not a footnote in FISA's legislative history. It is the definition that then-FHLBB Chair John E. Horne provided to Congress in response to a request for an explanation of what the term meant.[25] The legislative history clarifies that it is the definition that Congress had in mind when it passed the FISA. As the proposed rule notes, "Chairman Horne's articulation of what constitutes an unsafe or unsound practice was read into the record in both chambers of Congress."[26] According to the agencies, literally everyone - courts, commentators, John E. Horne and the members of Congress who relied on his definition, and even the agencies themselves - have misinterpreted the term and have been using the wrong standard.

Some courts have adopted the Horne Definition without, as the proposal would, imposing a heightened effects requirement, some have required heightened effects (but not all have applied

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[19] For purposes of 12 U.S.C. § 1818, the FBAs are the FDIC, the Fed, and the OCC. 12 U.S.C. § 1813(q). If the agencies are proposing to use an interpretation that is currently used for the same term under a different statute or by other agencies, they should explain why and provide notice and an opportunity to comment on that choice.
[20] Despite including 72 footnotes and additional in-text citations, the proposed rule includes no citation to precedent or other sources for the proposed definition. If the proposed definition has been used elsewhere, including if any element of is rooted informal suggestions the agencies have received, they should repropose with a citation to the source, which should also be made available to the public.
[21] Financial Institutions Supervisory Act of 1966, Pub. L. No. 89-695, 80 Stat 1028 (1966).
[22] *See* Holzman, *supra* note 4 at 428.
[23] *See Skidmore v. Swift & Co.*, 323 US 134, 140 (1944) ("The weight of [an agency's] judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.").
[24] *See, e.g.*, 112 Cong. Rec. 25008 (remarks of Rep. Thomas W. L. Ashley).
[25] *See id.* at 25008 (remarks of Rep. Thomas W. L. Ashley explaining that he asked John E. Horne for a definition "because all of us are interested in the definition of the words 'unsafe and unsound'").
[26] 90 Fed. Reg. at 48837 n.13 (citing 112 Cong. Rec. 25008, 26474 (1966) (remarks of Rep. Thomas W.L. Ashley and Sen. Absalom W. Robertson)).

this requirement), and one circuit may have inadvertently created its own definition.[27] But no court has ever offered the definition proposed by the agencies.

The agencies, as well as the Fed, have consistently used the Horne Definition, or very close paraphrases, for decades. For example, the FDIC's Formal and Informal Enforcement Actions Manual currently defines unsafe or unsound practices as "any action or lack of action that is contrary to generally accepted standards of prudent financial institution operation that, if continued, would result in abnormal risk of loss or damage to an IDI, its shareholders, or the DIF."[28] Do the agencies believe they have used the wrong definition all along?

3. The Agencies Appear to Have Misread the Legislative History.

In the proposed rule, the agencies,[29] like some courts[30] and some commentators,[31] appear to have misread and misapplied Representative Wright Patman's comments on the purpose of certain FISA provisions as suggesting that unsafe or unsound practices involve only large risks to banks. Patman's comments were about the tools FISA provided, not the meaning of "unsafe or unsound practices." Moreover, it is not clear that Patman intended to add anything further to the Horne Definition by this statement, and his description of the tools was just wrong. Twelve U.S.C. § 1818 authorizes enforcement actions in cases of misconduct but certain enforcement actions further require effects and culpability.[32] Standard cease-and-desist orders have never required any effects or culpability - not today[33] and not at the time of FISA's enactment.[34]

4. The Proposed Rule Would Arbitrarily Exclude Risks.

The proposed definition would ignore a critical piece of Horne's longer memorandum to Congress: that "[t]he concept of 'unsafe or unsound practices' is one of general application which touches upon the entire field of the operations of a financial institution."[35] The proposed rule would exclude parts of the entire field without justification.

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[27] *See, e.g.*, *Adams* at 16-29 (discussing the approaches of various circuits); Attachment A, Section III.B.4. (describing how the DC Circuit's alternative formulation is rooted in the Horne Definition and was never intended to be a comprehensive definition on its own).
[28] FDIC, Formal and Informal Enforcement Actions Manual 3-1 (Sept. 8, 2025), https://www.fdic.gov/regulations/examinations/enforcement-actions/complete-manual.pdf. *See also* *Adams* at 3 (reaffirming the Horne Definition as "the OCC's long-held interpretation, consistent with that of the other Federal banking agencies"_.
[29] 90 Fed. Reg. at 48,837 (quoting 112 Cong.Rec. 24984 (remarks of Rep. Patman)).
[30] *Gulf Federal* at 264 (quoting 112 Cong.Rec. 24984 (remarks of Rep. Patman)).
[31] *E.g.*, Keith R. Fisher, *Nibbling on the Chancellor's Toesies: A "Roguish" Concurrence with Professor Baxter*, 56 Law & Contemp. Probs. 45, 65 (1993) (quoting 112 Cong.Rec. 24984 (remarks of Rep. Patman)).
[32] For further discussion, see *Adams* at 15.
[33] 12 U.S.C. § 1818(b).
[34] *See* Pub. L. No. 89-695.
[35] Financial Institutions Supervisory Act of 1966: Hearings on S. 3158 Before the House Comm. on Banking and Currency, 89th Cong., 2d Sess. 49 (1966) (statement of John E. Horne, Chairman of the FHLBB), 112 CONG. REC. 26,474 (1966).

The Horne Definition refers to "loss or damage." The proposed definition's use of harm would largely ignore this. "[T]he agencies generally interpret harm to refer to financial losses. Therefore, to be an unsafe or unsound practice, a practice, act, or failure to act generally must have either caused actual material losses to the institution or must be likely to cause material loss or other negative financial impacts to the institution."[36] No legal explanation is provided for why the agencies will now generally exclude damages other than financial losses from unsafe or unsound practices.

It cites *Gulf Federal* in support of its decision to exclude "risks to the institution's reputation unrelated to financial condition."[37] However, the Supreme Court rejected *Gulf Federal*'s reasoning,[38] the Fifth Circuit has recognized that "*Gulf Federal* is thus not good authority for the proposition that the power delegated by Congress to the FHLBB was limited solely to the internal management of federal savings associations,"[39] and the OCC has explained how the Supreme Court's decision undermined *Gulf Federal*'s attempt to prevent "unsafe or unsound practices" from reaching considerations of public opinion and reputation risk.[40] Put simply, the Horne Definition includes reputation risks and attempts to exclude such considerations under the proposed interpretation are inconsistent with Supreme Court precedent.[41]

The proposed rule's reliance on *Gulf Federal* also raises an important question: do the agencies believe that an institution can, as the Fifth Circuit held in *Gulf Federal*, safely and soundly charge more interest than agreed to in its loan contracts? If so, why? How is overcharging customers and incurring potential legal liability to repay safe and sound? To take a more recent example, do the agencies concur with a former Wells Fargo IAP, that opening fake accounts implicates a bank's customer service reputation but not its safety and soundness?[42]

The preamble to the proposed rule also states that "[g]oing forward, the agencies expect that it would be rare for an institution to exhibit unsafe or unsound practices, as defined in the proposed rule, based solely on the institution's policies, procedures, documentation or internal controls, without significant weaknesses in the institution's financial condition (i.e., weaknesses that caused material harm to the financial condition of the institution, or were likely to materially harm the financial condition of the institution or likely to present material risk of loss to the DIF)."[43] What exactly this means is unclear, but to provide one example of why this approach is

[36] 90 Fed. Reg. at 48,839.
[37] 90 Fed. Reg. at 48,839 (citing *Gulf Federal* at at 264–65).
[38] *See Fidelity Federal Sav. & L Ass'n v. De la Cuesta*, 458 U.S. 141, 170 n.23 (1982).
[39] *First Gibraltar Bank v. Morales*, 19 F.3d 1032, 1051 (5th Cir. 1994).
[40] *See Adams* at 18-21. While *Gulf Federal* dealt with a federal savings association, the meaning of "unsafe or unsound practices" and the authority it provides is the same for every institution subject to 12 U.S.C. § 1818. Indeed, *Adams* itself dealt with the IAP of a national bank, not a federal savings association.
[41] This tension also provides good reason for the FDIC and OCC to abandon their proposed rulemaking that would prohibit consideration of reputation risk.
[42] *See* Pet'r's Br., *Russ Anderson v. OCC,* 31 (8th Cir. May 20, 2025), https://business.cch.com/BFLD/Petitioner-Brief-Anderson-v-OCC-8thCir-05212025.pdf. In her filing, the IAP asked, "In what sense does a mere reputational harm for poor customer service— Wells Fargo will open unnecessary accounts!—risk the safety of existing deposits or the soundness of the institution?" *Id.*
[43] 90 Fed. Reg. at 48,839

problematic the FDIC has deemed both (1) operating without adequate internal controls and an adequate audit program and (2) failure to implement adequate internal controls to be unsafe or unsound practices.[44]

The agencies should clarify if this would no longer be the case and why. Can the agencies explain how it can be safe and sound to operate without adequate internal controls? How will the agencies determine that an absence of adequate internal controls is unlikely to present material risks? How would they determine an absence of adequate internal controls is likely to present material risks? How would the agencies determine which institutions need adequate internal controls to operate safely and soundly?

5. The Proposed Definition of "Unsafe or Unsound Practices" Is Significantly Different from the Agencies' Longstanding Interpretation.

The proposed rule would not clarify the agencies' long-longstanding interpretation of "unsafe or unsound practices." It would instead be a sharp break motivated and explained by policy goals rather than a legal analysis of what the term "unsafe or unsound practices" means. There are several substantive and significant changes explored further below.

a. "Possible" to "Likely"

Requiring a practice to be "likely," if continued, to pose the necessary risk to an institution obviously differs from the Horne Definition's and the agencies' decades-long approach of requiring that the requisite risk be "possible." The proposed definition raises the bar, but it is not clear how high. While "possible" unambiguously covers anything that could happen,[45] "likely" may mean probable or even "very probable."[46] No legal explanation for this change is offered in the proposed rule. This change would be more ambiguous, further removed from the legislative history, and a more significant departure from the Horne Definition than any court has used.[47]

b. "Abnormal" to "Material"

"Abnormal" and "material" have different meanings. According to the dictionary the agencies cite for purposes of understanding how terms were used at the time of FISA's enactment, "abnormal" means "[d]eviating from the ordinary rule or type; contrary to rule or system; irregular, unusual, aberrant."[48] A 1966 dictionary includes several definitions that together

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[44] FDIC, *supra* note 28 at 3-1.
[45] *See Possible,* Merriam-Webster, https://www.merriam-webster.com/dictionary/possible.
[46] *See Likely,* Merriam-Webster, https://www.merriam-webster.com/dictionary/likely.
[47] Some courts do require "foreseeability." *See, e.g.*, *Landry v. FDIC*, 204 F. 3d 1125 1138 (DC Cir. 2000). Even "foreseeability" does not require a risk to be "likely." *See Foreseeability*, Merriam-Webster, https://www.merriam-webster.com/dictionary/foreseeable.
[48] 1 J.A. Simpson & E.S.C. Weiner, Oxford English Dictionary 31 (2d ed. 1989) (abnormal).

indicate variation from normal.[49] A modern dictionary's first definition of "abnormal" is "deviating from the normal or average."[50] Abnormal risk, therefore, refers to risks that are not normal or usual, which may or may not be a large risk.

By contrast, a risk would be material if it has "real importance or great consequences."[51] According to the proposed rule, "the agencies will consider the likely harm to an institution's financial condition to be material if it would materially impact the institution's capital, asset quality, liquidity, earnings, or sensitivity to market risk, or would materially impact the risk that an institution fails and causes a loss to the DIF."[52] This suggests a fundamentally different approach than a focus on abnormal risks.

"Materiality" as a financial concept predates enactment of FISA and the Horne Definition.[53] The agencies offer no explanation for why John E. Horne would not have used "material" if that was his intent.

The proposed rule never discusses what abnormal means, much less why the agencies now wish to abandon it. The Fed has explained that "abnormal risk" refers to "risks other than those inherent in doing business,"[54] consistent with its ordinary meaning of not normal or unusual. This does not involve complex judgments about whether a risk is sufficiently large to be "material" to the bank or the DIF. The proposed rule "does not explain whether or how their concept of 'materiality' relates to materiality under securities laws or other legal constructs."[55]

c. Ruling Out Risks to the Agencies and Macroprudential Risks

Unlike the Horne Definition and the agencies' current and longstanding approach, the proposed definition would only consider risks to the institution.

The Horne Definition refers to risks to an institution, its shareholders, or the agencies administering the insurance funds. The use of "or" indicates that each is an independent basis.

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[49] 1 Webster's Third New International Dictionary and Seven Language Dictionary 4 (1966) (abnormal). The definitions include "deviating from the normal," "differing from the typical," "greater than or superior to the normal," and "less than or inferior to the normal." *Id.*

[50] *Abnormal*, Merriam-Webster, https://www.merriam-webster.com/dictionary/abnormal.

[51] *Material*, Merriam-Webster, https://www.merriam-webster.com/dictionary/material.

[52] 90 Fed. Reg. at 48,839 (footnote omitted).

[53] *See* David A. Katz and Laura A. McIntosh, "Corporate Governance Update: 'Materiality' in America and Abroad," Harvard Law School Forum on Corporate Governance (May 1, 2021), https://corpgov.law.harvard.edu/2021/05/01/corporate-governance-update-materiality-in-america-and-abroad/.

[54] *In re Vickery*, AA-OCC-EC-96-95, at 20 (Apr. 14, 1997), https://www.federalreserve.gov/boarddocs/press/enforcement/1997/19970415/Attachment.pdf (quoting *In re Van Dyke*, No. AA-EC-87-88 (June 13, 1988), slip op. at 26, *aff'd*, *Van Dyke v. Board of Governors*, 876 F.2d 1377, 1380 (8th Cir. 1989)).

[55] Covington & Burlington LLP, "OCC and FDIC Propose Rule to Define Unsafe or Unsound Practices and Focus Supervisory and Enforcement Efforts on Material Financial Harm," (Oct. 9, 2025), https://www.cov.com/en/news-and-insights/insights/2025/10/occ-and-fdic-propose-rule-to-define-unsafe-or-unsound-practices-and-focus-supervisory-and-enforcement-efforts-on-material-financial-harm.

The OCC has left open the possibility that a practice that creates a risk to the DIF without a prior risk to the institution or its shareholders could be unsafe or unsound.[56] And courts have held that risk of loss or damage to the agencies administering the insurance funds, apart from risk to the bank or its shareholders, can be an unsafe or unsound practice.[57]

While the proposed rule would capture practices that otherwise satisfy the proposed definition and "[p]resent a material risk of loss to the Deposit Insurance Fund,"[58] the preamble indicates that the agencies intend for this provision to cover only microprudential risks. Specifically, the agencies state that this provision would capture practices that "negatively affect an institution's ability to avoid FDIC receivership and present a material risk of loss to the DIF as a result of the failure. . . . In other words, the proposed definition would capture a practice, act, or failure to act that materially increases the probability that an institution would fail and impose a material risk of loss to the DIF."[59] If the institution must experience the risk first, it is microprudential in nature. The agencies offer no legal justification for this change, which would treat practices such as hindering investigations and originating junk loans for distribution, potentially destabilizing the financial system and creating risks for the DIF, as safe and sound.

6. The Proposed Rule Is Inconsistent with the Text and Structure of 12 U.S.C. § 1818.

All enforcement actions under 12 U.S.C. § 1818 require misconduct (*e.g.*, an unsafe or unsound practice, a violation of law or regulation, or a breach of fiduciary duty[60]). Some also require effects.[61] Some further require culpability.[62] Notably, standard cease-and-desist orders only require misconduct.[63]

By requiring likely material harm for a practice to be unsafe or unsound, the proposed rule "conflicts with the fundamental structure of the FDI Act by introducing an effects element, textually reserved as a predicate for more severe remedies, into the definition of an element of misconduct."[64] Moreover, this embedded effects requirement within the misconduct element would, like *Gulf Federal*'s restrictive gloss, in some cases be greater than what is required by the effects element itself.[65] While the Horne Definition requires an "abnormal" risk, suggesting

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[56] *See Adams* at 16 ("[A]ny practice that threatens the insurance funds will almost certainly [but not necessarily] have also threatened both the institution or its shareholders earlier in time.").
[57] *See Seidman v. OTS*, 37 F.3d 911, 937 (3d Cir. 1994); *Calcutt v. FDIC*, 37 F. 4th 293, 326 (6th Cir. 2022).
[58] 90 Fed. Reg. at 48,849.
[59] 90 Fed. Reg. at 48,839.
[60] *See, e.g.*, 12 U.S.C. § 1818(e)(1)(A).
[61] *See, e.g.*, 12 U.S.C. § 1818(e)(1)(B)(i).
[62] *See, e.g.*, 12 U.S.C. § 1818(e)(1)(C)(i).
[63] *See* 12 U.S.C. § 1818(b).
[64] *See Adams* at 18.
[65] *See* 12 U.S.C. § 1818(e)(1)(B)(i) (requiring that, by reason of misconduct, the institution "has suffered or will probably suffer financial loss or other damage," not "material" harm).

an "increased risk of some kind,"[66] questions of safety and soundness generally are primarily qualitative, not quantitative, inquiries.[67]

Twelve U.S.C. § 1818(t)(2), which authorizes the FDIC to take enforcement actions when the appropriate federal banking agency fails to act, demonstrates the problem. Twelve U.S.C. § 1818(t)(2)(C) authorizes enforcement actions when an institution's "conduct or threatened conduct (including any acts or omissions) poses a risk to the Deposit Insurance Fund, or may prejudice the interests of the institution's depositors." Conduct that satisfies the agencies' proposed definition of "unsafe or unsound practices" would always meet this criterion. Conduct that is likely to materially harm the financial condition of an institution may prejudice the interests of the institution's depositors, and conduct "that materially increases the probability that an institution would fail and impose a material risk of loss to the DIF"[68] would necessarily pose a risk to the DIF. As a result, 12 U.S.C. § 1818(t)(2)(B), which authorizes certain enforcement actions for "unsafe or unsound practices" would be superfluous. It would always be satisfied when 12 U.S.C. § 1818(t)(2)(C) is.

B. The Proposed Rule Would Increase Safety and Soundness Risks by Undermining Supervisory and Enforcement Powers.

In addition to being legally impermissible, the proposed definition of "unsafe or unsound practices" would prevent the agencies from fully using the powers that Congress granted to address all risks to safety and soundness.

The proposed definition introduces a serious conceptual and policy problem. Expected risk is a function of the likelihood and magnitude of a risk. The proposed definition would allow for extremely large but unlikely risks, including those that threaten the stability of the bank. Under the "likely" standard, any risk, including those that if realized would collapse the bank, would be safe and sound so long as there is a less than 50% chance of actual material harm - and perhaps when the probability of harm is even greater.[69] The agencies would be preventing themselves from taking action to address serious safety and soundness risks were the rule to be finalized as proposed.

Determining whether a practice is "likely" to create material risks would be challenging. To highlight one complication, the likelihood of material harm resulting from a practice depends on the time horizon used - the longer, the more likely material harms become. Would examiners be considering the probability of material risks over a year? Five years? Indefinitely? It is far more

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[66] *See Adams* at 29.
[67] *Cf. In re Vickery* at 20 ("The safety or soundness element addresses the nature, rather than the degree, of the departure from ordinary standards of prudent banking.") (quoting *In re Van Dyke*, No. AA-EC-87-88 (June 13, 1988), slip op. at 26, *aff'd*, *Van Dyke v. Board of Governors*, 876 F.2d 1377, 1380 (8th Cir. 1989)).
[68] 90 Fed. Reg. at 48,839.
[69] *See Likely,* Merriam-Webster, https://www.merriam-webster.com/dictionary/likely (providing one definition of "likely" as "very probable").

administrable to determine whether a risk is possible and then determine whether, as a matter of supervisory judgment, an enforcement action is warranted.

Similarly, whether a risk, or even realized harm, is material is ambiguous. And the agencies would have to consider whether risks are large enough to be material ex ante. The materiality of a risk may only become apparent once it is realized, or, in other words, when it is too late.

The proposal's tailoring provisions are unworkable and further demonstrate the difficulties with using "material" risk rather than "abnormal" risk. Logically, using a materiality test means that smaller banks would be subject to higher standards, not, as the proposed rule suggests, lower standards. The preamble unintentionally reveals as much. It cites *Gulf Federal* as a basis for requiring material risks, indicating that materiality determinations rest, at least in part, on risks relative to an institution's assets.[70] The preamble's discussion of overdrafts totaling $2 million relative to tier 1 capital also demonstrates the problem. It suggests that $2 million in overdrafts would not pose "material" risk to an institution with sufficiently high tier 1 capital, which is more likely to be the case with large institutions. Surprisingly, the proposed rule never cites, much less discusses, the agencies' own previous recognition of this problem and rejection of such approaches.[71]

The proposed definition, however, would commit the agencies to tailoring,[72] and the preamble also describes how "the agencies would not expect that a particular projected percentage decrease in capital or liquidity that rises to the level of materiality for the largest institutions would necessarily also be material for community banks."[73] Put differently, the agencies plan to avoid the difficulties in attempting to tailor the rule while also considering risks from a materiality perspective by allowing greater relative risks at small institutions. The agencies provide no explanation for this proposed "much higher bar for a community bank than for a larger institution" to find a practice unsafe or unsound.[74] The consequence of this would be higher risks at small banks, particularly for uninsured depositors.

Finally, the proposal would rule out the ability to address build up of risks and vulnerabilities within the system that threaten the DIF. Under the proposed definition, a bank that originates and distributes junk loans could not be considered to be engaged in an unsafe or unsound practice, despite the risks such practices create for the DIF.[75]

II. The Proposed Approach to Matters Requiring Attention

The agencies should not finalize the proposed approach to MRAs. Many of the problems with the proposed definition of "unsafe or unsound practices" afflict the proposed MRA provisions.

[70] 90 Fed. Reg. at 48,839 n.29.
[71] *Adams* at 22*; In re Bank of Louisiana*, FDIC-12-489(b), FDIC-12-479(k), at 16 (Apr. 21, 2020).
[72] *See* 90 Fed. Reg. at 48,849.
[73] 90 Fed. Reg. at 48,839.
[74] 90 Fed. Reg. at 48,839.
[75] For a discussion of why the idea that "unsafe or unsound practices" is a microprudential only concept is mere folklore, see Attachment A, Part IV.

The proposed approach would limit MRAs to a practice, act, or failure to act that is

(1)

(i) Is contrary to generally accepted standards of prudent operation; and

(ii)

(A) If continued, could reasonably be expected to, under current or reasonably foreseeable conditions,

(1) Materially harm the financial condition of the institution; or

(2) Present a material risk of loss to the Deposit Insurance Fund; or

(B) Materially harmed the financial condition of the institution; or

(2) Is an actual violation of a banking or banking-related law or regulation.

Paragraph (1) is inconsistent with the Horne Definition and should be rejected for the same reasons as the proposed "unsafe or unsound practices" definition. Because MRAs are an informal and less severe response than a formal enforcement action under 12 U.S.C. § 1818, it would be nonsensical to impose a higher standard for MRAs as a matter of policy.

The proposed general exclusion of policies, procedures, or internal controls as grounds for an MRA raises similar problems as the parallel exclusion for the proposed definition of "unsafe or unsound practices." To restate part of the problem, are there circumstances in which inadequate internal controls would not warrant an MRA?

The proposed limitation of MRAs to actual violations of banking or banking-related laws or regulations suffers from similar problems. It is not clear what the agencies intend "actual," which does not appear in 12 U.S.C. § 1818, to mean, but it should not be higher than the statutory threshold for enforcement actions based on "violations" under 12 U.S.C. § 1813(v).[76] The limitation to "banking or banking-related laws or regulations" also is inconsistent with 12 U.S.C. § 1818. MRAs for non-banking and non-banking related laws or regulations would be prohibited by regulation while formal enforcement actions for the same would be authorized by statute. That makes no sense. Moreover, where is the line on banking and banking-related laws? Are all anti-fraud laws banking-related? Would 18 U.S.C. § 1001 be considered banking-related? The preamble expressly states that violations of tax laws, which potentially expose banks to significant liability, would not be grounds for an MRA under the proposal.[77] Why would the agencies preclude themselves from issuing an MRA if an institution refuses to pay taxes? The agencies may be aware of potential tax law violations before the Internal Revenue Service or other taxing authority is. If the agencies move forward with this proposal, they must first provide additional explanations and an opportunity to comment on this point.

[76] Twelve U.S.C. § 1813(v) defines "violation" as "includ[ing] any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation."

[77] 90 Fed. Reg. at 48,841.

III. Conclusion

For all the above reasons, I recommend that the agencies withdraw the proposed rule. The best option to ensure no unlawful rules are codified and that the agencies retain the flexibility to appropriately mitigate safety and soundness risks is to end this rulemaking process now.
The agencies could codify the Horne Definition as their interpretation of “unsafe or unsound practices,” but that is not necessary. Thank you again for the opportunity to comment on this rulemaking.

Sincerely,

Daniel Sufranski
Legal and Public Policy Research, LLC

The Outer Bounds of the Federal Banking Agencies' Unsafe or Unsound Practices Authority

Daniel Sufranski[1]

Abstract: Federal law requires banks to operate in a safe and sound manner, in addition to complying with a broad array of specific laws and regulations. To ensure safety and soundness, Congress gave the federal banking agencies significant powers to address unsafe or unsound practices through enforcement actions. However, no statute defines "unsafe or unsound practices." Two distinct, but related, questions help illuminate where the outer bounds of the federal banking agencies' "unsafe or unsound practices" lie: (1) what type of microprudential risk (*i.e.*, risks to an individual bank) is necessary for a practice to be unsafe or unsound and (2) do unsafe or unsound practices include those that create or contribute to macroprudential risks (*i.e.*, risks to other banks or the broader financial system) that may not pose a meaningful or discernible risk to the bank engaged in the practice. In light of the federal banking agencies' broad enforcement powers, differences in interpretation across circuits, and the current administration's open rulemaking to define "unsafe or unsound practices" by regulation, these questions are important and timely.

Legislative history, case law, statutory text, and agency statements indicate the best interpretation of "unsafe or unsound practices" is "any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk [of] loss or damage to an institution, its shareholders, or the agencies administering the insurance funds." This definition, provided by then-Federal Home Loan Bank Board Chair John E. Horne, does not require a threat to a bank's financial integrity or likely material risk or harm and it includes at least certain macroprudential threats that do not pose any identifiable risk to the bank engaged in the practice. The federal banking agencies have no authority to alter the fixed, outer boundaries of their "unsafe or unsound practices" authority. Because the Horne Definition is the best interpretation of the statutory text it is the only permissible definition.

[1] Acknowledgements TK. All views, errors, and omissions are the author's personal views and not the views of my employer.

I. Introduction

Federal laws require banks[2] to operate in a safe and sound manner and empower regulators to address unsafe or unsound practices.[3] The federal banking agencies (FBAs)[4] possess broad statutory authority to do so through the supervisory process and, under 12 U.S.C. § 1818, through formal enforcement actions.[5] The meaning of "unsafe or unsound practices" matters precisely because 12 U.S.C. § 1818 authorizes a variety of enforcement actions to address such practices. Understanding what falls within the scope of "unsafe or unsound practices" helps identify the breadth and limits of the enforcement powers, which in turn affects the influence of supervisory expectations and informal supervisory actions. Exactly what constitutes an "unsafe or unsound practice" and is therefore inconsistent with "safety and soundness," is a matter of dispute. "Unsafe or unsound practices" is not defined by statute, leading some courts to adopt interpretations that differ from the FBAs' long-held standard. In 2025, Treasury Secretary Scott Bessent indicated that defining unsafe or unsound practices by regulation was an administration priority.[6] The Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) have proposed a rule (FDIC/OCC proposal) to do just that,[7] while the Board of Governors of the Federal Reserve System (Fed) has announced that its interpretation of "unsafe or unsound practice will also be changing."[8]

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[2] For simplicity, this paper uses "banks" to refer to all entities subject to 12 U.S.C. § 1818. As discussed below, different entities are subject to various subsections of 12 U.S.C. § 1818, including certain entities that are not depository institutions. *See infra* notes 33-34 and accompanying text.
[3] *See, e.g.*, 12 U.S.C. § 1818.
[4] This paper focuses on the meaning of unsafe or unsound practices for purposes of 12 U.S.C. § 1818, which authorizes enforcement actions by the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency. *See* 12 U.S.C. § 1813(q). Therefore, it refers to those three agencies when using the terms "federal banking agencies" or "FBAs."
[5] *See infra* Section II.A.
[6] *See infra* Part III.
[7] Unsafe or Unsound Practices, Matters Requiring Attention, 90 Fed. Reg. 48,835 (Oct. 30, 2025).
[8] Mary Aiken and Julie Williams, Division of Supervision and Regulation, Board of Governors of the Federal Reserve System, Statement of Supervisory Operating Principles 3 (Oct. 29, 2025), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20251118a1.pdf

To determine which interpretation of "unsafe or unsound practices" is best, this paper addresses two distinct, but related, questions on where the outer bounds of agencies' authority to address "unsafe or unsound practices" lie: (1) what type of microprudential risk (*i.e.*, risks to an individual bank) is necessary for a practice to be unsafe or unsound under 12 U.S.C. § 1818[9] and (2) do unsafe or unsound practices include those that create or contribute to macroprudential risks (*i.e.*, risks to other banks or the broader financial system) that may not pose a meaningful or discernible risk to the bank engaged in the practice.[10] It demonstrates that the best interpretation of "unsafe or unsound practices" is the definition provided by former Federal Home Loan Bank Board (FHLBB) Chair John E. Horne (the Horne Definition): "any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk [of] loss or damage to an institution, its shareholders, or the agencies administering the insurance funds."[11] It further shows that this definition encompasses microprudential risks that do not pose a threat to a bank's financial integrity as well as macroprudential risks that banks create or contribute to, even in the absence of clear microprudential risk to the bank engaged in the practice.[12]

With respect to the requisite type of microprudential risk required for a practice to be unsafe or unsound, the banking industry and some courts have long favored limiting unsafe or unsound practices to those that threaten the financial "integrity," "stability," or "soundness" of a bank.[13] Some variations exist, but the point of these more restrictive approaches is to exclude practices that do not pose fairly serious microprudential risks–potentially all those that do not pose a risk of bank failure.[14] The FDIC and OCC's recently proposed defining "unsafe or unsound practices" by, among other things, focusing on likely material harms and risks and excluding macroprudential risks and risks to the agencies themselves.[15] Some courts and, historically, the FBAs have aligned on the Horne Definition without further quantitative qualification, an approach that considers whether a possible risk is abnormal rather than the size of the risk and is more firmly rooted in legislative history and statutory text.[16] This approach does not require showing that the bank's financial integrity is at risk or that material risk or harm is likely, scoping in many more practices as potentially unsafe or unsound.

With respect to the microprudential vs. macroprudential question, which has attracted less attention, discussions of safety and soundness often, but not always, frame the concept in exclusively microprudential terms.[17] This framing implies that unsafe or unsound practices also deal exclusively with microprudential risks. Under the conventional framework, "safety and soundness" refers to microprudential concerns while "financial stability" or similar terms refer to macroprudential ones. However, the solely microprudential approach to safety and

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[9] *See infra* Part III.
[10] *See infra* Part IV.
[11] *See infra* Part III.
[12] *See infra* Parts III-IV.
[13] *See infra* Section III.B.
[14] *See infra* Section III.B.
[15] *See infra* Section III.B.
[16] *See infra* Part III.
[17] See *infra* Part IV.

soundness has not been universal. The plain language of the Horne Definition (which refers to risk to the agencies administering the insurance funds), interagency guidance, and some statutes indicate that safety and soundness and unsafe or unsound practices have a macroprudential dimension, at least in certain circumstances.[18] Moreover, Congress and courts have used "financial stability" for microprudential purposes, despite its association with macroprudential concerns.[19] In short, there is no absolute division between "safety and soundness" and microprudential concerns on one hand and "financial stability" and macroprudential concerns on the other.

Together, these factors indicate that "safety and soundness" and "unsafe or unsound practices" cover macroprudential risks arising from a bank's activities. This approach is the most sensible from a practical perspective because containment of macroprudential risks is a precondition to microprudential safety and soundness.[20] A microprudential-only approach that permits the build up of systemic risks ultimately will be self-defeating.

While courts have not dealt with the question of whether "unsafe or unsound practices" encompasses a macroprudential perspective, the FDIC and OCC's proposed rule would rule that approach out, despite proposed regulatory text that may suggest otherwise. Specifically, the FDIC and the OCC would limit macroprudential considerations to those arising from the failure of an institution—a fundamentally microprudential problem that happens to have macroprudential effects. Such risks would be captured by other narrow views of safety and soundness and unsafe or unsound practices. Narrow approaches cannot, however, address the macroprudential risks of activities themselves, independent of a threat to the bank engaged in the activity. The text of the Horne Definition, which the FBAs have long supported, allows the FBAs to act even if they cannot identify a clear risk from the practice to the institution itself. Specifically, it allows the FBAs to address risks that one bank's actions, such as originating and distributing junk loans or generally financing activities that create systemic risks, create for the FDIC and the Deposit Insurance Fund (DIF).

The Supreme Court's *Loper Bright*[21] decision prompts a careful inspection of the FBAs' previous adoption of the Horne Definition, as well as the new approach proposed by the FDIC and OCC. No longer afforded the *Chevron* deference they previously relied on when interpreting the ambiguous term "unsafe or unsound practices,"[22] the only permissible definition of "unsafe or unsound practices" is the best interpretation. Reasonableness is not enough. While the FBAs are entitled to deference on factbound determinations regarding which practices meet the unsafe or unsound standard, they are not entitled to deference in defining the standard itself.[23] Given the lack of discretion to redefine the term, a close analysis demonstrates that the FBAs' historical interpretation of the type of risk required (*i.e.*,

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[18] See *infra* Part IV.
[19] See *infra* Part IV.
[20] See *infra* Section IV.H.
[21] Loper Bright Enterprises v. Raimondo*,* 603 U.S. 369 (2024).
[22] Chevron, U.S.A. v. Nat. Res. Def. Council, Inc., 467 U.S. 837 (1984). In the D.C. Circuit, the federal banking agencies did not benefit from *Chevron* deference even prior to *Loper Bright* because of circuit precedent prohibiting *Chevron* deference when multiple agencies are charged with implementing a single statute. *See* Profitt v. FDIC, 200 F.3d 855, 863 n.7 (2000).
[23] *See infra* Part V.

the Horne Definition) is the best interpretation.[24] In fact, more restrictive views, despite support from some courts and, currently, the FBAs themselves, are unreasonable given the statutory text and structure. To the extent Congress has granted discretion to the FBAs, their discretion is constrained by the limits imposed by the Horne Definition - limits which only Congress, not the FBAs, can change.[25]

The rest of this paper explores each issue discussed above in more depth. Part II provides an overview of enforcement actions authorized by 12 U.S.C. § 1818 and explains the Horne Definition. Part III discusses the "restrictive gloss" and limitations that some courts have imposed on the Horne Definition and the FDIC/OCC proposal, concluding that the unqualified Horne Definition is the best interpretation of "unsafe or unsound practices" with respect to microprudential risks. Part IV interrogates the common assumption that "safety and soundness" and "unsafe or unsound practices" refer to microprudential issues and that financial stability refers to macroprudential issues, showing that each of these terms can be used for both microprudential and macroprudential purposes, despite the FDIC/OCC proposal's explicit exclusion of macroprudential risks. It concludes that macroprudential risks and risks to the agencies are within the scope of "unsafe or unsound practices" and the Horne Definition. Part V discusses the implications of this analysis in light of *Loper Bright*—specifically, that the agencies have no authority to adopt any interpretation of "unsafe or unsound practices" other than the Horne Definition. Part VI offers concluding thoughts.

II. The Meaning of "Unsafe or Unsound Practices"

Safety and soundness is a broad term with no statutory definition.[26] Thinking about its opposites - "unsafe or unsound practices" and "unsafe or unsound conditions" - helps to clarify its meaning: If something is an unsafe or unsound practice, continuing the practice would be inconsistent with safety and soundness; if a bank is operating in an unsafe or unsound condition, the bank's condition is not safe and sound. These terms themselves are quite broad. The FDIC acknowledges that "[b]ecause unsafe or unsound practices may involve any area of an [insured depository institution's (IDI's)] operations, it is impossible to provide an all-inclusive list of such practices."[27] Similarly, it notes that "it is impossible to define precisely what constitutes an unsafe or unsound condition because an IDI's condition depends on virtually every aspect of its operations."[28]

This paper focuses on the meaning of unsafe or unsound practices because they are grounds for various enforcement actions by the FBAs under Section 8 of the Federal Deposit

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[24] *See infra* Parts III-V.
[25] *See infra* Part V.
[26] For a discussion of the original meanings of "safety" and "soundness," as well as the term "safety and soundness," see *infra* Section IV.C.
[27] FDIC, FORMAL AND INFORMAL ENFORCEMENT ACTIONS MANUAL 3-1 (Sept. 8, 2025), https://www.fdic.gov/regulations/examinations/enforcement-actions/complete-manual.pdf.
[28] *Id.* at 3-2.

Insurance Act (FDI Act), codified at 12 U.S.C. § 1818.[29] Like "safety and soundness," Congress has not provided a general definition of "unsafe or unsound practices" despite using the term many times. However, the FBAs until recently[30] had converged on a definition for purposes of 12 U.S.C. § 1818.[31] Specifically, they accepted the definition John E. Horne offered to Congress (the Horne Definition) during his tenure as the FHLBB Chair.[32] This section describes the general enforcement remedies available under 12 U.S.C. § 1818 in response to unsafe or unsound practices, as well as the Horne Definition.

A. Enforcement Actions Authorized by 12 U.S.C. § 1818 in Response to Unsafe or Unsound Practices

Twelve U.S.C. § 1818 authorizes the FBAs to take a range of enforcement actions in response to certain misconduct by IDIs[33] and certain other institutions[34] (collectively referred

[29] The federal banking agencies can also take certain actions based on unsafe or unsound conditions. *See, e.g.*, 12 U.S.C. § 1818(a)(2)(A)(ii). That concept is generally beyond the scope of this paper.

[30] *See infra* Part III.

[31] Other agencies can address unsafe or unsound practices via enforcement actions. *See* 12 U.S.C. § 1786 (National Credit Union Administration); 12 U.S.C. Chapter 46, Subchapter III (Federal Housing Finance Agency); 12 U.S.C. Chapter 23, Subchapter V, Part C (Federal Housing Finance Administration). Note that Congress delegated discretion to the Farm Credit Administration (FCA) to define unsafe or unsound practices for purposes of the institutions it regulates. *See* 12 U.S.C. § 2271(5)(A) (defining "unsafe or unsound practices" for purposes of the FCA's enforcement power, in part as, "hav[ing] the meaning given to it by the [FCA] by regulation, rule, or order"). The focus of this paper is on the meaning of unsafe or unsound practices under 12 U.S.C. § 1818. Other authorities are outside its scope.

[32] *See, e.g.*, *In the Matter of Adams*, OCC AA-EC-11-50 13 (OCC Sept. 30, 2014), https://occ.treas.gov/topics/laws-and-regulations/enforcement-actions/comptroller-orders/adams-final-decision-09-30-14.pdf [hereinafter *Adams*]; *FDIC*, *supra* note 27; *In re Smith and Kiolbas*a, Fed 18-036-E-I 41 (Oct. 24, 2021), https://www.federalreserve.gov/newsevents/pressreleases/files/enf20210330a1.pdf. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 replaced the FHLBB with the Office of Thrift Supervision (OTS). Pub. L. No. 101-73, §§ 201(b), 401(a)(2), 103 Stat. 183, 188, 354 (1989). Congress subsequently abolished the OTS and transferred its powers to the FBAs. The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 312-313, 124 Stat. 1376, 1521-23 (2010).

[33] For purposes of 12 U.S.C. § 1818, "insured depository institution" refers to "any bank or savings association the deposits of which are insured by the [FDIC]" and "any uninsured branch or agency of a foreign bank or a commercial lending company owned or controlled by a foreign bank." 12 U.S.C. § 1813(c)(2)-(3).

[34] Twelve U.S.C. § 1818 also applies to uninsured national banks. 12 U.S.C. § 1818(b)(5). In addition, certain provisions of 12 U.S.C. § 1818 apply to a range of institutions other than banks and savings associations, including bank holding companies, savings and loan holding companies, their subsidiaries, and foreign banks and companies subject to 12 U.S.C. § 3106, with exceptions for subsidiaries already subject to 12 U.S.C. § 1818. *See* 12 U.S.C. § 1818(b)(3)-(4), (t)(1). Twelve U.S.C. § 5362 further applies 12 U.S.C. § 1818(b)-(n) to nonbank financial companies supervised by the Fed and their subsidiaries (other than depository institution subsidiaries, which are already subject to 12 U.S.C. § 1818). The Fed's enforcement authority for depository institution subsidiaries and functionally regulated subsidiaries of such companies are subject to certain limitations. *See* 12 U.S.C. § 5362(b); *infra* Section IV.E. Twelve U.S.C. § 1867(b) subjects bank service companies to 12 U.S.C. § 1818.

to herein as banks for simplicity), as well as "institution-affiliated parties" (IAPs).[35] Because the type and characteristics of a bank determine its primary federal regulator, 12 U.S.C. § 1818 generally limits enforcement action authority to the "appropriate federal banking agency"[36] (AFBA).

The availability of these remedies depends on the nature of the misconduct and, in some cases, the effects of the misconduct and the culpability of the bank or IAP.[37] At a high level, three types of misconduct may authorize enforcement actions: (1) a violation of law,

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[35] "The term 'institution-affiliated party' means-

(1) any director, officer, employee, or controlling stockholder (other than a bank holding company or savings and loan holding company) of, or agent for, an insured depository institution;

(2) any other person who has filed or is required to file a change-in-control notice with the appropriate Federal banking agency under section 1817(j) of [Title 12 of the U.S. Code];

(3) any shareholder (other than a bank holding company or savings and loan holding company), consultant, joint venture partner, and any other person as determined by the appropriate Federal banking agency (by regulation or case-by-case) who participates in the conduct of the affairs of an insured depository institution; and

(4) any independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in-

(A) any violation of any law or regulation;

(B) any breach of fiduciary duty; or

(C) any unsafe or unsound practice,

which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution."

12 U.S.C. § 1813(u).

[36] "The term 'appropriate Federal banking agency' means-

(1) the Office of the Comptroller of the Currency, in the case of-

(A) any national banking association;

(B) any Federal branch or agency of a foreign bank; and

(C) any Federal savings association;

(2) the Federal Deposit Insurance Corporation, in the case of-

(A) any State nonmember insured bank;

(B) any foreign bank having an insured branch; and

(C) any State savings association;

(3) the Board of Governors of the Federal Reserve System, in the case of-

(A) any State member bank;

(B) any branch or agency of a foreign bank with respect to any provision of the Federal Reserve Act [12 U.S.C. 221 et seq.] which is made applicable under the International Banking Act of 1978 [12 U.S.C. 3101 et seq.];

(C) any foreign bank which does not operate an insured branch;

(D) any agency or commercial lending company other than a Federal agency;

(E) supervisory or regulatory proceedings arising from the authority given to the Board of Governors under section 7(c)(1) of the International Banking Act of 1978 [12 U.S.C. 3105(c)(1)], including such proceedings under the Financial Institutions Supervisory Act of 1966;

(F) any bank holding company and any subsidiary (other than a depository institution) of a bank holding company; and

(G) any savings and loan holding company and any subsidiary (other than a depository institution) of a savings and loan holding company."

Under the rule set forth in this subsection, more than one agency may be an appropriate Federal banking agency with respect to any given institution." 12 U.S.C. § 1813(q) (alterations in the original) (footnote omitted).

[37] 12 U.S.C. §1818. *See also Adams* ("Heightened forms of remedy require the agency to establish additional elements of proof tied to the 'effect' of the misconduct or the 'culpability' it reflects.").

regulation, order, condition imposed in writing by a FBA (usually in connection with the approval of any application or other request), or a written agreement with the FDIC or other FBA (referred to herein as "violations of law"),[38] (2) unsafe or unsound practices,[39] and breaches of fiduciary duty.[40] Some provisions include violations of "rules" as grounds for an enforcement action in addition to violations of regulations.[41] However, the FBAs have foreclosed the possibility of enforcement actions based on violations of supervisory guidance, even if the guidance is a rule, through their rules on guidance.[42]

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[38] 12 U.S.C. § 1818(a)(2)(A)(iii), (a)(8)(B)(ii)(IV), (b)(1), (c)(1), (e)(1)(A), (i)(2)(A), (i)(2)(B)(i)(I), (i)(2)(C)(i)(I). Twelve U.S.C. § 1813(v) defines "violation" broadly as "includ[ing] any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation."

[39] 12 U.S.C. § 1818(a)(2)(A)(ii), (a)(8)(B)(ii)(II), (b)(1), (c)(1), (e)(1)(ii), (i)(2)(B)(i)(II), (i)(2)(C)(i)(II), (t)(2)(B). Unlike violations of law and breaches of fiduciary duty, unsafe or unsound practices include an effects element within the definition of the misconduct prong itself, as discussed *infra* Section II.B.3-5.

[40] *See* 12 U.S.C. § 1818(e)(1)(A)(ii), (i)(2)(B)(i)(III), (i)(2)(C)(i)(III).

[41] 12 U.S.C. § 1818(a)(2)(A)(ii), (a)(8)(B)(ii)(III).

[42] Under the Administrative Procedure Act (APA), a "rule" is "the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency and includes the approval or prescription for the future of rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services or allowances therefor or of valuations, costs, or accounting, or practices bearing on any of the foregoing."
5 U.S.C. § 551(4). This definition encompasses a far wider range of agency statements than are typically referred to as "regulations." That term is usually reserved for what courts have called "legislative" rules. Such rules have the force and effect of law and are subject to the APA's notice-and-comment rulemaking requirements unless an exemption applies. *See* 5 U.S.C. § 553; https://www.acus.gov/sites/default/files/documents/34%20Distinguishing%20Between%20Legislative%20Rules%20and%20Non-Legislative%20Rules.pdf. On the other hand, general statements of policy and interpretative rules are "rules" under the APA, but they are not subject to notice-and-comment requirements unless otherwise required by statute. 5 U.S.C. § 553(b)(A). These rules are often referred to as "guidance" and are not legally enforceable. *See* https://www.justice.gov/jm/1-19000-limitation-issuance-guidance-documents-1; https://www.acus.gov/sites/default/files/documents/34%20Distinguishing%20Between%20Legislative%20Rules%20and%20Non-Legislative%20Rules.pdf. Language in 12 U.S.C. § 1818 authorizing enforcement actions for violations of "rules" generally, in addition to regulations, could be read as allowing the federal banking agencies to require compliance with otherwise unenforceable agency statements. Setting aside significant administrative law questions that would arise if that view were correct, the agencies have prevented themselves from pursuing that path by adopting regulations that prohibit enforcement actions based on "violations of" supervisory guidance. *See* 12 C.F.R. Part 4, Subpart F; 12 C.F.R. § 262.7, Appendix A to Part 262; 12 C.F.R. Part 302. As a result, the federal banking agencies cannot rely on the violation of a rule other than a regulation when bringing enforcement actions.

Some tension may exist between agency regulations prohibiting enforcement of supervisory guidance and the requirement under the Horne Definition that an unsafe or unsound practice be contrary to generally accepted standards of prudent operation discussed *infra* Section II.B.2. The AFBA must set some standard prior to bringing an enforcement action for unsafe or unsound practices. *See id.* However, that requirement does not mean that such standards must be codified in regulation or communicated via supervisory guidance. *See id*. The 12 U.S.C. § 1818 authority to address unsafe or unsound practices is additive to the authority to address violations of law. It allows the federal banking agencies to address safety and soundness concerns as they arise. While the federal banking agencies cannot cite a violation of or non-compliance with guidance in an enforcement action, they can still determine that the bank or IAP's actions are unsafe or unsound and may refer to guidance for examples of safe-and-sound conduct. *See* 12 C.F.R. Part 4, Subpart F, Appendix A; 12 C.F.R. Part 262, Appendix A; 12 C.F.R. Part 302, Appendix A.

Under this statutory framework, unsafe or unsound practices do not require a violation of any law or a breach of fiduciary duty because unsafe or unsound practices are an independent basis for enforcement actions. Therefore, the FBAs can require that banks and IAPs go beyond mere compliance with specific laws and adherence to fiduciary duties.[43] This additional safety and soundness requirement limits the powers of banks and expands the powers of the FBAs. If a bank cannot conduct an otherwise authorized activity in a safe and sound manner, it must refrain from the activity or potentially face an enforcement action.[44] When the AFBA identifies an unsafe or unsound practice, it may, depending on the specific circumstances, institute C&D proceedings,[45] issue a temporary (emergency) C&D order,[46] remove and prohibit IAPs from participating in the conduct of the affairs of a bank,[47] or impose civil money penalties (CMPs).[48] Even when it is not the AFBA, the FDIC also may suspend or terminate deposit insurance[49] and take other action in certain circumstances.[50]

The possibility of enforcement actions enhances the influence of communication of supervisory concerns and expectations.[51] If the AFBA expresses safety and soundness concerns about one or more practices, the bank and its IAPs understand that failure to course correct could lead to enforcement actions authorized for unsafe or unsound practices. Responses to supervisory concerns currently inform the FBAs' decision making regarding potential enforcement actions.[52]

Given the significant powers deriving from the determination that a practice is unsafe or unsound, Congress' decision not to define "unsafe or unsound practices" for purposes of 12

[43] For a brief discussion of the differences between unsafe or unsound practices and breaches of fiduciary duties, *see In the Matter of Ortega and Rogers*, AA-EC-2017-44, AA-EC-2017-45 88-91 (Nov. 30, 2023), https://occ.treas.gov/topics/laws-and-regulations/enforcement-actions/comptroller-orders/ortega-rogers-final-decision-occ-aa-ec-2017-44-45.pdf. For a longer scholarly commentary, *see* Heidi Mandanis Schooner, *Fiduciary Duties' Demanding Cousin: Bank Director Liability for Unsafe or Unsound Banking Practices*, 63 GEO. WASH. L. REV. 175 (1995), https://scholarship.law.edu/cgi/viewcontent.cgi?article=1264&context=scholar.
[44] With respect to national bank powers under 12 U.S.C. § 24(Seventh), the OCC has stated that an "activity cannot be part of the *business of banking* if the bank in question lacks the capacity to conduct the activity on a safe and sound basis." OCC Interpretive Letter No.1160 2 (Aug. 22, 2018) (emphasis in original), https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2018/int1160.pdf.
[45] 12 U.S.C. § 1818(b).
[46] 12 U.S.C. § 1818(c).
[47] 12 U.S.C. § 1818(e).
[48] 12 U.S.C. § 1818(i)(2).
[49] 12 U.S.C. § 1818(a).
[50] 12 U.S.C. § 1818(t).
[51] *See* Daniel K. Tarullo, *Bank Supervision and Administrative Law*, 2022 COLUM. BUS. L. REV. 279, 281-82, https://journals.library.columbia.edu/index.php/CBLR/article/view/9983/5045#:~:text=BANK%20SUPERVISION%20ANDADMINISTRATIVE%20LAWDaniel%20K.,relationship%20between%20banks%20and%20supervisors.
[52] *See, e.g.*, OCC, BANK ENFORCEMENT ACTIONS AND RELATED MATTERS, PPM 5310-3, 3 (May 25, 2023), https://www.occ.gov/news-issuances/bulletins/2023/ppm-5310-3.pdf ("The actions that the board and management take or agree to take in response to violations and concerns in [matters requiring attention] are factors in the OCC's decision to pursue a bank enforcement action and the severity of that action.").

U.S.C. § 1818 may be surprising.[53] Congress did, however, indicate what it meant. The legislative history shows that Congress had in mind a specific interpretation–the Horne Definition–provided by FHLBB Chair John E. Horne and recognized as the "authoritative definition."[54] The rest of this part discusses the Horne Definition.

B. The Horne Definition

While Congress was considering the Financial Institutions Supervisory Act of 1966 (FISA), which amended the FDI Act and authorized the AFBA to take a wider range of enforcement actions,[55] then-FHLBB Chair Horne submitted a memo (the Horne Memo) to Congress in response to a representatives' request for clarification of the term's meaning[56] "in support of the legislation."[57] While Horne acknowledged that defining "unsafe or unsafe practices" was difficult,[58] he still offered a definition:

"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 be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds."[59]

As a preliminary matter, the use of "or" between "risk" and "loss" was likely a typographical error. "Of" is more intuitive as it clarifies both what "risk" the Horne Definition is referring to and that "abnormal risk" together modifies both "loss" and "damage."[60] Retaining "or" would mean any type of loss or damage would be sufficient, as would any abnormal risk. This would be a more expansive reading of the term "unsafe or unsound practices" than even the FBAs have historically supported. Courts and the FBAs have at times used "of" when referring to or paraphrasing the Horne Definition, often without comment on the slight modification.[61] This paper will use "of" except in quotations of the unaltered Horne Definition.

Congress did not include the Horne Definition in FISA, but then Chairman of the Senate Banking Committee Senator A. Willis Robertson's rationale for inserting the full Horne

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[53] Some statutory provisions define specific unsafe or unsound practices. *See, e.g.*, 12 U.S.C. § 1818(b)(8) (stating that the AFBA may "deem [a bank] to be engaging in an unsafe or unsound practice" if "in its most recent report of examination, [the bank received] a less-than-satisfactory rating for asset quality, management, earnings, or liquidity" and does not correct the deficiency). Statutes applicable to agencies other than the federal banking agencies may also provide specific definitions. *See* 12 U.S.C. § 2271(5)(B) (defining practices as unsafe or unsound for purposes of the enforcement powers of the FCA).

[54] *Gulf Fed. Sav. and Loan Ass'n v. Federal Home Loan Bank Bd.*, 651 F.2d 259, 264 (5th Cir. 1981), *cert. denied,* 458 U.S. 1121 (1982).

[55] Thomas L. Holzman, *Unsafe or Unsound Practices: Is the Current Judicial Interpretation of the Term Unsafe or Unsound?*, 19 ANN. REV. BANKING L. 425, 430-31 (2000).

[56] *See* 112 CONG. REC. 25,008 (1966).

[57] *Adams*, *supra* note 32, at 3.

[58] *See* 112 CONG. REC. 26,474 (1966).

[59] 112 CONG. REC. 26,474 (1966).

[60] *See* Holzman, *supra* note 55, at 433-34.

[61] *See id*.

Memo[62] into the Congressional Record indicates why such inclusion was unnecessary. The Horne Memo itself begins with a clarification "that the term 'unsafe or unsound,' as used in the cease-and-desist provisions of [the bill], is not a novel term in banking or savings and loan parlance."[63] Instead, it "appear[ed] in the banking or savings and loan laws of 38 States" and existing federal law had authorized enforcement actions based on "unsafe or unsound practices" for decades.[64] Senator Robertson noted concerns that the bill's references to "unsafe and unsound practices created novel standards" and offered the Horne Memo specifically to dispel that notion.[65] The key distinction from prior statutes was neither the term "unsafe or unsound practice" nor its meaning. Instead, FISA expanded (1) the range of enforcement options at the agencies' disposal and (2) the contexts in which unsafe or unsound practices would be grounds for certain enforcement action.[66] These changes provided "more flexibility to carry out the kind of supervision necessary to the health of the system."[67]

The Horne Memo explains that the FHLBB knew of no "statute, either Federal or State, which attempts to enumerate all the specific acts which could constitute such practices."[68] Such an effort would be futile, according to Horne.[69] "The concept of 'unsafe or unsound practices' is one of general application which touches upon the entire field of the operations of a financial institution."[70] He feared that an "attempt to catalog within a single all-inclusive or rigid definition the broad spectrum of activities which are embraced by the term . . . would probably operate to exclude those practices not set out in the definition, even though they might be highly injurious to an institution under a given set of facts or circumstances or a cheme [sic] developed by unscrupulous operators to avoid the reach of the law."[71] Horne also noted that a "particular activity not necessarily unsafe or unsound in every instance may be so when considered in the light of all relevant facts."[72]

Against that backdrop, the Horne Definition provides "a central meaning which can and must be applied to constantly changing factual circumstances."[73] It is not surprising that Congress did not add this "central meaning" to the text of the final bill. The message of the Horne Memo, sufficient to assuage concerns and secure the votes for passage, was that the term "unsafe or unsound practices" referred to an already existing and understood standard that

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[62] Portions of the Horne Memo had been referenced in previous discussions and appeared in earlier editions of the Congressional Record. *See* 12 CONG. REC. 25,008

[63] 12 CONG. REC. 26,474 (1966).

[64] *Id.* For a discussion of the pre-FISA history of "unsafe or unsound practices" in federal and state law, see Lev Menand, *Why Supervise Banks? The Foundations of the American Monetary Settlement*, 74 VANDERBILT L. REV. 951, 980-1010 (2021), https://scholarship.law.vanderbilt.edu/cgi/viewcontent.cgi?article=4746&context=vlr [hereinafter Why Supervise] and Lev Menand, *The Monetary Basis of Bank Supervision* at 137-66 (unpublished manuscript) [hereinafter Monetary Basis].

[65] 112 CONG. REC. 26,474 (remarks of Sen. Robertson).

[66] *See* Holzman, *supra* note 55 at 430-31.

[67] *Id.* at 430.

[68] 112 CONG. REC. 26,474.

[69] *See* 112 CONG. REC. 26,474.

[70] 112 CONG. REC. 26,474.

[71] 112 CONG. REC. 26,474.

[72] 112 CONG. REC. 26,474.

[73] 112 CONG. REC. 26,474.

did not lend itself to a comprehensive statutory cataloging of such practices. Indeed, as one of "many . . . generic terms widely used in the law,"[74] including a precise definition of "unsafe or unsound practices" in the statute would have been unusual. The legislative history makes clear that Congress understood that the Horne Definition captured the "unsafe or unsound practices" standard.

This context also explains the "generally speaking" clause at the beginning of the Horne Definition. It does not mean that there are cases where the Horne Definition does not apply. Instead, it clarifies that Horne Definition is a general framework that the banking agencies would use to identify and take action against unsafe or unsound practices.

Because the Horne Definition includes several elements, this section briefly considers each in turn. While there are multiple reasonable ways to delineate the various elements, this paper uses the following formulation to highlight critical issues in identifying the outer bounds of the FBAs' unsafe or unsound practices: (1) any action, or lack of action; (2) which is contrary to generally accepted standards of prudent operation; (3) the possible consequences of which, if continued; (4) would be abnormal risk of loss or damage; (5) to an institution, its shareholders, or the agencies administering the insurance funds.

1. Any Action or Lack of Action

An unsafe or unsound practice can involve either an action or a lack of action. In other words, it is something a bank or IAP is doing, has done, is not doing, or has not done. In certain cases, unsafe or unsound practices include actions or lack of actions that may occur.[75] On its own, this element covers literally everything that a bank or IAP does or does not do. Nothing is out of scope if it satisfies the other elements of the Horne Definition.[76]

2. Which Is Contrary to Generally Accepted Standards of Prudent Operation

For an action or lack of action to constitute an unsafe or unsound practice, it must be "contrary to generally accepted standards of prudent operation." A generally accepted standard is not merely the common industry practice, and banks and IAPs cannot point to the conduct of others as a defense.[77] Instead, the FBAs determine the standards and have significant discretion in doing so. Some standard is required.[78] Like other regulatory

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[74] 112 CONG. REC. 26,474.
[75] 12 U.S.C. § 1818(b)-(c).
[76] *See* 112 CONG. REC. 26,474 ("The concept of 'unsafe or unsound practices' is one of general application which touches upon the entire field of the operations of a financial institution."); FDIC, *supra* note 27, at 3-1 ("unsafe or unsound practices may involve any area of an IDI's operations").
[77] *See* Frontier State Bank v. FDIC, 702 F.3d 588, 600 (10th Cir. 2012) (finding an unsafe or unsound practice despite use of "industry standard" data); FDIC-93-91e, A-2871 (June 9, 1997) (rejecting notion that an attorney's dual representation of the bank and the buyer in a real estate transaction, regardless of whether it was a "common or even the prevailing practice in the area").
[78] *See Adams* at 7 ("Enforcement Counsel must make some showing as to the relevant standards and the departure from those standards.").

standards, banks and IAPs must be able to ascertain the standards for unsafe or unsound practices.[79] But all that is required is that FBAs communicate some standard. This includes examiner communications directly to banks regarding a given practice.[80]

The federal banking agencies are not required to set standards for unsafe or unsound practices by regulation.[81] If they were, unsafe or unsound practices would provide no independent grounds for enforcement actions under 12 U.S.C. § 1818 beyond those already authorized for violations of law.[82] Furthermore, the federal banking agencies do not need to issue formal guidance establishing standards for specific conduct prior to determining that a practice is unsafe or unsound.[83]

Requiring otherwise would be impractical. Agency understanding of risks is constantly evolving and safety-and-soundness concerns are often fact-specific. The FBAs are not prohibited from changing their position and imposing standards contrary to previous ones as they gain knowledge.[84] Again, whether something is unsafe or unsound depends on the specific circumstances.[85]

3. The Possible Consequences of Which, If Continued, Would Be

The Horne Definition does not require a practice to have produced any consequences to be unsafe or unsound. Instead, it is intentionally and explicitly forward-looking. The question is what could happen if the bank or IAP continues the practice.[86] The Horne Definition refers to "possible consequences"[87] not just those that are certain or probable. There is, therefore, no requirement to demonstrate that abnormal risk of loss or damage is likely.[88] Instead, the

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[79] *See* General Elec. Co. v. EPA, 53 F.3d 1324, 1329 (D.C. Cir. 1995).

[80] *Adams*, supra note 32, at 63 (emphasis added) ("[B]anks must be guided by more general or analogous published guidance (as well as criticisms from examiners) in establishing proper policies and procedures to mitigate the often abundant risks associated with novel services and products.)" (emphasis added). See also General Elec. Co., 53 F.3d at 1329 ("Although the agency must always provide 'fair notice' of its regulatory interpretations to the regulated public, in many cases the agency's pre-enforcement efforts to bring about compliance will provide adequate notice.").

[81] The authority to set safety and soundness standards by regulation or enforceable guidelines expressly leaves "[o]ther authority not affected" and "is in addition to any other authority of the Federal banking agencies," including the federal banking agencies' 12 U.S.C. § 1818 authorities. 12 U.S.C. § 1831p-1(g).

[82] As noted *supra* note 38 and accompanying text, "violations of law" as used herein includes violations of regulations, consistent with the text of 12 U.S.C. § 1818.

[83] *See* Frontier State Bank v. FDIC, 702 F.3d 588, 599-600 (10th Cir. 2012). Given the agencies' rules on guidance, they cannot cite violations of guidance as basis for an enforcement action. *See supra* note 42 and accompanying text.

[84] *See* Frontier State Bank v. FDIC, 702 F.3d 588, 599-600 (10th Cir. 2012) (upholding finding of an unsafe or unsound practice based, in part, on use of data that the FDIC had previously "suggested" before identifying shortcomings with the data).

[85] *See supra* Section II.B.

[86] In the case of an enforcement action authorized when a bank or IAP is about to engage in an unsafe or unsound practice, the question is what happens if the bank or IAP begins to engage and continues to engage in that action or lack thereof.

[87] 112 CONG. REC. 26,474.

[88] *See infra* Section III.B.6.c for further discussion in light of the FDIC and OCC's proposed rule.

Horne Definition instructs the FBAs to consider what may happen if a bank or IAP continues its current practices.

At bottom, this element of the Horne Definition goes to the sustainability of the practice. A bank could make a few loans without evaluating a borrower's creditworthiness and be repaid timely without loss. But if the bank continued making loans without considering creditworthiness, actual losses, not just abnormal risk of loss or damage, certainly could result.

Note that the continuation referred to in the Horne Definition encompasses not just time (*i.e.* continuing the same practice in the future) but also the scope, magnitude, or number (*i.e.,* how widespread is the practice by the bank or the IAP). Consider an IAP at a large bank who made a single nominee loan.[89] Nominee loans have been deemed to be an unsafe or unsound practice.[90] There is no coherent way to assess the possible consequences resulting from the continuation of a single nominee loan over time. The only logical approach is to consider the effect of the IAP or the bank extending more nominee loans in the future.

This forward-looking assessment of potential risks from continuing a practice has broad implications and may cause courts to shy away from following it to its logical conclusions, even when recognizing it as the appropriate inquiry.[91] This hesitancy is a judicial failure[92] and changes neither the language nor the meaning of the Horne Definition.

4. Abnormal Risk of Loss or Damage

For a practice to be unsafe or unsound, the possible consequences must be an "abnormal risk of loss or damage." Recall that 12 U.S.C. § 1818 actions require misconduct, and some require effects and culpability.[93] This element of the Horne Definition embeds an effects requirement within the definition of "unsafe or unsound practices," which is a form of misconduct.

"Abnormal" risk refers to a risk that is not normal.[94] As the Fed once put it,

"The safety or soundness element addresses the nature, rather than the degree, of the departure from ordinary standards of prudent banking. Conduct departing from such

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[89] A nominee loan "is a loan in the name of one party that is intended for use by another." U.S. DEP'T OF JUST., CRIM. RESOURCE MANUAL 806, https://www.justice.gov/archives/jm/criminal-resource-manual-806-nominee-loans.
[90] FDIC, *supra* note 27at 3-1.
[91] *See infra* .
[92] *See Seidman v. OTS*, 37 F.3d 911, 942 (3d Cir. 1994) (criticizing the majority because the Horne Definition is clear "that the relevant 'risk' is not that occasioned by the specific conduct engaged in in this particular case, but rather the risk that would be occasioned *if similar conduct were 'continued' as a way of doing business*") (emphasis in original) (Stapleton, J., dissenting). *See also* Holzman, *supra* note 55, at 445-49 (discussing the flaws in the court's analysis).
[93] *See supra* Section II.A.
[94] Merriam-Webster currently defines "abnormal" as "deviating from the normal or average" and clarifies that it often indicates something is "unusual in an unwelcome or problematic way." *Abnormal*, Merriam-Webster, https://www.merriam-webster.com/dictionary/abnormal. For further discussion of the meaning of this term, *see infra* III.B.6.c.

standards represents an unsafe or unsound banking practice when it is of a kind that, if continued, would present an abnormal risk -- i.e., risks other than those inherent in doing business -- of harm or loss to the bank."[95]

This approach makes sense for two reasons. First, the provision of financial services necessarily entails some risk. Indeed, risk is inherent to banking.[96] The use of "abnormal" clarifies that the Horne Definition is not concerned with normal, unavoidable banking risks. Under the Horne Definition, even conduct contrary to generally accepted standards of prudent operation are not unsafe or unsound if the resulting risks are normal, or inherent in doing business.

Second, focusing on the nature of the risk rather than the size is appropriate due to the meaning of "abnormal." Implicit in the creation of an abnormal risk is some increase in risk, but whether something is "abnormal" is a qualitative, not quantitative, question.[97] The literal meaning of "abnormal" does not require that the risk be large, though large risks very well may be abnormal.[98]

One commentator noted that the Horne Memo suggests conduct that "could never have more than a trivial effect" cannot be an unsafe or unsound practice.[99] Reviewing DC Circuit precedent, the OCC concluded that unsafe or unsound practices require only an "increased risk of some kind."[100] Under the Horne Definition, a practice that creates a new risk that departs from the range of normal risks is sufficient. Some efforts to narrow the Horne Definition, discussed *infra* Part III, seem to recognize this implicitly, as they have added new language rather than rely on the concept of "abnormal risk" to assert that some significant *level* of risk must be present.[101] Other cases seem to equate abnormal risk with a threat to a

[95] *In re Vickery*, AA-OCC-EC-96-95, at 20 (Apr. 14, 1997), https://www.federalreserve.gov/boarddocs/press/enforcement/1997/19970415/Attachment.pdf (quoting *In re Van Dyke*, No. AA-EC-87-88 (June 13, 1988), slip op. at 26, *aff'd*, *Van Dyke v. Board of Governors*, 876 F.2d 1377, 1380 (8th Cir. 1989)) [hereinafter *Vickery*].

[96] *See* Holzman, *supra* note 55, at 433 ("banking involves inherent credit and interest rate risk"); MORGAN RICKS, THE MONEY PROBLEM 67-68 (2016) (demonstrating that a bank run is a Nash equilibrium outcome).

[97] *See Vickery* at 20. *Cf. In re Smith and Kiolbasa*, Fed 18-036-E-I 42 (Oct. 24, 2021) (The Horne Definition "focuses on the nature of the act rather than the express consequences of such act.") (citing *Adams*), https://www.federalreserve.gov/newsevents/pressreleases/files/enf20210330a1.pdf.

[98] Top synonyms for "abnormal" today include words such as "unusual," "extraordinary," "exceptional," "unique," "rare," "uncommon," "odd," "unnatural," and "irregular." *See Abnormal*, *supra* note 94. Something is abnormal whenever it deviates from normal, whether due to its magnitude or otherwise. In a scene from the classic comedy film *Young Frankenstein*, Dr. Frankenstein's assistant Igor retrieves an abnormal brain from the brain depository that does not appear to be any larger than the other brains. https://www.youtube.com/watch?v=hw6xBdXl1Aw. For further discussion, see *infra* III.B.6.c.

[99] Holzman, *supra* note 55, at 434. The focus of this commentary is "the institution and its risk profile." *Id.* As described *infra* Section II.B.5, the same rule should apply to risks to the DIF because risks to the DIF are an independent grounds for concluding that an unsafe or unsound practice has occurred.

[100] *Adams*, *supra* note 32, at 28 (quoting Kaplan v. OTS, 104 F.3d 417, 421 (D.C. Cir. 1997)).

[101] *See, e.g.*, *Frontier State Bank*, 702 F.3d, at 604 (defining an unsafe or unsound practice as "one which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds and that it is a practice which has a reasonably direct effect on an association's financial soundness"). *Adams*, *supra* note 32, at 4 (quoting an administrative law judge's interpretation of "unsafe or unsound practices" as "conduct that, at the time

bank's financial stability or integrity,[102] and in yet other cases, the view of "abnormality" is less clear.[103]

Some commentators have suggested that "abnormal" in the context of "unsafe or unsound practices" means something more than the dictionary definition. An attorney who represented an IAP[104] whose enforcement action was dismissed by the DC Circuit on jurisdictional grounds,[105] subsequently wrote that the Fed's focus on the nature of risks "mutated" unsafe or unsound practices into "unusual business practices."[106] He neither offered his own definition of "abnormal" nor explained how "unusual" risks would be different from "abnormal" ones.[107] Subsequent commentators who have repeated his criticism, without necessarily endorsing it, have not explained why the Fed's interpretation of "abnormal" is wrong.[108]

Finally, the Horne Definition focuses on abnormal *risk* of loss or damage.[109] Actual losses or damages are not sufficient.[110] Likewise, continued profitability does not prove that a practice involves no abnormal risk.[111]

5. To an Institution, Its Shareholders, or the Agencies Administering the Insurance Funds

The last component of the Horne Definition deals with the issue of who faces the abnormal risk. The Horne Definition identifies three options: the bank, its shareholders, or the agencies administering the insurance funds. The use of "or" indicates abnormal risk of loss or damage to any of the three is sufficient. Some courts have failed to include all three, but these

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it was engaged in, was contrary to generally accepted standards of prudent operation (that is, it constituted an imprudent act), the possible consequences of which, if continued, created an abnormal risk or loss or damage to the **financial stability** of the Bank") (emphasis in original).

[102] *See* Calcutt v. FDIC, 37 F. 4th 293, 326 (6th Cir. 2022) (describing the FDIC's opposition to a requirement that an unsafe or unsound practice threaten a bank's financial stability as opposition to a requirement that an unsafe or unsound practice pose abnormal risks).

[103] *See Johnson v. Office of Thrift Supervision*, 81 F. 3d 195, 204 (DC Cir. 1996) (holding that "'actual loss' does not, by itself, establish that the act posed an abnormal risk to the financial stability or integrity of the institution," finding that the agency did "not explain how [the] allegations demonstrate" a threat to the banks' "'stability' or 'integrity,'" and observing that "[o]n remand, the agency can attempt to explain this abnormal-risk determination").

[104] *See* Keith R. Fisher, *Nibbling on the Chancellor's Toesies: A "Roguish" Concurrence with Professor Baxter*, 56 LAW & CONTEMP. PROBS. 45, 66 n.82 (1993), https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=4177&context=lcp.

[105] *Stoddard v. Board of Governors*, 868 F.2d 1308, 1312 (D.C. Cir. 1989).

[106] Fisher, *supra* note 104 at 66.

[107] *See id.* at 65-66. As discussed *infra* Section III.B.3, the author also misinterpreted legislative history. *See id.* at 65.

[108] *See* Schooner, *supra* 43, at 195-96 (citing Fisher, *supra* note 104, at 66); Julie Andersen Hill, *Regulating Bank Reputation Risk*, 54 GA. L. REV. 523, 560 n.221 (2020) (quoting Schooner, *supra* note 43, at 195-96).

[109] *See supra* notes 60-61 and accompanying text for the use of "risk of loss or damage" rather than the original "risk or loss or damage"

[110] *See* Johnson v. OTS, 81 F.3d 195, 204 (D.C. Cir. 1996) ("the fact that an act results in an 'actual loss' does not, by itself, establish that the act posed an abnormal risk").

[111] Landry v. FDIC, 204 F.3d 1125, 1138 (D.C. Cir. 2000) (rejecting a defense based on "continuing profitability" because "the concept of risk . . . is independent of the outcome in a particular case").

omissions do not appear to have been the result of intentional narrowing of the Horne Definition.[112] The more common approach is to retain them all.[113]

Today the only relevant insurance fund for purposes of the federal banking agencies is the Deposit Insurance Fund (DIF) administered by the FDIC.[114] As a practical matter, risk to the "agencies administering the insurance funds" should be read as including risks to the DIF itself rather than only separate risks to the FDIC, which administers the DIF. While risk to the FDIC itself is sufficient,[115] the legislative history makes clear that the inquiry includes risk to the insurance funds as well.[116]

III. Attempts to Impose a Heightened Effects Requirements: the Main Debate

The meaning of the term "unsafe or unsound practice" remains a matter of dispute.[117] Perhaps because of the clear legislative history, that dispute has mostly focused on the level of risk necessary for a practice to be unsafe or unsound and whether any restrictions should be added or read into the open-ended nature of the Horne Definition, rather than more sweeping changes. Even when courts depart significantly from the Horne Definition's language, they continue to refer to its elements.[118] The FDIC/OCC proposal appears to have taken the Horne Definition as a starting point.[119] This section argues that the Horne Definition's approach of requiring just an abnormal risk, as originally articulated in the Horne Memo[120] is the best definition because it has solid roots in legislative history and comports with the statutory text and structure. It reviews attempts to narrow the interpretation by imposing heightened effects requirements and analyzes their shortcomings.

Until recently, the FBAs had followed the Horne Definition without qualification.[121] *Adams*, an OCC final decision terminating an enforcement action against an IAP, analyzes the meaning of "unsafe or unsound practices." It provides a thorough discussion of the Horne Definition

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[112] *See, e.g.*, First National Bank of Eden v. Department of the Treasury, 568 F.2d 610, 611 n.2 (8th Cir. 1978)
[113] *See, e.g. Gulf Federal*, 651 F.2d at 264.
[114] At the time of FISA's enactment, the Federal Savings and Loan Insurance Corporations (FSLIC) insured deposits at savings associations. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 abolished the FSLIC and gave the FDIC responsibility for insuring the deposits of savings associations. Arguably, the Horne Definition's reference to insurance funds could also refer to the Farm Credit Insurance Corporation's Insurance Fund and the National Credit Union Administration's Share Insurance Fund. That question is beyond the scope of this paper.
[115] *See Seidman*, 37 F.3d at 937 (holding that an "attempt to obstruct [an OTS] investigation, if continued, would pose an abnormal risk of damage to OTS," which administered the FSLIC, and therefore "constitutes an 'unsafe or unsound practice'").
[116] 112 CONG. REC. 26,474.
[117] *See e.g.*, Hill, *supra* note 108, at 558-61 (citing Heidi Mandanis Schooner, *Big Bank Boards: The Case for Heightened Administrative Enforcement*, 68 ALA. L. REV. 1011, 1021 (2017)).
[118] *See, e.g.*, *Landry*, 204 F.3d, at 1138 (equating DC circuit precedent on the meaning of unsafe or unsound practices with language derived from the Horne Definition).
[119] 90 Fed. Reg. at 48,837.
[120] With the minor typographical change of "or" to "of" discussed *supra* Section II.B.4.
[121] *See Adams*, *supra* note 32, at 23.

and explains why the unqualified form is the best interpretation.[122] *Adams* notes that the extensive discussion merely "reaffirm[ed] the OCC's long-held interpretation, consistent with that of the other Federal banking agencies, of the phrase 'unsafe or unsound practice.'"[123] The OCC's position rested on several grounds, including the statutory text and structure, the legislative history, case law interpreting "unsafe or unsound practices," and the now-overturned judicial doctrines set forth in *Chevron* and *Brand X*.[124] The Fed and FDIC have cited *Adams* in support of their continued use of the Horne Definition.[125]

Several courts have long put forth definitions of "unsafe or unsound practices" that narrow the Horne Definition by requiring a threat to the "stability," "integrity," "soundness," etc. of the institution.[126] These additions would impose a restrictive gloss, scoping out many potentially unsafe or unsound practices by heightening the required effects of a practice to be deemed unsafe or unsound. In *Adams*, the OCC directly addressed such judicial interpretations.[127] Despite the previous unanimity among the FBAs in support of the Horne Definition, they are now moving away from it. The FDIC/OCC proposal would also require heightened risks relative to the Horne Definition by requiring that the practice cause actual or likely material harm to the financial condition of the bank or be likely to present a material risk of loss to the DIF.[128] The Fed has announced that it will be changing its interpretation but has not provided specifics as of this writing.[129]

Portions of the following analysis rely heavily on arguments already made by others, including by the OCC in *Adams*, but they are worth examining again here for several reasons. First, *Adams* cited *Chevron* and *Brand X* in concluding that courts should defer to the FBAs' interpretation of "unsafe or unsound practices."[130] When the OCC determined that the unqualified Horne Definition was the appropriate interpretation, it immediately cited *Brand X* as permitting it to disregard contrary judicial precedent in the interpretation of ambiguous terms.[131] With *Loper Bright*, the Supreme Court overturned *Chevron* and *Brand X*,[132] perhaps inviting greater scrutiny of the OCC's previous position and, by extension, that of the other FBAs. But reliance on *Chevron* and *Brand X* is not necessary to make the case for the Horne Definition. While even *Adams* may not strictly rely on those cases, reviewing courts may be skeptical of an analysis with numerous citations to overturned precedent, even if that precedent was not determinative. In short, explaining why the Horne Definition is correct without *any* citation to *Chevron* or *Brand X* is worthwhile given *Loper Bright*.

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[122] *See id.* at 3-6, 9-26

[123] *Id.* at 3.

[124] *See id.* at 5 (citing National Cable & Telecommunications Ass'n v. Brand X Internet Services, 545 U.S. 967 (2005); Chevron U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984)).

[125] *See, e.g.*, *In re Smith and Kiolbasa* at 39-42; *In re Burgess*, FDIC-14-0307e, FDIC-14-0308k at 21-22 (Aug. 7, 2017).

[126] *See, e.g.*, *Gulf Federal*, 651 F.2d at 264, 267; *Seidman*, 37 F.3d at 928 .

[127] *See Adams*, *supra* note [XXX], at 17-25.

[128] *See* 90 Fed. Reg. at 48,849.

[129] *See* Mary Aiken and Julie Williams, *supra* note 8 at 3.

[130] *See Adams* at 5.

[131] *See Adams* at 13.

[132] *Loper Bright*, 603 U.S. at 412.

Second, the Horne Definition is under threat. The FDIC/OCC proposal would impose heightened effects requirements,[133] and even before *Loper Bright*, banking interests continued to contest the Horne Definition.[134] Potential targets of enforcement actions also are likely to intensify their efforts for a more restrictive definition. A recent Eighth Circuit challenge to an OCC enforcement action asserted that *Gulf Federal* is the appropriate definition of unsafe or unsound practices,[135] despite the Eighth Circuit expressly rejecting it previously.[136]

Third, little scholarly and similar work on unsafe or unsound practices generally has explored the Horne Definition in depth. There are notable exceptions,[137] but some discussions of unsafe or unsound practices do not engage with the Horne Definition at all.[138]

Finally, following Treasury Secretary Bessent's announcement that "defin[ing] 'unsafe or unsound' by rule using more objective measures rooted in financial risk" is an administration priority,[139] the FDIC and the OCC did, in fact, propose a new, narrower definition,[140] and the Fed announced it is revising its own interpretation.[141] While analysis of the Fed's new approach must await announcement of the new interpretation, the FDIC/OCC proposal suffers from serious problems in light of the legislative history and structure. Though the proposal is clearly rooted in the Horne Definition, its modifications result in an entirely new definition, never before used by the FBAs or the courts. As explained *infra* Parts III-V, the proposal is unlawful.

The rest of this section reviews efforts to interpret "unsafe or unsound practices" as requiring heightened risks or harm compared to the Horne Definition, the legislative history, the relevant statutory text, and some practical considerations. This analysis shows that the unqualified Horne Definition is the best interpretation of the term "unsafe or unsound practices."

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[133] *See* 90 Fed. Reg. at 48,849.
[134] *See* GREG BAER & JEREMY NEWELL, BANK POLICY INSTITUTE, TOO BIG TO MANAGE: IT'S NOT THE LAW 1 (Feb. 14, 2023) (describing the standard as requiring a threat to an institution's financial integrity), https://bpi.com/wp-content/uploads/2023/02/Too-Big-To-Manage-Its-Not-the-Law.pdf.
[135] https://business.cch.com/BFLD/Petitioner-Brief-Anderson-v-OCC-8thCir-05212025.pdf at 30-33 [hereinafter Anderson Brief]. The OCC later settled with the IAP without imposing any civil money penalty, despite the previous Comptroller finding that the IAP had engaged in serious misconduct. *See* Desiree Mathurin, "Wells Fargo exec ordered to pay $10M in fraud scandal instead will pay nothing," The Charlotte Observer (Oct. 23, 2025), https://www.charlotteobserver.com/news/business/article312615285.html.
[136] *See* Greene County Bank v. FDIC, 92 F.3d 633, 636 (8th Cir. 1996).
[137] *See e.g.*, Holzman, *supra* note 55, at 432; Hill, *supra* note 108 at 558-561; Schooner, *supra* note 43 at 189-96.
[138] *See, e.g.*, Christina P. Skinner, *Central Banks and Climate Change*, 74 VANDERBILT L. REV. 1301 (2021), https://scholarship.law.vanderbilt.edu/cgi/viewcontent.cgi?article=4783&context=vlr; Graham S. Steele, *Major Questions' Quiet Crisis*, 31 GEO. MASON L. REV. 265, 282-83, 294, 305 (2024) (discussing unsafe or unsound practices without referring to the Horne Definition), https://lawreview.gmu.edu/wp-content/uploads/2023/12/Steele-31-Geo-Mason-L-Rev-265-2024.pdf.
[139] Scott Bessent, "Remarks before the American Bankers Association" (Apr. 9, 2025), ttps://home.treasury.gov/news/press-releases/sb0078.
[140] *See* 90 Fed. Reg. at 48,849
[141] *See* Mary Aiken and Julie Williams, *supra* note 8at 3.

A. The Congressional Debate

Questions about the exact scope of the Horne Definition arose before enactment of FISA. Representative Chet Holifield voiced concerns about the meaning of "unsafe or unsound practices" based on his experience dealing with FHLBB investigations.[142] He raised various issues in direct response to other members reading him all or part of the Horne Definition.[143] Among his complaints were that regulations could prohibit the activities that the Horne Memo specifically described as unsafe or unsound, the FBAs habitually did not provide written descriptions of what exact practices were unsafe or unsound when accusing a bank of such practices, the Horne Definition itself "is no explanation," and that charges of unsafe or unsound practices had, to that time, been "applied arbitrarily, capriciously, and discriminatorily" in an inconsistent manner across banks.[144]

Supporters of the bill did not brush these concerns aside. House Banking Committee Chair Wright Patman noted that the issue of the meaning of "unsafe or unsound practices" was why FISA's enforcement provisions were set to expire and that the Committee planned to hold meetings before then.[145] However, enough members were satisfied with the Horne Definition, confined as it was to legislative history, for FISA to pass. In its final form, the bill set the expiration date for the enforcement provisions to June 30, 1972.[146] The Housing and Urban Development Act of 1970 repealed the expiration,[147] making FISA's enforcement action provisions permanent without Congress ever adding statutory detail to the meaning of unsafe or unsound practices.

Though Representative Holifield's concerns did not lead to action, comments from Chair Patman during the debate appear to be the genesis of courts' willingness to impose a restrictive gloss on the Horne Definition rather than simply follow its exact wording and a factor in the FDIC/OCC proposal's narrowing of "unsafe or unsound practices."[148] In discussing FISA, Patman said, "Of course, it should be clear to all that the cease-and-desist powers and management removal powers are aimed specifically at actions impairing the safety or soundness of our insured financial institutions. These new flexible tools relate strictly to the insurance risk and to assure the public of sound banking facilities."[149] These comments would have no identifiable impact on courts' review of enforcement actions based on unsafe or unsound practices until 15 years later.

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[142] 112 CONG. REC. 25,007-08.
[143] 112 CONG. REC. 25,008.
[144] 112 CONG. REC. 25,008.
[145] 112 CONG. REC. 25,007-08.
[146] Financial Institutions Supervisory Act, Pub. L. No. 89-695, § 401, 80 Stat 1028, 1056 (1966).
[147] *See* Pub. L. No. 91-609, § 908, 84 Stat. 1770, 1811.
[148] *See infra* Section III.B.3.
[149] 112 CONG. REC. 24,984.

B. *Gulf Federal*, Its Progeny, and the FDIC/OCC Proposal

Several early cases followed the Horne Definition closely or did not provide a clear judicial interpretation of "unsafe or unsound practices."[150] That changed with *Gulf Federal*. The Fifth Circuit's 1981 decision has been fairly influential, but the reasoning has serious problems. Despite these shortcomings, which the FBAs have previously recognized,[151] the FDIC/OCC proposal approvingly cites *Gulf Federal* in support of its narrow interpretation of "unsafe or unsound practices."[152] The rest of this section first describes *Gulf Federal's* restrictive gloss and the FDIC/OCC proposal. It then discusses the problems with those approaches, as well as the somewhat unique approach of the DC Circuit, where banks and IAPs may appeal enforcement actions.[153] It shows these interpretations' higher risk requirements relative to the Horne Definition are unwarranted.

1. *Gulf Federal's* Restrictive Gloss

Gulf Federal involved Gulf Federal Savings and Loan Association, which had overcharged customers by calculating interest using a 360-day year–a common practice then and now–rather than a 365 day year as provided in the loan agreements.[154] The FHLBB issued a C&D order requiring Gulf Federal to follow the loan agreements and make restitution to borrowers who made overpayments.[155]

Gulf Federal challenged the C&D order, arguing that the FHLBB's "function is to assure the financial stability of savings and loan associations, not to protect consumers from practices considered by the Board to be unfair."[156] After quoting Patman's comments on the purpose of the C&D and removal powers, the court recognized the Horne Definition as "the authoritative definition"[157] before qualifying it, without any acknowledgement that its new, purportedly Patman-consistent approach, was narrower. Ultimately, it "limit[ed] the 'unsafe or unsound practice' provision to an association's financial condition"[158] and held that "the 'unsafe or unsound practice' provision . . . refers only to practices that threaten the financial integrity of the association."[159] The court concluded that the risks the FHLBB identified - "potential liability to repay overcharged interest, and an undifferentiated 'loss of public confidence' in the bona fides of Gulf Federal's operations . . . bear only the most remote relationship to Gulf Federal's financial integrity and the government's insurance risk."[160] Describing these risks as "qualitatively different" from the risks identified in the Horne

[150] *See, e.g.*, Groos Nat'l Bank v. Comptroller of the Currency, 573 F.2d 889, 897 (5th Cir. 1978); *Eden*, 568 F.2d, at 11 n.2.
[151] *See, e.g.*, *Adams*, *supra* note 32 at 17-23.
[152] 90 Fed. Reg. at 48,838 n.17, 48,839 n.28-29.
[153] *See* 12 U.S.C. § 1818(a)(8)(D), (c)(2), (f), (h)(2), (n).
[154] *c*, at 261-62.
[155] See *id*. at 262.
[156] *Id.*
[157] *Id.* at 264.
[158] *Id*. at 265.
[159] *Id.* at 267.
[160] *Id.* at 264.

Memo,[161] the court noted the relatively small risk compared to Gulf Federal's total assets[162] and that repayment to customers would "mak[e] definite and immediate an injury which is, at worst, contingent and remote."[163] As a result, restitution would be inconsistent with "safeguard[ing] Gulf Federal's finances."[164] It further concluded that considering practices that result in a loss of public confidence to be unsafe or unsound "would result in open-ended supervision," be "unlike the loss of confidence which engendered the bank failures of the 1930's," and "depart[] entirely from the congressional concept of acting to preserve the financial integrity of [the FHLBB's] members."[165]

2. The FDIC/OCC Proposal

The FDIC/OCC Proposal would define "unsafe or unsound practices" as:

a practice, act, or failure to act, alone or together with one or more other practices, acts, or failures to act, that:
(1) Is contrary to generally accepted standards of prudent operation; and
(2)
    (i) If continued, is likely to—
        (A) Materially harm the financial condition of the institution; or
        (B) Present a material risk of loss to the Deposit Insurance Fund; or
    (ii) Materially harmed the financial condition of the institution.[166]

The FDIC/OCC proposal would also require tailoring "based on the capital structure, riskiness, complexity, activities, asset size and any financial risk-related factor that the [agency] deems appropriate."[167]

The proposed definition differs in several significant ways from the Horne Definition. The risk probability threshold that would authorize an enforcement action would be raised to "likely" from "possible." This change also differs from *Gulf Federal*, which displayed skepticism that "contingent and remote" risks could cause a practice to be unsafe or unsound[168] but still framed the inquiry as focused on the "possible consequences" of a practice.[169]

The FDIC/OCC proposal also would change the requisite type of risk or harm to "material" from "abnormal." Unlike "abnormal," "material" risk necessarily involves the degree, rather than the type, of risk, shifting a qualitative inquiry to a quantitative one.[170] As discussed in more detail *infra* Part IV, the preamble to the proposed rule clarifies that paragraph (2)(i)(B) captures likely material risk of loss to the DIF due to a material increase in the odds that the

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[161] *Id.*
[162] *Id.* at 264 n.4.
[163] *Id.* at 264.
[164] *Id.*
[165] *Id*. at 265.
[166] 90 Fed. Reg. at 48,849.
[167] *Id*.
[168] *Gulf Federal*, 651 F.2d,*l* at 264.
[169] *Id.* at 264 (quoting 112 CONG. REC. 24,984).
[170] *See infra* III.B.6.c.

bank will fail.[171] In other words, it is still a microprudential inquiry focused on loss to the bank. To the extent paragraph (2)(i)(B) or any other provision of the proposed definition would have the same practical meaning as *Gulf Federal*''s restrictive gloss requiring a threat to a bank's financial stability, integrity, etc., the criticisms of *Gulf Federal* herein would apply, and should be read as applying, equally to the FDIC/OCC proposal.[172]

The preamble to the FDIC/OCC proposal further clarified the agencies views of what "unsafe or unsound practices" means. "Financial condition" would be limited to "capital, asset quality, earnings, liquidity, or sensitivity to market risk."[173] The proposed definition "would not include risks to the institution's reputation unrelated to financial condition."[174] In addition, "the agencies expect that it would be rare for an institution to exhibit unsafe or unsound practices . . . based solely on the institution's policies, procedures, documentation or internal controls, without significant weaknesses in the institution's financial condition."[175] Regarding tailoring, "the agencies would not expect that a particular projected percentage decrease in capital or liquidity that rises to the level of materiality for the largest institutions would necessarily also be material for community banks."[176]

3. *Gulf Federal* and the FDIC and OCC Misread and Misapplied Patman's Statement

Gulf Federal's restrictive gloss - effectively requiring that the practices put the institution at risk of failure - and the FDIC/OCC proposal are unmoored from the Horne Definition. In both cases, the apparent rationale for the departure included Patman's comments. *Gulf Federal* quoted Patman's remarks in explaining why, in its view, the term "unsafe or unsound practices" was "restricted by its limitation to practices with a reasonably direct effect on an association's financial soundness."[177] The FDIC/OCC Proposal suggests that Patman's comments clarify the meaning of "unsafe or unsound practices."[178] Some commentators have pointed to his remarks as informative of the meaning of unsafe or unsound practices.[179] That reliance is entirely misplaced for multiple reasons.

First and most importantly, Patman's comments reflect the purpose and scope of the C&D and removal powers rather than the meaning of unsafe or unsound practices.[180] These are distinct concepts. FISA granted C&D and removal powers not just in the case of unsafe or

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171 *See* 90 Fed. Reg. at 48,839.
172 Note that (2)(i)(B) would capture practices "that materially increase[] the probability that an institution would fail." 90 Fed. Reg. at 48,839. Whether there is daylight between such practices and those that threaten a bank's financial integrity is unclear.
173 *Id.* at 48.838.
174 *Id.* at 48,839.
175 *Id.* at 48,839.
176 *Id.* at 48,839.
177 *Gulf Federa*l, 651 F. 2d at 264 (quoting 112 CONG. REC. 24,984).
178 *See* 90 Fed. Reg. at 48,837.
179 Fisher, *supra* note 104, at 65 (quoting Patman's comments as "demonstrat[ing] the magnitude of injury Congress sought to prevent"); Schooner, *supra* note 43, at 190 (describing Patman's comments as "[t]he only other significant legislative history" besides the Horne Memo).
180 *See* 112 CONG. REC. at 24,984.

unsound practices, but also for violations of law.[181] Patman's point was to emphasize when, given an unsafe or unsound practice or a violation of law, or a reasonable belief that such a practice or violation was about to occur, the AFBA could bring a C&D or removal action. His statement said nothing about what an unsafe or unsound practice is.

Second, if unsafe or unsound practices relate strictly to insurance risk, as the Fifth Circuit concluded and the FDIC/OCC proposal suggests based on Patman's comments,[182] the applicability of 12 U.S.C. § 1818 to entities other than insured banks raises significant issues. Congress subjected bank holding companies and their nonbank subsidiaries to certain provisions of 12 U.S.C. § 1818 in 1974.[183] One year after *Gulf Federal*, Congress extended this authority to uninsured national banks and bank service companies.[184] By making the C&D and removal and prohibition powers available for unsafe or unsound practices involving such entities, Congress indicated that those authorities do not "relate strictly to insurance risk." A threat to the financial integrity of an uninsured entity would not directly or immediately present (and would be neither necessary nor sufficient for such an entity's conduct to create) insurance risk to the government. For that reason, the *Gulf Federal* gloss is inappropriate for those entities even on *Gulf Federal*'s own terms.

Further, whether Patman's comments are best read as endorsing *Gulf Federal's* restrictive approach is unclear. Nowhere does he refer to threats to a bank's financial integrity. Instead, the Fifth Circuit interpreted references to "actions impairing the safety or soundness of our insured financial institutions," "insurance risk" and the need to "assure the public of sound banking facilities" as suggesting a threat to a bank's financial integrity was required. The Fifth Circuit also appears to have interpreted this language as requiring something like an imminent threat of a bank failure and risk to the insurance funds,[185] which is at odds with the text of the Horne Definition, which it recognized as "authoritative."[186]

Even if Patman did intend for something like the *Gulf Federal* restrictive gloss, his comment was wrong on its own terms with respect to the bill that was actually enacted. There were and still are no effects requirements - financial loss, prejudice to depositors, or anything else approximating a threat to the financial stability of the bank - for standard C&D proceedings.[187] To the extent Patman intended to describe what FISA required for agency use of the ordinary C&D powers, he was simply wrong.

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181 Pub. L. No. 89-695, §§ 101(a), 202.

182 *See Gulf Federa*l, 651 F. 2d at 264 (quoting Patman's comments on the the C&D and removal powers as "relat[ing] strictly to the insurance risk" and concluding that the conduct at issue "b[ore] only the most remote relationship to . . . the government's insurance risk"), 90 Fed. Reg. at 48,837.

183 Pub. L. No. 93-495, § 110, 88 Stat. 1500, 1506 (1974) (codified at 12 U.S.C. § 1818(b)(3)).

184 Pub. L. No. 97-320, §§ 404(c), 709, 96 Stat. 1469, 1512, 1543 (1982) (codified at 12 U.S.C. §§ 1818(b)(5), 1867(b)). Congress would later expand the scope of 12 U.S.C. § 1818 to nonbank financial companies supervised by the Fed. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 162, 124 Stat. 1376, 1421-22 (2010) (codified at 12 U.S.C. § 5362).

185 *See Gulf Federa*l, 651 F. 2d at 264-65 (concluding that the practice at issue was not unsafe or unsound because of the "remote relationship to Gulf Federal's financial integrity and the government's insurance risk" and the "loss of [public] confidence identified by the Board is unlike the loss of confidence which engendered the bank failures of the 1930's").

186 *Id.* at 264.

187 *See* 12 U.S.C. § 1818(b)-(c); Pub. L. No. 89-695, §§ 101(a), 201.

The removal provisions did, and still do, require certain specific effects, but they are no longer consistent with Patman's description, if they ever were. In addition to misconduct, FISA required that the AFBA determine that the bank "has suffered or will probably suffer substantial financial loss" or that depositors "could be seriously prejudiced."[188] Today the standards are lower. Congress has removed the requirement that the potential financial loss be "substantial" and that the potential prejudice to depositors be "serious."[189] Congress also allowed any financial gain or other benefit to satisfy the effects prong,[190] meaning no risk of financial loss or depositor prejudice is needed. FISA's requirement of substantial financial loss or serious prejudice to depositors - ambiguous terms themselves - may not necessarily implicate a bank's financial stability. A bank policy that materially interferes with depositors' ability to redeem their deposits would seriously prejudice depositors, but it would not automatically threaten the bank's financial integrity. Similarly, a very large bank could lose hundreds of millions of dollars without a threat to its financial integrity.[191]

Patman's error is obvious when considering violations of law. In the case of a violation of law, or even "a reasonable cause to believe that the bank is about to violate[] a law . . . the agency [could] issue and serve upon the bank a notice of charges in respect thereof."[192] A violation of law or an unsafe or unsound practice was and is enough for C&D proceedings, regardless of effects or culpability.

Gulf Federal avoided that issue because it concluded that no violation of law had occurred.[193] But it bizarrely noted that "[t]he 'violation of law' provision . . . may be subject to the same limits as [it imposed on] the 'unsafe or unsound practice' provision."[194] To be clear, *Gulf Federal* held that the practices at issue were not unsafe or unsound because the risks involved "b[ore] only the most remote relationship to Gulf Federal's financial integrity and the government's insurance risk," and the court suggested a similar requirement may apply to violations of law. There is no absolutely statutory basis for interpreting "violation" or "unsafe or unsound practice" to require a threat to a bank's financial integrity and the government's insurance risk. Given the specific effects requirements for temporary C&D orders and removals, the court's suggestion would amount to a judicial imposition of an entirely extratextual requirement.[195]

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188 12 U.S.C. § 1818(b)-(c); Pub. L. No. 89-695, §§ 101(a), 201.
189 12 U.S.C. § 1818(e)(1)(B)(i)-(ii).
190 12 U.S.C. § 1818(e)(1)(B)(iii).
191 As the OCC noted, the *Gulf Federal* gloss "implied that a large institution would have insulation from a charge of unsafe or unsound practices not available to identical conduct engaged in by a smaller institution." *Adams*, *supra* note 32, at 22.
192 *See* 12 U.S.C. § 1818(b)-(c); Pub. L. No. 89-695, §§ 101(a), 201.
193 *See Gulf Federal,* 651 F.2d, at 267.
194 *Id.* at 265 n.5.
195 Nevertheless, two years later, the Fifth Circuit did just that. In *First National Bank of Bellaire v. Comptroller of the Currency*, the court erroneously cited *Gulf Federal*'s dicta discussing the meaning of "violation" as if it had held that a violation of law required "a reasonably direct effect on a bank's financial stability." 697 F.2d 674, 681 (5th Cir. 1983). The court offered no explanation for this shift or why it imposed additional effects requirements on the meaning of the term "violation." Again, the source of the confusion was *Gulf Federal*'s elision of Chair Patman's description of the purpose and scope of the C&D proceedings and removal powers with the meanings of "unsafe or unsound practices" and "violations." Congress had clarified the meaning of "violation" in 1978, expressly defining it as "includ[ing] without limitation any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation." Financial

At bottom, what appears to have happened in the Fifth Circuit is this: a strand of legislative history discussed the *purpose* of two types of enforcement authorities, not the *meaning* of "unsafe or unsound practices." The comments in the legislative history misstated the contents of the subsequently enacted bill with respect to those enforcement authorities. The Fifth Circuit conflated the erroneous commentary on the predicates for certain enforcement actions with the definitions of the types of misconduct necessary to bring such enforcement actions. As a result, it imposed a restrictive gloss on the Horne Definition. This restrictive gloss, rooted in the Fifth Circuit's mistaken analysis of legislative history, is the ultimate source of all judicial attempts to narrow the Horne Definition by imposing a heightened effects requirement. All roads lead back to *Gulf Federal* and its misapplication of Patman's statement.[196]

This error extends to the FDIC/OCC proposal, which cites *Gulf Federal* several times in support of its narrow definition of "unsafe or unsound practices."[197] Like *Gulf Federal*, it also cites Patman's statement, which it says "further described the authority added" by FISA.[198] By quoting Patman and then proposing a narrower interpretation of "unsafe or unsound practices" than the unqualified Horne Definition, the FDIC and OCC appear to have followed the Fifth Circuit and others in misusing Patman's comments.

4. The Restitution and Civil Money Penalty Provisions of 12 U.S.C. § 1818 Further Demonstrate the Problems with Heightened Effects Requirements.

Institutions Regulatory and Interest Rate Institutions Control Act, Pub. L. No. 95-630, § 107(e)(1), 92 Stat. 3641, 3660 (1978). The circularity of the definition, which reveals its true purpose to *include* actions that may be reasonably thought to be outside the bounds of the plain meaning, remains substantially the same today. 12 U.S.C. § 1813(v). To ensure "include" was read broadly, Congress actually defined "includes" and "including." 12 U.S.C. § 1813(t). "The terms 'includes' and 'including' shall not be construed more restrictively than the ordinary usage of such terms so as to exclude any other thing not referred to or described." 12 U.S.C. § 1813(t)(1). That definition "shall not be construed as creating any inference that the term 'includes' or 'including' in any other provision of Federal law may be deemed to exclude any other thing not referred to or described." 12 U.S.C. § 1813(t)(2). This is the opposite of the Fifth Circuit's suggestion that a narrowing of the plain meaning was appropriate. *Bellaire*'s restrictive gloss on the meaning of violation is simply impossible to reconcile with the language of the statute as it stands today or at the time of the decision. No other court adopted the *Bellaire* view, and the Fifth Circuit itself has not applied that standard when dealing with other statutes that authorize actions in response to violations of law. *See Adams*, *supra* note 32, at 38-39 (citing Interamericas Investment, Ltd. v. Board of Governors, 111 F. 3d 376 (5th Cir. 1997)). The Ninth Circuit expressly rejected an argument that a C&D order requires an adverse effect on financial stability, holding that "upon a finding of a regulatory violation[, n]o other finding — of intent to violate, financial impact, or risk to the insurance fund — is required." Saratoga Sav. and Loan Ass'n v. Federal Home Loan Bank, 879 F. 2d 689, 693 (9th Cir. 1989).

[196] *See, e.g., Frontier State Bank*, 702 F.3 at 604 (defining "unsafe or unsound practices" as the Horne Definition plus "a reasonably direct effect on an association's financial soundness"). That decision cited *Simpson v. OTS*. *Id. Simpson* cited *Hoffman v. FDIC*. Simpson v. Office of Thrift Supervision, 29 F.3d 1418, 1425 (9th Cir.1994). And *Hoffman v. FDIC* cited *Gulf Federal.* Hoffman v. Federal Deposit Ins. Corp., 912 F.2d 1172, 1174 (9th Cir. 1990); *Adams*, *supra* note 32 at at 13.

[197] *See* 90 Fed. Reg. at 48838 n.17, 48839 n.28-29.

[198] *Id.* at 48,838.

The Fifth Circuit fundamentally misunderstood what risks Congress considered to be in scope for purposes of unsafe or unsound practices. *Gulf Federa*l questioned how forcing a bank to reimburse overcharged customers (*i.e.*, make restitution) could "safeguard Gulf Federal's finances" because it would "mak[e] definite and immediate an injury which is, at worst, contingent and remote."[199] Congress apparently thought otherwise and subsequently clarified this point. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) expressly authorized C&D orders that required certain specific affirmative actions, including "to make restitution or provide reimbursement, indemnification, or guarantee against loss if- (i) such depository institution or such party was unjustly enriched in connection with such violation or practice; or (ii) the violation or practice involved a reckless disregard for the law or any applicable regulations or prior order of the appropriate Federal banking agency."[200] Congress could not have been clearer that there are circumstances in which an unsafe or unsound practice could warrant restitution (*i.e.*, a *worsening* of the financial condition of the bank) through the C&D authority. This subsequent legislation undermines *Gulf Federal*'s rationale for qualifying the Horne Definition and the circumstances in which C&D orders are appropriate because the Fifth Circuit's general logic was correct. If an unsafe or unsound practice had to pose a threat to the financial integrity of a bank, it really would, or at least could, be counterproductive to require the bank to harm its own financial integrity by making restitution.

The power of the FBAs to impose CMPs further undercuts *Gulf Federal's* restrictive gloss. At the time of *Gulf Federal*, CMPs were only authorized when banks failed to implement final C&D orders.[201] Following *Gulf Federal's* logic, the Fifth Circuit would have required the AFBA to first demonstrate that an unsafe or unsound practice threatened the financial integrity of the bank and then, after the C&D order was issued, determine a CMP was appropriate for the bank's failure to implement the C&D order. The court's concerns about the impacts of requiring restitution to overcharged customers would apply here as well. Specifically, a CMP would only be authorized when the bank's financial integrity was already in question, meaning that the penalty itself would undercut the Fifth Circuit's expectation that the federal banking agencies' enforcement actions safeguard supervised institutions' finances. Today the CMP authority is far broader than when *Gulf Federal* was decided,[202] and it is even clearer that unsafe or unsound practices need not threaten the financial integrity of a bank.

Similar logical problems afflict the FDIC/OCC proposal, if to a lesser degree. Considering the different types of harm or risk the proposal would require makes this clear. If a bank had suffered actual or likely material harm, it is not clear why compounding that harm via a CMP or a restitution would be advisable. A mere abnormal risk does not necessarily implicate the same concerns regarding the effect of such an enforcement action on the bank's financial condition. That leaves practices that are likely to present a material risk of loss to the DIF, or, as the preamble clarifies, practices that "materially increases the probability that an institution would fail."[203] If a bank's probability of failure has materially increased, it is not

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[199] *Gulf Federal,* 651 F.2d at 264.
[200] https://www.govinfo.gov/content/pkg/STATUTE-103/pdf/STATUTE-103-Pg183.pdf#page=1 Sec. 902(a). Codified at 12 U.S.C. § 1818(b)(6).
[201] https://www.govinfo.gov/content/pkg/STATUTE-92/pdf/STATUTE-92-Pg3641.pdf at Sec. 107(e)(1); 12 U.S.C. § 1818(i)(2) (1982).
[202] *See* 12 U.S.C. § 1818(i)(2).
[203] 90 Fed. Reg. at 48,839.

clear that the *Gulf Federal* court would have supported concrete harms to its financial condition via restitution or a CMP.

5. *Gulf Federal* and the FDIC/OCC Proposal Exclusions of Certain Risks Are Contrary to Legislative History, Case Law, and FIRREA.

Gulf Federal and the FDIC/OCC proposal would exclude or at minimum deprioritize certain risks. Despite recognizing the Horne Definition as authoritative, *Gulf Federal* ignored another portion of the Horne Memo stating that "[t]he concept of "unsafe or unsound practices" is one of general application which touches upon the entire field of the operations of a financial institution."[204] The Horne Definition itself refers to "loss or damage."[205] *Gulf Federal* and the FDIC/OCC Proposal would ignore this legislative history and generally exclude certain risks.

a. Loss or Damage

The FDIC/OCC proposal generally would ignore that Horne and Congress understood "unsafe or unsound practices" as covering losses and damage. The FDIC/OCC proposal is focused on "harm" and "the [FDIC and OCC] generally interpret harm to refer to financial losses. Therefore, to be an unsafe or unsound practice, a practice, act, or failure to act generally must have either caused actual material losses to the institution or must be likely to cause material loss or other negative financial impacts to the institution."[206] Assuming "loss" covers financial losses, the FDIC and OCC have announced, without legal explanation, that they will generally ignore the Horne Definition's reference to "loss or damage."

b. Reputation Risk and Consumer Protection

Gulf Federal held that the federal banking agencies had no safety and soundness authorities with respect to banks' treatment of customers or with respect to public confidence in a bank's reputation.[207] The FDIC/OCC proposal now cites this language as justification for excluding reputation risk considerations from the proposed unsafe or unsound practices standard.[208]

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[204] 112 CONG. REC. at 26,474. *See also* Mary Thornton Horne, *Gulf Federal Savings and Loan v. Federal Home Loan Bank Board: A New Judicial Attitude toward the Regulation of Financial Institutions?*, 31 BUFFALO L. REV. 233, 241 (1982), https://digitalcommons.law.buffalo.edu/cgi/viewcontent.cgi?article=1843&context=buffalolawreview ("The court . . . failed to mention a warning issued by Chairman Horne . . . that the concept of 'unsafe and unsound practices' extended to every aspect of a financial institution's operation . . . .").

[205] 112 CONG. REC. 26,474.

[206] 90 Fed. Reg. at 48,839.

[207] *See Gulf Federal,* 651 F.2d, 265 ("If the Board can act to enforce the public's standard of fairness in interpreting contracts, the Board becomes the monitor of every activity of the association in its role of proctor for public opinion. This departs entirely from the congressional concept of acting to preserve the financial integrity of its members."). *See also Adams*, *supra* note 32, at 20.

[208] *See* 90 Fed. Reg. at 48839 n.28.

But this is not just a mere disagreement about the import of legislative history. The Supreme Court rejected *Gulf Federal*'s reasoning in a different case the following year, when it upheld an FHLBB mortgage contract regulation.[209] As the OCC has previously noted, the Supreme Court focused on *Gulf Federal*'s preemption analysis, but the same reasoning applied to *Gulf Federal*'s unsafe or unsound practices analysis.[210] The Fifth Circuit now recognizes that "*Gulf Federal* is not good authority for the proposition that the power delegated to the FHLBB was limited solely to the internal management of federal savings associations."[211] It is not clear why the FDIC/OCC proposal relies on *Gulf Federal*'s rejection of consideration of loss of public confidence as the sole justification for excluding reputation risk from its unsafe or unsound practices interpretation.[212] It offers no explanation for the change in the OCC"s position and is plainly in tension with Supreme Court precedent regarding the scope of the agency's authorities. It is simply wrong to suggest, as the FDIC/OCC proposal does, that the law compels the exclusion of reputation risk.

The FIRREA amendments discussed *supra* Section III.B.4 also are "in direct conflict with *Gulf Federal*'s conclusion that the supervisory agency has no consumer protection authority and thus supersedes that aspect of the *Gulf Federal* analysis."[213] It likewise conflicts with similar aspects of the FDIC/OCC proposal.

c. Policies, Procedures, Documentation, and Internal Controls

The FDIC/OCC proposal states that the two agencies "expect that it would be rare for an institution to exhibit unsafe or unsound practices, as defined in the proposed rule, based solely on the institution's policies, procedures, documentation or internal controls, without significant weaknesses in the institution's financial condition (*i.e.*, weaknesses that caused material harm to the financial condition of the institution, or were likely to materially harm the financial condition of the institution or likely to present material risk of loss to the DIF)."[214] While the parenthetical indicates such practices could still be unsafe or unsound if they otherwise satisfy the proposed definition, the same is true of literally any practice. Highlighting this issue in the preamble suggests a reduced willingness to find an unsafe or unsound practice on these basis, even if it satisfies the proposed definition. The unavoidable suggestion is that FDIC and OCC do not see inadequate policies, procedures, documentation, or internal controls as typically presenting the types of risks the proposed definition would capture.

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[209] *See* Fidelity Fed. Sav. & Loan Assn. v. De la Cuesta, 458 U.S. 141, 170 n.23. ("We . . . reject appellees' contention that the [FHLBB's] power to regulate federal savings and loans extends only to the associations' internal management, and not to any external matters, such as their relationship with borrowers. Although one federal and one state court have drawn this distinction, s*ee Gulf Federal Sav. & Loan Assn. v. Federal Home Loan Bank Bd.*, 651 F.2d at 266; *Holiday Acres No. v. Midwest Federal Sav. & Loan Assn.*, 308 N.W.2d at 478, we find no support in the language of the HOLA or its legislative history for such a restriction on the FHLBB's authority.") *See also Adams*, *supra* note 32, at 20-21.
[210] *See Adams* at 21.
[211] *First Gibraltar Bank v. Morales*, 19 F.3d 1032, 1051 (5th Cir. 1994).
[212] *See* 90 Fed. Reg. at 48839 n.28.
[213] *Adams*, *supra* note 32 at 22.
[214] 90 Fed. Reg. at 48,839.

6. Other Problems with the FDIC/OCC Proposal Heightened

The FDIC/OCC proposal includes heightened effects requirements. These changes in the proposal are generally justified on policy grounds rather than legal ones. As the FDIC and OCC put it: "The agencies believe this change [to the definition of "unsafe or unsound practices] will provide greater consistency for institutions and institution-affiliated parties and appropriately focus supervisory and institution resources on the most critical financial risks to institutions and the financial system."[215] Absent is a claim that the proposed definition is the best interpretation of the statute.

a. The Proposed Definition Is Unique and Without Precedent

As a preliminary matter, the FDIC/OCC proposal is novel. The FDIC and OCC do not cite any source for the specific definition proposed and appear to have developed it for the first time in the course of the rulemaking process. To do so almost 6 decades after FISA and the Horne Memo, and over 90 years after "unsafe or unsound practices" appeared in federal statutes[216] is striking. The FDIC and OCC appear to be taking the position that everyone who has ever weighed in on the meaning of "unsafe or unsound practices," including the agencies themselves, have been getting it wrong. The change in position at this late stage, undercuts claims that courts should respect the agencies' judgment.[217]

Furthermore, even courts that have not followed the Horne Definition have never held "unsafe or unsound practices" means what the FDIC and the OCC are proposing. The Horne Definition exists because a member of Congress asked what the term meant[218] and then both the Senate and the House of Representatives read the Horn Definition into the record.[219]

b. The FDIC and OCC Used Incorrect Methods of Statutory Interpretation

One of the few legal arguments for the change included in the FDIC/OCC proposal is the use of the ordinary meaning of "unsafe" and "unsound." The approach is misguided for several reasons.

[215] 90 Fed. Reg. at 48,837.
[216] *See* Holzman, *supra* note 32 at 428.
[217] *See Skidmore v. Swift & Co.*, 323 US 134, 140 (1944) ("The weight of [an agency's] judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.").
[218] *See* 112 Cong. Rec. at 25008 (remarks of Rep. Thomas W. L. Ashley explaining that he asked John E. Horne for a definition "because all of us are interested in the definition of the words 'unsafe and unsound'").
[219] *See* 112 Cong. Rec. 25008, 26474 (remarks of Rep. Ashley and Sen. Robertson).

As an initial matter, the FDIC and OCC describe a 1988 dictionary "commonly used at the time section 8 of the FDI Act was enacted."[220] This is a curious choice as FISA was enacted in 1966 and amended the already existing FDI Act.[221]

The FDIC and OCC also rely on the "ordinary meaning[s]" of the terms "unsafe" and "unsound." While courts usually apply a term's ordinary meaning, "this 'ordinary meaning' presumption can be overcome if there is evidence that the statutory term has a specialized meaning in law or in another relevant field."[222] "Unsafe or unsound practices" is such a term in banking law. By the time of FISA, the term had been in use for decades at the federal level and longer at the state level. Courts have not looked to the ordinary meaning of the words "unsafe" or "unsound." to interpret the term.[223]

The fact that a member of Congress asked the Chair of the FHLBB what the term meant and both houses read that definition into the record strongly suggests that "unsafe or unsound practices" is a term with a specialized meaning. The FDIC/OCC proposal does as well. If the ordinary meaning was the correct term, the FDIC and OCC would have proposed to define "unsafe or unsound practices" using ordinary dictionary definitions rather than inserting terms that reflect their own judgments. Instead, the FDIC/OCC proposal would create a new specialized meaning.

c. The FDIC/OCC Proposal Would Alter Key Terms Without Legal Justification.

The FDIC/OCC proposal would modify key terms and their meanings. These are not mere clarifications but substantive changes that significantly affect the scope of "unsafe or unsound practices." Three specific changes warrant discussion.

First, the FDIC/OCC proposal would require that a practice be "likely" to materially harm the financial condition of a bank or present material risk of loss to the DIF.[224] This change would be a sharp break from the agencies' current requirement that, consistent with the Horne Definition, risks be possible and a significantly higher standard proposed with no legal justification. It also adds ambiguity. Anything that can happen is "possible."[225] "Likely," on the other hand, may mean not just probable but "very probable."[226] Even courts that improperly evaluate foreseeability[227] in unsafe or unsound practices cases do not require the risk to be likely.[228] The change is especially problematic given the FDIC/OCC proposal's continued requirement that a practice be "contrary to generally accepted standards of prudent

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[220] 90 Fed. Reg. at 48,837 (citing 16 J.A. Simpson & E.S.C. Weiner, Oxford English Dictionary (2d ed. 1989)).
[221] *See* Pub. L. No. 89-695, § 202, 80 Stat 1028, 1046.
[222] VALERIE C. BRANNON, CONGRESSIONAL RESEARCH SERVICE, STATUTORY INTERPRETATION: THEORIES, TOOLS, AND TRENDS 20 (Apr. 5, 2018) (footnotes omitted) (citing FAA v. Cooper, 566 U.S. 284, 291-92 (2012) and Nix v. Hedden, 149 U.S. 304, 306 (1893)).
[223] *See* Calcutt v. FDIC, 37 F. 4th 293, 353-54 (6th Cir. 2022) (criticizing the court for not starting with the ordinary meaning) (Murphy, J., dissenting).
[224] 90 Fed. Reg. at 48,849.
[225] *See Possible,* Merriam-Webster, https://www.merriam-webster.com/dictionary/possible.
[226] *See Likely,* Merriam-Webster, https://www.merriam-webster.com/dictionary/likely.
[227] *See, e.g.*, *Landry v. FDIC*, 204 F.3d 1125 1138 (DC Cir. 2000).
[228] *See Foreseeable*, Merriam-Webster, https://www.merriam-webster.com/dictionary/foreseeable.

operation."[229] The FDIC/OCC proposal therefore provides significant protection to banks and IAPs that engage in imprudent acts. Even if they do, the FDIC and OCC would be required to show that material harm to the bank or material risk to the DIF is likely.

Assessing whether an outcome is "likely" to satisfy the proposed definition would be complicated. The FDIC and OCC would have to determine, on a case-by-case basis, whether a specific practice meets that standard. Adding to the challenge is the proposed definition's lack of clarity regarding the time period over which such assessments would be made. Consider a practice that examiners determine has a 30% chance of causing material harm over the course of a year but a 60% chance of causing material harm over the course of two years. Whether it is likely depends on the time period used. The longer the time period under consideration, the higher the odds that an imprudent act is "likely" to cause material harm or present a material risk of loss to the DIF. The "possible" standard from the Horne Definition is not just rooted in legislative history, but also avoids these complications.

Second, the FDIC/OCC proposal would require actual or likely "material harm" to the financial condition of a bank or a "material risk of loss" to the DIF. The Horne Definition used "abnormal" in 1966. The FDIC and OCC's preferred dictionary, *see infra* note 220 and accompanying text, defines "abnormal" as "[d]eviating from the ordinary rule or type; contrary to rule or system; irregular, unusual, aberrant."[230] At the time of FISA's enactment, one dictionary offered multiple definitions, leading with "deviating from the normal" and "differing from the typical."[231]
While that dictionary also defined "abnormal" as "greater than or superior to the normal," it offered yet another definition of "less than or inferior to the normal." *Id.* The common theme is that "abnormal" captures differences from normal. This is consistent with modern dictionaries.[232]

"Material" means something different. The most relevant definition is "real importance or great consequences."[233] While abnormal risks may be large, they do not need to be. Accordingly, the FDIC/OCC proposal would result in a shift in meaning away from "abnormal" risks, though it never discusses what "abnormal" means or why "material" is the better reading as a matter of law. For example, it does not explain the Horne Definition's use of "abnormal" when "materiality" had been used in financial regulation for decades before the enactment of FISA.[234] Presumably, Horne was aware of the concept.

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[229] 90 Fed. Reg. at 48,849.
[230] 1 J.A. Simpson & E.S.C. Weiner, Oxford English Dictionary 31 (2d ed. 1989) (abnormal). The FDIC/OCC cites this dictionary in assessing the meanings of "unsafe" and "unsound." *See* 90 Fed. Reg. at 48,837 n.11-12.
[231] 1 Webster's Third New International Dictionary and Seven Language Dictionary 4 (1966) (abnormal).
[232] *See Abnormal*, Merriam-Webster, https://www.merriam-webster.com/dictionary/abnormal.
[233] *Material*, Merriam-Webster, https://www.merriam-webster.com/dictionary/material. Because "material" was not used in FISA or the Horne Definition, the meaning at the time of FISA's enactment is not helpful in assessing what the FDIC and OCC mean when using the term today in the context of "unsafe or unsound practices."
[234] *See* David A. Katz and Laura A. McIntosh, "Corporate Governance Update: 'Materiality' in America and Abroad," Harvard Law School Forum on Corporate Governance (May 1, 2021), https://corpgov.law.harvard.edu/2021/05/01/corporate-governance-update-materiality-in-america-and-abroad/.

As with the use of "likely," the FDIC/OCC proposal would provide significant leeway for banks and IAPs to engage in imprudent acts without the possibility of an enforcement action. Imprudent acts that are likely to create risks of financial loss would be permissible, absent a violation of law, unless the risk is material. The same would be true in the case of actual financial loss. For example, if an IAP engaged in an act contrary to generally accepted standards of prudent operation that resulted in a loss of $10 million to a large bank, the IAP could argue that the (relatively) small financial loss precludes an unsafe or unsound practices finding.

To that point, the FDIC/OCC proposal adds ambiguity. Tthe FDIC and OCC chose not to define the term "material."[235] As one law firm noted, the FDIC/OCC proposal "does not explain whether or how their concept of 'materiality' relates to materiality under securities laws or other legal constructs."[236] What it means would be open for interpretation and a subject of dispute. As a practical matter, "materiality" determinations require judgments on the magnitude of uncertain risks over uncertain time horizons and their relative impact on a given bank. That is more complicated for banks and the agencies than determining if the risk is unusual or "other than those inherent in doing business."[237]

Third, the FDIC/OCC proposal rules out risks to the agencies and macroprudential risks to the DIF as potential grounds for an "unsafe or unsound practices" determination. The Horne Definition explicitly includes abnormal risk to the "agencies administering the insurance funds," independent of risks to a bank and its shareholders, as grounds for an unsafe or unsound practices finding.[238] Courts have held that imprudent practices that create such risks to the agencies are indeed unsafe or unsound.[239] If finalized, the FDIC/OCC proposal would not categorize such conduct as an unsafe or unsound practice unless it also satisfied the proposed definition in terms of risk to the bank itself.

Moreover, the FDIC/OCC proposal would exclude risks to the DIF that did not originate from a microprudential risk to a bank. The proposed regulatory text is confusing on this point, as it does refer to "material risk of loss to the Deposit Insurance Fund" as a separate criterion from risk of likely material harm to a bank.[240] However, the preamble clarifies that risk of loss to the DIF refers to such risks resulting from "a practice, act, or failure to act that materially

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[235] 90 Fed. Reg. at 48,839.
[236] Covington & Burlington LLP, "OCC and FDIC Propose Rule to Define Unsafe or Unsound Practices and Focus Supervisory and Enforcement Efforts on Material Financial Harm," (Oct. 9, 2025), https://www.cov.com/en/news-and-insights/insights/2025/10/occ-and-fdic-propose-rule-to-define-unsafe-or-unsound-practices-and-focus-supervisory-and-enforcement-efforts-on-material-financial-harm.
[237] *In re Vickery*, AA-OCC-EC-96-95, at 20 (Apr. 14, 1997), https://www.federalreserve.gov/boarddocs/press/enforcement/1997/19970415/Attachment.pdf (quoting *In re Van Dyke*, No. AA-EC-87-88 (June 13, 1988), slip op. at 26, *aff'd*, *Van Dyke v. Board of Governors*, 876 F.2d 1377, 1380 (8th Cir. 1989)).
[238] 112 CONG. REC. 26,474.
[239] *See Seidman v. OTS*, 37 F.3d 911, 937 (3d Cir. 1994) ("[An] attempt to obstruct the investigation, if continued, would pose an abnormal risk of damage to OTS. Accordingly, we hold that an attempt to hinder an OTS investigation constitutes an 'unsafe or unsound practice' . . . ."); *Calcutt v. FDIC*, 37 F. 4th 293, 326 (6th Cir. 2022) (upholding the FDIC's finding that repeatedly withholding information is an unsafe or unsound practice).
[240] 90 Fed. Reg. at 48,849

increases the probability that an institution would fail."[241] The proposed regulatory text read in its entirety also suggests this result, as actual harm to a bank would be grounds for an unsafe or unsound practice, but actual harm to the DIF would not.[242] The problems with this approach and the justification for considering practices that create macroprudential risks to the DIF to be unsafe or unsound are discussed further *infra* Part IV.

7. A DC Circuit Detour

The DC Circuit has at times offered a somewhat different formulation of unsafe or unsound practices that, to the extent it differs from the Horne Definition, is erroneous. Because banks and IAPs can appeal 12 U.S.C. § 1818 actions in the DC Circuit,[243] it deserves special attention. In 1996, the DC Circuit adopted *Gulf Federal's* restrictive gloss in *Johnson v. OTS*[244] and some commentators assert *Johnson*'s adoption of *Gulf Federal*'s restrictive gloss remains the law of the circuit.[245] This view is not unanimous, and subsequent cases have set forth a potentially different standard.[246]

One year after *Johnson*, the DC Circuit held in *Kaplan* that no unsafe or unsound practice had occurred because it could not "see how" the conduct at issue, "viewed ex ante, could be thought to have contributed to any increased risk."[247] Without citing *Johnson*, *Gulf Federal*, or the Horne Definition, the DC Circuit held that the AFBA "must show" an "undue risk" that is "reasonably foreseeable" and "pose[s] an increased risk of some kind."[248] This formulation resulted from the court's decision to identify "the common element" required for both an unsafe or unsound practice and a breach of fiduciary duty rather than address each separately.[249] It relied in part on *In re Seidman*, a Third Circuit case which itself adopted *Gulf Federal*'s restrictive gloss.[250] The court found this "common element" was not satisfied, thus there was no breach of fiduciary duty or unsafe or unsound practice.[251] Critically though, *Kaplan* never purported to offer a definition of "unsafe or unsound practices."

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[241] 90 Fed. Reg. at 48,839

[242] Specifically, the proposed definition would include practices that, (1) if continued, would likely cause (a) material harm to the financial condition of the bank or (b) present a material risk of loss to the DIF or (2) materially harm the bank. *See* 90 Fed. Reg. at 48,849.

[243] 12 U.S.C. § 1818(a)(8)(D), (c)(2), (f), (h)(2), (n); *see also* Baer & Newell, *supra* note 134, at 1 n.2 ("The law of the D.C. Circuit is effectively dispositive, given that the defendant in any action under 12 U.S.C. 1818 has the option of appealing to the D.C. Circuit, in addition to the relevant circuit for traditional venue purposes. Thus, a bank seeking to challenge an action can do no worse than the law of the D.C. Circuit.").

[244] *Johnson v. OTS*, 81 F.3d 195, 204 (D.C. Cir.1996) at 204.

[245] *See* Baer & Newell, *supra* note 134, at 1 n.2.

[246] *See Adams*, *supra* note 32 at 29 (describing the "status of *Johnson* and its adoption of *Gulf Federal*'s restrictive gloss as "unclear" and claiming that subsequent cases articulated a different interpretation more aligned with the Horne Definition).

[247] Kaplan v. US Office of Thrift Supervision, 104 F.3d 417, 421-22 (DC Cir. 1997).

[248] *Id.*

[249] *See id.*

[250] *See id.* at 421.

[251] *Id.* (concluding that the OTS had not "established that Kaplan breached any standard of care that could be deemed to apply to his behavior").

In *Landry*, the DC Circuit acknowledged that *Kaplan* departed from other circuits.[252] It did not, however, recognize that *Kaplan* offered no definition of "unsafe or unsound practices" but rather identified its purported common element with breaches of fiduciary duty. The *Landry* court instead cited *Kaplan* in defining an unsafe or unsound practice as a practice "that posed a reasonably foreseeable undue risk to the institution."[253] It then attempted to reconcile the difference with other circuits. After quoting the *Seidman* interpretation, including *Gulf Federal*'s restrictive gloss, the court equated "undue" risks with "abnormal" risks, "see[ing] no difference there," and noted that engaging in conduct with "reasonably foreseeable" risk "surely constitutes imprudence."[254] The decision did not directly engage with *Gulf Federal*'s restrictive gloss, but it began with an observation that "Congress has given the [FDIC] a variety of weapons to use against individuals whose actions threaten the integrity of federally insured banks or savings associations."[255] It appears, therefore, that the DC Circuit attempted to align itself with the *Gulf Federal* restrictive gloss as adopted by *Seidman*, though it is far from clear.

Dodge provides further evidence that the DC Circuit intended to retain the *Johnson* standard, which incorporated *Gulf Federal*'s restrictive gloss. In that case, the DC Circuit quoted the *Landry* interpretation of an unsafe or unsound practice and concluded, quoting *Johnson*, that the misconduct "threaten[ed] the financial integrity of the [Bank]."[256] In *Blanton*, a post-*Adams* case, the DC Circuit had no reason to address whether its "reasonably foreseeable undue risk" standard aligned with the unqualified Horne Definition or *Gulf Federal* because the OCC demonstrated "significant risk to the Bank's financial stability."[257]

While the DC Circuit's precedent is less than the model of clarity, its reasonably foreseeable undue risk standard appears to be an approximation of *Gulf Federal*'s restrictive gloss developed unintentionally by an attempt to find the common element between unsafe or unsound practices and breaches of fiduciary duty. To the extent that is the case, the *Gulf Federal* restrictive gloss is untenable for the reasons described above. To the extent the DC Circuit is using its own standard, there is no basis for it. An attempt to simplify the inquiry in a case involving alleged unsafe or unsound practices and breaches of fiduciary duty where the court determined neither had occurred cannot reasonably be considered a definition of "unsafe or unsound practices" after the fact.

Opinions using the reasonably foreseeable undue risk standard often refer only to risks "to the institution,"[258] though this has not been universal.[259] To the extent intended to exclude risks to shareholders and the insurance funds, rather than an artifact of cases dealing only

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[252] *See* Landry v. FDIC, 204 F.3d 1125, 1138 (DC Cir. 2000) ("In *Kaplan* we suggested that an 'unsafe or unsound practice' was one that posed a 'reasonably foreseeable' 'undue risk to the institution.' Other courts seem to have agreed, using slightly different language.") (citations omitted).
[253] *Id.*
[254] *Id.* at 1138.
[255] *Id.* at 1128.
[256] Dodge v. Comptroller of Currency, 744 F.3d 148, 156 (DC Cir. 2014) (quoting *Johnson v. OTS*, 81 F.3d 195, 204 (D.C.Cir.1996)) (alterations in the original).
[257] *See* Blanton v. Comptroller of the Currency, 909 F.3d 1162, 1172 (DC Cir. 2018).
[258] *See Dodge*, 744 F. 3d at 156; *Landry*, 204 F.3d at 1138; *Kaplan*, 104 F.3d at 421.
[259] *Blanton*, 909 F.3d at 1172 (referring to a "reasonably foreseeable undue risk" without any reference to "the institution" or similar language) (quotations omitted).

with risks to the bank, it is also an erroneous and unexplained deviation from the unqualified Horne Definition.

C. The Text and Structure of 12 U.S.C. § 1818 Rule Out Heightened Risk Requirements

Attempts to impose heightened effects requirements and limit unsafe or unsound practices as *Gulf Federal* and the FDIC/OCC proposal would are irreconcilable with the statutory text and structure of 12 U.S.C. § 1818. Reviewing the various enforcement options makes this clear. As discussed *supra* Section II.A, 12 U.S.C. § 1818 provides several enforcement remedies depending on the nature of the misconduct, the effects of the misconduct, and the culpability of the bank or IAP. Unlike other misconduct, unsafe or unsound practices under the Horne Definition include an embedded effects element within the definition of the misconduct prong itself.[260] Specifically, "the possible consequences of [the practice], if continued, [must] be abnormal risk [of] loss or damage to an institution, its shareholders, or the agencies administering the insurance funds"[261] for it to be unsafe or unsound. This embedded effects element does not require much. The AFBA must show only the potential for abnormal (not necessarily large)[262] risks of loss or damage, if the practice continues.

This approach to the embedded effects element is consistent with the statutory scheme that otherwise treats misconduct and effect as two separate elements for enforcement actions. It also treats unsafe or unsound practices similarly to other types of misconduct. Adding specific, heightened effects requirements to the unsafe or unsound practices determination, "conflicts with the fundamental structure of the FDI Act by introducing an effects element, textually reserved as a predicate for more severe remedies, into the definition of an element of misconduct."[263] For these reasons, arguments to impose a more stringent embedded effects requirement for determining whether misconduct has occurred are off base. The following discussion reviews relevant statutory provisions and demonstrates that the text and structure conflict with *Gulf Federal*'s restrictive gloss as well as the FDIC/OCC proposal.

1. Termination of Insurance

Perhaps surprisingly, the FDIC can terminate a depository institution's insured status based solely on a determination that the IDI or its directors or trustees has engaged in an unsafe or unsound practice.[264] No effects or culpability are necessary. Termination of insured status is the most severe penalty under 12 U.S.C. § 1818, and the broad grant of discretion to take this action, regardless of the effects of the misconduct, is somewhat anomalous.[265] As one commentator noted,[266] a guardrail might exist in the provision's requirement of "unsafe or

[260] *See supra* Section II.B.
[261] 112 CONG. REC. 26,474 (1966).
[262] *See supra* II.B.4.
[263] *Adams*, *supra* note 32 at 18.
[264] 12 U.S.C. § 1818(a)(2).
[265] *See* Holzman, *supra* note 55 at 435 n.52.
[266] *See id.*

unsound practices" (plural) rather than a single "practice."[267] In addition, Congress may have "desired to give the agencies the flexibility to terminate insurance based on the existence of unsafe and unsound practices in institutions in troubled financial condition but which could not be described as an 'unsafe and unsound condition' if it appeared that a less strenuous corrective measure was unlikely to redress the situation."[268] Congress also may have expected the federal banking agencies to use the authority cautiously, especially in light of the other, less drastic, options.[269]

In any event, the statute does not require unsafe or unsound practices to have any specific effects - a threat to the bank's financial stability, likely material harm, a material risk of loss to the DIF - for the FDIC to terminate an IDI's insured status. As long as the IDI or its directors or trustees "have engaged or are engaging in unsafe or unsound practices" or another form of misconduct,[270] the FDIC can terminate insurance.

2. Cease-and-Desist Proceedings

The AFBA can bring a C&D proceeding when, in its opinion, a bank or IAP "is engaging or has engaged, or the agency has reasonable cause to believe that the [bank] or any [IAP] is about to engage, in an unsafe or unsound practice."[271] There is no separate effects or culpability element, except when the AFBA brings a C&D proceeding requiring a bank to "make restitution or provide reimbursement, indemnification, or guarantee against loss."[272] In those cases, the AFBA must show unjust enrichment or a reckless disregard for the law, applicable regulations, or a prior order.[273]

An obvious response from the proponents of *Gulf Federal's* restrictive gloss and the FDIC/OCC proposal is that unsafe or unsound practices, at least for purposes of C&D orders, are, based on Patman's comments,[274] categorically limited to practices that threaten the financial stability of the bank. Therefore, a separate effects element is unnecessary. In addition to the problems with relying on Patman's comments,[275] this interpretation reads conditions into the statute that simply are not there and that Congress included for other enforcement options. It requires recognizing that Congress included explicit effects requirements for some enforcement actions and concluding that similar conditions nevertheless exist for those it did not.

It also clashes with 12 U.S.C. § 1818(b)(8), which authorizes the AFBA to deem a bank to be engaging in an unsafe or unsound practice if it received "a less-than-satisfactory rating for asset quality, management, earnings, or liquidity" and "the deficiency is not corrected."[276]

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[267] 12 U.S.C. § 1818(a)(2)(A)(i).
[268] Holzman, *supra* note 55 at 435 n.52.
[269] *See id.*
[270] 12 U.S.C. § 1818(a)(2)(A).
[271] 12 U.S.C. § 1818(b)(1).
[272] 12 U.S.C. § 1818(b)(6)(A).
[273] 12 U.S.C. § 1818(b)(6)(A).
[274] See *supra* Section III.B.3.
[275] *See id.*
[276] 12 U.S.C. § 1818(b)(8).

This provision allows the AFBA to treat a condition as an unsafe or unsound practice.[277] Less-than-satisfactory ratings correspond to CAMELS ratings of 3 or worse.[278] The definitions for the component ratings do not directly discuss whether the bank's financial stability is at risk.[279] However, a composite rating of 3 indicates that "[f]ailure appears unlikely . . . given the overall strength and financial capacity of these institutions."[280] A bank with a composite rating of 3 and component ratings of 3 across the board would be at unlikely risk of failure but, at the AFBA's discretion, could be engaging in an unsafe or unsound practice, regardless of any actions or lack thereof that satisfy the Horne Definition. The logical implication of 12 U.S.C. § 1818(b)(8) is that banks with CAMELS ratings of 1 and 2 could also be engaged in unsafe or unsound practices, but the AFBA could not base such a determination solely on such ratings.

Imposing a heightened effects requirement for C&D proceedings based on unsafe or unsound practices necessitates a strained reading of 12 U.S.C. § 1818(b) that creates tension within the subsection. The plain text of 12 U.S.C. § 1818(b)(8) allows the AFBA to treat a bank whose condition does not present a threat to its financial stability as having engaged in an unsafe or unsound practice. *Gulf Federal* requires reading all other provisions of 12 U.S.C. § 1818(b) as adding an implicit effects element of a threat to a bank's financial stability for C&D proceedings brought based on unsafe or unsound practices. There is no reason to do so.

The FDIC/OCC proposal is also in tension with 12 U.S.C. § 1818(b)(8). Two of the potential bases for a finding of unsafe or unsound practices under the proposal are likely or actual material harm to the bank's financial condition.[281] A composite CAMELS rating of two is warranted when "[t]here are no material supervisory concerns."[282] In other words, those bases under the FDIC/OCC proposal, which involve likely or actual material harm, correspond to a composite rating of 3, and Congress granted the FBAs specific authority to treat component ratings of 3 or worse for asset quality, management, earnings or liquidity as an unsafe or unsound practice. Furthermore, the other basis for a finding of unsafe or unsound practices under the FDIC/OCC proposal, is a "material[] increase[in] the probability that an institution would fail and impose a material risk of loss to the DIF."[283] That scenario appears to involve a "material supervisory concern," ruling out a composite rating of 2.[284] And the one specific example of such a material concern the FDIC/OCC proposal provides is a "the failure of an institution to implement appropriate contingency funding

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[277] Unsafe or unsound conditions are not grounds for C&D proceedings or a temporary C&D order under 12 U.S.C. § 1818(b) and (c).
[278] *See* *https://www.federalreserve.gov/boarddocs/srletters/1996/sr9638.htm* [hereinafter SR 96-38]. "CAMELS" refers to the six component ratings - capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risks - under the Uniform Financial Institutions Rating System.
[279] *See id*.
[280] *See id*. This has been the case since UFIRS was adopted in 1979. https://fraser.stlouisfed.org/files/docs/historical/frbdal/circulars/frbdallas_circ_19791129_no79-191.pdf at 5 [hereinafter UFIRS 1979].
[281] 90 Fed. Reg. at 48,849.
[282] SR 96-38, *supra* note 278. Since 1979, a composite rating of 2 has correspond to no material deficiencies. UFIRS 1979, *supra* note 280 at 5.
[283] 90 Fed. Reg. at 48,839.
[284] SR 96-38, *supra* note 278.

arrangements."[285] That suggests a liquidity rating of less than satisfactory, or 3 or worse,[286] which Congress has authorized the AFBA to consider an unsafe or unsound practice without regard to the Horne Definition, the FDIC/OCC proposal, or any other standard.[287]

The FDIC/OCC proposal, like the *Gulf Federal* restrictive gloss, thus requires a strained reading of 12 U.S.C. § 1818. If the FDIC and OCC's proposed definition were to take effect, it would transform 12 U.S.C. § 1818(b) from a permissive provision authorizing the FBAs to act even where the existence of an unsafe or unsound practice may be uncertain to a minimum threshold that requires a less-than-satisfactory rating for an unsafe or unsound practice determination, at least for certain aspects of a bank's financial condition. Any such transformation cannot be squared with the text and structure of the statute.

3. Temporary Cease-and-Desist Orders

The AFBA may issue temporary C&D orders that take effect pending the completion of C&D proceedings whenever the AFBA determines that the violations of law or unsafe or unsound practices are "likely to cause insolvency or significant dissipation of assets or earnings of the depository institution, or [are] likely to weaken the condition of the depository institution or otherwise prejudice the interests of its depositors prior to the completion of the [C&D] proceedings."[288] *Gulf Federal* held that an unsafe or unsound practice must "threaten the financial integrity"[289] of a bank, which appears to be a higher standard, and certainly no lower than what 12 U.S.C. § 1818(c) requires (*e.g.*, that the unsafe or unsound practice be "likely to weaken the condition" of the bank).

Temporary C&D orders would be available, therefore, whenever there is an unsafe or unsound practice, unless the threat to the financial integrity of the bank is not likely to cause effects that satisfy the 12 U.S.C. § 1818(c) requirement before the completion of standard C&D proceedings. Depending on those assessments, FBAs could often, and perhaps regularly, bypass the regular C&D process for unsafe or unsound practices. The text and structure of 12 U.S.C. § 1818(b) and (c) clearly indicate that is not the case. Moreover, determining the time horizon over which risks to financial integrity are likely to materialize is difficult to predict and depends on conditions external to the bank. For example, periods of stress such as the 2008 or 2023 crises could rapidly reduce the time it would take for the effects to materialize, shortening the time period during which the effects are likely without necessarily accelerating the pace of C&D proceedings.

Similarly, two bases of the FDIC/OCC proposal would require actual or likely material harm to the financial condition of a bank.[290] That would change the inquiry from one involving both the likelihood of risks materializing at all and the relevant time horizon into one that only entails a time horizon assessment. As a result, the tension with the statute and the practical challenges involved are elevated compared to the *Gulf Federal* standards.

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[285] 90 Fed. Reg. at 48,839.
[286] SR 96-38, *supra* note 278.
[287] *See* 12 U.S.C. § 1818(b).
[288] 12 U.S.C. § 1818(c)(1).
[289] *Gulf Federal*, 651 F.2d at 267.
[290] *See* 90 Fed. Reg. at 48,849.

The FDIC/OCC proposal's other potential basis of a practice that creates material risk of loss to the DIF due to a material increase in the probability of the bank's failure,[291] may appear to largely avoid this problem because it requires only a likely risk rather than likely harm. In practice, however, this may be a difficult distinction to implement. Will the FBAs and courts distinguish between likely material risk of loss to the DIF (*i.e.*, more than 50% chance that material risk will arise) and likely material harm to the DIF (*i.e.*, more than 50% chance the DIF will be materially harmed)? Additionally, the preamble is ambiguous on what exactly is required for this basis and how it differs from the others, at least with respect to 12 U.S.C. § 1818(c). While the proposed rule text indicates that it does not involve likely material harm to a bank's financial condition,[292] the preamble also describes it as covering practices that are "likely to negatively affect an institution's ability to avoid FDIC receivership and present a material risk of loss to the DIF as a result of the failure."[293] Any practice likely to negatively affect a bank's ability to avoid receivership is also likely to prejudice the interests of depositors at some point. That language suggests the FDIC/OCC proposal, including the likely material risk of loss to the DIF basis, turns the 12 U.S.C. § 1818(c) inquiry into one solely of timing rather than whether the severity of harm.

4. Removal and Prohibition Authority

Removal and prohibition actions require misconduct, effects, and culpability.[294] Unsafe or unsound practices; violations of laws; and breaches of fiduciary duty satisfy the misconduct element.[295] The effects element requires that the misconduct cause (1) the bank to suffer financial loss or other damage, or such loss or damage to be probable; (2) prejudice or potential prejudice to the interest of depositors; or (3) financial gain or other benefit to the party engaged in the misconduct.[296] The culpability element requires that the misconduct either (1) "involve[] personal dishonesty" or (2) "demonstrate[] willful or continuing disregard . . . for the safety or soundness" of the bank.[297]

Any attempt to define unsafe or unsound practices so as to require a threat to the financial stability of a bank is irreconcilable with the effects element for the removal and prohibition authority. Any practice that threatens the financial stability of a bank could prejudice the interest of depositors.[298] As a result, any unsafe or unsound practice would satisfy the effects element. That is inconsistent with statutory structure, which indicates that certain unsafe or unsound practices would not satisfy the effects element.[299] In addition, many or even most actions that threaten the financial stability of a bank may be likely to result in some level of financial loss or other damage.[300]

[291] *See* 90 Fed. Reg. at 48,849.
[292] *See* 90 Fed. Reg. at 48,849.
[293] *Id.* 48,839.
[294] *See* 12 U.S.C. § 1818(e)(1).
[295] *See* 12 U.S.C. § 1818(e)(1)(A).
[296] *See* 12 U.S.C. § 1818(e)(1)(B).
[297] *See* 12 U.S.C. § 1818(e)(1)(C).
[298] *See* 12 U.S.C. § 1818(e)(1)(C).
[299] *See* 12 U.S.C. § 1818(e)(1).
[300] *See* 12 U.S.C. § 1818(e)(1)(B)(i).

The likely or actual *material* harm bases in the FDIC/OCC proposal would impose a higher effects test within the misconduct element for an unsafe or unsound practice than the statute itself requires for the effects element. Twelve U.S.C. § 1818(e)(1)(A) only requires any actual or probable financial loss or other damage. It also appears higher than the potential prejudice to depositors required by 12 U.S.C. § 1818(e)(1)(B). As a result, 12 U.S.C. § 1818(e)(1)(C) would be unnecessary for any prohibition and removal predicated on an unsafe or unsound practice. This result highlights the problems with embedding effects tests into other elements given the misconduct, effects, and culpability structure of 12 U.S.C. § 1818. The FDIC/OCC's proposal would cause an effects test embedded within the misconduct element to override the effects element within the statute.

5. Civil Money Penalties

The CMP provisions of 12 U.S.C. § 1818(i)(2) also make the *Gulf Federal* gloss unreasonable and unworkable. Those provisions include three tiers of CMPs, with separate misconduct and effects prongs that vary by tier. This framework again clarifies that misconduct, such as an unsafe or unsound practice, is separate from the effects element. The Horne Definition emphasizes the nature of the risk of loss or damage rather than the size of the risk, in determining whether an unsafe or unsound practice has occurred.[301] The CMP provisions reflect that understanding by imposing different tiers of penalties based on the magnitude of loss or other consequences through the separate effects element.

Unsafe or unsound practices do not authorize a first-tier CMP,[302] but the *Gulf Federal* gloss and the FDIC/OCC proposal are plainly inconsistent with the effects element for second- and third-tier CMPs. For a second-tier CMP based on unsafe or unsound practices,[303] the bank or the IAP must have "recklessly engaged in an unsafe or unsound practice"[304] and the practice must "(I) [be] part of a pattern of misconduct; (II) cause[] or [be] likely to cause more than a minimal loss to such depository institution; or (III) result[] in pecuniary gain or other benefit to such party."[305] The AFBA does not even need to consider potential losses - pecuniary gain or a pattern of misconduct is enough. These provisions are irreconcilable with a requirement that the integrity of the institution be threatened, as *Gulf Federal* held, and the FDIC/OCC proposal. Indeed, either standard could prevent the AFBA from bringing a second tier CMP against an IAP who recklessly engaged in an unsafe or unsound practice under the Horne Definition that resulted in a pecuniary gain or other benefit because it would hold that the misconduct element (*i.e.*, the unsafe or unsound practice) requires a further embedded effect, not listed in the statute. Such a reading may also render the pattern of misconduct and pecuniary gain bases superfluous because an unsafe or unsound practice would likely involve risk of more than minimal loss.

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301 *See supra* Section II.B.4.

302 A first tier CMP is only authorized when a bank or IAP violates a law, regulation, written agreement, or certain orders and conditions imposed in writing. *See* 12 U.S.C. § 1818(i)(2)(A).

303 Alternatively, second-tier CMPs are also authorized for any violation that could be grounds for a first tier CMP or a breach of fiduciary. *See* 12 U.S.C. § 1818(i)(2)(B)(i).

304 12 U.S.C. § 1818(i)(2)(B)(i)(II).

305 12 U.S.C. § 1818(i)(2)(B)(ii).

Unsafe or unsound practices can be grounds for a third-tier CMP if the bank or IAP knowingly engaged in the misconduct[306] and "knowingly or recklessly cause[d] a substantial loss to such depository institution or a substantial pecuniary gain or other benefit to such party by reason of such" misconduct.[307] A "substantial loss" may not be equivalent to a loss that threatens the financial integrity or stability of a bank or even a "material" loss. Consider a loss of $10 million at a $500 billion bank. That loss would not threaten the bank's financial stability and may not be material, but it could reasonably be considered substantial. And the effects element requires no loss or risk of loss. Substantial pecuniary gain or other benefit is enough. *Gulf Federal* and the FDIC/OCC proposal would prevent third tier CMPs based on unsafe or unsound practices that meet the plain language of the effects prong of the statute if they did not meet an unstated embedded effects requirement in the misconduct prong beyond the minimal requirement of the Horne Definition. There is no basis for such a reading.

6. FDIC Authority to Bring Enforcement Actions against non-FDIC Regulated Banks

In certain circumstances, the FDIC can bring enforcement actions under 12 U.S.C. § 1818 when it is not the AFBA.[308] Such enforcement actions must satisfy one of four criteria under 12 U.S.C. § 1818(t)(2).[309] That provision involves the FDIC determining that "the [bank] or [IAP] is engaging in unsafe or unsound practices, and the . . . enforcement action will prevent the [bank] or [IAP] from continuing such practices."[310] Twelve U.S.C. § 1818(t)(2)(C) authorizes the FDIC to bring enforcement actions if it determines that "the conduct or threatened conduct (including any acts or omissions) poses a risk to the Deposit Insurance Fund, or may prejudice the interests of the institution's depositors."[311] Any conduct that threatens a bank's financial integrity may prejudice the interest of the bank's depositors and, if the bank is insured, pose a threat to the DIF.[312] Likewise, any conduct that is likely to materially harm the financial condition of an institution may prejudice the interests of the institution's depositors, and conduct "that materially increases the probability that an institution would fail and impose a material risk of loss to the DIF"[313] would necessarily pose a risk to the DIF. Put differently, Congress would have no reason to include 12 U.S.C. §

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[306] 12 U.S.C. § 1818(i)(2)(C)(i)(II). The same violations that could be grounds for a first tier CMP and breaches of fiduciary duty also satisfy the misconduct prong for a third tier CMP, provided that, as in the case of unsafe or unsound practices, the bank or IAP knowingly engaged in such misconduct. *See* 12 U.S.C. § 1818(i)(2)(C)(i).

[307] 12 U.S.C. § 1818(i)(2)(C)(ii).

[308] *See* 12 U.S.C. § 1818(t). The FDIC has authority to terminate deposit insurance, discussed above. *See* 12 U.S.C. § 1818(a).

[309] *See* 12 U.S.C. § 1818(t)(2).

[310] *See* 12 U.S.C. § 1818(t)(2)(B).

[311] This provision raises a question: what conduct that poses a risk to the DIF or may prejudice the interest of the institution's depositors is not an unsafe or unsound practice? The most important category is probably conduct that is not contrary to generally accepted standards of prudent operation. This situation could occur if there is no standard for the conduct at issue. Because 12 U.S.C. § 1818(t)(2)(C) involves the FDIC acting when it is not the AFBA, it is possible that the FDIC may be unable to set applicable standards for the bank and the AFBA fails to do so.

[312] It is not clear if a risk to the DIF in 12 U.S.C. § 1818(t)(2)(C) refers to any risk to the DIF or one that threatens the financial stability of the DIF. The former is the more straightforward reading as the statute contains no qualifications.

[313] 90 Fed. Reg. at 48,839.

1818(t)(2)(B), which authorizes enforcement actions to address unsafe or unsound practices, as a separate criterion under *Gulf Federal* and the FDIC/OCC proposal. Indeed, they would render 12 U.S.C. § 1818(t)(2)(B) as pure surplusage.

D. Practical Implications of Attempts to Narrow Unsafe or Unsound Practices

How significant are these efforts to narrow "unsafe or sound practices"? While no precedent that might shed light on the practical impacts of the FDIC/OCC proposed definition exists because no court has ever used it, gloss, examining cases where the question of a bank's "financial integrity" was relevant reveals is instructive with respect to the *Gulf Federal* restrictive gloss and more generally. In short, restrictions do matter but courts apply them inconsistently, perhaps in an attempt to avoid certain outcomes.

Gulf Federal's restrictive gloss and the FDIC/OCC proposal require an assessment of the magnitude of the risk posed by an unsafe or unsound practice. The former requires a possible threat to the bank's financial integrity and the latter requires likely or actual material harm or a likely material risk of loss to the DIF for a practice to be unsafe or unsound. The *Gulf Federal* court itself appeared disturbed that the FHLBB treated overcharges and potential liability amounting to approximately 0.1% of the bank's assets as an unsafe or unsound practice.[314] Had the bank been smaller, presumably the Fifth Circuit would have been more concerned about the same dollar amount of liability. In *Johnson*, the DC Circuit concluded that OTS "ha[d] not adequately explained the basis" for an unsafe or unsound practices determination because, among other things, its mere reference to actual loss did not establish a threat to the bank's financial integrity.[315]

The FDIC[316] and OCC[317] have both recognized that quantitative requirements based on relative risk to the bank necessarily imply higher standards for smaller banks. Yet, the FDIC/OCC ignores this precedent. Its justification for requiring material harm also references the same scenarios that the FDIC and OCC previously used to demonstrate that relative quantitative approaches would result in higher standards for smaller banks. Specifically, the proposal favorably refers to (1) *Gulf Federal*'s comparison of potential liability to bank assets[318] and (2) overdrafts relative to capital.[319] In *Adams*, the OCC directly criticized *Gulf Federal*'s potential liability to assets comparison as leading to higher standards for small banks.[320] The FDIC has noted that such an approach would permit "[a]n employee at a large financial institution [to] steal or run up overdrafts of millions of dollars, without being subject

[314] *See Gulf Federal*, 651 F.2d at 264 n.4.
[315] *Johnson*, 81 F.3d at 204.
[316] *In re Bank of Louisiana*, FDIC-12-489(b), FDIC-12-479(k), at 16 (Apr. 21, 2020) (describing such "perverse and unintended results").
[317] *Adams*, *supra* note 32 at 22 (concluding that this approach "implied that a large institution would have insulation from a charge of unsafe or unsound practices not available to identical conduct engaged in by a smaller institution").
[318] 90 Fed. Reg. at 48,839 n.29.
[319] 90 Fed. Reg. at 48,839 n.30.
[320] *Adams*, *supra* note 32 at 22.

to the FDIC's enforcement authority, while an employee at a smaller bank who committed the same transgressions on a smaller scale would."[321]

The FDIC/OCC proposal offers no explanation for their new position that relative quantitative requirements are appropriate. The FDIC/OCC proposal's material risk of loss to the DIF basis will at best be neutral, Whether a practice that is not likely to materially harm the financial condition of a bank nevertheless materially increases the likelihood of the bank's failure may not be inversely related to the size of the bank.

The unqualified Horne Definition and *Gulf Federal* both consider the possible consequences of a practice, "if continued." Theoretically, that should cover many practices that may threaten an institution's financial integrity, but courts applying the *Gulf Federal* restrictive gloss may not consider the consequences of continuing a practice. For example, one court acknowledged that the relevant consideration was the effect of the misconduct–in this case, an unauthorized loan commitment–"if repeated."[322] It then immediately concluded that "[a]lthough issuance of even [a] single commitment exposed [the bank] to some potential risk of loss, that potential risk did not begin to approach the abnormal risk involved [when a] bank [is] exposed to a serious threat to financial stability."[323] There is no indication that the court meaningfully considered the possible consequences of the practice expanding in scale or persisting over time. The FDIC/OCC proposal's requirement that material harm to the institution or material risk of loss to the DIF be likely, not just possible, probably will exacerbate these problems. While the required magnitude of harm is lower (or at least not any larger), the required probability is higher. Courts and the FBAs will have to ask not just what could happen but what is likely to happen. To the extent hesitancy already exists to evaluate possible consequences, additional hesitancy should be expected in determining likely consequences.

The *Gulf Federal* restrictive gloss may lead courts to treat some practices as inherently outside the scope of unsafe or unsound practices for purposes of 12 U.S.C. § 1818. *Gulf Federal* itself determined not only that the risk to the bank was small but also that the FHLBB "used its cease and desist authority improperly, in an attempt to enter the consumer protection field."[324] The resulting "potential liability to repay overcharged interest, and an undifferentiated 'loss of public confidence'" were too "remote" for the Fifth Circuit.[325] These comments suggest the Fifth Circuit thought customer protections could never threaten a bank's financial integrity. Indeed, the Fifth Circuit may have concluded that there would be no unsafe or unsound practice even if Gulf Federal had drastically overcharged customers and its potential liability had been far greater. As discussed *supra* III.B.5.b. the Supreme Court rejected the notion that the FHLBB's authority was limited to a savings "associations' internal management and not to any external matters, such as their relationship with borrowers."[326] Nevertheless, an IAP appealing an OCC enforcement action urged the Eighth Circuit to overturn its precedent rejecting *Gulf Federal* because the alleged unsafe or

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[321] *In re Bank of Louisiana*, FDIC-12-489(b), FDIC-12-479(k), at 16 (Apr. 21, 2020).
[322] *Seidman*, 37 F.3d at 929.
[323] *Id.*
[324] *Gulf Federal*, 651 F.2d at 261.
[325] *Id.* at 264.
[326] Fidelity Fed. Sav. & Loan Assn. v. De la Cuesta, 458 US 141, 170 n.23 (1982).

unsound practices related to Wells Fargo's account scandal and therefore involved mere customer protection considerations.[327] With a perhaps surprising degree of indignation, the IAP asked the court, "[i]n what sense does a mere reputational harm for poor customer service— Wells Fargo will open unnecessary accounts!—risk the safety of existing deposits or the soundness of the institution?"[328]

Conversely, some courts applying *Gulf Federal's* restrictive gloss have treated some practices, such as breaches of fiduciary duty[329] and falsification of bank records,[330] as inherently unsafe or unsound, without considering any effect on the bank's financial integrity. Other courts that have cited *Gulf Federal* appear not to have applied it or recognized any difference from the Horne Definition.[331] The FBAs have noted these inconsistencies.[332]

However, it is not clear if the FDIC/OCC proposal would treat any practices as inherently unsafe or unsound. There are indications that it will not. For example, although the FDIC currently deems lack of adequate internal controls to be an unsafe or unsound,[333] the FDIC/OCC proposal states that the two agencies "expect that it would be rare for an institution to exhibit unsafe or unsound practices, as defined in the proposed rule, based solely on the institution's . . . internal controls, without significant weaknesses in the institution's financial condition."[334] More generally, the FDIC/OCC proposal's focus on material harms and risks suggests an elevated concern for fact-specific considerations. Specifically, "the agencies would not expect that a particular projected percentage decrease in capital or liquidity that rises to the level of materiality for the largest institutions would necessarily also be material for community banks."[335] The FDIC/OCC proposal offers no explanation for this approach, but it appears designed to minimize concerns that a relative quantitative approach would disproportionately burden small banks.

Whether application of the *Gulf Federal* gloss would determine the outcome of particular enforcement action is not always clear. In *Adams*, the OCC rejected the administrative law judge's (ALJ) adoption of the *Gulf Federal* restrictive gloss and determined that the IAP's

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[327] Anderson Brief, *supra* note 135 at 30-35.
[328] *Id.* at 31.
[329] Hoffman, 912 F.2d at 1174 ("breaches of fiduciary duty by bank officials are inherently dangerous and cannot be considered safe"). Note, however, that Congress and the agencies have clarified that breaches of fiduciary duty and unsafe or unsound practices are not synonymous. *See* 12 U.S.C. § 1818(e)(1)(A), (i)(2)(B)(i), (i)(2)(C)(i); *supra* note 43.
[330] Jameson v. Federal Deposit Insurance Corp., 931 F. 2d 290, 291 (5th Cir. 1991) (upholding the FDIC's conclusion that "falsification [of records] compromised the integrity of the Bank's records" without any analysis of whether the bank's financial integrity was actually threatened).
[331] The Seventh Circuit described the "unsafe or unsound practices" standard as "embrac[ing] action which is contrary to generally accepted standards of prudent operation and potentially exposes the bank to an abnormal risk of loss or harm contrary to prudent banking practices." Michael v. FDIC, 687 F. 3d 337, 352 (7th Cir. 2012). It then cited *Seidman* and *Landry*. *Id* at 352. *Seidman* adopted the *Gulf Federal* gloss and concluded that unsafe or unsound practices require a risk to a bank's financial stability. *See Seidman*, 37 F.3d at 928. *Landry* equated the DC Circuit's "reasonably foreseeable undue risk" test to *Seidman*'s financial stability risk requirement. *See Landry*, 204 F.3d at 1138.
[332] *See In re Smith and Kiolbasa*, *supra* note 97 at 43 n.22; *Adams*, *supra* note 32 at 22, 24-25.
[333] *See* FDIC, *supra* note 27 at 3-1.
[334] 90 Fed. Reg. 48,839.
[335] *Id.* at 48,839.

actions could have been an unsafe or unsound practice under the Horne Definition.[336] The potential unsafe or unsound practices involved various failures to manage risks associated with remotely created checks."[337] However, the OCC declined to remand the enforcement action to the ALJ for new findings of fact because of the additional time involved and instead terminated the enforcement action.[338] The actions were almost certainly an unsafe or unsound practice under the Horne Definition,[339] but no final decision ever confirmed as much.

In a Fed enforcement action for unsafe or unsound practices involving, among other things, misappropriation of trade secrets and interference with contracts and business opportunities,[340] the IAPs argued that the ALJ should have applied the *Gulf Federal* restrictive gloss instead of the unqualified Horne Definition.[341] The Fed rejected the IAP's argument, confirmed that the unqualified Horne Definition was the appropriate standard, and concluded that the IAPs' actions were an unsafe or unsound practice.[342] The Fed did not, however, indicate whether application of the *Gulf Federal* gloss would have resulted in a different outcome.

IV. Lurking in the Shadows: Macroprudential Unsafe or Unsound Practices?

"Safety and soundness" is often, but not always, seen as a purely microprudential concept[343] and contrasted with "financial stability," which is often framed as macroprudential.[344] This standard framework suggests that "unsafe or unsound practices" is also a purely microprudential concept.

Whether safety and soundness and unsafe or unsound practices include macroprudential concerns where there is little or no discernible risk to the bank has received relatively little attention. When the issue has come up, the banking lobby has pushed back against any notion that safety and soundness mandates include macroprudential concerns.[345] This part

[336] *See Adams*, *supra*, note 32 at 48.
[337] *Id.* at 1.
[338] *Id.* at 2.
[339] *See* FDIC, *supra* note 27 at 3-1-3-2.
[340] *In re Smith and Kiolbas*a, *supra* note [X] at 36.
[341] *Id.* at 36-37.
[342] *Id.* at 38-46.
[343] *See, e.g.*, Skinner, *supra* note 138 at 1314 ("The Fed's responsibility to ensure firms remain safe and sound refers to its 'microprudential' role.").
[344] *See, e.g.*, European Central Bank, "Financial stability and macroprudential policy," https://www.ecb.europa.eu/ecb/orga/tasks/stability/html/index.en.html ("The overarching goal of macroprudential policy is to preserve financial stability."); Fed, "How We Promote Financial Stability," https://www.federalreserve.gov/aboutthefed/fedexplained/financial-stability.htm ("Financial stability in its most basic form could be thought of as a condition where financial institutions and markets are able to support consumers, communities, and businesses even in an otherwise stressed economic environment.").
[345] *See, e.g.*, Bill Nelson, Greg Baer and Jeremy Newell, Bank Policy Institute, "Why Leveraged Lending Guidance is Far More Important, and Far More Misguided, Than Advertised" (Nov. 14, 2017),

argues that this distinction reflects a "folklore of safety and soundness,"[346] rather than a categorical limitation to microprudential concerns. Similarly, "financial stability" can refer to macroprudential and microprudential risks.

The Horne Definition itself, statutes, legislative history, case law, and agency statements indicate that there is no clear division between microprudential risks and "safety and soundness" on one side with macroprudential risks and "financial stability" on the other. Indeed, safety and soundness cannot be accomplished by focusing on microprudential issues alone because macroprudential safety and soundness is a precondition to microprudential safety and soundness.[347]

To clarify, this paper uses a broad and perhaps simple view of the term "macroprudential." It includes not just "the specific relations among parts of the system - including transactions between counterparties, the 'platforms' or infrastructures on which they transact, and the specific legal rights and obligations associated with particular financial instruments"[348] but also the general impact of one bank's practices on other banks and the DIF. In other words, reference to macroprudential risks herein include those that could "induce larger macroeconomic fluctuations and can cause widespread financial distress and bankruptc[ies] . . . even if sensible microprudential policies are followed."[349] In short, the macroprudential approach envisioned here refers to efforts "to safeguard the financial system as a whole by addressing market-wide vulnerabilities."[350]

The Horne Definition covers certain macroprudential risks–specifically, abnormal risks to the DIF. These may differ in scope from the type of financial instability that is characteristic of financial crises. Just as the Horne Definition does not require a threat to the financial integrity of a bank, it also does not require a threat to the financial integrity of the DIF or any type of quantitative minimum. All it requires is "any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if

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https://bpi.com/why-leveraged-lending-guidance-is-far-more-important-and-far-more-misguided-than-advertised/
(describing interagency Leveraged Lending Guidance focused on macroprudential risks as "not rooted in statutory safety and soundness authority" and arguing that, even if the Fed does have authority to address this by the Dodd-Frank Act, "the OCC and the FDIC are granted no such 'financial stability' authority, by Dodd-Frank or any other statute.")].

346 Remarks by Nathan Tankus - Aug. 27, 2024; *see also* Luke Herrine, *The Folklore of Unfairness*, 76 NEW YORK UNIV. L. REV. 431 (2021), https://www.nyulawreview.org/wp-content/uploads/2021/05/Herrine.pdf.

347 And "[macroprudential] financial stability requires a strong microprudential framework to ensure that individual firms are safe and sound." KADIJA YILLA AND NELLIE LIANG, BROOKINGS INSTITUTION, WHAT ARE MACROPRUDENTIAL TOOLS? (Feb. 11, 2020). https://www.brookings.edu/articles/what-are-macroprudential-tools/.

348 Robert C. Hockett, *The Macroprudential Turn: From Institutional 'Safety and Soundness' to Systematic 'Financial Stability' in Financial Supervision*, 9 VIRGINIA L. & BUS. REV. 201, 209 (2015), https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=2542&context=facpub.

349 NATHAN TANKUS, THE NEW MONETARY POLICY: REIMAGINING DEMAND MANAGEMENT AND PRICE STABILITY IN THE 21ST CENTURY 12 (Jan. 2022), https://files.modernmoney.network/M3F000001.pdf.

350 Jeremy C. Kress & Jeffrey Y. Zhang, *The Macroprudential Myth*, 112 GEROGETOWN L. REV. 569, 572 (2024), https://www.law.georgetown.edu/georgetown-law-journal/wp-content/uploads/sites/26/2024/06/Kress-Zhang_The-Macroprudential.pdf (citing Samuel G. Hanson, Anil K Kashyap & Jeremy C. Stein, A Macroprudential Approach to Financial Regulation, J. ECON. PERSPS., Winter 2011, at 4-7).

continued, would be abnormal risk [of] loss or damage to . . . the agencies administering the insurance funds."[351]

For example, a bank that originates and distributes junk loans using laxer underwriting criteria than if it were planning to hold the loans creates abnormal risks for the DIF because risks related to inadequate underwriting are not inherent to banking. When other banks acquire those loans, the abnormal risk remains. The abnormal risk to the new owners presents abnormal risks to the DIF.

Whether practices that create only macroprudential risks can be unsafe or unsound matters because bank activities may pose risks for other banks and the DIF without violating any laws, breaching fiduciary duties, or posing a clear abnormal microprudential risk to the bank engaged in the activity. While the FBAs theoretically can use the supervisory process to address such macroprudential concerns, the "influence of specified supervisory expectations rests in part on the prospect of formal enforcement actions."[352] If the FBAs cannot deploy 12 U.S.C. § 1818 enforcement actions to address macroprudential risks, they will have limited ability to address the build up of systemic vulnerabilities and risks of shocks. If activities that create macroprudential risks can be unsafe or unsound, the FBAs have more flexibility and power to address threats to the financial system.

A. The Micro vs. Macro Dichotomy Generally

Discussions of "safety and soundness" often tie the concept to microprudential concerns and contrast it with "financial stability" and its focus on macroprudential risks.[353] A close

[351] 112 CONG. REC. 26,474.

[352] Tarullo, *supra* note 51 at 281. It also rests on the requirement for supervisory ratings and approval requirements for certain activities. *See id.* at 282. Note, again, that one opposing view is that macroprudential financial stability concerns are solely the domain of the Fed, not the FDIC or OCC. *See* Nelson, et al., *supra* note 345.

[353] *See, e.g.*, Lilla & Yang, *supra* note 347 ("**Macroprudential** policies are financial policies aimed at ensuring the stability of the financial system as a whole to prevent substantial disruptions in credit and other vital financial services necessary for stable economic growth. . . . In contrast, **microprudential** supervision and regulation focus on the safety and soundness of individual financial institutions, not the financial system as whole.") (emphasis in original); THE FED, THE FED EXPLAINED 1 (Aug. 2021), https://www.federalreserve.gov/aboutthefed/files/the-fed-explained.pdf ("The Federal Reserve . . . **promotes the stability of the financial system** and seeks to minimize and contain systemic risks through active monitoring and engagement in the U.S. and abroad [and] **promotes the safety and soundness of individual financial institutions** and monitors their impact on the financial system as a whole . . . .") (emphasis in original) [hereinafter THE FED EXPLAINED]; The Fed, "Monitoring Risk Across the Financial System" (Dec. 17, 2021), https://www.federalreserve.gov/financial-stability/monitoring-risk-across-the-financial-system.htm ("The Federal Reserve and other regulators have long supervised individual banks and other critical financial institutions to make sure they are operated in a 'prudent' and 'safe and sound' manner and are not taking excessive risks. Whereas that traditional—or microprudential—approach to supervision and regulation focuses on the safety and soundness of individual institutions, the Dodd-Frank Act required the Federal Reserve and other financial regulatory agencies look across the entire financial system for risks, adopting a macroprudential approach to financial stability."); Kress & Zhang, *supra* note 350 at 578 ("The 2008 financial crisis ushered in a novel approach to financial market oversight, known as macroprudential regulation, that emphasizes system-wide financial stability. This new discipline breaks with decades of tradition in which policymakers focused on individual banks' safety and soundness instead of the financial system as a whole.") (footnote omitted); Hockett, *supra* note 348 at 206 ("The shift from

examination shows that the micro vs. macro dichotomy between safety and soundness and financial stability is not so clear.

One indication that there are no firm micro or macroprudential boundaries on these concepts is the frequent practice of clarifying which types of prudential goals safety and soundness and financial stability policies attempt to address. For example, phrases such as "safety and soundness of individual institutions" and the "stability of the financial system" to convey that the former is microprudential and the latter is macroprudential are common.[354] But if "safety and soundness" is inherently microprudential and "financial stability" inherently macroprudential, there would be no need for clarifications. Yet they persist, indicating that the division is not absolute. Indeed, references to the "safety and soundness *of individual institutions*" implies that less common phrases, like "safety and soundness *of the financial system*" or some sectoral subset are coherent and mean something different than aggregated microprudential safety and soundness. Likewise, references to the stability of the financial system indicate that microprudential financial stability is a coherent concept as well.

Of course, "safety and soundness" could be purely microprudential notwithstanding references to safety and soundness "of the banking system," "of the financial system," etc. Those terms could refer to the microprudential safety and soundness of each individual institution comprising the system and nothing more. The Fed's description of "safety and soundness" as "how well banks manage and control their risks as well as the strength of their financial and managerial resources"[355] seems to reflect this sentiment.

But treating references to safety and soundness of a system as microprudential runs into problems. Most importantly, the safety and soundness of a *system* is not the same as the safety and soundness of its component parts or achievable by ensuring each individual bank merely addresses its own risks.[356] Macroprudential objectives require a macroprudential approach. Moreover, descriptions of "microprudential supervision and regulation [as] focus[ed] on the safety and soundness of individual financial institutions, not the financial system as whole"[357] correctly note that a microprudential approach is not primarily concerned with the system.

The FBAs sometimes break from the micro/macro dichotomy. For example, the Fed notes that "adequate capital is essential to the safety and soundness of financial institutions and the financial system as a whole" as is "adequate liquidity."[358] If references to safety and soundness on some systemic basis - the financial system, the banking system, etc. - are truly microprudential, as Brainard's comments suggest, the Fed's statement is duplicative.

primarily microprudential to combined micro- and macroprudential finance-regulatory policy is, before anything else, a shift of attention or focus. Specifically, it is a shift from exclusive attention to the safety and soundness of individual financial institutions to a focus upon the health and stability of the financial system as a whole.").

354 *See id.*

355 The Fed, "About Bank Supervision" (Apr. 27, 2023), https://www.federalreserve.gov/supervisionreg/understanding-federal-reserve-supervision.htm

356 *See, e.g.*, Lilla & Yang, *supra* note 347 (discussing how "relying on microprudential oversight could make the system less stable"); https://www.bis.org/review/r171013f.pdf; https://www.systemicrisk.ac.uk/sites/default/files/publications/dp-37.pdf.

357 https://www.brookings.edu/articles/what-are-macroprudential-tools/

358 The Fed Explained, *supra* note 353 at 80.

The reference to safety and soundness of financial institutions would have the same scope and meaning as safety and soundness of the financial system as a whole. The more sensible interpretation is that the Fed intended to highlight microprudential and macroprudential concerns, notwithstanding the use of "safety and soundness." Further support for this view can be found in the Fed's description of its "two-pronged approach" to supervision.[359] This consists of a "microprudential approach [that] seeks to ensure the safety and soundness of individual institutions" and a "macroprudential approach [that] focuses on the soundness and resilience of the financial system as a whole and addresses how the actions of one institution, or set of institutions, can impact other institutions and the U.S. economic and financial system overall."[360] According to the Fed, supervision "seeks to ensure that an institution complies with . . . rules and regulations, and that it operates in a safe and sound manner."[361] When read together, these statements indicate that ensuring that an institution operates in a "safe and sound manner" includes considering "how the actions of one institution . . . impact other institutions and the U.S. economic and financial systems."

Similarly, "financial stability" has taken on specific, purely macroprudential meanings for certain purposes, but these definitions do not prevent its relevance in microprudential contexts. The Financial Stability Oversight Council (FSOC) defines "[f]inancial stability . . . as the financial system being resilient to events or conditions that could impair its ability to support economic activity, such as by intermediating financial transactions, facilitating payments, allocating resources, and managing risks."[362] The Fed considers the financial system to be "stable when banks, other lenders, and financial markets are able to provide households, communities, and businesses with the financing they need to invest, grow, and participate in a well-functioning economy—and can do so even when hit by adverse events, or 'shocks.'"[363] Courts applying the *Gulf Federal* restrictive gloss that refer to a financial stability requirement for "unsafe or unsound practices" are not using either of these definitions, or anything like them, because those courts were referring to microprudential risks.[364]

There are many examples of the imagined wall of separation–with "microprudential" and "safety and soundness" on one side and "macroprudential" and "financial stability" on the other–breaking down. The rest of this part identifies further cracks in the wall and interrogates these implications.

B. Macroprudential Considerations in the Horne Definition and *Gulf Federal*

[359] *Id.* at 75.
[360] *Id.* at 75.
[361] *Id.* at 63.
[362] https://home.treasury.gov/system/files/261/Analytic-Framework-for-Financial%20Stability-Risk-Identification-Assessment-and-Response.pdf at 78,032.
[363] https://www.federalreserve.gov/publications/files/financial-stability-report-20250425.pdf at v.
[364] *See, e.g.*, *Johnson*, 81 F.3d at 204 (referring to "the financial stability or integrity of the institution").

Any attempts to confine unsafe or unsound practices and safety and soundness considerations for purposes of 12 U.S.C. § 1818 to purely microprudential issues faces a significant challenge: the plain text of the Horne Definition covers macroprudential concerns. Moreover, even *Gulf Federal* reflected macroprudential motivations.

1. The Horne Definition Includes Purely Macroprudential Risks

Twelve U.S.C. § 1818 is silent on whether practices that create abnormal macroprudential risks (e.g., risks to other banks and the DIF) are potentially unsafe or unsound practices. The Horne Definition is not. It refers to abnormal risk of loss or damage to "[1] an institution, [2] its shareholders, [3] *or the agencies administering the insurance funds*."[365] The concern for risks to the agencies administering the insurance funds (or the insurance funds themselves)[366] is separated by "or" and is independent of the risks to the institution and its shareholders.[367] If the potential risk to the DIF created from a bank's practices is abnormal - not necessarily large - and the the practices are contrary to generally accepted standards of prudent operation, they are unsafe or unsound practices under a literal reading of the Horne Definition.

A literal reading reflects reality - a bank may engage in practices that, at least initially, create risks for the DIF without creating any identifiable risk to the institution itself. For example, a bank that originates loans for distribution without appropriate underwriting has, at least as an initial matter, created risks for other institutions that flow to the DIF, rather than the originating bank. Those risks may eventually flow back to the originating bank due to instability within the banking or broader financial system. Technically, by requiring consideration of the possible consequences of an action or lack thereof, if continued, the Horne Definition requires consideration of those second order effects on the originating bank. But even if the FBAs cannot identify any risk to the originating bank that will result from its activities, risk to the insurance funds is enough.

Adams briefly addressed the possibility that an unsafe or unsound practice could involve only macroprudential risks. Noting that the Eighth Circuit "omit[ted] the original Horne [Definition] mention of risk to the insurance funds," the OCC observed "that omission *may not* matter, as any practice that threatens the insurance funds will *almost certainly* have also threatened both the institution or its shareholders earlier in time."[368] While this reading by the OCC comes close to requiring a threat to the institution or its shareholders, it stops short.

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[365] 112 CONG. REC. at 26,47.

[366] *See supra* Section II.B.5.

[367] Risks to institutions and to shareholders may appear synonymous and weigh against reading the effects element as referring to three separate risks. However, distinct risks are possible. Notably, shareholders of national banks faced double liability until 1937. https://www.occ.gov/publications-and-resources/publications/economics/moments-in-history/pub-moments-in-history-shareholder-double-liability.pdf. The first federal statutes to refer to unsafe or unsound practices were enacted in 1933. Whether or not state-chartered banks impose double liability on shareholders is a question of state law, and the Horne Definition encompasses such situations.

[368] *Adams,* supra note 32 at 16 n.17 (emphasis added). Additionally, *Eden*'s deviation from the Horne Definition was due to the OCC's own failure to follow the unaltered Horne Definition. *See Eden*, 568 F.2d at 611 n.2 (attributing the definition of "unsafe or unsound practices" to the Comptroller).

Revising the OCC's comment to "omitting risks to the insurance funds *may matter* because a practice that threatens the insurance funds *may not* have also threatened both the institution or its shareholders earlier in time," would frame the issue differently but retain the same literal meaning.

In any event, the OCC did not foreclose the possibility that an unsafe or unsound practice may only pose a threat to the DIF. It also implied that there could be circumstances in which a bank's activities first create risks for the DIF and subsequently create risks for the bank engaged in the activity. Further, the OCC appeared to overlook Third Circuit precedent concluding that a practice posing an "abnormal risk of damage to" an agency, not the bank itself, was unsafe or unsound.[369]

In contrast to the OCC's suggestion that the difference was potentially minor, Professor Heidi Mandanis Schooner, writing almost two decades before *Adams*, observed that the "variation is potentially significant because proscribing conduct that might result in an abnormal risk or loss to the FDIC as insurer is not necessarily the same as prohibiting conduct that might result in an abnormal risk or loss to the institution or its shareholders."[370] Her concern appeared to be bank practices that initially pose significant risk to the bank itself, as she noted the possibility of a bank "engaging in a risky business transaction with potential for great financial returns." The crucial point, though, is that what constitutes "abnormal risk" is different from the perspective of a profit-seeking bank and its shareholders compared to the FDIC.[371] Professor Schooner's analysis shows that a careful reading of the Horne Definition treats risks to the DIF as distinct from those to a bank or its shareholders, suggesting macroprudential risks are well within the agencies' remit.

The OCC's hesitancy to acknowledge that an unsafe or unsound practice could imperil the DIF without first threatening the institution or its shareholders is somewhat surprising. Before *Adams*, interagency guidance on leveraged lending discussed *infra* Section IV.G.1 highlighted macroprudential risks. But openly claiming that practices that create macroprudential risks, without first creating microprudential risks, could be "unsafe or unsound" would invite immediate criticism from the banking industry. The opposition to the interagency leveraged lending guidance is instructive of the expected pushback.[372] The industry response likely would have been more intense had the OCC directly asserted that practices that create macroprudential risks could be unsafe or unsound and thereby empower the FBAs to use their 12 U.S.C. § 1818 authorities

Two points of clarification are in order. First, unlike the Gramm-Leach-Bliley Act's (GLBA) complementary activities provisions discussed *infra* Section IV.D.1, the Horne Definition refers to risks to the insurance funds, not the financial system generally. That implies that the macroprudential risk from a bank's practices must be borne by *other banks* that in turn create risks for the DIF for a practice to be unsafe or unsound. A practice that creates risks for the financial system likely involves risks to the DIF, but the AFBA would have to show

[369] *Seidman*, 37 F.3d at 937.
[370] Schooner, *supra* note 43 at 191 n.96.
[371] *Id.* at 191 n.96.
[372] *See infra* Section IV.G.1.

abnormal risk to the DIF to conclude the practice is unsafe or unsound on purely macroprudential grounds.

Second, macroprudential risks can have a range of meanings. It would be a mistake to equate macroprudential risk with relatively narrow conceptions of financial instability.[373] The Horne Definition encompasses a different range of risks to the DIF. The requirement is an abnormal, not necessarily large, risk. If one bank's actions create risks for other banks that create risks to the DIF, that is enough, assuming the other elements of an "unsafe or unsound practice" are met.

2. Macroprudential Concerns in *Gulf Federal*

Despite limiting "unsafe or unsound practices" to those that threaten a bank's financial integrity, a microprudential concern, *Gulf Federal* reflects macroprudential concerns. The opinion notes that the conduct at issue "[bore] only the most remote relationship to Gulf Federal's financial integrity and *the government's insurance risk*."[374] The statement clarifies that the reason *Gulf Federal* required a threat to the bank's financial integrity was because that threat also created insurance risk for the federal government. As the opinion noted, a major duty of the FHLBB was "to protect the government's interest as an insurer of deposits."[375]

Gulf Federal required a threat to the financial integrity of the bank because that was the channel by which risk flowed to the insurance fund. Essentially, the Fifth Circuit limited "unsafe or unsound practices" to microprudential risks that would have macroprudential effects. To borrow language from the Dodd-Frank Act, the Fifth Circuit's concern was that "material financial distress"[376] at a bank could expose the government to risk as the insurer of deposits. It seems not to have considered, however, the fact that the "nature, scope, size, scale, concentration, interconnectedness, or mix of the activities" of a bank could have the same effect, even in the absence of material financial distress.[377] This was an error and should have been avoided by the *Gulf Federal* court, which recognized the Horne Definition as authoritative.

3. Macroprudential Concerns in the FDIC/OCC Proposal

The FDIC/OCC proposal includes language that appears, like the Horne Definition, to explicitly incorporate macroprudential concerns. However, the preamble makes clear this is not what the FDIC and OCC intended. Instead, like *Gulf Federal*, the FDIC/OCC proposal errs by limiting its macroprudential scope to microprudential issues that have macroprudential consequences.

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[373] For example, some commentators equate financial instability solely, or at least primarily, to panics and runs on bank deposits and other short-term debt. *See* Morgan Ricks and Zhang & Gorton.
[374] Emphasis added.
[375] *Gulf Federal*, 651 F.2d at 262.
[376] 12 U.S.C. § 5323(a)(1).
[377] 12 U.S.C. § 5323(a)(1).

The FDIC/OCC proposal ignores risks that one bank's actions can have on another bank's safety and soundness. Section __.__(a)(2)(i)(B) of the FDIC/OCC proposal refers to practices that are likely to "[p]resent a material risk of loss to the Deposit Insurance Fund."[378] That provision seems to address impacts that one banks' practices can have on another and ultimately the DIF, especially when considering the proposed definition's other two bases: likely or actual material harm to the financial condition of the bank. But the preamble clarifies that the FDIC and OCC are concerned about the microprudential risk of failure that ultimately flows to the DIF, not the origination and distribution of junk loans, for example. Instead, this provision is intended to capture situations where a bank's financial condition is not likely to experience material harm but the odds of its failure have materially increased, thereby creating material risk of loss for the DIF.

Though this provision reflects macroprudential concerns, like *Gulf Federal*, the approach is entirely microprudential. The only risks that qualify are microprudential risks that happen to impact the DIF. Even worse, the FDIC/OCC proposal leaves no room for the agencies to consider risks to the DIF or the agencies administering the insurance funds, unlike some courts' implementation of *Gulf Federal*'s restrictive gloss.[379] The FDIC and the OCC offer no explanation for this clear break with the plain text of the Horne Definition, their own precedent, and caselaw. It appears rooted in a mistaken assumption that safety and soundness and unsafe or unsound practices are inherently microprudential concepts.

C. Macroprudential Considerations and the Origins of "Unsafe or Unsound" and "Safety and Soundness"

The macroprudential concerns embedded in the Horne Definition and reflected in *Gulf Federal* echo earlier understandings of "unsafe or unsound practices" and "safety and soundness," described in Professor Lev Menand's reviews of the origins of those terms.[380] His work demonstrates that macroprudential considerations were originally a core component of these concepts.[381] While the Horne Definition's approach is somewhat different, the inclusion of macroprudential risks is nonetheless consistent with the origins of the term "unsafe or unsound practices."

Historically, "soundness" was a microprudential concept and "safety" was a macroprudential one. "'Sound' is an adjective that was commonly used to describe monetary instruments . . . that could be converted into base money . . . on demand at par."[382] A bank's soundness, therefore, is a microprudential issue and an unsound practice would involve risk that an individual bank would not be able to convert its monetary instruments (e.g., notes and

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[378] 90 Fed. Reg. at 48,849.

[379] *Seidman* held both that an unsafe or unsound practice must "pose an abnormal risk to the financial stability of the banking institution" and that an "attempt to obstruct [an FBA] investigation, if continued, would pose an abnormal risk of damage to" the FBA. 37 F.3d at 928, 937.

[380] Monetary Basis, *supra* note 64 at 152; Why Supervise*, supra* note 64.

[381] Monetary Basis, *supra* note 64 at 152.

[382] *Id.* "Soundness is a technical term that reflects the animating purpose of banking law—to create 'bank money' that is equivalent to a 'base' of government-issued cash or coin." Why Supervise, *supra* note 64 at 959 n.33.

deposits) into base money. On the other hand, "[a] 'safe' bank is one that inspires confidence in the monetary system generally."[383] Nineteenth century state banking laws dealing with the impacts that one state bank branch could have on others, thus endangering the broader system, framed this concern as a matter of "safety."[384] For example, Indiana could close a private branch of its state bank "if the interest of the State or safety of the other Branches require[d] it."[385] While this authority appears to have been limited to microprudential issues at a private branch,[386] the purpose was macroprudential. Ohio's laws indicated a similar concern for safety in a macroprudential sense (i.e., concern for other branches).[387] States also created "Safety Funds" to pay off "the notes and deposits of banks that failed,"[388] which helped to prevent wider distress.

Professor Menand concludes that "'[s]afety and soundness is best understood as a hendiadys" and, therefore, a single concept.[389] Under this analysis, "[a]n unsafe and unsound practice is one that hinders the ability of a bank to redeem its monetary instruments in base money in a way that threatens the public's confidence in the bank-issued money supply and the stability of the overall monetary system."[390] The question was whether the bank was "unsafely unsound."[391] This conclusion challenges the view that practices that, at least initially, create risks only for the insurance funds may be unsafe or unsound because such practices would not affect the ability of the bank to meet its own deposit withdrawals at par. Those practices would not be unsound, just unsafe, according to the original understanding of those terms.

However, the original understanding no longer holds. Twelve U.S.C. § 1818 uses "unsafe *or* unsound practices" throughout, not "and."[392] That change suggests no need for an unsafe practice, which threatens "the monetary system generally" under the original 19th-century understanding,[393] to also be unsound. An unsafe or unsound practice is one that is inconsistent with either safety or soundness, not necessarily the "safety and soundness" hendiadys. The macroprudential threat would be enough for the practice to be "unsafe."

The application of 12 U.S.C. § 1818 to entities other than depository institutions[394] provides additional evidence that Congress has altered the meaning of these terms such that

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[383] *Monetary Basis*, *supra* note 64 at 152. "[A] bank's monetary instruments are 'safe' when the holders of those instruments are comfortable using them as a store of value." *Id.*
[384] *Id*.
[385] *Id.* (quoting "An Act Establishing a State Bank" (Jan. 28, 1834), at § 44, reprinted in CHARTER OF THE STATE BANK OF INDIANA (1849), at 14).
[386] *Id.* at 152 n.184 (quoting "An Act Establishing a State Bank" (Jan. 28, 1834), at § 44, reprinted in CHARTER OF THE STATE BANK OF INDIANA (1849), at 14).
[387] *Id.* at 146 n.156.
[388] Why Supervise, *supra* note 64 at 985. *See* Monetary Basis, *supra* note 64 at 152.
[389] *Id.* at 153. A "hendiadys" is a figure of speech, "in which two terms separated by a conjunction work together as a single complex expression." https://www.virginialawreview.org/wp-content/uploads/2020/12/Bray_Online.pdf at 688. Then-Acting Comptroller of the Currency Michael Hsu also described "safety and soundness" as a hendiadys. https://www.occ.gov/news-issuances/speeches/2021/pub-speech-2021-105.pdf at 4.
[390] Monetary Basis, *supra* note 64 at 108.
[391] *See id.* at 108, 152.
[392] The original formulation of "unsound and unsafe" also flipped the modern order. *See id.* at 153).
[393] *See id.* at 152 (unpublished manuscript).
[394] *See* 12 U.S.C. §§ 1818(b), 1867(b), 5362.

macroprudential safety risks are sufficient to identify an unsafe or unsound practice. While such entities could pose risks to the monetary system generally and thus be unsafe, they may not issue their own monetary instruments. They certainly do not issue[395] "deposits."[396] An entity that does not issue monetary instruments could never be "unsound" according to the original 19th century meaning. Yet Congress subjected such entities to the unsafe or unsound practices authority in 12 U.S.C. § 1818.[397] This decision also indicates that there is no need to determine that a deposit-issuing institution has engaged in a practice that risks its ability to convert deposits into base money. To do so would require references to "unsafe or unsound practices" in the same statute to mean different things for purposes of different entities.

Moreover, the Horne Definition itself treats abnormal risks to the bank, its shareholders, or the agencies administering the insurance funds as independent bases for a finding of an unsafe or unsound practice.[398] That is the definition of "unsafe or unsound practice" that Congress had in mind and that courts have deemed "authoritative." There is no need to show a risk to the bank itself,[399] and, as discussed *supra* Section III.C, *Gulf Federal*'s restrictive gloss and the FDIC/OCC proposal conflict with the text and structure of 12 U.S.C. § 1818. Any understanding of "unsafe or unsound practices" as *requiring* a threat to a bank's ability to meet deposit withdrawals at par was lost by the enactment of FISA and further rejected by subsequent legislation modifying 12 U.S.C. § 1818.

Despite these changes, a historically consistent reading of both "unsafe or unsound practices" and the Horne Definition would include macroprudential risks. Treating a practice that poses abnormal risk to the insurance funds as unsafe, and thus an "unsafe *or* unsound practice" under 12 U.S.C. § 1818 is entirely consistent with the original approach.

D. Breakdowns of the Micro vs. Macro Dichotomy in Federal Law

Federal banking law has not always adhered to the macro vs. micro dichotomy, at times using "safety and soundness" for macroprudential purposes and "financial stability" for microprudential ones. This section discusses the former before turning to the latter. It then discusses the implications of continued clarifications in banking law regarding the micro or

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395 Laws, regulations, and general descriptions of banking often refer to banks as receivers or takers of deposits. *See, e.g.*, 12 C.F.R. § 7.4007(a); https://www.mercatus.org/macro-musings/aaron-klein-real-time-payments-and-financial-regulation ("Legally, banking is tied to the taking of deposits from people . . . ."). It is more accurate to view chartered banks as issuers of deposits. *See* https://scholarship.law.vanderbilt.edu/cgi/viewcontent.cgi?article=2052&context=faculty-publications at 758-60. Deposits, like bank notes, are liabilities of a bank and as such are issued by the bank. *See* https://scholarship.law.vanderbilt.edu/cgi/viewcontent.cgi?article=2052&context=faculty-publications at 760-61.

396 Although only chartered banks and savings associations may issue deposits, "Congress has not provided a functional definition of 'deposit' for this purpose and nonbanks issue all sorts of functional substitutes for deposits on an enormous scale." https://justmoney.org/m-ricks-whats-at-stake-in-debates-over-bank-money-creation-mechanics/ (citing 12 U.S.C. § 378).

397 *See supra* Section II.A.

398 *See supra* Section II.B.5.

399 *See Seidman*, 37 F.3d at 937 (finding an unsafe or unsound practice due to abnormal risk to the OTS).

macroprudential scope of "safety and soundness" and "financial stability" and what this means for 12 U.S.C. § 1818.

1. Statutory References to Macroprudential Safety and Soundness

Some statutory provisions position macroprudential concerns as the focus of safety and soundness.[400] In certain other provisions, Congress has described safety and soundness in purely microprudential terms.[401] In yet other statutory provisions, the scope of safety and soundness is ambiguous.[402] In those cases, the context and purpose of the provision may be informative as to the scope. There is no basis, however, for treating those provisions as categorically microprudential. The existence of clear statutory provisions indicating that safety and soundness has a macroprudential component caution against assuming that general statutory references to safety and soundness are solely microprudential. Instead, an unqualified reference to safety and soundness should be read as including both microprudential and macroprudential considerations, unless the context suggests otherwise, to avoid reading unintended qualifications into the meaning.[403]

An unambiguous Congressional command to consider macroprudential safety and soundness is found in GLBA. Section 103(a) of GLBA, codified at 12 U.S.C. § 1843(k), permits financial holding companies to engage in activities or acquire shares of companies that engage in activities that are "complementary to a financial activity and do[] not pose a substantial risk to the *safety or soundness of depository institutions or the financial system generally*."[404] While the reference to the "safety and soundness of depository institutions"

[400] *See, e.g.*, 12 U.S.C. § 1464(s)(3) (permitting the AFBA to "treat the failure of any savings association to maintain capital at or above the minimum level required by the Comptroller under [12 U.S.C. § 1464(s) or (t)] as an unsafe or unsound practice"). While adequate capital can prevent the failure of a bank and any resulting macroprudential effects, "[c]apital is a quintessential microprudential device." Kress & Zhang, *supra* note 350 at 593.
[401] *See, e.g.*, 12 U.S.C. § 1843(k)(1)(B) (referring to "risk to the safety and soundness of . . . the financial system generally").
[402] For example, 12 U.S.C. § 1 charges the OCC "with assuring the safety and soundness of . . . the institutions and other persons subject to its jurisdiction" but leaves ambiguous whether the safety and soundness of "institutions" means on an individual basis or a systemic one.
[403] This is certainly the case within a single statute under the presumption of consistent usage and material variation canon. There is also good reason to presume consistent usage of references to safety and soundness unsafe or unsound practices, without micro or macroprudential qualifications since they are widely used terms with general, consistent meanings.
[404] Pub. L. No. 106-102, 113 Stat. 1338 (Nov. 12, 1999) (emphasis added).

could be microprudential or macroprudential,[405] the reference to "the financial system generally" cannot. It is unambiguously macroprudential.[406]

Even if references to system-wide safety and soundness can make sense as purely microprudential in some circumstances, that approach is incoherent when referring to the impact of complementary activities authorized for financial holding companies on the "financial system generally." This provision requires the Fed to consider the impact of an activity on firms it does not supervise or regulate. It could not assess the microprudential impact on every financial institution. The only way for this provision to have any coherent meaning is to read it as requiring the Fed to consider the safety and soundness impact of authorizing an activity on a systemic level. Additionally, the Fed cannot authorize a complementary activity that will have microprudential benefits for a financial holding company if the activity will pose a substantial risk to the financial system generally. This is a macroprudential consideration that requires using a macroprudential approach. If safety and soundness were inherently microprudential, that would be nonsensical.[407] The general implication from this language is that a practice that creates macroprudential risks may be an unsafe or unsound practice under 12 U.S.C. § 1818.[408]

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[405] The Fed has interpreted the reference to "depository institutions" to mean "depository institution subsidiaries" of the financial holding company (FHC) engaged in the complementary activity https://www.govinfo.gov/content/pkg/FR-2016-09-30/pdf/2016-23349.pdf at 67,222 ("When determining that an activity is complementary to a financial activity for an FHC, the Board must find that the activity does not pose a substantial risk to the safety and soundness of **depository institution subsidiaries of the FHC** or the financial system generally.") (emphasis added). The statute does not clarify that the only relevant depository institutions to consider are the subsidiaries of the FHC seeking approval under the complementary activities authority. *See* 12 U.S.C. § 1843(k)(1)(B).

[406] The language is notable given recent protestations from Fed Chair Jerome Powell that, in other contexts, the Fed has no obligations beyond the institutions it regulates. [link to the Twitter clip from Casten questioning and note that it is a different context]. If the Fed's responsibilities under section 103 of the Gramm-Leach-Bliley Act (GLBA) were limited to the institutions it supervises, Congress would have written the text accordingly. Instead, it extended the Fed's obligation to consider macroprudential safety and soundness risks for the entire financial system, even with respect to entities it does not regulate or supervise. The text as written commands the Fed to go beyond the technical confines of Horne Definition, which is limited to banks, their shareholders, and the DIF, not all financial risks. The difference here is likely more technical than practical, as a risk to general financial stability will likely pose threats to the DIF. The real impact of the GLBA language is to ensure that the Fed is actually considering those broader risks to the financial system when determining whether and under what conditions to approve a complementary activity.

[407] While the Fed acknowledges this requirement and repeats it verbatim when discussing its complementary activities responsibilities, it also sometimes reverts to the micro vs. macro dichotomy. *See* Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies Related to Physical Commodities, 79 Fed. Reg. 3329, 3330, 3332 (Jan. 21, 2014) (referring to the statutory requirement to determine that an authorized complementary activity does "not pose substantial risks to the safety and soundness of depository institutions or the financial system generally" while considering whether its existing safeguards for complementary activities "adequately protect against risks to safety and soundness and U.S. financial stability"). It is not clear how the Fed considered safety and soundness risks to the financial generally as the conditions it imposed on complementary activities are primarily aimed at the microprudential safety and soundness of the FHC. *See id.* at 3330-31.

[408] As a practical matter, the Fed would have no need to rely on that authority. When permitting a complementary activity, the Fed imposes various conditions in writing, which function, or could function, as the generally accepted standards referenced in the Horne Definition. However, should an institution deviate from those standards in such a way that it created abnormal micro- or macroprudential safety and soundness risks that could qualify as an unsafe or unsound practice

Opponents of this approach may point to section 604(e) of the Dodd-Frank Act, which amended the Bank Holding Company Act's general standards of review for certain nonbanking activities, including complementary activities, by adding "risk to the stability of the United States banking or financial system" as a separate criterion in addition to the previously enacted "unsound banking practices" criterion.[409] That change might suggest that "unsound banking practices" is purely microprudential.

That interpretation is wrong. Assuming "unsound banking practices" as the same meaning as "unsafe or unsound practices" in 12 U.S.C. § 1818,[410] it does not encompass all threats to the U.S. financial system. It is limited to risks to banks, their shareholders, and the DIF, not the financial system generally. While the Fed already had to consider the safety and soundness risks to the financial system generally for complementary activities, the review provisions apply to other activities as well, which included no such separate requirement to consider effects outside the banking system prior to the Dodd-Frank Act.[411] Furthermore, the existence of interconnections between large financial institutions, one of the primary sources of "risks to the stability of the United States banking or financial system," is not, or at least is not necessarily, a practice. The review criteria that existed before the Dodd-Frank Act, did not expressly include such risks,[412] but new activities could create those conditions. Rather than indicating a microprudential reading of "unsafe banking practices," the amendment reflects an attempt to ensure that all financial stability risks, whether due to unsound banking practices or not, could be considered - unsurprising given that the Dodd-Frank Act was enacted "[t]o promote the financial stability of the United States."[413]

The phrase "safety and soundness of the financial system" or "safety and soundness of the banking system" appears in numerous bills introduced since 1989.[414] The Dodd-Frank Act

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under the Horne Definition, that deviation from the conditions imposed in writing would constitute a violation of law under 12 U.S.C. § 1818. Similarly, an institution that engages in an unauthorized purportedly complementary activity would violate the law.

409 Codified at 12 U.S.C. § 1843(j)(2)(A).

410 "Unsafe or unsound banking practice" is sometimes used in the 12 U.S.C. § 1818 context. *See Eden*, 568, F.2d at 611. If the two terms are not synonymous, the Dodd-Frank Act change does not evidence any tension with interpreting unsafe or unsound practices as encompassing macroprudential risks.

411 Twelve U.S.C. § 1843(j)(2)(A) criteria apply to all notices under subsection (j). Notice also is generally required for "any nonbanking activity" or "acqui[sition] or ret[ention of] ownership of or control of the the shares of a company engaged in" certain activities. 12 U.S.C. § 1843(j)(1)(A).

412 In addition to "unsound banking practices," the pre-Dodd-Frank Act express criteria were limited to "undue concentration of resources, decreased or unfair competition, [and] conflicts of interests," but the Fed was required to "consider whether performance of the activity by a bank holding company or a subsidiary of such company can reasonably be expected to produce benefits to the public . . . that outweigh potential adverse effects." 12 U.S.C. § 1843(j)(2)(A).

413 Page 1 https://www.govinfo.gov/content/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf.

414 https://www.congress.gov/119/bills/hr2702/BILLS-119hr2702ih.pdf;
https://www.congress.gov/119/bills/s875/BILLS-119s875rs.pdf;
https://www.congress.gov/115/bills/hr6746/BILLS-115hr6746ih.pdf;
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https://www.congress.gov/115/bills/s488/BILLS-115s488eah.pdf;

illustrates that Congress sometimes uses "safety and soundness" for macroprudential purposes, even while also using "financial stability" for macroprudential purposes. Examples include:

- Section 174(a)(9), which required the Government Accountability Office (GAO) to consider "any other relevant factors relating to *the safety and soundness of our financial system*" for purposes of a study on the use of hybrid capital instruments in Tier 1 capital;[415]
- Section 174(b)(6), which required the GAO to consider "any other relevant factors relating to *the safety and soundness of our financial system*" for purposes of a study of capital requirements applicable to U.S. intermediate holding companies of foreign banks;[416]
- Section 301(1), which includes among the purposes of Title III of the Dodd-Frank Act "to provide for the *safe and sound operation of the banking system of the United States*;"[417]
- Section 603(b)(1), which required the GAO to study "whether it is necessary, in order *to strengthen the safety and soundness of institutions or the stability of the financial system*, to eliminate [certain] exceptions" under the Bank Holding Company Act;[418]
- Section 604(d), which requires the Fed to consider the "extent to which a proposed acquisition, merger, or consolidation" involving a bank holding company "would result

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https://www.congress.gov/110/bills/s3739/BILLS-110s3739is.pdf; https://www.congress.gov/109/statute/STATUTE-119/STATUTE-119-Pg3601.pdf; https://www.congress.gov/109/bills/s1568/BILLS-109s1568is.pdf; https://www.congress.gov/109/bills/hr2061/BILLS-109hr2061ih.pdf; https://www.congress.gov/106/bills/hr4203/BILLS-106hr4203ih.pdf; https://www.congress.gov/bill/101st-congress/senate-bill/3209/text/is?format=txt&q=%7B%22search%22%3A%22%5C%22safety+and+soundness+of+the+financial+system%5C%22%22%7D&r=15&s=4; https://www.congress.gov/111/crec/2010/05/12/CREC-2010-05-12-pt1-PgS3648.pdf; https://www.congress.gov/amendment/111th-congress/senate-amendment/3956/text/submitted/2085969; Note that some of these bills are different versions of the same substantive legislation (e.g., https://www.congress.gov/119/bills/hr2702/BILLS-119hr2702ih.pdf and https://www.congress.gov/119/bills/s875/BILLS-119s875rs.pdf) of the same substantive legislation. Some of these bills did become law. https://www.congress.gov/109/statute/STATUTE-119/STATUTE-119-Pg3601.pdf.

[415] Emphasis added. As further evidence that safety and soundness and financial stability do not sit clearly on either side of the micro/macro line, the GAO report released pursuant to this provision noted that

- "Eliminating Tier 1 hybrid capital likely will have modest negative effects on the existing capital measures of individual banking institutions and lending and could improve institutions' financial stability." https://www.gao.gov/assets/gao-12-237.pdf at ??? [there is no page number. The next page is i.]
- "Regulators require institutions to maintain certain levels of capital to promote stability across the banking industry and protect the nation's financial system." *Id.* at 1
- "[I]ncreased reliance on stronger forms of capital should increase institutions' financial stability." *Id.* at 30.

While the Dodd-Frank Act used safety and soundness language traditionally categorized as microprudential to refer to the financial system, in the required report, GAO used financial stability terminology usually categorized as macroprudential to refer to risks to both individual institutions and the financial system as a whole.

[416] Emphasis added.

[417] Codified at 12 U.S.C. § 5401(1) (emphasis added).

[418] Emphasis added.

in greater or more concentrated risks to the *stability of the United States banking or financial system*;"[419]

- Section 604(f), which requires the federal banking agencies to consider whether a bank merger would pose a "*risk to the stability of the United States banking or financial system*;"[420] and
- Section 1023(a), which authorizes FSOC to set aside Consumer Financial Protection Bureau regulations that FSOC "decides . . . would put *the safety and soundness of the United States banking system or the stability of the financial system of the United States at risk*."[421]

Note that section 604(d) and (f) refer to "the stability of the United States banking system or financial system" and section 1023(a) refers to the "safety and soundness of the United States banking system or the stability of the financial system of the United States." Do these mean completely different things, as a microprudential only view of "safety and soundness" would imply? No. As discussed, systemic considerations are different from an aggregation of microprudential risks. While safety and soundness is neither inherently microprudential nor macroprudential, safety and soundness of the banking *system* is an inherently macroprudential concept.

Dodd-Frank Act provisions using safety and soundness for microprudential purposes and financial stability for macroprudential ones do not detract from the main point: neither safety and soundness (or unsafe or unsound practices) nor financial stability have inherently microprudential or macroprudential meanings. They can be used in either context.

This breakdown in the micro vs. macro dichotomy continues to appear post-Dodd-Frank as well. The safety and soundness provisions in the GENIUS Act, for example, further demonstrate the lack of a clear micro/macro wall between safety and soundness and financial stability. The statute includes references to "safety and soundness risks of [an] insured depository institution;"[422] "safe and sound operation of an institution;"[423] "material risk[s] to the safety and soundness of the United States banking system, the financial stability of the United States, or the Deposit Insurance Fund;"[424] "safe and sound operation of State qualified payment stablecoin issuers;"[425] "significant safety and soundness risks to the financial system of the United States;"[426] and "financial stability risks posed to the safety and soundness of the broader financial system by payment stablecoin activities."[427]

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[419] Codified at 12 U.S.C. § 1842(c)(7) (emphasis added).
[420] Codified at 12 U.S.C. § 1828(c)(5) (emphasis added).
[421] Codified at 12 U.S.C. § 5513(a) (emphasis added).
[422] Guiding and Establishing National Innovation for U.S. Stablecoins Act, Pub. L. No. 119-27, § 4(a)(1)(A)(ii) (2025).
[423] *Id.* at § 4(a)(4)(B)(i).
[424] *Id.* at §. 4(a)(12)(B)(i)(I) & 4(a)(12)(C)(i)(I). Note that this language refers to safety and soundness risks to financial stability rather than as separate micro and macro considerations. It is not clear what that means. Perhaps more importantly, it refers to safety and soundness risks to the DIF, suggesting that practices that pose such risks would be unsafe or unsound.
[425] *Id.* at § at 4(b)(5)(B)(ii).
[426] *Id.* at § at 4(d)(3)(C)(ii)
[427] *Id.* at § at 15(a)(3). If this wording is intended to highlight differences between "financial stability" and "safety and soundness" and the interactions between them, it still refers to safety and soundness in systemic, macroprudential terms.

Statutory references to "safety and soundness" for macroprudential purposes inform the meaning of "unsafe or unsound practices" under FISA and the FDI Act. The plain reading of the Horne Definition of "unsafe or unsound practices" includes macroprudential considerations. While the common association of "safety and soundness" with purely microprudential concerns may caution against accepting the literal wording of the Horne Definition, repeated use of safety and soundness for macroprudential purposes dispels that notion. The best reading of the Horne Definition is that it means what it says: unsafe or unsound practices may involve risks to the DIF without risks to the bank itself. *Gulf Federal* and the FDIC/OCC proposal on the other hand, exclude purely macroprudential concerns despite these clear indications from Congress that safety and soundness is not just a microprudential concept.

2. Statutory References to Microprudential Financial Stability

Other statutory provisions use financial stability in a microprudential context. Twelve U.S.C. § 1844(e)(1) refers to "serious risk to the financial safety, soundness, or stability of a bank holding company subsidiary bank." Another provision, 12 U.S.C. § 1817(j)(7)(C), authorizes the AFBA to disapprove a proposed acquisition if "either the financial condition of any acquiring person or the future prospects of the institution is such as might jeopardize the financial stability of the bank." And the GENIUS Act refers to "serious risk to the financial safety, soundness, or stability of [a] State qualified payment stablecoin issuer."[428] These provisions unambiguously clarify that financial stability is not just a macroprudential concept.[429] The macroprudential "financial stability" definitions discussed above cannot be applied in a coherent way to these provisions. This use of financial stability for microprudential purposes is, however, consistent with how *Gulf Federal* and its progeny discussed the erroneous restrictive gloss on the Horne Definition, as well as the purpose of FISA.[430]

3. Continued Clarifications Imply a Need for Clarifications

Even when Congress does follow the usual micro vs. macro dichotomy post-Dodd-Frank Act, it often includes text clarifying that it is using safety and soundness for microprudential risks and financial stability for macroprudential ones. In addition to the GENIUS Act provisions, Section 401(a) of the Economic Growth, Regulatory Relief, and Consumer

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[428] *Id.* at § 7(e)(1)(C) & 7(e)(2)(C)

[429] Another provision of that section uses financial stability for macroprudential purposes. 12 U.S.C. § 1844(c)(2)(A)(i)(II)(bb) (referring to "the stability of the financial system of the United States").

[430] *See, e.g.*, *Gulf Federal*, 651 F.2d at 262 ("The purpose of the amendment was to enhance the Board's ability to promote financial stability among federally chartered savings and loan institutions."); https://scholar.google.com/scholar_case?case=10620780727434880121&q=landry+dc+circuit+unsound&hl=en&as_sdt=20000006 at 928 (holding that an unsafe or unsound practice "must pose an abnormal risk to the financial stability of the banking institution"); *Seidman*, 37 F.3d at 204 ("Clearly, the fact that an act results in an 'actual loss' does not, by itself, establish that the act posed an abnormal risk to the financial stability or integrity of the institution.").

Protection Act (EGRRCPA) amended the Dodd-Frank Act[431] by adding language, codified at 12 U.S.C. § 5365 (a)(2)(C) on "[r]isks to financial stability and safety and soundness." This provision authorizes the Fed to extend prudential standards established under 12 U.S.C. § 5365 to one or more bank holding companies with total consolidated assets of $100 billion or more.[432] To do so, the Fed must "determine[] that application of the prudential standard is appropriate—(I) to prevent or mitigate risks to the financial stability of the United States . . . or (II) to promote the safety and soundness of the bank holding company or bank holding companies" and take into consideration various risk-related factors.[433] If financial stability and safety and soundness were categorically macroprudential and microprudential respectively, there would be no reason for statutory clarifications. But again, Congress continues to include such clarifications, indicating that there is no categorical distinction between microprudential safety and soundness risks on the one hand and macroprudential financial stability risks on the other.

4. Implications for 12 U.S.C. § 1818

Statutory references to safety and soundness as including macroprudential concerns provide additional reason to read "unsafe or unsound practices" for purposes of 12 U.S.C. § 1818 as including practices that create risks to the DIF regardless of risk to the bank (*i.e.*, risks that are macroprudential in nature). The plain language of the Horne Definition is consistent with that approach, but the *Gulf Federal* restrictive gloss and the FDIC/OCC proposal are not. To conclude otherwise would require treating practices that create macroprudential safety and soundness risks as safe and sound because a practice is either safe and sound or unsafe or unsound. There is no middle category.

Congress does not use "safety and soundness" and "financial stability" solely for microprudential or macroprudential purposes, respectively, when drafting legislation. That should give agencies, courts, and commentators pause when interpreting general references to "safety and soundness" and "unsafe or unsound practices."

E. Activities and Practices as Macroprudential Risks and Section 162 of the Dodd-Frank Act

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431 Technically, this EGRRCPA provision by its terms amended the Financial Stability Act of 2010 (i.e., Title I of the Dodd-Frank Act). *See* Pub. L. No. 115-74, § 401(a) (2018); Pub. L. No. 111-203, § 101.

432 EGRRCPA changed the general total consolidated assets threshold to $250 billion. *See* section 401(a) of EGRRCPA, codified at 12 U.S.C. § 5365(a)(1).

433 12 U.S.C. § 5365(a)(2)(C).

Congress has recognized that an institution's activities and practices, not just its failure, can have macroprudential consequences.[434] Numerous statutory provisions state as much.[435] Section 162 of the Dodd-Frank Act, codified at 12 U.S.C. § 5362, clarifies that the FBAs' 12 U.S.C. § 1818 authorities include "unsafe or unsound practices" that create macroprudential risks.

Twelve U.S.C. § 5362 generally applies 12 U.S.C. § 1818(b)-(n) to designated SIFIs. It does not include new supervisory or enforcement authorities. Instead, it makes available existing 12 U.S.C. § 1818 powers and generally enables the Fed to bring any enforcement action under 12 U.S.C. § 1818(b)-(n).

However, Congress placed limitations on that authority for designated SIFIs' depository institution subsidiaries and functionally regulated subsidiaries.[436] The substantive limitation contained in 12 U.S.C. § 5362(b) with respect to depository institution and functionally regulated subsidiaries restricts enforcement actions to cases in which the Fed "determines that a condition, practice, or activity of" such a subsidiary "does not comply with the regulations or orders prescribed by the [Fed] under [Title I of the Dodd-Frank] Act, or otherwise poses a threat to the financial stability of the United States."[437] Several types of misconduct that may be grounds for an enforcement action under 12 U.S.C. § 1818 are taken off the table - breaches of fiduciary duty, violations other than of Fed regulations or orders promulgated under Title I of the Dodd-Frank Act, and unsafe or unsound practices - unless they pose a threat to the financial stability of the United States.

The implications of this limitation for the meaning of "unsafe or unsound practices" may not be obvious, but they are important. If unsafe or unsound practices under 12 U.S.C. § 1818 are solely microprudential, the only unsafe or unsound practices that are within the scope of 12 U.S.C. § 5362 are those involving microprudential risks that have macroprudential effects (*i.e.*, where the risk of institution failure threatens U.S. financial stability). But that reading does not align with the text of 12 U.S.C. § 5362(b)(1), which refers to a "condition, practice, or activity." An institution's "condition" is fundamentally microprudential in nature but can affect financial stability.[438] Conversely, there is nothing inherently microprudential about practices and activities. They can create macroprudential risks without threatening an institution's financial integrity, as numerous provisions of the Dodd-Frank Act affirm.[439] The use of "practice" in12 U.S.C. § 5362(b)(1) parallels 12 U.S.C. § 1818's use of "unsafe or

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434 For example, it authorized the FSOC to determine that "the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of [a] U.S. nonbank financial company, could pose a threat to the financial stability of the United States" and subject such companies to supervision by the Fed." 12 U.S.C. § 5323(a)(1).
435 *See* 12 U.S.C. §§ 5322(a)(1), (a)(2)(H), (a)(2)(J)-(K), (d)(4), 5323(a)(2)(G), (b)-(c); 5325(a), (b)(3)(A)(iii), (b)(3)(C); 5326(a)(4); 5330, 5331(a); 5333(a)(1)(F)-(H); 5344(b)(1)(B)(i); 5361(a)(1)(A); 5362(b).
436 *See* 12 U.S.C. § 5362(b)
437 12 U.S.C. § 5362(b)(1).
438 Recall that the AFBA may treat a less than satisfactory rating for asset quality, management, earnings, or liquidity as unsafe or unsound practice under 12 U.S.C. § 1818(b)(8), which authorizes C&D proceedings and orders under 12 U.S.C. § 1818(b) and (c).
439 *See supra* Section IV.D.1.

unsound practices."[440] If a practice does not violate a law or breach a fiduciary duty but creates solely macroprudential risks to the financial stability of the United States, reading unsafe or unsound practices to be purely microprudential would prevent the Fed from taking action under 12 U.S.C. § 5362 - and the AFBA under 12 U.S.C. § 1818. That result is contrary to the intent evidenced by 12 U.S.C. § 5362 to permit 12 U.S.C. § 1818 enforcement actions for practices and activities that threaten the financial stability of the United States, regardless of microprudential risk.

Interpreting "unsafe or unsound practices" under 12 U.S.C. § 1818 otherwise would lead to absurd results. The FSOC may designate a SIFI after determining "that [its] material financial distress . . . *or* the nature, scope, size, scale, concentration, interconnectedness, or mix of [its] activities . . . could pose a threat to the financial stability of the United States."[441] The text of 12 U.S.C. § 5362 likewise refers to practices and activities that "pose[] a threat to the financial stability of the United States." Neither provision mentions any effect on the institution. If FSOC designates a SIFI based on its activities rather than the risk posed by material financial distress, the sensible reading of 12 U.S.C. § 5362 is that it empowers the Fed to use its *existing* 12 U.S.C. § 1818 authorities to address risks to U.S. financial stability that the SIFI's or its subsidiaries' activities pose regardless of potential financial distress to the SIFI or its subsidiaries. There is no reason to read a requirement of microprudential risk into 12 U.S.C. § 5362. To do so would require the Fed to show both microprudential and macroprudential risk to determine that a practice is unsafe or unsound from the perspective of U.S. financial stability, even if the basis for designation was the SIFI's activities, not the threats posed by material financial distress. This result would be contrary to the overall approach to financial stability in the Dodd-Frank Act.

The procedural limitation in 12 U.S.C. § 5362 provides further evidence that "unsafe or unsound practices" in 12 U.S.C. § 1818 concern macroprudential risks. Twelve U.S.C. § 5362(b)(1) requires the Fed to first make a recommendation to initiate a supervisory action or enforcement proceeding in writing to the primary financial regulatory agency of a SIFI's depository institution or functionally regulated subsidiary. Only if the primary financial regulatory agency does not take action acceptable to the Fed can the Fed then take the supervisory or enforcement action on its own[442] The Fed has no powers under 12 U.S.C. § 5362 beyond those granted to the AFBA under 12 U.S.C. § 1818, and neither does the

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[440] Twelve U.S.C. § 1818 also uses "activity" or "activities" but less frequently. The federal banking agencies can limit activities through C&D proceedings in response to unsafe or unsound practices or violations of law. 12 U.S.C. § 1818(b)(7). They also can issue a temporary C&D order requiring "the cessation of any activity or practice which gave rise, whether in whole or in part, to . . . incomplete or inaccurate state of the books or records" or "the immediate cessation of any activity or practice described [in 12 U.S.C. § 1828(a)(4)], which gave rise to [a] notice of charges" filed under 12 U.S.C. § 1818(b)(1). 12 U.S.C. § 1818(c)(3)(A)(i), (c)(4)(A)(i)(II), Finally, 12 U.S.C. § 1818 also identifies certain activities that a person subject to a removal and prohibition order may not conduct without risking criminal penalties. 12 U.S.C. § 1818(e)(6), (j).

The drafters may not have intended for activities to be a separate category from practices. The Horne Definition of "unsafe or unsound practices" refers to "any action or lack of action," and it is not clear anything would change if the Horne Definition referred to "activities."

[441] 12 U.S.C. § 5323(a)(1) (emphasis added).

[442] 12 U.S.C. § 5362(b)(2). The primary financial regulatory agency refers to the AFBA with respect to depository institution subsidiaries and either the SEC, CFTC, or a state insurance authority for functionally regulated subsidiaries. See 12 U.S.C. §§ 1813(c)(1); 1844(c)(5); 5301(11)-(12), (18)(A).

AFBA. If the Fed makes a recommendation, the AFBA can only follow it if the AFBA has existing authority to do so. Assuming, for the reasons discussed above, that the Fed does have authority to address practices that are unsafe or unsound from a macroprudential perspective for designated SIFIs and their subsidiaries, it would defy logic for AFBAs to lack that authority for banks already subject to 12 U.S.C. § 1818. Instead, the macroprudential scope of 12 U.S.C. § 5362 clarifies the macroprudential scope of 12 U.S.C. § 1818 in the same manner that subsequently enacted legislation clarified that the unqualified Horne Definition is the best interpretation of "unsafe or unsound practices."[443]

The primary financial regulatory agencies for functionally regulated subsidiaries do not have any enforcement authority under 12 U.S.C. § 1818 and may have no corresponding authorities under their own statutes. Those agencies may not be able to implement the Fed's recommended enforcement actions, but that is not indicative of the Fed's own authority under 12 U.S.C. § 1818 via 12 U.S.C. § 5362. Congress did not limit the Fed to the enforcement powers of functional regulates. The statutory text clarifies that the Fed can use 12 U.S.C. § 1818 to address practices that threaten the financial stability of the United States. Whether the principal financial regulatory agencies of a SIFI's functionally regulated subsidiaries have authority to take such actions is of no consequence in determining the Fed's powers.

F. Twelve U.S.C. § 1818-Based Objections and Responses

If 12 U.S.C. § 1818 indicated that unsafe or unsound practices referred solely to microprudential considerations or contained language that prohibited enforcement actions based on macroprudential risks, that would outweigh suggestions to the contrary from other statutes. No such indications exist.

While no 12 U.S.C. § 1818 enforcement action requires macroprudential effects, involuntary deposit insurance terminations and C&D proceedings require no effects at all - micro- or macroprudential.[444] The requisite misconduct alone is enough. And one provision is limited to macroprudential risks. Twelve U.S.C. § 1818(r)(2)(B) authorizes enforcement actions against foreign banks and their officers, directors, employees, and agents for acts or practices that occurred outside the United States if "the alleged act or practice is one which, if proven, would, in the judgment of the [FDIC's] Board of Directors, adversely affect the insurance risk assumed by the [FDIC]." This could result from risk to the foreign bank itself, but that would be neither necessary nor sufficient. There must be a macroprudential risk to the DIF, which could also result from the risks the bank creates or contributes to without implicating its own financial stability.

For other enforcement actions, microprudential criteria risks without corresponding macroprudential criteria could suggest that unsafe or unsound practices must involve microprudential risk. This inference would be misguided. Consider that violations of law can

[443] *See supra* Section III.B.4.
[444] *See* 12 U.S.C. § 1818(a)(2).

also authorize enforcement actions. Given the statutory structure, it would defy logic to suggest that violating a law aimed at preventing macroprudential risks could not be grounds for a 12 U.S.C. § 1818 enforcement action if the other elements were satisfied. There is no reason why it would be different for unsafe or unsound practices. Moreover, even 12 U.S.C. § 1818 enforcement actions that specify certain microprudential effects contain language that could allow the enforcement action to be brought if the effects are solely macroprudential, as discussed in the rest of this section.

1. Civil Money Penalties

Though the CMP provisions include no effects element related to macroprudential concerns, practices that create such risks could nonetheless warrant a CMP. Second and third tier CMPs may be based on microprudential risk or actual loss,[445] but they are not the only options for the effects element. Misconduct could result in second tier CMPs if the misconduct is "part of a pattern of misconduct" or "result[s] in pecuniary gain or other benefit to" the party engaged in the misconduct - whether a bank or an IAP.[446] Similarly, a bank or IAP "knowingly or recklessly" causing "substantial pecuniary gain or other benefit to such party by reason of" the party's misconduct authorizes a third tier CMP.[447] Banks and IAPs may engage in activities that create macroprudential risks, such as originating and distributing loans that they would never hold on their own balance sheets, because of potential pecuniary gain. Such practices could be a part of a pattern of misconduct. For these reasons, macroprudential unsafe or unsound practices would fit seamlessly into the structure of the CMP provisions.

2. Removals and Prohibitions

The effects element for a removal and prohibition is satisfied when, by reason of an IAP's misconduct,

"(i) such insured depository institution or business institution has suffered or will probably suffer financial loss or other damage;
(ii) the interests of the insured depository institution's depositors have been or could be prejudiced; or
(iii) such party has received financial gain or other benefit by reason of such violation, practice, or breach."[448]

Twelve U.S.C. § 1818 (e)(1)(B)(i) and (ii) relate to microprudential risk and no provision refers to macroprudential risk. Again, however, this is not a reason to think that macroprudential risks are outside the scope of unsafe or unsound practices. Again, an IAP may engage in a practice that creates macroprudential risks, such as originating poorly

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445 *See* 12 U.S.C. § 1818(i)(2)(B)(ii)(II), (i)(2)(C)(ii). First tier CMPs require violations of law and have no effects element. *See* 12 U.S.C. § 1818(i)(2)(A).
446 12 U.S.C. § 1818(i)(2)(B)(ii)(I), (III).
447 12 U.S.C. § 1818(i)(2)(C)(ii).
448 12 U.S.C. § 1818(e)(1)(B).

underwritten loans for distribution, because of the financial gain or other benefit, which would authorize a removal and prohibition.

3. Temporary C&D Orders

Temporary C&D orders are only available to the AFBA when the bank or IAP's misconduct or threatened misconduct "is likely to cause insolvency or significant dissipation of assets or earnings of the depository institution, or is likely to weaken the condition of the depository institution or otherwise prejudice the interests of its depositors prior to the completion of the [C&D] proceedings conducted pursuant to" 12 U.S.C. § 1818(b)(1).[449] Each of these potential bases for a temporary C&D is microprudential in nature.

If unsafe or unsound practices can include macroprudential risks to the DIF, it may seem odd that such practices would not allow for a temporary C&D unless they also pose microprudential risks. There is, however, good reason to restrict temporary C&D orders to microprudential risks. It is far easier to identify when microprudential risks are likely to manifest over short-time horizons compared to macroprudential risks. The likelihood of the former can be assessed by evaluating the financial condition of the bank and the direct and immediate impact of the misconduct on the bank's condition. Macroprudential risks, on the other hand, may consist of the build up of vulnerabilities over time and the likelihood of hard to forecast shocks. Predicting the timing of a macroprudential event–other than one that involves the macroprudential consequences of a microprudential event (i.e., a bank failure) - is difficult.

Moreover, temporary C&D orders are just one type of C&D order that 12 U.S.C. § 1818 authorizes in specific circumstances.[450] General C&D orders are not limited to microprudential risks as they require no effects.[451]

4. FDIC Authorities When It Is Not the AFBA

Certain aspects of the FDIC's authority under 12 U.S.C. § 1818(t) to bring an enforcement action when the AFBA fails to follow the FDIC's recommendations could be read as limiting unsafe or unsound practices to microprudential risks. Quoting 12 U.S.C. § 1818(t)(2) in its entirety helps showwhy this reading is off-base.

"**(2) FDIC's authority to act if appropriate Federal banking agency fails to follow recommendation**

If the appropriate Federal banking agency does not, before the end of the 60-day period beginning on the date on which the agency receives the recommendation under paragraph (1), take the enforcement action recommended by the [FDIC] or provide a plan acceptable to the [FDIC] for responding to the [FDIC] concerns, the [FDIC] may take the recommended

[449] 12 U.S.C. § 1818(c)(1).
[450] 12 U.S.C. § 1818(c)(1).
[451] *See* 12 U.S.C. § 1818(b).

enforcement action if the [FDIC's] Board of Directors determines, upon a vote of its members, that-

> (A) the insured depository institution is in an unsafe or unsound condition;
> (B) the institution or institution-affiliated party is engaging in unsafe or unsound practices, and the recommended enforcement action will prevent the institution or institution-affiliated party from continuing such practices;
> (C) the conduct or threatened conduct (including any acts or omissions) poses a risk to the Deposit Insurance Fund, or may prejudice the interests of the institution's depositors or
> (D) the conduct or threatened conduct (including any acts or omissions) of the depository institution holding company poses a risk to the Deposit Insurance Fund, provided that such authority may not be used with respect to a depository institution holding company that is in generally sound condition and whose conduct does not pose a foreseeable and material risk of loss to the Deposit Insurance Fund."[452]

Twelve U.S.C. § 1818(t)(2)(B) is clearly focused on unsafe or unsound practices, while 12 U.S.C. § 1818(t)(2)(C) and (D) include explicit reference to risks to the DIF, a macroprudential concern. As a result, 12 U.S.C. § 1818(t)(2)(B) and unsafe or unsound practices generally could be read, erroneously, as purely microprudential. The macroprudential focus of 12 U.S.C. § 1818(t)(2)(C) and (D) do not constrain, or even imply any constraints, on the scope of unsafe or unsound practices under 12 U.S.C. § 1818(t)(2)(B).

The history of 12 U.S.C. § 1818(t) clarifies why When first enacted, it applied only to the OTS and savings associations and included only two grounds for FDIC action: if "(A) the [savings] association [was] in an unsafe or unsound condition; or "(B) failure to take the recommended action [would] result in continuance of unsafe or unsound practices in conducting the business of the savings association."[453]

A subsequent amendment that expanded the scope to all the AFBAs and all insured depository institutions authorized the FDIC to take action if "(A) the insured depository institution is in an unsafe or unsound condition; (B) the institution is engaging in unsafe or unsound practices, and the recommended enforcement action will prevent the institution from continuing such practices; or (C) the institution's conduct or threatened conduct (including any acts or omissions) poses a risk to the Deposit Insurance Fund, or may prejudice the interests of the institution's depositors."[454] This change and the other provisions of 12 U.S.C. § 1818 clarify why 12 U.S.C. § 1818(t)(2)(C) should not be read as limiting 12 U.S.C. § 1818(t)(2)(B), and unsafe or unsound practices generally, to microprudential risks.

[452] 12 U.S.C. § 1818(t)(2) (footnotes omitted). Note that 12 U.S.C. § 1818(t) is not a model of perfect drafting. It contains three errors identified by the Office of the Law Revision Counsel. See footnotes at 12 U.S.C. § 1818(t)(2)(C), (t)(2)(D), and (t)(6), and note that the statute includes two (t)(6)'s.
[453] https://www.govinfo.gov/content/pkg/STATUTE-103/pdf/STATUTE-103-Pg183.pdf at sec. 912.
[454] https://fraser.stlouisfed.org/files/docs/historical/congressional/pl102_242.pdf at 307. Note that holding companies generally are only treated as insured depository institutions for purposes of 12 U.S.C. § 1818(b) through (s). *See* 12 U.S.C. § 1818(b)(3)-(4).

As an initial matter, the 12 U.S.C. § 1818(t)(2)(C) includes an explicit reference to risks to the DIF, a macroprudential risk, but it also refers to risks to "the institution's depositors," a microprudential concern due to the focus on a single institution. As noted *supra* II.B.5, "unsafe or unsound practices" also encompasses microprudential and macroprudential risks. The inclusion of a macroprudential consideration is less significant than it may appear at first glance.

That said, 12 U.S.C. § 1818(t)(2)(C) includes two key differences with respect to 12 U.S.C. § 1818(t)(2)(B). Neither suggests limiting "unsafe or unsound practices" to microprudential risks. First, it does not require the conduct, such as an unsafe or unsound practice has occurred yet. 12 U.S.C. § 1818(t)(2)(B) does. That is no reason to think that 12 U.S.C. § 1818(t)(2)(B) means an unsafe or unsound practice cannot create a risk to the DIF without microprudential risk. Second, 12 U.S.C. § 1818(t)(2)(C), does not require an unsafe or unsound practice. Actual or potential violations of law or breaches of fiduciary duty could authorize a 12 U.S.C. § 1818(t)(2)(C) action. It is open-ended authority for the FDIC to address any misconduct that threatens the DIF.[455]

Having addressed the possible objections based on 12 U.S.C. § 1818(t)(2)(C), responding to 12 U.S.C. § 1818(t)(2)(D)-based objections is more straightforward. Added by the Dodd-Frank Act, 12 U.S.C. § 1818(t)(2)(D) authorizes the FDIC to take action against depository institution holding companies "if the conduct or threatened conduct (including any acts or omissions) of the depository institution holding company poses a risk to the Deposit Insurance Fund, provided that such authority may not be used with respect to a depository institution holding company that is in generally sound condition and whose conduct does not pose a foreseeable and material risk of loss to the Deposit Insurance Fund."[456] Reading 12 U.S.C. § 1818(t)(2) in its entirety and in light of the history of the individual provisions clarifies that 12 U.S.C. § 1818(t)(2)(A)-(C) apply to insured depository institutions while 12 U.S.C. § 1818(t)(2)(D) applies only to depository institution holding companies. If 12 U.S.C. § 1818(t)(2)(C) applied to depository institution holding companies, it would authorize FDIC actions that 12 U.S.C. § 1818(t)(2)(D) prohibits - enforcement actions for conduct that poses a risk to the DIF without meeting the other requirements of 12 U.S.C. § 1818(t)(2)(D). In other words, the text of 12 U.S.C. § 1818(t)(2)(C) and 12 U.S.C. § 1818(t)(2)(D) are irreconcilable unless the former does not apply to depository institution holding companies. Because 12 U.S.C. § 1818(t)(2)(D) is the only provision of 12 U.S.C. § 1818(t)(2) that applies to depository institution holding companies, 12 U.S.C. § 1818(t)(2)(B), which references unsafe or unsound practices generally, is never grounds for the FDIC to take action against a depository institution holding company and 12 U.S.C. § 1818(t)(2)(D) cannot be read as limiting 12 U.S.C. § 1818(t)(2)(B) in any way.

In addition, 12 U.S.C. § 1818(t)(2)(D) requires (1) a macroprudential threat (risk to the DIF) that is foreseeable and material or (2) that the depository institution holding company be in less than generally sound condition. This language implies that a risk to the DIF does not

[455] The use of "conduct" in 12 U.S.C. § 1818(t)(2)(C) is odd. When the FDIC is the AFBA, it can only bring an enforcement action for specific types of misconduct (e.g., violations of law, unsafe or unsound practices, or breaches of fiduciary duties). *See supra* Section II.A. The plain language of 12 U.S.C. § 1818(t)(2)(C) suggests no such limitation. 12 U.S.C. § 1818(t)(1) clarifies that limitation does exist.
[456] https://www.govinfo.gov/content/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf at sec. 172(b).

need to involve any imminent risk of bank failure. If the bank is generally sound but the DIF is threatened, 12 U.S.C. § 1818(t)(2)(D) may authorize an enforcement action. The Horne Definition, unlike *Gulf Federal*'s restrictive gloss and the FDIC/OCC proposal, recognizes that risks to the bank and the DIF can arise independently.

G. Agency Statements

In their own statements, the federal banking agencies do not always adhere to the traditional micro/macro dichotomy. This section first discusses the agencies' guidance on leveraged lending, which took an explicitly macroprudential approach to safety and soundness. The FDIC and OCC have since withdrawn this guidance with ambiguous effect. It then discusses the agencies' rules on guidance, which show more alignment with the traditional view but do not limit the scope of unsafe or unsound practices to microprudential concerns. Finally, it briefly discusses how the OCC recently described the nature of its 12 U.S.C. § 1818 powers that indicate a macroprudential shift.

1. Leveraged Lending Guidance

In 2013, the FBAs jointly published guidance on leveraged lending (Leveraged Lending Guidance).[457] Concerns that financial institutions would lower underwriting standards when originating loans for sale with no intention of ever holding them on their own books (i.e., originate to distribute), as they had during the Great Financial Crisis, were top of mind.[458] Transferring loans reduces or eliminates risks to the originating institution, but the loans become the new owner's problem. The aggregate risk in the system stays constant but potentially imperils actors other than the originator. The Leveraged Lending Guidance addressed these macroprudential risks that a bank's activities pose to the rest of the financial system and invoked safety and soundness in doing so. The agencies wrote:

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[457] FDIC, Fed, & OCC, Interagency Guidance on Leveraged Lending (Mar. 21, 2013), https://www.federalreserve.gov/supervisionreg/srletters/sr1303a1.pdf [hereinafter Leveraged Lending Guidance]. The Leveraged Lending Guidance notes that "numerous definitions of leveraged lending exist throughout the financial services industry and commonly contain some combination of the following:

- Proceeds used for buyouts, acquisitions, or capital distributions.
- Transactions where the borrower's Total Debt divided by EBITDA (earnings before interest, taxes, depreciation, and amortization) or Senior Debt divided by EBITDA exceed 4.0X EBITDA or 3.0X EBITDA, respectively, or other defined levels appropriate to the industry or sector.
- A borrower recognized in the debt markets as a highly leveraged firm, which is characterized by a high debt-to-net-worth ratio.
- Transactions when the borrower's post-financing leverage, as measured by its leverage ratios (for example, debt-to-assets, debt-to-net-worth, debt-to-cash flow, or other similar standards common to particular industries or sectors), significantly exceeds industry norms or historical levels."

Id. at 4.

In the Comptroller's Handbook, the OCC also acknowledged that "[n]umerous definitions of leveraged lending exist" but stated that "it broadly considers a leveraged loan to be a transaction where the borrower's post-financing leverage, when measured by debt-to-assets, debt-toequity, cash flow-to-total debt, or other such standards unique to particular industries, significantly exceeds industry norms for leverage." OCC, Leveraged Lending, Comptroller's Handbook at 2-3 (Feb. 2008), https://occ.treas.gov/publications-and-resources/publications/comptrollers-handbook/files/leveraged-lending/pub-ch-leveraged-lending.pdf.

[458] *See, e.g.*, FDIC Center for Financial Research Working Paper No. 2010-08

"[F]inancial institutions should ensure they do not unnecessarily heighten risks by originating poorly underwritten loans. For example, a poorly underwritten leveraged loan that is pooled with other loans or is participated with other institutions may generate risks for the financial system. This guidance is designed to assist financial institutions in providing leveraged lending to creditworthy borrowers in a safe-and-sound manner."[459]

The guidance sets forth the supervisory expectation that "an institution's underwriting standards should consider . . . [w]hether the business premise for each transaction is sound and the borrower's capital structure is sustainable regardless of whether the transaction is underwritten for the institution's own portfolio or with the intent to distribute. The entirety of a borrower's capital structure should reflect the application of sound financial analysis and underwriting principles."[460] Although the Leveraged Lending Guidance did not refer to "unsafe or unsound practices" or potential risks to the DIF specifically, as would be required under the Horne Definition, the macroprudential approach to safety and soundness is clear.

The explicit consideration of macroprudential risks did not go unnoticed. The Bank Policy Institute (BPI) claimed that "the leveraged lending guidance is not rooted in the statutory safety and soundness authority granted to the federal banking agencies."[461] It is not clear what BPI meant, as it did not indicate which statutory authority it was referring to.[462] Rather than clarifying, it argued that the Fed's authority to issue the Leveraged Lending Guidance was questionable or, if accurate, "worrisome."[463] BPI further asserted that neither the OCC nor the FDIC had any "such 'financial stability' authority" (presumably of the macroprudential variety) at all.[464]

There is reason to think that Congress did not agree with BPI's position. Because the agencies did not submit the Leveraged Lending Guidance to Congress when, it faced a potential Congressional Review Act (CRA) challenge years after its release.[465] Despite Republicans controlling the House of Representatives, the Senate, and the presidency, Congress did not take advantage of the CRA's filibuster-avoiding procedures to overturn the rule and prevent the federal banking agencies from "reissu[ing the rule] in substantially the same form" or issuing any "new rule that is substantially the same" as the overturned rule "unless the reissued or new rule is specifically authorized by a law enacted after the date of the joint resolution disapproving the original rule."[466]

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459 Leveraged Lending Guidance, *supra* note 457 at 1.
460 *Id.* at 6.
461 Nelson, et al., *supra* note 345.
462 For example, BPI may have meant that the unsafe or unsound practices authorities in 12 U.S.C. § 1818 involve only microprudential risks or that the agencies did not issue the guidance pursuant to its authority to set enforceable safety and soundness standards under 12 U.S.C. § 1831p-1.
463 Nelson, et al., *supra* note 345.
464 *Id.*
465 Responding to a request from Senator Pat Toomey, the Government Accountability Office determined that Leveraged Lending Guidance is a "rule" under the CRA in 2017. Government Accountability Office, Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation--Applicability of the Congressional Review Act to Interagency Guidance on Leveraged Lending, B-329272 (Oct. 19, 2017), https://www.gao.gov/assets/b-329272.pdf.
466 5 U.S.C. § 801(b)(2).

The FDIC and OCC, but not the Fed, recently withdrew the Leveraged Lending Guidance.[467] Potential inappropriate or even illegal overreach into macroprudential concerns is not among the reasons listed for their withdrawal. Moreover the withdrawal itself includes eight "general principles for safe and sound lending when managing the risks associated with leveraged lending."[468] Though less clear than in the Leveraged Lending Guidance, some of the principles indicate possible continued supervisory attention on macroprudential safety and soundness risks.[469]

2. Supervisory Criticism and the Rules on Guidance

Language in the federal banking agencies' respective rules on guidance present a challenge to using the supervisory process and enforcement actions to address unsafe or unsound practices that create macroprudential risks. Each FBA has said that, as a matter of policy, "[s]upervisory criticisms should continue to be specific as to practices, operations, financial conditions, or other matters that could have a negative effect on the safety and soundness of the financial institution, could cause consumer harm, or could cause violations of laws, regulations, final agency orders, or other legally enforceable conditions."[470] This language indicates an unwillingness to use the supervisory process to address macroprudential risks unless there is also a risk to the safety and soundness of the [individual] financial institution, potential harm to consumers, or a violation of laws, etc. involved.

For two reasons, the rules on guidance are not insurmountable obstacles to a macroprudential approach to unsafe or unsound practices. First, the agencies' rules on guidance cannot narrow the meaning of "unsafe or unsound practices" beyond the bounds set by Congress. For all the reasons discussed above, the unqualified Horne Definition is the best reading of the term, and under *Loper Bright*, statutes have a single meaning, even if other readings are reasonable. And the Horne Definition includes macroprudential considerations. Indeed, the rules purport not to limit the scope of safety and soundness but rather the scope of the agencies' own actions. Second, the approach set forth in the rules on guidance is a matter of policy, and adopted via regulation relatively recently, in 2021.[471] Prior to that, the agencies had issued the Leveraged Lending Guidance with its explicitly macroprudential focus. And according to the banking lobby, the federal banking agencies took supervisory action to address those macroprudential risks.[472] The agencies could

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[467] FDIC & OCC, "Interagency Statement on OCC and FDIC Withdrawal from the Interagency Leveraged Lending Guidance Issuances" (Dec. 5, 2025), https://www.occ.gov/news-issuances/bulletins/2025/bulletin-2025-44a.pdf.
[468] *Id.* at 2.
[469] *See id.* at 2-3. These at least potentially macroprudential principles include "Each bank should have effective risk management and controls for transactions in its pipeline, including loans to be held and those to be distributed" and "A bank's underwriting criteria should consider a loan's purpose and sources of repayment and the capacity to de-lever over a reasonable period. Given the risk profiles of leveraged lending transactions, underwriting criteria should be consistently applied to these transactions." *Id.* at 2. Risk management and controls for loans to be distributed as well as consistent underwriting criteria (including for loans to be distributed) are not necessarily important from a microprudential perspective.
[470] 12 C.F.R. Part 4, Subpart F, Appendix A (2)(iii); Part 262, Appendix A; Part 302, Appendix A.
[471] 12 C.F.R. Part 4, Subpart F, Appendix A (2)(iii); Part 262, Appendix A; Part 302, Appendix A.
[472] *See* Nelson, et al., *supra* note 345 ("[B]y all accounts, the agencies began in 2014 to enforce the leveraged guidance as if it were a binding regulation.").

reverse the microprudential focus of the policy in the future, as no statute compels it. Furthermore, the agencies gave themselves some flexibility by saying what "[s]upervisory criticism *should*" involve, not "must." That is the classic word choice to indicate that an agency statement is not legally binding.

3. Recent Comments on 12 U.S.C. § 1818

Recently, the OCC has invoked systemic considerations as the basis for its 12 U.S.C. § 1818 powers. Specifically, it has argued that 12 U.S.C. § 1818 enforcement action vindicate "the public's right to a safe and sound banking system."[473] This language is clearly macroprudential in nature and indicates that the purpose of 12 U.S.C. § 1818 is broader than ensuring microprudential safety and soundness. It aims to provide a safe and sound banking *system* for the public, which requires a macroprudential approach. This further supports reading the Horne Definition as having a macroprudential scope and encompassing abnormal risks to the DIF, apart from any risk to the bank or its shareholders.

H. Macroprudential Stability Is a Precondition for Microprudential Safety and Soundness

There is one overarching practical reason to read safety and soundness as including macroprudential risks: a microprudential-only approach will not work. In times of widespread financial instability, even strong banks are at risk of failure due to the inherent risks of banking.[474] The federal banking agencies cannot ensure the safety and soundness of individual institutions if the system as a whole is at risk. Risks to the DIF, as contemplated by the Horne Definition, both could themselves create safety and soundness risks for other banks and could result from one bank's activities creating risks for other banks.

Attempting to protect individual institutions while allowing them to create or contribute to systemic risks is a recipe for failure of banks and by the FBAs. Eventually, those risks will come back, if not to the same institutions that created the risk, then to others.[475] To treat such risks as outside the bounds of unsafe or unsound practices would take formal enforcement actions off the table unless some law was broken or fiduciary duty breached. Without the threat of an enforcement action, the federal banking agencies' ability to address such concerns informally through the supervisory process would be diminished.[476]

This practical need to consider macroprudential risks, along with the explicit macroprudential language of the Horne Definition, the historic macroprudential origins of "safety and soundness," statutory breakdowns in the micro vs. macro dichotomy, the ability of

[473] OCC briefs in Ortega and Anderson. The OCC prevailed in the Fifth Circuit. *See* https://www.ca5.uscourts.gov/opinions/pub/23/23-60617-CV0.pdf.
[474] Morgan Ricks and Diamond & Dybvig.
[475] *See* https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf at 307 (identifying supervisory failures in the build up to the Great Financial Crisis because "it was difficult to express . . . concerns forcefully when financial institutions were generating record-level profits" despite the risks proliferating throughout the financial system").
[476] *See* Tarullo, *supra* note 51.

misconduct to satisfy the elements of 12 U.S.C. § 1818 actions without any microprudential risks, the Dodd-Frank Act's use of 12 U.S.C. § 1818 to authorize macroprudential enforcement actions under 12 U.S.C. § 5362, and agency statements indicating macroprudential approach to safety and soundness support one conclusion: a practice may be unsafe or unsound if it poses an abnormal risk to the DIF, even if there is no risk to the bank or its shareholders.

V. The Agencies Cannot Alter the Horne Definition's "Unsafe or Unsound Practices" Standard.

The agencies have long relied on *Chevron*[477] and *Brand X*[478] as justification for continued reliance on the Horne Definition when interpreting the term "unsafe or unsound practices," even when some courts disagreed with that standard.[479] Under *Brand X*, agencies were not bound by prior judicial interpretations of statutes unless the court held that the provision was unambiguous.[480] Since courts have not held that "unsafe or unsound practices" is unambiguous, *Brand X* permitted the federal banking agencies to continue to rely on *Chevron* despite some courts interpreting "unsafe or unsound practice" more narrowly than the agencies did.[481] *Loper Bright* has eliminated that option by overruling *Chevron*.[482] The agencies can no longer claim they are entitled to deference merely because they are interpreting a statute they are tasked with implementing.

While is it not clear whether the FDIC and OCC have concluded that their proposed definition of "unsafe or unsound practices" is a matter of deference or discretion, they do cite to *Groos*,[483] potentially suggesting they have wide latitude to define the term.[484] The FDIC/OCC proposal also specifically quotes the following statement: "The phrase 'unsafe or unsound banking practice' is widely used in the regulatory statutes and in case law, and one of the purposes of the banking acts is clearly to commit the progressive definition and eradication of such practices to the expertise of the appropriate regulatory agencies."[485]

It is true that *Loper Bright* did not rule out delegations of discretion to agencies or non-*Chevron* deference supported by other caselaw. "When the best reading of a statute is that it

[477] Chevron U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984).
[478] National Cable & Telecommunications Ass'n v. Brand X Internet Services, 545 U.S. 967 (2005).
[479] *See, e.g.*, *Adams*, *supra* note 32 at 8, 13.
[480] *See Brand X*, 545 U.S. at 982.
[481] *Adams*, *supra* note 32 at 13. An exception to this general rule for purposes of 12 U.S.C. § 1818 existed in circuits that did not defer to agency interpretations of statutes when multiple agencies were responsible for implementation. *See* Proffitt v. FDIC, 200 F. 3d 855, 860 (DC Cir. 2000). Prior to *Loper Bright*, the OCC concluded this exception should not apply to the FDI Act. *See Adams*, *supra* note 32 at 29-37.
[482] *See* Loper Bright Enterprises v. Raimondo, 603 U.S. 369, 412 (2024).
[483] Groos Nat'l Bank v. OCC, 573 F.2d 889 (5th Cir. 1978).
[484] *See* 90 Fed. Reg. at 48.837 n.5.
[485] *See* 90 Fed. Reg. at 48.837 n.5 (quoting *Groos* 573 F.2. at 897).

delegates discretionary authority to an agency, the role of the reviewing court under the APA is, as always, to independently interpret the statute and effectuate the will of Congress subject to constitutional limits. The court fulfills that role by recognizing constitutional delegations, fixing the boundaries of the delegated authority and ensuring the agency has engaged in reasoned decisionmaking within those boundaries."[486] Deference continues to be appropriate for "factbound determinations,"[487] or mixed questions of law and fact.

The issue with respect to the meaning of "unsafe or unsound practices" post-*Loper Bright* is what authority has Congress delegated to the agencies. Is it authority to redefine "unsafe or unsound practices" or is it authority to determine that an unsafe or unsound practice has occurred given the existing meaning of the term (*i.e.*, is the meaning of "unsafe or unsound practices" itself the fixed boundary of any delegated authority)? For the reasons discussed below, it is the latter.

Delegations can be express or implicit. The FDIC/OCC proposal cites no language expressly delegating to the FBAs authority to define "unsafe or unsound practices" because there is none. Congress did grant the Farm Credit Administration express authority to define "unsafe or unsound practices" for its purposes.[488] It did not do so for the FBAs under 12 U.S.C. § 1818. There is also no implicit delegation to define "unsafe or unsound practices." *Loper Bright* confirmed that Congress may authorize an agency to "fill up the details" or define the term "subject to the limits imposed by a term or phrase that leaves agencies with flexibility, such as 'appropriate' or 'reasonable.'"[489] The FDIC/OCC proposal does not cite any statutory text that grants such authority. The AFBA has authority to institute enforcement actions based on its unsafe or unsound practices "determination" or "opinion," but these grants of authority refer to specific practices, not the meaning of the term itself.[490] What "unsafe or sound practices" means as a general matter and the standard against which agency action invoking that authority is judged against, is a "pure legal question."[491]

The FBAs are entitled to deference on factbound determinations made against that legal standard. Those determinations under 12 U.S.C. § 1818 involve "specific application of a broad statutory term."[492] In such cases, "the reviewing court's function . . . limited."[493]

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[486] *Loper Bright*, 603 U.S. at 395 (cleaned up).
[487] *Id.* at 389.
[488] 12 U.S.C. § 2271(5) ("the term 'unsafe or unsound practice' shall—

(A) have the meaning given to it by the Farm Credit Administration by regulation, rule, or order; and

(B) mean any significant noncompliance by a System institution (as determined by the Farm Credit Administration, in consultation with the Farm Credit System Insurance Corporation) with any term or condition imposed on the institution by the Farm Credit System Insurance Corporation under section 2277a–10 of this title.").

[489] *Loper Bright*, 603 U.S. at 395.
[490] *See* 12 U.S.C. § 1818(a)(2)(A)(i), (a)(2)(B), (a)(3), (a)(8)(B)(ii)(II), (b), (c), (e)(1)(A)(ii), (t)(2)(B). The CMP provisions that reference unsafe or unsound practices do not include such language. *See* 12 U.S.C. § 1818(i)(2)(B)(ii), (i)(2)(C)(ii).
[491] *Loper Bright*, 603 U.S. at 389.
[492] *NLRB v. Hearst Publications, Inc.*, 322 U. S. 111, 131 (1944).
[493] *NLRB v. Hearst Publications, Inc.*, 322 U. S. 111, 131 (1944).

Indeed, cases describing the broad authority of the AFBAs to address unsafe or unsound practices provide no basis for concluding that the FDIC and OCC possess authority to define "unsafe or unsound practices." Delegations must include an intelligible principle,[494] and implementing agencies cannot depart from the limitations and boundaries Congress imposed.[495] The AFBAs cannot narrow the interpretation any more than they can declare by regulation that prudent practices can be unsafe or unsound. Second, this case law is inapposite. Despite discussing the meaning of unsafe or unsound practices, the *Groos*, *Independent Bankers*, and *Investment Company Institute* courts were not referring to a general interpretation of the term. Instead, they dealt with whether specific practices were unsafe or unsound.[496] The standard against which such definitions must be evaluated (i.e., the meaning of "unsafe or unsound practices") is a different matter. Against that standard, the agencies have flexibility to determine whether a practice is unsafe or unsound given their expertise, but they cannot change the standard itself. To conclude otherwise, would require taking the position that the FBAs' discretion is unbounded, which would itself render the delegation unconstitutional.[497]

Of course, this raises another question: what is the standard that sets the boundaries of FBAs' discretion with respect to enforcement, regulatory, and supervisory actions under the "unsafe or unsound practices" authority of 12 U.S.C. § 1818. "[S]tatutes, no matter how impenetrable, do— in fact, must—have a single, best meaning."[498] With the end of *Chevron* deference, "if [a statutory interpretation] is not the best, it is not permissible."[499]

Because *Adams* cited *Chevron* and *Brand X* extensively, *Loper Bright* may appear to call the Horne Definition into question. Such appearances are illusory. Its firm roots in legislative history and its consistency with the statutory text and structure, the Horne Definition is the best definition of "unsafe or unsound practices." For all the reasons discussed above, *Gulf Federal* and its progeny, as well as the FDIC/OCC proposal and the DC Circuit approach, were and are misguided. The mere fact that the Horne Definition is better is sufficient to rule the others out as permissible interpretations.[500] In other words, *Loper Bright* commands that "unsafe or unsound practices" be interpreted consistent with the Horne Definition in its original, unqualified form.

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[494] *See* JW Hampton, Jr., & Co. v. United States, 276 US 394, 409 (1928).

[495] *See Loper Bright*, 603 U.S. at 413.

[496] *Groos*, 573 F.2d. at 897 (responding to claim that "the phrase 'unsafe or unsound' lacks definite meaning and cannot be used as a basis for depriving them of any rights" by noting that "Congress commit[ted] the progressive definition and eradication of such practices [not the standard for what practices may be defined as unsafe or unsound] to the expertise of the appropriate regulatory agencies). Independent Bankers Ass'n v. Heimann, 613 F. 2d 1164,1168-69 (DC Cir. 1979) (discussing and upholding a regulation defining certain practices related to credit life insurance as unsafe or unsound); Investment Co. Institute v. FDIC, 815 F. 2d 1540, 1550 (DC Cir. 1987) (upholding an FDIC rule against challenge that it permitted unsafe or unsound practices). *See also Adams*, *supra* note 32 at 16 (observing that Groos "did not adopt a definition of ['unsafe or unsound practices'], but indicated that courts should be deferential to the practical implementation of the term by the banking agencies").

[497] *See supra Loper Bright*, 603 U.S. at 395.

[498] *Loper Bright*, 603 U.S. at 400.

[499] *Loper Bright*, 603 U.S. at 400.

[500] *See Loper Bright*, 603 U.S. at 400.

Further, while assuming that safety and soundness and unsafe or unsound practices referred, including with respect to the Horne Definition itself, only to microprudential risks may have been reasonable under *Chevron*, that position is no longer tenable. As described above, Congress explicitly uses "safety and soundness" to refer to both micro- and macroprudential risks. Therefore, defaulting to a microprudential-only interpretation is untenable. In many instances, the best reading very well may be that "safety and soundness" or "unsafe or unsound practices" has macroprudential reach. Twelve U.S.C. § 1818 is one such statute, and the plain text of the Horne Definition is entirely consistent with that interpretation.

VI. Conclusion

The federal banking agencies possess broad powers to address "unsafe or unsound practices" under 12 U.S.C. § 1818. However, that authority is not unbounded. The Horne Definition, as the best interpretation of the term, limits just how broad this authority is. On two important questions - whether the practice must pose a risk to financial integrity and whether only microprudential risks are within scope - the answer is "no." The AFBA need not show anything more than abnormal, not necessarily large, risk, and a risk to the DIF, apart from any risk to the bank or its shareholders, is sufficient. Enforcement actions addressing such practices remain within the outer bounds of the federal banking agencies' authorities.

Taking these powers seriously and fully utilizing them up to their outer bounds will enable the federal banking agencies to better address micro- and macroprudential risks, whether traditional or emerging, through formal enforcement actions or the supervisory process. At the same time, this clear, best meaning prevents efforts to expand or restrict the standard set forth in the Horne Definition. While the federal banking agencies' unsafe or unsound practices authority is broad, it does not empower the agencies to redefine "unsafe or unsound practices." The meaning of that term is the set by Congress against which the FBAs' exercise of their authorities is evaluated. Put simply, the Horne Definition, which encompasses macroprudential risks and risks to the agencies, defines the unalterable outer bounds of the FBAs' "unsafe or unsound practices" authorities.

#2014-126
Terminates **#N11-004** and **#N12-001**

UNITED STATES OF AMERICA
DEPARTMENT OF THE TREASURY
OFFICE OF THE COMPTROLLER OF THE CURRENCY

In the Matter of **Patrick Adams** Former President and Chief Executive Officer T Bank, N.A. Dallas, Texas	**FINAL DECISION** OCC AA-EC-11-50

THOMAS J. CURRY, Comptroller of the Currency:

FINAL DECISION TERMINATING ENFORCEMENT ACTION

This is an enforcement action brought by the Enforcement and Compliance Division ("Enforcement Counsel") of the Office of the Comptroller of the Currency ("OCC") against Patrick Adams ("Respondent" or "Adams"), former President and Chief Executive Officer of T Bank, N.A., Dallas, Texas ("T Bank" or "the Bank"). Pursuant to 12 U.S.C. § 1818(b) and § 1818(i)(2), Enforcement Counsel has sought an order to cease and desist and an assessment of a civil money penalty of $100,000 against Adams in connection with his role from 2005 to 2007 in T Bank's inadequate management of risks related to processing remotely created checks ("RCCs")[1] for numerous merchants.

The Notice of Charges, filed September 26, 2011, charged that Adams engaged in unsafe or unsound practices by: 1) failing to ensure that the Bank performed adequate and ongoing due diligence before and after opening accounts for merchants to deposit RCCs; 2) failing to ensure that the Bank had adequate policies, procedures, systems, and internal controls in place to manage and mitigate the risks associated with the Bank's relationship with those merchants; 3) failing to ensure that the Bank had adequate policies, procedures, and controls for tracking, investigating, and responding to consumer complaints of, *inter alia*, unauthorized RCCs; and 4) allowing the continued deposit of RCCs into those merchants' accounts despite the possibility that consumers were being harmed. Enforcement Counsel issued a subsequent Amended Notice of Charges adding the allegation that Adams' removal of documents constituting non-public OCC information from the Bank was, *inter alia*, a violation

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[1] For a definition of RCCs, see the Bank Secrecy Act Manual of the Federal Financial Institutions Examination Council at https://www.ffiec.gov/bsa_aml_infobase/pages_manual/OLM_063.htm (last visited Sept. 22, 2014): "A remotely created check (sometimes called a 'demand draft') is a check that is not created by the paying bank (often created by a payee or its service provider), drawn on a customer's bank account. The check often is authorized by the customer remotely, by telephone or online, and, therefore, does not bear the customer's handwritten signature."

of regulation. On the basis of the allegations, Enforcement Counsel sought a cease-and-desist order and an assessment of a civil money penalty in the amount of $100,000 against Adams.

A hearing was conducted before Administrative Law Judge ("ALJ") C. Richard Miserendino in January and February, 2012 in Fort Worth, Texas. Both sides filed Post-Hearing Briefs. On November 8, 2012, the ALJ issued a recommended decision ("Recommended Decision" or "RD") containing Recommended Findings of Fact and Recommended Conclusions. Those findings and conclusions were predominantly favorable to Adams and unfavorable to Enforcement Counsel. Ultimately, the ALJ recommended that both the cease-and-desist order and civil money penalty actions be dismissed. In response, Enforcement Counsel filed exceptions. Adams did not. In March 2013, the Comptroller certified that the record of the proceeding was complete.

Upon review of the record, the Recommended Decision incorporating Recommended Findings of Fact and Conclusions, and Enforcement Counsel's Exceptions, the Comptroller hereby declines to adopt the ALJ's Recommended Findings of Fact and Recommended Conclusions. Instead, the Comptroller reaches conclusions of law that reflect substantial agreement with Enforcement Counsel's exceptions and consistency with past OCC legal positions. The ALJ's Recommended Findings of Fact, predicated upon incorrect legal standards, including the deference due testimony of bank examiners, do not form an adequate basis for the Comptroller to reach final findings of fact. In order to do so, it would be necessary for the Comptroller to remand the matter to the ALJ to reconsider his Recommended Findings of Fact under the Comptroller's corrected standards. In light of the further extension of time that would be necessary to effect a remand, however, the Comptroller will not remand, and will not reach final findings of fact. Instead, in an exercise of his plenary discretion over remedies, the Comptroller hereby orders the action terminated, and the outstanding Notices of Charges and Assessment dismissed.

As outlined in the following Summary of the Legal Analysis, this Final Decision addresses three distinct issues of law and attendant deference questions. For each issue, the analysis is preceded by a Statement of the Case describing the ALJ's Recommended Decision and the positions of the parties. While not reaching findings of fact, the Comptroller reviews the evidence in the record that supported the agency in initiating and prosecuting this action.

THE COMPTROLLER'S CONSIDERATION OF LEGAL ISSUES PRESENTED

SUMMARY OF THE LEGAL ANALYSIS IN THIS FINAL DECISION

This case presents three issues for the Comptroller's decision: first, whether the ALJ used the proper legal standard in evaluating whether Respondent engaged in "unsafe or unsound practices" within the meaning of the enforcement provisions of the Federal Deposit Insurance Act ("FDI Act");[2] second, whether the ALJ used the proper legal standard in determining whether Respondent had committed a violation of law within the meaning of those provisions; and, third, whether the ALJ erred in withholding deference from the opinions offered by the OCC's examiners in their hearing testimony.

For the reasons outlined in this Summary and explained in detail below, the Comptroller reaffirms the OCC's long-held interpretation, consistent with that of the other Federal banking agencies, of the phrase "unsafe or unsound practice." In addition, the Comptroller adheres to the dominant interpretation of the FDI Act requirements for a violation of law, and reemphasizes the standards for deference to examiner testimony.

Standard for Unsafe or Unsound Practice.

The FDI Act contains no definition of the phrase "unsafe or unsound practice." The authoritative definition of the term derives from material provided to Congress in 1966 in support of the legislation that employed the term. John E. Horne, then Chairman of the Federal Home Loan Bank Board ("FHLBB"), described the term as including:

> any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.[3]

The OCC and the other Federal banking agencies consistently have relied on this definition in bringing enforcement cases in the decades since then.

The courts, however, have not uniformly applied the Horne definition. Some federal circuit courts of appeals have adhered to the Horne standard without material deviation. Some have discussed the application of a standard more restrictive than Horne but without relying on a more restrictive standard as the basis for decision in any case. Finally, a minority of circuits apply the Horne definition with a restrictive gloss that serves to narrow the circumstances under

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[2] 12 U.S.C. §§ 1818(b), 1818(i)(2).

[3] *Financial Institutions Supervisory Act of 1966: Hearings on S. 3158 Before the House Comm. on Banking and Currency*, 89th Cong., 2d Sess. 49 (1966) (statement of John E. Horne, Chairman of the FHLBB), 112 CONG. REC. 26,474 (1966).

which enforcement actions may be taken. The ALJ relied on cases in this last category – principally the Fifth Circuit's *Gulf Federal* decision[4] – to establish the standard for determining whether Respondent had engaged in unsafe or unsound practices.

In *Gulf Federal*, decided in 1981, the Fifth Circuit considered a case in which the FHLBB alleged that a Federal savings association had engaged in an unsafe or unsound practice and a violation of law in miscalculating the interest due on loans under a method that was inconsistent with the method specified in the loan documents to the detriment of its borrowers. The FHLBB issued a cease-and-desist order directing the thrift to recalculate the interest as called for by the loan agreements and to reimburse borrowers for the difference. The Fifth Circuit held that the FHLBB lacked cease-and-desist authority in these circumstances, limiting the term "unsafe or unsound practice" only to practices "that threaten the financial integrity of the association." Citing *Gulf Federal* (and other cases including cases from the Third and D.C. Circuits that relied upon *Gulf Federal*), the ALJ concluded that an unsafe or unsound practice includes:

> conduct that, at the time it was engaged in, was contrary to generally accepted standards of prudent operation (that is, it constituted an imprudent act), the possible consequences of which, if continued, created an abnormal risk or loss or damage to the **financial stability** of the Bank.

In this decision, the Comptroller rejects *Gulf Federal* as the standard for determining whether an unsafe or unsound practice has occurred. The reasons for the Comptroller's decision include these, among others:

- *Gulf Federal*'s restrictive gloss, which requires that a practice produce specific effects that threaten an institution's financial stability, conflicts with the text and structure of the statute;

- the *Gulf Federal* standard is inconsistent with the Horne definition, which contemplates that a practice may be unsafe or unsound, and therefore warrant sanction and remediation, even if it does not threaten the continued viability of the institution;

- in the *De la Cuesta* case,[5] decided the year after *Gulf Federal*, the Supreme Court expressly rejected a key reason for the Fifth Circuit's decision that the thrift's failure to adhere to the terms of its agreements with its borrowers was not an unsafe or unsound practice – the lower court's understanding that the FHLBB lacked the authority to supervise thrifts' relationships with their borrowers; and

- later-enacted legislation, including amendments to the FDI Act that expressly authorize the OCC (and the other Federal banking agencies) to seek affirmative relief, including

[4] *Gulf Federal Savings & Loan Ass'n v. Federal Home Loan Bank Board*, 651 F.2d 259 (5th Cir.1981).

[5] *Fidelity Federal Sav. & L Ass'n v. De la Cuesta*, 458 U.S. 141 (1982).

restitution, cannot be squared with *Gulf Federal*'s holding that conduct cannot be redressed unless it threatens an institution's financial stability.

Further, the Comptroller declines to conclude, as recommended by the ALJ, that the OCC is obligated by the Law of the Circuit Doctrine to conform to the legal standards of the Fifth and D.C. Circuits, the two circuits available to Respondent to file a petition for review of the Comptroller's decision. First, the cases cited by the ALJ to support application of the Law of the Circuit Doctrine are inapposite. In addition, the federal system for national banks and federal thrifts, as other financial institution supervisory regimes, requires uniformity in the predicates for enforcement actions. More important, in the *Brand X*[6] case, the Supreme Court has recognized that a judicial construction of an ambiguous statutory term in a statute that an agency is responsible for administering does not preclude the agency from reaching a contrary statutory interpretation otherwise entitled to deference under the *Chevron*[7] doctrine so long as the judicial ruling is not based on the plain meaning of the statute. Because "unsafe or unsound practice" has never been determined to have a plain meaning, the Comptroller is not bound by contrary caselaw so long as *Brand X* applies, *i.e.*, so long as the Comptroller's statutory interpretation is entitled to *Chevron* deference. Accordingly, *Brand X* would apply in judicial review of an agency interpretation in the Fifth Circuit.

The Comptroller has reviewed caselaw from all of the other circuits that have construed the term "unsafe or unsound practice," including cases from the Third Circuit (where caselaw adopts a restrictive gloss); the Second, Eighth, and Eleventh Circuits (where cases support the Horne standard); and the Seventh, Ninth, and Tenth Circuits (where cases discuss a standard more restrictive than Horne but do not rely on such a standard as the basis for a decision). As the detailed discussion below demonstrates, this review results in no basis for the Comptroller to depart from the Horne standard. Furthermore, several of those circuits expressly recognize *Chevron* deference to interpretations of the FDI Act, and only the Second Circuit has (inconsistently) adopted the D.C. Circuit doctrine of withholding deference from agency interpretations of statutes, such as the FDI Act, implemented by multiple agencies (described below). Thus, any meaningfully contrary authority in other circuits would be subject to *Brand X* on judicial review.

In the D.C. Circuit, the precise formulation of the unsafe or unsound practice standard has varied. The Comptroller also has reviewed the D.C. Circuit caselaw in detail. While the status of a 1996 case adopting a more stringent standard is unclear, the prevailing standard is the one articulated in subsequent cases – that is, that an unsafe or unsound practice is one that poses a "reasonably foreseeable undue risk to the institution." This later caselaw equates foreseeability with "increased risk of some kind." To the extent that "foreseeability" means "increased risk of some kind," this formula is consistent with Horne, and the Comptroller adopts that understanding. This reading of the present state of the law in the D.C. Circuit suggests consistency with Horne and thus with the Comptroller's interpretation of unsafe or unsound practice.

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[6] *National Cable & Telecommunications Ass'n v. Brand X Internet Services*, 545 U.S. 967 (2005).

[7] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

Alternatively, if there were a conflict between the D.C. Circuit standard and the Horne standard, the Comptroller would decline to adopt the ALJ's recommendation for the same reasons this decision declines to accept the view of the Fifth Circuit. The departure from that analysis, though, is that while the Fifth Circuit (and almost all other circuits) would apply *Brand X* to review of agency interpretations of the FDI Act, the D.C. Circuit, which has repeatedly declined to apply *Chevron* to agency interpretations of the FDI Act, would presumably not apply *Brand X* under present law.

The prevailing rationale in the D.C. Circuit for withholding *Chevron* deference embraces policy concerns stemming from the possibility of incidental overlap of agency supervisory authority under the FDI Act: that a single term might be given different meanings by different agencies, or that a single supervised party might be subject to conflicting guidance from different agencies. As explained below, concerns about these adverse consequences likely are misplaced as a practical matter. Even if there were significant areas of agency overlap, in the Comptroller's view, reconsideration of the doctrine of withholding of deference from agencies interpreting the FDI Act would be timely and warranted for important reasons, including: the doctrine's tension with the test for *Chevron* application repeatedly stated by the Supreme Court and the *Chevron* policies repeatedly reaffirmed by the Court; the circuit split with other courts of appeals that continue to apply *Chevron* to interpretations of the FDI Act; and the D.C. Circuit's acknowledged inconsistency in applying the doctrine.

Violation of Law.

As a predicate for the cease-and-desist order and civil money penalty it sought, Enforcement Counsel charged Respondent with a violation of a regulation that governs the protection of non-public OCC information. In the Recommended Decision, the ALJ noted that the statutory term "violation" is defined broadly, but applied a restrictive gloss to the statutory term in reliance on the Fifth Circuit's *Bellaire* decision,[8] which purported to adopt the *Gulf Federal* test and apply it to the independent statutory predicate violation of "law, rule, or regulation." In that case, the Fifth Circuit found the test met because there was a "direct relationship" between compliance with the statute at issue and the bank's financial soundness.

Here, the ALJ concluded that the regulation at issue "does not bear any relation to the financial stability of the Bank, and [Adams'] actions in taking nonpublic information did not threaten the Bank's integrity." Again applying the Law of the Circuit Doctrine, the ALJ followed *Bellaire* and ruled that the law that Respondent is alleged to have violated "must bear a relationship to the financial soundness of the Bank in order to support a cease-and-desist order."

The Comptroller declines to adopt the ALJ's recommended standard. The meaning of the statute is plain. A cease-and-desist order may be predicated on a violation of a "law, rule, or regulation." The FDI Act defines "violation" as "any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding and

[8] *First National Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674 (1983).

abetting a violation." There is no statutory text that supports a limitation upon the unqualified violation of law as a predicate for remedies, including that suggested by the ALJ. Moreover, the weight of more recent law, including in the Fifth Circuit, supports the rejection of the *Bellaire* gloss. The *Bellaire* restriction is contrary to the plain meaning of the statutory term, statutory structure, caselaw, and policy. A violation of the OCC's regulation justifies imposition of a cease-and-desist order without a showing of the relationship to the institution's financial integrity.

Deference to Examiner Opinions.

As explained in the decision, the ALJ departed from long-established caselaw in adopting a nondeferential standard of review of examiner judgments. The Comptroller declines to adopt that standard and adheres to the current standard, derived from *Sunshine State Bank v. FDIC.*[9]

Moreover, to the extent that the Recommended Decision purports to require that formal guidance be issued before examiners may testify that practices are contrary to generally accepted standards of prudent operation, the Comptroller concludes that that requirement is error. Caselaw supports the conclusion that the OCC's bank supervisors cannot be precluded from acting with respect to novel banking practices until such time as the agency has issued formal guidance. It is sufficient that supervisors can identify more general risks that cause those practices to depart from generally accepted standards of prudent operation even if the specific practices at issue are novel. Enforcement Counsel argues that the "weight of authority is that examiners must establish what acts were imprudent, not establish affirmative standards of what constituted adequate due diligence, sound policy, or prudent risk management." The Comptroller does not completely agree. The Horne definition requires a showing that the conduct be "contrary to generally accepted standards of prudent operation." Accordingly, Enforcement Counsel must make some showing as to the relevant standards and the departure from those standards. The novelty of a given practice cannot be permitted to preclude such a showing so long as more general relevant standards apply.

[9] *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (11th Cir. 1986).

STATUTORY AND PROCEDURAL BACKGROUND

The FDI Act authorizes the "appropriate Federal banking agency" to impose various remedies for misconduct by a banking institution or an institution affiliated party ("IAP") such as Respondent. 12 U.S.C. §§ 1813(u)(1), 1818(b)(1). Congress has designated the OCC as the appropriate Federal banking agency under the FDI Act with respect to national banks and Federal savings associations. 12 U.S.C. § 1813(q)(1).[10]

Under the FDI Act, the alternative predicates for a cease-and-desist order include, *inter alia*: 1) engaging in an unsafe or unsound practice and 2) violating a law, rule, regulation, or a condition imposed in writing. 12 U.S.C. § 1818(b)(1). If the agency finds that the record made at the hearing before the ALJ establishes the required basis, the agency may impose an order to cease and desist from the violation or practice. The agency may also order a party to take "affirmative action" to correct the conditions resulting from any such violation or practice. 12 U.S.C. § 1818(b)(6). An additional remedy is the imposition of civil money penalties for specified infractions, categorized into three escalating "tiers" of penalties ranging from a maximum of $5,000 per day in the First Tier, to $25,000 per day in the Second Tier, to $1 million per day (or one percent of the assets of the institution) in the Third Tier. Here, Enforcement Counsel alleged that Adams "recklessly engaged in an unsafe or unsound practice" that was part of a "pattern of misconduct" as the basis for a total Second Tier civil money penalty of $100,000 against Adams.[11]

The FDI Act calls for the Comptroller to review the record established at the hearing to determine whether, in his judgment, Enforcement Counsel has met its burden of supporting its allegations by a preponderance of the evidence in the record. 5 U.S.C. § 556(d); *Steadman v. SEC*, 450 U.S. 91 (1981). The Comptroller is free to accept or reject the ALJ's recommendations; a reviewing court defers to the factual interpretations of the agency, rather than to the ALJ. *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 853 (D.C. Cir. 1970); *Stanley v. Board of Governors*, 940 F.2d 267, 272 (7th Cir. 1991). The agency acts within its discretion when it rejects the credibility findings of the ALJ where the agency bases its decision on substantial evidence. *Id.*

The OCC's Final Decision is subject to appellate review by the filing of a petition for review in either the U.S. Court of Appeals for the D.C. Circuit or the court of appeals for the circuit in which the home office of the institution is located. 12 U.S.C. § 1818(h)(2). In this case, because the institution is located in Dallas, Texas, a petitioner would have a choice of

[10] The OCC is also the appropriate Federal banking agency with respect to Federal branches and agencies of foreign banks. The FDIC has backup authority that allows it to recommend that the appropriate Federal banking agency take any enforcement action against an institution or IAP that is authorized under 12 U.S.C. § 1818 as well as other statutory provisions and authorizes the FDIC to take action if the appropriate Federal banking agency fails to do so. 12 U.S.C. § 1818(t).

[11] The agency may seek a Second Tier civil money penalty for conduct constituting a violation of law, regulation, or certain orders, reckless engagement in an unsafe or unsound practice, or a breach of fiduciary duty, which forms a pattern of misconduct, causes or is likely to cause more than a minimal loss to the institution, or results in pecuniary or other gain to the individual. 12 U.S.C. § 1818(i)((2)(B).

either the Fifth Circuit or the D.C. Circuit as a venue for a petition for review. The substantive standards for review are provided by the Administrative Procedure Act, chapter 7 of Title 5 of the U.S. Code. *Id.* The agency's Final Decision will be upheld if it is supported by substantial evidence and it is not arbitrary and capricious or contrary to law. 5 U.S.C. § 706(2)(A), (E). The Comptroller has wide discretion in the choice of remedy. *Butz v. Glover Livestock Commission Co.*, 411 U.S. 182, 188 (1971); *Central Nat'l Bank of Mattoon v. U.S. Dep't of Treasury*, 912 F.2d 897, 904-05 (7th Cir. 1990); *Brickner v. FDIC*, 747 F.2d 1198, 1203 (8th Cir. 1984).

I. THE MEANING OF THE STATUTORY TERM "UNSAFE OR UNSOUND PRACTICE."

As explained above, the ALJ relied upon caselaw, primarily from the Fifth Circuit and D.C. Circuit, to impose a more stringent standard for finding an unsafe or unsound practice than that applied by the OCC and the other Federal banking agencies. Upon review of all of the relevant authority, including the statutory text and structure, the Comptroller finds this to be error and adheres to the OCC's definition of the term.

A. Statement of the Case.

1. The Recommended Decision.

The Recommended Decision surveys the legislative history of the FDI Act, the general interpretations of the term "unsafe or unsound practice," and the materially uniform interpretations of the banking agencies. RD 64-67.

Horne Definition. Because the term is not defined by the FDI Act, the RD notes that courts have long consulted the "authoritative definition" contained in the legislative history of the legislation that first employed the term as a predicate for these forms of enforcement remedies. In hearings before Congress preceding its adoption of the Financial Institutions Supervisory Act of 1966 ("FISA"), John E. Horne, the Chairman of the FHLBB, at that time the supervisory agency for savings associations,[12] provided a memorandum containing his interpretation of the phrase:

> 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 be abnormal risk or[13] loss or damage to an institution, its shareholders, or the agencies

[12] The FHLBB was the predecessor to the Office of Thrift Supervision ("OTS"), most functions of which were transferred to the OCC in 2010 pursuant to Title III, section 312 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank Act") (codified at 12 U.S.C. § 5412(b)(2)(B)(i)).

[13] As noted below, there is some question whether the text should read "of" rather than "or."

> administering the insurance funds.

Financial Institutions Supervisory Act of 1966: Hearings on S. 3158 Before the House Comm. on Banking and Currency, 89th Cong., 2d Sess. 49 (1966) (statement of John E. Horne, Chairman of the FHLBB), 112 CONG. REC. 26,474 (1966).

The RD notes that the banking supervisory agencies have adopted standards that remain close to the original Horne definition, and have rejected additional showings such as a requirement that the conduct in question must "threaten the bank's financial integrity" or "have a reasonably direct effect on its financial soundness." RD 68.

RD Survey of Caselaw in the Third, Fifth, Ninth, and D.C. Circuits. The RD surveys the courts of appeals decisions that have imposed a more stringent requirement, variously stated in terms such as the conduct must "threaten the bank's financial stability or integrity" or have a "reasonably direct effect on the bank's financial soundness." RD 69-73. Because any enforcement order issued by the Comptroller is subject to petitions for review in either the Fifth Circuit or the D.C. Circuit, the ALJ applied a "Law of the Circuit Doctrine" to follow the standards applied in those two courts. RD 74. The RD relies upon three cases in particular, two in the Fifth Circuit and one in the D.C. Circuit: *Gulf Federal*, *Bellaire*, and *Johnson v. OTS*, 81 F.3d 195 (D.C. Cir. 1996). RD 69-73. Melding the authority of those cases, the ALJ formulated the standard to be, at least for this case:

> conduct that, at the time it was engaged in, was contrary to generally accepted standards of prudent operation (that is, it constituted an imprudent act), the possible consequences of which, if continued, created an abnormal risk or loss or damage to the **financial stability** of the Bank.

RD 74 (emphasis added).

In *Gulf Federal*, as described in the RD, the relevant supervisory agency, the FHLBB, sought a cease-and-desist order under an agency-specific statutory provision analogous to the current cease-and-desist authority in 12 U.S.C. § 1818(b).[14] RD 69. The FHLBB alleged that the thrift had engaged in an unsafe or unsound practice and a violation of law in miscalculating the interest due on loans under a method that was inconsistent with the method specified in the loan documents and that disadvantaged its borrowers. *Gulf Federal*, 651 F.2d at 261. The FHLBB issued a cease-and-desist order directing the thrift to recalculate the interest as called for by the loan agreements and to reimburse borrowers for the difference. *Id.* The Fifth Circuit held that the FHLBB lacked cease-and-desist authority in these circumstances, limiting the term "unsafe or unsound practice" to practices that have "a reasonably direct effect on an association's financial soundness." RD 70.

Two years later, in *Bellaire,* the Fifth Circuit confirmed the *Gulf Federal* restrictive gloss on the definition of an unsafe or unsound practice and extended it to a violation of law.

[14] 12 U.S.C. § 1464(d)(2)(A).

"It is important to remember that both situations are limited to practices with a reasonably direct effect on a bank's financial stability." *Bellaire*, 697 F.2d at 681. RD 72. The court also rejected the OCC's argument that *Gulf Federal* should be limited to the FHLBB and not applied to the OCC.

In *Johnson v. OTS*, 81 F.3d 195 (D.C. Cir. 1996), the D.C. Circuit recited the *Gulf Federal* restrictive gloss in overturning an agency cease-and-desist order predicated upon a thrift's decision to appeal the denial of a charter change application. RD 72. The D.C. Circuit relied on "the weight of the case law" in stating that "the unsafe or unsound practice provision . . . refers only to practices that threaten the financial integrity of the institution." *Id.* at 204. RD 72.

The RD supported this conclusion with reference to an influential Third Circuit case, *Seidman v. OTS*, 37 F.3d 911, 928 (3d Cir. 1994) ("*Seidman*") that adopted and applied the stringent gloss. RD 73. The RD also cites two Ninth Circuit cases that relied on *Gulf Federal* in adopting the gloss that an unsafe or unsound practice must have a "reasonably direct effect on an association's financial soundness." *Hoffman v. FDIC*, 912 F.2d 1172, 1174 (9th Cir. 1990). *See also Simpson v. OTS*, 29 F.3d 1418, 1425 (9th Cir. 1994).

"Law of the Circuit Doctrine." Relying upon two courts of appeals cases, the RD concludes that the ALJ was obligated to conform to the standards of the Fifth and D.C. Circuits, the two courts available to Adams to file a petition for review of any adverse decision by the Comptroller. RD 74.

2. Adams' Position.

Adams did not file exceptions to the ALJ's Recommended Decision. In his Post-Hearing Brief, he urged the standard adopted by the ALJ, relying primarily upon *Gulf Federal* and *Bellaire*, but also surveying decisions in other circuits. Adams Br. 4-8. Adams argues that because the Bank was profitable during his tenure, his misconduct could not have satisfied the financial stability standard. Br. 8.

3. Enforcement Counsel's Exceptions on Standard for Unsafe or Unsound Practice.

In its Brief in Support of Exceptions ("EC Br."), Enforcement Counsel argues that the ALJ's proffered standard for an "unsafe or unsound practice" is erroneous as a matter of law because it is contrary to canons of statutory construction, because it is unsupported by relevant legislative history and the weight of authority, and because it would severely hamper enforcement authority. EC Br. 6-13. Enforcement Counsel argues that the unqualified Horne definition should remain the OCC's standard for "unsafe or unsound practice."

Statutory Language and Scheme. Enforcement Counsel argues that the ALJ's standard conflicts with canons of statutory construction that favor interpretations that give meaning to every term and disfavor surplusage. EC Br. 7. Enforcement Counsel points to provisions of the FDI Act that contain **express** requirements that certain "effects" result from misconduct in order to establish the predicate for an enforcement order. Enforcement Counsel argues that the imposition of an extra-statutory "threat to financial integrity" standard for the misconduct element of "unsafe or unsound practice" represents a judicially created "effects" test that cannot be reconciled with express statutory "effects" requirements. EC Br. 8.

***Legislative History*.** Enforcement Counsel argues that the ALJ's proposed standard is at odds with the legislative history of FISA. First, it is inconsistent with the Horne definition, which speaks to imprudent actions, the "possible consequences of which, if continued, would be abnormal risk or loss or damage" to an institution, its shareholders, or the insurance funds. EC Br. 9-10. The Horne definition does not require an effect on the "financial stability" of the institution. *Id.* Moreover, Enforcement Counsel points out that in considering the bill that became FISA, Congress considered and rejected a proposal from the thrift industry that would have imposed such a requirement. *Id.*

Enforcement Counsel also argues that a statutory amendment to the cease-and-desist provision in 1989 reflects a further statutory structure inconsistency with the ALJ's proposed standard. EC Br. 10.

***Weight of Authority*.** Enforcement Counsel argues that the ALJ's proposed standard is contrary to the weight of authority expressed in courts of appeals decisions, final orders in agency enforcement adjudications, and recommended decisions by the ALJs of Office of Financial Institution Adjudication. EC Br. 10-13. Enforcement Counsel argues that the OCC has consistently rejected the *Gulf Federal* gloss since its first adjudication following the decision, *In the Matter of Citizens Nat'l Bank*, No. AA-EC-81-06 at 33 & n.84 (OCC June 17, 1982).

***Law of the Circuit Doctrine*.** Enforcement Counsel challenges the primary rationale given by the ALJ for adopting the proposed standard, that he was bound to follow the authority of the Fifth and D.C. Circuits reflected in *Gulf Federal*, *Bellaire*, and *Johnson v. OTS*, notwithstanding the contrary positions of the OCC and the other banking agencies. EC Br. 26. Enforcement Counsel first argues that the two cases relied upon by the ALJ for that proposition are inapposite. EC Br. 27. Second, Enforcement Counsel argues that the proposition advanced by the ALJ is inconsistent with the Supreme Court decision in *Brand X*, which held that "prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision follows from the unambiguous terms of the statute and leaves no room for agency discretion." *Brand X*, 545 U.S. at 969. EC Br. 28. Because the term "unsafe or unsound practice" is undefined and ambiguous, Enforcement Counsel argues that the OCC is not bound by the cases relied upon by the ALJ, which did not declare that the interpretation they adopted proceeded from the plain meaning of the statute. Accordingly, Enforcement Counsel argues that the Comptroller is authorized to adopt his own interpretation of the statutory term. EC Br. 30-31.

In the courts of appeals that extend *Chevron* deference to banking supervisory agencies interpreting the FDI Act, including the Fifth Circuit, there is no threshold question whether

Brand X applies. The D.C. Circuit, however, in a string of cases stretching back to 1993, has withheld *Chevron* deference from the banking agencies' interpretations of the FDI Act on the ground that Congress directed that multiple agencies implement the same statute, potentially leading to conflicting and confused guidance. Enforcement Counsel argues that no such conflict would arise in this case because the banking agencies have not differed in their interpretations of the term "unsafe or unsound practice." EC Br. 31. Enforcement Counsel also points to caselaw within the D.C. Circuit giving deference to banking supervisory agencies' interpretations of other statutes notwithstanding that those statutes, like the FDI Act, were administered by multiple agencies. EC Br. 32.

Enforcement Counsel also argues that the ALJ's proposed Law of the Circuit Doctrine would be unworkable where the two courts of appeals that are potential venues for review do not agree upon the applicable standard. EC Br. 32-33. That is the case here, where the Fifth Circuit in *Gulf Federal* and the D.C. Circuit in *Johnson v. OTS* and other cases adopted somewhat different formulations in interpreting the statutory term. *Id.*

B. The Comptroller's Conclusions of Law Regarding the "Unsafe or Unsound Practice" Standard.

The Comptroller declines to adopt the ALJ's recommended test for unsafe or unsound practice for the reasons advanced by Enforcement Counsel and for additional reasons. Instead, the Comptroller adheres to the OCC's long-held definition of "unsafe or unsound practice" based upon the Horne definition. Thus, the Comptroller adopts the following interpretation of the term "unsafe or unsound practice" in the FDI Act: ***An unsafe or unsound practice includes any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.***

Because the term "unsafe or unsound practice" is an ambiguous term in a statute that the OCC is responsible for interpreting, the Comptroller is authorized by *Brand X* to assign meaning to the term, notwithstanding contrary judicial precedent so long as those courts did not conclude that the term was unambiguous. There are numerous reasons why the Comptroller declines to adopt the restrictive gloss imposed by *Gulf Federal* and the courts that have relied upon *Gulf Federal* including that: the gloss is in conflict with the statutory text and structure; it is inconsistent with Horne and with the statutory purpose; and a key component of *Gulf Federal*'s reasoning was rejected by the Supreme Court a year after it was decided.

The parties and the ALJ addressed the caselaw in three parts: 1) the Fifth Circuit; 2) the other circuit courts of appeals; and 3) the D.C. Circuit. Discussion of the Fifth Circuit's decision in *Gulf Federal* also has meaning nationwide because those cases that have adopted a standard other than Horne have invariably relied upon *Gulf Federal*. As discussed below, *Brand X* plainly applies in the Fifth Circuit and presumptively in the other circuits that have recited the *Gulf Federal* gloss, providing the Comptroller with clear authority to adhere to the Horne standard. The standard in the D.C. Circuit has been formulated variously over time, but the Comptroller construes that standard as most recently articulated by the court to be consistent with Horne. To the extent that the standards cannot be harmonized, the Comptroller suggests that it would be appropriate for the D.C. Circuit to reconsider its resistance to applying *Chevron* deference, and hence *Brand X*, to the banking agencies' interpretations of the FDI Act. Ultimately, the Comptroller is unpersuaded that this caselaw provides sufficient reason to depart from the Horne standard.

1. Background.

"Unsafe or unsound practice" generally. The term "unsafe or unsound practice" is widely used in banking statutes, regulations, and supervisory materials. Its first appearance in federal banking law has been traced to 1933, when it was adopted as a basis for the Board of Governors of the Federal Reserve System ("Federal Reserve") to remove a banking official from office, and it was subsequently used in two provisions dealing with termination of insurance. *See* T. Holzman, "Unsafe Or Unsound Practices: Is The Current Judicial Interpretation of the Term Unsafe Or Unsound?," 19 Ann. Rev. Banking L. 425, 428-29 (2000). The history of the term shows no attempt to define it prior to FISA, the pivotal 1966 legislation that provided the banking supervisory agencies with the power to issue cease-and-desist orders and more general power to issue removal-and-prohibition orders in addition to the existing authority to terminate deposit insurance.

FISA. The legislative history indicates that the FISA legislation was designed to provide supervisory agencies with more flexible supervisory tools than the existing, rarely used, power to terminate deposit insurance. "The Federal supervisory agencies have been seriously handicapped in their efforts to prevent irresponsible and undesirable practices by deficiencies in the statutory remedies. Experience has often demonstrated that the remedies now available to the banking agencies are not only too drastic for use in many cases, but are also too cumbersome to bring about prompt correction and promptness is very often vitally important . . ." S. Rep. No. 89-1482, at 5 (1966). FISA provided the banking agencies with the power to issue cease-and-desist orders and removal-and-prohibition orders against bank officers and directors. FISA also provided agencies with emergency authority to issue immediately effective cease-and-desist orders and removal-and-prohibition orders subject to stringent substantive requirements and expedited judicial review. The establishment of an unsafe or unsound practice forms one of the alternate predicates for cease-and-desist orders, prohibitions, and civil money penalties, making it a common denominator for relief.

The Horne Definition. FISA did not provide a textual definition for the statutory term "unsafe or unsound practice," but the legislative history contains a memorandum from FHLBB Chairman John Horne that has been the touchstone for explicating the term:

> 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 be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the

insurance funds.[15]

112 CONG. REC. 26,474 (1966).

Structure of the FDI Act. The FDI Act has been amended several times since FISA, most substantially in 1989 in the Financial Institutions, Reform, Recovery, and Enforcement Act ("FIRREA"), which strengthened agency enforcement powers in multiple respects.[16] The term "unsafe or unsound practice" as a basis for a cease-and-desist order has not been amended, but it takes additional meaning from the contemporary structure of the enforcement provisions of the FDI Act.

Those provisions offer agency enforcement staff a range of potential remedies, from the most basic, such as a cease-and-desist order requiring the cessation of conduct, to the severe, including prohibition of an individual from the financial services industry or civil money penalties in large amounts. This availability of graduated remedies reflects the ways in which Congress empowers the financial supervisory agencies to match remedies to the severity or persistence of the problem being addressed. The most basic remedies are textually predicated on misconduct, without more. Thus, a cease-and-desist order may be issued when the agency establishes the existence of an unsafe or unsound practice or a violation of law. 12 U.S.C. § 1818(b)(1). Heightened forms of remedy require the agency to establish additional elements of proof tied to the "effect" of the misconduct or the "culpability" it reflects. The distinct cease-and-desist remedies of restitution, reimbursement, indemnification, or guarantee against loss require a showing of unjust enrichment (a form of "effect" element) or that the misconduct involved a reckless disregard for the law (a form of "culpability" element). 12 U.S.C. § 1818(b)(6)(A). The severe remedy of prohibition requires the showing of at least one element in each of three tiers of alternative elements: misconduct (unsafe or unsound practice or violation of law, rule, or order, or breach of fiduciary duty); effect (financial gain or other benefit to the respondent or financial loss or other damage to the institution or prejudice to the depositors); and culpability (personal dishonesty or willful and continuing disregard for safety or soundness). 12 U.S.C. § 1818(e)(1). This same pattern is reflected in the escalating tiers of civil money penalties: simple misconduct supports the lowest level of penalty and the higher

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[15] The Horne definition contains ambiguities that have not been explored in subsequent decisions. The original phrasing is "abnormal risk **or** loss or damage," and not "abnormal risk **of** loss or damage," as some subsequent formulations have stated it. *See* Holzman at 448-49. There is merit in this reformulation, as it answers the question of "risk of what?" that the original statement leaves hanging. It also resolves the question whether "abnormal" modifies "loss or damage" in addition to "risk." No reviewing court has parsed the formulation so closely that the choice of one or the other would likely have made a difference in the outcome of litigated cases.

[16] In 1989, Congress enacted FIRREA in response to the savings and loan crisis, which expanded agency enforcement authority in several respects. "Read in its entirety, the statute manifests a purpose of granting broad authority to financial institution regulators." *Akin v. OTS*, 950 F.2d 1180, 1184 (5th Cir. 1992). Among other things, FIRREA added express cease-and-desist authority for agencies to seek affirmative relief including, in certain circumstances, restitution. 12 U.S.C. § 1818(b)(6)(A). The legislative history shows that Congress intended to supersede contrary Seventh Circuit judicial authority in doing so. *Akin*, 950 F.2d at 1184 (citing H.R. Rep. No. 54(I), 101st Cong., 1st Sess. 467-68 (1989)); *see also FDIC v. Bank of Coushatta*, 930 F.2d 1122, 1126 (5th Cir. 1991) (noting express congressional purpose in FIRREA capital directive provision to supersede capital holding in *Bellaire*).

two penalty tiers require showings of effect or culpability. 12 U.S.C. § 1818(i)(2)(A)-(C).

Early Caselaw. One of the earliest cases to interpret the statutory term "unsafe or unsound practice" upheld an OCC cease-and-desist order predicated on unsafe and unsound practices. *First National Bank of Eden v. Department of the Treasury*, 568 F.2d 610 (8th Cir. 1978). The court observed: "Congress did not define unsafe and unsound banking practices in section 1818(b). However, the Comptroller suggests that these terms encompass what may be generally viewed as conduct deemed contrary to accepted standards of banking operations which might result in abnormal risk or loss to a banking institution or shareholder." *Id.* at 611 n. 2. Accordingly, the Eighth Circuit approved a version[17] of the Horne definition.

Similarly, in two early cases, the Fifth Circuit affirmed cease-and-desist orders issued by the OCC predicated on an "unsafe or unsound practice" defined consistently with Horne. In one case, the Fifth Circuit expressly endorsed the Eighth Circuit's *Eden* standard. *First Nat'l Bank of Lamarque v. Smith*, 610 F.2d 1258, 1265 (5th Cir. 1980). In another early case, the Fifth Circuit did not adopt a definition of the term, but indicated that courts should be deferential to the practical implementation of the term by the banking agencies: "The phrase 'unsafe or unsound banking practice' is widely used in the regulatory statutes and in case law, and one of the purposes of the banking acts is clearly to commit the progressive definition and eradication of such practices to the expertise of the appropriate regulatory agencies." *Groos Nat'l Bank v. Comptroller of the Currency,* 573 F.2d 889, 897 (5th Cir. 1978). Even before *Chevron,* therefore, the Fifth Circuit had endorsed a deferential review of agency implementation and interpretation of the term.

[17] Notably, the *Eden* formulation looks to risk or loss to a "banking institution or shareholder," but omits the original Horne mention of risk to the insurance funds. In practice, that omission may not matter, as any practice that threatens the insurance funds will almost certainly have also threatened both the institution or its shareholders earlier in time.

2. The Comptroller Rejects the Fifth Circuit Gulf Federal Standard, Which Restricts Unsafe or Unsound Practices to Conduct that Threatens the Financial Soundness of an Institution.

The *Gulf Federal* decision was an outlier when decided and criticized by the Supreme Court soon thereafter. Its resonance in later caselaw is unjustified.

a. Gulf Federal Imposes a Restrictive Gloss on the Horne Standard.

In *Gulf Federal*, the case principally relied upon by the ALJ, the Fifth Circuit held that a proposed cease-and-desist order was not authorized by the statutory provisions addressing "unsafe or unsound practice" or violation of law. The practice addressed in the enforcement action was the thrift's action in charging, for a period of years, interest calculated at a rate higher than that called for in the loan agreements. *Gulf Federal*, 651 F.2d at 261-62. The FHLBB instituted cease-and-desist proceedings against the thrift to take corrective action, alleging that it was an unsafe and unsound practice and a violation of law for the thrift to charge interest at a rate higher than contractually due and seeking corrective action. After a hearing, the FHLBB issued a cease-and-desist order directing that the thrift calculate interest consistently with its loan agreements and reimburse borrowers for the difference between what they paid and what they should have paid. *Id*.

Before the Fifth Circuit, the thrift argued that the FHLBB's statutory authority was limited to assuring "the financial stability" of savings and loan associations, and did not extend to the authority "to protect consumers from practices considered by [the FHLBB] to be unfair." *Id.* at 262. The FHLBB responded that its organic statute, the Home Owners' Loan Act ("HOLA"), gave it "cradle to grave" plenary authority over thrift institutions, including the authority to remedy the practice at issue. *Id*.

The Fifth Circuit endorsed the thrift's position that the FHLBB's authority was constrained.[18] The panel purported to endorse the Horne definition. The Court noted that both the House and Senate had referred to this definition as "authoritative." *Id.* at 264. Rather than relying upon Horne, however, the panel added a restrictive gloss that limited application of the statutory term to "practices with a reasonably direct effect on an association's financial soundness." *Id*. The Fifth Circuit identified the basis for this gloss in statements in the legislative history by individual members of Congress to the effect that the delegation of authority to the agency was not overly broad, related "strictly to the insurance risk," and was meant to assure the public of sound banking facilities. *Id.*

[18] The *Gulf Federal* court refused to extend deference to the FHLBB in its statutory interpretation, saying that the definition of the limits of the agency's authority called for "judicial, not administrative expertise." *Id*. at 263. *Gulf Federal* in 1981 predated the Supreme Court's adoption of the *Chevron* doctrine in 1984. *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc*., 467 U.S. 837 (1984). Accordingly, this aspect of *Gulf Federal* implicitly has been overruled by succeeding Supreme Court and Fifth Circuit authority.

The court did not explicate the meaning of "a reasonably direct effect upon financial soundness," other than to deny that it applied to the risks identified in that case by the FHLBB, including the potential liability to repay overcharged interest and a "loss of public confidence" in the reputation of the thrift. "Such potential risks bear only the most remote relationship to Gulf Federal's financial integrity and the government's insurance risk. They are qualitatively different from the risks" identified by Chairman Horne. *Id.* The court acknowledged that the thrift's liability for repayment of overcharged interest could lead to financial loss but minimized that risk by comparing the ratio of that potential liability to the overall assets of the institution. The panel criticized the FHLBB for seeking relief – repayment to the Bank's customers of the amounts overcharged – that would cause losses to be realized rather than merely "contingent and remote." *Id.* The court also dismissed the FHLBB's "loss of public confidence" rationale, stating that that power would make the FHLBB "monitor of every activity of the association in its role of proctor for public opinion. This departs entirely from the congressional concept of acting to preserve the financial integrity of its members." *Id.* at 265. "We limit the 'unsafe or unsound practice provision' to an association's financial condition."[19] *Id.*

In a separate holding, the violation of law arguments advanced by the FHLBB as a basis for the issuance of the cease-and-desist order were rejected because the court determined that none of the cited laws were in fact violated.[20] Among the rejected violation of law arguments was that federal common law preempted state contract law and established the basis for liability based on the thrift's breach of contract. *Id.* at 266. Echoing its reasoning in the "unsafe or unsound practice" analysis, the Fifth Circuit stated that the authority relied upon by the FHLBB only established federal control over the internal management of Federal savings and loan associations. Because the mortgage contract issues did not implicate the sound management of thrifts, or the insurance liability of the government, and did not require a uniform federal rule, Louisiana contract law was not preempted. *Id.* Accordingly, the court's understanding of the limited scope of the FHLBB's authority underlay both the unsafe or unsound practice holding and a portion of the violation of law holding.

b. The Gulf Federal Gloss Is in Conflict with Statutory Text and Structure.

The restrictive addition to the Horne standard suggests that a practice display a specific degree of "effect" – a threat to the financial soundness of the institution – before the practice may be deemed unsafe or unsound. That proposition conflicts with the fundamental structure of the FDI Act by introducing an effects element, textually reserved as a predicate for more severe remedies, into the definition of an element of misconduct. Moreover, it would require a degree of effect much more severe than the express effects elements in other statutory provisions. For a prohibition remedy, for example, the statute specifies three tiers of

[19] The *Gulf Federal* court used the terms "financial soundness," "financial integrity," and "financial condition" interchangeably and seemed to equate them with the formulation of "financial stability" used by the thrift in its argument.

[20] The Court also suggested, without holding, that its "financial integrity" gloss might similarly apply to the violation of law provision, without citing any additional authority for that proposition. *Id*. at 265 n.5. The succeeding decision in *Bellaire* converted this dictum into a holding. *Bellaire*, 697 F. 2d at 681.

alternative elements that must be established: "misconduct," "effect," and "culpability." The required statutory effect tier for prohibition may be satisfied by a showing of: financial gain to the individual; that the institution "suffered or probably will suffer financial loss or other damage;" or that the interests of the depositors could be prejudiced. 12 U.S.C. § 1818(e)(1)(B). Where, textually, therefore a prohibition can be imposed by a simple showing of "financial loss or other damage," *Gulf Federal* would require that such loss be of a magnitude that threatened the institution's integrity to warrant the less severe remedy of a cease-or-desist order. Even more disruptive to the statutory scheme, *Gulf Federal* would inject this elevated "effects" requirement into the "misconduct" definition of an unsafe or unsound practice, so that a higher degree of effect would need to be shown in the misconduct tier than in the effects tier. *Gulf Federal* is therefore in irreconcilable conflict with the statutory text and structure.

Gulf Federal would create similar conflicts with other statutory remedies. The requirements for a Second Tier civil money penalty may be satisfied if the misconduct at issue, *inter alia*, "causes or is likely to cause more than minimal loss" to the institution. 12 U.S.C. § 1818(i)(2)(B)(ii)(II). A temporary cease-and-desist order may be satisfied by a showing, *inter alia*, that the misconduct is likely to "weaken the condition of the institution." 12 U.S.C. § 1818(c)(1). In each instance, where the remedy sought is predicated on the misconduct element of unsafe or unsound practice, the *Gulf Federal* gloss would impose a steeper effects test at the misconduct tier than the textually specified effects requirements for that remedy.

c. The Gulf Federal Gloss Is Inconsistent with Horne.

While characterizing the Horne definition as "authoritative," *Gulf Federal* adopted a standard that is inconsistent with Horne in fundamental respects. Horne: "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 be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds." Insofar as the *Gulf Federal* gloss requires a risk to the insurance funds – which implies that the institution be at risk of failure – it is plainly inconsistent with the Horne standard, which also embraces risks to the institution and its shareholders. Such risks can be posed by practices with potential consequences much less severe than those that would threaten the stability or soundness of the institution. Another crucial difference is that Horne directs attention to the nature of the practice and not necessarily any already-realized actual effect from the practice: it is sufficient that it be of a type "the possible consequences of which, if continued" would be abnormal risk or loss or harm.

Under the Horne definition, accordingly, the misconduct at issue in *Gulf Federal*, an institution cheating its borrowers, can represent risks to the institution in the form of compensatory and perhaps punitive liability as well as reputation risk,[21] even if those risks

[21] The OCC formally recognizes "reputation risk" as a species of "safety or soundness" concern. As set out in the Comptroller's Handbook for Large Bank Supervision, the OCC identifies eight different categories of risk that may have an impact on the safety or soundness of a financial institution: credit risk, interest rate risk, liquidity risk, price risk, operational risk, compliance risk, strategic risk, and reputation risk. As defined in the Handbook:

would not necessarily directly affect the institution's soundness.

d. The Supreme Court Expressly Rejected the Limits upon FHLBB Authority Identified in Gulf Federal.

The Supreme Court expressly rejected a fundamental part of the reasoning of *Gulf Federal* only a year after it was decided, authority that has not been acknowledged by the courts that have relied upon *Gulf Federal*. *Gulf Federal*'s unsafe or unsound practice holding was based in substantial part on the Fifth Circuit's understanding that the FHLBB lacked the power to supervise thrifts' relationships with borrowers. "If the [FHLBB] can act to enforce the public's standard of fairness in interpreting contracts, the [FHLBB] becomes the monitor of every activity of the association in its role of proctor of public opinion. This departs entirely from the congressional concept of acting to preserve the financial integrity of its members." *Gulf Federal*, 651 F.2d at 265. That understanding also controlled the *Gulf Federal* preemption holding. *Id.* at 266. *See supra* p. 18.

In *Fidelity Federal Sav. & L Ass'n v. De la Cuesta*, 458 U.S. 141 (1982), the Court upheld the authority of the FHLBB to promulgate a preemptive regulation governing due-on-sale provisions in thrift mortgage contracts. In reaching that conclusion, the Court rejected the argument that the statutory authority of the FHLBB was insufficiently broad to permit it to regulate mortgage contracts. "Thus in [HOLA], Congress gave the [FHLBB] plenary authority to issue regulations governing federal savings and loans. . . ." *Id.* at 160. "The broad language of [HOLA] expresses no limits on the [FHLBB's] authority to regulate the lending practices of federal savings and loans." *Id.* at 161.

In *De la Cuesta*, the Supreme Court criticized *Gulf Federal*'s limited view of FHLBB authority twice in reaching that conclusion. First, a footnote collecting cases acknowledged the FHLBB's authority to issue preemptive regulations and identified *Gulf Federal* as one of only two decisions that erroneously reached the contrary conclusion. *Id.* at 151 n.9. The Court identified in a parenthetical the *Gulf Federal* proposition it thought wrong: "[FHLBB] has authority only over internal management of savings and loans, and not over disputed loan agreement provisions." *Id.* Second, more directly, the Court stated: "**We therefore reject appellees' contention that the [FHLBB's] power to regulate federal savings and loans extends only to the associations' internal management and not to any external matters, such as their relationship with borrowers.** Although one federal and one state court have

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> Reputation risk is the risk to current or anticipated earnings, capital, or franchise or enterprise value arising from negative public opinion. This risk may impair a bank's competitiveness by affecting its ability to establish new relationships or services or continue servicing existing relationships. Reputation risk is inherent in all bank activities and requires management to exercise an abundance of caution in dealing with customers, counterparties, correspondents, investors, and the community.

Comptroller's Handbook, Large Bank Supervision (January 2010) (Updated May 2013), p. 63, available at http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/lbs.pdf (last visited Sept. 24, 2014).

drawn this distinction [*citing Gulf Federal* and a state case], we find no support in the language of the HOLA or its legislative history for such a restriction on the [FHLBB]'s authority." *Id.* at 170 n.23 (emphasis added).

While both of the Supreme Court's citations are to the *Gulf Federal* preemption holding, that holding relied upon precisely the same proposition as that substantially underlying the unsafe or unsound practice analysis: that the FHLBB's authority was limited to internal management and did not extend to a thrift's mortgage contracts. The Supreme Court's flat rejection of that proposition accordingly undermined a primary basis for the restrictive gloss in *Gulf Federal* just a year after *Gulf Federal* was decided.[22] For those courts that have relied upon *Gulf Federal* in the enforcement context, the failure to acknowledge the necessary effect of *De la Cuesta* on the authority of *Gulf Federal* undermines the authoritativeness of those decisions.

e. The Policy Implications of the Gulf Federal Gloss Conflict with the Statutory Purpose of FISA.

As noted above, the legislative history indicates that the FISA legislation was designed to provide supervisory agencies with more flexible supervisory tools than the previously existing, rarely used, power to terminate deposit insurance. S. Rep. No. 89-1482, at 5 (1966). The provision of cease-and-desist authority to the agencies furthered the Congressional intent to permit agencies greater flexibility to intervene before a bank's deteriorated condition became irreversible. That purpose cannot be reconciled with the *Gulf Federal* requirement that agencies cannot act upon an unsafe or unsound practice until such time as the conduct threatens an institution's stability.[23]

f. Later-Enacted Legislation Supersedes Gulf Federal.

Even if *Gulf Federal* were good law at the time, Congress' later addition of enforcement tools in subsequent legislation would strongly indicate congressional intent to supersede *Gulf Federal*, even though the statutory term in 1818(b)(1) has not been amended. In 1989, Congress enacted FIRREA in response to the savings and loan crisis, which expanded agency enforcement authority in several respects. "Read in its entirety, the statute manifests a purpose of granting broad authority to financial institution regulators." *Akin v. OTS*, 950 F.2d 1180, 1184 (5th Cir. 1992). Among other things, FIRREA added express cease-and-desist authority

[22] A Fifth Circuit decision in a preemption case in 1994 acknowledged that *Gulf Federal* was not good law on this point. *First Gibraltar Bank v. Morales*, 19 F.3d 1032, 1051 (5th Cir. 1994) (federal statutes and regulations preempt state homestead law). The *First Gibraltar Bank* court concluded "*Gulf Federal* is not good authority for the proposition that the power delegated to the FHLBB was limited solely to the internal management of federal savings associations in light of *De la Cuesta*." *Id.*

[23] To the extent that the legislative history of FISA is entitled to weight, Enforcement Counsel is correct that the thrift industry proposed a statutory test resembling the *Gulf Federal* gloss that was not enacted. *Hearings on S. 3158 Before the House Comm. on Banking and Currency*, 89th Cong., 2d Sess. 320-21 (1966). An OCC adjudication cited that legislative history in rejecting the *Gulf Federal* gloss. *In re Citizens Nat'l Bank*, No. AA-EC-81-06 at 33 & n.84 (OCC June 17, 1982).

for agencies to seek affirmative relief, including, in certain circumstances, restitution. 12 U.S.C. § 1818(b)(6)(A).[24] This statutory authority to seek restitution is in direct conflict with *Gulf Federal*'s conclusion that the supervisory agency has no consumer protection authority, and thus supersedes that aspect of the *Gulf Federal* analysis. Any reliance on the FISA legislative history that controlled *Gulf Federal* must therefore be reconsidered in light of the intent of Congress in FIRREA and later-adopted legislation.

g. The Gulf Federal Gloss Has No Consistent Meaning.

The most potentially disruptive implication of the *Gulf Federal* analysis was the court's suggestion that the potential liability loss to the thrift must be weighed against its asset base to determine whether the practice causing the loss was unsafe or unsound. This suggestion implied that a practice could not be unsafe or unsound until the institution approached failure. It also implied that a large institution would have insulation from a charge of unsafe or unsound practices not available to identical conduct engaged in by a smaller institution. But in *Bellaire*, decided just two years later, the Fifth Circuit purported to apply the *Gulf Federal* gloss in reviewing a cease-and-desist order based on a "violation of law," and yet did so in a very different way. In *Bellaire*, it was not a realized threat to the financial soundness of the institution that mattered, but that the insider lending statute at issue was of **a type** that had a "direct relationship" with a "bank's soundness." So stated, the gloss appears to be consistent with Horne. Subsequent cases in other circuits quoting *Gulf Federal* have sometimes replicated this ambiguity between quantified threats to soundness on the one hand and generic relationship to **potential** risks on the other. *See, e.g.*, *Seidman v. OTS*, 37 F.3d 911 (3d Cir.1994) (discussed *infra* pp. 25-26).

h. Brand X Applies to the Comptroller's Interpretation in the Fifth Circuit.

The ALJ concluded that the Comptroller is bound by the authority of the Fifth Circuit under the "Law of the Circuit Doctrine." The Comptroller concludes otherwise and declines to adopt the ALJ's recommended conclusion on this point, in general for the reasons advanced by Enforcement Counsel.

First, the OCC is not bound by caselaw on the basis identified by the ALJ. The primary reason given by the ALJ for conforming to the restrictive gloss is what he identified as the "Law of the Circuit Doctrine," relying on two cases, *Hoffman v. FDIC*, 912 F.2d 1172 (9th Cir. 1990) and *Llapa-Singhi v. Mukasey*, 520 F.3d 897 (8th Cir. 2008). RD 74. Neither case stands for the proposition that either the ALJ or the agency must tailor its reasoning at the adjudication stage to the law of the courts in which a petition for review might be filed. The cases instead stand in relevant part for the proposition that circuit courts of appeals are not bound by the decisions of other courts of appeals. *See Hoffman*, 912 F.2d at 1175; *Llapa-Singhi*, 520 F.3d at 901.

Second, the OCC is responsible for interpreting statutes for national banks and federal

[24] The legislative history shows that Congress intended to supersede contrary Seventh Circuit judicial precedent in doing so. *Akin*, 950 F.2d at 1184 (citing H.R. Rep. No. 54(I), 101st Cong., 1st Sess. 467-68 (1989)).

thrifts with home offices in states throughout the nation. It is neither practical nor appropriate for the OCC to adopt different statutory interpretations for institutions with home offices in different circuits, or alternatively, attempt to meld standards drawn from different courts. A fundamental characteristic of the national bank system is that the system's federal character enables implementation of uniform national standards. *See, e.g., Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 10-15 (2007). The same is true for the system of federal thrifts. *De la Cuesta*, 458 U.S. at 159-161. The OCC has long adhered to a definition of unsafe or unsound practice based upon Horne, as have the other banking regulatory agencies. It would be contrary to the systemic needs for uniformity, and for clear guidance to national banks and federal thrifts, for the OCC to attempt to tailor its standards to the circuit in which a given national bank or federal thrift is located. It would also be unworkable where the standards of the home circuit and the D.C. Circuit were not identical.

Most important, in the *Brand X* doctrine, the Supreme Court has recognized that: "A court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion." *Brand X*, 545 U.S. at 982. Because "unsafe or unsound practice" has never been determined to have a plain meaning, the Comptroller is not bound by contrary caselaw so long as *Brand X* applies.

The Fifth Circuit extends *Chevron* deference to banking agencies in interpreting the FDI Act. *See Akin v. OTS*, 950 F.2d 1180, 1185 (5th Cir. 1992); *Bullion v. FDIC*, 881 F.2d 1368, 1374 (5th Cir. 1989). There is therefore no threshold question whether *Brand X* would apply in judicial review of an agency interpretation in the Fifth Circuit.

3. Caselaw in the Courts Other than the Fifth and D.C. Circuits Provides No Basis for Departing from the Horne Standard.

In addition to the law of the Fifth Circuit and the D.C. Circuit, the ALJ relied upon cases in the Third and Ninth Circuits. A survey of "unsafe or unsound practice" definitions in the other courts of appeals reveals a nominal split in formulations. Some circuits have applied Horne without qualification. Others have added some form of a restrictive gloss. Examination of those cases, though, shows that the restrictive gloss has been the basis for a holding in only one case outside of the Fifth and DC Circuits, *Seidman*, a Third Circuit case analyzed below. Because those circuits have not elaborated upon their understanding of the gloss, and have not relied upon it to decide a case, they provide no compelling reason for the Comptroller to depart from Horne. Furthermore, several of those circuits expressly recognize *Chevron* deference to interpretations of the FDI Act, and only the Second Circuit has adopted the D.C. Circuit doctrine of withholding deference from statutes implemented by multiple agencies, so that any meaningfully contrary authority in other circuits would be subject to *Brand X* in judicial review.

*a. Several Circuits Adhere to Horne***.**

The Eighth Circuit has consistently applied a version of the Horne definition for unsafe or unsound practice, and has directly rejected modifying that standard to apply a restrictive gloss. One of the earliest cases to interpret the statutory term unsafe or unsound practice upheld an OCC cease-and-desist order predicated on unsafe and unsound practices on the basis of a version of the Horne definition. *First National Bank of Eden v. Department of the Treasury*, 568 F.2d 610, 611 n.2 (8th Cir. 1978). The Eighth Circuit has since adhered to this version of the Horne definition repeatedly. *See Northwest Nat'l Bank v. Department of the Treasury*, 917 F.2d 1111, 1115 (8th Cir. 1990) (*Eden* formulation); *Oberstar v. FDIC*, 987 F.2d 494, 502 (8th Cir. 1993) (*Eden* formulation); *Greene County Bank v. FDIC*, 92 F.3d 633, 636 (8th Cir. 1996) (*Eden* formulation); *cf. Van Dyke v. Board of Governors*, 876 F.2d 1377, 1380 (8th Cir. 1989) ("abnormal risk of loss or harm contrary to prudent banking practices") (construing "willful disregard for safety or soundness" in the prohibition provision). In *Greene County*, the Eight Circuit expressly rejected the argument that "unsafe or unsound practice" standard should be limited to practices "having a reasonably direct effect on the Bank's financial condition," notwithstanding its acknowledgment that courts in the Third, Ninth, and Fifth circuits had adopted that gloss, because it was "well-settled in this Circuit" that the *Eden* standard applied. *Greene County*, 92 F.3d at 636.

The Second and Eleventh Circuits have adopted versions of the Horne definition without the restrictive gloss. *See Gully v. NCUA*, 341 F.3d 155, 165 (2d Cir. 2003) (accepting Horne); *Cavallari v. OCC*, 57 F.3d 137, 142 (2d Cir. 1995) (accepting *Eden* formulation); *Doolittle v. NCUA*, 992 F.2d 1531, 1538 (11th Cir. 1993) (Eighth Circuit standard).

b. Several Circuits Have Recited a Restrictive Standard But Have Not Applied It.

In *Michael v. FDIC*, 687 F.3d 337, 352 (7th Cir. 2012), the Seventh Circuit appeared to adopt the Eighth Circuit standard, citing to *Van Dyke*. The Seventh Circuit also, then, cited to *Seidman*, without expressly adopting the restrictive gloss and also quoted the D.C. Circuit's *Landry* test ("reasonably foreseeable undue risk to the institution") without noting any tension between the standards.[25] *Michael*, accordingly, supports the proposition, discussed below, that the prevailing D.C. Circuit standard is consistent with Horne.

The Tenth Circuit, similarly, appears to have come down on both sides of the issue without indicating awareness that it was doing so. The Tenth Circuit firmly endorsed the Horne/Eighth Circuit standard in the context of the culpability term "disregard for safety and soundness" in *Grubb v. FDIC*, 34 F.3d 956, 962 (10th Cir. 1994). Much later, in a case that was deferential to the banking agency, the Tenth Circuit recited a restrictive gloss without indicating that it intended any change in its precedent and without placing weight on it: "[Horne definition plus] reasonably direct effect on an association's financial status." *Frontier State Bank v. FDIC*, 702 F.3d 588, 604 (10th Cir. 2012).

The Ninth Circuit has applied a "reasonably direct effect on financial soundness" test

[25] The Seventh Circuit applies the *Chevron* framework to interpretations of the FDI Act. *Larimore v. Comptroller*, 789 F.2d 1244, 1248 (7th Cir. 1986) (Step One). Accordingly, *Brand X* would apply to judicial review in the Seventh Circuit.

without explanation, but the gloss has not been the basis for a holding. *See Hoffman v. FDIC*, 914 F.2d 1172, 1174 (9th Cir. 1990) (quoting but not adopting *Gulf Federal*); *Simpson v. OTS*, 29 F.3d 1418, 1425 (9th Cir. 1994). Notwithstanding its repetition of the gloss, the *Simpson* panel deferred to the agency under *Chevron* and sustained a cease-and-desist order. *See id.* at 1425. Another Ninth Circuit panel repeated the *Simpson* formulation, including the gloss, but applied the standard deferentially. *De La Fuente v. FDIC*, 332 F.3d 1208, 1222-23 (9th Cir. 2003). Because the panel recognized that "we may not substitute our judgment for that of the agency," the panel sustained the agency's sanctions based on an unsafe or unsound practice. *Id.* at 1225.[26]

Because the Seventh, Ninth and Tenth Circuits have not relied upon the restrictive gloss to decide a case, and have not provided a rationale for imposing the additional requirement, they provide no persuasive reason for the Comptroller to depart from Horne. Furthermore, the Seventh and Ninth Circuits recognize *Chevron* deference to interpretations of the FDI Act, and none of the three courts has adopted the D.C. Circuit multiple-agency doctrine, so that any meaningfully contrary authority would be subject to *Brand X* upon judicial review.

c. Seidman, Which Applied a Restrictive Standard, Relied upon Bad Law.

Seidman v. OTS, 37 F.3d 911 (3d Cir. 1994), was cited by the ALJ, relied upon by several other courts including the D.C. Circuit in *Johnson v. OTS*, and is notable in several respects. First, it is one of the few courts applying the *Gulf Federal* gloss to explain in any length its adoption of the restrictive standard, and has been relied upon by other courts that adopted the gloss without explication.[27] Second, *Seidman* applied the restrictive standard inconsistently, once in the *Gulf Federal* sense[28] and a second time in the *Bellaire* sense.[29] Third, a dissenting judge forcefully endorsed the standard applied by the banking agencies and Horne and would have upheld the agency charges of unsafe or unsound practices that the majority vacated. *Id.* at 940-45.

[26] The Ninth Circuit recognizes *Chevron* deference to interpretations of the FDI Act, so that *Brand X* would apply in any judicial review in that circuit. *Simpson v. OTS*, 29 F.3d 1418 (9th Cir. 1994).

[27] One of the remedies sought by the OTS in *Seidman* was a cease-and-desist order predicated on an allegedly unsafe or unsound practice where a thrift officer approved a commitment for a mortgage where the chairman of the board had a conflict of interest. In interpreting the term unsafe or unsound practice, the court applied *Chevron* and adopted the Horne definition. *Seidman*, 37 F.3d at 924, 927. The court added a restrictive gloss, however: "The imprudent act must impose an abnormal risk to the financial stability of the institution." *Id.* at 928.

[28] The Third Circuit determined that on the facts of the case, the potential harm to the thrift did not rise to the level of an unsafe or unsound practice, but was rather more like the risks in *Gulf Federal*: "contingent, remote harms" that could ultimately result in minor financial losses to the institution, but did not pose such an abnormal risk that the thrift's financial stability was threatened. *Id.* at 929.

[29] The *Seidman* court found that an attempt to hinder the OTS investigation was inherently unsafe or unsound, without quantifying the risk. "Where a party attempts to induce another to withhold information from the agency, the agency becomes unable to fulfill its regulatory function. Such behavior, if continued, strikes at the heart of the regulatory function." *Id.* at 937. Accordingly, an attempt to hinder an agency investigation, without more, constitutes an unsafe or unsound practice.

Most important, the legal basis for the Third Circuit's adoption of the gloss is unsound. The court stated that it had derived that standard from four cases: *Gulf Federal* and the legislative history relied on there; the Fifth Circuit's decision in *MCorp Financial, Inc. v. Board of Governors*, 900 F.2d 852 (5th Cir. 1990), which had also relied on *Gulf Federal;* and two Eighth Circuit cases that applied the Horne standard without a gloss. The court's reliance on *Gulf Federal* was misplaced for the reasons stated above. Reliance on the Fifth Circuit's decision in *MCorp* was also error; the Supreme Court had previously reversed that decision for lack of jurisdiction. *Board of Governors v. MCorp Financial, Inc.*, 502 U.S. 32 (1991).[30] The Eighth Circuit cases do not support the restrictive standard. The Third Circuit decision therefore lacks a basis in viable authority for its adoption of the restrictive gloss.

Seidman's adoption of a form of restrictive gloss on the Horne definition has been influential with other courts. The infirmities in *Seidman*'s reasoning and the force of the dissent, however, undermine *Seidman* as a basis for any departure from Horne.[31]

[30] The Supreme Court in *MCorp* in 1991 had reversed the Fifth Circuit merits decision for lack of jurisdiction. *See MCorp,* 502 U.S. at 44-45). The Fifth Circuit has acknowledged this result. "The Supreme Court reversed this court's decision in *MCorp* for lack of jurisdiction, thereby vacating our ruling on the scope of § 1818." *Akin v. OTS*, 950 F.2d 1180, 1185 (5th Cir. 1992). Accordingly, no part of the *MCorp* Fifth Circuit merits opinion on unsafe or unsound practice remained good law when *Seidman* was decided in 1994.

[31] The Third Circuit applies *Chevron* deference to agency interpretations of the FDI Act. *Seidman,* 37 F.3d at 924. Accordingly, *Brand X* would apply to judicial review in the Third Circuit.

4. Caselaw in the D.C. Circuit Provides No Basis for Departing from the Horne Standard.

a. The D.C. Circuit Standard Is in Harmony with Horne.

In the D.C. Circuit, the precise formulation for unsafe or unsound practice has varied. The case relied upon by the ALJ, *Johnson v. OTS,* 81 F.3d 195 (D.C. Cir. 1996), departed from previous deferential D.C. Circuit authority and has been succeeded by other D.C. Circuit cases that seem to have adopted a different standard. Because one construction of the D.C. Circuit standard is consistent with Horne, the law of the D.C. Circuit does not provide a reason for the Comptroller to depart from the Horne standard.

Early cases. In two early cases, neither of them a review of an enforcement adjudication, the D.C. Circuit indicated that it would defer to the banking agencies in defining "unsafe or unsound practice." In 1979, the D.C. Circuit denied a challenge to an OCC regulation concerning credit life insurance because of the agency's authority to interpret section 1818(b). "The Comptroller's statutory duties require the closest monitoring and continuous supervision of [national banks]. Thus, the Comptroller's discretionary authority to define and eliminate 'unsafe and unsound conduct' is to be liberally construed." *Independent Bankers Ass'n of America v. Heimann*, 613 F.2d 1164, 1168-69 (D.C. Cir. 1979). Similarly, in denying a challenge based on *Gulf Federal* to an FDIC regulation as inconsistent with section 1818(b), the D.C. Circuit stated: "Authority to determine what constitutes an 'unsafe' or 'unsound' banking practice is firmly committed to the agency." *Investment Company Institute v. FDIC*, 815 F.2d 1540, 1550 (D.C. Cir. 1987).

Johnson v. OTS. The D.C. Circuit departed from that deferential approach, without acknowledging the departure, in *Johnson v. OTS*, 81 F.3d 195, 109 (D.C. Cir. 1996). The agency, which was seeking a cease-and-desist order based, *inter alia*, on unsafe or unsound practices, adopted a two-part definition consistent with the Horne definition. *Id.* at 201. The agency charged that this definition was satisfied by the thrift's officers' expenditure of legal fees to pursue an unsuccessful appeal of an agency decision, where the interests of the thrift insiders diverged from that of the thrift. *Id.* at 204. The D.C. Circuit concluded that this "perfunctory analysis" was at odds with the "weight of case law" holding that the "'unsafe or unsound practice' provision refers only to practices that **threaten the financial integrity** of the association." *Id.* (emphasis added). The only two cases identified by the D.C. Circuit as support for this proposition were *Gulf Federal* and S*eidman*. The court did not acknowledge the authority on the other side of the split in the circuits. The court did not elaborate on the meaning of the test, other than to observe that the actual loss caused by the conduct did not, by itself, establish an abnormal risk to the financial stability or integrity of the institution. *Id.*

The persuasiveness of this authority is compromised by the two cases that make up the "weight of authority" reasoning. First, for the reasons given above, *Gulf Federal* is unentitled to weight. Second, the Third Circuit's decision in *Seidman* has distinctive infirmities, as discussed above. In any event, subsequent D.C. Circuit caselaw suggests that the *Johnson* formulation is not the current D.C. Circuit standard.

Kaplan/*Landry*. A year after *Johnson*, the D.C. Circuit stated the test differently, again without extended analysis. At one point, the court observed that "it may also be true – assuming a breach of duty is a violation of a 'law' or an unsafe unsound practice under § 1818(b)(1) – that the bank regulating agencies administering § 1818 are entitled to obtain at least a cease-and-desist order against a bank director. . . **whether or not harm befalls the financial institution**." *Kaplan v. OTS,* 104 F.3d 417, 421 (D.C. Cir. 1997) (emphasis added). This formulation appears to be in tension with the "threat to financial integrity" *Johnson* standard. The *Kaplan* court elaborated that: "whether one speaks of a breach of fiduciary duty or an unsafe or unsound practice, the common element that OTS must show is behavior that creates an **undue risk to the institution**." *Id.* at 421 (emphasis added). "**Any such risk must of course be reasonably foreseeable**. That is not to say that the exact series of events that cause injury or loss to the institution must be perceived or even perceivable, but surely no director can be faulted for approving a management proposal that does not pose an **increased risk of some kind** to the financial institution." *Id.* (emphasis added). The court did not cite to *Johnson* or repeat the formulation used in *Johnson*. The court did not state a basis for the "reasonably foreseeable" additional requirement or explain it further. It is notable, though, that the quoted passage appeared to equate "reasonable foreseeability" with "increased risk of some kind."

In a succeeding case, the D.C. Circuit applied the *Kaplan* formulation rather than the *Johnson* formulation, though it did acknowledge *Johnson* on a related point. "In *Kaplan* we suggested that 'an unsafe or unsound practice' was one that posed a 'reasonably foreseeable' 'undue risk to the institution.'" *Landry v. FDIC,* 204 F.3d 1125, 1138 (D.C. Cir. 2000). While the *Landry* panel did not apply a restrictive gloss, it harmonized its approach with the Third Circuit in *Seidman,* which had. Factually, the bank in *Landr*y had been in a weakened condition, so that the conduct "created an undue and abnormal risk of insolvency," *id.*, but the *Landry* panel did not suggest that a risk of insolvency was required. To the contrary: "Landry argues that the continuing profitability of the Bank during the relevant period forecloses a finding of undue risk, but in so arguing he misconstrues the concept of risk, which is independent of the outcome in a particular case. Just as a loss, without more, does not prove an act posed an abnormal risk [citing to *Johnson*], a profit does not establish its absence." *Id.* The *Landry* panel's emphasis on abnormal risk to the institution, rather than to its stability or integrity, is consistent with Horne.[32]

Dodge. The most recent D.C. Circuit decision on point relies upon *Landry* and *Kaplan* for the applicable standard: "An unsafe or unsound practice is one that posed a reasonably foreseeable undue risk to the institution." *Dodge v. Comptroller of the Currency,* 744 F.3d 148, 156 (D.C. Cir. 2014) (internal quotations omitted). In addition, though, the *Dodge* court continues: "There was substantial evidence that Dodge's repeated reporting of certain

[32] A D.C district court decision characterized the *Kaplan* standard as the operative standard in the D.C. Circuit. "In this circuit, a Bank operates in an unsafe or unsound condition if it is in a condition or engaged in a practice that presents a reasonably foreseeable undue risk to the institution." *United Western Bank v. Office of the Comptroller of the Currency*, 928 F. Supp. 2d 70, 94 (D.D.C. 2013).

contributions as qualifying capital 'threatened the financial integrity of the [thrift].' *Id.* (quoting *Johnson v. OTS*). Accordingly, while the court relied upon the *Kaplan/Landry* standard, it also found the *Johnson* standard satisfied.

Read collectively, these cases suggest that, while the status of *Johnson* and the more stringent standard is unclear, *Kaplan*/*Landry* is the prevailing standard in the D.C. Circuit: an unsafe or unsound practice is one that poses a "reasonably foreseeable undue risk to the institution." As noted above, *Kaplan* equated foreseeability with "increased risk of some kind." The Ninth Circuit so understood *Kaplan*.[33] *De La Fuente*, 332 F.2d at 1223. To the extent that "foreseeability" means "increased risk of some kind," the *Kaplan* formula is consistent with Horne, and the Comptroller adopts that understanding.[34]

Accordingly, this reading of the present state of the law in the D.C. Circuit suggests consistency with Horne and thus with the Comptroller's interpretation of unsafe or unsound practice.

b. If a Conflict Were to Exist Between the Standard Adopted by the Comptroller and the Law of the D.C. Circuit, It Could Be Resolved by Application of Chevron and Brand X Deference to Agency Interpretations of the FDI Act.

Because the Comptroller does not identify a necessary conflict with the law of the D.C. Circuit, there is no need to consider the ALJ's recommendation that the Comptroller is bound by the Law of the Circuit Doctrine.

Alternatively, if such a conflict existed, the Comptroller would decline to adopt the ALJ's recommendation for the same reasons as addressed above for the Fifth Circuit: the cases cited for the Law of the Circuit Doctrine are inapposite, and the federal system for national banks and federal thrifts requires uniformity in the predicates for an enforcement action. The departure from the analysis for other circuits, though, is that while *Brand X* plainly

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[33] This reading is further supported by the Seventh Circuit in *Michael v. FDIC*, 687 F.3d 337, 352 (7th Cir. 2012), which, as noted above, cited the Eighth Circuit standard and the *Landry* standard as consistent.

[34] Other constructions of "foreseeability" would produce conflict with statutory structure and function. For example, if foreseeability required a certain state of mind, it would introduce a culpability element into the definition of a form of misconduct. That would conflict with the structure of the statute, as outlined above, which addresses state of mind in such distinct culpability elements as "willful or continuing disregard" for safety or soundness, an alternate element supporting prohibition, 12 U.S.C. § 1818(C)(1)(c)(ii), or "recklessly engages" in an unsafe or unsound practice, an element of a Second Tier civil money penalty. 12 U.S.C. § 1818(i)(2)(B)(i)(II). The focus in identifying an unsafe or unsound practice is the nature of the practice, which exists independently of foreseeability. Alternatively, to the extent that "foreseeability" invokes equitable considerations, it is appropriately addressed by reviewing courts under the rubric of "arbitrary and capricious" rather than in the definition of misconduct. Even if foreseeability were cognizable under Horne, it would conflict with authority recognizing that a practice might reasonably be deemed unsafe or unsound, and subject to a cease-and-desist order, even if the risks were not previously apparent to the institution or the agency. *See Frontier State Bank v. FDIC*, 702 F.3d 588, 599-600 (10th Cir. 2012) (evolving understanding of practice by agency and industry does not preclude cease-and-desist order); *see also Kaplan*, 124 F.3d at 421 (exact sequence of events need not be perceived or perceivable).

applies to review of agency interpretations of the FDI Act in the Fifth Circuit and almost all other circuits, it would presumably not apply under present law in the D.C. Circuit, which has repeatedly declined to apply *Chevron* to agency interpretations of the FDI Act.

The D.C. Circuit's approach to C*hevron* and the FDI Act has evolved in at least three distinct phases. In the first, the circuit applied a deferential approach to expert banking agencies under the FDI Act, including the OCC's interpretation of "unsafe or unsound." In the second, in decisions in the 1990s, the court initially likened the banking agencies' interpretations of the FDI Act to agency interpretations of "generic" statutes, such as the Administrative Procedure Act or the Rehabilitation Act, in which no agency was given specific interpretive authority by Congress. The court has since receded from that characterization, acknowledging that the banking agencies have specialized expertise.[35] The prevailing D.C. Circuit rationale for withholding deference embraces policy concerns stemming from the possibility of incidental overlap of agency supervisory authority under the FDI Act: that a single term might be given different meanings by different agencies, or that a single supervised party might be subject to conflicting guidance from different agencies.

Those concerns are misplaced as a practical matter. None of the cases where deference was withheld under the FDI Act involved manifest conflicts among the agencies in defining statutory terms. In practice, because the FDI Act assigns primary supervisory responsibility to each agency for distinct supervised populations, the likelihood of conflicting guidance from different agencies to the same entity is minimized. Congress has designated the OCC as the appropriate Federal banking agency under the FDI Act in the case of national banks, federal branches and agencies of foreign banks, and Federal savings associations. 12 U.S.C. § 1813(q)(1). Overlapping statutory authority over the same institution is possible in only a small subset of the institutions supervised by the OCC.[36] Courts in the DC Circuit have at times showed consciousness of the tension between the guidance rationale for withholding deference and the Congressional assignment of distinct primary responsibilities that alleviate the risks of conflict.[37] That consciousness has not yet caused the court to reconsider its doctrine.

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[35] *See, e.g., Collins v. NTSB*, 352 F.3d 1246, 1253 (D.C. Cir. 2003).

[36] While the FDI Act provision allocating agency responsibilities leaves open the general possibility that more than one agency may be the "appropriate Federal banking agency" with respect to an institution, that same section specifically assigns distinct responsibilities that are inconsistent with overlap. 12 U.S.C. § 1813(q). A narrow exception is presented by branches of foreign banks, which may be supervised by the Federal Reserve and the OCC, and with respect to insured branches, the FDIC. *See* 12 U.S.C. §§ 1813(q)(2)(B); 1813(q)(3)(B). With respect to the OCC's predominant supervised population, national banks and Federal savings associations, Congress has designated no other agency as the "appropriate Federal banking agency." While the FDIC has backup authority that allows it to recommend enforcement action by the primary supervisory agency, and authorizes the FDIC to act if the primary supervisor does not (12 U.S.C. § 1818(t)), that authority by its terms preserves the distinction between primary supervisor and backup authority, and therefore does not create confusion as to the primary source of guidance for the supervised institutions.

[37] *See, e.g., Rappaport v. OTS*, 59 F.3d 212, 221-22 (D.C. Cir. 1995) (Rogers, J. concurring) (delineation of agency responsibilities under the FDI Act responds to guidance concerns); *cf. Nat'l Home Equity Mortgage Ass'n v. OTS*, 271 F. Supp. 2d 264, 274-75 (D.D.C. 2003), *aff'd* 373 F.3d 1355, 1361 n.* (D.C. Cir. 2004) (deference extended to multiple agencies under the Parity Act because statute delineates distinct supervisory populations).

Even if there were a significant area of agency overlap, it could be addressed by the mechanisms the agencies employ for coordinating the interpretation and implementation of shared statutes, which has been the prevailing norm for over twenty years. Most recently, the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank Act") mandated a number of joint rulemakings. *See, e.g., id*. at Title VI, § 619, 124 Stat. 1620 (requiring the Federal banking agencies to issue joint regulations implementing prohibitions on proprietary trading) (codified at 12 U.S.C. § 1851(b)(2)(B)(i)(l)). Through the Dodd-Frank Act, Congress was attentive to delineating authority among agencies when, for example, it transferred the functions of the former OTS to other agencies and established a new agency in the Consumer Financial Protection Bureau ("CFPB").

The D.C. Circuit's reservation to the judiciary of interpretive authority over the FDI Act also creates disharmony with the Supreme Court's recent repeated reaffirmations of the policies underlying *Chevron*. Those policies include uniform standards of judicial review and preference for the uniformity created by deference to expert agency interpretations, in contrast to the disparate interpretations that can be caused by *de novo* review by multiple courts of appeals. The issue in this case illustrates that dysfunction. While the three banking agencies have adopted materially identical formulations of "unsafe or unsound practice," the courts of appeals have adopted a variety of different formulations. For an institution that operates nationally or regionally, as do many national banks and federal thrifts, there is accordingly far more prospect of conflicting guidance from the courts of appeals than from the supervisory agencies, especially as each institution has a single primary supervisor.

Reconsideration of the D.C. Circuit doctrine is warranted for good reasons, including: 1) tension with the test for *Chevron* stated by the Supreme Court and derogation from the C*hevron* policy favoring uniformity of agency interpretation; 2) the circuit split created and maintained with other courts of appeals that continue to apply *Chevron* to interpretations of the FDI Act; and 3) the court's inconsistency in applying the doctrine, as the D.C. Circuit itself has acknowledged.

Tension with Supreme Court Authority. The Supreme Court has not addressed whether *Chevron* deference should be withheld where Congress has assigned multiple agencies to administer a statute with respect to distinct supervised populations. But that proposition finds no support in the Supreme Court's recently reiterated threshold principle: "Under *Chevron*, we presume that when an agency-administered statute is ambiguous with respect to what it prescribes, Congress has empowered the agency to resolve the ambiguities." *Utility Air Regulatory Group v. EPA*, 134 S.Ct. 2427, 2439 (2014). "[T]he preconditions to deference under *Chevron* are satisfied because Congress has unambiguously vested the [agency] with general authority to administer the [statute] through rulemaking and adjudication,[38] and the agency interpretation at issue was promulgated in the exercise of that authority." *Arlington v. FCC*, 133 S.Ct. 1863, 1874 (2013).

[38] Accordingly, the Supreme Court has recently reaffirmed that adjudications are entitled to the same deference as rulemakings under *Chevron*.

Applying this test here, Congress has assigned the OCC plenary authority, with very limited exceptions, to adopt regulations "to carry out the responsibilities of the office. . . ." 12 U.S.C. § 93a. The FDI Act defines the term "appropriate Federal banking agency" to be the OCC with respect to adjudications involving national banks and Federal savings associations. 12 U.S.C. § 1813(q)(1). Accordingly, Congress has designated the OCC as the agency to administer the FDI Act with respect to national banks and Federal savings associations, and under the basic *Chevron* test, the OCC is empowered to resolve ambiguities in terms such as "unsafe or unsound practice" in actions with the requisite formality, such as rulemakings and adjudications.

In *Brand X*, the Supreme Court reiterated its preference that statutes be interpreted by agencies rather than courts. "[A]llowing a judicial precedent to foreclose an agency from interpreting an ambiguous statute . . . would allow a court's interpretation to override an agency's. *Chevron*'s premise is that it is for agencies, not courts, to fill statutory gaps." *Brand X*, 545 U.S. at 983. The Court warned that a contrary rule would lead to the "ossification" of much statutory law "by precluding agencies from revising unwise judicial constructions of ambiguous statutes. Neither *Chevron* nor the doctrine of *stare decicis* requires these haphazard results." *Id*.

Moreover, in a series of recent cases, the Supreme Court has resisted making exceptions to the application of *Chevron* where it was urged that special circumstances justified them. In each case, the Court indicated that, once the fundamental requirements of authority and formality had been satisfied, *Chevron* deference should not be withheld due to the specific context. While the Court has not addressed the exception for multiple agencies, such an exception runs counter to the Court's repeated expressions of policy with respect to *Chevron*.

Most recently, the Court rejected a carve-out for questions of agency "jurisdiction." *Arlington v. FCC*, 133 S.Ct. 1863 (2013). "No matter how it is framed, the question a court faces when confronted with an agency's interpretation of a statute it administers is always, simply, *whether the agency has stayed within the bounds of its statutory authority*." *Id.* at 1868 (emphasis in original). The *Arlington* majority also rejected the notion that the reviewing court must "search provision-by-provision to determine 'whether [that] delegation covers the 'specific provision' and 'particular question' before the court." "What the dissent needs, and fails to produce, is a single case in which a general conferral of rulemaking or adjudicative authority has been held insufficient to support *Chevron* deference for an exercise of that authority within the agency's substantive field. There is no such case . . . " *Id*. at 1874. The Court reiterated the policy articulated in *Brand X*. "Thirteen Courts of Appeals applying a totality-of-the-circumstances test would render the binding effect of agency rules unpredictable and destroy the whole stabilizing purpose of *Chevron*." *Id*.

Two years earlier, in *Mayo Foundation for Medical Education and Research v. United States*, 131 S.Ct. 704 (2011), the Court overruled earlier authority that had the effect of creating an exception from *Chevron* for Department of the Treasury tax regulations. "[The Petitioner] has not advanced any justification for applying a less deferential standard of review to Treasury Department regulations than we apply to the rules of any other agency. In the absence of such justification, we are not inclined to carve out an approach to administrative review good for tax law only. To the contrary, **we have expressly recognized the importance of maintaining a uniform approach to judicial review of administrative action**." *Id*. at 713 (emphasis added and internal quotations and brackets omitted).

The *Mayo Foundation* Court noted that the principles underlying *Chevron*, including the reliance on an expert agency to resolve statutory gaps and ambiguities, apply fully in the tax context. "We see no reason why our review of tax regulations should not be guided by agency expertise pursuant to *Chevron* to the same extent as our review of other regulations." *Id*. The Court also departed from pre-*Chevron* precedent that drew a distinction between rules adopted pursuant to general authority and those issued under a specific grant of authority because "the administrative landscape has changed significantly." Deference is appropriate "when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority." *Id.* (quoting *U.S. v. Mead*, 533 U.S. 218, 226-27 (2001)). "Our inquiry in that regard does not turn on whether Congress's delegation of authority was general or specific." *Id.*[39]

Accordingly, in addition to the recently reaffirmed threshold principles that support *Chevron* deference to the OCC in interpreting the FDI Act, the Court has repeatedly rejected invitations to withhold *Chevron* deference for specific issues.[40] It has also reaffirmed principles that support reconsideration of the D.C. Circuit's disparate treatment of the banking agencies under the FDI Act, including "the importance of maintaining a uniform approach to judicial review of administrative action principle," and the importance of agency expertise.[41]

Split in the Circuits. Since 1993, only one other court of appeals has adopted the multiple-agency doctrine, while the weight of circuit authority is to the contrary. Courts of appeals for the Third, Fifth, Seventh, Eighth, and Ninth Circuits have extended deference to the banking agencies' interpretations of the FDI Act. *See, e.g.*, *Seidman v. OTS*, 37 F.3d 911, 924 (3d Cir. 1994); *Akin v. OTS*, 950 F.2d 1180, 1185 (5th Cir. 1992); *Bullion v. FDIC*, 881 F.2d

[39] In the third recent case to reject a carve-out, the Court applied the *Chevron* framework to an agency regulation that it deemed preemptive in *Cuomo v. Clearing House, LLC*, 557 U.S. 519, 525 (2009).

[40] The Supreme Court has not articulated a principle for resolving the question of multiple agencies and *Chevron*, but, in practice, faced with actual conflicts of statutory interpretation, the Supreme Court has tended to assess which interpretation deserves deference rather than negating deference entirely. In *Martin v. Occupational Safety & Health Reg. Commission*, 499 U.S. 144 (1991), the Court held that deference was due the interpretation of the primary executive branch enforcer (the Secretary of Labor) rather than to that of the independent review board (the Occupational Safety and Health Review Commission). More recently, the Court reversed a decision by the Second Circuit blocking enforcement of an agency regulation that was admittedly in direct conflict with another agency regulation. Rather than withhold deference in the face of an actual conflict, the Court expressly applied *Chevron* deference to the agency's view as to which regulation controlled. *Long Island Care at Home v. Coke*, 127 S.Ct. 2339 (2007).

[41] More specifically, the Supreme Court in 1986 applied *Chevron* deference to an FDIC interpretation of the term "deposit" under a non-enforcement provision of the FDI Act. *FDIC v. Philadelphia Gear Corp.*, 476 U.S. 426, 439 (1986).

1368, 1374, (5th Cir. 1989); *Larimore v. Comptroller*, 789 F.2d 1244, 1248 (7th Cir. 1986) (Step One); *Oberstar v. FDIC*, 987 F.2d 494, 501 (8th Cir. 1993) (Step One); *Van Dyke v. Board of Governors*, 876 F.2d 1377, 1379 (8th Cir. 1989); *Simpson v. OTS*, 29 F.3d 1418, 1425 (9th Cir. 1994). In addition, the Tenth Circuit has extended *Chevron* deference to a banking agency in interpreting the Change-in-Bank-Control Act, which is also interpreted by multiple agencies. *Rapp v. OTS*, 52 F.3d 1510, 1518 (10th Cir. 1995).

Indeed, since the D.C. Circuit multiple-agency *Chevron* doctrine was first suggested in *dicta* in 1993, only one other circuit, the Second, has agreed with the doctrine, and it has done so inconsistently. In two cases, the Second Circuit reviewed FDI Act decisions *de novo*. *Cousins v. OTS*, 73 F.3d 1242, 1249 (2d Cir. 1996); *Greenberg v. Board of Governors*, 968 F.2d 164, 170 (2d Cir. 1992). In two others, the Second Circuit extended deference to agencies applying the FDI Act. *Hutensky v. FDIC*, 82 F.3d 1234, 1239 (2d Cir. 1996); *Cavallari v. OCC*, 57 F.3d 137, 142-43 (2d Cir. 1995). In two non-FDI Act multiple-agency cases, the Second Circuit gave less than full deference. *1185 Avenue of the Americas v. RTC*, 22 F.3d 494, 497 (2d Cir. 1994); *Lieberman v. FTC*, 771 F.2d 32, 37 (2d Cir. 1985).

The Seventh Circuit, in contrast, expressly declined to adopt the D.C. Circuit multiple-agency doctrine in a non-FDI Act case. *Board of Trade of City of Chicago v. SEC*, 187 F.3d 713, 718-19 (7th Cir. 1999) (Securities and Exchange Commission and Commodity Futures Trading Commission).

Accordingly, the pronounced weight of circuit caselaw is contrary to the D.C. Circuit's multiple-agency doctrine. Reconsideration by the D.C. Circuit would reduce a persistent split in the circuits.

Inconsistent Application of the Multiple-Agency Approach. In its most recent application, the D.C. Circuit took note that its FDI Act doctrine has not been applied consistently within the D.C. Circuit. "We have not been entirely consistent and unambiguous on this point." *DeNaples v. OCC*, 706 F.3d 481, 488 n.4 (D.C. Cir. 2013) (citing *Stoddard v. Board of Governors*, 968 F.2d 164, 170 (D.C. Cir. 1989) (*Chevron* framework applied to Federal Reserve interpretation of section 8(e) of FDI Act).[42] The *DeNaples* court also noted the contrary FDI Act *Chevron* practices of the Fifth Circuit (*Akin*) and Eighth Circuit (*Van Dyke*). *Id.*

As noted above, early applications of the multiple-agency doctrine to the FDI Act relied upon cases that withheld deference because the statutes involved were "generic" – the agency at issue had no special responsibility for interpreting the statute – overlooking the distinctions with the FDI Act, where the agencies have specialized expertise.[43] In 1995, the court in

[42] The *DeNaples* court did not note that, even before *Stoddard*, the D.C. Circuit had deferred to agency interpretations of the FDI Act, as noted above. *Independent Bankers Ass'n of America v. Heimann*, 613 F.2d 1164, 1168-69 (D.C. Cir. 1979); *Investment Company Institute v. FDIC*, 815 F.2d 1540, 1550 (D.C. Cir. 1987) ("Authority to determine what constitutes an 'unsafe' or 'unsound' banking practice is firmly committed to the agency.").

[43] In *Wachtel v. OTS*, 982 F.2d 581, 585 & n.3 (D.C. Cir. 1993), the *Chevron* point was supported only by a

Rappaport v. OTS, 59 F.3d 212 (D.C. Cir. 1995), introduced a policy rationale for withholding deference: "The alternative would lay the groundwork for a regulatory regime in which either the same statute is interpreted differently by the several agencies or the one agency that happens to reach the courthouse first is allowed to fix the meaning of the text for all. Neither outcome is unthinkable, of course, but neither has the OTS suggested any reason to believe the congressional delegation of administrative authority contemplates such peculiar corollaries." *Id.* at 217 (citations omitted). The reasoning did not purport to apply the classic *Chevron* threshold test, accordingly, but instead relied upon hypothesized practical anomalies that could result from deferring to multiple agencies.

The court further developed the guidance rationale, and receded from the treatment of the FDI Act as a generic statute, in *Collins v. NTSB,* 351 F.3d 1246, 1253 (D.C. Cir. 2003). In *Collin*s, the court reviewed its jurisprudence on deference and multiple agencies and established three classes of shared-enforcement schemes. The first embraces generic statutes, such as the Administrative Procedure Act, Freedom of Information Act, and Federal Advisory Commission Act, where "broadly sprawling applicability undermines any basis for deference and courts must therefore review interpretive decisions de novo." *Id*. The court identified a second class for the FDI Act: "where the agencies have specialized enforcement responsibilities but their authority potentially overlaps – thus creating risks of inconsistency or uncertainty – de novo review may also be necessary." *Id.* In a third class: "But for statutes where expert enforcement agencies have mutually exclusive authority over separate sets of regulated persons," the guidance concerns do not negate *Chevron* deference. *Id*. *Collins* therefore represented a shift from categorizing the FDI Act with generic statutes, recognizing that the agencies have "specialized enforcement responsibilities," and rooting the lack of deference in the policy concerns of "inconsistency" and "uncertainty."

The court again applied, and again modified, the guidance rationale in *DeNaples*, which withheld deference from the Federal Reserve by denying application of the exclusive-authority third category identified in *Collins*. The case addressed the interpretations by the OCC and the Federal Reserve, in distinct but consistent adjudications, of a provision of the FDI Act, 12 U.S.C. § 1829. Because the FDI Act assigns to the Federal Reserve exclusive authority over the discrete set of bank holding companies, the Federal Reserve claimed *Chevron* deference for its interpretation under the exclusive-authority category identified in *Collins*. The court rejected the application of *Collins* because, even though the Federal Reserve has exclusive authority over individuals with respect to bank holding companies, other agencies have authority over the same individuals with respect to their relationships with other financial entities. *DeNaples*, 706 F.3d at 488.[44] Accordingly, *DeNaples* represents yet another

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citation to *Professional Reactor Operator Soc'y v. NRC*, 939 F.2d 1047, 1051 (D.C. Cir. 1991), withholding deference from interpretation of the Administrative Procedure Act, which governs all agencies. In *Rappaport v. OTS*, 59 F.3d 212 (D.C. Cir. 1995), the majority relied most heavily upon a Supreme Court case withholding deference where 27 agencies interpreted the Rehabilitation Act and thus no agency had relevant expertise. *Bowen v. American Hospital Ass'n*, 476 U.S. 610, 642 n.30 (1986). *Bowen* contrasted that absence of expertise with a case deferring to the Federal Reserve's expertise under the Bank Holding Company Act. *Id.* (citing *Board of Governors v. Investment Co. Inst.,* 450 U.S. 46, 56 and n. 21 (1981)).

[44] Moreover, the court found a compelling need for interpretive uniformity with respect to section 19, where a potential criminal penalty attached. *DeNaples*, 706 F.3d at 488.

evolution of the D.C. Circuit's multiple-agency doctrine.[45]

An answer to the guidance policy concerns was articulated in a concurrence by Judge Rogers in *Rappaport*. She noted that the FDI Act assigns primary responsibility to specific agencies for separate sets of supervised institutions, and that any potential overlap or conflicting guidance can be resolved between the agencies. "It appears too facile to conclude that deference is inappropriate simply because more than one agency is involved in administering a statute." 59 F.3d at 221-22. Under the FDI Act, "[t]he statute instructs how to determine the 'appropriate' entity for administering provisions of the statute. *See* 12 U.S.C. § 1813(q)(4) (the director of OTS is the 'appropriate Federal banking agency' in the case of any savings association or any savings and loan holding company). As is evident, Congress intended the several agencies that administer [the FDI Act] to agree regarding their respective roles and exercise their expertise accordingly." *Id.* Thus, "deference may nonetheless be appropriate where only expert banking agencies administer the statute and there is no disagreement among them about their respective responsibilities or the agency position under review." *Id*.[46] The panel majority made no response to Judge Rogers' arguments and the D.C. Circuit has not since expressly addressed them.[47]

In interpreting statutes other than the FDI Act, the D.C. Circuit has not consistently applied the multiple-agency doctrine. *See, e.g., Individual Reference Services Group, Inc. v. FTC*, 145 F. Supp. 2d 6, 23-24 (D.D.C. 2001), rejecting challenge to *Chevron* deference to regulations issued by six agencies, including banking agencies), *aff'd, Trans Union LLC v. FTC*, 295 F.3d 42, 50 (D.C. Cir. 2002); *National Home Equity Mortgage Ass'n v. OTS*, 271 F. Supp. 2d 264, 274-75 (D.D.C. 2003) (applying *Chevron* to statute interpreted by multiple agencies where divisions of agency responsibility nullified concerns about conflicting agency interpretations) *aff'd*, *National Home Equity Mortgage Ass'n v. OTS*, 373 F.3d 1355, 1361 n* (D.C. Cir. 2004) (multiple-agency argument not reached because not preserved on appeal).

As discussed above, resolution of the D.C. Circuit FDI Act *Chevron* doctrine is unnecessary to the resolution of this adjudication. For the foregoing reasons, however,

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[45] *Proffitt v. FDIC*, 200 F.3d 855 (D.C. Cir. 2000), an FDI Act enforcement case, primarily reviewed application of a statute of limitations, 28 U.S.C. § 2462, which no agency has authority to implement by regulation. *Id.* at 860. Accordingly, under the threshold *Chevron* test, *Chevron* deference was facially not applicable. The D.C. Circuit invoked its multiple-agency doctrine with respect to incidental consideration of the FDI Act. *Id.* at 860-65.

[46] More generally, the Seventh Circuit has expressed doubt about the severity of the policy concerns arising from inconsistent agency interpretation. "[I]t is possible to defer simultaneously to the two incompatible agency positions. . . . There's no problem of logical impossibility; the court could accept the position of whichever agency's order is under review." *Board of Trade of the City of Chicago v. SEC*, 187 F.3d 713, 719 (7th Cir. 1999).

[47] Judge Rogers reiterated some question about application of the multiple-agency doctrine in *dicta* in a case where the D.C. Circuit ruled for the agency in a case involving shared-statutory responsibility without resolving whether or not *Chevron* deference was due. *Bullcreek v. NRC*, 359 F.3d 536, 541 (D.C. Cir. 2004). In reviewing the support for deference, Judge Rogers cited to the Seventh Circuit's disagreement with *Rappaport* in *Board of Trade of City of Chicago*, *supra*, and to her own concurrence in *Rappaport*. *Id.*

including the Supreme Court's recent *Chevron* jurisprudence and the long-maintained split in the circuits, such reconsideration would be timely and warranted.

II. VIOLATION OF LAW.

A. Statement of the Case.

1. Recommended Decision.

As a predicate for the cease-and-desist order and civil money penalty, Enforcement Counsel charged Adams with a violation of a regulation that governs the protection of nonpublic OCC information, 12 C.F.R. § 4.36(d). In analyzing this statutory predicate, the ALJ noted that the statutory term "violation" is defined broadly. 12 U.S.C. § 1813(v); RD 74. The ALJ applied a restrictive gloss, however, to the statutory term in reliance on the Fifth Circuit's decision in *First Nat'l Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674, 681 (5th Cir. 1983). *Bellaire* purported to adopt the *Gulf Federal* test and apply it to the independent statutory predicate, violation of law, rule, or regulation. RD 76. "It is important to remember that both situations [*i.e.*, unsafe or unsound practice and violation of law] are limited to practices with a reasonably direct effect on a bank's financial stability." *Bellaire*, 697 F.2d at 681. In that case, the Fifth Circuit found the test met because there was a "direct relationship" between compliance with the statute at issue, 12 U.S.C. § 375(a), and the bank's financial soundness. *Id.* at 683; RD 76.[48]

In this case, the ALJ concluded that the regulation violated "does not bear any relation to the financial stability of the Bank, and [Adams'] actions in taking nonpublic supervisory information did not threaten the Bank's integrity." RD 76. Again applying the Law of the Circuit Doctrine, the ALJ followed *Bellaire* and ruled that the law that Adams is alleged to have violated "must bear a relationship to the financial soundness of the Bank in order to support a cease-and-desist order." RD 76.

2. Enforcement Counsel's Exceptions.

Enforcement Counsel argues that the weight of caselaw, prior interpretations by the OCC and the other banking agencies, and the statutory language, history, and statutory structure are at odds with the ALJ's interpretation of violation of law. EC Br. 14-16. Furthermore, Enforcement Counsel argues the interpretation would fundamentally hamper the ability of the banking agencies to pursue enforcement actions for violations of law before violations rise to the level of threatening the integrity of the institution. EC Br. 14.

Enforcement Counsel argues that the plain meaning of the statutory text precludes the ALJ's interpretation. EC Br. 15. The term "violation" is defined extremely broadly. 12 U.S.C. § 1813(v). The terms "law" and "regulation" are neither defined nor textually qualified

[48] As discussed above, the *Bellaire* gloss was applied differently from that suggested in *Gulf Federal*. Where *Gulf Federal* suggested the need for a specific identified threat to financial soundness, *Bellaire* was satisfied where the statutory provision at issue was of a type that guarded against such threats.

in any way. Accordingly, the plain meaning of the statute is at odds with the restrictive test. Furthermore, just as with "unsafe or unsound practice," the structure of the FDI Act, which expressly states effects tests elsewhere, is in conflict with the judicially created restrictive test for "law." EC Br. 15. Caselaw supports Enforcement Counsel's interpretation. EC Br. 16. Enforcement Counsel also suggests that *Bellaire* has been abrogated by statute in light of the expansion of enforcement authority effected by FIRREA in 1989. EC Br. 16.

B. Comptroller's Conclusion of Law Regarding Violation of Law.

The Comptroller declines to adopt the ALJ's proffered standard for the reasons given by Enforcement Counsel. While all of the reasons advanced by Enforcement Counsel have merit, the strongest is that the meaning of the statute is plain. A cease-and-desist order may be predicated on a violation of "a law, rule, or regulation." 12 U.S.C. § 1818(b)(1). The FDI Act defines "violation" as "any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding and abetting a violation." 12 U.S.C. § 1813(v).[49] There is no statutory text that supports a limitation upon the unqualified violation of law as a predicate for a cease-and-desist order or other remedy, including the limitation suggested by the ALJ.

The Recommended Decision correctly states the applicable statutory law, and the caselaw broadly interpreting statutes addressing violations of law. See RD 74 (citing *Lowe v. FDIC*, 958 F.2d 1526, 1535 (11th Cir. 1992); *Del Junco v. Conover*, 682 F.2d 1338, 1342 (9th Cir. 1982) and *Lindquist v. Vennum v. FDIC*, 103 F.3d 1409, 1415 (8th Cir. 1997)).

The ALJ's erroneous departure from this line of cases was based solely upon *Bellaire*, decided two years after *Gulf Federal* and relying heavily upon its reasoning. The court invoked the FISA legislative history to suggest that the Comptroller's authority must be limited to protect against "arbitrary government action." *Bellaire*, 697 F.2d at 681. On that basis, without more, the Fifth Circuit purported to extend the *Gulf Federal* unsafe or unsound practice restrictive gloss to violations of law, rule or regulation. "It is important to remember that both situations [unsafe or unsound practices and violations of law] are limited to practices with a reasonably direct effect on a bank's financial stability." *Id.* (citing *dicta* in *Gulf Federal* at 264, 265 n.5). The ALJ determined that he was bound by this limitation upon agencies' cease-and-desist authority. RD 71-72.

Enforcement Counsel is correct that *Bellaire* stands alone among the courts that have construed the violation of law provision in applying a restrictive gloss. Adams has identified no other case that has applied the *Bellaire* gloss to a violation of law. Indeed, the reasoning of a subsequent Fifth Circuit case casts doubt on the continued viability of the *Bellaire* gloss even in the Fifth Circuit. In *Interamericas Investment, Ltd. v. Board of Governors*, 111 F. 3d 376 (5th Cir. 1997), the Federal Reserve imposed civil money penalties under the materially identical provisions of the Bank Holding Company Act ("BHCA") relating to a violation of law. "The BHCA defines a 'violation' of its provisions as 'any action . . . for or toward

[49] This definition was added by FIRREA in 1989, so that it may represent a legislative supersession of the *Bellaire* gloss.

causing, bringing about, participating in, counseling, or aiding or abetting a violation.' 12 U.S.C. § 1847(b)(5). There is no mention of scienter: the *action* alone constitutes the violation." *Interamericas*, 111 F.3d at 384 (emphasis in original). The *Interamericas* panel's reasoning – that the statute does not permit additional nontextual requirements – is inconsistent with *Bellaire*. Furthermore, the Fifth Circuit in *Interamericas* made no mention of *Bellaire*. *Interamericas* suggests that the prevailing Fifth Circuit standard for imposing a cease-and-desist order to remedy a violation of law under the banking statutes requires only establishing the violation of law.

The Ninth Circuit reached that conclusion, and explained at length why it rejected the argument that a threat to the financial stability of an institution must be shown for a cease-and-desist order predicated on a violation of law. *Saratoga Savings and Loan v. Federal Home Loan Bank Board*, 879 F.2d 689, 693 (9th Cir. 1989). "[T]he plain language of the statute contains no such requirement." *Id.* "The statute is unambiguous in providing the [FHLBB] with the power to issue cease and desist orders upon a finding of a regulatory violation. No other finding – of intent to violate, financial impact, or risk to the insurance fund – is required." *Id.*[50] Given that lack of ambiguity, the court declined to examine the FISA legislative history relied upon in *Bellaire*, but in any event, found that legislative history consistent with the FHLBB's view of its cease-and-desist authority. *Id.*

The *Saratoga* court rejected the argument that Adams advances here, and that the ALJ accepted – that the financial stability gloss is supported by *Bellaire* and *Gulf Federal*. "[The thrift] cites no authority that requires the [FHLBB] to find that a specific violation will have an effect on the financial stability of the bank or the fund. Instead, the cases upon which it relies merely require that the underlying regulation have the financial stability of the bank as its purpose." *Id.* (citing *Bellaire*, 697 F.2d at 683). The *Saratoga* panel also distinguished *Gulf Federal*, pointing out that the violation of law holding in *Gulf Federal* did not apply a restrictive gloss, but simply found that no law had been violated. *Id.* The court also endorsed the agency's policy argument: "To interpret the statute as [the thrift] suggests would strip the [FHLBB] of its authority to curtail abuses *before* they harm the institution." *Id*. (emphasis in original). The Ninth Circuit found it immaterial that the violations were "technical, isolated, unintentional, and not likely to be repeated." *Id.* "When violations occur, the [FHLBB] is within its discretion in issuing such an order and we review only to determine whether the order is arbitrary, capricious, or an abuse of discretion." *Id.*

Other courts have repeatedly resisted suggestions that nonstatutory additional elements be added to the statutory requirement. *See, e.g.*, *Del Junco v. Conover*, 682 F.2d 1338, 1342 (9th Cir. 1982) ("On its face, section 1818(b)(1) requires no knowledge on the part of the wrongdoer."); *Lindquist & Vennum v. FDIC*, 103 F.3d 1409, 1415 (8th Cir. 1997) (condition of bank and motives of prospective stock purchasers irrelevant to violation of law). *Cf. Lowe v. FDIC*, 958 F.2d 1526, 1535 (11th Cir. 1992) (materially identical "violation" definition "clearly includes any action, intentional or inadvertent by which a party participates in" a violation); *Fitzpatrick v. FDIC*, 765 F.2d 569, 577-78 (6th Cir. 1985) (good faith relevant only to amount

[50] The court noted, in contrast, that an effect is textually required for a temporary cease-and-desist order. *Id*.

of a penalty, not to existence of violation under materially identical definition of "violate"). The Second Circuit also resisted an attempt to apply another sort of gloss to the plain meaning of violation of law. *Cousin v. OTS*, 73 F. 3d 1242, 1251 (2d Cir. 1996) ("The [agency's] determination that the misconduct prong may be met by violations of any law, banking-related or otherwise, is clearly supported by the statute.").

Accordingly, the weight of more recent law, including in the Fifth Circuit, supports the rejection of the *Bellaire* gloss. Enforcement Counsel is correct that the *Bellaire* restriction is contrary to the plain meaning of the statutory term, statutory structure, caselaw, and policy. A violation of the OCC's regulation justifies imposition of a cease-and-desist order without any additional showing.

III. DEFERENCE TO EXAMINER OPINIONS.

The ALJ proposed a departure from long-established caselaw in adopting a nondeferential standard of review of examiner judgments. The Comptroller declines to adopt that standard and adheres to the current standard, derived from *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (11th Cir. 1986).

A. Statement of the Case.

1. The Recommended Decision.

The OCC offered the testimony of six current or former National Bank Examiners ("NBEs") in the hearing. In considering the weight to be given their testimony, the ALJ purported to apply the controlling case authority on the issue of deference due to bank examiners, *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (11th Cir. 1986), RD 77-80, but applied it incorrectly. The ALJ concluded that, "while each examiner in this case was qualified to testify as an expert, their predictive evaluations of the risks presented by [Adams'] conduct by and large lack a sufficient factual or legal basis to warrant deference under *Sunshine State*." RD 77-78.

In support of this conclusion, the ALJ first determined that the question whether conduct is "an unsafe or unsound practice" is ultimately a question of law exclusively within the province of the ALJ, so that no deference is due the examiners on that point. RD 78. Second, because the examiners were applying the OCC's definition of "unsafe or unsound practice," and not the ALJ's, the ALJ reasoned that deferring to their opinions would be to negate his role in the adjudicatory process. RD 78. Third, the ALJ found that the OCC had insufficiently defined the standards of prudent operation bearing upon the conduct alleged in this case, so that a constituent element of "unsafe or unsound practice" was undeveloped before the conduct occurred. RD 79. He reasoned that the judgments of the examiners therefore represented retrospective assessments to which he could not defer. RD 79.

2. Adams' Position.

Adams did not take a position on the issue in his Post-Hearing Brief.

3. Enforcement Counsel's Exceptions.

Enforcement Counsel argues that the ALJ was in error in each of the three reasons given for withholding deference, and that those errors, combined with his other errors of law, led to his overall erroneous findings and conclusions. EC Br. 19-26. Enforcement Counsel argues that the *Sunshin*e standard distinguishes between objectively verifiable facts, which may be reviewed by the ALJ *de novo*, and exercises of judgment by examiners, which should not be disregarded in the absence of compelling evidence that they lack a rational basis. EC Br. 20 (citing *Sunshine*, 783 F.2d at 1583). Enforcement Counsel reviews numerous administrative adjudication decisions by the OCC, FDIC, and OTS, applying the *Sunshine* standard that have indicated that, while the ALJ ultimately makes findings on whether the conduct constitutes an unsafe or unsound practice, deference is due examiners' opinions on the issue. EC Br. 21-22. Enforcement Counsel points out that the ALJ's position represents a departure from his previous recommendations and rulings. EC Br. 22

Enforcement Counsel argues that the ALJ's determination that no deference is due the examiners because he disagreed with the substantive standards being applied represents a misapplication of *Sunshine*. EC Br. 24. Enforcement Counsel argues that safety and soundness determinations are at the heart of bank supervision and therefore within the agency's realm of expertise. Enforcement Counsel submits that the ALJ did not make the determinations required by *Sunshine* as a basis for rejecting the examiners' opinions – that the opinions were arbitrary and capricious or outside the zone of reasonableness. EC Br. 24-25. Enforcement Counsel also argues that the ALJ departed from accepted banking agency standards of proof in requiring that formal guidelines be issued as to a particular practice before opining that conduct departed from standards of prudent operation. EC Br. 25-26. Enforcement Counsel argues that the burden is on the examiners to establish what acts were imprudent, not establish affirmative standards of what constituted adequate due diligence, sound policy, or prudent risk management. EC Br. 25.

B. The Comptroller's Conclusions of Law on Deference to Examiner Opinions.

The Comptroller accepts Enforcement Counsel's exceptions in large part, largely for the reasons advanced by Enforcement Counsel.

The ALJ erred in concluding that examiners are not entitled to deference on questions of safety and soundness because they are purely questions of law. Enforcement Counsel is correct that settled caselaw and Federal banking agency decisions establish that the "judgment" component of examiners' safety and soundness determinations is entitled to deference from the ALJ.

In *Sunshine*, the Eleventh Circuit held: "the unique experience of the bank examiners involved in this examination leads to the conclusion that their classifications were entitled to deference and could not be overturned unless they were shown to be arbitrary and capricious, or outside a 'zone of reasonableness.'" *Sunshine*, 783 F.2d at 1581. As to "objectively verifiable facts," which "require no particular training or expertise, the ALJ as fact finder is entitled to reach his own *de novo* conclusions as to the correctness of these underlying factual findings." *Id.* at 1583.

Accordingly, the standard set by *Sunshine*, and applied by the Federal banking agencies since, reduces to: 1) objectively verifiable facts may be reviewed by the ALJ *de novo*; 2) examiner judgments based on those facts may not be rejected unless there is a finding that they are a) without an objective factual basis, or b) outside the zone of reasonableness or arbitrary and capricious. This is the standard that has repeatedly been applied by the Federal banking agencies. *See* EC Br. at 21-22 (collecting administrative decisions).

The ALJ erred in failing to defer to the judgment of the examiners in identifying unsafe or unsound practices. The conclusion that given conduct is an unsafe or unsound practice is ultimately an application of a legal standard to evidence, including examiner judgment, and deference is due that judgment within the limits recognized in *Sunshine*. The Comptroller finds the ALJ's contrary ruling to be in error.

The Comptroller also does not accept the ALJ's second reason for failing to defer to the examiners, for which he stated two bases. First, the ALJ thought the examiners were applying an erroneous standard for unsafe or unsound practices, to which it would be improper to defer. As discussed above, the Comptroller concludes that the standard recommended by the ALJ is erroneous. Second, the ALJ suggested that it is not the place of the examiners to express an opinion on the ultimate legal question to be determined but rather that examiner testimony be limited to the constituent element of the standards for prudent banking. RD 77. The Comptroller concludes that the issue of the proper legal standard for unsafe or unsound practice is a pure question of law that is ultimately for the Comptroller, and as to which no deference is due the examiners – or the ALJ. The application of that legal standard to the conduct at issue represents an application of law to evidence, including examiner judgment, where the allocation of deference is governed by *Sunshine*, as discussed above. The expression of expert judgment as to whether a given set of facts represents an unsafe or unsound practice is very much within the competence of the OCC's NBEs.

The Comptroller adopts Enforcement Counsel's exceptions as to the ALJ's third ground for withholding deference from the examiners, with one exception noted below. To the extent that the ALJ purports to require that formal guidance must have been issued as to a specific banking product before examiners may testify that practices related to that product are contrary to generally accepted standards of prudent operation, that requirement is error. OCC supervision cannot be precluded from acting with respect to novel banking practices until such time as it has such experience with those practices as to issue formal guidance. *See Frontier State Bank v. FDIC*, 702 F.3d 588, 599-600 (10th Cir. 2012) (bank properly ordered to cease and desist from relying on faulty data even though agency earlier suggested such reliance, where change in agency position due to evolving agency and industry knowledge). It is sufficient that supervisors can identify more general risks that cause practices to depart from generally accepted standards of prudent operation even if the specific practices at issue are novel. *See Groos Nat'l Bank v. Comptroller of the Currency*, 573 F.2d 889, 897 (5th Cir. 1978) ("The phrase 'unsafe or unsound banking practice' is widely used in the regulatory statutes and in case law, and one of the purposes of the banking acts is clearly to commit the progressive definition and eradication of such practices to the expertise of the appropriate regulatory agencies.")

Enforcement Counsel argues that the "weight of authority is that examiners must establish what acts were imprudent, not establish affirmative standards of what constituted adequate due diligence, sound policy, or prudent risk management." EC Br. 25. The Comptroller does not completely agree. The Horne definition requires a showing that the conduct be "contrary to generally accepted standards of prudent operation." Accordingly, Enforcement Counsel must make some showing as to the relevant standards and the departure from those standards, as it has in this case. *See infra* pp. 51-53, 56-57, 60, 63-67. The novelty of a given practice will not preclude such a showing so long as more general relevant standards apply.

THE COMPTROLLER'S REVIEW OF THE EVIDENCE IN THE RECORD

As noted above, the Comptroller, in his discretion, declines to make any findings of fact leading to the imposition of any penalties on Adams and declines to remand the case to the ALJ for new findings based on the corrected legal standards enunciated in this opinion. Were the case to be remanded, however, the record evidence could support the conclusion that Respondent engaged in unsafe or unsound practices in the management of the Bank's remotely created check business and committed a violation of law by taking non-public OCC information without prior authorization from the OCC warranting imposition of a cease-and-desist order pursuant to 12 U.S.C. § 1818(b). Additionally, the record evidence could provide a basis for imposing a Second Tier civil money penalty under 12 U.S.C. § 1818(i)(2)(B) for reckless engagement in unsafe or unsound practices establishing a pattern of misconduct.[51]

I. OVERVIEW OF THE RCC BUSINESS AT T BANK.

T Bank opened for business in November 2004 after receiving a charter from the OCC to operate as a national bank. Hearing Transcript ("Tr.") 135:9-10 (Adams), 1775:16-19 (Basso). Adams was the Bank's first President and Chief Executive Officer ("CEO"); he served as CEO until July 2007 and as President and as a director of the Bank until his resignation in July 2010. Joint Stipulations ("Jt. Stips.") ¶¶ 1-2; Tr. 135:4-19 (Adams). In this capacity, Adams had responsibility for ensuring the Bank was being operated in a safe and sound manner and in compliance with all applicable laws, rules, and regulations. Jt. Stips. ¶ 3.

From December 2005 to August 2007, T Bank opened and maintained an account relationship with a third-party payment processor named Giact Systems, Inc. ("Giact") and approximately 60 merchant retail businesses for which Giact processed payments ("Giact Merchant-Clients" or "Merchant Clients"). Jt. Stips. ¶¶ 4-5, 8; Tr. 142:14-145:12 (Adams); Joint Exhibit ("Jt. Ex.") 102/2. Using a payment system called remotely created checks ("RCCs"), Giact facilitated the transfer of funds from consumers' bank accounts to the accounts of the Giact Merchant-Clients in exchange for goods and services sold over the internet and by mail order such as merchant finance cards, credit repair services, discount travel clubs, prepaid debit cards, herbal and nutritional supplements, pay day lending, skin care and weight loss products, post office exam preparatory courses, and gas additive products. Tr. 181:21-183:11, 189:2-18, 193:8-194:19, 220:17-222:15, 608:16-610:6 (Adams), 704:20-705:4 (Stamm); Jt. Ex. 102/4-5. (Relationship collectively defined as the "RCC business" or the "Giact business.")

W. Carter Messick, National Bank Examiner, testified as an expert on payment systems that RCCs are a payment device created when a consumer holder of a checking account provides the account and routing number of the consumer's checking account and authorizes a payee, either verbally or through a web-based authorization, to draw a check without the

[51] Consistent with the Comptroller making no findings of fact, this Review of the Evidence in the Record is not intended to be a comprehensive account of all of the record evidence that might relate to whether a cease-and-desist order or civil money penalty should be imposed against Adams. In this discussion, the Comptroller specifically rejects certain ancillary factual conclusions expressed in the Recommended Decision. To the extent this decision is silent with respect to other factual observations of the ALJ or other evidence in the record, such silence should not be construed as expressing a view regarding that evidence.

consumer actually signing the check. Tr. 21:3-24:22 (Messick); *see also* Jt. Stips. ¶ 7, Jt. Ex. 102/3. Giact processed payments by creating RCCs using consumers' bank account information supplied by the Merchant Clients; the checks were then deposited electronically into the Merchant Clients' accounts at T Bank. Tr. 144:13-145:12 (Adams). A bank into which an RCC is deposited, such as T Bank, is termed "the bank of first deposit" and is liable to reimburse consumers for any unauthorized RCCs. Tr. 67:22-71:2 (Messick). There is a greater risk of fraud posed by RCCs as compared to other forms of payment because RCCs are often utilized by high-risk merchants, such as internet merchants, because there is lesser ability for payment processors and regulators to detect fraud committed using RCCs, and because of the higher volume of payments that can be processed using RCCs. Tr. 58:5-61:3, 62:21-64:16, 117:11-118:12 (Messick). Failing to conduct adequate due diligence on merchants such as the Merchant Clients could cause a bank to unknowingly process payments for illegal or unsavory clients. Jt. Stips. ¶ 10.

A significant percentage of the RCCs originally deposited in accounts of the Merchant Clients at T Bank were returned to T Bank and charged back[52] to the Merchant Clients after being presented to the consumers' banks for payment due to reasons including unauthorized transactions. Tr. 926:7-929:4 (Bermingham). Returned RCCs generated fee income for T Bank, paid by the Merchant Clients, at the rate of three to five dollars per return. Tr. 147:22-149:10 (Adams). Between 2005 and 2007, T Bank generated approximately $1.9 million in income through the processing of RCCs, mostly comprised of return fee income, allowing the Bank to be profitable over this period of time. Tr. 1369:12-1376:11 (Fronk). At the time T Bank entered the Giact business, Adams was aware that a high number of returns, as well as complaints from consumers concerning unauthorized RCCs, could be an indication of potential fraudulent activity. Jt. Stips. ¶ 9. Additionally, a lack of appropriate monitoring of account activity, management of returns, and timely corrective action in a relationship with a merchant, such as one of the Merchant Clients, could result in operational losses for a bank. Jt. Stip. ¶ 2.

With the Giact relationship under increasing scrutiny from the OCC, on July 25, 2007 T Bank's Board of Directors voted to terminate the Giact business. Tr. 201:1-6, 250:10-251:7 (Adams). By the end of August 2007, T Bank had ceased processing RCCs for the Giact Merchant-Clients. Tr. 201:1-6, 250:10-251:7 (Adams). Effective April 15, 2010, the OCC and the Bank entered a Formal Agreement that required the Bank to pay restitution to certain customers of Giact Merchant-Clients to address unfair practices in connection with the Giact and Merchant-Client accounts and remediate possible harm suffered by consumers. Tr. 565:15-566:22 (Adams); Jt. Ex. 122. The Bank ultimately paid out approximately $2.8 million in restitution and related expenses. Tr. 1380:12-15 (Fronk). The Formal Agreement also required that T Bank appoint a compliance committee and develop policies, procedures, and standards for future payment processor relationships to ensure compliance with safe and sound banking practices and all applicable laws including the Federal Trade Commission Act. Jt. Ex. 122.

[52] This Final Decision uses the terms "return" and "chargeback" interchangeably to describe the RCCs returned to T Bank and charged back to the Merchant Clients.

II. EVIDENCE IN THE RECORD INDICATING UNSAFE OR UNSOUND PRACTICES ASSOCIATED WITH MANAGEMENT OF T BANK'S RCC BUSINESS AND A VIOLATION OF LAW.

As explained above, the Comptroller finds as a matter of law that the Horne definition provides the standard for determining whether conduct constitutes an "unsafe or unsound practice" within the meaning of 12 U.S.C. § 1818. *See supra* p. 16. Under the Horne definition, an unsafe or unsound practice is "any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds." Under this correct definition of unsafe or unsound practice, which rejects the *Gulf Federal* effects tests, *see supra* pp. 16-29, a finder of fact could conclude that the conduct described in the evidence warranted imposition of an order to cease and desist.

Testimony from former Bank employees (including Respondent and his former Compliance Officer), documentary evidence from the Bank's own files and systems as well as the OCC's supervisory communications to the Bank, and the fact and expert testimony of six current and former NBEs provide evidence of multiple failures in connection with the processing of RCCs at T Bank. These included (a) failure to conduct adequate, industry standard due diligence on the Giact Merchant-Clients (all of which were high-risk account holders) and take appropriate action with respect to accounts in light of derogatory information; (b) failure to obtain anticipated chargeback data and other data, monitor accounts, and establish a reserve policy and thereby ensure adequate reserves on the Giact Merchant-Clients' accounts; and (c) failure to develop a formal system for tracking, responding to, and investigating consumer complaints. This record evidence could allow the conclusion that these management failures exposed the Bank to abnormal and undue risks and constituted unsafe or unsound practices and that Respondent, as President and CEO of the Bank, bore the ultimate and undelegable responsibility for these failures. Tr. 136:15-142:12 (Adams), 1382:12-18, 1400:2-16, 1430:18-21 (Fronk), 1219:2-11 (McKnight).

In addition, the record evidence could support the conclusion that Adams violated the OCC's regulation found at 12 C.F.R. § 4.36(d) when he removed non-public OCC information from the Bank without prior authorization. As detailed above, *see supra* pp. 38-40, the Comptroller rejects the *Bellaire* formulation that would require a violation of law to have an effect on the financial stability of an institution before a cease-and-desist order could be imposed under 12 U.S.C. § 1818(b)(1).

A. Record Evidence of Insufficient Initial and Ongoing Due Diligence on the Merchant Clients and Failure to Take Appropriate Action on Accounts with Derogatory Information.

The record in this matter contains evidence that Adams failed to ensure that T Bank conducted adequate due diligence on the Giact Merchant-Clients thereby exposing the Bank to undue risk. The ALJ based his conclusion that Enforcement Counsel failed to meet its burden of proof with respect to unsafe or unsound practices on an incorrect definition of unsafe or unsound practices. RD 98-99. The Comptroller has corrected this legal interpretation. *See supra* p. 16. Additionally, the ALJ's analysis of the record evidence is flawed, in large part because of his failure to give the testimony of NBEs the deference due to it as a matter of law under *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (11th Cir. 1986). *See supra* pp. 42-43.

The ALJ concluded that in the absence of generally accepted standards or supervisory guidance, Adams undertook reasonable due diligence efforts and developed a risk-based approach to managing the Giact Merchant-Clients' accounts. RD 23. In short, the ALJ determined that "the Bank, under Respondent's direction, did as much as it could under the circumstances." RD 86. The record, however, contains evidence that Respondent's due diligence efforts were incomplete and inadequate and exposed the Bank to undue risk. Considerable published guidance contained in and referenced in the evidentiary record is generally applicable to RCCs, *see infra* pp. 63-67, and negates the ALJ's conclusion that there were no generally accepted standards of prudent operation of an RCC business. The expert testimony of OCC examiners further explains and corroborates that generally accepted standards of prudent operation of an RCC business were discernable from the published guidance.

1. T Bank Did Not Collect or Review Complete Due Diligence Information Required by Its Own Checklists.

In email correspondence admitted into evidence and in his testimony at trial, Adams acknowledged that the Giact Merchant-Client accounts were high-risk accounts, but initially, in 2006, he took no steps to ensure that T Bank had policies and procedures governing due diligence for high-risk accounts. Jt. Ex. 99/3; Tr 147:7-21, 150:14-20; 159:15-19 (Adams).[53] In April 2006, after several Merchant Clients' accounts had already been opened, Adams developed an internal checklist of due diligence items to be collected concerning each Merchant Client, including basic business organization and financial information, personal financial information regarding the principals of the business, and agreements and forms between the Merchant and the Bank and the Merchant and Giact. Jt. Ex. 12; Tr. 157:5-18; 329:10-11 (Adams). This first due diligence checklist came into use in May 2006. Tr. 155:22-156:1 (Adams). Susan Bermingham, former First Vice President, Compliance Officer, and Operations Officer at T Bank, created a revised and expanded checklist specifying the required

[53] Respondent testified that he believed T Bank was ultimately obtaining the due diligence required for high-risk accounts prior to developing the due diligence checklists. Tr. 157:19-158:10, 159:9-11 (Adams). But a review of the due diligence collected for two of the first Giact Merchant-Clients, Safepay and Bio Performance, indicates that information ultimately required under the Bank's checklists was not obtained for Safepay or Bio Performance. *See* Jt. Exs. 13 and 18, Tr. 289:13-290:2, 349:14-16, 637:12-21 (Adams). After T Bank had been processing RCCs for Bio Performance, a seller of "gas pills," for two or three months, the Texas Attorney General issued a freeze on the account and brought suit against Bio Performance leading to T Bank seeking legal advice on its management of the Giact business from the law firm Haynes & Boone ("H&B"). Tr. 299:17, 307:7-15, 308:7-13, 445:20-446:3 (Adams).

due diligence items and preferred items; a checklist that was finalized and came into use on July 26, 2006. Respondent's Exhibit ("Resp. Ex.") 95/3-4, Jt. Ex. 42/128,[54] Tr. 337:1-7 (Adams); 888:1-12 (Bermingham). The General Assurances Agreement ("GAA") entered into between T Bank and Giact in August 2006 required Giact to conduct "industry standard due diligence with respect to the Merchant Clients, including with respect to their Merchant's business practices, procedures, credit standing, history of consumer complaints, lawsuits, and judgments." Jt. Ex. 32/1; *see also* Jt. Stips. ¶ 6. Both the May 2006 and the July 2006 checklists required the Bank to collect Giact's due diligence documentation on each Merchant Client. Jt. Ex. 12; Resp. Ex. 95/3-4, Jt. Ex. 42/128.

Although the contents of the GAA and the Bank's due diligence checklists reflect Respondent's understanding that generally accepted standards of prudent banking operation called for collecting certain information on the Merchant Clients to complete adequate due diligence, he, by his own admission, failed to ensure that the Bank obtained the due diligence specified on the checklists. Tr. 156:7-18; 160:7-16 (Adams). Moreover, Compliance Officer Bermingham was highly critical of T Bank's due diligence efforts. She believed that the documentation that the Bank collected for the Giact Merchant-Clients was insufficient, given the higher-risk transactions involved. Tr. 888:13-891:5 (Bermingham). On May 15, 2006, she emailed Adams to inform him that she was uncomfortable with the Bank's lack of documentation and basic due diligence information on the Giact Merchant-Clients. Jt. Exs. 10-20; Tr. 892:10-13 (Bermingham). For example, she found articles of incorporation, financial information of the businesses, website information, and three months of prior bank statements missing for many Merchant Clients. Jt. Exs. 10-20; Tr. 894:9-13; 895:1-12 (Bermingham). When she raised her concerns about the lack of information on the Merchant Clients, she described Adams as "kind of lackadaisical . . . not real concerned." Tr. 895:13-896:17 (Bermingham).

At some point in 2006, Compliance Officer Bermingham began reviewing the due diligence information collected at account opening by Lee Ann Stamm, T Bank's former Customer Relation Manager ("CRM"), in an effort to verify that the proper documentation was being obtained and analyzed prior to approving the new Giact Merchant Clients' accounts for RCC processing. Tr. 884:21-886:1 (Bermingham). CRM Stamm testified that Giact was "upset" when Compliance Officer Bermingham was reviewing the due diligence files because it could take as long as seven days for her to approve an account to process RCCs and Giact wanted the accounts able to process RCCs within 24 to 48 hours. Tr. 692:2-695:5 (Stamm).

In a June 22, 2006 email from a Giact representative to Adams, Giact expressed the desire to direct additional RCC business to T Bank if the Bank was able to "turn the accounts around quickly." Jt. Ex. 22. After a time, Adams instructed that Merchant-Clients' accounts be allowed to process RCCs prior to Compliance Officer Bermingham reviewing the due

[54] The revised July 2006 checklist required T Bank to collect a Merchant Client's articles of incorporation, bylaws, certificate of good standing, and website information; the principals' drivers licenses and credit reports; and several other forms, agreements, and other documents. Resp. Ex. 95/3-4. Preferred items included in the July 2006 checklist were the Merchant Client's and principals' current financial statements and prior tax returns from two years, the Merchant Client's merchant processing statements from the prior three months, and bank statements from the prior three months. Resp. Ex. 95/3-4.

diligence and, at times, without the Bank having received the minimum information required. Tr. 886:4-887:11; 900:15-902:12 (Bermingham). In an August 3, 2006 email, Adams instructed Compliance Officer Bermingham to allow a new Merchant Client to begin processing RCCs although it had not yet provided written consent to establish reserves, an item required under the due diligence checklist, because, in Respondent's words, T Bank "need[ed] the deposits." Jt. Ex. 31/1. Adams had the final say on what accounts would be opened. Tr. 1430:1-17 (Fronk). Compliance Officer Birmingham could not recall one Giact Merchant for whom the Bank had obtained all of the information called for on the Bank's due diligence checklist. Tr. 897:9-17; 898:3-9; 922:2-11; 976:16-22 (Bermingham).

2. Enhanced Due Diligence Efforts Were Minimal and the Bank Allowed Merchant Clients to Process RCCs Despite Derogatory Information.

As for T Bank's efforts at enhanced due diligence, the evidence shows they were partial and ineffective because Respondent failed to ensure that the Bank properly consider and act on some of the negative information uncovered about certain Giact Merchant-Clients. In October 2006, T Bank requested that the law firm of Haynes and Boone ("H&B") carry out due diligence reviews on some existing and some new Giact Merchant-Clients. Tr. 165:10-166:5 (Adams).[55] But in March 2007, H&B ceased carrying out enhanced due diligence and preparing reports on any other existing or new Merchant Clients. Tr. 169:12-21. In total, H&B prepared reports on no more than 15 to 17 potential or existing Merchant Clients, whereas 66 Merchant Clients opened accounts at T Bank for initiating RCCs. Tr. 425:2-3; 561:19-562:1, 634:9-17 (Adams).[56]

In many instances, H&B uncovered derogatory information about Merchant Clients, but Respondent allowed the Merchant Clients to process RCCs through the Bank anyway. Tr. 907:10-21, 908:16-21 (Bermingham). For example, Respondent allowed Merchant Client Momentum Direct, an internet seller of nutrition supplements, to continue to process RCCs through T Bank although H&B reported that the Merchant was "not financially stable" and was "possibly not [] a genuine business at all." Jt. Ex. 63; Tr. 1390:3-1391:4 (Fronk). Respondent allowed another Merchant Client, Global Life Enhancements, which he described as a mail order seller of herbal supplements and diet pills, to open an account for RCC processing, although H&B reported that the business was the subject of numerous complaints on consumer websites such as Ripoff Report and Better Business Bureau; H&B warned T Bank that Global Life Enhancements may not be a genuine business. Jt. Ex. 46/1-2; Tr. 194:8-19 (Adams). H&B also reported that Global Life Enhancements operated a business called Herbal Smoke Shop which sold drug paraphernalia and herbal mixes as substitutes for illegal narcotics and that there was a "significant chance" it could become the target of a Food and Drug Administration investigation. Jt. Ex. 46/1. In another example, H&B reported that Enterprise Technology Group, d/b/a Ameritrust, was potentially breaking the law by requiring customers to pay money

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[55] H&B did not carry out enhanced due diligence on all of the Merchant Clients already processing RCCs through T Bank. Tr. 166:1-5 (Adams).

[56] *See also* 425:14-426:21 (Adams) (identifying Joint Exhibits 46, 57, 59, 63 and Respondent's Exhibits 12-14, 17, 18, 21, 23, 25, and 26 as due diligence reports prepared by H&B).

in order to obtain loans. Resp. Ex. 18/1. H&B warned that the Merchant Client may not be a genuine business, but rather, a credit-card scammer who used the name of a nationally known company to enhance his credibility. *Id.* H&B warned that the CEO of another Merchant Client, SMFI Advanced Business Concepts, was suspected of involvement in a pyramid marketing scheme and that the operations and functions of his company were unknown. Jt. Ex. 59. Nevertheless, Respondent allowed these accounts to be opened for RCC processing.

3. T Bank's External Consultants Also Found Due Diligence Inadequacies.

T Bank's external consultants and auditors Delong Consulting ("Delong") and RLR Consulting ("RLR") made findings that concurred with Compliance Officer Bermingham's views on the inadequacy of T Bank's due diligence. Jt. Exs. 61, 62, 76, 112. Delong noted in its Bank Secrecy Act review for T Bank, as of March 12, 2007, that the Bank's files were missing due diligence information obtained by Giact for three out of five Giact Merchants sampled; four of the five accounts were missing Giact account applications, checklists, and/or risk assessments required under the Bank's Customer Identification Program, among other policy exceptions. Jt. Ex. 62:2-3, 6-7. In its Bank Secrecy Act Compliance Audit Report, dated May 11, 2007, Delong concluded that additional account monitoring and due diligence were required to enable the Bank to determine "return/chargeback percentages in relation to deposits, and assess[] whether return volume is consistent with anticipated activity." Jt. Ex. 76/3, 4-5. Additionally, better "evaluation of whether certain Giact Merchant accounts should be closed and suspicious activity reports filed as a result of high chargeback/return percentages and unsatisfactory Better Business Bureau reports" was required. Jt. Ex. 76/5. As a result of its Customer Due Diligence review, as of March 12, 2007, Delong found derogatory information about Giact Merchant-Clients My Clean Start and Enterprise Technology Group, similar to what was reported by H&B. Jt. Ex. 61/4-5. Additionally, Delong reported that another Merchant Client, Virtual Works, LLC ("Virtual Works"), a purveyor of a "virtual" debit card, had an "F" rating with the Better Business Bureau due to consumer complaints about misleading advertising and unauthorized charges to consumers. Jt. Ex. 61/3-4.

In its Summary of T Bank Engagement as of July 25, 2007, RLR stated that all of the six Merchant Clients' due diligence files it audited were missing corporate bylaws, a required item under the Bank's due diligence checklist, and that financial information was listed as only a "preferred" item on the current due diligence checklist instead of "required." Jt. Ex. 112/13. RLR further criticized T Bank's lack of periodic follow up with respect to financial information. Jt. Ex. 112/8. It further found that "[d]ocumentation for . . . procedures . . . was not complete, was located in different places and was very subjective." Jt. Ex. 112/4, 13.[57]

4. OCC's Examiners Testified that These Due Diligence Failures Were

[57] RLR determined that T Bank was lacking needed documentation for High Risk Merchant Account Policy and Procedures, CCX PayFormer Service Policy and Procedures, Risk Assessment Rating Matrix for High Risk Merchant Accounts, Underwriting Matrix for calculation of credit risk and reserve requirements, and High Risk Merchant/CCX PayFormer Client Checklist. Jt. Ex. 112/2.

Unsafe or Unsound Practices.

As discussed above, testimony from Adams and the Bank's own Compliance Officer and the Bank's own internal documents show that the due diligence T Bank carried out on the Giact Merchant-Clients was inconsistent, incomplete, and overall inadequate. Additionally, the testimony of OCC NBEs[58] regarding their observations and findings as supervisors of the Bank corroborates the inadequacy of the due diligence efforts at T Bank.

Ronald P. Algier, National Bank Examiner and Examiner-in-Charge of T Bank for the OCC's 2006 Examination ("2006 Exam"), Tr. 986:7-988:2 (Algier), described in the Report of Examination ("ROE") for the 2006 Exam and in his testimony that Adams emphasized profitability of the Bank at the expense of safety and soundness considerations and was insensitive to or had insufficient knowledge of risk management techniques. Jt. Ex. 34/4, Tr. 990:7-994:7 (Algier). These deficiencies applied to his management of the RCC business. Tr. 994:12-995:19 (Algier).

Lesa Kay Fronk, National Bank Examiner,[59] was Portfolio Manager for T Bank at the time of the OCC's 2005 Examination ("2005 Exam") and during reviews of the Bank following-up on the 2005 Exam; she was again involved with supervision of T Bank in 2007. Tr. 1356:3-1357:1; 1381:3-13 (Fronk). NBE Fronk testified that the Bank did not consistently receive the basic information about the Merchant Clients that Giact was required to provide; nevertheless, Respondent allowed the accounts to process RCCs. Tr. 1385:21-1386:7, 1386:22-1387:5 (Fronk). She also testified that Respondent allowed accounts to be opened despite negative information having been received from H&B about certain Merchant Clients.

[58] The ALJ expressed doubt as to the credibility of certain OCC witnesses on the subject of why the OCC increasingly scrutinized the RCC business at T Bank, implying that it was due solely to political pressure following concerns about RCC processing at another institution. *See, e.g.*, RD 46 n.30, 52 n.35. The ALJ acknowledged correctly, however, that "[i]f the practices Respondent and the Bank were engaged in were in fact 'unsafe or unsound' it should make no difference why the OCC turned its attention to them." RD 46 n.30. Moreover, witnesses did explain the reasons for the OCC's increased focus, as time went on. For example, activity in the Merchant Clients' accounts had increased in 2007. Tr. 1192:16-18 (McKnight). Also, the OCC became concerned that the risks associated with the Giact relationship could not be mitigated to a satisfactory level. Tr. 1078:20-1079:3 (Algier). Moreover, an OCC witness testified that it would make sense for a regulator concerned about problems at one institution to conduct follow-up at a different institution in a similar situation, and disagreed with the notion that the OCC had had no regulatory interest in the Giact relationship until after an RCC controversy had emerged at another institution. Tr. 1070:6-1073:1 (Algier). *See infra* pp. 62-63 (discussing supervisory attention to the RCC business during the OCC's 2006 Examination of T Bank and in the Memorandum of Understanding that followed).

[59] The ALJ criticized NBE Fronk for not fully answering questions more than once, implying she lacked forthrightness. *See, e.g.*, RD 52 n.35, RD 58-59. But a review of the transcript indicates that her answers, criticized by the ALJ, were appropriate in context. In one instance, Respondent's Counsel asked her a question in which he falsely identified her as the author of an email and then abandoned his line of questioning after Enforcement Counsel objected to his mischaracterizing question. Resp. Ex. 61, Tr. 1603:7-15. In another instance, Respondent's Counsel asked her general questions about her views, as expressed once in a specific email, prior to counsel confronting her with or otherwise identifying the email and thereby refreshing her recollection. Tr. 1570:6-13 (Fronk). Respondent's Counsel's technique could understandably fail to elicit complete information from a witness. When Respondent's Counsel eventually showed her the email, she acknowledged her statements in it. Resp. Ex. 73, Tr. 1622:2-1625:4 (Fronk).

Tr. 1389:19-1390:2 (Fronk). Respondent also failed to ensure that Bank personnel conducted ongoing due diligence. Tr. 1397:4-21 (Fronk).

David Pennell, National Bank Examiner, participated in a follow-up interim review of T Bank in July 2007 and in the OCC's 2007 Examination ("2007 Exam"). Tr. 1126:15-1127:15 (Pennell). During the interim review, NBE Pennell reviewed a sample of approximately 39 individual files for the Giact Merchant-Clients and found that the Bank had no satisfactory program to identify high-risk accounts, to identify the risks inherent in the associated businesses, or to carry out the required ongoing enhanced due diligence of the Merchant Clients' accounts. Tr. 1128:19-1135:17, 1136:1-11, 1176:21-1177:17 (Pennell); OCC's Exhibit 10. NBE Pennell found in his file review that T Bank was missing "significant pieces" of due diligence information. Tr. 1136:5-7 (Pennell). Items required by Bank policy, *e.g.*, Giact and Bank forms, were missing from the due diligence files. Tr. 1139:10-1143:4 (Pennell); OCC's Exhibit ("OCC Ex"). 10. The Bank was not properly documenting the accounts and assessing the risks that they posed before opening them and was not doing "any additional follow-up beyond that." Tr. 1143:16-1144:2 (Pennell). For example, the Bank was not comparing actual transaction volumes through accounts to anticipated transaction volumes documented in the due diligence. Tr. 1144:2-11 (Pennell). The files were incomplete for a large percentage of the portfolio. Tr. 11458-13 (Pennell). Specifically, 14 accounts lacked historic or estimated chargeback levels, leaving the Bank with no starting point from which to monitor actual chargebacks. Tr. 1146:11-1147:4 (Pennell). NBE Pennell concluded that T Bank's "enhanced due diligence [policy] didn't exist [and that t]he original customer due diligence program was inadequate and insufficient"; T Bank was "not adequately complying with [its customer due diligence] policy. They were not getting documentation . . . or monitoring the information that they had against the accounts that existed." Tr. 1148:11-19, 1155:3-12 (Pennell). T Bank was also failing to supplement the information on existing Merchant Clients in its files as it expanded its due diligence requirements. Tr. 1174:12-21 (Pennell).

The examiners explained that these due diligence failures created reputation risk, compliance risk, transactional (or operational) risk related to liability for fraudulent items, and litigation and financial risk for the Bank generally. *See* Tr. 1395:14-1396:16, 1399:14-1400:1 (Fronk). NBE Pennell testified that the Bank's insufficient risk identification and deficient due diligence on Giact Merchant-Clients created reputational, transactional, and compliance risk. Tr. 1147:5-15; 1174:22-1175:11 (Pennell). *See also infra* pp. 63-67 (detailing relevant risks identified in regulators' published guidance and by NBE Messick).

NBE Fronk testified that it was unsafe or unsound to fail to obtain the required due diligence on the Merchant Clients before opening accounts because failure to understand a Merchant Client's business and any derogatory information about them created abnormal risk for the Bank. Tr. 1387:6-1388:7 (Fronk). She testified that ongoing monitoring of the Merchant Clients was required in the form of internet, Better Business Bureau, and Federal Trade Commission research; the Bank, however, did not do this and this failure was unsafe or unsound. Tr. 1396:17-1398:3 (Fronk). She also testified that it was unsafe or unsound and contrary to standards of ordinary care to open or allow accounts to remain open after receiving derogatory information about a Merchant Client. Tr. 1390:3-1391:4, 1391:10-14, 1393:7-1394:2, 1395:4-13 (Fronk). NBE Algier testified that it was unsafe or unsound for a bank to enter a business area without first identifying the risks entailed and determining whether it could adequately manage the risk and that the management of the RCC business at T Bank was unsafe or unsound. Tr. 1005:18-1006:14, 1029:16-1030:5, 1049:9-1050:15 (Algier).[60]

B. Record Evidence of Failure to Ensure Policies, Procedures, Systems, and Internal Controls to Adequately Mitigate the Risks Associated with the Giact RCC Business.

There also exists evidence in the record upon which a fact finder could conclude that Adams failed to ensure that policies, procedures, systems, and internal controls at T Bank were adequate to mitigate the risks posed by the Giact business. As with the due diligence related charges, the ALJ concluded that Enforcement Counsel failed to meet its burden of proof with respect to unsafe or unsound risk mitigation practices, citing an incorrect definition of unsafe or unsound practices. RD 110. Under the corrected legal standard, *see supra* p. 16, the record evidence could support the conclusion that, under Respondent's leadership, T Bank failed to obtain data on the Merchant Clients needed to monitor chargeback activity and failed to monitor accounts adequately, exposing the Bank to abnormal risks and constituting unsafe or unsound practices.

The Comptroller also disagrees with the ALJ's conclusion that there is no evidence that generally accepted standards of prudent operation required T Bank to have more thoroughly tracked RCC returns, to have adopted a policy on when accounts should be closed for excessive chargebacks, or to have better determined the amount and ensured the availability of adequate reserves. RD 102, 107, 113. On the contrary, the record evidence indicates that the internal control failures and the absence of a policy for establishing reserves, resulted in the Bank maintaining inadequate reserves to mitigate the risks posed by the RCC business, which in the opinion of the OCC's examiners were unsafe or unsound practices. Because the testimony of the OCC's examiners is entitled to deference, *see supra* pp. 42-43, a finder of fact could conclude that unsafe or unsound practices occurred with respect to internal controls and maintenance of reserves to mitigate risks associated with the Giact business.

1. Testimony from Respondent and Other Bank Witnesses, as Well as Bank Documents, Are Evidence of Inadequacy in the Bank's Internal Controls.

With respect to internal controls, Adams testified that T Bank had no system for tracking or monitoring the ratios of RCC returns to deposits for individual Giact Merchant-Clients and that there were no chargeback or transaction limits for Merchant Clients' accounts. Tr. 170:18-175:1, 177:22-179:3 (Adams); *see also* Jt. Ex. 95/1. He acknowledged,

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[60] Respondent's Counsel objected to NBE Algier's testimony on safety and soundness in connection with identification of risks associated with new products. The ALJ overruled the objection stating "I'll allow his testimony. He's a board-certified examiner. I think he knows what safe and sound is." Tr. 1006:11-14 (Miserendino). The ALJ also allowed testimony from NBE Algier, over objection, that the management of the Giact relationship was unsafe or unsound. Tr. 1029:21-22 (Miserendino).

for example, that several Merchant Clients had chargeback rates ranging from approximately 50 percent to 65 percent in May 2007 and one (My Clean Start, a credit repair service) had a chargeback rate of 75 percent in May 2007. Jt. Ex. 75, Tr. 189:2-194:19, 222:4-18 (Adams). The Bank had no written policy or procedure for monitoring why consumers' banks were returning RCCs, Tr. 187:1-20 (Adams), and no written policy indicating what level of excessive chargeback rate would result in the Bank closing a Merchant Client's account, Tr. 219:2-220:10 (Adams). The Bank created no reports comparing anticipated or historic return volume to actual return volume. *Id.* The Bank also had no written policies for setting adequate reserves for accounts. Tr. 183:15-186:1, 216:2-6 (Adams), 1544:19-1545:2 (Higgs); *see also* Jt. Exs. 95/1, 113/2.

CRM Stamm described in her testimony that T Bank kept track of returns from "an income standpoint" only and that she prepared monthly income reports related to returns at the request of Adams. Tr. 729:4-730:22 (Stamm). These reports tracked the total amount of returns, but did not examine returns as a percentage of a Merchant Client's deposit balance or through comparison to projected rates of return until close to the end of the Giact relationship. *Id., see also* Tr. 713:1-6 (Stamm). T Bank did not track the reasons for returns until June 2007. Tr. 727:2-18 (Stamm).[61]

Sue Higgs, T Bank's former Chief Financial Officer ("CFO") and Cashier, testified that she shared responsibility with CRM Stamm for processing RCC returns and responding to complaints about unauthorized RCC transactions; she stated that T Bank had no policy or standards for when it would open an account for a Giact Merchant-Client or policies or procedures for closing the accounts of Giact Merchant-Clients, based on volume of returns, complaints, or any other factor. Tr. 1531:16-1532:3; 1542:11-1543:21 (Higgs). This absence of policy existed despite the fact that Adams was aware that the RCC business would involve a high level of returns and a high level of return fee income, the fee income being the purpose of the RCC business for T Bank. Tr. 1543:22-1544:18 (Higgs). CRM Stamm testified that CFO Higgs complained to Adams that the Giact business was resulting in an inordinate amount of returns, but that he "really liked this business and wanted to develop it;" he "wanted the bank to keep processing these kinds of merchants because it was an electronic business . . . and he really wanted to expand that for the bank." Tr. 763:6-764:3 (Stamm).

Compliance Officer Bermingham noted that "in a traditional banking environment," a bank would close [an] account pretty rapidly" with a volume of returned checks similar to what was occurring in the Merchant Clients' accounts with RCC returns. Tr. 895:13-896:10 (Bermingham). But T Bank had no policy on a level of unacceptable chargebacks. Tr. 916:16-20 (Bermingham); *see also* Jt. Ex. 95/1. When she raised her concerns about the volume of RCCs being returned, like with her complaints about inadequate due diligence, Adams' response was "a little lackadaisical . . . not real concerned." Tr. 896:11-17 (Bermingham).

2. The Bank's External Auditors Stated that Internal Controls Related to

[61] When the OCC asked T Bank for this information in June 2007, the Bank had to request this information from Giact because the Bank did not have it. Jt. Ex. 89.

Account Monitoring and Reserves Were Inadequate.

In its 2007 review, the Bank's external auditor Delong found that risk-mitigating controls, including monitoring returns of RCCs for the Giact Merchant-Clients, were not consistently applied. Jt. Ex. 76/3. Delong also concluded that risk-rating scores for Giact Merchant-Clients with high chargebacks and high risk business areas did not "appear in line with actual risks" and no procedures were established to periodically reassess and document risk ratings. Jt. Ex. 76/3. Delong observed that Merchant Client Virtual Works had a projected return rate of 2 percent at account opening, but an actual return rate of 63 percent, and Merchant Client Ameritrust had a projected return rate of 2 percent, but an actual return rate of 73 percent. Jt. Ex. 61/3-4.[62] Delong also observed that the Bank's only tracking of chargebacks looked at number of returns per week with no tracking of trends or the relation of chargebacks to total deposits. Jt. Ex. 76/4, Jt. Ex. 62/2.

In another 2007 review, the Bank's outside consultant RLR criticized that "T Bank ha[d] no procedure for closing accounts with excessive unauthorized returns." Jt. Ex. 112/11. Moreover, fraud monitoring was insufficient with respect to returns in particular. Jt. Ex. 112/6, 9. "Risk assessments, underwriting scoring and reserve requirements were arrived at too subjectively and need[ed . . .] more structure and consistency." Jt. Ex. 112/4, 7-8.[63] RLR was also critical of T Bank's account hold practices because after the initial 30 days an account was open, all accounts reverted to a standard hold without any individualized assessment of whether an extended hold should be maintained. Jt. Ex. 112/5.[64, 65]

3. OCC Witnesses Testified that Internal Controls Failures Were Unsafe or Unsound Practices.

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[62] In another example, Merchant Client Global USI reported a historic return rate of 2 percent to 3 percent at account opening, Jt. Ex. 21/48, but experienced a return rate of 87 percent in May through June of 2007, OCC Ex. 9/2. The reserve on this account of $5,853 was insufficient to mitigate the risk posed by this high level of returns. Tr. 1412:2-1413:2 (Fronk); Jt. Exs. 86, 88.

[63] For example, the Bank required no reserve for Merchant Client LowPay which had a return rate of 50 percent. Tr. 1414:1-13 (Fronk), Jt. Ex. 49/1.

[64] Respondent testified that T Bank's Board of Directors never had the opportunity to implement RLR's recommendations because the Board voted to end the Giact business the same day it was presented with the RLR report. Tr. 417:15-418:2 (Adams). He acknowledged on cross-examination, however, that some of the points raised by RLR were addressed by the OCC previously in the 2006 Exam. Tr. 639:7-641:2 (Adams).

[65] Delong also recommended a separation of duties for persons responsible for Giact Merchant-Client account relationships and Giact Merchant-Client monitoring. Jt. Ex. 76/3. Similarly, RLR criticized that the client relationship manager, CRM Stamm, was performing too many roles in relation to due diligence and monitoring the Giact business. Jt. Ex. 112/3, 6. CRM Stamm was the only bank employee responsible for tracking returns and monitoring the Giact Merchant-Clients' accounts. Tr. 188:6-12 (Adams). One of the OCC's examiners testified that insufficiently staffing day-to-day handling of the Giact relationship with one employee created conflicts of interest and was also an unsafe or unsound practice for which Respondent was responsible as president and CEO of the Bank. Tr. 1214-19, 1282-87 (McKnight); *see also* Tr. 1430:7-9 (Fronk).

NBE Pennell testified that the absence of due diligence data covering historical or anticipated chargebacks and average and maximum transaction sizes made the Bank unable to set proper reserves for accounts, vulnerable to monetary loss risk, and unable to identify suspicious activity in accounts. Tr. 1147:5-1148:10, 1169:15-1170:16 (Pennell). NBE Fronk testified that the failure to monitor the reasons for and the rates of returns, to close accounts for excessive returns, or to establish a policy in this regard were unsafe or unsound practices and contrary to ordinary standards of care. Tr. 1400:17-1408:11 (Fronk). Respondent, as President and CEO of the Bank, was responsible for this failure. *Id.*, Tr. 1430:10-13 (Fronk). She also testified that inadequate reserves exposed T Bank to potential overdrafts and financial losses,[66] that it was impossible to set adequate reserves without analyzing return rates, and that it was unsafe or unsound and contrary to standards of ordinary care to have insufficient reserves. Tr. 1408:12-1409:4, 1418:17-1420:5 (Fronk). NBE Fronk testified that it was unsafe or unsound and contrary to standards of prudent operation to have no specific policy on setting reserves for Giact Merchant-Clients and that Respondent, as President and CEO of the Bank, was responsible for this failure. Tr. 1413:18-1415:3 (Fronk). *See also infra* pp. 63-67.

Louis A. Thompson, the OCC's Deputy Chief Accountant, Tr. 1487:6-14, 1490:9-12 (Thompson), testified as an expert in accounting concerning the deficiency in reserves identified by the Bank's Controller, Amy Birt, in June 2007. Jt. Exs. 103, 104. Deputy Chief Accountant Thompson concluded that the deficiency in reserves of $835,303.51 represented approximately 125 percent of the Bank's net income and more than 6.4 percent of the Bank's tier one capital for the most recent financial reporting quarter; this was a substantial and material deficiency. Tr. 1490:16-1497:18 (Thompson).[67, 68]

C. Record Evidence that T Bank Had No Formal Systems for Monitoring and Responding to Consumer Complaints.

[66] In a memo dated April 17, 2006, the law firm H&B warned T Bank that it would be liable for returned items. Jt. Ex. 8/4.

[67] The ALJ did not find that reserves maintained by the Bank were inadequate after crediting and accepting the testimony of Respondent that Controller Birt's calculations of the deficiency were a "worst case scenario," hypothetical, and never adopted by the Bank. RD 111-12 (citing Tr. 475-478 (Adams)). While the ALJ is correct that Controller Birt presented her methodology as "open for discussion" with her Bank colleagues, she also stated in an email, as the Bank's Controller, that "it is clear that overall reserves are inadequate to mitigate risks associated with several high risk accounts." Jt. Ex. 104.

[68] The Comptroller is unpersuaded by the ALJ's conclusion that T Bank sufficiently mitigated the Bank's risk exposure through procedures other than reserve accounts for specific Merchant Clients, including the Bank's own reserve against potential loss, 8-day holds on accounts, and the existence of a Giact money market account with T Bank. RD 11-12, 27, 110. The Bank's reserve consisted of Bank money, not money put in reserve by the Merchant Clients, and therefore credit risk remained present. Tr. 1413:3-17 (Fronk). There is no evidence that permanent holds were in place on the Merchant Clients' accounts; the evidence indicates that extended holds were temporarily imposed when an account was opened and reverted to standard holds after 30 days. Tr. 294:10-18, 442:9-17 (Adams); Jt. Ex. 112/5. With respect to the Giact money market account, there is no evidence that T Bank ever obtained a guaranty providing it access to the money market account to cover losses from any Merchant Client specifically or all of the Merchant Clients generally. Tr. 1391:5-22 (Fronk).

The record evidence could support the conclusion that T Bank had no formal policies, procedures, or systems for monitoring or responding to consumers' complaints related to the Giact Merchant-Clients and RCCs debited from the consumers' accounts. The ALJ's legal conclusion that the lack of a proper monitoring and response system was not unsafe or unsound was based on his mistaken view that an unsafe or unsound practice must have an adverse effect on a bank's financial stability. RD 122. Under the correct legal standard for unsafe or unsound practices, *see supra* p. 16, testimony from the OCC's examiners indicates that T Bank's insufficient complaint monitoring and response system was contrary to standard banking practices and exposed the Bank to undue risks and constituted an unsafe or unsound practice. Tr. 1193:3-1197:4, 1218:4-1219:16, 1273:14-1282:11 (McKnight). Under the correct legal standard requiring deference to the testimony of NBEs, *see supra* pp. 42-43, there exists record evidence of unsafe or unsound practices in connection with deficient complaint monitoring and response systems under Respondent's leadership at T Bank.[69]

1. Bank Witnesses Testified that There Were No Systems to Ensure an Adequate Response to Consumer Complaints.

Adams was aware as early as 2006 that T Bank was receiving complaints from consumers that the Giact Merchant-Clients were making unauthorized deductions from consumers' accounts using RCCs deposited into the Merchant Clients' T Bank accounts; the volume of complaints "ramped up" in the Fall of 2006. Tr. 197:20-200:22, 202:12-16 (Adams). In addition to these complaints received directly from consumers[70] and returns coming to the Bank via the payment system, T Bank received complaints of unauthorized charges to consumer accounts directly from consumers' banks. Tr. 207:14-208:1 (Adams). Respondent testified, however, that the Bank had no written formal policies on monitoring, tracking, or responding to complaints directly from consumers or complaints of non-authorized

[69] The ALJ's conclusion that the lack of a formal policy was irrelevant because T Bank refunded money to consumers in response to all consumer complaints, RD 96, 116-17, 118, 123, is unsupported by the evidentiary record. The record contains testimony and documentary evidence related to consumer complaints and returns of different types. The record evidence covers the distinct issues of (1) the Bank's responses to RCCs returned through the payment system for insufficient funds or unauthorized transaction, *see, e.g.*, Tr. 196:10-197:2 (Adams), 1531:2-15 (Higgs); (2) complaints received from consumers directly regarding unauthorized transactions or other problems , *see, e.g.*, Tr. 202:12-205:12 (Adams), 738:4-744:8 (Stamm); Jt. Ex. 120/7; and (3) complaints from consumers' banks (not through the payment system) concerning unauthorized transactions, *see, e.g.*, Tr. 560:18-561:18 (Adams). The ALJ repeatedly cites an exchange between Respondent's Counsel and NBE Fronk in which NBE Fronk is questioned, "you're aware that the bank had a policy of refunding virtually all disputed transactions, even before any investigation. Isn't that correct?" She answered, "Yes, I am aware of that." Tr. 1726:15-19 (Fronk); *see* RD 96, 117, 118, 123. This agreement with Respondent's Counsel's general question conflating returns, consumer complaints, and consumers' banks' complaints into one category does not establish that every complaint of every kind resulted in a refund. Adams testified that all RCCs returned for insufficient funds through the payment system resulted in refunds that were charged back to the Merchant-Client without questions or investigation. Tr. 196:10-197:2 (Adams). However, the evidence did not establish that T Bank always provided refunds in response to complaints from consumers directly or complaints from their banks. On the contrary, according to CRM Stamm, refunds normally were made in response to bank complaints with consumer affidavits only if a transaction was "indeed fraudulent." *See* Jt. Ex. 115.

[70] NBE Fronk explained that consumers were contacting the Bank, instead of the Merchant Clients, with complaints because consumers did not have access to correct contact information for the Merchant Clients. Tr. 1424:7-1427:1 (Fronk).

transactions from consumers' banks. Tr. 202:12-205:12, 207:14-211:10 (Adams). At the time, Respondent attributed consumer complaints, including returns through the payment system, to "buyer's remorse." Tr. 1421:7-1422:1 (Fronk); Tr. 923:19-927:6 (Bermingham). Regarding complaints received directly from consumers, according to CRM Stamm the volume was as high as five to ten a week, but there was no formal process, policy, or procedure for tracking, monitoring, or handling those complaints. Tr. 739:4-746:3 (Stamm). She noted that the bank "did do some refunds" in response to complaints received from consumers' banks, but would not provide a refund if proof of authorization was available. Tr. 746:4-749:6 (Stamm).[71]

2. T Bank's Consultants Criticized T Bank's Inadequate Complaint Response Systems.

Adams testified that for one Merchant Client, Virtual Works, the Bank would refund "anything that came back on their account as a did not authorize . . . Immediately, without even checking the authorization." Tr. 561:12-18 (Adams). The Bank's consultant Delong, however, questioned why, according to Compliance Officer Bermingham, Virtual Works had stopped payment on most of the refund checks that appeared on its February 2007 T Bank account statement. Jt. Ex. 61/3. At the same time, Delong also raised concern that Compliance Officer Bermingham had identified returns charged back to multiple Giact Merchant-Clients from the same consumer, indicating inappropriate sharing of consumer information among the Merchant Clients and possible fraud. *Id.* at 3-5.

In the same vein, the Bank's consultant RLR found that documentation and research on complaint processing was missing from the files on the Merchant Clients and the Bank kept no statistics on complaints of unauthorized transactions received from consumers' banks. Jt. Ex. 112/8, 10-11. RLR criticized T Bank for its practice of responding to bank complaints of unauthorized debits by sending out a form letter[72] which claimed that the disputed transaction was authorized without having first researched it with Giact or the Merchant Client; T Bank would only obtain the authorization (or process a refund) if a consumer's bank followed up on the form letter with a second complaint containing an affidavit from the consumer. *Id.*; *see also* Tr. 209:17-212:15, 560:17-561:18, 645:2-13 (Adams); Tr. 746:4-749:6 (Stamm).

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[71] CRM Stamm testified that the volume of complaints from banks that debits were unauthorized was difficult to keep up with and she would sometimes fall two weeks behind in responding due to the high volume. Tr. 755:8-756:22 (Stamm). In response to her requests for assistance, Adams did not hire or assign any additional operations staff to assist CRM Stamm. Tr. 761:3-22 (Stamm).

[72] Among her criticisms of the form letter, NBE McKnight noted that it was unusual for a bank to respond to such complaints with such a general form letter which did not identify the consumer or include a complaint number or any other way to track, monitor, or review the complaint response process for any individual complaint. Tr. 1202:9-1206:3 (McKnight). *See* Jt. Ex. 65 (sample form letter).

3. The OCC's Examiners Testified that Failure to Ensure Adequate Systems to Monitor and Respond to Consumer Complaints Was an Unsafe or Unsound Practice.

Mary McKnight, National Bank Examiner, Southern District Lead Compliance Expert, participated in the 2007 Exam, Tr. 1184:21-1185:6 (McKnight), and testified as an expert witness on safety and soundness and compliance with OCC laws and regulations, specifically unsafe or unsound practices with respect to consumer complaint response systems and staffing at T Bank. Tr. 1218:4-1219:16, 1282:22-1287:8 (McKnight). In the OCC's 2007 Examination of T Bank, NBE McKnight found an unsafe or unsound lack of monitoring, investigation, response to, or aggregate review of customer complaints concerning the Giact Merchant-Clients and an absence of policies and procedures before (or after) entering the RCC business. Tr. 1196:8-1197:4, 1214:2-1219:16 (McKnight). These unsafe or unsound practices exposed the Bank to compliance risk (with respect to Bank Secrecy Act and Suspicious Activity Report filing compliance and unfair or deceptive practices), legal risk, and reputation risk to the Bank, impacting the Bank's earnings and capital and financial safety and soundness. Tr. 1273:14-1282:11 (McKnight). NBE Fronk concurred that T Bank's lack of a formal system to track and monitor complaints was unsafe or unsound. Tr. 1422:18-1423:21 (Fronk). Based on this testimony, a finder of fact could conclude in this case that unsafe or unsound practices occurred at T Bank under Respondent's leadership in connection with deficient complaint monitoring and response systems. The OCC's examiners testified that preventing these deficiencies was Respondent's responsibility as President and CEO of the Bank. Tr. 1211:21-1216:3 (McKnight); 1423:1-4 (Fronk). *See also infra* pp. 63-67.

D. Record Evidence that the Taking of Non-Public OCC Information Without Prior Authorization Is a Violation of Law.

For the reasons noted above, the Comptroller makes no findings of fact and imposes no penalty with respect to Respondent Adam's removal of non-public OCC information from the Bank upon his departure. The record contains evidence, however, that a violation of 12 C.F.R. § 4.36(d) took place when Respondent, as admitted in his testimony, copied his hard drive shortly after his resignation and took a copy home. Tr. 227:1-13 (Adams). The ALJ concluded that although Respondent's removal of this information from the Bank was inadvisable, no violation of law took place warranting imposition of a cease-and-desist order because a violation of law, within in the meaning of 12 U.S.C. 1818(b), requires an effect on the financial stability of the institution and no such impact occurred as a result of Respondent's failure to abide by OCC regulation. RD 139. The Comptroller has determined that no such effects test exists under 12 U.S.C. 1818(b). *See supra* pp. 38-40. Admission that he removed the copied hard drive from the Bank constitutes evidence that Respondent knowingly removed non-public OCC information[73] from the Bank including ROEs and supervisory correspondence without authorization in violation of law. RD 126; Tr. 228:16-21, 234:22-235:3 (Adams), Tr.

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[73] The regulations define non-public OCC information as including records "created or obtained" by the OCC "in connection with the OCC's performance of its responsibilities, such as a record concerning supervision, licensing, regulation, and examination of a national bank . . ." 12 C.F.R. § 4.32(b)(1)(i). "A report of examination" and "supervisory correspondence" constitute non-public OCC information. 12 C.F.R. § 4.32(b)(1)(iii).

1462:6-1465:20 (Fronk). Based upon this admission, a finder of fact could determine that the grounds for imposing a cease-and-desist order had been met in this case.

OCC regulations state that "[a]ll non-public OCC information remains the property of the OCC. . . . Except as authorized by the OCC, no person obtaining access to non-public information under this section may make a copy of the information and no person may remove non-public OCC information from the premises of the institution, agency, or other party in authorized possession of the information." 12 C.F.R. § 4.36(d). It is the OCC's policy that non-public OCC information "is confidential and privileged." 12 C.F.R. § 4.36(b). Maintenance of the proper confidentiality of OCC supervisory information is essential to the effectiveness of the OCC's supervisory mission. It is therefore essential that all individuals and entities with access to non-public OCC information comply with the regulations prohibiting unauthorized use or disclosure of this information. *See* 12 C.F.R. §§ 4.36(d), 4.37(b)(1)(ii). Under the correct legal standard for a violation of law, *see supra* pp. 38-40, the evidence supporting the conclusion that Respondent took non-public OCC information in violation of 12 C.F.R. § 4.36(d) could persuade the finder of fact that the conduct warranted imposition of a cease-and-desist order.

III. EVIDENCE IN THE RECORD OF RECKLESS ENGAGEMENT IN UNSAFE OR UNSOUND PRACTICES FORMING A PATTERN OF MISCONDUCT AND WARRANTING A SECOND TIER CIVIL MONEY PENALTY.

The Comptroller makes no findings of fact supporting imposition of a civil money penalty and declines to impose a civil money penalty on Respondent for the reasons discussed above. Upon the record evidence, however, a finder of fact could conclude that Respondent recklessly engaged in unsafe or unsound practices forming a pattern of misconduct that could warrant imposition of a Second Tier civil money penalty. *See* 12 U.S.C. § 1818(i)(2)(B). For the purpose of a Second Tier civil money penalty, conduct is deemed "reckless" when it is "done in disregard of, and evidencing a conscious indifference to, a known or obvious risk of a substantial harm." *Cavallari v. Comptroller of the Currency*, 57 F.3d 137, 142 (2d Cir. 1995) (citing *Simpson v. Office of Thrift Supervision*, 29 F.3d 1418, 1425 (9th Cir. 1994)) (applying interpretation of "reckless disregard for the law" under 12 U.S.C. § 1818(b)(6)(A)(ii) as "when: (1) the party acts with clear neglect for, or plain indifference to, the requirements of the law, applicable regulations or agency orders of which the party was, or with reasonable diligence should have been, aware; and (2) the risk of loss or harm or other damage from the conduct is such that the party knows it, or is so obvious that the party should have been aware of it.").

While RCCs may have been a new banking product being offered to retailers at the time T Bank entered the Giact business, the record evidence indicates that the OCC's examiners provided T Bank with supervisory guidance on how to identify and manage risks associated with the RCC business. Additionally, published guidance on relevant subjects such as merchant processing generally, new products and services, third-party relationships, and Bank Secrecy Act ("BSA")/Anti-Money Laundering ("AML") requirements for banking high-risk customers were all applicable to T Bank's management of its RCC business. Indeed, Adams' own Compliance Officer, other Bank employees, and external advisors hired by the Bank warned him of the risks T Bank faced in undertaking the RCC business. *See supra* pp. 48-50, 55, 58. This record evidence could support the conclusion that Respondent recklessly engaged in unsafe or unsound practices that would support imposition of Second Tier civil money penalty within the meaning of 12 U.S.C. § 1818(b)(6)(A)(ii).

A. Evidence that the OCC Provided a Supervisory Response Critical of the Giact Business Starting During Its 2006 Examination of T Bank and Addressed Deficiencies in the RCC Business in a 2007 Memorandum of Understanding.

The record contains evidence that the OCC's examiners communicated to T Bank that its management of the Giact business was deficient and required improvement in order to operate the Bank in a safe and sound manner.[74] The ROE for the 2006 Exam cited Giact by name with respect to the need for better analysis of deposits returned to the Bank and improved customer activity reports and monitoring of deposits in the context of AML compliance. Jt. Ex. 34/40. The 2006 Exam ROE indicated that these Giact-related concerns were addressed by actions called for in the Matters Requiring Attention ("MRA") section of the ROE. Jt. Ex. 34/40. The BSA/AML MRA states specifically, "management needs to expand the monitoring of the high risk Giact-related deposit accounts . . . ." Jt. Ex. 34/12. The vendor management MRA explicitly mentioned the need for increased due diligence with respect to Giact and the need for a standard reserve analysis for all Giact customers. Jt. Ex. 34/15.[75] Additionally, NBE Algier testified that sections of the 2006 Exam ROE dealing with improvements needed in the rollout of new products and services [76] and in the Bank's risk management controls and compliance management risk structure applied to the Giact business. Jt. Ex. 34/4-6, 8, 23-25, Tr. 996:7-17, 998:16-1000:20, 1004:16-1005:14, 1008:18-1009:22, 1010:4-1011:5 (Algier). As the examiner-in-charge at the 2006 Exam, NBE Algier discussed the Giact relationship with

[74] The ALJ faulted the OCC for not commenting on the sufficiency of the Bank's due diligence or monitoring and tracking of accounts during the 2006 Exam, RD 25, n.20, 27-28, 37-38, 44-45, and criticized an OCC enforcement document for not mentioning Giact by name, RD 35. The ALJ was persuaded by Adams and other T Bank witnesses that the OCC had offered no contemporaneous guidance to the Bank on managing the Giact business. RD 9-10. In the view of the Comptroller, this factual conclusion is unsupported by the record evidence.

[75] NBE Algier confirmed the applicability of these MRAs to the Giact RCC business and explained that the OCC does not, in its ROEs and MRAs, tell a bank specifically what steps it should take to address risks; rather, it is the responsibility of management and the board of directors of a bank to develop their specific risk management practices because the bank managers and officers are in the best position to do so with reference to relevant published guidance from bank regulators. Tr. 1013:5-1014:18, 1017:22-1019:20, 1027:9-1028:6, 1060:2-1061:8 (Algier).

The ALJ's view that BSA/AML risk concerns can only exist in relation to potential money laundering (and no other criminal activity, such as fraud), RD 26 n.21, is an overly narrow view of the requirements of the law and the proper functioning of a proper suspicious activity monitoring function. NBE Pennell testified, for example, that his review of T Bank's compliance with the BSA evaluated whether the Bank was establishing and following policies and procedures to identify its customers, *i.e.*, the Giact Merchant-Clients, and the nature of their businesses to evaluate the risk of money laundering or other transactions taking place. Tr. 1128:8-1129:13, 1136:16-1137:11 (Pennell).

The ALJ's preoccupation with whether Giact was properly denominated as a third-party *vendor* in relation to the examiners' requirement that a proper reserve analysis be established, RD 34-35, is similarly misplaced. The fundamental point of the MRA was that a reserve analysis was required to mitigate risks associated with the Giact business. NBE Algier testified that analysis of returns for setting reserves was still required and BSA/AML concerns were still present even if (as the Bank argued) the Giact Merchant-Clients' accounts were normal customer accounts and not part of a vendor relationship *per se*. Tr. 1022:15-1024:20 (Algier).

[76] The RCC business with Giact was not part of T Bank's business plan included in its charter application. Tr. 1010:14-20 (Algier).

Respondent "numerous times" including in an exit meeting at the conclusion of the exam. Tr. 988:13-990:6 (Algier). NBE Algier recounted discussions he held with Adams about the designation of Giact Merchant-Clients' accounts as high risk, the need for monitoring those accounts, and identifying and managing risks associated with new products and services, including BSA/AML risks. Tr. 1000:21-1002:18, 1010:4-1013:4, 1013:5-1015:22 (Algier).

Following the 2006 Exam, on April 12, 2007, the OCC and T Bank executed an enforcement document, Memorandum of Understanding between T Bank and the OCC, with the aim of correcting deficiencies the OCC's examiners found during the 2006 Exam ("the MOU"). The words "Giact" and "RCC" do not appear in the MOU; NBE Algier explained that it is usual for the OCC to draft enforcement documents broadly, without specific references of that kind, because of the potential broad distribution of the document and also to avoid narrowly focusing a bank on specific areas of concern to the exclusion of other areas that may raise similar concerns. Tr. 1073:2-19 (Algier).[77] His testimony confirmed that the MOU articles relating to new product development risk management, BSA/AML compliance,[78] and vendor management[79] were connected to the RCC business, although, as is customary, the MOU did not identify Giact or RCCs by name. Tr. 1062:18-1064:9 (Algier).

B. Evidence of Published Supervisory Guidance and Standards of Prudent Operation Applicable to Managing an RCC Business at the Time T Bank Entered and Continued the RCC Business.

When banks are introducing novel services and products, as T Bank did with RCCs from 2005 to 2007, banks *must* be guided by more general or analogous published guidance (as well as criticisms from examiners) in establishing proper policies and procedures to mitigate the often abundant risks associated with novel services and products. *See supra* p. 43. In April 2008, the OCC published bulletin OCC Bulletin 2008-12, entitled Payment Processors, Risk Management Guidance. Resp. Ex. 77. This bulletin makes specific reference to RCCs.[80]

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[77] NBE Fronk testified similarly that enforcement actions are typically not worded with the specificity that would be found in an ROE; for this reason, she directs banks to look at recent ROEs in order to understand the relevant detail of a related enforcement action. Tr. 1361:8-13, 1554:21-1555:9 (Fronk).

[78] Documentary evidence establishes that T Bank understood the MOU article on BSA/AML compliance to pertain to the Giact business. The Bank's June 12, 2007 report on compliance with the MOU referenced and attached a report prepared by Delong Consulting Services, L.C. that discussed BSA/AML compliance deficiencies in connection with the Giact relationship. Resp. Ex. 40/11, 121.

[79] The Bank's June 12, 2007 report on compliance with the MOU again made clear the Bank's knowledge that the MOU addressed Giact. The Bank recounted its objection to the OCC's examiners identifying Giact as a vendor in the Bank's response to the vendor management article of the MOU. Resp. Ex. 40/17.

[80] In addition to incorrectly concluding that the OCC's supervisory activities did not address the Giact relationship, the ALJ was mistaken in his failure to recognize the OCC published guidance generally applicable to RCCs and the Giact business and erred in his conclusion that there was no relevant supervisory guidance available to Respondent to guide him in his management of the RCC business. *See* RD 79-80 n.41. The Comptroller rejects the view that OCC published guidance must specifically address a payment system instrument, such as RCCs or any other, by name in order for the guidance to be applicable. The ALJ erred in concluding that the OCC's supervisory and enforcement functions are limited only to products and activities specifically identified in prior guidance when our

Although this was the first OCC bulletin to specifically mention RCCs, there existed at the time T Bank entered and remained in the RCC business published guidance applicable to the merchant processing services the Bank was offering.[81] In this regard, W. Carter Messick, National Bank Examiner, Lead Expert for Operational Risk and Enterprise Governance, Mid-Size Bank Supervision, Tr. 19:14-18, 31:3-17 (Messick), testified that he had been unaware of RCCs being utilized in the retail market until 2007. Tr. 127:15-19 (Messick). Nevertheless, as an expert on safety and soundness issues involving electronic payments, Messick testified that more general guidance incorporated and applied to managing an RCC business, including the OCC's Merchant Processing Comptroller's Handbook (December 2001) ("Merchant Processing Handbook"),[82] Tr. 74:17-78:1, 108:4-110:4, 113:8-114:20 (Messick), and OCC Bulletin 2004-20, Risk Management of New, Expanded, or Modified Bank Products and Services, Risk Management Process, May 10, 2004 ("2004 New Product Guidance"),[83] Tr. 78:2-16, 108:4-110:4, 113:8-114:20, 127:22-128:14 (Messick). He also

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examiners identify unsafe or unsound practices in connection with novel banking products or services. *See supra* p. 43.

[81] Indeed, the 2008 Payment Processor bulletin states that the principles and procedures outlined in the OCC's 2001 Merchant Processing Handbook, *see infra* n.82, "are also applicable to the processing of other payment instruments, including RCCs and [Automated Clearing House ("ACH")] transactions." Resp. Ex. 77/2 n.5.

[82] The 2001 version of the Merchant Processing Handbook warns banks to consider the strategic risk at stake in merchant processing in connection with a bank's liability for fraud and chargeback losses and highlights that "[c]redit risk arising from chargebacks is a significant risk to . . . earnings and capital" and identifies reputation and transaction risks involved. Merchant Processing Handbook at 17-21. The handbook stresses the importance of an antifraud system to monitor each merchant's daily activity and describes primary methods for controlling risk including risk management processes that include written policies and procedures, staffing levels commensurate with workload, monitoring of sales activity, chargebacks, and fraud, and a formal merchant underwriting and approval policy which requires obtaining certain minimum due diligence information. *Id.* at 22-24, 30-31. "Higher risk" merchants should "undergo far greater [underwriting] analysis" and be continually monitored. *Id.* at 25, 27. In the case of internet merchants, banks should determine whether "heightened fraud and chargeback risk warrants the use of additional risk mitigation techniques, such as delaying settlement or establishing reserves." *Id.* at 26. Banks with payment processing relationships should monitor each merchant's daily chargeback activity and establish reserves to mitigate credit risk. *Id.* at 31-32, 73.

The ALJ took administrative notice of the 2001 Merchant Processing Handbook but refused to attribute knowledge of it to Adams. RD 9-10, n.7; Tr. 1763:18-1764:4 (Miserendino). Adams indicated in his testimony, however, that he was aware of the Merchant Processing Handbook and believed that its guidance applied to management of T Bank's RCC business because, according to Respondent's testimony, the Bank did collect the due diligence prescribed by the handbook. Tr. 328:15-17, 352: 2-6 (Adams).

[83] Available at http://www.occ.gov/news-issuances/bulletins/2004/bulletin-2004-20.html (last visited Sept. 4, 2014).

The 2004 New Product Guidance identifies failure to establish effective risk management processes with respect to new, expanded, or modified products and services as an unsafe or unsound banking practice. Effective risk management processes include (1) adequate due diligence prior to introducing product, (2) developing and implementing controls and processes to measure, monitor, and control risk, (3) developing and implementing appropriate performance monitoring and review systems. The guidance warns of the risks to earnings and capital embedded in the strategic, reputation, credit, transaction, and compliance risks potentially associated with new products and services.

indicated that prior to banks beginning to process RCCs for retailers, banks utilized Automated Clearing House ("ACH") payment processing which was analogous to RCCs and the subject of explicit OCC guidance on risk management.[84] Tr. 110:11-111:7, 113:8-16, 123:20:-128:14 (Messick).

NBE Messick described the type of due diligence that the Merchant Processing Handbook directs a bank to undertake to identify high-risk customers including "collect[ing] identifying information on the principals of a company, what business they're in, what the products, goods and services that they sell are, and what their past banking relationship was, what their payment volumes were, what their return volumes were or chargeback volume on credit cards, and looking at that, make a determination of whether they're high risk or not." Tr. 74:17-78:1 (Messick). He explained that the merchant processing guidance requires deeper due diligence with respect to high-risk merchants. Before processing for a high-risk merchant, a bank may take the due diligence deeper by "sampling the telemarketing scripts, looking at web-based ads and doing deeper . . . due diligence, to understand the credibility of the company." *Id.* He explained that the 2004 New Product Guidance "lays out the expectation that banks have strong due diligence and approval processes for any new third party relationships, and any policies and procedures, expertise already in existence as they're moving into new business lines, new products and services." Tr. 78:2-16 (Messick). He also noted that the Bank Secrecy Act Manual of the Federal Financial Institutions Examination Council ("FFIEC's BSA/AML Manual") was relevant guidance for establishing due diligence procedures to identify and monitor higher-risk accounts in the RCC context. Tr. 58:5-15, 110:11-111:3 (Messick); *see also* Tr. 1733:7-16 (Fronk).[85]

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[84] *See, e.g.*, OCC Bulletin 2002-2, ACH Transactions Involving the Internet, Guidance and Examination Procedures, January 14, 2002; OCC Bulletin 2006-39, Automated Clearing House Activities, September 1, 2006 (replaces OCC Bulletin 2002-2), available at
http://www.occ.gov/news-issuances/bulletins/2006/bulletin-2006-39.html (last visited Sept. 4, 2014).

OCC Bulletin 2006-39 warns that engaging "in new ACH activities" without "implement[ing] appropriate controls . . . is an unsafe or unsound practice and can result in increased credit, compliance, reputation, strategic, and transaction risks, and, in some cases, deterioration in the bank's condition." "[E]ffective ACH risk management" requires "written policies and procedures, strong internal controls, and a risk-based audit program." The guidance identifies "credit-repair services, certain mail order and telephone order (MOTO) companies," among others, as "inherently more risky" and likely to have more "incidents of unauthorized returns." Increased monitoring is required with these companies as a "high level of unauthorized returns is often indicative of fraudulent activity."

The ALJ sustained an objection by Respondent's counsel to the relevance of this guidance and did not allow Respondent to be questioned on it, although Respondent acknowledged that he should have received this guidance. Tr. 651:18-655:10. (Adams).

[85] Although various past revisions of the manual referenced by the witnesses are not exhibits in the record, the FFIEC's BSA/AML Manual address risks associated with RCCs specifically starting with the manual's 2006 revisions in the section dealing with Third-Party Payment Processors and instructs that banks should have an understanding of chargeback history for RCCs as part of effective monitoring. *Id.* at 205-06 & n.173. The current version of the manual continues to discuss RCCs specifically and is available at
https://www.ffiec.gov/bsa_aml_infobase/pages_manual/OLM_063.htm (last visited Sept. 4, 2014).

FFIEC's BSA/AML requirements for categorizing banking activity as high risk were discussed with T Bank

In the 2006 Exam, the OCC's examiners directed T Bank management to OCC Bulletin 2001-47, Third-Party Relationships, Risk Management Principles, November 1, 2001 ("2001 Third Party Guidance), Jt. Ex. 1, Jt. Ex. 34/6, Jt. Ex. 51/3, which also contains guidance on managing risks in relationships with third parties in a safe and sound manner.[86] The guidance warns banks that "management and the board must exercise due diligence prior to entering the third-party relationship and effective oversight and control afterwards." Jt. Ex. 1/4.[87]

NBE Messick described the risks connected to processing RCCs for retailers to include credit risk related to settling transactions (a risk exacerbated in the case of a high level of returns for which a bank may be held ultimately liable), compliance risk related to unfair and deceptive practices, reputation risk, and operational risk related to potential fraud. Tr. 61:4-64:16, 67:18-71:2, 72:8-74:16, 74:17-76:10 (Messick). He explained that the risk of fraud is higher when processing RCCs than with ACH payments which can be monitored more closely by the bank, bank regulators, and the clearing house processing the payment. Tr. 63:21-64:16 (Messick). NBE Messick testified that to manage risks involved in merchant processing, banks must put in place procedures for underwriting (*i.e.*, carrying out due diligence on) new merchants which examine a merchant's industry, volume of transactions, financial condition, creditworthiness, and background of principals; set limits on the volume of payments and returns as well as limits on returns as a percentage of payment volume; and institute processes for monitoring merchants to identify those who exceed those limits and escalation and audit procedures that would allow review of consumer audio and website authorizations, and termination procedures to manage merchants who exceed established limits. Tr. 83:21-84:14, 92:1- 96:17 (Messick). NBE Messick testified that it is unsafe or unsound for a bank to accept RCCs from high-risk merchants without these adequate procedures, policies, systems, and controls to mitigate and manage risk. Tr. 96:11-17 (Messick). NBE Messick's testimony on

management in the course of the 2006 Exam. Tr. 1013:10-1014:20 (Algier). The 2005 version of the FFIEC's BSA/AML Manual includes requirements for customer due diligence, enhanced due diligence for high-risk customers, and ongoing due diligence of the customer base in support of suspicious activity reporting. *Id.* at 37, 41. A section on third-party payment processors warns that "some processors may be vulnerable to money laundering, identity theft, and fraud schemes" creating the risk of "processing illicit or sanctioned transactions." *Id.* at 121. To effectively monitor such accounts a bank should have an understanding of processor information including "chargeback history." *Id.* at 122.

[86] The 2001 Third Party Guidance highlighted that "credit risk for some . . . third-party programs may be shifted back to the bank if the third party does not fulfill its responsibilities or have the financial capacity to fulfill its obligations." Jt. Ex. 1/6. The guidance directs banks to establish policies for risk assessment, proper due diligence, and ongoing controls and oversight to mitigate strategic, reputation, compliance, and transaction risk posed by third parties.

[87] The ALJ accuses Enforcement Counsel of misrepresenting the text of OCC Bulletin 2001-47 when it paraphrased this line. RD 97. Enforcement Counsel did not convey a materially different meaning in its paraphrase which was not in quotation marks or otherwise represented as the actual text of the guidance. EC's Post-Hearing Brief at 71. In at least two other places in the brief, Enforcement Counsel accurately quoted the passage. EC's Post-Hearing Brief at 13-14, 97.

the standards for prudent management of a payment processing business are rooted in the guidance articulated in the published supervisory guidance discussed above.[88]

As discussed above, evidence exists in the record that Respondent knew or should have known of the applicability of published guidance to the new line of business he developed for the Bank. Evidence exists that Adams, however, disregarded or failed to give proper consideration to the regulatory guidance and the risks of which he was aware or should have been aware and instead recklessly entered the RCC business with insufficient due diligence, account monitoring and reserves, and complaint monitoring and response policies, procedures, and systems in place. The evidence referenced above could support the conclusion that Respondent engaged in unsafe or unsound practices forming a pattern of misconduct despite warnings from Compliance Officer Bermingham and other Bank staff as well as the OCC's Examiners that greater efforts were required to mitigate the risks associated with the RCC business. Based on the record therefore, under the correct legal standards set forth in this opinion, a fact finder could conclude that the evidence supported imposition of a Second Tier civil money penalty against Adams.

[88] *See supra* pp. 63-66.

CONCLUSION

For the foregoing reasons, the legal standards recommended by the ALJ are rejected. The Comptroller states above the correct legal standards applicable in this case with respect to the meaning of unsafe or unsound practices and a violation of law under 12 U.S.C. § 1818(b) and § 1818(i)(2) and with respect to the deference due to the testimony of national bank examiners. The Comptroller declines to remand the case to the ALJ for new findings of fact and imposition of penalties for the reasons stated above. The charges against Patrick Adams are dismissed.

IT IS SO ORDERED, this 30th day of September, 2014.

/s/ Thomas J. Curry
THOMAS J. CURRY
COMPTROLLER OF THE CURRENCY