TO: Board of Directors

FROM: Sandra L. Thompson
Director
Division of Supervision and Consumer Protection

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SUBJECT: Final Amendments to the Guidelines for Appeals of Material Supervisory Determinations

EXECUTIVE SUMMARY

This is a recommendation that the Board adopt final amendments to the Guidelines for Appeals of Material Supervisory Determinations to better align the FDIC's Supervisory Appeals Review Committee (SARC) process with the material supervisory determinations appeals procedures at the other Federal banking agencies. The recommended final amendments would modify the supervisory determinations eligible for appeal to eliminate the ability of an FDIC-supervised institution to file an appeal with the SARC with respect to determinations or the facts and circumstances underlying a recommended or pending formal enforcement-related action or decision, including the initiation of an investigation and the referral to the Attorney General or a notice to the Secretary of Housing and Urban Development for apparent violations of the Equal Credit Opportunity Act or the Fair Housing Act. The recommended final amendments also include limited technical amendments. The revised Guidelines would become effective upon adoption.

RECOMMENDATION

The Division of Supervision and Consumer Protection and the Legal Division recommend that the Board of Directors adopt the recommended final amendments and authorize publication of the attached Notice of Guidelines in the *Federal Register*.

BACKGROUND

Section 309(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 (Pub. L. 103-325, 108 Stat, 2160) (Riegle Act), required the FDIC (as well as the other Federal banking agencies and the National Credit Union Administration Board (NCUA)) to establish an independent intra-agency appellate process to review material supervisory determinations. The Riegle Act defines the term "independent appellate process" to mean a review by an agency official who does not directly or indirectly report to the agency official who made the material

supervisory determination under review. In the appeals process, the FDIC is required to ensure that (1) an appeal of a material supervisory determination by an insured depository institution is heard and decided expeditiously; and (2) appropriate safeguards exist for protecting appellants from retaliation by agency examiners.

The term "material supervisory determinations" is defined in the Riegle Act to include determinations relating to: (1) Examination ratings; (2) the adequacy of loan loss reserve provisions; and (3) loan classifications on loans that are significant to an institution. The Riegle Act specifically excludes from the definition of "material supervisory determinations" a decision to appoint a conservator or receiver for an insured depository institution or to take prompt corrective action pursuant to section 38 of the Federal Deposit Insurance Act (FDI Act), 12 U.S.C. 1831o. Finally, Section 309(g) (12 U.S.C. 4806(g)) expressly provides that the Riegle Act's requirement to establish an appeals process shall not affect the authority of the Federal banking agencies to take enforcement or supervisory actions against an institution.

On May 27, 2008, the FDIC published in the Federal Register, for a 60-day comment period, a notice and request for comments respecting the proposed revisions to the Guidelines for Appeals of Material Supervisory Determinations. (73 *Fed. Reg.* 30393). The comment period closed July 28, 2008. The FDIC received a total of five comment letters from one depository institution (Monitor Bank, Big Prairie, Ohio); three banking associations (Wisconsin Bankers Association, American Bankers Association, and the Independent Community Bankers of America); and Ronald R. Glancz, Esq., Venable, LLP, on behalf of interested clients, all of whom opposed the proposed revisions. The following is a discussion of the revised Guidelines and the comments received.

Comments Filed

A comment was filed by Monitor Bank, Big Prairie, Ohio (Monitor). Monitor opposes the proposed amendments. Stating that there "needs to be an effective and non-biased appeals process for banks," Monitor concludes that the proposal "to further reduce the … ability, to appeal FDIC supervisory determinations is completely over-reaching, and should not be enacted into law."

The Wisconsin Bankers Association (WBA) also opposes the proposed amendments. The WBA believes that the FDIC's original decision to allow appeals of underlying determinations was the correct interpretation of the Riegle Act and "helps assure banks of fundamental fairness and due process in connection with material supervisory determinations made by the FDIC." The WBA asserts that "there is no requirement under the Riegle Act that the FDIC march in lock step with the other Federal Banking Agencies regarding the appeals process," and that the proposed amendments are unnecessary and would "remove one of the few efficient opportunities available to banks for an independent review of those underlying facts and circumstances that exist at the time of an examination."

The American Bankers Association (ABA) opposes the proposed amendments while advocating an increased role for the FDIC Ombudsman in the appeals process. The ABA states that "independent review of the underlying facts, circumstances, and determinations is necessary to

preserve the integrity of the regulatory system and perceived fairness of the process while maintaining a necessary level of accountability." The ABA believes that "the proposed changes would reduce opportunities to resolve issues in a constructive manner at a time of increasing need for such opportunities." "It will diminish the utility of appeals processes and force more disputes to be resolved through an adversarial enforcement process." The ABA also advocates creation of an appeals process that would "vest the FDIC Ombudsman with more authority to resolve disputes through comparatively quick and inexpensive informal appeals."

The Independent Community Bankers of America (ICBA) likewise opposes the proposed changes and argues for an increased role for the FDIC Ombudsman. The ICBA supports an FDIC appeals process that is "generally unrestricted in scope," so long as "the appellate process does not get overloaded or interfere with the FDIC's ability to bring formal or informal enforcement actions." The ICBA believes that the FDIC has failed to justify the proposed changes and argues that the proposed changes would "unnecessarily restrict and complicate the SARC process and further discourage bankers from filing appeals." The ICBA recommends that the FDIC consider ways to further involve the FDIC Ombudsman in the SARC appeals process which "would make the process more impartial and user friendly, and could encourage banks to pursue appeals."

Mr. Glancz opposes the proposed changes advocating retention of the current system as "expeditious review of specific material supervisory determinations does not conflict with the FDIC's authority to pursue any enforcement action." He argues that the SARC appeal process may enable the FDIC to discover that a proposed enforcement action is based on flawed information. He contends that precluding the SARC appeal process while the FDIC pursues an enforcement action, can burden a supervised bank with erroneous findings or incorrect downgrades that may cause the bank significant financial harm. Finally, Mr. Glancz asserts that the proposed changes are not needed, the current process works well and the industry needs more opportunities for informal review.

Response to Comments

The commenters uniformly expressed support for an independent review of underlying facts, circumstances, and determinations, and that there needs to be "an effective and non-biased appeals procedure for banks." We believe that the numerous informal exchanges of views between banks and the FDIC in the supervisory process prior to pursuit of any enforcement action, plus the numerous reviews of proposed enforcement actions prior to their initiation ensure the independent and impartial review advocated by the commenters. In addition, the administrative hearing process, including final decision-making by the FDIC Board of Directors, and the right to court review of final enforcement orders have uniformly been found to provide all required due process.

The Monitor comment states that "making changes based on the anti-bank mentality of other agencies should never be grounds for the FDIC to further reduce the rights of the banks it supervises," and the WBA noted that the FDIC is not required to "march in lock step" with the other banking agencies. The interpretation of the Riegle Act requirements by the other agencies is not being used to support a reduction in rights of FDIC-supervised banks, but rather supports

the conclusion that the Riegle Act never required review of determinations underlying formal enforcement-related actions in the first instance. In the absence of such a requirement, substantial uniformity among the various banking agencies promoting equal treatment of all banks and thrifts appealing material supervisory determinations is a desirable goal which is served by the amendments proposed herein.

Proposals for an increased role for the FDIC Ombudsman in the supervisory appeals process have been advanced by several organizations, including the ABA and ICBA here, for a number of years. These proposals have been considered and have been consistently rejected by the FDIC because a decisional role for the Ombudsman would potentially conflict with the Ombudsman's statutory mandate as an independent liaison with aggrieved institutions. Given this, and that this portion of the comments in substance suggest an alternative to the SARC procedures, the recommended change is not warranted.

Recommended Final Amendments

A. Amendment of Determinations Eligible for Review

Determinations underlying enforcement actions, including the citation of apparent violations of law or regulation, have been appealable under the FDIC's Guidelines since their adoption in 1995. The final amendments to the Guidelines eliminate the ability of an FDIC-supervised institution to file an appeal with the SARC with respect to determinations or the facts and circumstances underlying recommended or pending formal enforcement-related actions or decisions, including the initiation of a formal investigation and the referral to the Attorney General or a notice to the Secretary of Housing and Urban Development for apparent violations of the Equal Credit Opportunity Act or the Fair Housing Act. The proposed amendments to the Guidelines satisfy the requirements of the Riegle Act and better align the FDIC's material supervisory determination appeals procedures with those of the other Federal banking agencies.

B. Independent Review Requirement

Section 309(a) of the Riegle Act required the FDIC to establish an appellate process to review material supervisory determinations. The SARC must make its decision based on "facts of record," which are limited to the Report of Examination, the FDIC-supervised institution's appeal, an FDIC staff response, and, in some cases, a brief oral presentation before the SARC. The SARC appeals process does not involve any further factual development through discovery.

Decisions to proceed with a formal enforcement action, on the other hand, must be supported by facts demonstrating both the existence of the violation at issue as well as facts that satisfy all of the required elements of the enforcement action to be pursued. All FDIC formal enforcement actions are reviewed by a number of high-level FDIC officials both prior and subsequent to their initiation.

Ultimately, the FDIC Board of Directors (the Board) decides the outcome of any contested enforcement action and that decision is fully supported by a factual record compiled through investigation, discovery, and an administrative hearing held before an impartial administrative

law judge who makes findings of fact, conclusions of law and recommends a decision to the Board.

The FDIC's current procedures for initiating formal enforcement actions ensure review of material supervisory determinations by impartial, high-level FDIC officials. Thus, there is no legal requirement or other need for determinations underlying formal enforcement-related actions to be separately reviewable by the SARC. The commenters uniformly expressed support for an independent review of underlying facts, circumstances, and determinations, and that there needs to be "an effective and non-biased appeals procedure for banks." We believe that the numerous informal exchanges of views between banks and the FDIC in the supervisory process prior to pursuit of any enforcement action, plus the numerous reviews of proposed enforcement actions prior to their initiation ensure the independent and impartial review advocated by the commenters. In addition, the administrative hearing process and the right to court review of final enforcement orders have uniformly been found to provide all required due process.

C. Parity With Other Federal Agencies

As previously noted, the Riegle Act required all of the Federal banking agencies and the NCUA to establish appellate processes to review material supervisory determinations. While the various appellate processes adopted by the Federal banking agencies differ in substance and procedure, no Federal banking agency, other than the FDIC, expressly allows review of determinations that underlie formal enforcement actions.

OCC Bulletin 2002-9, National Bank Appeals Procedures (February 25, 2002) (OCC Guidelines), exempts from its definition of appealable matters "any formal enforcement-related actions or decisions, including decisions to: (a) seek the issuance of a formal agreement or cease and desist order, or the assessment of a civil money penalty pursuant to Section 8 of the [FDI Act] . . . and (d) commence formal investigations pursuant to 12 USC 481, 1818(n) and 1820(c)[.]" Additionally, the OCC Guidelines define the term "formal enforcement-related actions or decisions" as including "the underlying facts that form the basis of a recommended or pending formal enforcement action, the acts or practices that are subject of a pending formal enforcement action, and OCC determinations regarding compliance with an existing formal enforcement action."

The supervisory determinations that may be reviewed on appeal by the OTS, as defined by Thrift Bulletin TB 68a (June 10, 2004), do not include decisions relating to "formal enforcement-related action" such as "[i]nitiating a formal investigation[,]" "[f]iling a notice of charges[,]" and "[a]ssessing civil money penalties."

During the adoption of its internal appeals process, the Board of Governors of the Federal Reserve System (Federal Reserve) specifically rejected a suggestion received through comment that institutions consenting to the issuance of a formal enforcement action, such as a cease and desist order, be allowed to use the internal appeals process to challenge the material supervisory determinations that led to the enforcement action. The Federal Reserve found this suggestion to be inconsistent with the intent of the Riegle Act, which was to "provide an avenue for the review

of material supervisory determinations and not contest enforcement actions for which an alternative appeals mechanism exits." (60 *Fed. Reg.* 16472, March 30, 1995).

The NCUA limits the type of determinations eligible for review under its appeals process to the specific determinations expressly stated in the Riegle Act. (60 *Fed. Reg.* 14795, March 20, 1995).

D. Notice of Enforcement-Related Action or Decision

At present, only the OCC's Guidelines explicitly provide that a decision to pursue a formal enforcement action will cut off rights to file a material supervisory determination appeal. In this regard, OCC Bulletin 2002-9 states that a formal enforcement-related action or decision "commences when a Supervision Review Committee determines that the OCC will pursue a formal action," at which time the matter becomes unappealable. The OCC has Supervision Review Committees at both the Regional and Washington offices with delegations of authority to initiate different types of formal enforcement actions. The FDIC structure of enforcement matter decision-making is different, generally vesting authority to initiate formal enforcement actions in designated DSC officials, after Legal Division reviews, and in some cases following oversight by the Case Review Committee in Washington.

The essence of the OCC's cut-off point is that a decision has been made by appropriately authorized officials that a formal enforcement action will be pursued. In order to mirror the cut-off point as closely as possible, the proposed amendments establish the FDIC's cut-off point as the date when "the FDIC initiates a formal investigation … or provides written notice to the bank indicating its intention to pursue available formal enforcement remedies …, including written notice of a referral to the Attorney General or a notice to the Secretary of Housing and Urban Development for apparent violations of the Equal Credit Opportunity Act or the Fair Housing Act."[1] Operational procedures will be established that provide that when an FDIC official with authority to initiate a formal enforcement action decides that the facts and circumstances then known warrant initiation of such action, a letter to the bank will be sent notifying the bank of the decision to pursue formal action. Such notice will render the underlying facts and circumstances that form the basis of the enforcement action unappealable.

E. Additional Technical Amendments

Paragraph C of the Guidelines (Institutions Eligible to Appeal) stated that the Guidelines apply to insured depository institutions that the FDIC supervises "(i.e., insured State nonmember banks (except District banks) and insured branches of foreign banks)." The 2004 District of Columbia Omnibus Authorization Act, Pub. L. No. 108-386, § 8, extended to the FDIC regulatory and

[1] When the OCC determines that there is reason to believe an instance or pattern or practice of discrimination exists that will result in either a referral to the Department of Justice or notification to the Department of Housing and Urban Development, the appropriate senior deputy comptroller will provide written notice to the bank of this finding. National banks may file an appeal to the ombudsman for reconsideration of this decision within 15 calendar days of the date of this letter.

supervisory authority over District of Columbia banks. Consequently, the parenthetical "except District banks" has been stricken from Paragraph C of the Guidelines.

Paragraph D of the Guidelines (Determinations Subject to Appeal), at subsection (b), permitted the appeal of "EDP ratings." The current equivalent is "IT ratings," and the substitution is made in Paragraph D.

Paragraph G of the Guidelines (Appeal to the SARC) provided that the Director of the Division of Supervision and Consumer Protection may, with the approval of the SARC Chairperson, transfer a request for review directly to the SARC if the Director determines that the institution is entitled to relief that the Director lacks delegated authority to grant. This provision expedites the SARC process by eliminating the need for the Division Director to deny relief to an institution to enable it to file its appeal to the SARC. In order to further facilitate the prompt resolution of requests for review, a mechanism through which the Division Director may seek guidance from the SARC Chairperson has been added to Paragraph G. The addition to Paragraph G reads: "The Division Director may also request guidance from the SARC Chairperson as to procedural or other questions relating to any request for review."

Paragraph N of the Guidelines (Publication of Decisions) provided that SARC decisions will be published, and that published decisions will be redacted to avoid disclosure of exempt information. Because there are circumstances where no amount of redaction of the full-text SARC decision would be sufficient to prevent improper disclosure, while at the same time providing a meaningful statement of what was decided, Paragraph N has been revised to state that: "In cases where redaction is deemed to be insufficient to prevent improper disclosure, published decisions may be presented in summary form."

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