Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990
Division of Risk Management Supervision

October 3, 2017

TO: Board of Directors

FROM: Doreen R. Eberley
Director
[redacted]

SUBJECT: Modifications to the Statement of Policy for Section 19 of the Federal Deposit Insurance (FDI) Act

EXECUTIVE SUMMARY

The Division of Risk Management Supervision (RMS) recommends that the Board of Directors (Board) amend the Statement of Policy for Section 19 of the Federal Deposit Insurance Act (SOP) to modify the criteria that defines *de minimis* offenses, to clarify existing statements, and to remove outdated references to the Office of Thrift Supervision (OTS).

The recommended modifications are incorporated into the proposed revised SOP, attached as Exhibit A (redline format) and Exhibit B (clean format), and are described more fully in this memorandum. In addition, RMS recommends that the Board authorize the Executive Secretary to publish the notice in the Federal Register, attached as Exhibit C, which describes the modifications in detail. Staff recommends publishing the proposed changes in the Federal Register for solicitation of public comment prior to issuance of a final amendment by the Board of Directors. The Legal Division (Legal) has determined that solicitation of public comment is not required under the Administrative Procedure Act.[1] However, staff recommends seeking public comment because the proposed revisions are considered substantive. By seeking public comment, the FDIC can consider the views of the industry and other interested parties about the functionality of the proposed revisions. The proposed modifications provide carefully measured changes to the SOP that will reduce regulatory burden, promote public awareness of the law, and decrease the number covered offenses that will require an application.

Concur:

[redacted]
Charles Yi
General Counsel

[1] 5 U.S.C. § 553(b)(A).

Section 19 of the FDI Act, 12 U.S.C. §1829(a)(1)(A) (Section 19), prohibits, without the prior written consent of the FDIC, a person convicted of any criminal offense involving dishonesty or breach of trust or money laundering (covered offenses), or who has entered into a pretrial diversion or similar program in connection with a prosecution for such offense (program entry), from becoming or continuing as an institution-affiliated party (IAP), owning or controlling, directly or indirectly, an insured institution, or otherwise participating, directly or indirectly, in the conduct of the affairs of an insured institution. Further, the law forbids an insured institution from permitting such a person to engage in any conduct or to continue any relationship prohibited by Section 19. It also imposes a ten-year ban against the FDIC's consent for a person convicted of certain crimes enumerated in Title 18 of the United States Code, absent a motion by the FDIC and approval by the sentencing court.

The FDIC originally promulgated the SOP in 1998 to replace and supersede prior guidelines regarding Section 19. The SOP created a category of covered offenses that the FDIC would deem to be *de minimis* due to the minor nature of the offenses and the low risk that the covered party would pose to an insured institution. For such *de minimis* offenses, approval under Section 19 is automatically granted, and an application is not required. Under the SOP as it was issued in 1998, a covered offense is considered *de minimis* if it meets the following criteria:

- There is only one conviction or program entry of record for a covered offense;
- The offense was punishable by imprisonment for a term of ***less than one year*** and/or a fine of ***less than $1,000***, and the individual did not serve jail time [emphasis added];
- The conviction or program was entered at least five years prior to the date an application would otherwise be required; and
- The offense did not involve an insured depository institution or insured credit union.

Since it was promulgated in 1998, the SOP has been amended on three occasions. In 2007, a clarification to the SOP was issued based on an amendment to the statute that addressed IAPs participating in the affairs of bank holding companies and savings and loan holding companies. More substantive revisions were made in 2011 and 2012, as described below, to provide clarification and interpretation of the SOP and to further expand the *de minimis* criteria.

2011 Amendment

On May 13, 2011, the SOP was updated to clarify certain aspects of the SOP that had caused confusion in its interpretation involving: (i) the applicability of Section 19 on bank and thrift holding company IAPs, (ii) the term "complete expungement," and (iii) the factors for considering *de minimis* offenses. The 2011 amendment clarified the *de minimis* offense criteria by clarifying the existing maximum potential imprisonment and the maximum potential fine to read as follows:

- The offense was punishable by imprisonment for a term of ***one year or less*** and/or a fine of ***$1,000 or less***, and the individual did not serve time in jail. [emphasis added]

An additional amendment to the *de minimis* provisions was also necessary because many had interpreted the SOP to exclude from qualification as *de minimis* any conviction or program entry based on the writing of "bad" or insufficient funds check(s) because checks, by nature, typically "involve an insured depository institution or insured credit union." The amendment established that the *de minimis* offense exception applies if there is only one conviction for issuing "bad" or insufficient funds check(s) based on one or more checks with an aggregate face value of $1,000 or less, and no insured financial institution or insured credit union was a payee on any of the checks.

2012 Amendment

The SOP was amended again on December 18, 2012, to modify the *de minimis* offense criteria to reduce the number of Section 19 applications and regulatory burden. The amendment was prompted by a surge in Section 19 applications, including a large number of individual waiver applications where the filing did not meet one of the *de minimis* factors regarding the maximum potential fine or the jail time served. Staff performed research and analyzed the laws of numerous states and discovered that fines for minor infractions can often be up to $2,500. In addition, analysis of the recent applications identified numerous cases where minimal, actual jail time was included as part of the sentence. However, such minimal jail time was not a significant factor in the FDIC's consideration of the application.

Staff focused on amending the *de minimis* criteria to include more situations where an application was likely to be approved. As a result, the Board of Directors modified the language regarding potential fine and imprisonment by raising the maximum fine from "$1,000 or less" to "$2,500 or less" and by increasing allowable actual jail time from zero days to "three days or less" in connection with the covered offense. These changes were the only material modifications to the *de minimis* criteria in the 2012 amendment.

ANALYSIS OF PROPOSED CHANGE

Since the issuance of the 2012 amended SOP, staff continues to approve a substantial portion of applications where: (1) the crime is relatively minor, (2) the covered offenses have occurred when the individuals were young adults, and (3) reasonable time has passed without additional covered offenses. The FDIC has also received numerous inquiries from members of Congress and from various consumer advocacy groups that are critical of the application process and law's dragnet that catches a number of minor offenses in perpetuity. In response to these concerns and supported by careful analysis, staff recommends expanding the *de minimis* criteria in the SOP to apply to additional low-risk cases that, in our experience, present a high likelihood of approval. In addition, further clarifications are necessary to update the SOP for outdated references.

To assess potential modifications, staff performed research and analyzed a sample of 155 Section 19 waiver applications processed by the FDIC from January 2012 to December 2016. In analyzing these cases, staff identified a subset of low-risk cases that fall into three general categories: (1) "bad" or insufficient funds checks (bad checks) of moderate aggregate value; (2) small dollar, simple theft; and (3) isolated, minor offenses committed by young adults. Staff believes that carefully measured changes to the SOP with regard to these three factors are

appropriate. Our analysis indicates that the proposed revisions would result in a reduction by approximately 28 percent the number of applications required.

Insufficient Funds Checks

The first proposed revision to the *de minimis* criteria is to revise the existing bad checks provisions. Staff has experienced applications involving bad checks where individuals have been convicted on multiple accounts, one conviction for each bad check, all in a single court appearance. Such instance would not qualify as *de minimis* because there is more than one covered offense. Staff has also experienced comparable situations that qualify for the *de minimis* exception because, although the offense involved multiple bad checks, there was a single conviction covering all bad checks that were issued by the individual. The difference between these situations appears inconsequential. In staff's experience of processing cases involving bad checks, we have recognized that most of these cases are the result of inadequate management of the account rather than an intentional bad act.

To compensate for disparate treatment of similar circumstances and to exclude additional low risk offenses, staff recommends revising the SOP to consider as *de minimis* convictions and program entries for bad checks as long as the aggregate total face value of the bad check(s) cited across all conviction(s) is $1,000 or less and as long as an insured depository institution or credit union was not a payee on the check(s). In addition, because we would classify this type of conviction as one that, in most cases, is the result of error rather than a deliberate act, the proposed revision would eliminate the five-year waiting period to qualify for the *de minimis* exception that is normally required for rehabilitation. The revision would allow multiple bad check offenses to be *de minimis* while maintaining the existing dollar threshold to discern the more egregious activities, which would require an application. Based on our analysis, staff estimates that adoption of the proposed bad checks provisions would reduce by 12 percent the number of applications required.

Small Dollar, Simple Theft

The second proposed revision to the *de minimis* criteria is to add a new category that allows certain small dollar theft offenses to qualify as *de minimis*. Theft is indisputably a crime of dishonesty. However, staff has experienced cases where a single instance of simple theft below a small dollar threshold represent a relatively low risk and generally results in approval of an application following a reasonable period of rehabilitation. The proposed revision would include as *de minimis* a single conviction or program entry for simple theft of goods, services, currency, or monetary instruments where the amount involved was $500 or less, provided there is no other covered offense and where it has been five years since the conviction or program entry (30 months in the case of an individual age 21 or younger – see next section). This category would eliminate the application of the imprisonment and/or fine criteria used as part of the general *de minimis* exception to filing based on the amount of the theft. In defining the term "simple theft" the SOP would exclude burglary, forgery, robbery, embezzlement, identity theft, and fraud. Based on our analysis, staff estimates that adoption of this small dollar, simple theft provision would reduce by nine percent the number of applications required.

Isolated, Minor Offenses Committed by Young Adults

The third proposed revision to the *de minimis* criteria is to add a new category to provide exceptions for an isolated and minor covered offense committed by an individual during early adulthood. Staff has experienced numerous applications that otherwise meet the *de minimis* criteria except that five years has not elapsed since the date of the conviction or program entry. Further, a considerable number of the offenses have occurred when the applicants were young adults, and that single offense is precluding their employment by an insured institution at a stage of life when they may be attempting to start long-term careers. The proposed revision would reduce the *de minimis* waiting period by 50 percent, from 60 months to 30 months, if the individual was 21 years or younger at the time of the conviction or program entry. Staff does not recommend completely eliminating the waiting period altogether because it is a positive factor for rehabilitation. Based on our analysis, staff estimates that adoption of these provisions would reduce by seven percent the number of applications required.

Additional Clarifying Revisions

In addition to the proposed revisions of the *de minimis* criteria, staff recommends that the Board update the SOP to remove outdated references to the former OTS and to further clarify various aspects of the SOP.

The SOP currently states that all convictions for offenses involving the illegal manufacture, sale, distribution of, or trafficking in controlled substances shall require an application. Among many of the applications that staff has processed and approved include charges involving an individual's possession of a controlled substance in sufficient volume to imply intent to distribute the drug and, therefore, would require an application under the SOP's existing language. Staff recommends clarifying that such offenses may also be deemed automatically approved and not require an application if the *de minimis* criteria are met.

Guidance previously published by the FDIC has reminded the banking industry that insured institutions' applications for employment, background check programs, and hiring practices must comply with Section 19 and that insured institutions cannot employ an individual subject to Section 19, even if an application is pending with the FDIC. Staff is aware that this may preclude an institution from considering qualified applicants in such situations. As a compromise and as a means of providing guidance, staff recommends that clarifying language be inserted into the SOP stating that insured institutions may extend a conditional offer of employment contingent on the completion of a background check, provided that the job applicant may not begin employment until the insured institution has determined the applicant is not barred under Section 19.

Finally, staff recommends that the Board take the opportunity to make revisions to further define and explain key terms and concepts and to better match the SOP's evaluation criteria to that which the Section 19 requires. Experience has shown that applicants have had difficulty interpreting certain aspects of the SOP. Staff recommends making revisions to address the following matters: (1) conditions that constitute a complete expungement, (2) treatment of pretrial diversion or similar program, (3) other types of restrictions treated as jail time, (4)

requirements to complete all sentencing or program provisions before an application will be accepted, and (5) violations of sections of Title 18 set out in 12 U.S.C. §1829(a)(2) that cannot qualify as *de minimis*.

Recommendation

In summary, staff believes that adjusting the *de minimis* exceptions appears reasonable. By expanding the *de minimis* criteria as proposed herein, the FDIC can provide immediate relief to individuals who represent a low-risk to the Deposit Insurance Fund (DIF) and who would otherwise be required under Section 19 to file waiver applications that would likely be approved under existing policy. Based on our analysis, the proposed changes would not have altered the outcome of any applications that were controversial or ultimately denied. Staff believes that the proposed changes will not impair the integrity of Section 19 or cause undue threat to the DIF. These modifications to the existing SOP are beyond clarifications or technical changes. Therefore, staff recommends publishing the proposed changes in the Federal Register for solicitation of public comment prior to issuance of a final amendment by the Board of Directors.

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