



Federal Deposit Insurance Corporation

550 17th Street NW, Washington, D.C. 20429-9990

Division of Risk Management Supervision

July 3, 2018

TO: Board of Directors

FROM: Doreen R. Eberley
Director

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Act (SOP) to modify the criteria that defines *de minimis* offenses, to clarify existing statements, and to remove outdated references to the Office of Thrift Supervision (OTS). Section 19 generally prohibits persons convicted of certain crimes from participating in the affairs of an insured depository institution.

In December 2017, the Board authorized the Executive Secretary to publish 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) determined that solicitation of public comment was not required under the Administrative Procedure Act.¹ However, the proposed revisions are considered substantive, and by seeking public comment, the FDIC is able to consider the views of the industry and other interested parties. The proposal was published in the January 8, 2018, Federal Register public notice, and the 60-day comment period ended on March 9, 2018.

After careful consideration of the comments received, staff recommends some additional amendments. 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 and the proposed Federal Register notice, attached as Exhibit C. The proposed modifications provide carefully measured changes to the SOP while preserving the purpose of the law that will reduce regulatory burden, promote public awareness of the law, and decrease the number of covered offenses that will require an application. Staff recommends that the Board approve the proposed revisions to the SOP and authorize the General Counsel and Executive Secretary to take such other actions and issue such other documents related to the foregoing as they deem necessary or appropriate to fully carry out the Board's objectives in connection with this matter.

Concur:

Charles Yi
General Counsel

¹ 5 U.S.C. § 553(b)(A).

BACKGROUND

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 granting 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 covered offense for issuing “bad” or insufficient funds check(s) based on one or more checks with an aggregate face value of \$1,000 or less, provided that no insured financial institution or insured credit union was a payee on any of the checks and at least five years has passed since the conviction or program entry.

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 application filings and regulatory burden. The amendment was prompted by a surge in Section 19 applications, including a large number of individual waiver applications for which 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 approved a modification of the language regarding potential fine and imprisonment to raise 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.

OPPORTUNITIES FOR FURTHER REVISIONS

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 the law’s dragnet that catches a number of minor offenses in perpetuity. In response to these concerns and supported by careful analysis, staff proposed to the Board, in December 2017, expanding the *de minimis* criteria in the SOP to apply to additional low-risk cases that, based on experience, present a high likelihood of approval. In addition, further clarifications were proposed to update the SOP for outdated references.

To assess potential modifications, staff performed research and analyzed a sample of 155 Section 19 individual 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.

ANALYSIS OF PROPOSED CHANGES AND PUBLIC COMMENTS

At its December 2017 meeting, the Board approved seeking public comment on staff's proposed revisions to the SOP. The notice was published in the January 8, 2018 Federal Register, and the 60-day comment period ended on March 9, 2018. The FDIC received seven comment letters from various sources, including an individual, an insured bank, depository institution trade groups, advocacy groups, and a legal aid services organization. All comments received were generally supportive of the proposed changes in the SOP. Three commenters did not suggest any additional changes or modifications, while the remaining four commenters suggested a number of additional clarifications or modifications. After careful consideration of all comments, staff recommends that the Board adopt the revisions to the SOP as proposed in the public notice with certain additional clarifications and with the further expansion of two aspects of the *de minimis* criteria, further described herein. Staff analysis indicates that the proposed revisions, including additional modifications proposed after considering public comments, would result in a reduction of over 30 percent in the number of applications required.

Insufficient Funds Checks

The public notice proposed expanding the *de minimis* criteria by revising the existing bad checks provisions. The revision was prompted by staff's experience with applications involving bad checks for which individuals have been convicted on multiple counts, 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. Staff considers the difference between these situations to be inconsequential. In staff's experience of processing cases involving bad checks, 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, the FDIC sought public comment on a proposed revision to 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 checks cited across all convictions is \$1,000 or less and as long as an insured depository institution or credit union was not a payee on any checks. In addition, because the FDIC 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.

Public comments received were in favor of adopting the expanded bad check *de minimis* criteria. Staff recommends that the Board adopt the amendment as proposed.

Small Dollar, Simple Theft

The public notice also proposed expanding the *de minimis* criteria by adding 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 represents a relatively low risk and generally results in approval of an application following a reasonable period of rehabilitation. The public notice proposed to 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 at least five years has passed since the conviction or program entry (30 months in the case of an individual age 21 or younger – see next section). This category eliminates the application of the imprisonment and/or fine criteria used as part of the general *de minimis* exception to filing. In defining the term “simple theft” the proposed SOP excludes burglary, forgery, robbery, embezzlement, identity theft, and fraud.

Public comments received were in favor of adopting this new category of the *de minimis* exception to filing an application. After further internal review, staff recognized that this provision, as proposed, is inconsistent with other *de minimis* criteria in that it does not exclude offenses that resulted in a loss to an insured depository institution or insured credit union. Staff recommends that the Board adopt the revision as proposed with the additional restriction that an offense committed against an insured depository institution or insured credit union will not qualify as *de minimis*.

Isolated, Minor Offenses Committed by Young Adults

The public notice proposed expanding the *de minimis* criteria by adding 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 public notice proposed reducing 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 did not recommend completely eliminating the waiting period altogether because it is a positive factor for rehabilitation.

Public comments received were generally in favor of adopting this new category of the *de minimis* exception to filing an application. After further internal review, staff recommends an additional change to the proposed provision, which would slightly expand its scope. As proposed in the public notice, the offense would be *de minimis* if the conviction or program entry date occurred when the applicant was age 21 years or younger. Staff has determined that the age of the individual on the date of the offense is more relevant than the age on the date of conviction or program entry in that the conviction or program entry often occurs several months following the offense date. Accordingly, staff recommends that the Board adopt the proposed age-based *de minimis* criteria with the additional amendment that, where all of the elements of a covered offense occurred at the age of 21 or younger, the covered offense will be considered *de minimis* if the conviction or program entry occurred 30 months or more before an application would otherwise be required.

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Fake, False, or Altered IDs to Purchase Alcohol

After consideration of public comments, staff recommends one additional covered offense be added to the *de minimis* exceptions to filing an application. One commenter recommended that all offenses for the use of false identification be considered *de minimis*. Although staff does not recommend extending an exception as far as the commenter suggested, staff recommends that the Board adopt as a *de minimis* offense a conviction or program entry based on the use of “fake,” “false,” or “altered” identification by an underage person for the purpose of purchasing alcohol or entering a drinking establishment, provided that the person has no other conviction or program entry for a crime covered under Section 19.

Additional Technical Revisions

In addition to revisions of the *de minimis* criteria, the public notice proposed various technical updates to the SOP to remove outdated references to the former OTS and to further clarify various aspects of the SOP. Furthermore, after considering comments received, some additional clarifications and modifications appear warranted.

Drug-Related Crimes

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. 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. The public notice included proposed changes to the SOP clarifying that such offenses may also be deemed automatically approved and not require an application if the *de minimis* criteria are met.

Commenters viewed this clarification favorably, but some requested that the SOP go further and completely exempt drug-related crimes from the definition of a covered offense. Staff does not recommend accepting this recommendation.

Conditional Offers of Employment

The statement of policy 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, the public notice proposed that clarifying language be inserted into the SOP stating that FDIC-supervised 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.

Commenters viewed this clarification favorably, but some requested that the SOP go further by requiring all insured institutions to adopt the practice of making conditional offers of employment *prior* to conducting a background check into the applicant’s prior arrests,

convictions, or program entries. Staff recommends that the Board not adopt the commenters' suggestion for several reasons. The law does not grant the FDIC authority to impose such conditions on insured institutions, and the FDIC does not have supervisory authority over insured institutions for which it is not the primary federal regulator. Imposition of such a requirement would require changes to the regulation that cannot be accomplished through a statement of policy.

Clarification of Other Key Terms and Provisions

Finally, the public notice proposed revisions to further define and explain key terms and concepts and to better match the SOP's evaluation criteria to that required by Section 19. Experience has shown that applicants have had difficulty interpreting certain aspects of the SOP. Public comment was sought on proposed revisions to address the following matters: (1) conditions that constitute a complete expungement, (2) treatment of program entries, (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*.

Commenters were supportive of these proposed revisions, although some suggested that the FDIC be more liberal in its treatment of complete expungements and program entries. For various reasons explained in the proposed Federal Register notice, attached as Exhibit C, staff does not recommend adopting several of the commenters' suggestions to treat all expungements as complete and to treat program entries the same as complete expungements. Notwithstanding, in considering these comments, staff recommends that the proposed language in the SOP be altered to help clarify and more carefully focus on the type of expungement that should be excluded as a covered offense under Section 19.

Commenters also expressed concern over the proposed definition of "jail time" as it pertains to the *de minimis* factors. The public notice proposed to define "jail time" to include any significant restraint on an individual's freedom of movement, which includes, as part of the restriction, confinement where the person may leave temporarily only to perform specific functions or during specified times periods or both. In reviewing the comments, staff agrees that this definition is too broad and recommends that the Board adjust the language to reflect that the confinement is to a specific facility or building on a continuous basis where the person may leave temporarily only to perform specific functions or during specified times periods or both. It is not intended to apply to those on probation or parole who may be restricted to a particular jurisdiction or who must report occasionally to an individual or to a specified location.

In addition to those described above, further clerical edits to the SOP and explanations of commenters' suggestions that staff does not recommend be adopted are contained in the proposed Federal Register notice, attached as Exhibit C.

RECOMMENDATION

In summary, staff believes that adjusting the *de minimis* exceptions is appropriate. 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), as well as to insured depository institutions, and who would otherwise be required under Section 19 to file waiver applications

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that would likely be approved under existing practice. Based on staff 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. Although staff does not recommend accepting all suggestions received from public commenters, the comments received from various stakeholders, including an insured depository institution, industry trade groups, and advocacy groups, were generally in favor of the Board's proposal. Staff recommends that the Board of Directors approve the proposed revisions to the SOP, as detailed in the attachments, and authorize the Executive Secretary to publish the final amended SOP in the Federal Register and to authorize the General Counsel and Executive Secretary to make technical, non-substantive, or conforming changes to the attached Federal register notice and Statement of Policy, and to take such other actions and issue such other documents related to the foregoing as they deem necessary or appropriate to fully carry out the Board's objectives in connection with this matter.

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