FDIC
Federal Deposit Insurance Corporation
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August 14, 2020

MEMORANDUM TO: The Board of Directors

FROM: Nicholas J. Podsiadly
General Counse

SUBJECT: Notice and Request for Comment - Guidelines for Appeals of Material Supervisory Determinations

Recommendation

Staff recommends that the Board of Directors (Board) adopt the attached Notice and Request for Comment (Notice) and authorize its publication in the *Federal Register*. Through this Notice, the FDIC would propose to establish an independent office that would generally replace the existing Supervision Appeals Review Committee (SARC) and to modify the procedures and timeframes for considering formal enforcement-related decisions through the supervisory appeals process.

Background

Section 309(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 (Riegle Act) required each of the federal banking agencies to establish an independent intra-agency appellate process to review material supervisory determinations (MSDs).[1] To satisfy this requirement, the Board established the SARC and adopted *Guidelines for Appeals of Material Supervisory Determinations* (*Guidelines*) governing the appellate process. The Board has periodically amended the Guidelines, often through notice and comment.

Under the FDIC's current supervisory appeals process, institutions are encouraged to make good-faith efforts to resolve disagreements with examiners and/or the appropriate FDIC Regional Office. If these efforts are not successful, the institution may submit a request for review with the appropriate Division Director, who issues a written decision. If the institution is not satisfied with the Division Director's decision, it may appeal that decision to the SARC, a standing Board-level committee that is authorized to decide supervisory appeals.

In 2019, the FDIC decided to explore potential improvements to the supervisory appeals process. As part of this process, the FDIC's Office of the Ombudsman hosted a Webinar and in-person listening sessions in each FDIC Region regarding the agency's supervisory appeals and dispute resolution processes. The sessions offered bankers and other interested parties an opportunity to provide input and recommendations regarding the supervisory appeals process.

Among other topics, session participants focused on the composition of the SARC and opportunities to further enhance the independence of the appeals process. Participants offered a

[1] 12 U.S.C. § 4806(a).

range of suggestions, including adding an individual who is not otherwise affiliated with the FDIC to the SARC, such as a retired banking attorney or a former Federal or State bank regulator. Certain challenges were also discussed with respect to adding an individual who is not affiliated with the FDIC, such as ensuring the confidentiality of information and the avoidance of conflicts of interest. Participants also raised questions concerning the timeframes for appeals and the types of matters that may be appealed if the FDIC pursues a formal enforcement action. These discussions indicated that the procedures that apply to supervisory appeals when the FDIC has provided notice of a written or proposed enforcement action may be a source of confusion to bankers.

Staff is proposing amendments to the *Guidelines* that are intended to address these issues. Specifically, the proposal would: (1) generally replace the existing SARC with an independent, standalone office within the FDIC that is authorized to review and resolve supervisory appeals; and (2) modify the procedures and timeframes that apply to appeals of MSDs relating to formal enforcement-related actions through the supervisory appeals process.

Proposed Office of Supervisory Appeals

The proposal would replace the SARC with an independent, standalone office within the FDIC, known as the Office of Supervisory Appeals (Office). The Office would report directly to the FDIC Chairperson's Office and would have delegated authority to independently consider and resolve intra-agency supervisory appeals. The Office would be fully independent of the Divisions that have authority to issue MSDs (*i.e.*, the Division of Risk Management Supervision, the Division of Depositor and Consumer Protection, and the Division of Complex Institution Supervision and Resolution), while still operating within the FDIC.

Under the proposed amendments to the Guidelines, the Office would be devoted to executing the FDIC's supervisory appeals functions, including reviewing appeals and issuing decisions. The Office would be staffed by individuals with bank supervisory or examination experience (for example, retired bank examiners). These reviewing officials would be employees of the FDIC and may serve on staggered terms. To promote the independence of the Office, staff anticipates that the FDIC would recruit externally and employ reviewing officials on a part-time or intermittent, time-limited basis. It is possible that reviewing officials for incoming appeals would be selected from a pool on a case-by-case basis. As employees of the FDIC, reviewing officials would be cleared for potential conflicts of interest and would be subject to the FDIC's normal requirements for confidentiality.

Under the proposed appellate process, the FDIC would continue to encourage institutions to make good-faith efforts to resolve disagreements with examiners and/or the appropriate Regional Office. If these efforts are not successful, the institution could submit a request for review to the Division Director. Upon receiving a request for review, the Division Director would have the option of issuing a written decision or sending the appeal directly to the Office. Institutions that disagree with a decision made by the Division Director could submit an appeal to the Office.

If an appeal is submitted to the Office, it would be considered by a three-member panel that would issue a written decision to the institution. The institution, the relevant Division Director, and the Ombudsman would be permitted to submit views to the review panel. The Legal Division would provide counsel to the Office. Oral presentation would be permitted if a request is made by the institution or by FDIC staff.

The panel would review appeals for consistency with the policies, practices, and mission of the FDIC and the overall reasonableness of, and the support offered for, the positions advanced, consistent with the existing standard of review for the SARC. The scope of the panel's review would be limited to the facts and circumstances as they existed prior to, or at the time the MSD was made, even if later discovered, and no consideration would be given to any facts or circumstances that occur or corrective action taken after the determination was made. The Office's role would not be to set policy, as this is the province of the Board and its designees. For that reason, the Office would not consider aspects of an appeal that seek to change or modify FDIC policy or rules. Additionally, if an institution has multiple appeals pending based upon similar facts and circumstances, those appeals could be consolidated for expediency.

Consistent with the existing *Guidelines* and the Riegle Act, decisions to appoint a conservator or receiver for an insured depository institution would not be considered material supervisory determinations. Under this proposal, the *Guidelines* would further clarify that decisions made in furtherance of the resolution or receivership process or planning (such as decisions made pursuant to Parts 370, 371, and 381, and section 360.10 of the FDIC's rules and regulations) also would not be considered material supervisory determinations. Unlike the "material supervisory determinations" enumerated in the statute and the current *Guidelines*,[2] decisions made under the regulatory provisions identified above are not focused on monitoring for and addressing issues that may affect an institution's condition. Instead, these decisions involve actions related to assessing or promoting the resolvability of certain institutions, such as those facilitating the prompt payment of deposit insurance to a large number of depositors or the orderly resolution of an institution with a portfolio of qualified financial contracts.

The proposed structure could provide several advantages in comparison with the existing supervisory appeals process. A standalone office within the FDIC staffed by professionals serving term or other non-permanent appointments could operate independently, and without perceived conflicts of interest, in the FDIC's organizational structure. Establishing the Office within the FDIC would continue to protect supervisory and confidential information, and avoid actual and perceived conflicts of interest, while still satisfying the FDIC's statutory requirement to have an intra-agency appeals process. The proposed structure also would be scalable in terms of staffing, so the Office may be in a position to adapt more quickly to cyclical workload variations, allowing the FDIC to handle varying numbers of appeals in shorter periods of time.

[2] The Riegle Act defined "material supervisory determinations" to include determinations relating to examination ratings, the adequacy of loan loss reserve provisions, and loan classifications on loans that are significant to an institution. 12 U.S.C. § 4806(f)(1)(A). Section D of the current *Guidelines* defines "material supervisory determinations" more broadly to include seventeen different types of supervisory determinations.

Proposed Amendments Relating to Enforcement Actions

The proposal also would amend the procedures and timeframes that apply to appeals of MSDs relating to formal enforcement-related actions or decisions. The FDIC typically identifies the facts and circumstances that may give rise to a formal enforcement action during the examination process, and these facts and circumstances are described in a Report of Examination that is transmitted to the institution at the conclusion of the examination. Once a formal enforcement action commences, the MSDs and the underlying facts and circumstances that form the basis for the enforcement action generally cannot be appealed through the supervisory appeals process; instead, institutions may contest such MSDs through the administrative enforcement process.

In July 2017, the FDIC revised the *Guidelines* to provide an opportunity for institutions to appeal certain MSDs underlying formal enforcement actions through the supervisory appeals process.[3] Specifically, the *Guidelines* provide that if the FDIC does not commence a formal enforcement action within 120 days after giving written notice to an institution of a recommended or proposed formal enforcement action, the institution may appeal the facts and circumstances underlying the formal enforcement action to the SARC, unless the SARC Chairperson agrees to extend the 120-day period. This permits the SARC to consider an institution's appeal of an MSD if there are delays in the formal enforcement action process.

While the 2017 amendments to the Guidelines may have been helpful in addressing some of the issues encountered in administering the supervisory appeals process, staff believes that further changes to the process may be beneficial. Consistent with feedback obtained through the 2019 listening sessions, staff has observed some confusion as to when determinations underlying formal enforcement-related actions become appealable. In addition, a timeframe longer than 120 days may be necessary in order to fully review the facts and circumstances that may lead to formal enforcement actions, to ensure that such actions are not brought prematurely, and to allow sufficient time for an institution to consider and execute a consent order.

The proposal would clarify that, for purposes of the supervisory appeals process, a formal enforcement-related action commences – and appeal rights become generally unavailable – when the FDIC initiates a formal investigation, issues a notice of charges (or notice of assessment, as applicable), provides an institution with a draft consent order, or otherwise provides written notice stating that the FDIC is reviewing the relevant facts and circumstances to determine whether a formal enforcement action is merited. This written notification may be provided in the transmittal letter that accompanies the Report of Examination.

The proposal would further require that if the FDIC provides written notice that the FDIC is determining whether a formal enforcement action is merited, the FDIC must provide the institution a draft consent order within 120 days of the date on which notice was given. Such a draft consent order could include a standalone cease and desist order, an order to pay civil money penalties, or an order for restitution. If the FDIC fails to provide the institution a draft consent order within this 120-day period, supervisory appeal rights would be made available.

[3] 82 FR 34522 (July 25, 2017).

Once the FDIC provides an institution with a draft consent order, the parties would have an opportunity to negotiate the details of a potential settlement. The proposal would not impose a fixed time limit on such negotiations. At any time, if the institution believes that further negotiations would not be productive and notifies the Division of this decision in writing, the Division would have 90 days from receiving the institution's rejection of the consent order to issue a notice of charges (or assessment) or to open an order of investigation, or the institution's supervisory appeal rights would be made available. In either case, once supervisory appeal rights are made available, the institution would have 60 days to file an appeal, consistent with the standard timeline for appealing material supervisory determinations. If the institution agrees to the consent order, then the matter would be resolved and the need for an appeal would be obviated.

Conclusion

Staff recommends that the Board adopt the attached Notice and authorize its publication in the *Federal Register* with a comment period ending on October 20, 2020.

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