



Federal Deposit Insurance Corporation

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

Division of Supervision and Consumer Protection

October 5, 2007

TO: Board of Directors

FROM: Sandra L. Thompson
Director

SUBJECT: Amendments to FDIC Rules and Regulations Relating to Suspension, Removal, and Prohibition in the Case of Certain Criminal Offenses and Rules and Regulations Applicable to Proceedings Relating to Cease-and-Desist Orders

EXECUTIVE SUMMARY

Section 8(g) of the Federal Deposit Insurance Act (FDI Act) authorizes the FDIC to temporarily suspend or permanently remove an institution-affiliated party (IAP) from office when that person has been charged with or convicted of certain crimes. Section 708 of the Financial Services Regulatory Relief Act of 2006 (FSRRA) modified Section 8(g) in a number of ways that require technical and conforming amendments to the FDIC rules and regulations. The most significant amendment to Section 8(g) clarifies that the appropriate Federal banking agency may suspend or prohibit an IAP charged with or convicted of certain crimes from participation in the affairs of any depository institution. The changes to Section 8(g) became effective October 13, 2006.

Section 702 of FSRRA also added a new Section 50 to the FDI Act which authorizes the FDIC to enforce written conditions and written agreements without regard to the unjust enrichment or reckless disregard requirements of Section 8(b)(6). The addition of Section 50 requires technical amendment to the Section 8(b) procedural regulations at 12 C.F.R. 308.127.

The proposed revisions to the FDIC rules and regulations do not require a general notice of proposed rulemaking under Section 553(b) of Title 5 of the United States Code because the final rule contains only clarifications and technical changes intended to bring the agency's rules into conformity with statutory changes. Therefore, public notice and comment are not necessary.

Concur:

Sara A. Kelsey
General Counsel

RECOMMENDATION

The Division of Supervision and Consumer Protection requests that the Board of Directors authorize publication of the attached Final Rule in the *Federal Register* to implement the necessary technical and conforming amendments to the FDIC's rules and regulations due to the recent changes in Section 8(g) and the addition of Section 50 to the FDI Act.

BACKGROUND

Section 8(g)

Section 8(g) of the FDI Act granted the Federal banking agencies the authority to suspend an institution-affiliated party (IAP) from office or to prohibit that individual from participating in the conduct of the institution's affairs if such party is: (1) charged in any information, indictment or complaint with the commission of or participation in a crime involving dishonesty or breach of trust which is punishable by imprisonment for a term exceeding one year under State or Federal law; and (2) if continued service by the individual may pose a threat to the interests of the bank's depositors or may threaten to impair public confidence in the bank. Section 8(g) also includes provisions to permanently remove the IAP if he or she is convicted of the crime.

Section 708 of FSRRA made various modifications to Section 8(g) of the FDI Act to clarify the extent of the suspension, removal and prohibition authority of the Federal banking agencies in cases of certain crimes by IAPs. Most significantly, Section 708 amended Section 8(g) to clarify that the appropriate Federal banking agency may suspend or prohibit an IAP from participation in the affairs of any depository institution.

On August 9, 1991, the FDIC issued a final rule entitled "Rules of Practice and Procedure." Subpart N of that rule created Sections 308.161 through 308.164 of the FDIC Rules and Regulations, which prescribe the FDIC's procedures for implementing Section 8(g). Since much of the language of Section 8(g) is repeated in the FDIC's implementing regulations, numerous conforming amendments of the regulations are required. In addition to the conforming amendments, a few minor changes to the regulations are suggested strictly to standardize references contained in the various sections and to make the hearing procedures easier to understand.

Section 50

Section 702 of FSRRA added a new Section 50 to the FDI Act, 12 U.S.C. § 1831aa, providing that the FDIC may enforce conditions imposed in writing in connection with any action on any application, notice or other request concerning the depository institution and any written agreement entered into between the agency and the depository institution or institution-affiliated party without regard to the unjust enrichment or reckless disregard requirements of Section 8(b)(6). In enacting the new Section 50, Congress intended to legislatively overturn decisions of the District of Columbia Court of Appeals in *Wachtel v. Office of Thrift Supervision*, 982 F.2d 581 (D.C. Cir. 1993) and *Rapaport v. U.S. Dept. of Treasury, Office of Thrift Supervision*, 59

F.3d 212 (D.C. Cir. 1995), requiring findings of unjust enrichment or reckless disregard before net worth maintenance agreements could be enforced under Section 8(b).

On August 9, 1991, the FDIC issued a final rule entitled “Rules of Practice and Procedure.” This rule contained a subpart G, entitled “Rules and Procedures Applicable to Proceedings Relating to Cease-and-Desist Orders” which included Section 308.127, entitled “Scope.” The final rule would amend Section 308.127(a) in both the heading and at the end, to reference the new Section 50 of the FDI Act.

ANALYSIS OF PROPOSED CHANGES

Section 8(g)

Predicate Offense

The FSRRA changed the predicate offense description in Section 8(g) from “[w]hensoever any institution-affiliated party is charged in any information, indictment, or complaint, with the commission of or participation in ...” to “is the subject of any information, indictment, or complaint, involving the commission of or participation in ...” The language in the final rule mirrors this change. This amendment would allow the Federal banking agencies to suspend or remove an individual who becomes involved in the affairs of an insured depository institution after being charged with a covered crime, as it makes little sense that a person could be removed when charged with a crime while serving but could not be removed if he becomes affiliated after indictment for the same crime.

Required Findings

The FSRRA revised the required findings for suspension under Section 8(g) from “if continued service or participation by such party may pose a threat to the interests of the depository institution’s depositors or may threaten to impair public confidence in the depository institution” to “if continued service or participation by such party posed, poses, or may pose a threat to the interests of the depositors of, or threatened, threatens, or may threaten to impair public confidence in, any relevant depository institution.” The term “relevant depository institution” is defined in a new subsection (E) to Section 8(g) to mean any depository institution of which the party was an IAP at the time the information, indictment, complaint, suspension notice, or order of prohibition is issued. The final rule conforms to this revised language, which is viewed favorably. Although untested at this point, the law now allows the Federal banking agencies to prove that the IAP posed a threat at the time of the misconduct rather than proving that the individual “may pose” a threat in the future. For example, an officer that embezzled considerable sums from a bank clearly posed a threat to the interests of the depositors at the time of the embezzlement. Whether that same person continues to pose a threat could be subject to debate – due to rehabilitation, improvement in internal controls, etc. Finally, the use of the past-tense “posed” or “threatened” resolves uncertainty as to whether Section 8(g) applies if the institution no longer exists.

Scope of Suspension or Prohibition

The FSRRA amended the scope of the prohibition detailed in Section 8(g) from “further participation in any manner in the conduct of the affairs of the depository institution” to “any depository institution.” Although only a single-word amendment, this change marks a significant improvement in the regulation. The appropriate Federal banking agency may suspend or prohibit individuals who are the subject of criminal proceedings involving certain crimes from participation in the affairs of any depository institution, not just the depository institution with which the IAP is or was associated. Conforming amendments are included in the final rule.

Corrected Cross Reference

Section 308.163(b)(2) currently states, “An order of removal or prohibition shall be entered if a judgment of conviction is entered against the individual for a crime described in Section 308.161(a)(ii).” Section 308.161(a)(ii) does not exist. The final rule corrects this cross reference from 308.161(a)(ii) to 308.161(a)(2). This change is not the result of the FSRRA.

Notice of Hearing

Section 308.163(a)(2) currently states, “The written notice of suspension shall: (i) Inform the institution-affiliated party that a written request for a hearing, stating the relief desired and grounds therefore, and any supporting evidence, may be filed ...” The content of this section is moved to a new Section 308.163(c) in the proposed rule to make it clear that there is a right to a hearing regarding both notices of suspension and prohibition and orders of removal and prohibition. This change is not the result of the FSRRA, but conforms to existing practice.

Hearing Procedures

Section 308.164 of the final rule clarifies the FDIC’s hearing procedures. References to the party filing the request for hearing are changed from the “applicant” to the “institution-affiliated party.” Although not specified in Section 8(g) of the FDI Act, Section 308.164(c) currently states that the “applicant or the bank” may waive a hearing. The proposed rule eliminates the bank’s ability to waive a hearing since the suspension or prohibition primarily impacts the institution-affiliated party, who should be able to have a hearing on the issues if so desired. Subsections (d) and (e) are amended to make it clear that there is a right to a hearing regarding both notices of suspension and prohibition and orders of removal and prohibition. These changes are not the result of the FSRRA, but conform to existing practice.

Section 50

Reference

Section 308.127(a) would be amended, in both the heading and at the end, to cross-reference the new Section 50 of the FDI Act.

Staff Contacts

Division of Supervision and Consumer Protection:

Brett McCallister

Review Examiner

(816) 234-8099 Ext. 4223

Legal Division:

Richard A. Bogue

Counsel

(202) 898-3726

Jose A Romanach

Senior Attorney

(972) 761-2620