

March 20, 2008

**TO:** Board of Directors

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

Sara A. Kelsey  
General Counsel

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

## **EXECUTIVE SUMMARY**

This is a proposal that the Board approve publication of recommended 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 proposed 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 formal enforcement-related action or decision, including the initiation of an investigation. The proposed amendments also include limited technical amendments.

## **RECOMMENDATION**

The Division of Supervision and Consumer Protection and the Legal Division request that the Board of Directors authorize publication of the attached Notice and Request for Comment document in the *Federal Register* for a 60-day comment period.

## **BACKGROUND**

Section 309(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 (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 also 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) 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) of the Riegle Act expressly provides that the 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 December 28, 1994, the FDIC published in the Federal Register, for a 30-day comment period, a notice of and request for comments on proposed Guidelines for Appeals of Material Supervisory Determinations (“Guidelines”) (59 *Fed. Reg.* 66965). In these Guidelines, the FDIC proposed that the term “material supervisory determinations,” in addition to the statutory exclusions noted above, also should not include: (1) determinations for which other appeals procedures exist (such as determinations relating to deposit insurance assessment risk classifications); (2) decisions to initiate formal enforcement actions under section 8 of the FDI Act; (3) decisions to initiate informal enforcement actions (such as memoranda of understanding); (4) determinations relating to a violation of a statute or regulation; and (5) any other determinations not specified in the Riegle Act as being eligible for appeal.

Commenters to the proposed Guidelines suggested that the proposed limitations on determinations eligible for appeal were too restrictive. In response to comments received, the FDIC modified the proposed Guidelines to provide that although determinations to take prompt corrective action or initiate formal or informal enforcement actions are not appealable, the determinations upon which such actions may be based are appealable provided they otherwise qualify. On March 21, 1995, the FDIC’s Board of Directors adopted the proposed Guidelines. (60 *Fed. Reg.* 15923). The Guidelines were modified in 2004 to change the composition and procedures of the SARC (69 *Fed. Reg.* 41479). The revised Guidelines were disseminated to FDIC-supervised financial institutions through a Financial Institution Letter, FIL-113-2004, issued October 13, 2004.

## **ANALYSIS OF PROPOSED CHANGES**

### ***I. Amendment of Determinations Eligible for Review***

Determinations underlying enforcement actions, such as the citation of apparent violations of law or regulation, have been appealable under the FDIC’s Guidelines since their enactment in 1995. Recent appeals by FDIC-supervised institutions have, however, highlighted a situation where an appeal to the SARC is inconsistent with the intent of the Riegle Act that “the appeals process not impair, in any way, the agencies’ litigation or enforcement authority.” (Senate Report No. 103-

169). Accordingly, amendments to the Guidelines are proposed 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 formal enforcement-related action or decision, including the initiation of a formal investigation. Such amendments would satisfy all Riegle Act requirements while also better aligning FDIC material supervisory determination appeals procedures with those of the other Federal banking agencies.

#### ***A. 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, sometimes, a brief oral presentation before the SARC. The SARC appeals process does not involve any further factual development through investigation or 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. The ability to initiate (through issuance of a notice or stipulated order) routine cease-and-desist actions under section 8(b) of the FDI Act has for more than a decade been delegated to FDIC Regional Directors. Decisions to initiate enforcement actions pursuant to section 8(b) of the FDI Act must be made at the Deputy Regional Director or Regional Director level, following review and concurrence by the Regional Counsel.

All other, non-routine enforcement actions are generally reviewed at the highest levels of the FDIC before issuance. 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 facts, 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 high level FDIC officials. Thus, there is no need for determinations underlying formal enforcement actions to be separately reviewable by the SARC.

#### ***B. Parity With Other Federal Agencies***

As previously noted, section 309(a) of the Riegle Act required each of the Federal banking agencies and the NCUA to establish appellate processes to review material supervisory determinations. The appellate processes adopted by the various agencies differ significantly in substance and procedure. Thus, it is apparent that the Riegle Act contains few absolute requirements, and those absolute requirements do not include appeals of determinations or facts and circumstances underlying formal enforcement actions. Indeed, no Federal bank regulatory agency, other than the FDIC, explicitly allows review of determinations that underlie a formal enforcement action.

OCC Bulletin 2002-9, National Bank Appeals Procedures (February 25, 2002) (OCC Guidelines), which governs the appeals procedure adopted at the OCC, 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, 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 the 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]nitiation of a formal investigation[,]” “[f]iling a notice of charges[,]” and “[a]ssessing civil money penalties.” Both the OCC and the OTS specifically include formal investigations in the definitions of enforcement-related actions excepted from appeal.

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 to contest enforcement actions for which an alternative appeals mechanism exists.” (60 *Fed. Reg.* 16472, March 30, 1995).

The National Credit Union Association (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).

Thus, in addition to satisfying the Riegle Act’s requirement that the Federal banking agencies adopt an independent review process, the proposed amendments would modify the FDIC’s current Guidelines so as to be consistent with the other Federal banking agencies, promoting equal treatment of all banks and thrifts appealing material supervisory determinations.

### ***C. 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 decisionmaking is different, generally vesting authority to initiate formal enforcement

actions in designated DSC officials, in some cases with concurrence requirements and in some cases following oversight by the Case Review Committee in Washington.

The essence of the OCC's cut-off date 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 date as closely as possible, the proposed amendments would establish the FDIC's cut-off date as the date when "the FDIC ... provides written notice to the bank indicating its intention to pursue available formal enforcement remedies ...." Operational procedures will be established to 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.

## *II. Additional Technical Amendments*

Paragraph C of the Guidelines (Institutions Eligible to Appeal) states 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 supervisory authority over District of Columbia banks. Consequently, the parenthetical "except District banks" would be stricken from Paragraph C of the Guidelines.

Paragraph G of the Guidelines (Appeal to the SARC) provides 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 is proposed for Paragraph G. An addition to Paragraph G would read: "The Division Director may also request guidance from the SARC Chairperson as to procedural or other questions relating to any request for review."

### Staff Contacts

Division of Supervision and Consumer Protection:  
Frank Gray  
Section Chief  
(202) 898-3508

Legal Division:  
Richard A. Bogue  
Counsel  
(202) 898-3726