



TO: Board of Directors

FROM: Doreen R. Eberley
Director

SUBJECT: Conversion of the Statement of Policy for Section 19 of the Federal Deposit Insurance Act to a Regulation

SUMMARY

The Division of Risk Management Supervision (RMS) recommends that the Board of Directors (Board) convert the Statement of Policy (SOP) for Section 19 of the Federal Deposit Insurance Act, 12 U.S.C. § 1829 (Section 19), to a regulation and adopt changes to clarify the application process for insured depository institutions and individuals who seek relief from Section 19 and expand the scope of relief available for certain offenses.

The FDIC published a Notice of Proposed Rulemaking (NPR) in the *Federal Register* on December 16, 2019. The NPR proposed to codify the SOP as a regulation and solicited public comments on additional proposals to expand the scope of relief available for certain offenses. The comment period for the NPR closed on March 16, 2020.

Incorporating the SOP into the FDIC's regulations will provide for greater transparency as to the FDIC's interpretation of Section 19, provide greater certainty as to the FDIC's processes regarding Section 19, and aid both insured depository institutions and individuals who may be affected by Section 19 to understand its impact and potentially seek relief from its provisions.

Additionally, staff recommends that several modifications be made to the SOP. The recommended modifications are incorporated into the proposed regulation, attached as Exhibit A, and are described more fully in this memorandum and the proposed *Federal Register* Notice, which is attached as Exhibit B. The proposed modifications reflect carefully measured changes to the SOP that will clarify the FDIC's interpretation of Section 19, reduce regulatory burden on the banking industry and the public, and decrease the number of covered offenses that will require an application. Staff recommends that the Board approve the proposed regulation 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. The existing SOP will be rescinded if and when the proposed regulation is approved.

Concur:

Nicholas Podsiadly
General Counsel

BACKGROUND

Section 19 prohibits, without the prior written consent of the FDIC, any person who has been convicted of a crime of dishonesty, breach of trust, or money laundering, or who has agreed to enter into a pretrial diversion or similar program in connection with a prosecution for such an offense (program entry) (collectively, covered offenses), 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 depository 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 for a person convicted of certain crimes enumerated in Title 18 of the United States Code, which can be removed only upon 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 sets forth the FDIC's standards for implementing Section 19, defines key terms, establishes when an application is required, and specifies which factors the FDIC will evaluate when considering an application. The SOP also created a category of covered offenses that the FDIC would consider *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 deemed automatically granted, and an application is not required.

Since it was promulgated in 1998, the SOP has been amended four times.¹ The Board approved the most recent amendment to the SOP in July 2018, after considering public comments. The 2018 changes to the SOP reduced regulatory burden, promoted public awareness of the law, and expanded the *de minimis* criteria to reduce the number of covered offenses that required an application. Despite these amendments and the regulatory relief they provided, the FDIC continues to receive communications from members of Congress, consumer advocacy groups, and others that criticize the application process and the minor nature of certain offenses captured by the law. For these reasons, the NPR solicited public comment to determine the views of interested parties regarding the proposed regulation.²

ANALYSIS OF PROPOSED REGULATION AND CHANGES BASED ON PUBLIC COMMENTS

Incorporating the SOP into the FDIC's regulations will provide greater transparency and clarity to the banking industry and public regarding the FDIC's Section 19 process. The proposed regulation will not change the way in which the FDIC processes Section 19 applications, but will clarify how the FDIC interprets and applies Section 19 and will expand the scope of offenses for which relief is available. The FDIC sought public comment on this proposed regulation and received nine comment letters from various sources, including one from an individual, three from policy institutes, one from a reentry employment provider, one from a depository institution trade group, two from financial institutions, and one from an advocacy group on behalf of 28 other organizations. One commenter did not suggest any additional changes or modifications,

¹ The SOP was clarified in 2007 and 2011, modified in 2012, and last revised in 2018.

² See 84 Fed. Reg. 68,353 (Dec. 16, 2019).

while the remaining eight commenters suggested several additional clarifications or modifications. In particular, commenters overwhelmingly supported and proposed a general easing of the *de minimis* criteria in the SOP.

After consideration of all comments, staff recommends that the Board approve the conversion of the SOP to a regulation, as proposed in the Notice, with changes regarding how expungements are treated, and with expansion of the *de minimis* criteria as described below. The proposed revisions, which are consistent with prior changes to the SOP approved by the Board, are expected to result in a significant reduction in the number of applications required for minor offenses. Staff analysis of the 199 applications processed from January 1, 2017, through April 30, 2020, indicates that, under the proposed revisions, there would have been over 30 percent fewer applications required.³ Based on this analysis, staff believes that the suggested revisions may reduce *future* applications by as much as 30 percent. Given the variety of factors that affect the number of applications that we receive, however, the Notice keeps our existing Paperwork Reduction Act (PRA)⁴ estimates and announces a plan to revisit them with empirical data when the FDIC conducts its next PRA information-collection renewal.

In response to the comments, staff reviewed the existing SOP criteria to identify areas where additional relief could be granted or additional exceptions added. Based on this review, staff recommends the following changes be incorporated into the regulation.

Expungements

The current SOP notes that a conviction or program entry that has been completely expunged is not subject to Section 19 and does not require an application.⁵ For the expungement to be considered “complete” under the current SOP, the jurisdiction granting the expungement must not allow the conviction or program entry to be used for any subsequent purpose, including but not limited to an evaluation of a person’s fitness or character. This constraint has been a source of confusion for the industry and individual applicants, and the FDIC has twice undertaken to clarify this term in prior SOP revisions. The public comments to the NPR make it clear that the confusion remains.

Six of the nine comments received addressed expungements, with five commenters recommending that the FDIC consider all expungements “complete.” To support this view, commenters highlighted the variance in expungement practices between jurisdictions and the significant ambiguity for applicants and banks that are tasked with interpreting unfamiliar state law. In fact, only a few states and jurisdictions have expungement processes that result in a “complete expungement” under the standards set forth in the current SOP. Staff accordingly believes, after analyzing this issue, that the SOP definition of “complete expungement” may be overly restrictive.

Having considered the public comments, staff recommends that this exclusion be expanded from “complete expungement” to include all expungements. Doing so will provide regulatory relief to

³ The FDIC approved 100 percent of these applications.

⁴ 44 U.S.C. 3501 *et seq.*

⁵ Covered offenses that have been pardoned, and which are not otherwise excluded by the SOP, will still require an application.

certain individuals who are currently required to file an application. Staff review of applications received from January 1, 2017, through April 30, 2020, revealed that approximately 10 percent of applications received had a conviction or program entry that had been expunged but did not meet the SOP standards for “complete expungement.” Of those applications, 100 percent were approved.

De Minimis Requirements

Number of Convictions/Program Entries, and Time Elapsed Since Conviction/Program Entry

Under the current SOP, certain minor offenses are deemed to present low risk to insured institutions. Currently, an individual’s covered offense may be considered *de minimis* only when there is one conviction or program entry, and the conviction or program entry occurred at least five years before the date on which an application would be required. For applicants whose underlying misconduct occurred when they were 21 years of age or younger, the waiting period is reduced to 30 months. Certain individuals may also be required to complete all sentencing or program requirements before qualifying for the *de minimis* exception.

Staff continues to process a number of applications from individuals who are low risk, and these applications are generally approved. Staff review of these applications revealed that many include multiple convictions or program entries for minor offenses, or convictions or program entries that occurred less than 5 years (or 30 months) ago. Because these applications are considered low risk and are generally approved, staff recommends expanding the *de minimis* criteria to include individuals with up to two convictions or program entries, each of which offenses would, by themselves, qualify under the *de minimis* exception.

In addition, staff recommends eliminating the current 5-year (or 30-month) waiting period for when a single covered offense would be considered *de minimis*. Staff also recommends a 3-year waiting period (or 18 months if all underlying misconduct occurred when the individual was 21 or younger) for when two covered offenses can be considered *de minimis*.⁶ Staff review of applications received from January 1, 2017, through April 30, 2020, revealed that, if the changes in this paragraph and the prior paragraph were implemented, approximately 19 percent of applications received would have been considered *de minimis* and would not have required an application. Of those applications, 100 percent were approved.

Small-Dollar, Simple Theft

The small-dollar, simple theft *de minimis* criteria was added to the SOP by the FDIC Board in July 2018. The SOP currently states that a conviction or program entry based on the simple theft of goods, services, or currency (or other monetary instrument) may qualify for the *de minimis* exception if the following conditions apply: the aggregate value of the currency, goods, or services taken was \$500 or less at the time of the conviction or program entry; the person has no other conviction or program entry subject to Section 19; the applicant meets the waiting period requirements described above; and the conviction or program entry was not committed against

⁶ Staff notes that, during the *de minimis* waiting period, individuals retain the option of filing an application for consideration by the FDIC.

an insured financial institution or insured credit union. Simple theft excludes burglary, forgery, robbery, identity theft, and fraud.

Staff continues to process Section 19 applications for convictions or program entries involving small-dollar, simple theft. These covered offenses are relatively low-risk and generally result in approval of an application following a reasonable period of rehabilitation. After analysis of relevant data and consideration of public comments, staff recommends that the Board increase the dollar threshold for small-dollar theft to \$1,000. This increase will reduce the number of low-risk applications that have historically been approved, and will better align this monetary threshold with the limit for “bad” or insufficient funds checks, as some commenters suggested. Staff review of applications received from January 1, 2017, through April 30, 2020, revealed that approximately one percent of applications received would have been considered *de minimis* and not required an application if the changes recommended in this paragraph were implemented. Of those applications, 100 percent were approved.

Fake, False, or Altered Identification

In July 2018, the FDIC Board of Directors approved revisions to the SOP that established additional criteria for the *de minimis* exception concerning the use of a fake, false, or altered form of identification for the purpose of purchasing alcohol or gaining admittance into an establishment where alcohol is served, where there is no other conviction or program entry subject to Section 19.

Staff has considered the public comments and situations in which certain individual applicants might have covered offenses that would not be considered *de minimis* because the underlying statutes do not make reference to alcohol. Staff has further determined that the fake, false, or altered identification provisions can be expanded to provide additional regulatory relief without significantly increasing risk to the financial system. Accordingly, staff recommends that the *de minimis* criteria be expanded to include the use of a fake, false, or altered identification by a person under the age of 21 to circumvent age-based restrictions on purchases, activities, or entry. Staff review of applications received from January 1, 2017, through April 30, 2020, revealed that approximately one percent of applications received would have been considered *de minimis* and not required an application if the changes recommended in this paragraph were implemented. Of those applications, 100 percent were approved.

CLARIFICATION OF OTHER KEY TERMS AND PROVISIONS

The Rule clarifies when and how an application must be filed, the application types available, and how the FDIC will evaluate an application. The Rule also addresses denials of applications. Based on comments received, the FDIC will provide clarification of certain aspects in the application instructions and in the publication *Your Complete Guide to Section 19*, but staff believes the Rule is not the appropriate forum to provide this information.

Exhibit B, which is the proposed *Federal Register* Notice, contains further clerical edits to the proposed regulation, and also provides explanations of those comments that staff does not recommend be adopted.

RECOMMENDATION

In summary, staff believes that incorporating the SOP into the FDIC's regulation is appropriate and will provide for greater transparency and certainty regarding the FDIC's Section 19 processes. The proposed regulation will not impair the integrity of Section 19 and will not increase the risk to the Deposit Insurance Fund (DIF).⁷ In addition, staff believes the proposed changes to the regulation based on comments received will provide immediate relief to individuals who represent a low risk to the DIF, as well as to insured depository institutions, and who would otherwise be required under Section 19 to file waiver applications that would very likely be approved under existing practices. Based on staff analysis, the proposed changes would not have altered the outcome of any applications that were controversial or ultimately denied. Although staff does not recommend accepting all suggestions received from public commenters, the comments received from various stakeholders, including insured depository institutions and advocacy groups, were generally in favor of these proposals.

Staff recommends that the Board approve the proposed conversion of the SOP to a regulation, including incorporating the revisions previously described, and authorize the Executive Secretary to publish the final regulation in the *Federal Register*. Staff also recommends that the Board authorize the General Counsel and Executive Secretary to make technical, non-substantive, or conforming changes to the attached *Federal Register* Notice and regulation, 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.

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⁷ No covered offense may qualify as *de minimis* when committed against an insured depository institution or insured credit union. Moreover, the proposed Rule will clarify that, except for covered offenses involving "bad" or insufficient funds checks, or the use of false identification to circumvent age-based restrictions, no offense will be considered *de minimis* unless all sentencing or program requirements have been completed.