January 4, 2021

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Attention: Comments
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Comment Intake
Bureau of Consumer Financial Protection
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Re: Role of Supervisory Guidance, Notice of Proposed Rulemaking – OCC Docket ID OCC-2020-0005; Board Docket No. R-1725 and RIN 7100-AF96; FDIC RIN 3064-AF40; NCUA Docket ID NCUA–[2020–0098]; CFPB Docket No. CFPB–2020–0033 and RIN 3170–AB02

Dear Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on the proposed rule cited above ("Proposal" or "Release"),[2] issued by the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Board"), the Federal Deposit Insurance Corporation ("FDIC"), the National Credit Union Administration ("NCUA"), and the Bureau of Consumer Financial Protection ("Bureau") (collectively, the "Agencies"). The Agencies issued the Proposal in response to a petition for rulemaking filed by two associations representing the banking industry. It addresses the role of supervisory guidance in the prudential regulation and supervision of the financial institutions under the jurisdiction of the respective Agencies.

The Proposal is creditable insofar as the Agencies wisely rejected a major attempt in the Petition to neuter banking supervision by requiring all supervisory criticism to be based exclusively on violations of laws or rules or "demonstrable" safety and soundness concerns. Unfortunately, however, the provisions that the Agencies chose to ***include*** in the Proposal are unnecessary and potentially damaging to the bank supervision process. They are unnecessary because it is already widely understood that guidance is generally not legally enforceable; they are potentially damaging because the language of the Proposal may lend itself to an interpretation that could eliminate a meaningful role for supervisory guidance as the basis for supervisory criticisms.

Supervisory criticisms, and the guidance that often informs them, are valuable tools that help prevent unsafe or abusive bank conduct from ripening into outright violations of law, dangerous instability, and consumer harm. If finalized and applied in a way that allows for such an interpretation, the Proposal can only make it more difficult for bank supervisors to hold banks—including the largest banks, which can pose a direct threat to financial stability and the economic wellbeing of the public when badly managed—accountable for dangerous practices, poor management, and ineffective oversight by bank boards of directors.

OVERVIEW OF THE PROPOSAL

On September 18, 2018, the Agencies issued an "Interagency Statement Clarifying the Role of Supervisory Guidance" ("2018 Statement").[3] As characterized in the Release, "the 2018 Statement reiterated well-established law by stating that, unlike a law or regulation, supervisory guidance does not have the force and effect of law" and therefore "does not create binding legal obligations."[4]

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[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

[2] 85 Fed. Reg. 15,909 (March 20, 2020).

[3] Release at 70,512.

[4] *Id.*

Shortly thereafter, on November 5, 2018, two of the leading trade associations representing the interests of the banking industry, the Bank Policy Institute and the American Bankers Association ("Petitioners"), filed a petition for rulemaking ("Petition") asking the Agencies to codify the 2018 Statement in a rule.[5] The Petition argued that a rule formally embodying the 2018 Statement was necessary to "bind future agency leadership and staff to the 2018 Statement's terms" and to remove ambiguities in the 2018 Statement regarding the role of supervisory guidance in connection with matters requiring attention ("MRAs") and other supervisory actions and criticisms.

The Agencies granted the Petition and issued the Proposal for comment. The Release explains that the Proposal would clarify the 2018 Statement and codify it in the form of a rule that would supersede the 2018 statement and bind all of the Agencies.[6]

While the Release essentially characterizes the Proposal as merely confirming that the agencies "will continue to follow and respect the limits of administrative law in carrying out their supervisory responsibilities,"[7] the Release and the 2018 Statement appear to go significantly further. For example, the 2018 Statement declared that the agencies would not "criticize" a supervised financial institution, or issue an enforcement action, on the basis of a "violation" or "non-compliance" with supervisory guidance. In other words, the 2018 Statement went beyond merely prohibiting the use of guidance as the basis for an enforcement action and may be interpreted as meaning that deviations from guidance may not even serve as the basis for supervisory criticisms, which are fundamentally distinct from enforcement actions.

Finally, the Release devotes virtually no discussion or analysis of any benefits that could be expected to accrue from the Proposal if it is finalized, either in the form of more effective supervision, greater financial stability, enhanced safety and soundness, or reduced consumer abuse. In reality, the Release may well undermine all of these goals and benefit banks exclusively.

SUMMARY OF COMMENTS

Better Markets strongly supports the Agencies' decision to deny the most dangerous request made in the Petition for rulemaking. The Petitioners urged the Agencies to adopt the extreme position that all forms of supervisory criticism, including MRAs and others, should be based "only on a violation of a statute, regulation, or order." In fact, of course, especially since the 2008 financial crisis, bank supervisors have appropriately based their criticisms on imprudent bank practices that may not yet have ripened into violations of laws or rules but which if left unaddressed could undermine safety and soundness or pose harm to consumers. This prophylactic authority is essential for correcting bank practices before they result in violations of law, dangerous

[5] Release at 70,515.
[6] Release at 70,512; 70,515.
[7] Release at 70,512.

instability, or customer harm, and the Agencies rightly rejected the Petitioners' attempt to eliminate it.

Setting aside this appropriate rejection of an especially dangerous de-regulatory measure, the Proposal remains unwarranted and unwise for several reasons. Most significantly, by codifying the 2018 Statement, the Proposal may undermine the important role that supervisory guidance can play by informing supervisory ***criticism***, rather than merely clarifying that it will not serve as the basis for ***enforcement*** actions. This goes beyond what "well-established" law requires and it furthermore represents dangerous policy.

In addition, the Agencies have failed to justify the Proposal. It is unnecessary to the extent it simply recites well-established principles holding that guidance does not have the force and effect of laws or rules. And it is unwise to the extent it goes further and may constrain the use of guidance as a supervisory tool in connection with criticisms that do not equate with enforcement actions. Moreover, the Release fails to offer any countervailing benefits or show how the Proposal will promote safety and soundness or consumer protection, nor could it credibly do so.

Unfortunately, the Proposal will have another subtler but still powerful and negative impact by sending a signal to banks that supervision in general will be more constrained and by affording banks wider discretion to simply ignore supervisory guidance. Even the possibility of such an outcome argues against the issuance of this rule. In short, the Release—which is part of a broader and sustained de-regulatory effort under the Trump Administration[8]—will weaken the supervision of banks, including the largest and most systemically important institutions that recent history has shown can cause or exacerbate a financial crisis with devastating consequences.

Rather than seeking to undermine the supervision of banks by weakening the important role of supervisory guidance, the Agencies should instead be devoting their resources to enacting rules that facilitate enforcement with meaningful consequences when large banks fail to meet appropriately high standards and engage in conduct that puts the financial system, economy, and public at risk. Strong and enforceable rules are especially necessary to promote consumer protection, increase banks' financial resilience, and facilitate the orderly resolution of large banks should that become necessary.[9]

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[8] For an analysis of the broad deregulatory push during the Trump administration, *see* Better Markets, *Road to Recovery: Protecting Main Street from President Trump's Dangerous Deregulation of Wall Street, available at* https://bettermarkets.com/sites/default/files/documents/BetterMarkets_Road_To_Recovery_Sept_15_2020.pdf; *see also* Better Markets, *Federal Reserve Actions Under the Trump Administration Have Significantly Weakened Post-Crisis Banking Protection Rules, available at* https://bettermarkets.com/sites/default/files/Better_Markets_WhitePaper_Fed_Actions_Under_Trump_Administration_12-03-2020.pdf.

[9] Currently, key expectations for large bank resolution planning, including for liquidity at material legal entities, are articulated in non-binding supervisory guidance that cannot serve as the basis for enforcement actions. The Federal Reserve and the FDIC should fortify that guidance by

In short, the best course of action would be for the Agencies to withdraw this Proposal in its entirety and rescind the 2018 Statement. At a minimum, the Proposal should clearly state that supervisory guidance can and will be used by supervisors to inform their assessments of banks' practices; that it may be cited as a basis for their criticisms; and that such criticisms can include those found in matters requiring attention, memoranda of understanding, and downgrades to supervisory ratings. Further, to counter any possible increase in the public's perception that "easing the burden on banks" is among their primary goals, the Agencies should publicly and forcefully recommit to holding large banks to the very highest standards and to using their full authority to take actions with meaningful consequences for banks when they fail to meet those standards.

COMMENTS

1. The Agencies should hold firm and continue to reject calls to limit supervisory criticisms to violations of laws or regulations or demonstrable safety and soundness concerns.

Better Markets strongly supports the Agencies' decision to reject a key aspect of the Petitioners' request. Specifically, the Petitioners sought to ensure that supervisory criticisms, such as MRAs and matters requiring immediate attention ("MRIAs"), could only result from circumstances in which a bank had already broken the law or violated a rule, or was already demonstrating significant safety and sounds concerns. Such an approach would effectively sever the link between supervisors' assessments of potentially dangerous practices at banks—which may fall short of breaking the law or violating a rule—and supervisory tools that can motivate timely and meaningful action to remedy such dangerous practices before they inflict significant harm on banks, the financial system, or consumers. Those tools include potential downgrades in supervisory ratings and limits on expansionary activities that a bank may wish to pursue.

It is imperative that the Agencies maintain this stance. As noted in the Release, early identification and remediation of emerging sources of potential safety and soundness concerns are critical to ensuring that dangerous practices at banks are addressed ***before*** they become problems that could threaten the collapse of a bank:

> The agencies' examiners all take steps to identify deficient practices before they rise to violations of law or regulation or before they constitute unsafe or unsound banking practices. The agencies continue to believe that early identification of deficient practices serves the interest of the public and of supervised institutions.[10]

Better Markets strongly agrees that such early identification is crucial. Moreover, it is equally important that supervisors have strong regulatory tools at their disposal to ensure banks are motivated to address such dangerous weaknesses. This is an indisputable lesson learned during

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implementing enforceable rules ensuring that firms are affirmatively required to take actions that leave them better prepared to face possible resolution in times of distress.

[10] Release at 70,515.

the financial crisis, which highlighted the dangers of the pre-crisis supervisory approach that quite apparently failed to effectively identify and require banks to address emerging sources of safety and soundness concerns. This is particularly important with respect to large banks, where serious problems may undermine the stability of the financial system, precipitate a broader crisis that can spread harm far beyond the offending banks, and require massive taxpayer-funded support. Waiting until an identified dangerous practice at a large bank has already become a violation of law or a "demonstrable" safety and soundness concern before requiring the bank to fix it would be a dereliction of supervisory responsibility and clearly run counter to the public interest.

Accordingly, if the Agencies choose to proceed with the Proposal and finalize it, they must, at a minimum, hold firm and continue to reject any language stating or implying that supervisory criticisms may only be based on violations of law or regulations that have already commenced or occurred, or on demonstrable current safety and soundness issues. Moreover, in light of misinterpretations of the Proposal discussed below, the Agencies should also affirmatively declare that supervisory criticisms need not be based solely on violations of law or regulations.

2. **The Proposal threatens to undermine effective supervision by weakening guidance as the basis even for criticisms that are entirely separate from enforcement actions.**

Guidance is an important supervisory vehicle through which Agencies articulate, both to supervised entities and their supervisors, expectations about practices that may promote or undermine a bank's safety and soundness, often relying on examples. As explained in the 2018 Statement:

> [S]upervisory guidance outlines the agencies' supervisory expectations or priorities and articulates the agencies' general views regarding appropriate practices for a given subject area. Supervisory guidance often provides examples of practices that the agencies generally consider consistent with safety-and-soundness standards or other applicable laws and regulations, including those designed to protect consumers. Supervised institutions at times request supervisory guidance, and such guidance is important to provide insight to industry, as well as supervisory staff, in a transparent way that helps to ensure consistency in the supervisory approach.[11]

While there can be no literal "violation" of guidance in the context of an enforcement action, since guidance is not legally enforceable, supervisory assessments made by bank examiners should be and often are informed by supervisory guidance and form, at least in part, the basis for supervisory criticisms. This promotes both clarity and consistency of treatment across supervised entities.

However, the 2018 Statement, which the Proposal would codify in a rule, threatens to weaken the role of supervisory guidance as the basis for supervisory criticisms:

[11] 2018 Statement at 1.

> ***Examiners will not criticize*** (through the issuance of matters requiring attention, matters requiring immediate attention, matters requiring board attention, documents of resolution, and supervisory recommendations) ***a supervised financial institution for***, and agencies will not issue an enforcement action *on the basis of,* ***a "violation" of or "non-compliance" with supervisory guidance***.

Release at 70519 (emphasis added). This language could be interpreted by some as removing guidance from the permissible grounds that may inform the basis for any supervisory criticisms, not just enforcement actions. The agencies should eliminate this potential for confusion and misunderstanding by stating clearly that guidance can and will be used to inform, and serve as the basis for, criticisms.

The Agencies' ostensible rationale for this language is to avoid a conflict with the general legal proposition that guidance is not legally enforceable and therefore, as a conceptual matter, cannot be "violated." But to the extent this portion of the Proposal is intended to ensure that guidance is not considered legally enforceable, it is wholly unnecessary. Even under the "well-established law" described in the Release, it is quite permissible for guidance to be used as a set of standards that may indeed inform a criticism, provided that application of the guidance is used for ***corrective*** purposes, not to support an ***enforcement action***. Criticism and enforcement are fundamentally distinct supervisory tools. Enforcement is designed to punish and deter unlawful conduct after the fact, while criticism allows supervisors to identify supervisory concerns and induce changes in bank behavior before those concerns ripen into violations of law or materially unsafe or unsound banking practices. In fact, guidance and the process of supervisory criticism are designed and deployed to ***avoid*** the need for enforcement and punitive sanctions—a supervisory approach that actually benefits banks as well as the public interest in stable and fair credit markets.[12] And none of this suggests that supervisory criticisms have the force and effect of law in the way statutes and rules bind market participants, since they serve as criticisms, not mandates subject to punitive measures for noncompliance. That remains true even if a bank's failure to adjust its conduct in response to criticism leads to regulatory consequences designed to incentivize corrective behavior.

The Release indicates that under the Proposal, examiners may still reference supervisory guidance "to provide ***examples*** of safe and sound conduct, appropriate consumer protection and risk management practices, and other actions for addressing compliance with law or regulations."[13] However, this is too vague and threatens to marginalize the role of guidance to the point that it becomes almost useless in the process of issuing criticisms designed to correct deficient bank practices. Furthermore, placing this limitation on the permissible use of guidance gives banks

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[12] The Release itself recognizes this important distinction. *See* Release at 70515 ("early identification of deficient practices serve the interest of the public . . . ") and n. 12 ("The visitorial powers facilitate early identification of supervisory concerns . . .). Yet the Proposal may remove the ability of supervisors to rely upon guidance when formulating criticisms aimed at preempting dangerous or abusive bank behavior.

[13] Release at 70,515.

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another possible basis on which to challenge supervisory criticisms as unlawful by arguing that supervisors improperly relied on guidance as the justification for the criticism.

This limiting language in the Proposal governing supervisory guidance poses yet another threat. Some commenters have interpreted it to signify the much broader proposition that supervisory criticism in general should only be based on outright violations of rules and laws—a conclusion that the Release elsewhere attempts to dispel, as discussed in Section 1 above. For example, the Independent Bankers Association of Texas has submitted a comment letter claiming that the Proposal "clarifies that regulated financial institutions should only be subject to criticism due to a violation of a law or regulation."[14] Thus, as currently worded, the Proposal may unduly limit the role of supervisory guidance and in addition, may even be invoked to challenge any supervisory criticisms that are not based on violations of laws or rules.

The result of this Proposal will be to make it more difficult for bank supervisors to effectively hold even the very largest banks accountable for dangerous practices, poor management, and ineffective oversight by their boards of directors. This is likely why the requested changes are so strongly desired by the Petitioners acting on behalf of the industry. Indeed, their strong support for certain aspects of the Proposal should be ample evidence to the Agencies that the Petitioners believe the Proposal will undermine the effectiveness of supervision.[15]

If the Agencies insist on finalizing the Proposal, they must correct all of these deficiencies. The Agencies should remove the references to criticisms in the language from the Proposal quoted above, thus limiting that paragraph to the basic proposition that the Agencies will not "issue an ***enforcement*** action" on the basis of supervisory guidance. Furthermore, the Proposal should clearly state that supervisory guidance can and will be used by supervisors to inform their assessments of banks' practices; that it may be cited as a basis for their criticisms; and that such criticisms can include those found in matters requiring attention, memoranda of understanding, and downgrades to supervisory ratings.

3. <u>The agencies fail to justify the Rule in terms of benefits to safety and soundness, consumer protection, or the broader public interest.</u>

As a threshold matter, to the extent the Proposal seeks to formalize the proposition that supervisory guidance itself is not legally enforceable and cannot serve as the basis for any enforcement action, it is unnecessary. That principle of administrative law is widely understood

[14] Independent Bankers Association of Texas, Comment Letter to the Agencies on the Proposal, Nov. 5, 2020.

[15] Both Petitioners have a clear interest in limiting supervision of the financial industry. The BPI represents 41 of the largest banks operating in the United States, and their members collectively make 68% of the nation's loans. Similarly, the ABA represents and advocates for banks of all sizes. *See* Bank Policy Institute Mission Statement, *available at* https://bpi.com/about-us, and American Bankers Association Membership Information, *available at* https://www.aba.com/about-us/membership

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and generally accepted. Accordingly, there is no need to declare the point in guidance, such as the 2018 Statement, nor is there any need to formalize it in a rule. It follows by operation of law, without the assistance of an agency's pronouncements. Thus, the Proposal is largely a solution in search of a problem that does not exist. In reality, it serves as an excuse to promulgate another de-regulatory measure that will undermine banking regulation and supervision, not merely "clarify" the law. The Agencies' time and effort would be better spent seeking to strengthen and enhance regulations, as well as supervisory practices and enforcement mechanisms, rather than on unnecessary and counterproductive rulemaking.[16]

Not surprisingly, the Release lacks any analysis of how it will ***promote*** safety and soundness or consumer protection (which the Release expressly acknowledges as the primary duties of the agencies). The Release cites only the most tangential, speculative, and implausible public benefits, and that is solely in the Bureau's separate analysis. There, the Release notes the hypothetical possibility that greater certainty regarding the legal obligations addressed in supervisory guidance ***may*** result in reduced compliance costs, and that reduced compliance costs for banks ***may*** in turn translate into better terms or better availability of consumer financial products.[17]

Yet there is quite clearly no necessary link between reduced compliance costs (i.e., "reduced regulatory burden") and consumer welfare. Indeed, it is at least as likely that the effect would be simply to increase bank profits by reducing expenditures on practices that make them safer and less likely to harm consumers. Other than this weak argument offered in the Bureau's discussion of "potential benefits and costs," the Release is devoid of any analysis as to how it, or the 2018 Statement which it codifies, would serve the public interest. In reality, as shown above, the Proposal threatens to weaken supervisory tools and accountability by weakening and creating confusion about the appropriate grounds for supervisory criticisms, thus increasing risk and undermining the public interest.

The Agencies are in essence proposing to undermine the effectiveness of banking supervision, including supervision of the largest and most systemically important banks, in a way that clearly runs counter to the public interest, all in pursuit of the socially dubious goal of reducing burdens on banks. Clearly, the principal beneficiaries of the Proposal will be banks, not the broader public. For all of these reasons, the Agencies should abandon the Proposal, or at a minimum, correct its deficiencies as outlined above.

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16 We also note that the legal analysis underpinning the Release is overly simplistic. Although the Release portrays the distinction between guidance and legislative rules as simple and clear, it is in fact a legally complex area of law that has been hotly litigated in the courts and debated among administrative law experts for decades. *See* Ronald M. Levin, *Rulemaking and the Guidance Exemption,* 70 ADMIN. L. REV. 263, 265 (Spring 2018). Even the Release acknowledges as a point of "clarification" that some guidance can indeed form the basis for supervisory criticism if not enforcement. *See* Release at 70,515 n.10.

17 Release at 70,518.

CONCLUSION

We hope you find these comments helpful.

Sincerely,

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