IBC
INTERNATIONAL BANCSHARES
CORPORATION

June 21, 2022

Mr. James P. Sheesley
Assistant Executive Secretary
ATTN: Comments – RIN 3064-ZA-20
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

RE: Comments of International Bancshres Corporation on RIN-3064-ZA20, Guidelines for Appeals of Material Supervisory Determinations

Dear Mr. Feldman:

International Bancshares, a multi-bank financial holding company headquartered in Laredo, Texas, appreciates the opportunity to submit comments in response to the May 20, 2022 Notice and Request for Comment issued by the Federal Deposit Insurance Corporation relating to Guidelines for Appeals of Material Supervisory Determinations, RIN 306.

With over $16 billion in assets, International Bancshares, through its five bank subsidiaries (collectively, "IBC") provides commercial and retail banking services in communities in South, Central, and Southeast Texas and the State of Oklahoma. IBC's flagship bank is International Bank of Commerce — Laredo, which represents the majority of IBC's banking assets. IBC also has four other banks: (i) Commerce Bank, a Texas state banking association located in Laredo, Texas; (ii) International Bank of Commerce, Brownsville, a Texas state banking association located in Brownsville, Texas; (iii) International Bank of Commerce, Zapata, a Texas state banking association located in Zapata, Texas; and (iv) International Bank of Commerce – Oklahoma, an Oklahoma state chartered bank. IBC serves 75 communities throughout Texas and Oklahoma with 167 branches and more than 260 ATMs, and provides full service banking, including seven days a week at some of its locations.

An effective and fair supervisory examination process is vital to the health of the U.S. banking system and bank customers. FDIC examiners have tremendous power over the banks they supervise. In particular, FDIC examiners can issue Material Supervisory Determinations that impose great costs on banks, require significant changes that affect customers, and limit a bank's activities. For the supervisory process to function to the benefit of both banks and their customers, supervised institutions must have access to a fair, efficient, and transparent process for appealing these important determinations. Over the course of many years it

became clear that the FDIC's intra-agency appeal process did not meet these criteria. As a result, in January 2021, after a long process of seeking input from banks and their customers, the FDIC made important changes to its appeal process. While not perfect, the new guidelines that the FDIC promulgated at that time was a step in the right direction. Most significantly, the January 2021 Guidelines established an independent Office of Supervisory Appeals (the "Office"), so that banks could obtain a more independent review of agency actions. In an abrupt about-face, however, and with no prior notice, the FDIC reversed itself last month, disbanded the Office before it even had a chance to do any work, and re-imposed the prior appeals process that it had recognized as inadequate only 16 months earlier.

The FDIC's action in issuing the May 2022 Guidelines was wrong for a number of reasons. First, the FDIC's Notice did not provide a reasoned explanation for its policy change. Second, the FDIC did not follow the appropriate process for making such a significant change. And as a substantive matter, the previously discredited process that the FDIC has now re-imposed does not provide banks the type of "independent" review required by the Riegle Act. Accordingly, the FDIC should rescind the May 2022 Notice and restore the Office. Furthermore, the FDIC should use this episode as an opportunity to initiate a broader process to evaluate the agency appeal process. Specifically, it should commence a new notice-and-comment process to provide an opportunity to consider other ways to bring independence and accountability to the review of Material Supervisory Determinations. Finally, in light of the failure of the appeal process to meet the objectives of the Riegle Act, the FDIC should consider whether legislation may be necessary to ensure that banks have a full and fair opportunity to challenge FDIC actions, enforce bank regulatory accountability, ensure consistent application of the banking laws, and promote efficient operation of the banking system. The FDIC should welcome robust dialogue on these important issues, and we urge it to use this Comment process as a means for doing so.

BACKGROUND

The Riegle Community Development and Regulatory Improvement Act of 1994 (the "Riegle Act") requires Federal banking agencies to establish an "independent intra-agency appellate process" to review material supervisory determinations. From 1995 to 2021, the FDIC purported to satisfy this obligation through its Supervisory Appeals Review Committee ("SARC"), comprised of political appointees to the FDIC Board. Recognizing the flaws in the SARC, most specifically the lack of independence, in September 2020, the FDIC issued "Guidelines for Appeals of Material Supervisory Determinations" which set forth proposed new guidelines and explained the reasons the FDIC determined new guidelines were necessary. *See* Guidelines for Appeals of Material Supervisory

Determinations, 85 Fed. Reg. 54,377 (Sept. 1, 2020) (the "September 2020 Notice"). Notably, the FDIC explained that the proposed new guidelines were based on input from a number of "listening sessions on supervisory appeals and dispute resolution process" that it conducted in 2019. *Id.* at 54,378. The FDIC noted that the "sessions offered bankers and other interested parties an opportunity to provide individual input and recommendations regarding the supervisory appeals process." *Id.* The September 2020 Notice stated, "The FDIC's experience with the SARC, along with feedback obtained through the listening sessions, suggests that there may be opportunities to improve the FDIC's supervisory appeals process, particularly with respect to enhancing the independence of the SARC and the procedures and timeframes that apply to determinations in the context of formal enforcement-related decisions." *Id.*

The guidelines proposed in the September 2020 Notice established a new "Office of Supervisory Appeals" that would replace the SARC. The September 2020 Notice stated that this structure would improve the appeal process because the "Office would be fully independent of those FDIC Divisions with authority to issue material supervisory determinations." *Id.* After explaining how the new Office would function, the September 2020 Notice stated, "The FDIC anticipates that these combined changes could provide several advantages over the existing supervisory appeals process and would address several of the recommendations presented during the Webinar and in-person listening sessions." *Id.* at 54,379. In particular, the FDIC noted, "the supervisory appeals process could operate more independently, and without perceived conflicts of interest." *Id.* The September Notice requested comments from banks and other interested parties regarding the proposed new guidelines.

After receiving and assessing comments submitted in response to the September 2020 Notice, the FDIC issued its final "Guidelines for Appeals of Material Supervisory Determinations" in its January 25, 2021 "Notice of guidelines" (the "January 2021 Notice"). Guidelines for Appeals of Material Supervisory Determinations, 86 Fed. Reg. 6880 (Jan. 25, 2021). The January 2021 Notice promulgated new guidelines (the "January 2021 Guidelines") and explained at length the FDIC's reasons for replacing the prior guidelines and the SARC. The January 2021 Guidelines defined the Office as "an appellate body" that "will make independent supervisory determinations." *Id.* at 6887.

The January 2021 Notice stated that the FDIC "expects that a period of time will be necessary to establish and staff the Office," that the "current Guidelines, which permit appeals of Division Director's decisions to the SARC, will apply until the Office is fully operational," and that it would "publish a notice to inform institutions when this occurs." *Id.* at 6885.

Instead of following through on its commitment to establish the Office and implement the January 2021 Guidelines, the FDIC abruptly reversed course and—with no advance notification or opportunity for the public to comment—rescinded the January 2021 Guidelines. Specifically, on May 20, 2022 the FDIC issued a Notice and request for comment regarding new "Guidelines for Appeals of Material Supervisory Determinations," 87 Fed. Reg. 30,942 (May 20, 2022), (the "May 2022 Notice"). The May 2022 Notice rescinded the January 2021 Notice and Guidelines and issued new guidelines, which reinstated the SARC. Not only did the FDIC eliminate the Office with no public notice or opportunity for comment, the FDIC actually eliminated the office and restored the SARC even before publication of the notice. *See id.* at 30,943 (noting that "[t]hese revised Guidelines took effect on May 17, 2022").

The May 2022 Notice provided no explanation for the FDIC's decision to "restore [the] committee structure" other than unsubstantiated references to "staffing concerns that were inherent in the Office structure and may potentially threaten to hinder the effectiveness of the process going forward." *Id.* at 30,942. In addition to eliminating the Office and restoring the SARC, the FDIC rescinded the restriction on ex parte communications, stating that "a provision limiting communications with supervisory staff is no longer appropriate." *Id.* at 30,943. As for its decision to rescind the January 2021 Guidelines and implement new guidelines with no notice or comment—indeed, even before publication of the Notice—the FDIC stated only that it believes "taking action quickly in this instance minimizes the potential for confusion among insured depository institutions with respect to the process they must follow in the event they wish to appeal a material supervisory determination." *Id.*

DISCUSSION

I. THE FDIC SHOULD RESCIND THE MAY 2022 NOTICE AND REINSTATE THE PROCEDURES ESTABLISHED IN THE JANUARY 2021 NOTICE.

For a number of reasons, the FDIC should rescind the May 2022 Notice and should not return to the SARC process. First, the new guidelines—just like the pre-2021 guidelines that the FDIC recognized as inadequate—do not provide banks an effective intra-agency appeal process. Second, the FDIC failed to provide an adequate explanation for eliminating the January 2021 Guidelines and returning the process it had recently recognized as inadequate. Third, the FDIC did not follow an appropriate process in rescinding the January 2021 Guidelines and issuing new guidelines.

A. The May 2022 Guidelines Do Not Provide Banks An Effective Way to Appeal Material Supervisory Determinations.

The May 2022 Guidelines do not provide banks with an effective intra-agency appeal process, which the FDIC itself recognized when it replaced the SARC with the Office. The ineffectiveness of the SARC as a means to challenge material supervisory determinations is evident in the fact that extremely few banks opted to take advantage of the process. As noted in the May 2022 Notice, "in the fifteen years prior to the establishment of the Office, 51 appeals were submitted to the SARC out of 113,448 examinations." *Id.* at 30,943, n. 7. The situation appears to be getting even worse. In the last three years, the FDIC has issued only *one* appeal decision—and that decision was a mere two pages.

Banks pursued so few appeals with the SARC because they understood that the process did not provide them with an independent review of the FDIC's determinations. The record of wins and losses at the SARC is striking. As noted in one academic article, bank appellants fully prevailed in only two of the 58 decisions issued by the SARC between 2005 and 2012. *See* Julie A. Hill, *When Bank Examiners Get it Wrong: Financial Institution Appeals of Material Supervisory Determinations*, 92 Wash. U. L. Rev. 1101, 1144, 1148-49 (2015). Since that time, the SARC has issued 14 additional appeal decisions, and in all but two of them the SARC ruled against the bank. When banks have a record of four wins against 68 losses, it is difficult to conclude that the process is working as intended.

The FDIC itself recognized, by replacing the SARC process with the Office, that the SARC process was extremely flawed. In promulgating the January 2021 Guidelines, the FDIC itself stated that the objective was "to promote independence." 86 Fed. Reg. at 6882. In essence then, the FDIC acknowledged that that SARC does not provide banks with an independent review.

The SARC appeals process contrasts with the appeals process followed by the Office of the Comptroller of the Currency (the "OCC"). The OCC allows national banks to appeal directly to an independent ombudsman, who "operates independently from the bank supervision process and reports directly to the Comptroller of the Currency." See OCC, Bulletin 2013-15, Bank Appeals Process: Guidance for Bankers (2013).

The elimination of the prohibition on ex parte communications also renders the appeals process less likely to be effective. The January 2021 Notice recognized that allowing the individuals deciding an appeal to discuss the issues presented with the very employees whose actions have been challenged undermines the appeal

process. *See* 86 Fed. Reg. at 6883, 6887. Indeed, prohibiting ex parte communications is a fundamental aspect of rules governing courts and other decision-making bodies. The ex parte rules are designed to ensure that parties receive due process. Whenever a party to a dispute comes before a tribunal, that party is entitled to a fair hearing, which includes equal access to the decision-maker. Even if members of the SARC or the Office act with the best of intent, allowing them to speak with agency employees about an appeal without involving the bank in the discussion undermines confidence in the integrity of the process, and this likely is one of the reasons why banks have so infrequently utilized the FDIC's intra-agency appeals process.

B. The FDIC Did Not Provide An Adequate Explanation For Its Decision to Abandon The Appeal Office and Reinstate the SARC.

The Supreme Court has made clear that an administrative agency like the FDIC "must give adequate reasons for its decisions." *Encino Motorcars, LLC v. Navarro*, 579 U.S. 211, 212 (2016). Specifically, the agency "must examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" *Motor Vehicle Mfrs. Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (citation omitted). The importance of providing clear and rational reasons for an agency decision is even greater when an agency is changing its existing policies. When doing so, the agency must "show that there are good reasons for the new policy." *Encino Motorcars*, 579 U.S. at 221 (citation omitted).

The May 2022 Notice does not provide an adequate explanation for its decision to "restore the SARC as the final level of review of material supervisory determinations," 87 Fed. Reg. at 30,943, devoting a scant two paragraphs to its reasoning.

First, the May 2022 Notice states that "experience suggests that its longstanding practice of providing Board-level review of material supervisory determinations would better promote independence and accountability in the appellate process." *Id.* at 30,942. But the notice does not state what "experience" it is referring to, or how that experience has led the FDIC to conclude that the SARC "better promote[s] independence" when it reached the opposite conclusion a little over a year ago. The May 2022 Notice also states that "allowing material supervisory determinations to be appealed to a Board-level committee underscores the significance of an independent review and lends credibility to the process," but this statement conflicts with the FDIC's prior statement in the September 2020 Notice. *Id.* In that notice, the FDIC indicated "the supervisory appeals process could operate more independently, and without perceived conflicts of interest" if the

SARC were replaced with the independent Office. 85 Fed. Reg. at 54,379. Notably, while the members of the SARC are political appointees, the individual members of the Office established by the January 2021 Guidelines would not be political appointees.

Second, the May 2022 Notice states that the FDIC "believes that restoring the SARC as the final level of review for supervisory appeals will address staffing concerns that were inherent in the Office structure." 87 Fed. Reg. at 30942. In support of this "belief," the notice states only that "experience suggests that it may be challenging to recruit and retain individuals with sufficient expertise and judgment to make final supervisory decisions on behalf of the agency." *Id.* at 30,943. But the notice cites no actual experience in support of this "suggestion," which is not surprising given that the FDIC never allowed the Office to commence operations. Nor does the notice provide any facts or reasoning to support the statement that using "existing staff" for appeals "rather than employees dedicated solely to the appeals function (even on a part-time basis) is also a more cost-effective use of the Deposit Insurance Fund, given the historically infrequent nature of supervisory appeals." *Id.* And, of course, the primary reason for the "historically infrequent nature of supervisory appeals" can be attributed in large part to the fact that banks understood that they were unlikely to get a fair consideration of their appeal from "existing staff."

C. The FDIC Did Not Follow Appropriate Process In Rescinding The January 2021 Guidelines.

In addition to requiring agencies to provide reasons for their decisions, particularly when changing a recently adopted policy, the Administrative Procedure Act (the "APA") requires an agency to follow certain procedures when it issues rules. Section four of the APA generally requires a federal agency to provide public notice and an opportunity for comment on any proposed rule. 5 U.S.C. § 553. The notice and comment requirement applies equally to agency action amending or repealing a prior rule. *See Perez v. Mortg. Bankers Ass'n*, 575 U.S. 92, 101 (2015). As the Supreme Court noted in that decision, "agencies use the same procedures when they amend or repeal a rule as they used to issue the rule in the first instance"). *Id.* at 1206; *see also F.C.C. v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (noting the APA "makes no distinction . . . between initial agency action and subsequent agency action undoing or revising that action"). Here, however, the FDIC did not use the same procedures when it rescinded the January 2021 Guidelines that it used when it adopted those guidelines.

The FDIC may take the position that it was not required to follow notice and comment requirements based on an assertion that the guidelines are just general

statements of policy or agency organization rules. But this position would ignore the fact that the guidelines were promulgated specifically to satisfy a law of Congress. The promulgating notice expressly cites the statutory basis for issuing the guidelines. In addition, the guidelines have a real and substantial effect on the rights of banks, given that they affect the ability to obtain review of decisions that materially impact an appealing bank.

Moreover, the APA states that even interpretive rules, policy statements, or rules of agency procedure or practice may be required to comply with notice and comment requirements where notice and comment is "required by statute." Here, the underlying statute required notice and comment, at least in the first instance. *See* 12 U.S.C. § 4806(c) (requiring agencies to provide public notice and opportunity for comment on proposed guidelines for the establishment of an appellate process under the statute). It seems logical to conclude that subsequent changes to those proposed guidelines would equally require notice and comment and, as discussed below, that appears to have been the interpretation by the FDIC until quite recently

The conclusion that changes to the January 2021 Guidelines should have undergone notice and comment is further supported by the fact that the FDIC seemingly went through notice and comment for each prior change to the guidelines with the exception of the May 2022 revisions at issue here. The initial promulgation occurred in March 1995, with an initial notice and comment period beginning in December 1994. *See* Intra-Agency Appellate Process, 60 Fed. Reg. 15,923, 15,923-24 (Mar. 28, 1995). The Guidelines were amended several more times, each after a notice and comment period. *See* Intra-Agency Appeal Process: Guidelines for Appeals of Material Supervisory Determinations and Guidelines for Appeals of Deposit Insurance Assessment Determinations, 69 Fed. Reg. 41,479, 41,480 (Jul. 9, 2004); Guidelines for Appeals of Material Supervisory Determinations, 82 Fed. Reg. 34,522, 34,522 (Jul. 25, 2017); 86 Fed. Reg. at 6880 (Jan. 25, 2021). Only the most recent changes occurred without prior notice and comment. This history indicates that the FDIC itself determined that it could not promulgate or modify the guidelines without providing notice and comment.

Finally, these concerns about the lack of public involvement in and transparency regarding the FDIC's sudden policy shift are exacerbated by the current composition of the FDIC Board. The FDIC board is supposed to be bipartisan and include five Senate-confirmed members. Currently, however, there is no confirmed Chair of the FDIC, and the board comprises an acting chair and two outside board members. One of those board members is also serving solely in an "acting" capacity. In addition, all current members of the board are from the same political party. This anomaly renders it even more important for the agency to follow a

transparent and deliberative decision-making process and not engage in conduct that could be perceived as political decision-making behind closed doors.

II. THE FDIC SHOULD CONSIDER ADDITIONAL IMPROVEMENTS TO ITS INTRA-AGENCY PROCESS TO COMPLY WITH ITS RIEGLE ACT OBLIGATIONS.

In addition to rescinding the May 2022 Notice and restoring the Office, the FDIC should consider additional improvements to its intra-agency appeals process. Specifically, the FDIC should (i) apply a de novo standard of review to intra-agency appeals; and (ii) impose a stay during the pendency of an appeal such that any supervisory action that would adversely impact the institution is not effective until the appellate review has concluded.

A. FDIC Should Apply De Novo Review To Appeals.

In promulgating the January 2021 Guidelines, the FDIC considered adopting a de novo standard of review in order to "align the standard with the approach recently taken by the Federal Reserve Board (FRB)." 86 Fed. Reg. at 6883. Although the FDIC did "agree[] that a change in the standard of review for appeals to the Division Director would be appropriate," it did not "alter the standard of review when the appeal is reviewed by the Office." *Id.* The FDIC should reconsider this decision and should provide for a de novo standard of review. Under this standard, no deference would be applied with respect to the examiner's interpretation of the law or the examiner's factual findings. In addition to aligning its approach to that of the Federal Reserve, adopting an explicit de novo standard of review would indicate that the appellate body—whether the SARC or the Office—is more than simply a "rubber stamp" for the examiner's determination. Applying a more robust standard of review would increase institutions' confidence in the fairness and transparency of the bank regulatory system and would increase the frequency of appeals.

B. The FDIC Should Impose A Stay On Any Enforcement Actions While An Appeal Is Pending.

The FDIC should revise the Guidelines to stay supervisory actions during the pendency of the appeal. Currently, the FDIC's initial determinations can trigger significant collateral sanctions, even before the agency has made a final determination. Banks are unable to challenge these initial determinations before the restrictions are imposed, only after the fact. If the FDIC refers a matter to the Department of Justice (the "Department"), for example, and removes the bank from expedited branch approval, the bank languishes without any relief until the

Department acts. Restrictions on opening bank branches can have a detrimental impact on banks, such as bringing expansion activity at a bank to a halt. Accordingly, without a stay, the FDIC's proposed changes offer minimal benefit to banks.

At the very least, the FDIC should implement a mechanism, similar to the OCC's process, whereby a bank can be relieved of its obligation to comply with a supervisory decision or action while the appeal is pending. *See* OCC, Bulletin 2013-15 (noting that, "[i]n appropriate circumstances . . . the Ombudsman or the appropriate OCC official, upon written request of a bank, may relieve the bank of the obligation to comply with a supervisory decision or action while the supervisory appeal is pending").

III THE FDIC SHOULD SUPPORT EFFORTS TO CREATE AN INDEPENDENT PROCESS TO APPEAL MATERIAL SUPERVISORY DETERMINATIONS.

The FDIC's action in rescinding the January 2021 Notice shows that the FDIC has failed to effectuate the will of Congress as embodied in the Riegle Act, which required bank regulators to establish an independent intra-agency appellate process to review material supervisory determinations. The long and sorry history of the FDIC's attempts to implement the Riegle Act shows that a truly independent appeal process is necessary.

Experience with implementation of the Riegle Act shows that due process for examined institutions requires giving them the opportunity to for *independent* review. Banks should be able to obtain review of material supervisory determinations from an individual who is not paid by the agency that conducted the examination. In this regard, we urge the FDIC to support proposed legislation that would establish an Independent Examination Review Director, under the aegis of the Federal Financial Examinations Institution Council ("FFIEC"). Such a structure should authorize the independent director to review the examination record and, at the institution's request, direct an evidentiary hearing to enable the director to decide whether to uphold the agency's examination determination.

In addition to making the supervisory examination process more fair and efficient, such a structure would promote greater uniformity among the various regulatory agencies. As Professor Julie Andersen Hill has noted, because "regulators differ significantly in the type of review that they provide" and each "sets its own standard of review," "some financial institutions are entitled to a more thorough review of their appeals than others." *See* Julie A. Hill, *Improving Appeals of Material Supervisory Determinations*, Banking Persps. (Sept. 3, 2017),

https://www.bankingperspectives.com/improving-appeals-of-material-supervisory-determinations/. There is no reasonable basis for a bank's rights to contest a Material Supervisory Determination by a federal examiner to differ based on whether the bank has a state or federal charter, or whether the bank is or is not a member of the Federal Reserve. Moreover, subjecting material supervisory determinations from all bank regulators to review by the same independent decisionmaker would help ensure that banks were not being held to different standards based solely on the identity of their primary regulator. Most importantly, subjecting agency determinations to an independent Director would impose much-needed accountability for those agencies. An institution faced with an examination determination that is based on inaccurate information or an incorrect application of the law has no recourse today but to ask one of the agency's own employees to intercede.

Finally, it should be clear that, like other final agency action, the director's determination can be appealed to the Federal Court of Appeals for review. The Supreme Court and numerous courts of appeal have emphasized that executive agency action that is not subject to review by the judiciary runs afoul of the Separation-of-Powers protections in our Constitution. Indeed, concern about providing too much power to one particular person or agency goes all the way back to the Founders. James Madison stated in The Federalist No. 47, "The accumulation of all powers legislative, executive and judiciary, in the same hands, whether of one, a few, or many, and whether hereditary, self-appointed, or elective, may justly be pronounced the very definition of tyranny." In referencing this foundational principle, the Fifth Circuit in the recently issued *Jarkesy v. SEC* decision, No. 20-61007 (5th Cir. May 18, 2022), held that SEC proceedings before administrative law judges violated the U.S. Constitution because they deprived the respondent of its right to a jury, and gave too much discretion to the agency to decide whether to file an action in court or before its own administrative law judges. For the same reason, it is important that a bank harmed by a Material Supervisory Determination can petition a court of appeals to review the agency decision and strike it down if it is not justified by the facts or the law.

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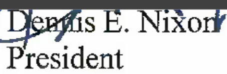
In order to have an effective supervisory examination process that best serves both banks and their customers, it is necessary to provide banks with a fair, efficient, and effective process for appealing an FDIC Material Supervisory Determination. Congress recognized this when it adopted the Riegle Act in 1995 and required the prudential regulators to establish intra-agency appeal processes. Unfortunately, the FDIC has failed to effectuate the intent and will of Congress. Its SARC process lacks independence and therefore has been little used. The FDIC recognized these

flaws when it spoke to bankers and the public and attempted to remedy the flaws in the January 2021 Guidelines. The recent, unprecedented action to throw all that away and return to the old way of doing business was ill-advised. The FDIC should rescind the May 2022 Notice, restore the January 2021 Guidelines, and begin a process that will lead to real reform in this important area.

Sincerely,



Dennis E. Nixon
President
International Bancshares Corporation