International Bancshares
Corporation

October 3, 2016

Mr. Robert E. Feldman
Executive Secretary
Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

RE: Federal Deposit Insurance Corporation, Notice and Request for Comment Regarding Proposed Amendments to 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 the following comments in response to the Notice and Request for Comment ("Notice") by the Federal Deposit Insurance Corporation ("FDIC") relating to its proposed amendments to the Guidelines for Appeals of Material Supervisory Determinations ("Guidelines").

With over $11.8 billion in assets, International Bancshares is the largest Hispanic-owned financial holding company in the continental United States. Its four bank subsidiaries (collectively, "IBC") provide commercial and retail banking services through facilities located 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 three 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; and (iii) International Bank of Commerce, Zapata, a Texas state banking association located in Zapata, Texas. IBC now serves 88 communities throughout Texas and Oklahoma with 204 branches and more than 310 ATMs, and provides full service banking seven days a week.

IBC welcomes the FDIC's efforts to improve the appeals process for Material Supervisory Determinations ("MSDs"), but additional amendments are needed to ensure fairness and instill confidence in the bank regulatory system. Federal bank regulators such as the FDIC are charged with overseeing all aspects of bank operations and have the power to shut down, fine, restrict branches, and take other actions against banks as a result of their MSDs.

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When bankers and bank regulators disagree, principles of fairness and due process mandate that banks be provided a fair and efficient avenue for review of regulatory decisions. In reality, however, the Guidelines, even as proposed, significantly limit financial institutions' access to meaningful and independent review of most adverse regulatory decisions. Accordingly, additional changes to the Guidelines are needed to expand the scope and independence of the bank regulatory appeals process to promote regulatory accountability and ensure that banks are treated fairly. These changes include:

- **Expanding the scope** of MSDs to include any supervisory action that would adversely impact the institution;
- **Imposing 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;
- **Allowing independent review**, with initial appeals directly to the Supervision Appeals Review Committee ("SARC") and appeals of final SARC decisions to the U.S. Court of Appeals; and
- **Providing de novo review** of MSDs.

An effective and fair supervisory examination process is vital to the health of our banking system and beneficial to the consumers it serves. These proposed reforms would promote transparency, fairness to banks, and competition in the marketplace.

Background

The Notice requests comment on the FDIC's proposed amendments to its Guidelines. FDIC, Docket No. FIL-52-2016, Notice and Request for Comment: Guidelines for Appeals of Material Supervisory Determinations (2016). The FDIC's proposed amendments stem from "the FDIC's experience in administering the current appellate process," such that "there are changes that could be beneficial to allow for additional avenues of redress with respect to certain" MSDs. Notice at 6. The Notice states that the FDIC reviewed the appellate policies for the Office of the Comptroller of the Currency ("OCC") and the Board of Governors of the Federal Reserve System. *Id.* The Notice adds that the proposed amendments would "expand institutions' appellate rights under certain circumstances" and "promote greater consistency with the other Federal banking agencies." *Id.*

IBC appreciates the FDIC's efforts to improve the current MSD appeals process and "allow for additional avenues of redress." Indeed, this goal is important because the current process is not working as intended. Banks file very few appeals, with the FDIC receiving an average of seven appeals per year between 2005 and 2012, and banks fully prevailing in only two out of 58 FDIC decisions in that same time period. *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).

At the same time, the proposed amendments fall short of achieving the FDIC's stated goals and the objectives of the Riegle Community Development and Regulatory Improvement Act of 1994 ("Riegle Act"). The Riegle Act required the FDIC and other federal banking agencies to establish an independent, intra-agency appellate process for banks to obtain review of MSDs. IBC urges the FDIC to further revise the Guidelines to provide financial institutions with fair, independent, and broad access to review of MSDs, consistent with the intent of the Riegle Act. In that spirit, IBC hopes that the FDIC finds the following information helpful as it moves forward with its amendments to the Guidelines.

I. THE FDIC'S PROPOSED CHANGES ARE AN IMPROVEMENT, BUT STILL FALL SHORT.

A. The FDIC Should Further Expand The Scope Of MSDs.

The Notice proposes two key changes to the scope of MSDs subject to appeal. Under the current Guidelines, "FDIC determinations regarding compliance with an existing formal enforcement action" are not considered MSDs and therefore are not appealable. Guidelines at Part D(e). The Notice amends Part D to allow appeals of such determinations, unless the FDIC "determines that the lack of compliance with an existing enforcement action requires additional enforcement action," in which case "the proposed new enforcement action is not appealable." Notice at 11-12. The Notice states that this amendment "would enhance institutions' opportunities to obtain an independent review of supervisory determinations" and references a similar provision in the OCC's appeals process to support this amendment. *Id.* at 6-7.

Additionally, the current Guidelines do not allow appeals of informal enforcement actions, such as memoranda of understanding. Guidelines at Part D(d). The Notice proposes allowing appeals of decisions to initiate informal enforcement actions. Notice at 7. According to the Notice, such a change "would better conform the FDIC's Guidelines" to the OCC's current appeals process. *Id.*

IBC welcomes these proposed changes to the Guidelines, which expand the scope of MSD appeals and provide needed reforms, but these proposed changes do not address two primary problems with the current process that the FDIC should address: (i) financial institutions still cannot file an appeal if the FDIC provides written notice that it will pursue a formal enforcement action, including a referral to the Department of Justice ("DOJ"); and (ii) institutions cannot appeal determinations and the underlying facts and circumstances that form the basis of a recommended or pending formal enforcement action.

Any Adverse Impact

To address the above concerns, IBC strongly urges the FDIC to broadly define MSDs to include any supervisory action that would adversely impact the financial institution. A supervisory action that would adversely impact the institution would include the following actions, many of which are currently not appealable: (i) formal enforcement-related actions or decisions; (ii) assessment of a civil money penalty; (iii) restriction on the institution's ability to open or expand branches; (iv) restriction on the institution's ability to purchase other institutions or assets of other institutions; (v) a decision to refer a matter to another agency for enforcement; (vi) public disclosure of a determination that the institution has violated any law or regulation, has committed an unsafe or unsound practice, or is in an unsafe or unsound condition; or (vii) any downgrade of an institution's Community Reinvestment Act ("CRA") or CAMELS rating, or some component thereof, which change would have tangible adverse consequences to the institution, without respect to whether such downgrade may be related to an agency enforcement decision.

A supervisory action that would adversely impact the institution would not include the appointment of a receiver for a regulated institution or any action taken after the appointment of a receiver; or a temporary cease and desist order pursuant to 12 U.S.C. § 1818(c).

Expanding the scope of MSD appeals in this manner would not result in abuse of the review process or efforts to delay or evade appropriate supervisory action. An institution could seek review of an agency determination only if the determination is significant – such as a rating downgrade or suspension of the institution's ability to open new bank branches or engage in other significant transactions. Without this expansion, banks will continue to have no "avenues of redress" for most supervisory actions that have an adverse impact on their operations for years.

Determinations and Underlying Facts and Circumstances

Even if the FDIC chooses not to expand the scope of MSD appeals to encompass any supervisory action that would adversely impact the financial institution, IBC strongly urges the FDIC to allow financial institutions to appeal determinations and the underlying facts and circumstances that form the basis of a recommended or pending formal enforcement-related action. The FDIC included such a provision in its 1995 Guidelines, stating 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 (e.g., loan classifications) are appealable provided they otherwise qualify." Intra-Agency Appellate Process, 60 Fed. Reg. 15923 (March 21, 1995). However, in 2008, the FDIC eliminated the ability of institutions to file an appeal for determinations or the facts and circumstances underlying a recommended or pending formal enforcement-related action or decision, including the initiation of an investigation. Guidelines for Appeals of Material Supervisory Determinations, 73 Fed. Reg. 54822 (Sept. 16, 2008). The stated reason for this change was to align the appellate process with the other agencies. *Id.*

The FDIC should reverse its 2008 decision that eliminated this avenue of appeal. Indeed, in its Notice, the FDIC acknowledges that the current process is too restricted, noting that "based on the FDIC's experience," additional changes "could be beneficial to allow for additional avenues of redress." Notice at 6. Allowing such appeals would improve the fairness and accountability of the federal bank regulatory system. In particular, the FDIC's ratings and classifications – which often relate to or underlie enforcement actions – have significant consequences for banks, and can result in restrictions on payment of dividends, severance packages, and interest rates, restrictions on asset growth, expansion, and other activities, and even receivership. Indeed, examination rating downgrades can render a bank ineligible for expedited branch approval and ineligible to accept state deposits or participate in federal loan programs. Yet the FDIC's position has been that banks cannot appeal these so-called "underlying facts and circumstances," even when the bank wishes to challenge the ratings themselves and not the formal enforcement-related action and decision.

The Notice states that the purpose of the current proposed changes is to "promote greater consistency with the other Federal banking agencies." Notice at 6. To that end, the OCC's bank appeals process, while preventing banks from appealing a "decision by the supervisory office to pursue a formal enforcement-related action," still allows banks to appeal conclusions in the report of examination. OCC, Bulletin 2013-15, Bank Appeals Process (2013). At the very least, the FDIC should similarly allow appeals of conclusions in the examination report, even if formal enforcement actions and the general underlying facts and circumstances are not appealable.

Academic analysis also supports the proposal to allow appeals of MSDs related to enforcement actions. "There is no indication that institutions' use of the MSD appeals processes during the time these appeals were allowed hampered enforcement activity." Hill at 1173. MSD appeals are "informal, inexpensive, and speedy" compared to contesting an enforcement action. *Id.* at 1174-75. Furthermore, allowing for a more expansive scope of MSDs would provide institutions "more opportunity to correct examiner errors" and increase confidence "that the MSD appeal processes provided consistent rights to all financial institutions." *Id.* at 1175.

Additionally, the FDIC should clarify the definition of a "formal enforcement-related action or decision," which is still unclear. Even under the proposed amendments, the risk exists that examiners may engage in subtle retaliation by attempting to shield key MSDs from appellate review by labeling them "enforcement related" or initiating formal enforcement-related actions on the eve of appeal to prevent review of MSDs. The FDIC should use this opportunity to revise the Guidelines to minimize such risks.

In sum, the FDIC should further revise the Guidelines to allow appeals of all supervisory actions that adversely impact financial institutions, but, if nothing else, at least allow appeals of conclusions in the examination report consistent with the OCC's process. Otherwise, under the current process, an institution can appeal certain examination ratings where there is no pending enforcement action, but lose that right to appeal once an enforcement action is recommended or proposed.

B. The FDIC Should Clarify What Triggers A Formal Enforcement-Related Action.

The Notice proposes two key changes to Part D regarding the commencement of a formal enforcement-related action. First, under the current Guidelines, a formal enforcement-related action or decision "commences" when the FDIC "initiates a formal investigation" or "provides written notice to the bank indicating its intention to pursue available formal enforcement remedies." Guidelines at Part D. The Notice revises this language so that a formal enforcement-related action or decision commences when the FDIC initiates a formal investigation or "provides written notice to the bank of a recommended or proposed formal enforcement action." Notice at 12. The Notice states that the change "would make the Guidelines more consistent with" the OCC process. *Id.* at 8.

IBC welcomes the FDIC's efforts to revise the Guidelines to clarify when a formal enforcement-related action commences, but additional clarification is needed. As noted above, the definition of a "formal enforcement-related action" is still unclear and subject to potential manipulation by examiners. Regarding the proposed changes from "intention" to "recommended or proposed" and "formal enforcement remedies" to "formal enforcement action," it is unclear whether these revisions materially change the trigger for the commencement of a formal enforcement-related action. The FDIC should explain the reason for and significance of the proposed changes, if any, and whether the changes require, as they should, the FDIC to satisfy a higher threshold to initiate an action that terminates appellate rights.

Second, the Notice proposes adding a sentence to this same paragraph in Part D that a formal enforcement-related action or decision "does not affect the appeal of any material supervisory determination that is pending under these guidelines." Notice at 12-13. The Notice summarizes the change but does not explain the reason for the change.

IBC also appreciates this revision, although the FDIC should clarify the purpose and significance of the change. In particular, the FDIC should confirm that the proposed amendment would prevent the initiation of a formal enforcement-related action from terminating or otherwise affecting the pending appeal of any MSD. However, this revision does little to address the issue that appellate review is still foreclosed if the bank does not appeal the MSD before the commencement of the formal enforcement-related action. In other words, an institution can appeal certain MSDs where there is no pending enforcement action, but loses that right to appeal once an enforcement action is recommended or proposed. Additionally, as discussed below, the revision has limited usefulness if certain penalties and restrictions are not stayed during the pendency of the appeal.

C. The FDIC Should Shorten The Time Period To "Revive" An Appeal To 60 Days.

The Notice proposes providing for additional SARC appeal rights in connection with certain MSDs, such as:

- Allowing SARC appeals when the FDIC has provided an institution with written notice of a recommended or proposed formal enforcement action, but does not pursue an enforcement action within 120 days of the written notice.

- Allowing SARC appeals when the FDIC's referral to the Attorney General for certain violations of the ECOA is returned to the FDIC, and the FDIC does not initiate an enforcement action within 120 days of the date the referral is returned.

- Allowing SARC appeals when the FDIC provides notice to HUD for violations of the ECOA or FHA, but does not initiate an enforcement action within 120 days of the date the notice is provided.

Notice at 13. The Notice states that "these additional appeal rights may be extended if the FDIC and the institution mutually agree and deem it appropriate in order to reach a mutually agreeable solution." *Id.* at 9. The FDIC would provide written notice to institutions of these rights "within 10 days of a determination that appeal rights have been made available." *Id.*

IBC appreciates these changes to clarify the situation where the FDIC provides written notice of a recommended or proposed formal enforcement action but ultimately does not pursue the action. However, although the new time restrictions provide some benefit, 120 days (and longer in many cases) is a significant period of time where the financial institution is unable to exercise its appellate rights. A more appropriate time period to "revive" appellate rights would be 60 days, primarily because during this time period, banks are still subject to penalties and restrictions that can adversely affect operations, such as restrictions on expansion activity. Thus, a shorter time period reduces the impact that these delays have on the bank's operations and competitiveness and expedites the bank's access to appellate relief.

II. ADDITIONAL CHANGES ARE NEEDED TO IMPROVE THE FAIRNESS, INDEPENDENCE AND TRANSPARENCY OF THE APPEALS PROCESS.

Although IBC welcomes the FDIC's efforts to improve the bank regulatory appeals process, additional changes are needed, including imposing a stay of supervisory actions during the pendency of any appeal, allowing independent review, and providing *de novo* review of MSDs.

A. The FDIC Should Stay Actions During The Pendency Of The Appeal.

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 DOJ, for example, and removes the bank from expedited branch approval, the bank languishes without any relief until the DOJ 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 SARC can relieve the bank of its obligation to comply with a supervisory decision or action while the appeal is pending. *See* OCC, Bulletin 2013-15, Bank Appeals Process (2013) (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.").

B. The FDIC Should Follow The OCC And Offer Independent Review.

The Guidelines require financial institutions to file appeals of MSDs "with the Division that made the determination, either the" Director, Division of Depositor and Consumer Protection, or Director, Division of Risk Management Supervision. Guidelines at Part F. Appeals must be filed "within 60 calendar days following the institution's receipt" of an examination report containing an MSD or other written communication of an MSD. *Id.* Appeals to SARC are not allowed until the bank "has first filed a timely request for review with the appropriate Division or Office Director." *Id.*

This process is deficient because it does not allow an institution to obtain independent review of important supervisory determinations. An institution faced with an MSD that is based on inaccurate information or an incorrect application of the law has no recourse today but to first ask one of the examination directors to intercede. This process has proven to be both ineffective and inefficient.

The best way to protect institutions is to allow banks to file an initial appeal directly to SARC, which exists outside of the supervision structure. Indeed, the OCC offers this type of independent review. Banks can file appeals directly to the OCC Ombudsman, which "operates independently from the bank supervision process and reports directly to the Comptroller of the Currency." *See* OCC, Bulletin 2013-15, Bank Appeals Process (2013). Academic analysis also supports direct appeals to SARC. *See* Hill at 1170 (describing the benefits of a "dedicated appellate authority outside the examination function," including consistent decisions, transparency, and increased bank confidence in the MSD appeals process).

In addition to providing the right to independent review, the FDIC should clarify that final SARC decisions can be appealed to the federal court of appeals. Currently, banks do not have clear access to courts. Some level of judicial oversight is necessary to ensure that the FDIC acts within the bounds of the law and does not abuse its power.

Finally, even if the FDIC continues with Director-level appeals – which it should not – the FDIC should increase the transparency of Director-level appeals by publishing the decisions. The Director-level appeals currently are less available and complete compared to SARC appeals. *See* Hill at 1106 (noting that public decisions "allow institutions, regulators, and the public to learn how the agency reads and applies relevant statutes and regulations"). Indeed, the "FDIC does not publicly release Director-stage decisions," such that decisions at this stage "are a near complete black box" and a "mystery." *Id.* at 1143, 1168.

C. FDIC Should Apply De Novo Review To Appeals.

The FDIC also should use this opportunity to change the standard of review applied to appeals to a *de novo* standard. The current standard of review needs clarification and is too deferential to examiners. The Guidelines do not even identify a standard of review for Director-level appeals. If the FDIC continues to provide for such appeals, the agency should specify the standard of review that is applied at this stage.

SARC appeals are reviewed under a deferential standard "for consistency with the policies, practices, and mission of the FDIC and the overall reasonableness of, and the support offered for, the positions advanced." Guidelines at Part M. Academic analysis supports that this standard of review is not sufficient to protect institutions' appellate rights. *See* Hill at 1176 (noting that "standards of review that refer only to law and policy are unhelpful in addressing . . . factual disputes" or "when existing law or policy do not cover the issue raised by the financial institution.")

The FDIC should apply a more robust *de novo* standard of review. Under this standard, no deference would be applied with respect to the examiner's interpretation of the law or its factual findings. The financial institution would be entitled to adduce evidence and engage in reasonable discovery. Applying a more robust standard of review would increase institutions' confidence in the fairness and transparency of the bank regulatory system.

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The FDIC should pursue a policy objective of providing financial institutions with greater access to the appellate process, particularly given the strikingly low number of appeals to date. Although IBC welcomes the FDIC's proposed changes, these amendments are not sufficient. Additional changes are needed to promote transparency and fairness to banks.

The needed changes include expanding access to the appellate process such that any supervisory action that would adversely impact the financial institution could be appealed, including a decision to remove an institution from expedited bank application approval. At the very least, the FDIC should allow financial institutions to appeal determinations and the underlying facts and circumstances that form the basis of a recommended or pending formal enforcement action to prevent examiners from using vague terms such as "enforcement-related" as a way to shield key MSDs from appellate review. The FDIC also should clarify its changes regarding the commencement of a formal enforcement-related action, and shorten the time frame to 60 days for when institutions' appellate rights are revived after written notice of a formal action. Furthermore, the FDIC should allow stays of supervisory actions while an appeal is pending, which would also stay related sanctions, such as restrictions on a bank's ability to purchase other institutions or assets of other institutions. Independent review is also needed, and the FDIC should allow direct appeals to the SARC and judicial review by the federal court of appeals. Finally, the FDIC should apply a robust, *de novo* standard of review to appeals.

Implementing the changes outlined above, in addition to the changes proposed in the Notice, will render the FDIC's regulatory appeal process fairer, more effective, and more consistent with the Congressional mandate under the Riegle Act.

Sincerely,

Natividad Lozano, III
Executive Vice President
International Bank of Commerce