



THE AMERICAN ASSOCIATION OF BANK DIRECTORS

Attention: David Baris
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October 20, 2020

By email: Comments@FDIC.gov
Robert E. Feldman
Executive Secretary
Attention: Comments, Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Comments on Guidelines for Appeals of Material Supervisory
Determinations RIN 3064-ZA20

Dear Ladies and Gentlemen:

Thank you for the opportunity to comment on your proposed Guidelines.

Our focus is on how the FDIC may enhance the effectiveness of the appeals process in line with the intent of the US Congress and maintenance of a strong banking system. An open and candid appeals process that will lead to the truth is supportive of a safe and sound banking system.

Since the end of 1989, the American Association of Bank Directors has been an advocate for bank directors. As such, it has advanced numerous recommendations to the federal banking agencies to revise their regulatory approach to outside bank directors and their banks. We have consistently urged the agencies to assure due process for banks and IAPs that we believe will help assure that the determination of the facts and supervisory judgment will be in line with the best interests of individual banks and the banking industry.

This is the time for the FDIC to utilize its rule-making authority and other powers to enhance due process protections and strengthen assurances that its supervisory office and examiners are acting in the best interests of banks and the banking industry.

A robust appeals process should be part of that effort.

The FDIC's proposed Guidelines are a major step to strengthening the appeals process but more still needs to be done.

The banking industry is facing its largest challenge since the Great Recession. Even though it is not at fault for the COVID-19 crisis, it may face considerable financial stress once the forbearance period expires.

If and when that happens, we know from history what happens to bank examination and enforcement processes.

Criticisms mount. Threats of enforcement action increase. Enforcement actions multiply. Supervisory staff feels pressure to take stringent regulatory actions. Disagreements frequently arise. Fear of personal liability spikes.

That's exactly what happened during and after the Great Recession. Even though banks were not responsible for the dramatic downturn in the economy and real estate values, they were stuck with the results.

According to Deloitte's study on banking agency enforcement actions from 2000 through part of 2015, the federal banking agencies issues 583 enforcement actions of various types, with the majority of them coming from the FDIC. Many of these actions imposed onerous and expensive requirements on banks.

Enforcement actions reached their peak in 2010. That year, the federal banking agencies issued 1,795 enforcement actions.

Deloitte's totals did not include informal, undisclosed enforcement actions such as MOUs. Our guess is that they totaled in the thousands in 2010 and even in 2014.

It is at times like this that the appeals process becomes even more important.

Our review of your proposed Guidelines takes this history into account.

Appeals during pendency of enforcement action considerations

The FDIC's proposed Guidelines specifically prohibit a bank from filing an appeal of a material supervisory determination during the pendency of the FDIC's consideration of a formal or informal enforcement action. The appeal can only be made if the FDIC does not produce the enforcement document or order of investigation within 120 days of the notification of a possible enforcement action.

It is during this period – when the FDIC staff is still deciding whether to take enforcement action – that the right to appeal is essential. By the time the FDIC staff decides on the enforcement action to be taken, it's almost always too late, even where the factual basis for such action was insufficient.

Practically speaking, challenging the supervisory office and examiners on the facts or interpretations of the facts or laws/regulations/regulatory policies must be done prior to the decision by the agency to pursue an enforcement action. Very few banks choose to fight a consent order or other enforcement action for good reasons, but not necessarily because they believe the examiners were correct or that the requirements of the enforcement document are in the best interests of the bank.

The final form of the Guidelines should allow an appeal without any limitations relating to whether an enforcement action is contemplated.

Burden of proof

The proposed Guidelines state that in an appeal, the burden of proof is on the bank.

This needs to change. Both the bank and the supervisory office should be treated the same. The new Office should determine the facts and interpretation of applicable laws, regulations and regulatory policies on a de novo basis.

Nothing in the applicable law requires the FDIC to place the burden of proof on the bank. Section 309(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 (12 USC 4806) requires the agencies to promote a fair and open appeal process. Placing the burden of proof on the party that is filing the appeal is not fair and is not conducive to determining objectively the facts or the proper interpretation of laws, regulations and regulatory policy.

During and soon after the Great Recession, there was a tendency for examiners and

their supervisors to have a bias to take enforcement action so that they would not be found at fault later for having missed a problem. In their material loss reports on failed banks, the banking agency Inspectors General routinely reinforced this tendency by faulting the agencies and their staff for not taking enforcement actions early enough. Given the potential for after-the-fact criticism, there will be examiners and supervisors who will err on the side of criticizing a practice or action even where the criticism is not warranted. The new Office of Supervisory Appeals should not give the supervisory staff the benefit of the doubt when that dynamic is operative.

Rights during appeal

The proposed Guidelines do not address details on the rights of those appealing a material supervisory determination.

Specifically, although the appealing party's submission to the Office of Supervisory Appeals is presumably shared with the supervisory office, the supervisory office's response to the appeal apparently is not available to the appealing party. This would be a fundamental breach of due process principles.

The proposed Guidelines also do not address ex parte communications, which should be either limited or prohibited.

We recommend that the final Guidelines include a provision ensuring that the appealing party has a right to review all of the submissions of the supervisory office to the Office of Supervisory Appeals.

We agree with the proposed Guidelines' provision that requires an oral presentation to be granted upon request where the FDIC staff and bank will be allowed to present their positions. Both parties should be present at the oral presentation.

Absence of references to IAPs

The proposed Guidelines do not mention IAPs and how they or their banks may appeal a material supervisory determination affecting the IAP.

Material supervisory determinations may include, for example, certain conclusions reached by the supervisory office on individual IAPs, enforcement actions being considered against an IAP, or informal enforcement actions, such as letters of reprimand, against IAPs. Informal enforcement actions may not be adjudicated and therefore the IAP has no recourse other than to appeal to the Office of Supervisory Appeals individually or through the bank. Some informal enforcement actions can be taken without the consent of the IAP, thus making it even more important that the IAP be entitled to appeal a material supervisory determination to the Office of Supervisory Appeals. Material supervisory determinations should include such informal enforcement actions imposed on board members or management that impact their performance at the bank or that may injure their reputation or livelihoods. The applicable statute refers to material supervisory determinations "made at" the bank, which would include the examples we have provided.

We recommend that the final Guidelines state that IAPs may appeal material supervisory determinations to the Office of Supervisory Appeals directly or through their banks.

Limitations on material supervisory determinations

The proposed Guidelines restrict what constitutes a material supervisory determination in excess of the statutory limitations.

In light of the Congressional intent to provide meaningful appeals, the final Guidelines

should only limit the definition of “material supervisory determinations” to those set forth in the statute.

For example, the proposed Guidelines exclude from the definition of material supervisory determinations “determinations and the underlying facts and circumstances that form the basis of a recommended or pending formal enforcement action.” As previously noted, the underlying facts and circumstances that form the basis of a recommended or pending formal enforcement action should be subject to an appeal so that the FDIC staff will not take formal enforcement action in opposition to the facts and circumstances that might otherwise go unchallenged.

The proposed Guidelines exclude from the definition of material supervisory determinations “determinations for which other appeals procedures exist...” The statute is silent on this exclusion. This provision at the very least should be narrowed to exclude only those determinations subject to appeal procedures under the APA and statutory provisions appointing an administrative law judge and guaranteeing appeals to the courts.

The applicable statute does not exclude changes in senior executive officers or boards of directors from the definition of material supervisory determinations. Therefore, the final Guidelines should not exclude such changes unless the bank is under a PCA directive.

Even as to appeals relating to PCA matters, the proposed Guidelines should clarify that only decisions to take prompt corrective action are barred by the statute. Underlying facts and interpretations that constitute material supervisory determinations may be appealed whether the decision is to place a bank under PCA or to impose requirements, restrictions or prohibitions pursuant to a PCA Directive. The final Guidelines should clarify this point.

Hiring of personnel to serve on the Office of Supervisory Appeals

The proposed Guidelines do not specify who has the power to appoint those who will serve in the Office of Supervisory Appeals. We suggest that the decision to hire should be made by the FDIC Board of Directors.

Sincerely,



David Baris
President