IBC
INTERNATIONAL BANCSHARES
CORPORATION

November 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 Bancshares Corporation on RIN-3064-ZA20, Guidelines for Appeals of Material Supervisory Determinations

Dear Mr. Sheesley:

International Bancshares, a multi-bank financial holding company headquartered in Laredo, Texas, appreciates the opportunity to submit comments in response to the October 21, 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.

The FDIC's processes for providing the banks they supervise with an opportunity to obtain review of Material Supervisory Determinations has been broken for many years. Its ineffectiveness is well illustrated by the fact that so few banks considered it worthwhile to pursue an appeal. As former FDIC Director McWilliams noted, between 2007 and August 2020 only fifty appeals were filed, out of a total of 111,516 exams. In 2021 the FDIC took a positive step to improve the system by replacing the Supervisory Appeals Review Committee ("SARC") with an

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independent Office of Supervisory Appeals (the "Office" or "OSA"). In May of this year, however, before the OSA was even staffed, the FDIC abruptly—and without notice—eliminated it and returned to the old, broken system. IBC and others noted the procedural and substantive failings of the FDIC's action in comments submitted in June 2022. Rather than meaningfully address this criticism, however, the FDIC simply tinkered with the old, failed system. The minor proposed changes to the guidelines do not address the fundamental problems in the system. In order to give banks an opportunity to obtain a fair review of Material Supervisory Determinations, a fresh approach is needed. We believe the Director McWilliams' OSA structure, although not perfect, was a far better system and should not have been abandoned.

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. 12 U.S.C. § 4806(a). From 1995 to 2021, the FDIC purported to satisfy this obligation through the SARC, comprised of political appointees to the FDIC Board and their designates. 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"). 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. at 54,378.

The guidelines proposed in the September 2020 Notice established a new Office of Supervisory Appeals to 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.* In particular, the individuals serving on the OSA would not be current FDIC officials but would be former government employees with bank supervision experience. *Id.* The September 2020 Notice stated that the

changes would allow "the supervisory appeals process [to] operate more independently, and without perceived conflicts of interest." *Id.* at 54,379. After receiving and assessing comments on the proposal, the FDIC issued its final "Guidelines for Appeals of Material Supervisory Determinations" in January 2021. Guidelines for Appeals of Material Supervisory Determinations, 86 Fed. Reg. 6880 (Jan. 25, 2021). The January 2021 Guidelines defined the Office as "an appellate body" that "will make independent supervisory determinations." *Id.* at 6887.

In May 2022, the FDIC abruptly reversed course. With no advance notification or opportunity for the public to comment it rescinded the January 2021 Guidelines and issued new guidelines, which reinstated the SARC retroactively. *See* Guidelines for Appeals of Material Supervisory Determinations, 87 Fed. Reg. 30,942 (May 20, 2022) (the "May 2022 Notice"). The FDIC provided no explanation for its 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.*

IBC and other organizations submitted comments expressing concern about the abandonment of the OSA and the return to the SARC structure. The commenters recommended that the FDIC restore the OSA as it provided greater independence and objectivity in the decision-making process. In its own comment letter, IBC also proposed that the FDIC stay supervisory actions during the pendency of an appeal. *See* Letter from Dennis E. Nixon, President, Int'l Bancshares Corp., to James P. Sheesley, Assistant Exec. Sec'y, FDIC (June 21, 2022).

On October 21, 2022, the FDIC issued a notice proposing changes to its supervisory guidelines. *See* Guidelines for Appeals of Material Supervisory Determinations, 87 Fed. Reg. 64,034 (Oct. 21, 2022) (the "October 2022 Notice"). The October 2022 Notice rejected calls to return to the OSA and instead proposed certain minor changes to the SARC process, including the addition of the Ombudsman as a nonvoting member of the SARC and the addition of a statement in the guidelines to the effect that an institution may request a stay of a supervisory action during the pendency of an appeal. *See id.* at 64,038. The October 2022 Notice invited interested parties to submit comments on the proposed changes. *Id.*

DISCUSSION

I. THE PROPOSED CHANGES TO THE GUIDELINES DO NOT REMEDY THE FATAL FLAWS IN THE PROCESS.

As numerous comments submitted in June 2022 noted, the FDIC's action in dismantling the Office of Supervisory Appeals without Notice and Comment was

inconsistent with requirements in the Administrative Procedure Act, and its after-the-fact rationales—unsupported assertions regarding "staffing concerns" and the Board's "experience"—did not meet the standard for "reasoned decision making" established by the Supreme Court in *State Farm* and *Encino Motorcars*. *See Motor Vehicle Mfrs. Ass'n of the U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983); *Encino Motorcars, LLC v. Navarro*, 579 U.S. 211, 212 (2016). While the FDIC has, after-the-fact, conducted a Notice and Comment process, it has failed to meaningfully address legitimate concerns about its supervisory appeal process.

A. Reverting to the Failed SARC Structure Shows a Lack of Commitment to Reform.

The FDIC's abandonment of the Office of Supervisory Appeals and return to the SARC structure shows a lack of commitment to reforming the appeals process. Although the FDIC's proposed SARC structure touts the inclusion of the non-voting Ombudsman as a step towards independence and in alleviating financial institutions' fears in submitting appeals, it does not go far enough. The proposed SARC structure lacks appropriate independence and true neutrality primarily because it is comprised of current FDIC employees, rather than the outside members that would comprise the original Office of Supervisory Appeals. The review panel's makeup inevitably begets conflicts of interests because FDIC employees are beholden, at some level, to the interests of the FDIC rather than the interest of fairness and the banking system.

Such a structure inhibits independent decision-making and objectivity, stifles differing views, and lessens the likelihood that institutions will view the appellate process as a viable opportunity to obtain a fair and meaningful hearing. Independent, outside members have the advantage of bringing industry expertise, depth of knowledge, and impartiality to the reviews process. Boards of directors and government committees, for example, benefit from the influence of outside, independent members. *See* Gregory H. Shill, *The Independent Board as Shield*, 77 Wash. & Lee L. Rev. 1811, 1838 (2020) (noting the New York Stock Exchange's rationale for requiring publicly listed companies to have majority independent boards and stating that independent-dominated boards "increase the quality of board oversight and lessen the possibility of damaging conflicts of interest"). The lack of outside, independent members on the panel also raises concerns of potential retaliation upon appealing a supervisory determination. The reticence of banks to utilize the SARC process evidences this fear. *See* Jelena McWilliams, Chairman, FDIC, Statement on the Request for Comment on Changes to Supervisory Appeals Process (Aug. 21, 2020) (noting that during 2017 through 2020, only nine appeals were filed with the SARC out of 18,413 exams—an average of approximately only three appeals per year).

B. Adding the Ombudsman to the Committee as a Non-Voting Member Does Not Meaningfully Address the Problem of the Committee's Lack of Independence.

In lieu of adopting a more independent and objective structure, as exemplified by the Office of Supervisory Appeal, the FDIC instead proposes to "add the Ombudsman to the Supervisory Appeals Review Committee . . . as a non-voting member." Guidelines for Appeals of Material Supervisory Determinations, 87 Fed. Reg. at 64,037. This proposal is plainly insufficient and does not meaningfully address the problem of the Committee's lack of independence.

First, adding the agency Ombudsman to the SARC is no substitute for true independence. Although the FDIC heralds the Ombudsman as a neutral arbiter, *see id.* (noting that "the Ombudsman has a longstanding role as a neutral advocate for a fair and impartial process"), the fact remains that the Ombudsman is an FDIC employee and reports to the Office of the FDIC Chairman. The Ombudsman thus may feel pressured to advocate for an outcome favoring the FDIC as opposed to a bank challenging its supervisory examiners. As an FDIC employee, the Ombudsman is beholden to the agency's interests rather than the interests of the appealing institution.

Second, whatever benefit there would be in adding the Ombudsman to the SARC is undercut by making him a purely "advisory" member, with no vote. The October 2022 Notice states that adding the Ombudsman to SARC may help to address "concerns regarding the need for a balance of perspectives to be reflected in the appellate process." *Id.* Indeed, the October 2022 Notice goes on to note that the Ombudsman "does not have any ongoing relationship with, or oversight responsibility for, the agency's supervision function, and including the Ombudsman's perspective may enhance independence and address perceptions of fairness." *Id.* Assuming this to be the case, why then would such a person not be given a vote on matters before the SARC? While the October 2022 Notice expresses a concern that an institution could be less willing in the future to utilize the Ombudsman's services if the Ombudsman might decide a matter against the institution, this argument makes little sense. Indeed, the Office of the Comptroller of the Currency endows its Ombudsman with the power to decide intra-agency appeals, and there is no indication that national banks are less likely to seek to utilize the OCC's Ombudsman for that reason.

Adding the Ombudsman to the SARC but not providing him with a vote makes him little more than a token and does not resolve the concerns expressed regarding the SARC's lack of independence.

C. The FDIC Should Impose A Presumptive Stay On Any Enforcement Actions While An Appeal Is Pending and Not Simply Inform a Bank that it May Seek a Stay.

In its June 2022 Comment Letter, IBC set forth reasons why the FDIC should "revise the Guidelines to stay supervisory actions during the pendency of [an] appeal" of a Material Supervisory Determination. Letter from Dennis E. Nixon to James P. Sheesley, *supra* at 9. As the Comment noted, restrictions imposed on an institution resulting from a Material Supervisory Determination can have a detrimental impact on that institution, potentially undermining the value of any successful appeal. In response, the FDIC stated that there "may be situations where a stay is appropriate to mitigate consequences of a determination during appellate review" but declined to make a stay automatic or presumptive. Guidelines for Appeals of Material Supervisory Determinations, 87 Fed. Reg. at 64,038. Instead, the FDIC "proposes to amend the Guidelines to allow an IDI to request a stay of a supervisory action or determination from the appropriate Division Director while its appeal is pending." *Id.* Whether to grant a stay request would be up to the "discretion" of the Division Director, and any such stay could be "subject to conditions" imposed by the Division Director. *Id.*

The FDIC's proposed addition to the guidelines does not sufficiently address the concerns regarding the reluctance of depository institutions to utilize the intra-agency appeals process. Instead of leaving the question of a stay up to the discretion of the Division Director, the FDIC should automatically issue a stay unless the Division Director can make a showing in writing that a stay would pose a threat to the safety and soundness of the institution or otherwise adversely impact the banking system.

Adoption of a presumptive stay would foreclose any harm to a bank while its appeal is pending before the SARC. As the FDIC itself acknowledged, such harms can include unreasonable expenses, delays, and other consequences, such as "removing an institution from expedited processing of applications." *Id.* This harm is wholly prevented if financial institutions are provided an automatic stay.

Moreover, providing for a presumptive stay would eliminate the possibility that the SARC would be improperly influenced by a denial of a financial institution's request for a stay. The SARC might be persuaded that a bank is unlikely to succeed on the merits of its appeal, or that the bank's appeal lacks merit altogether, if the stay request is denied. This scenario would leave the bank in a worse position than if it had not moved for a stay in the first place. By putting in the Division Director's hands discretion to determine whether to grant a stay request, the proposed

supervisory guideline places a bank in a difficult position when assessing whether to exercise its rights.

Furthermore, the expedited nature of the SARC process mitigates any concern the agency could have regarding the impact of a stay while the appeal is pending. The FDIC's proposed guidelines provide that the SARC must notify institutions of its appeal decision within 45 days after the date the SARC meets to consider the appeal. Guidelines for Appeals of Material Supervisory Determinations, 87 Fed. Reg. at 64,041. This meeting is held within 90 days after either the date of the filing of the appeal or the date that the FDIC Division Director refers the appeal to the SARC. *Id.* Thus, any stay of the decision will not be lengthy—in the longest-case scenario the stay will last no more than 135 days, or about four months.

Finally, providing for a presumptive stay of a Material Supervisory Determination that is appealed would have the salutary effect of encouraging more banks to appeal such determinations. Subjecting more examiner decisions to appellate scrutiny would improve the supervisory process in at least two ways. First, examiners are likely to make better decisions, more fair and more consistent decisions, if they know that those decisions may well be reviewed by others. As Justice Brandeis noted, "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman." Louis D. Brandeis, *Other People's Money--and How the Bankers Use It* 92 (1914). Second, appellate review benefits not only the bank that filed the appeal but also the entire banking system because it facilitates informed decision making. While there are valid reasons why supervisory examinations must remain confidential, that confidentiality can mean that banks and regulators have little insight into how important new issues are addressed. The supervisory appeals process increases within the agency knowledge of actions examiners take, and the publication of appeals decisions (even in redacted form) allows for more informed deliberation and decision-making regarding the types of issues that are appealed.

II. THE FDIC'S RESPONSE TO COMMENTS ON THE APPEAL PROCESS SHOWS THE NEED TO CREATE AN INDEPENDENT PROCESS TO APPEAL MATERIAL SUPERVISORY DETERMINATIONS.

In our June 2022 Comment Letter, we noted that the FDIC's action in rescinding the January 2021 Notice showed that the FDIC had failed to effectuate the will of Congress as embodied in the Riegle Act and that it was necessary to establish a truly independent appeal process. The FDIC's ham-handed response to the various comments submitted at that time—adding the Ombudsman to the Committee but as a nonvoting member, declaring that a bank can ask for a stay while an appeal is

pending but providing no assurances that it would grant such a request—makes it apparent that the current process does not achieve the objectives of the Riegle Act. and that a fresh approach is required.

Experience with implementation of the Riegle Act shows that due process for examined institutions requires giving them the opportunity 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. Subjecting agency determinations to an independent Director would impose much-needed accountability for those agencies. In addition to making the supervisory examination process more fair and efficient, such a structure would promote greater uniformity among the various regulatory agencies. 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 U.S. system of government is built on the principle of checks and balances, and for too long administrative agencies such as the FDIC have operated without effective review and oversight by the judicial branch. An independent review process with the opportunity for judicial review would go a long way to restoring proper balance.

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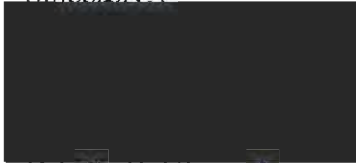
Providing banks an efficient and effective way to obtain a fair and independent review of Material Supervisory Determinations will improve agency decision making, provide greater predictability and stability to banks, strengthen the banking system, and ultimately redound to the benefit of bank customers. The FDIC took a step in the right direction in 2020 when it scrapped the SARC and created the Office of Supervisory Appeals. The sudden reversal of that decision, and the return to a system that clearly had not worked indicated a concerning lack of commitment to transparency and reform. While the proposed changes to the Supervisory Guidelines set forth in the October 2022 Notice represent improvements, they are not enough to rescue a failed process. Instead of tinkering at the margins, what is needed is the development of a truly independent process that will give banks a full and fair opportunity to obtain review of Material Supervisory Determinations from a neutral decisionmaker, subject to judicial review.

Sincerely,



Dennis E. Nixon
President
International Bancshares Corporation