Federal Deposit Insurance Corporation
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Division of Risk Management Supervision
Division of Complex Institution Supervision and Resolution

TO: Board of Directors

FROM: Doreen R. Eberley
Director

Arthur J. Murton
Director

SUBJECT: Revisions to the FDIC's Section 19 Regulations

SUMMARY

The Division of Risk Management Supervision (RMS) and the Division of Complex Institution Supervision and Resolution recommend that the Board of Directors (Board) revise regulations concerning section 19 of the Federal Deposit Insurance (FDI) Act (section 19) to conform to the Fair Hiring in Banking Act (FHBA or Act), which became effective on December 23, 2022.

On November 14, 2023, the FDIC published a notice of proposed rulemaking (proposal) to conform the FDIC's section 19 regulations with the FHBA. The FDIC issued the proposal following consultation and coordination with the National Credit Union Administration (NCUA), the Board of Governors of the Federal Reserve System (FRB), and the Office of the Comptroller of the Currency (OCC) "to promote consistent implementation [of the FHBA] where appropriate." The FDIC proposed to revise its rules and procedures to conform them to the FHBA and to clarify certain provisions of that statute. The comment period closed on January 16, 2024. Based on the comments received, staff proposes certain additional changes to the rule, none of which is considered significant.

Among other provisions, the FHBA excluded or exempted categories of otherwise covered offenses from the scope of section 19. The FHBA also clarified several definitions in section 19 and provided application-processing procedures. Staff considers most of the proposed revisions to the section 19 regulations to be required by the FHBA. Other proposed revisions reflect the FDIC's interpretation of section 19 in light of the FHBA.

The recommended modifications are incorporated into the proposed regulation, attached as Exhibit A, and are described more fully in this memorandum and the proposed *Federal Register* Notice, which is attached as Exhibit B. Staff recommends that the Board approve the proposed regulation and authorize the General Counsel and Executive Secretary (or designees) to take such other actions and issue such other documents related to the foregoing as they deem necessary or appropriate to fully carry out the Board's objectives in connection with this matter.
Concur:

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Harrel Pettway
General Counsel

BACKGROUND

Section 19 prohibits, without the prior written consent of the FDIC, a person convicted of any criminal offense involving dishonesty, breach of trust, or money laundering, or who has entered into a pretrial diversion or similar program in connection with a prosecution for such an offense (collectively, covered offenses), from becoming or continuing as an institution-affiliated party; owning or controlling, directly or indirectly, an insured institution; or otherwise participating, directly or indirectly, in the conduct of the affairs of an insured institution. Further, the law forbids an insured institution from permitting such a person to engage in any conduct or to continue any relationship prohibited by section 19.

From 1998 until 2020, the FDIC had a Statement of Policy that was issued under section 19, occasionally revised, and published in the *Federal Register*. The purpose of the Statement of Policy was to "provide the public with guidance relating to section 19 and the FDIC's application of this statute."[1] In 2020, following notice and comment, the FDIC revised and codified the Statement of Policy into the FDIC's Filing Procedures under part 303, subpart L, and Rules of Practice and Procedure under part 308, subpart M.[2]

On December 23, 2022, the President signed into law the FHBA, which significantly revised section 19 and was effective immediately. The notable changes to section 19 under the FHBA are discussed below.

ANALYSIS OF PROPOSED REGULATION

The proposed revisions to the FDIC's section 19 regulations are primarily intended to align the regulations with the FHBA's provisions. The proposed revisions address, among other topics, the types of offenses covered by section 19, the effect of the completion of sentencing or pretrial-diversion program requirements in the context of section 19, and the FDIC's procedures for reviewing applications filed under section 19. The proposed *Federal Register* Notice for the regulation fully details these changes. The most significant changes to the section 19 regulations due to the FHBA, in staff's view, are as follows.

Certain older offenses. The FHBA excludes certain offenses from the scope of section 19 based on the amount of time that has passed since the offense occurred or since the individual was released from incarceration. If an individual has a covered offense and (1) it has been seven years or more since the offense occurred[3] or (2) the individual was incarcerated with respect to the offense and it has been five years or more since the individual was released from incarceration, the Act excludes such an offense from the scope of section 19.[4] That is, no consent application is required. Moreover, if an individual (1) committed a covered offense when the individual was 21 years of age or younger and (2) if it has been more than 30 months since the sentencing for that offense occurred, the Act excludes the offense from the scope of

[1] *See* 85 Fed. Reg. 51,312, 51,312 (Aug. 20, 2020) (Final Rule revising and codifying the Statement of Policy into the Code of Federal Regulations).
[2] *See id*.
[3] Legal staff interprets the term "offense occurred" to mean the "last date of the underlying misconduct." In instances with multiple offenses, "offense occurred" means the last date of any of the underlying offenses.
[4] 12 U.S.C. § 1829(c)(1)(A).

section 19.[5] All of these revisions mark a paradigm shift concerning section 19. Until the passage of the FHBA, individuals with covered offenses on their records faced potentially a lifetime ban from banking without the FDIC's consent. The revised language means that all state offenses and the vast majority of federal offenses will be removed from the scope of section 19 after seven years—at the latest.

Expunged, sealed, and dismissed criminal records. The Act excludes certain convictions from the scope of section 19 that have been expunged, sealed, or dismissed.[6] The FDIC's current regulations contain interpretative language concerning such offenses, but the statute has now codified the notion that certain expunged, sealed, or dismissed convictions are excluded from the scope of section 19. The proposed rule would modestly broaden the statutory language concerning such offenses. The statute addresses expungements, sealings, or dismissals through court order; it is silent as to such actions by operation of law. The proposed rule would include expungements, sealings, and dismissals by operation of law, which would harmonize the FDIC's current regulations concerning expunged, sealed, and dismissed records with the statutory language and provide a more comprehensive framework as to such records.

De minimis offenses. The FHBA excludes "de minimis" offenses from the scope of section 19, and this category includes relatively minor offenses that are specified either by the FHBA or by the FDIC through regulations.[7] In the FHBA, a subcategory of *de minimis* offenses is called "designated lesser offenses," which offenses include the use of fake identification, shoplifting, trespass, fare evasion, driving with an expired license or tag (and such other low-risk offenses as the FDIC may designate), if one year or more has passed since the applicable conviction or program entry.[8]

Criminal offenses involving dishonesty. The FHBA excludes certain offenses from the definition of "criminal offenses involving dishonesty," including (1) misdemeanor criminal offenses committed more than one year before the date on which an individual files an application, excluding any period of incarceration, and (2) "an offense involving the possession of controlled substances."[9] Historically, the FDIC has required an application as to drug-related offenses—aside from simple-possession offenses.[10] The rationale the FDIC has relied on has been that such non-simple-possession offenses (e.g., trafficking and manufacturing) inherently involve dishonesty, breach of trust, or money laundering. In light of the FHBA, however, staff believes that Congress intended to exclude, *at least*, the offenses of simple possession and possession with intent to distribute from the "involving dishonesty" category because of the statute's use of the phrase "involving the possession of controlled substances." Additionally, staff believes that the FDIC should shift from the presumption that other drug-related offenses are necessarily subject to section 19 as crimes involving dishonesty, breach of trust, or money laundering. It is *possible* that the elements of a drug-related crime could implicate one of those three categories

[5] 12 U.S.C. § 1829(c)(1)(B). The statutory revisions concerning all of these older offenses do not affect the specific federal offenses listed under 12 U.S.C. § 1829(a)(2) (e.g., money laundering).
[6] *See* 12 U.S.C. § 1829(c)(2).
[7] *See* 12 U.S.C. § 1829(c)(3).
[8] 12 U.S.C. § 1829(c)(3)(D).
[9] 12 U.S.C. § 1829(g)(2)(C).
[10] *See* 85 Fed. Reg. at 51,313 ("The FDIC maintains that an application is required for it to determine the nature of the offense and elements of the crime and therefore it will continue the current requirement that an application be filed, unless the offense is *de minimis*.")

(and if so, an application would be required), but it is not *necessarily* so. Because this proposed rulemaking implements the new statutory language concerning "involving possession," this proposed rulemaking provides an opportunity for the FDIC to treat drug offenses the same as all other types of crimes—which do not automatically trigger the need for an application. Moving away from that presumption of coverage under section 19 would also align the FDIC with the FRB's treatment of drug-related offenses; the FRB does not presume that drug-related offenses are subject to section 19 and instead looks at the statutory elements of such crimes like any other form of criminal conduct.

Standards for FDIC review of section 19 applications. The FHBA prescribes standards for the FDIC's review of applications submitted under section 19.[11]

Lastly, the FHBA requires the FDIC to "consult and coordinate" with the NCUA "as needed to promote consistent implementation [of the Act] where appropriate."[12] Accordingly, since the enactment of the Act, staff has worked with staff from the NCUA, as well as staff from the FRB and OCC, in an effort to ensure consistent interpretation and implementation of the FHBA.

EVALUATION OF PUBLIC COMMENTS

FDIC requested comments on all aspects of its approach to section 19 and, specifically, the following topics of interpretation:

- the date on which a criminal offense "occurred" or was "committed;"
- the date on which "sentencing occurred;"
- whether section 19 encompasses foreign convictions and pretrial diversions;
- the standard for expungements, sealings, and dismissals;
- "offenses involving controlled substances;" and
- *de minimis* offenses.

The FDIC received five comments from six different commenters, consisting of two individuals and four advocacy groups (two advocacy groups provided a joint comment). All of the comments generally supported the proposal. The comment received from one advocacy group did not offer specific changes to the proposal but urged the FDIC and other financial regulators to strengthen their enforcement practices. The other commenters suggested a variety of changes. The comments and staff's responses are discussed below (note that we did not receive any comments concerning the standard for expungements, sealings, and dismissals).[13]

Offense Committed/Offense Occurred

The FHBA states that the term "criminal offense involving dishonesty" does not include "a misdemeanor criminal offense committed more than one year before the date on which an

[11] *See* 12 U.S.C. § 1829(f).
[12] 12 U.S.C. § 1829(f)(9).
[13] Staff, as part of the FDIC's obligation to "consult" and "coordinate" with the NCUA, considered the comments that were submitted in connection with the NCUA's parallel rulemaking. *See* 88 Fed. Reg. 76,702 (Nov. 7, 2023). With one exception—described below—staff recommends that the FDIC not adopt the suggestions provided in those comments. Staff's detailed analysis of those comments is contained in the attached *Federal Register* Notice.

individual files a consent application, excluding any period of incarceration."[14] The FHBA also states that section 19's restrictions will not apply to an offense if "it has been 7 years or more since the offense occurred."[15] Staff interprets the term "offense occurred" to mean the "last date of the underlying misconduct." In instances with multiple offenses, "offense occurred" means the last date of any of the underlying offenses. Staff also considers the phrases "offense committed" and "offense occurred" to be substantially similar.

Two commenters disagreed with the FDIC's proposed interpretation of this statutory language and stated that "offense occurred" or "offense committed" should mean the date of the plea, conviction, or program entry. In staff's view, however, the plain meaning of the terms "committed" and "occurred" mean when the underlying misconduct happened. This interpretation is buttressed by Congress's use of the date of conviction or program entry elsewhere in the statute; that is, the statute distinguishes between when misconduct was "committed" or "occurred" and the date of a "conviction" or "program entry."

Two commenters expressed concerns that insured depository institutions (IDIs) would have difficulty with ascertaining the underlying date(s) of misconduct for job applicants, as part of background inquiries (the proposed regulations require IDIs to conduct "reasonable, documented inquiries" to verify an applicant's history). These commenters noted that background-check reports that are commercially or otherwise available tend to list the date of arrest, conviction, or release from incarceration, but not necessarily the date of the underlying misconduct. Staff believes that, for many applicants, an IDI will be able to determine whether an offense is covered by section 19 using the background-check reports noted by the commenters. An IDI may conduct a reasonable, documented inquiry by using the date of conviction or program entry if it is clear from that information that an applicant's offense is not subject to section 19 due to the amount of time that has elapsed. On the other hand, if an IDI cannot ascertain whether an offense is subject to section 19 based on the date of conviction or program entry, it may be necessary for the IDI to perform additional research to determine the last date of the underlying misconduct.

Sentencing Occurred

The FHBA states that, for individuals who committed an offense when the individual was 21 years of age or younger, section 19 shall not apply to the offense if it has been more than 30 months since the sentencing occurred.[16] Staff interprets "sentencing occurred" to mean the date on which a court imposed the sentence (as indicated by the date on the court's sentencing order), not the date on which all conditions of sentencing were completed.

One commenter agreed with staff that the term "sentencing occurred" should mean the date when the court imposed the sentence. Another commenter—to the NCUA's parallel notice of proposed rulemaking under the FHBA—suggested that the term "sentencing occurred" should mean the date that appears on the sentencing order, instead of the date the court's clerk entered the order on the docket. Staff agrees with this suggestion, as indicated above.

[14] 12 U.S.C. § 1829(g)(C)(i).
[15] 12 U.S.C. § 1829(c)(1)(A)(i).
[16] 12 U.S.C. § 1829(c)(1)(B).

Foreign Convictions and Pretrial Diversions

Staff added language to the regulation to codify the FDIC's long-held position that an individual who is convicted of or enters into a pretrial diversion program for a criminal offense involving dishonesty, breach of trust, or money laundering in foreign jurisdictions is subject to section 19, unless the offense is otherwise excluded under the FHBA or 12 C.F.R. part 303, subpart L.

One commenter stated that foreign convictions and pretrial diversions should be excluded from the scope of section 19. This commenter cited the difficulty of investigating criminal matters in foreign jurisdictions in which an applicant may have worked or resided, noted that banks might not have operations in such jurisdictions, and expressed concern that banks could expose themselves to liability in foreign jurisdictions by conducting background checks. Moreover, this commenter said that certain applicants for bank employment may already have completed a background check for the visa process; there would therefore be a risk of duplication with a bank's investigation.

Staff has retained its proposed language as to foreign offenses due to the importance of ensuring that individuals with covered offenses do not participate in the affairs of IDIs without the FDIC's consent. Staff has, however, provided in the preamble to the proposed regulation several non-exhaustive ways in which banks could comply with this requirement.

Offenses Involving Possession of Controlled Substances

The FHBA excludes from the scope of covered offenses "an offense involving the possession of controlled substances."[17] Staff interprets this phrase concerning controlled substances to exclude, at a minimum, criminal offenses involving the simple possession of controlled substances and possession with intent to distribute a controlled substance. This revised regulatory language would mark a shift from the FDIC's current section 19 regulations, which require an application for all convictions and pretrial diversions concerning the illegal manufacture, sale, distribution of, or trafficking in controlled substances.

One commenter specifically supported the FDIC's proposal concerning controlled substances. Another commenter said that the FDIC's proposed language was overly broad and contrary to congressional intent and that the proposed exclusion should be limited to the offense of simple possession of controlled substances. This commenter added that banks would face reputational risks if they hired individuals who had been convicted of the crime of possession with the intent to distribute controlled substances. This commenter also recommended that the FDIC retain its regulatory text concerning the illegal manufacture, sale, distribution of, or trafficking in controlled substances.

Staff believes that the proposed language is consistent with the text and purposes of the FHBA and would align the FDIC's interpretation of section 19 as to offenses involving controlled substances more closely with other Federal financial institution regulators. The FHBA explicitly excludes from the category of "criminal offense involving dishonesty" "an offense *involving* the possession of controlled substances," not just the offense of "possession of controlled substances." The modifier "involving," in staff's view, expands that exclusion beyond simple-possession offenses. The revised regulatory language, however, will recognize that a drug-related offense *could* potentially involve dishonesty, breach of trust, or money laundering.

[17] 12 U.S.C. § 1829(g)(2)(C)(ii).

Moreover, while section 19 provides statutory barriers to the employment of certain individuals due to their criminal history, IDIs otherwise retain the discretion, under that statute, as to which applicants they want to hire. Staff also notes that this revision to the FDIC's section 19 regulations will *not* affect the FDIC's ability to consider drug-related offenses, as they pertain to the suitability of an individual, under other statutory provisions, including the Change in Bank Control Act and section 32 of the FDI Act.

De minimis Offenses

Staff made a number of changes to this section based on the statutory revisions and comments received. Two commenters asked for additional clarity on what constitutes a *de minimis* offense. Another commenter requested that the FDIC revise this section to exempt *de minimis* offenses from the scope of section 19's prohibition to align with the FHBA. In agreement, staff has revised the regulation to treat *de minimis* offenses—a category that includes the sub-category "designated lesser offenses"—as offenses that are excluded from the prohibitions of 12 U.S.C. § 1829(a) (assuming certain conditions are met) and for which no application is required.

Staff also deleted former section 303.227(c) concerning fidelity bond coverage and disclosure of *de minimis* offenses to IDIs. This now-deleted section had required that, "Any person who meets the criteria under this section shall be covered by a fidelity bond to the same extent as others in similar positions, and must disclose the presence of the conviction(s) or program entry(ies) to all IDIs in the affairs of which that person intends to participate." Since the FHBA has excluded *de minimis* offenses from the scope of section 19, staff believes that these requirements should no longer attach to individuals who have committed such offenses. This change is in response to one commenter's request that the FDIC clarify its position concerning *de minimis* offenses and is related to another commenter's suggestion that the FDIC treat *de minimis* offenses the same way as "designated lesser offenses" by excluding both types of offenses from the scope of section 19.

Lastly, one commenter requested that the FDIC explain which offenses are considered "designated lesser offenses" that do not require FDIC consent. Staff believes that the revised regulations adequately define such offenses.

Reasonable, Documented Inquiry

The proposed regulations require IDIs to make a "reasonable, documented inquiry" to verify an applicant's history to ensure that a person who has a covered offense on the person's record is not hired or permitted to participate in the IDI's affairs without the prior written consent of the FDIC. In the FDIC's 2020 Final Rule concerning revisions to the FDIC's section 19 regulations, the FDIC stated, "The procedures that constitute a reasonable inquiry will vary from bank to bank, and the FDIC believes that this determination is best left to the business judgments of these institutions." Staff recommends that the FDIC reaffirm this position (with the added requirement since 2020 that the inquiry be documented). This recommendation is in response to one commenter's suggestion. The same commenter recommended that the FDIC clarify that a "reasonable, documented inquiry" would include verifying that the date of conviction or program entry occurred at least one year or seven years prior, as applicable. As noted above and in the preamble to the final rule, there may be circumstances in which the date of conviction or program entry may provide sufficient information to an IDI that an offense is excluded from the scope of section 19. On the other hand, if an IDI cannot ascertain whether an offense is subject to section 19 based on the date of conviction or program entry, it may be necessary for the IDI to perform additional research to determine the last date of the underlying misconduct.

Evaluation of Applications

One commenter requested that the FDIC establish internal timelines to evaluate applications filed under section 19 and to provide a copy of an applicant's criminal history record to the applicant once the FDIC receives it from the Federal Bureau of Investigation (FBI). The proposed regulation adopts this recommendation in part. Under the proposed regulation, the FDIC will make reasonable efforts to communicate with the subject of the application within 15 calendar days of receipt of the criminal history record from the FBI to inform the individual that the FDIC will be providing them with a copy of the report and to verify the individual's contact information. The FDIC will also make reasonable efforts to send the report to the individual within 5 business days of successful verification of the individual's contact information. If the individual believes that there are any inaccuracies in the report, the FDIC will direct the individual to an appropriate contact at the FBI where the individual can seek corrections to the report.

Other Alternatives Considered

As previously noted, almost all proposed substantive changes to the FDIC's section 19 regulations stem from the FHBA's revisions to section 19. The FDIC had limited discretion in adopting alternatives to those statutory revisions. Staff considered other proposals that were submitted by the commenters and which proposals are detailed in the *Federal Register* Notice, but staff believes that the final amendments represent the most appropriate option for covered entities and individuals.

RECOMMENDATION

In summary, staff considers most of the proposed revisions to the section 19 regulations to be required by the FHBA. Other proposed revisions reflect the FDIC's interpretation of statutory prohibitions in light of the FHBA, more closely align the FDIC's section 19 regulations with those of other Federal financial institution regulators, and make a number of non-substantive, technical edits. The revisions address, among other topics, the types of offenses covered by section 19, the effect of the completion of sentencing or pretrial-diversion program requirements in the context of section 19, and the FDIC's procedures for reviewing applications filed under section 19. Comments received from various stakeholders were generally in favor of these proposals.

Staff recommends that the Board approve the proposed revisions and authorize the Executive Secretary and General Counsel (or designees) to publish the final regulation in the *Federal Register*. Staff also recommends that the Board authorize the General Counsel and Executive Secretary (or designees) to make technical, non-substantive, or conforming changes to the attached *Federal Register* Notice and regulation, and authorize the General Counsel and Executive Secretary to take such other actions and issue such other documents related to the foregoing as they deem necessary or appropriate to fully carry out the Board's objectives in connection with this matter.

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