



Federal Deposit Insurance Corporation

550 17th Street NW, Washington, D.C. 20429-9990

Division of Risk Management Supervision

November 26, 2012

TO: Board of Directors

FROM: Sandra L. Thompson
Director

SUBJECT: Modifications to the Statement of Policy for Section 19 of the Federal Deposit Insurance (FDI) Act

EXECUTIVE SUMMARY

The Division of Risk Management Supervision (RMS) recommends that the Board of Directors (Board) amend the Statement of Policy for Section 19 of the FDI Act (SOP) to modify the potential fine and jail time served factors considered for *de minimis* convictions.

The recommended modifications are incorporated into the revised SOP, attached as Exhibit A (redline format) and Exhibit B (clean format), and are described more fully in this memorandum. In addition, RMS recommends that the Board authorize the Executive Secretary to publish the notice in the Federal Register, attached as Exhibit C, which describes the modifications in detail. The Legal Division (Legal) has determined that solicitation of public comment is not necessary because the Administrative Procedure Act does not generally require public comment regarding statements of policy¹ when the proposed revisions are limited, largely clarifying, and technical in nature. Further, the modifications will reduce regulatory burden.

Concur:

Richard J. Osterman, Jr.
Acting General Counsel

¹ 5 U.S.C. § 553(b)(A).

Modifications to FDIC Statement of Policy on Section 19 of the FDI Act

Section 19 prohibits, without the prior written consent of the FDIC, a person convicted of any criminal offense involving dishonesty or breach of trust or money laundering (covered offenses), or who has entered into a pretrial diversion or similar program in connection with a prosecution for such offense, from becoming or continuing as an institution-affiliated party (IAP), 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 of the FDI Act, 12 U.S.C. §1829(a)(1)(A) (Section 19). It also imposes a ten-year ban against the FDIC's consent for a person convicted of certain crimes enumerated in Title 18 of the United States Code, absent a motion by the FDIC and approval by the sentencing court.

The SOP was last updated on May 21, 2011, to clarify: (i) the applicability of Section 19 on bank and thrift holding company IAPs, (ii) the term "complete expungement," and (iii) the factors for considering *de minimis* convictions. Approval under Section 19 is automatically granted, and an application is not required if the covered offense meets the following criteria:

- There is only one conviction or program entry of record for a covered offense;
- The offense was punishable by imprisonment for a term of one year or less and/or a fine of \$1,000 or less, and the individual did not serve time in jail;
- The conviction or program entry was entered at least five years prior to the date an application would otherwise be required; and
- The offense did not involve an insured depository institution or insured credit union.

Further, the *de minimis* test also covers a conviction or program entry of record based on the writing of a "bad" or insufficient funds check(s) if the following applies:

- All other requirements of the *de minimis* offense provisions are met;
- The aggregate total face value of the "bad" or insufficient funds check(s) cited in the conviction was \$1,000 or less; and
- No insured depository institution or insured credit union was a payee on any of the "bad" or insufficient funds check(s) that were the basis for conviction.

ANALYSIS OF PROPOSED CHANGE

Recently, there has been a surge in applications pursuant to Section 19 by individuals who are currently employed by insured depository institutions (insured institutions) and whose recent background checks have revealed a covered offense. The increase in applications largely resulted from two factors. First, recent mergers of entities, such as investment firms, into banks have made Section 19 applicable to employees not previously covered. Second, the Secure and Fair Enforcement for Mortgage Act of 2008 requires insured institutions to perform checks on all mortgage loan originators. Some insured institutions, after performing the new required background checks, recognized deficiencies in their background check process, and performed new background checks on *all* of their existing employees.

Staff considered expanding the automatic approval criteria in the SOP to apply to additional low-risk cases that in our experience present a high likelihood of approval. Three of the more

Modifications to FDIC Statement of Policy on Section 19 of the FDI Act

common reasons an application fails the *de minimis* test are that: 1) it has been less than five years since the conviction or program entry, 2) the person served some jail time (often just pre-conviction time), and 3) while the actual misconduct appears to have been minor, the potential sentence was for greater than one year in jail or a fine greater than \$1,000. Staff believes that a change to the SOP in regard to jail time and/or the aspects of potential punishment is appropriate. However, staff does not recommend changing the five-year period because it is a positive factor for rehabilitation. Further, staff does not recommend changing the potential imprisonment of one year or less because this factor is not impacted by changes in economic conditions and is often a dividing point between misdemeanors and felonies.

The FDIC has received a number of Section 19 individual waiver applications where the filing did not meet one of the *de minimis* factors regarding the maximum potential fine or the jail time served. Experience has shown that under most state potential sentencing guidelines, fines for minor infractions can be \$2,500 or less. Additionally, we have seen numerous cases where minimal, actual jail time was included as part of the sentence; however such minimal jail time has not been a significant factor in our decisions. Adjusting the *de minimis* exceptions to permit an increase in the potential fine to \$2,500 and a limited number days of actual jail time served for minor infractions appears just and reasonable. Based on our review of applications we have received and decided, the proposed changes to the *de minimis* exception would not have altered the outcome of any denial.

By increasing the range of the maximum potential fine to \$2,500 or less, and allowing up to three days of actual jail time served, the FDIC can provide immediate relief to the individuals impacted by the increase in merger activity while maintaining the integrity of Section 19 and protecting the Deposit Insurance Fund. Therefore, staff recommends that the *de minimis* language for the imprisonment and fine discussion be revised to reflect the following:

“The offense was punishable by imprisonment for a term of one year or less and/or a fine of \$2,500 or less, and the individual did not serve more than three (3) days of actual jail time.”

These modifications can be issued as a clarifying or technical change to the existing SOP which staff can accomplish promptly following Board approval and publication in the *Federal Register*.

Staff Contacts

Division of RMS:

Martin P. Thompson
Senior Review Examiner
(202) 898-6767

Legal Division:

Michael P. Condon
Counsel
(202) 898-6536

EXHIBIT A

FDIC STATEMENT OF POLICY FOR SECTION 19 OF THE FDI ACT

Section 19 of the Federal Deposit Insurance Act ([12 U.S.C. 1829](#)) prohibits, without the prior written consent of the Federal Deposit Insurance Corporation (FDIC), a person convicted of any criminal offense involving dishonesty or breach of trust or money laundering (covered offenses), or who has agreed to enter into a pretrial diversion or similar program in connection with a prosecution for such offense, from becoming or continuing as an institution-affiliated party, owning or controlling, directly or indirectly an insured depository institution (insured institution), or otherwise participating, directly or indirectly, in the conduct of the affairs of the insured institution. In addition, 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. It imposes a ten-year ban against the FDIC's consent for persons convicted of certain crimes enumerated in Title 18 of the United States Code, absent a motion by the FDIC and court approval.

Section 19 imposes a duty upon the insured institution to make a reasonable inquiry regarding an applicant's history, which consists of taking steps appropriate under the circumstances, consistent with applicable law, to avoid hiring or permitting participation in its affairs by a person who has a conviction or program entry for a covered offense. The FDIC believes that at a minimum, each insured institution should establish a screening process which provides the insured institution with information concerning any convictions or program entry pertaining to a job applicant. This would include, for example, the completion of a written employment application which requires a listing of all convictions and program entries. The FDIC will look to the circumstances of each situation to determine whether the inquiry is reasonable. Upon notice of a conviction or program entry, an application seeking the FDIC's consent prior to the person's participation must be filed.

Section 19 applies, by operation of law, as a statutory bar to participation absent the written consent of the FDIC. The purpose of an application is to provide the applicant an opportunity to demonstrate that, notwithstanding the bar, a person is fit to participate in the conduct of the affairs of an insured institution without posing a risk to its safety and soundness or impairing public confidence in that institution. The burden is upon the applicant to establish that the application warrants approval.

A. Scope of Section 19

Section 19 covers institution-affiliated parties, as defined by [12 U.S.C. 1813\(u\)](#) and others who are participants in the conduct of the affairs of an insured institution. This Statement of Policy applies only to insured institutions, their institution-affiliated parties, and those participating in the affairs of an insured depository institution. Therefore, all employees of an insured institution fall within the scope of section 19. In addition, those deemed to be de facto employees as determined by the FDIC based upon generally applicable standards of employment law, will also be subject to section 19. Whether other persons who are not institution-affiliated parties are covered depends upon their degree of influence or control over the management or affairs of an insured institution. For example, section 19 would not apply to persons who are merely

employees of an insured institution's holding company, but would apply to its directors and officers to the extent that they have the power to define and direct the policies of the insured institution. Similarly, directors and officers of affiliates, subsidiaries or joint ventures of an insured institution or its holding company will be covered if they are in a position to influence or control the management or affairs of the insured institution. Those who exercise major policymaking functions of an insured institution would be deemed participants in the affairs of that institution and covered by section 19. Typically, an independent contractor does not have a relationship with the insured institution other than the activity for which the insured institution has contracted. Under 12 U.S.C. 1813(u), independent contractors are institution-affiliated parties if they knowingly or recklessly participate in violations, unsafe or unsound practices or breaches of fiduciary duty which are likely to cause significant loss to, or a significant adverse effect on, an insured institution. In terms of participation, an independent contractor who influences or controls the management or affairs of the insured institution, would be covered by section 19. Further, "person" for purposes of section 19 means an individual, and does not include a corporation, firm or other business entity.

Individuals who file an application with the FDIC under the provisions of Section 19 who are participating in the affairs of a bank or savings and loan holding company may also have to comply with any filing requirements of the Board of the Governors of the Federal Reserve System under 12 U.S.C. §1819(d) in the case of a bank holding company, and the Office of Thrift Supervision under 12 U.S.C. §1819(e), in the case of a savings and loan holding company until the Transfer Date as that term is used in the Dodd-Frank Wall Street Reform Act (Public Law 111-203, §311, July 21 2010). Upon the Transfer Date applications related to savings and loan holding companies should be filed with the Board of Governors of the Federal Reserve System.

Section 19 specifically prohibits a person subject to its coverage from owning or controlling an insured institution. For purposes of defining "control" and "ownership" under section 19, the FDIC has adopted the definition of "control" set forth in the Change in Bank Control Act ([12 U.S.C. 1817\(j\)\(8\)\(B\)](#)). A person will be deemed to exercise "control" if that person has the power to vote 25 percent or more of the voting shares of an insured institution (or ten percent of the voting shares if no other person has more shares) or the ability to direct the management or policies of the insured institution. Under the same standards, person will be deemed to "own" an insured institution if that person owns 25 percent or more of the insured institution's voting stock, or ten percent of the voting shares if no other person owns more. These standards would also apply to an individual acting in concert with others so as to have such ownership or control. Absent the FDIC's consent, persons subject to the prohibitions of section 19 will be required to divest their ownership of shares above the foregoing limits.

B. Standards for Determining Whether an Application Is Required

Except as indicated in paragraph (5), below, an application must be filed where there is present a conviction by a court of competent jurisdiction for a covered offense by any adult or minor treated as an adult, or where such person has entered a pretrial diversion or similar program regarding that offense.

(1) Convictions. There must be present a conviction of record. Section 19 does not cover arrests, pending cases not brought to trial, acquittals, or any conviction which has been reversed on appeal. A conviction with regard to which an appeal is pending will require an application until or unless reversed. A conviction for which a pardon has been granted will require an application. A conviction which has been completely expunged is not considered a conviction of record and will not require an application. For an expungement to be considered complete, no one, including law enforcement, can be permitted access to the record even by court order under the state or federal law which was the basis of the expungement.

(2) Pretrial Diversion or Similar Program. Program entry, whether formal or informal, is characterized by a suspension or eventual dismissal of charges or criminal prosecution upon agreement by the accused to treatment, rehabilitation, restitution, or other noncriminal or nonpunitive alternatives. Whether a program constitutes a pretrial diversion is determined by relevant federal, state or local law, and will be considered by the FDIC on a case-by-case basis. Program entries prior to November 29, 1990, are not covered by section 19.

(3) Dishonesty or Breach of Trust. The conviction or program entry must be for a criminal offense involving dishonesty, breach of trust or money laundering. "Dishonesty" means directly or indirectly to cheat or defraud; to cheat or defraud for monetary gain or its equivalent; or wrongfully to take property belonging to another in violation of any criminal statute. Dishonesty includes acts involving want of integrity, lack of probity, or a disposition to distort, cheat, or act deceitfully or fraudulently, and may include crimes which federal, state or local laws define as dishonest. "Breach of trust" means a wrongful act, use, misappropriation or omission with respect to any property or fund which has been committed to a person in a fiduciary or official capacity, or the misuse of one's official or fiduciary position to engage in a wrongful act, use, misappropriation or omission.

Whether a crime involves dishonesty or breach of trust will be determined from the statutory elements of the crime itself. All convictions for offenses concerning the illegal manufacture, sale, distribution of or trafficking in controlled substances shall require an application.

(4) Youthful Offender Adjudgments. An adjudgment by a court against a person as a "youthful offender" under any youth offender law, or any adjudgment as a "juvenile delinquent" by any court having jurisdiction over minors as defined by state law does not require an application. Such adjudications are not considered convictions for criminal offenses.

(5) *De minimis* Offenses. Approval is automatically granted and an application will not be required where the covered offense is considered *de minimis*, because it meets all of the following criteria:

- There is only one conviction or program entry of record for a covered offense;
- The offense was punishable by imprisonment for a term of one year or less and/or a fine of ~~\$2,500~~ \$1,000 or less, and the individual did not served more than three (3) days or less of actual jail time~~not serve time in jail~~;

- The conviction or program was entered at least five years prior to the date an application would otherwise be required; and
- The offense did not involve an insured depository institution or insured credit union.

A conviction or program entry of record based on the writing of a "bad" or insufficient funds check(s) shall be considered a *de minimis* offense under this provision even if it involved an insured depository institution or insured credit union if the following applies:

- All other requirements of the *de minimis* offense provisions are met;
- The aggregate total face value of the bad or insufficient funds check(s) cited in the conviction was \$1000 or less; and
- No insured depository institution or insured credit union was a payee on any of the bad or insufficient funds checks that were the basis of the conviction.

Any person who meets the foregoing criteria shall be covered by a fidelity bond to the same extent as others in similar positions, and shall disclose the presence of the conviction or program entry to all insured institutions in the affairs of which he or she intends to participate.

C. Procedures

When an application is required, forms and instructions should be obtained from, and the application filed with, the appropriate FDIC Regional Director. The application must be filed by an insured institution on behalf of a person unless the FDIC grants a waiver of that requirement. Such waivers will be considered on a case-by-case basis where substantial good cause for granting a waiver is shown.

D. Evaluation of Section 19 Applications

The essential criteria in assessing an application are whether the person has demonstrated his or her fitness to participate in the conduct of the affairs of an insured institution, and whether the affiliation, ownership, control or participation by the person in the conduct of the affairs of the insured institution may constitute a threat to the safety and soundness of the insured institution or the interests of its depositors or threaten to impair public confidence in the insured institution. In determining the degree of risk, the FDIC will consider:

- (1) The conviction or program entry and the specific nature and circumstances of the covered offense;
- (2) Evidence of rehabilitation including the person's reputation since the conviction or program entry, the person's age at the time of conviction or program entry, and the time which has elapsed since the conviction or program entry;
- (3) The position to be held or the level of participation by the person at an insured institution;

(4) The amount of influence and control the person will be able to exercise over the management or affairs of an insured institution;

(5) The ability of management of the insured institution to supervise and control the person's activities;

(6) The degree of ownership the person will have of the insured institution

(7) The applicability of the insured institution's fidelity bond coverage to the person;

(8) The opinion or position of the primary Federal and/or state regulator; and

(9) Any additional factors in the specific case that appear relevant.

The foregoing criteria will also be applied by the FDIC to determine whether the interests of justice are served in seeking an exception in the appropriate court when an application is made to terminate the ten-year ban prior to its expiration date.

Some applications can be approved without an extensive review because the person will not be in a position to constitute any substantial risk to the safety and soundness of the insured institution. Persons who will occupy clerical, maintenance, service or purely administrative positions, generally fall into this category. A more detailed analysis will be performed in the case of persons who will be in a position to influence or control the management or affairs of the insured institution. Approval orders will be subject to the condition that the person shall be covered by a fidelity bond to the same extent as others in similar positions. In cases in which a waiver of the institution filing requirement has been granted to an individual, approval of the application will be conditioned upon that person disclosing the presence of the conviction to all insured institutions in the affairs of which he or she wishes to participate. When deemed appropriate, approval orders may also be subject to the condition that the prior consent of the FDIC will be required for any proposed significant changes in the person's duties and/or responsibilities. Such proposed changes may, in the discretion of the Regional Director, require a new application. In situations in which an approval has been granted for a person to participate in the affairs of a particular insured institution and subsequently seeks to participate at another insured institution, approval does not automatically follow. In such cases, another application must be submitted.

[Source: 63 Fed. Reg. 66184 December 1, 1998; amended May 10, 2011]

EXHIBIT B

FDIC STATEMENT OF POLICY FOR SECTION 19 OF THE FDI ACT

Section 19 of the Federal Deposit Insurance Act (12 U.S.C. 1829) prohibits, without the prior written consent of the Federal Deposit Insurance Corporation (FDIC), a person convicted of any criminal offense involving dishonesty or breach of trust or money laundering (covered offenses), or who has agreed to enter into a pretrial diversion or similar program in connection with a prosecution for such offense, from becoming or continuing as an institution-affiliated party, owning or controlling, directly or indirectly an insured depository institution (insured institution), or otherwise participating, directly or indirectly, in the conduct of the affairs of the insured institution. In addition, 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. It imposes a ten-year ban against the FDIC's consent for persons convicted of certain crimes enumerated in Title 18 of the United States Code, absent a motion by the FDIC and court approval.

Section 19 imposes a duty upon the insured institution to make a reasonable inquiry regarding an applicant's history, which consists of taking steps appropriate under the circumstances, consistent with applicable law, to avoid hiring or permitting participation in its affairs by a person who has a conviction or program entry for a covered offense. The FDIC believes that at a minimum, each insured institution should establish a screening process which provides the insured institution with information concerning any convictions or program entry pertaining to a job applicant. This would include, for example, the completion of a written employment application which requires a listing of all convictions and program entries. The FDIC will look to the circumstances of each situation to determine whether the inquiry is reasonable. Upon notice of a conviction or program entry, an application seeking the FDIC's consent prior to the person's participation must be filed.

Section 19 applies, by operation of law, as a statutory bar to participation absent the written consent of the FDIC. The purpose of an application is to provide the applicant an opportunity to demonstrate that, notwithstanding the bar, a person is fit to participate in the conduct of the affairs of an insured institution without posing a risk to its safety and soundness or impairing public confidence in that institution. The burden is upon the applicant to establish that the application warrants approval.

A. Scope of Section 19

Section 19 covers institution-affiliated parties, as defined by 12 U.S.C. 1813(u) and others who are participants in the conduct of the affairs of an insured institution. This Statement of Policy applies only to insured institutions, their institution-affiliated parties, and those participating in the affairs of an insured depository institution. Therefore, all employees of an insured institution fall within the scope of section 19. In addition, those deemed to be de facto employees as determined by the FDIC based upon generally applicable standards of employment law, will also be subject to section 19. Whether other persons who are not institution-affiliated parties are covered depends upon their degree of influence or control over the management or affairs of an insured institution. For example, section 19 would not apply to persons who are merely

employees of an insured institution's holding company, but would apply to its directors and officers to the extent that they have the power to define and direct the policies of the insured institution. Similarly, directors and officers of affiliates, subsidiaries or joint ventures of an insured institution or its holding company will be covered if they are in a position to influence or control the management or affairs of the insured institution. Those who exercise major policymaking functions of an insured institution would be deemed participants in the affairs of that institution and covered by section 19. Typically, an independent contractor does not have a relationship with the insured institution other than the activity for which the insured institution has contracted. Under 12 U.S.C. 1813(u), independent contractors are institution-affiliated parties if they knowingly or recklessly participate in violations, unsafe or unsound practices or breaches of fiduciary duty which are likely to cause significant loss to, or a significant adverse effect on, an insured institution. In terms of participation, an independent contractor who influences or controls the management or affairs of the insured institution, would be covered by section 19. Further, "person" for purposes of section 19 means an individual, and does not include a corporation, firm or other business entity.

Individuals who file an application with the FDIC under the provisions of Section 19 who are participating in the affairs of a bank or savings and loan holding company may also have to comply with any filing requirements of the Board of the Governors of the Federal Reserve System under 12 U.S.C. §1819(d) in the case of a bank holding company, and the Office of Thrift Supervision under 12 U.S.C. §1819(e), in the case of a savings and loan holding company until the Transfer Date as that term is used in the Dodd-Frank Wall Street Reform Act (Public Law 111-203, §311, July 21 2010). Upon the Transfer Date applications related to savings and loan holding companies should be filed with the Board of Governors of the Federal Reserve System.

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(2) Pretrial Diversion or Similar Program. Program entry, whether formal or informal, is characterized by a suspension or eventual dismissal of charges or criminal prosecution upon agreement by the accused to treatment, rehabilitation, restitution, or other noncriminal or nonpunitive alternatives. Whether a program constitutes a pretrial diversion is determined by relevant federal, state or local law, and will be considered by the FDIC on a case-by-case basis. Program entries prior to November 29, 1990, are not covered by section 19.

(3) Dishonesty or Breach of Trust. The conviction or program entry must be for a criminal offense involving dishonesty, breach of trust or money laundering. "Dishonesty" means directly or indirectly to cheat or defraud; to cheat or defraud for monetary gain or its equivalent; or wrongfully to take property belonging to another in violation of any criminal statute. Dishonesty includes acts involving want of integrity, lack of probity, or a disposition to distort, cheat, or act deceitfully or fraudulently, and may include crimes which federal, state or local laws define as dishonest. "Breach of trust" means a wrongful act, use, misappropriation or omission with respect to any property or fund which has been committed to a person in a fiduciary or official capacity, or the misuse of one's official or fiduciary position to engage in a wrongful act, use, misappropriation or omission.

Whether a crime involves dishonesty or breach of trust will be determined from the statutory elements of the crime itself. All convictions for offenses concerning the illegal manufacture, sale, distribution of or trafficking in controlled substances shall require an application.

(4) Youthful Offender Adjudgments. An adjudgment by a court against a person as a "youthful offender" under any youth offender law, or any adjudgment as a "juvenile delinquent" by any court having jurisdiction over minors as defined by state law does not require an application. Such adjudications are not considered convictions for criminal offenses.

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- All other requirements of the *de minimis* offense provisions are met;
- The aggregate total face value of the bad or insufficient funds check(s) cited in the conviction was \$1000 or less; and
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- (1) The conviction or program entry and the specific nature and circumstances of the covered offense;
- (2) Evidence of rehabilitation including the person's reputation since the conviction or program entry, the person's age at the time of conviction or program entry, and the time which has elapsed since the conviction or program entry;
- (3) The position to be held or the level of participation by the person at an insured institution;

- (4) The amount of influence and control the person will be able to exercise over the management or affairs of an insured institution;
- (5) The ability of management of the insured institution to supervise and control the person's activities;
- (6) The degree of ownership the person will have of the insured institution
- (7) The applicability of the insured institution's fidelity bond coverage to the person;
- (8) The opinion or position of the primary Federal and/or state regulator; and
- (9) Any additional factors in the specific case that appear relevant.

The foregoing criteria will also be applied by the FDIC to determine whether the interests of justice are served in seeking an exception in the appropriate court when an application is made to terminate the ten-year ban prior to its expiration date.

Some applications can be approved without an extensive review because the person will not be in a position to constitute any substantial risk to the safety and soundness of the insured institution. Persons who will occupy clerical, maintenance, service or purely administrative positions, generally fall into this category. A more detailed analysis will be performed in the case of persons who will be in a position to influence or control the management or affairs of the insured institution. Approval orders will be subject to the condition that the person shall be covered by a fidelity bond to the same extent as others in similar positions. In cases in which a waiver of the institution filing requirement has been granted to an individual, approval of the application will be conditioned upon that person disclosing the presence of the conviction to all insured institutions in the affairs of which he or she wishes to participate. When deemed appropriate, approval orders may also be subject to the condition that the prior consent of the FDIC will be required for any proposed significant changes in the person's duties and/or responsibilities. Such proposed changes may, in the discretion of the Regional Director, require a new application. In situations in which an approval has been granted for a person to participate in the affairs of a particular insured institution and subsequently seeks to participate at another insured institution, approval does not automatically follow. In such cases, another application must be submitted.

[Source: 63 Fed. Reg. 66184 December 1, 1998; amended May 10, 2011]