FDIC
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

October 18, 2022

MEMORANDUM TO: The Board of Directors

FROM: Harrel M. Pettway
General Counsel

SUBJECT: Proposed Amendments to the Guidelines for Appeals of Material Supervisory Determinations

Recommendation

Staff recommends that the Board of Directors (Board) adopt the attached Proposed Amendments to the Guidelines for Appeals of Material Supervisory Determinations and authorize the publication in the *Federal Register* of the Notice and Request for Comment on the Amendments. Through this Notice, the FDIC would propose to amend the Guidelines for Appeals of Material Supervisory Determinations (Guidelines) by expanding and clarifying the role of the agency's Ombudsman. The proposed Guidelines also would require that materials considered by the Supervision Appeals Review Committee (SARC) be shared with both parties to the appeal, subject to applicable legal limitations on disclosure, and would allow insured depository institutions to request a stay of a material supervisory determination while an appeal is pending. The Notice would solicit comment on the proposal with a comment period of 30 days.

Background

Section 309(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 (Riegle Act) required each federal banking agency to establish an independent intra-agency appellate process to review material supervisory determinations.[1] To satisfy this requirement, the Board established the SARC and adopted the Guidelines to govern the appellate process.[2] The Board has periodically amended the Guidelines, often through notice and comment.

In January 2021, the FDIC revised the Guidelines to replace the SARC as the final level of review in the appellate process with a standalone office within the FDIC, designated the Office of Supervisory Appeals (Office).[3] After appealing a material supervisory determination to the relevant Division Director, an insured depository institution (IDI) would have had the option to appeal to the Office. The Guidelines did not provide for additional review beyond the Office.

[1] 12 U.S.C. 4806(a).
[2] 60 Fed. Reg. 15923 (Mar. 28, 1995).
[3] 86 Fed. Reg. 6880 (Jan. 25, 2021).

Earlier this year, the FDIC revised the Guidelines by restoring the SARC as the final level of review of material supervisory determinations made by the FDIC.[4] The revised Guidelines reconstituted the SARC as it existed in 2021. The FDIC decided to restore the SARC based on the agency's longstanding practice of ensuring Board-level review of material supervisory determinations, noting that this promotes both independence and accountability in the appellate process. Board-level review ensures accountability for the FDIC's supervisory determinations remains with the Board, consistent with sound corporate governance principles.

While the revised Guidelines were effective on May 17, 2022, the FDIC invited comments on all aspects of the revised Guidelines. The FDIC specifically asked for comments regarding the inclusion of the Ombudsman's perspective in the supervisory appeals process and for other ways to enhance the process while remaining consistent with the Ombudsman's role as a neutral liaison between supervised IDIs and the FDIC.

Discussion of Comments

The FDIC received four comment letters; these comments are discussed in further detail below.

Restoration of SARC Structure

Commenters generally disagreed with the restoration of the SARC structure and the FDIC's conclusion that this would enhance the independence of the appellate process. Commenters stated that the appellate process will be less independent if the Board has control over the outcome. In addition, commenters also raised the concern that the SARC structure may not provide the intended balancing of perspectives, given the current composition of the Board.

Some commenters recommended that the FDIC restore the Office of Supervisory Appeals. These commenters believed that the Office of Supervisory Appeals provided for greater independence in decision-making. Commenters also raised concerns with the process used to restore the SARC structure without first soliciting comment, and stated that the FDIC did not sufficiently explain why the Office of Supervisory Appeals structure could or should no longer function.

Ombudsman's Role

Commenters supported expanding the Ombudsman's role in the appeals process, explaining that Ombudsmen are experienced professionals specifically trained in resolving disputes between bankers and regulators. One commenter stated that Ombudsmen advocate for a fair and impartial process at the FDIC and would be a valuable source of information that would benefit appeals panel discussions.

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[4] 87 Fed. Reg. 30942 (May 20, 2022).

Communications

The revised Guidelines eliminated a provision that was added specifically to accommodate the Office of Supervisory Appeals. This provision required that any communications between the Office and supervisory staff be in writing and shared with an appealing IDI, subject to limitations on disclosure. Commenters stated that the requirement to share *ex parte* information with both parties is a fundamental right to assure that both parties are aware of the information shared with the decision-maker and have an opportunity to respond to that information.

Standard of Review

A commenter recommended that the FDIC adopt a *de novo* standard of review, asserting that this would be consistent with the standard adopted by the Board of Governors of the Federal Reserve System in its supervisory appeals process and explained that a more robust *de novo* standard of review would increase institutions' confidence in the process.

Stay of Material Supervisory Determinations

A commenter recommended that the FDIC stay supervisory actions during an appeal because supervisory determinations can have consequences for an institution, such as removing an institution from expedited processing of applications.

Proposed Guidelines

Based on the recommendations from commenters, staff is recommending that the Board propose to amend the Guidelines to address commenters' concerns as discussed below.

SARC Structure

The proposed Guidelines would retain the SARC as the final level of review of material supervisory determinations made by the FDIC. Review of material supervisory determinations by a Board-level committee such as the SARC promotes accountability in the supervisory appeals process. Ultimate responsibility for the FDIC's supervision function is vested in the Board by statute, and the SARC structure ensures that the Board remains accountable for the agency's supervisory determinations. Accordingly, the FDIC's longstanding practice has been to ensure Board-level review of material supervisory determinations with a panel also including other senior officials. The Guidelines governing the Office allowed for reliance on individuals with previous supervisory experience recruited from outside the FDIC and hired for intermittent service on a time-limited contract basis to make final supervisory determinations on behalf of the FDIC.

Hiring individuals from outside the agency represented a significant departure from the FDIC's established approach for over 25 years of reliance on a Board-level committee and undermines accountability for these supervisory determinations. Moreover, it is fundamentally inconsistent with how the other financial regulators have carried out their responsibilities under the Riegle Act. While there is some diversity of approach among the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the National Credit Union Administration, all of these agencies utilize full-time internal staff or Board members to carry out their appeals processes. The Office of the Comptroller of the Currency allows supervisory appeals to be decided by its Ombudsman, the National Credit Union Administration allows appeals to a committee of senior staff or directly to its Board of Directors, and the Board of Governors of the Federal Reserve System utilizes panels of staff from the Federal Reserve Banks and the Board of Governors.

Review of material supervisory determinations by the SARC also promotes independence from the usual supervisory and examination channels in a manner consistent with the Riegle Act. As provided by the statute, independent review means review "by an agency official who does not directly or indirectly report to the agency official who made the material supervisory determination under review." Members of the Board (and their special assistants or deputies) are agency officials independent from the staff that carry out day-to-day supervisory responsibilities. They also bring important knowledge and experience with current applicable laws, regulations, and policies when they consider appeals.

In terms of timing, comment was not solicited prior to restoring the SARC structure because, at that time, there were no pending appeals and the new Office had not yet been utilized in any cases. The FDIC sought to avoid a situation in which an appeal might be filed while these Guidelines and the appropriate appeals structure were under review. As indicated in the May 2022 notice, taking action quickly minimized the potential for confusion among IDIs with respect to the process they must follow in the event they wish to appeal a material supervisory determination. While the FDIC's primary reason for restoring the SARC structure was promoting independence and accountability in the process, it noted that staffing considerations also favored a return to the SARC structure. Commenters sought additional detail on these considerations. The FDIC had engaged in extensive efforts to recruit reviewing officials to staff the Office of Supervisory Appeals, extending the application postings for these positions in an attempt to develop a broad pool of applicants. Three reviewing officials were hired, but this would have been insufficient to provide for the minimum three-member panel if an individual were unable to participate in the review of an appeal due to a conflict of interest or illness, leaving the Office unable to function.

In response to commenters' concerns regarding the need for a balance of perspectives to be reflected in the appellate process, staff recommends that the FDIC propose to add the Ombudsman to the SARC as a non-voting member. Adding the Ombudsman as a non-voting member would minimize any potential for conflict with the Ombudsman's statutory role. Under the Riegle Act, the Ombudsman acts as liaison between the agency and any affected person, and assures that safeguards exist to encourage complainants to come forward and preserve confidentiality.[5] The FDIC's Ombudsman has a longstanding commitment to neutrality that

[5] 12 U.S.C. 4806(d). The FDIC notes that the OCC Ombudsman's role in deciding supervisory appeals predates the enactment of the Riegle Act (which also required the appointment of an Ombudsman). The FDIC also notes that the Ombudsmen at the Board of Governors of the Federal Reserve System and the National Credit Union Administration are not involved in decision making for appeals.

could be compromised if the Ombudsman were to serve as a voting member of the SARC. As a non-voting member, the Ombudsman would be expected to attend SARC meetings, participate in discussions, and offer views, opinions, and advice to the SARC during its deliberations based on the Ombudsman's perspective as a neutral advocate for a fair process, and as a party independent of the supervisory process. Under the proposed Guidelines, the Ombudsman would also have access to all materials reviewed by the SARC.

Staff recognizes that adding the Ombudsman to the SARC could cause IDIs to reconsider whether they should share confidential information with the Ombudsman, given that the Ombudsman could be involved in deciding a potentially related supervisory appeal. The current Guidelines provide a mechanism to address this by allowing a SARC member to designate the most senior member of his or her staff to serve on the SARC on his or her behalf. Staff is proposing to broaden this authority to allow a SARC member to designate any member of his or her staff within the member's area of responsibility. For example, if the Ombudsman were unable to serve as a SARC member with respect to a particular appeal because of information learned from meeting with the IDI, he or she might designate a Regional Ombudsman who has not been involved in the matter to serve on the SARC instead.

Commenters also expressed concern about possible retaliatory actions if an IDI submits a supervisory appeal. Due to these concerns, staff recommends proposing to amend the Guidelines to require the Ombudsman to monitor the supervisory process following an IDI's submission of an appeal. The Ombudsman would be expected to report to the Board on these matters periodically. Staff believes these enhancements to the process may alleviate some IDIs' concerns regarding potential retaliation.

Sharing of Materials

Due to commenters' concerns regarding the elimination of a provision that generally required communications to be shared with the appealing institution, staff recommends that the proposal include a provision requiring that all materials considered by the SARC are shared with both parties to the appeal, subject to applicable legal limitations on disclosure.[6] The Ombudsman would verify that both parties have received all materials considered by the SARC.

Standard of Review

In 2021, the FDIC amended the Guidelines to provide that the Division Director's standard of review would be substantially similar to the standard of review employed by the Federal Reserve's initial review panels.[7] Under the FDIC's Guidelines, the Division Director considers whether a material supervisory determination is consistent with applicable laws, regulations, and policies, and makes his or her own supervisory determination without deferring to the judgments of either party. This may be considered a *de novo* standard of review, and

[6] For example, the disclosure of confidential supervisory information and certain other types of information is restricted under 12 CFR part 309. Thus, to the extent that materials shared with the SARC include such confidential supervisory information relating to another IDI, for example, that material could be redacted.
[7] 86 Fed. Reg. 6880, 6883 (Jan. 25, 2021).

remains unchanged in the current Guidelines. Staff believes that the standard of review set forth in the FDIC's process is consistent with the standard of review used by the Federal Reserve, in that neither standard provides that the decision maker will defer to the judgment of agency staff that made the material supervisory determination under review.

The Guidelines also clearly explain the standard of review for the SARC, promoting transparency and enabling institutions to understand how their appeals will be evaluated. The SARC reviews appeals for consistency with the policies, practices, and mission of the FDIC and the overall reasonableness of, and the support offered for, the positions advanced. This is similar to the standard of review employed by the Federal Reserve's final review panels, which consider whether the decision of the initial review panel is reasonable and whether there has been a clear error of judgment. Staff believes the agencies' standards are generally consistent, and neither agency's process provides for a *de novo* standard at the final level of review.

Stay of Material Supervisory Determinations

The FDIC has previously stated that institutions may request a stay of supervisory actions from the appropriate Division Director during the pendency of an appeal,[8] but staff agrees that it would be useful to address this aspect of the process expressly in the Guidelines to better ensure that IDIs are aware of the ability to request a stay. Accordingly, staff recommends proposing to amend the Guidelines to expressly permit IDIs to request a stay of an action or determination while an appeal is pending. The Division Director would have discretion to grant a stay, and would generally decide whether a stay is granted within 21 days of receiving the IDI's request. The Division Director could grant a stay subject to certain conditions where appropriate.

Request for Comment

The Notice prepared by staff includes a request for comment, particularly regarding the role of the Ombudsman, sharing of appeal materials, and the ability of an IDI to request a stay of a supervisory action.

Conclusion

Staff recommends that the Board approve the attached Notice and Request for Comment for publication in the *Federal Register*, with a comment period of 30 days.

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[8] *See* 82 Fed. Reg. 34522, 34526 (July 25, 2017).