FDIC Federal Deposit Insurance Corporation

December 13, 2022

MEMORANDUM TO: The Board of Directors

FROM: Harrel M. Pettway
General Counsel

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

Recommendation

Staff recommends that the Board of Directors (Board) adopt the attached Notice of Guidelines and authorize its publication in the *Federal Register*. Through this Notice, the FDIC would amend the Guidelines for Appeals of Material Supervisory Determinations (Guidelines) by: (1) expanding and clarifying the role of the agency's Ombudsman in the appeals process, including adding the Ombudsman to the Supervision Appeals Review Committee (SARC) as a non-voting member; (2) requiring that materials considered by the SARC be shared with both parties to the appeal on a timely basis, subject to applicable legal limitations on disclosure; and (3) allowing insured depository institutions (IDIs) to request a stay of a material supervisory determination while an appeal is pending. Staff recommends that the revised Guidelines become effective upon approval by the Board in order to provide the benefits of the amendments to appealing institutions as soon as possible.

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 since that time.

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 IDI would have had the option to appeal to the Office. The Guidelines did not provide for additional review beyond the Office.

Earlier this year, the FDIC revised the Guidelines by restoring the SARC as the FDIC's final level of review of material supervisory determinations.[4] At that time, the FDIC requested

[1] 12 U.S.C. 4806(a).
[2] 60 Fed. Reg. 15923 (Mar. 28, 1995).
[3] 86 Fed. Reg. 6880 (Jan. 25, 2021).
[4] 87 Fed. Reg. 30942 (May 20, 2022).

comment on the revised Guidelines, including, in particular, how the process could be further enhanced to include the Ombudsman's perspective. Commenters generally disagreed with the restoration of the SARC structure, but supported expanding the Ombudsman's role in the appeals process. In addition, commenters recommended changes to other aspects of the appeals process, including the sharing of information with an appealing institution, the standard of review, and staying supervisory actions while an appeal is pending.

October 2022 Proposal to Amend the Guidelines

In October 2022, the FDIC proposed further amendments to the Guidelines to incorporate certain suggestions made by commenters and address concerns raised by the commenters. Recognizing the need for a balance of perspectives to be reflected in the appellate process, the FDIC proposed to add the Ombudsman to the SARC as a non-voting member. Adding the Ombudsman to the SARC as a non-voting member would minimize any potential for conflict with the Ombudsman's statutory role as a liaison between the agency and any affected person. 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.

The FDIC also recognized 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 FDIC proposed to address this by allowing a SARC member to designate any member of his or her staff within the member's area of responsibility to serve on the SARC on his or her behalf. 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 institution, he or she might designate a Regional Ombudsman who has not been involved in the matter to serve on the SARC instead.

In addition, the FDIC sought to address concerns expressed by commenters about possible retaliatory actions if an IDI submits a supervisory appeal. The proposal required the Ombudsman to monitor the supervisory process following an IDI's submission of an appeal, and noted that the Ombudsman would be expected to report to the Board on these matters periodically.

The proposal also sought to address commenters' concerns regarding the elimination of a provision that generally required communications between the Office and supervisory staff to be shared with the appealing institution. The FDIC agreed that basic notions of fairness support a requirement that both parties to the appeal are aware of the information considered by the decision-maker. The proposal required that all materials considered by the SARC be shared with both parties to the appeal, subject to applicable legal limitations on disclosure.[5] The Ombudsman would oversee this aspect of the process, verifying that both parties have received all materials considered by the SARC.

The proposal further expressly permitted 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.

Discussion of Comments

The FDIC received three comment letters in response to the proposed Guidelines: (1) a joint letter from six banking industry trade associations; (2) a letter from a bank holding company; and (3) a letter from a nonprofit think tank. While commenters were appreciative of some of the FDIC's proposed changes, they all had further suggestions.

SARC Membership

Commenters were generally supportive of including the Ombudsman as a member of the SARC. While commenters viewed this change as an improvement, one commenter questioned why the Ombudsman would be made a non-voting member, rather than a voting member, of the SARC.

A commenter suggested that the Guidelines specify the criteria for minimum qualifications to serve as a voting member of the SARC when an individual is designated by an FDIC Director, stating that this would promote greater credibility and trust in the process. The commenter also recommended that the FDIC develop and maintain a list of qualified candidates outside the FDIC to serve on the SARC, including current state supervisors (from states and regions outside of where the appeal originated) and retired examiners, and allow FDIC Directors to appoint individuals from this list to serve on the SARC.

Stay of a Supervisory Decision or Action

Commenters generally appreciated the proposal to allow institutions to request a stay of a material supervisory determination while an appeal is pending. However, one commenter suggested requiring the SARC, rather than the appropriate Division Director, to decide requests for stays. The commenter recommended that the FDIC set specific standards for evaluating stay requests, and making public the basis for denial of any stay request (subject to the protection of confidential information). Another commenter suggested that a stay would be automatic unless the relevant Division Director can make a showing in writing that a stay would pose a threat to the safety and soundness of the bank or otherwise adversely impact the banking system.

[5] 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.

Appeal Directly to SARC and SARC Standard of Review

One commenter suggested giving institutions the option to bypass the Division Director level review and appeal directly to the SARC. This commenter also suggested requiring the SARC to conduct a *de novo* review and prohibiting the SARC from relying on the opinions and conclusions of the Division Directors, including their findings of facts.

Sharing of Information

A commenter suggested that the FDIC clarify that both parties will receive the information considered by the SARC on a timely basis prior to the issuance of the SARC's decision, so that both parties will have an opportunity to correct the factual record prior to a SARC decision.

Burden of Proof

A commenter stated that the burden of proof in appeals proceedings should not be on the institution, noting that this is not required by statute, and the appellate process is not governed by the Administrative Procedure Act or other formal judicial review procedures. The commenter stated that this reinforces a structure under which an appeal cannot succeed unless the decision maker rules that the people they supervise are not merely wrong, but clearly wrong.

Inspector General Review

One commenter recommended that the FDIC instruct the FDIC's Office of the Inspector General (OIG) conduct periodic reviews of the appellate process as well as the decisions or outcomes of appeals, and publish these findings on the FDIC's website. The commenter stated that the FDIC Board should annually review and approve the OIG's findings and make them public.

Final Guidelines

Staff recommends amending the Guidelines generally as proposed, with additional changes intended to address certain concerns raised by the commenters. As discussed further below, the revised Guidelines would include the following changes: 1) adding the Ombudsman as a non-voting member of the SARC, 2) requiring all materials considered by the SARC to be shared with both parties to the appeal on a timely basis, subject to applicable legal limitations on disclosure, and 3) requiring the Division Director, when deciding whether to issue a stay with respect to a material supervisory determination, to provide the institution with the reason(s) for his or her decision in writing.

Ombudsman's Role

The revised Guidelines include the Ombudsman as a non-voting member of the SARC. Staff believes that this provides for a balance of perspectives to be reflected in the process while minimizing potential for conflict with the Ombudsman's statutory role that may result if the Ombudsman were a voting member. The FDIC's Ombudsman has a longstanding commitment to neutrality that could be compromised if the Ombudsman were to serve as a voting member of the SARC. If the Ombudsman were a voting member, he or she might decide a matter against the institution, and this possibility could affect IDIs' willingness to utilize the Ombudsman's services. As a non-voting member, the Ombudsman would 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. As a SARC member, the Ombudsman would have access to all materials reviewed by the SARC. Consistent with these changes, the revised Guidelines include conforming amendments in sections G.4 and J.

In addition, the revised Guidelines would require the Ombudsman to monitor the supervisory process following an IDI's submission of an appeal. This should help to alleviate concerns regarding potential retaliation. The Ombudsman would be expected to report to the Board on these matters periodically.

Consistent with the proposal, the revised Guidelines would allow a SARC member to designate any member of his or her staff within the member's area of responsibility to serve on the SARC on his or her behalf. For example, if the Ombudsman is unable to serve as a SARC member with respect to a particular appeal because of information learned from meeting with the institution, he or she might designate a Regional Ombudsman who has not been involved in the matter to serve on the SARC instead.

The Ombudsman also would oversee the sharing of information considered by the SARC in connection with the appeal, as described in further detail below.

Sharing of Information

A commenter appreciated the proposed provision that would require information considered by the SARC to be shared with both parties to the appeal, subject to applicable legal limitations on disclosure. However, the commenter suggested that the FDIC clarify the timing of when parties will receive this information. The revised Guidelines state that information considered by the SARC (subject to applicable legal limitations on disclosure) will be shared on a timely basis. This information will be provided in time for the appealing institution to prepare for a meeting with the SARC, if oral presentation is requested. The revised Guidelines provide that the Ombudsman will oversee this aspect of the process, verifying that both parties have received all materials considered by the SARC.

Stay of Material Supervisory Determinations

As discussed above, commenters raised concerns relating to the proposed provision of the Guidelines that would allow institutions to request a stay of a supervisory determination while an appeal is pending. The revised Guidelines would provide that requests for a stay should be directed to and decided by the Division Director. In order to preserve the SARC's independent judgment based on the complete record of the appeal as provided by the appealing bank and the responsible supervisory staff, decision-making authority regarding a request for a stay will remain with the appropriate Division Director. In response to comments, the Guidelines would require any decision with respect to a stay include the reason(s) for the decision in writing. This is also consistent with current practice. In terms of standards for evaluating a request for a stay, the decision may be based on a number of factors, including the likelihood of irreparable and/or material harm. The resolution of procedural requests, including a request for a stay, will typically be set forth in the SARC's decision with respect to an appeal, which will be published as provided by the Guidelines.

If an institution is concerned about the impact of a supervisory determination, section G of the Guidelines also provides for expedited review by the SARC under appropriate circumstances. In some circumstances, this course of action may be more appropriate than requesting a stay of a supervisory decision or action.

Responses to Other Comments

SARC Membership

A commenter suggested that the Guidelines specify the criteria for minimum qualifications to serve as a voting member of the SARC when an individual is designated by an FDIC Director, stating that this would promote greater credibility and trust in the process. SARC members that have been designated by Directors are special assistants or deputies to that Director and have a broad view of FDIC policy due to their positions. They are agency officials independent from the staff that carry out day-to-day supervisory responsibilities, but have substantial exposure to the supervisory process, providing a strong foundation for reviewing material supervisory determinations.

Appeal Directly to SARC

A commenter suggested giving institutions the option to bypass the Division Director level review and appeal directly to the SARC. The FDIC has previously noted, however, that its experience in administering the appellate process suggests that Division-level review resolves issues, narrowing the matters in dispute prior to SARC review or eliminating the need for an appeal to the SARC. Division-level review also ensures that arguments are more fully developed for the SARC's review, and allows the Division Director to correct errors and maintain consistency across the organization. The Division Director also has the authority to refer an appeal directly to the SARC under the current Guidelines.

Structure of Appeals Process

The commenters did not support the approach reflected in the proposed Guidelines, with two commenters recommending that the either FDIC reinstate the Office of Supervisory Appeals or develop and maintain a list of qualified candidates outside the FDIC to serve on the SARC. The Riegle Act requires appeals to be decided by agency officials, as it defines "independent appellate process" as "review by an agency official who does not directly or indirectly report to the agency official who made the material supervisory determination under review."[6] Review of material supervisory determinations by a Board-level committee such as the SARC also promotes accountability in the supervisory appeals process. Ultimate responsibility for the FDIC's supervision function is vested in the agency's Board of Directors by statute, and the SARC structure ensures that the Board remains accountable for the agency's supervisory determinations. Hiring individuals from outside the agency to make final supervisory decisions was a significant departure from the FDIC's established approach for more than 25 years of reliance on a Board-level committee and could undermine accountability for supervisory determinations. Moreover, this approach differed significantly from how the other agencies subject to the Riegle Act carry out their responsibilities under the Act. While there is some diversity of approach, the Federal Reserve Board of Governors, the Office of the Comptroller of the Currency, and the National Credit Union Administration utilize full-time, internal staff or Board members in their appeals processes.

SARC Standard of Review

The SARC reviews an appeal for consistency with the policies, practices, and mission of the FDIC and the overall reasonableness of, and the support offered for, the positions advanced. Staff believes this standard of review is appropriate at the final level of review, and is retaining it in the revised Guidelines. In addition, as the FDIC noted in the October 2022 proposal, use of a *de novo* standard at the final level of review would be inconsistent with the appeals processes used at other banking agencies, such as the Board of Governors of the Federal Reserve System. However, the Division Director considers whether material supervisory determinations are consistent with applicable laws, regulations, and policy, and makes his or her own supervisory determination without deferring to the judgments of either party. The FDIC has previously noted that this approach may reasonably be characterized or described as a *de novo* standard of review, while in fact providing more specificity on the actual considerations to be applied.

Burden of Proof

The Guidelines provide that the burden of proof as to all matters at issue in the appeal rests with the institution. A commenter raised concern with this provision, stating that an appeal cannot succeed unless the decision maker finds that a determination is not merely wrong, but clearly wrong. This conflates the burden of proof with the standard of review. The burden of proof only provides that the institution must come forward with evidence or arguments in order to make its case. The standard of review provides the level of proof demanded to satisfy that burden. The Guidelines do not require the institution to demonstrate that the determination is clearly wrong. Rather, the SARC reviews whether a material supervisory determination is consistent with the established policies, practices, and mission of the FDIC, as well as the overall reasonableness of, and the support offered for, the positions advanced.

[6] 12 U.S.C. § 4806(f)(2).

Inspector General Review

As noted above, a commenter recommended that the FDIC instruct the FDIC's Office of the Inspector General to conduct periodic reviews of the appellate process, and recommended that the FDIC's Board annually review and approve the OIG's findings and make them public. The OIG, however, is an independent office that conducts audits, evaluations, investigations, and other reviews of FDIC programs and operations. The FDIC generally does not instruct the OIG to initiate particular reviews. With respect to review of OIG findings, the FDIC's Audit Committee reviews all reports from the OIG relating to FDIC's operations. The FDIC is not in a position to approve the findings of the OIG, which is an independent office.

Conclusion

Staff recommends that the Board approve the attached Notice of Guidelines for publication in the *Federal Register*. The revised Guidelines would: expand and clarify the role of the FDIC's Ombudsman in the appeals process, including adding the Ombudsman to the SARC as a non-voting member; require that materials considered by the SARC be shared with both parties on a timely basis, subject to applicable legal limitations on disclosure; and allow IDIs to request a stay of a material supervisory determination while an appeal is pending. The revised Guidelines would take effect immediately upon the Board's approval in order to provide the benefits of these amendments to appealing institutions as soon as possible.

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