November 21, 2022

James P. Sheesley
Assistant Executive Secretary
Attention: Comments – RIN 3064-ZA20
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Guidelines for Appeals of Material Supervisory Determinations

Dear Mr. Sheesley:

We, the undersigned banking trade associations[1], appreciate the FDIC soliciting further public comment on amendments to its Guidelines of Material Supervisory Determinations ("Guidelines").[2] In response to the initial feedback collected after the FDIC Board voted to reconstitute the Supervision Review Appeals Committee ("SARC")[3], the FDIC is proposing to amend its Guidelines of Material Supervisory Determinations ("Guidelines") to (1) add the Ombudsman to the SARC as a non-voting member; (2) require the Ombudsman to monitor the supervision process following an institution's submission of an appeal; (3) require materials considered by the SARC to be shared with both parties to the appeal; and (4) allow IDIs to request a stay of a material supervisory determination while an appeal is pending.[4]

[1] The American Association of Bank Directors, the American Bankers Association, the Bank Policy Institute, the Consumer Bankers Association, the Independent Community Bankers of America, and the Mid-size Bank Coalition of America (collectively, "the Associations").

[2] FDIC, FIL-46-2022, *Proposed Amendments to Guidelines for Appeals of Material Supervisory Determinations* (Oct. 18, 2022) available at: https://www.fdic.gov/news/financial-institution-letters/2022/fil22046.html.

[3] FDIC, *Sunshine Act Meeting,* (June 2, 2022) available at: https://www.fdic.gov/news/boardmatters/2022 /2022-05-17-notice.html.

[4] FIL-46-2022.

Unfortunately, notwithstanding the FDIC's proposed modifications, many of the fundamental concerns we previously articulated remain.[5] Once again, the Associations strongly recommend that the FDIC reinstate the Office of Supervisory Appeals ("OSA") as the best way to achieve the FDIC's stated goals for a more independent, fair and credible material supervisory determination appeals process. By abandoning the OSA after only five months of operation, the FDIC has prematurely given up on a process that holds extraordinary promise of providing FDIC-supervised banks a fair and impartial forum for appeal. Should the FDIC choose to retain the SARC, however, this letter identifies several opportunities for improvement that can help the FDIC better meet its objectives. These include:

- Setting minimum qualifications for voting members of the SARC who are not FDIC Board members and providing them the resources to conduct a *de novo* review;

- Providing banks the option to bring appeals directly to the SARC and bypass the first level of review by the appropriate FDIC Division Director.

We also offer recommendations in response to the most recent proposed modifications to the Guidelines relating to: (i) *ex parte* communications; (ii) stays of supervisory actions pending an appeal; and (iii) accountability and independence of the SARC. More specifically, our recommendations include:

- Prohibiting *ex parte* communications during an appeal;

- Providing for any *ex parte* communications that inadvertently occur to be memorialized in writing and made available to both the SARC and the appealing bank on a timely basis;

- Providing for the SARC – rather than the FDIC Division Director – to consider IDI requests for stays of material supervisory determinations pending appeal at the SARC; and

- Adopting reasonable standards that the decision-maker must apply in evaluating requested stays of material supervisory determinations.

While we appreciate the agency's stated objective to enhance due process – and support certain aspects of the proposal such as a new requirement to share SARC information with both parties as a necessary safeguard to protect against one-sided information sharing – on the whole, the FDIC's most recent proposal sets forth only a patchwork of changes that do not fundamentally alter the shortcomings of the appeals process. For example, while we support the expanded role of the FDIC Ombudsman in the supervisory appeals process as a non-voting member, the participation of the FDIC Ombudsman on the SARC does not meaningfully redress imbalances inherent in current and proposed review approaches.

Accordingly, even with the proposed modifications to the SARC, the FDIC's appeals process will not meet the expectations Congress had when it adopted Section 309(a) of the Riegle Community Development and Regulatory Improvement Act in 1994. Based on experience and past precedent, banks believe there is little likelihood of success in appealing a material supervisory determination and that the risk of

[5] *See gen.* comment letter submitted by AABD, ABA, BPI, CBA, ICBA, and MBCA to the FDIC on June 21, 2022 regarding "Guidelines for Appeals of Material Supervisory Determinations" available at: https://www. consumerbankers.com/cba-issues/comment-letters/joint-comment-letter-fdic-re-supervisory-appeals.

retribution from within the agency (whether real or just perceived) too often outweighs any benefit of pursuing an appeal.

Examiners are often asked to make complex and subjective judgments on matters such as loan quality and the capabilities of management and the board. They cannot be expected to always get it right and, if they are wrong, the consequences to banks can be severe.[6] The FDIC and the industry have a common interest in getting examination results right and having banks trust the appeals process.

I. <u>If the FDIC Determines Not to Resurrect the OSA, the FDIC Should at a Minimum Introduce Further Reforms Relating to the Minimum Qualifications of SARC Members and the Basic Structure of the Appeals Process</u>

As a voice independent of supervision, the Ombudsman can potentially play a useful role on the SARC, even without a vote. Nonetheless, a new non-voting representative does not address inherent imbalances in the appeals process. At a minimum, further reforms are required relating to the minimum qualifications of SARC members and the basic structure of the appeals process. Under both the current and proposed approaches, two-thirds of the voting members of the SARC are delegees – deputies or "special assistants" – of FDIC Directors. The other voting member is an FDIC Director. This composition is inherently part of the FDIC leadership structure and provides appellants little confidence the most senior executives of the agency (or their designees) will disagree with agency approaches or decisions of the people they lead.

a. Minimum Qualifications for Voting Members of the SARC

Any finalized Guidelines should specify the criteria for minimum qualifications to serve as a voting member of the SARC when an individual is designated by an FDIC Director. Specifying minimum qualifications for these members of the SARC would promote greater credibility and trust in the process. We recommend 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 the Guidelines should be revised to allow FDIC Directors to appoint individuals from this list to serve on the SARC.

b. Option to Bypass FDIC Division Director Level Review and Instead Appeal Directly to the SARC

The FDIC should revise the Guidelines to expressly permit banks to bypass initial review by Division Directors and instead file an appeal directly with the SARC – i.e., similar to the supervisory appeals process currently used by the OCC (which allows an appeal directly with the OCC Ombudsman). Moreover, we recommend that the final Guidelines expressly prohibit SARC members from relying on the opinions and conclusions of the applicable Division Directors, including their findings of facts. Instead, the Guidelines should state clearly that the SARC will conduct a *de novo* review and the FDIC should ensure that the SARC is appropriately staffed, and has the resources necessary, to perform a *de novo* review.

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[6] For example, a less than satisfactory CAMELS rating now is self-enforcing, with dramatic and automatic consequences for the bank and its parent holding company (*e.g.*, loss of 'financial holding company' status).

The current and proposed appeals process – with two levels of appellate review – is inherently biased towards the supervisory office and Division Directors and cumbersome for appellants to navigate. Over time, the number of appeals filed with the agency have been few and far between – reflecting the reality that many banks do not believe the process affords any reasonable chance of success on appeal.[7] At the very least, this tiny number of appeals (even recognizing that many exams do not provide criticism or a legitimate basis upon which to mount an appeal) suggest that the appeals process is not regarded by the industry as meaningful. The data alone argues for more fundamental revisions than the Guidelines proposed. In all likelihood, FDIC Board members and/or their designees on the SARC will almost always defer to and rely upon a Division Director's initial review of the matter under either the current or proposed Guidelines.[8] This deference is particularly troublesome because Division Directors are themselves conflicted with the examination teams they directly supervise. By the nature of the position (i.e., as a mentor and supervisor for examiners) a Division Director is almost certainly inclined to support his or her staff against a challenge to their decision-making. Moreover, in complex or contentious matters, they are often deeply involved, directly or indirectly, in managing and advising the bank's examiners on material supervisory determinations even before an appeal is filed.

II. <u>The Burden of Proof in Appeals Proceedings Should not be Placed on the Appealing IDI</u>

According to the proposed Guidelines, the burden of proof as to all matters at issue in the appeal rests with the IDI. The FDIC should not place the burden of proof on appealing banks. Such a requirement is not required by statute and is unnecessarily prescriptive because the SARC process is not governed by the Administrative Procedures Act or other formal judicial review procedures. Moreover, as proposed, because appealing banks carry the burden of proof, the SARC reinforces the disproportionate influence of the Division Directors by allowing the SARC to defer to these Directors' opinions. In effect, the Guidelines continue to reinforce a structure under which an appeal cannot succeed unless the appellate decision-maker rules that the people they supervise are not merely wrong, but clearly wrong. This standard both reduces sharply the prospects of success on appeal and increases the fear of retribution because of the "clearly wrong" argument that the appealing banks must make.

III. <u>The FDIC Should Prohibit *Ex Parte* Communications and Ensure that Both Parties Have an Opportunity to Correct the Factual Record Prior to a SARC Decision</u>

We support the proposed change to the Guidelines providing that both parties will receive all information considered by the SARC (subject to applicable confidentiality restrictions) but believe that it does not go far enough to ensure fundamental rights.

First, the FDIC should prohibit *ex parte* communications (including oral communications) during an appeal and require any *ex parte* communications that inadvertently occur to be memorialized in writing and made available to both the SARC and the appealing bank on a timely basis. As the preamble to the proposed Guidelines recognizes, the requirement that *ex parte* information be shared with both parties

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[7] Between January 2007 and January 2021, only 51 appeals were filed to the SARC out of 113,448 exams. FDIC, *Statement by FDIC Chairman Jelena McWilliams on Changes to Supervisory Appeals Process* (January 19, 2021), available at: https://www.fdic.gov/news/speeches/2021/spjan1921.html.

[8] Since FDIC members of the SARC often have an ongoing relationship with the examination staff involved in the appeal, it may be difficult for the SARC to opine upon material supervisory matters with necessary objectivity and impartiality.

in the appeal is a fundamental right to ensure that both parties are aware of information shared with the decision-maker.

Second, the proposed Guidelines should clarify the timing of when information considered by the SARC will be shared with both parties. If information is shared following a SARC decision, the parties will not have an opportunity to respond to (*e.g.*, to correct the record), as appropriate. Accordingly, the Guidelines should clarify that both parties will receive all information on a timely basis prior to the issuance of the SARC's decision. Moreover, parties should have a fair opportunity to present their case that the information is factually incorrect or irrelevant/misleading to the controversy at issue.

IV. The SARC Should Consider IDI Requests for Stays of Material Supervisory Determinations Pending Appeal at the SARC and Reasonable Standards for Evaluating Requested Stays of Material Supervisory Determinations Should be Memorialized and Applied

We agree in principle with the proposed amendment to the Guidelines that provides an IDI with the ability to request a stay of a FDIC supervisory decision or action while a supervisory appeal is pending.[9] Unlike the proposed approach, however, we recommend that the SARC – rather than the applicable Division Director – be the decision-maker where the appeal is pending at the SARC.

The ability to petition for a stay is especially important because, absent a stay pending the final determination, institutions could suffer many, or even all, the consequences of a final determination, thus rendering the appeal worthless as a practical matter. Under the proposed Guidelines, Division Directors have unfettered discretion to grant or reject requests for stays. Since the Division Directors perform the first level of review in the supervisory appeals process, the Director may have already determined that the appeal should be dismissed. Accordingly, allowing Division Directors to decide requests for stays is a less independent process than allowing the SARC to decide these requests when the appeal is pending at the SARC.

Additionally, to best preserve due process rights, the FDIC should adopt the following recommendations:

a. Reasonable Standards for Decision Makers to Follow in Evaluating Stay Requests

When considering requests for stays pending appeal in analogous contexts, decision-makers such as courts are required to evaluate the request with reasonable standards in mind. More specifically, decision-makers often evaluate whether there is a likelihood of irreparable, immediate and/or material harm. Absent these circumstances, a stay of a material supervisory determination should generally be deemed appropriate. Accordingly, rather than providing the decision-maker unfettered discretion in evaluating a request for a stay, we recommend that the final version of the amended Guidelines establish a rational basis on which the decision-maker (*e.g.*, the SARC or Division Director, as appropriate) analyze the merits of an appeal (*e.g.*, in general, a lack of irreparable, immediate and/or material harm often should be consistent with granting a stay while an appeal is pending).

[9] *See* 87 Fed. Reg. 64034 at 64041 (Oct. 21, 2022) ("Institutions may request from the appropriate Division Director a stay of a supervisory action or determination while an appeal of that determination is pending. The request must be in writing and include the reason(s) for the stay. The Division Director has discretion to grant a stay and will generally decide whether to grant a stay within 21 days of receiving the institution's request.")

b. Transparency into the Basis for Decisions Denying Stay Requests

The SARC – subject to protecting confidential supervisory information and the identity of the appealing institution – should be required to provide appellants and the public[10] some insight into the basis for its decision *(e.g.*, if a stay is denied, what was the rationale (i.e., the harm that needs to be avoided).)

V. <u>Steps Should be Taken to Promote the Independence and Accountability of the SARC Through OIG Audits and Ombudsman Investigations</u>

This responsibility to audit the independence of the SARC and its conformance with sound corporate governance principles should fall to the FDIC's Office of Inspector General.

If the FDIC maintains the SARC, the FDIC should instruct the Inspector General to periodically review both the SARC process as well as the decisions or outcomes of appeals, and to publish these findings in a public, and visible location on the FDIC's website. This review process would enable the FDIC to promote independence by undertaking a regular, formal review of the SARC to substantiate and make continued improvements to its independence, just as financial institutions verify the independence of their internal audit function.

The findings of the Inspector General as to the SARC's independence should be reviewed and approved by the FDIC Board annually and, once approved, should be made available to the public. Finally, the FDIC should empower the Ombudsman to investigate whether there are incidents of agency retribution during or after an appeal and provide the Ombudsman the resources to support that role.

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The Associations appreciate the FDIC's consideration of the foregoing recommendations in response to the FDIC's request for comment on the proposed Guidelines.

[10] Any information provided to the public should be anonymized.

Sincerely,

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David Androphy
Senior Manager
Prudential Regulation & Asset Management
American Bankers Association

Gregg Rozansky
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American Association of Bank Directors: The American Association of Bank Directors (AABD), founded in 1989 in the midst of the S&L crisis, provides directors of U.S. banks and savings institutions with the educational, informational and training resources to serve their institutions effectively and in a manner that will minimize risk of personal liability. It also represents their interests before federal and state legislative bodies, banking supervisory agencies and judicial bodies. It has established a Task Force of former banking agency senior officials, bank directors and CEOs, bank counsel, and academics to study how changes in law, regulation, and bank regulatory practices may minimize the risk of personal liability of bank directors consistent with safe and sound banking.

American Bankers Association: The American Bankers Association is the voice of the nation's $23.7 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $19.6 trillion in deposits and extend $11.8 trillion in loans.

Bank Policy Institute: BPI is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks, and the major foreign banks doing business in the United States. Collectively, they employ almost two million Americans, make nearly half of the nation's bank-originated small business loans and are an engine for financial innovation and economic growth.

Consumer Bankers Association: The Consumer Bankers Association is the only national financial trade group focused exclusively on retail banking and personal financial services—banking services geared toward consumers and small businesses. As the recognized voice on retail banking issues, CBA provides leadership, education, research, and federal representation for its members. CBA members include the nation's largest bank holding companies as well as regional and super-community banks that collectively hold two-thirds of the total assets of depository institutions.

Independent Community Bankers of America: The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. With nearly 50,000 locations nationwide, community banks constitute roughly 99 percent of all banks, employ nearly 700,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding nearly $5.9 trillion in assets, over $4.9 trillion in deposits, and more than $3.5 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America. For more information, visit ICBA's website at www.icba.org.

Mid-size Bank Coalition of America: The MBCA is the voice of America's mid-size banks. The MBCA represents more than 100 banks that are devoted to driving positive change and helping their clients, employees and communities flourish. MBCA members range in size from about $10 billion to $100 billion in assets and average approximately $20 billion. Our banks collectively serve clients and communities through more than 13,000 branches in all 50 states, Washington, DC, and three U.S. territories. MBCA banks are typically the largest independent banks headquartered in their respective states.