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PUBLIC INTEREST COMMENT

THE FDIC SHOULD RESTORE THE OSA OR, AT MINIMUM, SOLICIT PUBLIC VIEWS BEFORE REGRESSING TO THE SARC

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Guidelines for Appeals of Material Supervisory Determinations
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We appreciate the opportunity to comment on the proposed change by the Federal Deposit Insurance Corporation (FDIC) to its intra-agency supervisory review process. The Mercatus Center at George Mason University is dedicated to bridging the gap between academic ideas and real-world problems and to advancing knowledge on the effects of society. This comment does not represent the views of any party or special interest group. Rather, it is designed to help the FDIC as it considers how to handle its statutory obligation to provide insured depositories an effective means of appealing material supervisory decisions.

SUMMARY OF COMMENT

In May 2022, the FDIC announced that it was reinstituting its Supervisory Appeals Review Committee (SARC) in place of a recently established and more independent Office of Supervisory Appeals (OSA).[1] The FDIC cited concerns about staffing the OSA as well as a belief that keeping supervisory appeals at the board-of-directors level would ensure better accountability.[2] The FDIC also removed the requirement that ex parte information be shared with both parties in the appeal.[3] The FDIC also announced that, contrary to the process for establishing the OSA, there was no

1. 87 Fed. Reg. 30942 (May 20, 2022).
2. 87 Fed. Reg. 30943.
3. *Id.*

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invitation for the public comment before the change, and instead it opened a 30-day comment period after the change took effect.[4]

The FDIC's decision to abandon the OSA so soon after its implementation and without opportunity for public comment is unwarranted, and the acting chairman should reconsider this action. The introduction of the OSA format, while not perfect, addressed important deficiencies of the SARC and was a welcome change within the industry to the SARC format. Returning to the SARC format means less transparency, potentially less discipline around the process, and ultimately less trust in the FDIC's appeal process among banks, policymakers, and the public. The FDIC should restore the OSA or, at minimum, conduct a robust solicitation of views, including public comment, before any changes are made.

BACKGROUND

The Riegel Community Development and Regulatory Improvement Act of 1994 required the federal banking agencies, including the FDIC, to establish "independent intra-agency appellate process[es]."[5] These processes were tasked with reviewing appeals brought by regulated depository institutions regarding "material supervisory determinations."[6] The law defined "independent appellate process" as one where the review was done by "an agency official who does not directly or indirectly report to the agency official who made the material supervisory determination under review."[7]

Pursuant to the law, in 1995 the FDIC established SARC, which originally included the FDIC vice chair, the director of the Division of Supervision, the director of the Division of Compliance and Consumer Affairs, the FDIC ombudsman, and the general counsel, with the director of the Division of Insurance being added as a voting member later.[8] In 2004, the SARC's structure was revised, with the SARC now including one of the FDIC's three inside directors (who served as SARC chair), as well as a deputy or special assistant of the other two inside directors, with the chair able to name SARC members in the event of a vacancy, provided no member was involved in making the supervisory determination that was being reviewed.[9]

In 2019, the FDIC engaged in a consultation period on the agency's appeals process. Among the feedback that the FDIC received were suggestions for how to change the composition of the SARC to improve its independence and ensure that members had the necessary expertise on banking supervision to effectively review FDIC determinations.[10]

In 2020, the FDIC sought comment on proposed changes to the composition of the SARC as well as on the appeals process more broadly.[11] The FDIC proposed changing the name of the SARC to the OSA.[12] The OSA as proposed was to be an independent office within the FDIC that was

4. 87 Fed. Reg. 30942.
5. 12 U.S.C. 4806(a).
6. *Id.*
7. 12 U.S.C. 4806(f)(2).
8. 85 Fed. Reg. 54377, 54377–54378 (Sept. 1, 2020).
9. 85 Fed. Reg. 54378.
10. *Id.*
11. 85 Fed. Reg. 54377.
12. 85 Fed. Reg. 54378.

staffed by former FDIC officials who had bank supervisory experience.[13] The FDIC believed that the change would provide several benefits, including greater independence and less risk of real or perceived conflicts of interest, better protection of confidential data, better and more consistent decisions over time, and more staffing flexibility.[14]

In January 2021, the FDIC announced final changes to its independent appeals process.[15] The new process largely followed the 2020 proposal and had the OSA staffed with former government employees who had bank supervisory experience hired on a term basis.[16] Additionally, on the basis of public comments expressing concern about ex parte communications between supervisory staff and the OSA, the FDIC announced that any communications between a party to the appeal and the OSA would be provided to the other party, subject to certain limitations.[17]

DISCUSSION

Bank supervision is a highly important government function that relies as much on judgment as on process in its assessment of a commercial bank's management and performance. Though bank examiners do an excellent job in their examination and oversight role, mistakes and meaningful differences in judgment do occur within the examination and supervisory process. It serves both banks and the FDIC well to have a process that allows for these differences to be reviewed and corrected when appropriate. It also gives the FDIC meaningful credibility when that review process relies on outside, independent parties to render the final recommendation in such matters.

Bank regulators' power to sanction bank management for actions that may threaten a bank's safety is substantial. Moreover, determinations about such actions often depend on examiner judgment and sometimes result in supervisory overreach.[18] The effects of such overreach has been documented in several high-profile incidents.[19] Following some of these incidents, the FDIC affirmed that "regulatory threats, undue pressure, coercion, and intimidation designed to restrict access to financial services for lawful businesses have no place at the FDIC."[20] The fact that the FDIC had to make such an affirmation demonstrates the need for an objective, independent appeals process for those subject to such powerful oversight. This history almost certainly contributed to the concerns regarding retaliation expressed during the FDIC's prior solicitation of public views on its reform of the supervisory appeals process.[21]

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13. *Id.*
14. 85 Fed. Reg. 54379.
15. 86 Fed. Reg. 6880 (Jan. 21, 2021).
16. 86 Fed. Reg. 6885.
17. 86 Feg. Reg. 6887.
18. *See* Gulf Fed. Sav. & Loan Assoc. v. Fed. Home Loan Bank Bd., 651 F.2d 259 (5th Cir. 1981) (rejecting the Federal Home Loan Bank Board's claim that it had authority to issue a cease and desist on the grounds of reputational risk on a matter that did not pose a risk to the institution's financial condition); *but see* Greene County Bank v. FDIC, 92 F.3rd 633 (8th Cir. 1996) (rejecting the requirement that the institution's financial condition be imperiled for the regulator to issue a cease and desist).
19. *See, e.g.*, Office of the Inspector Gen., OIG-16-001, Report of Inquiry into the FDIC's Supervisory Approach to Refund Anticipation Loans and the Involvement of the FDIC Leadership and Personnel (2016); Office of the Inspector Gen., AUD-15-008, The FDIC's Role in Operation Choke Point and Supervisory Approach to Institutions That Conducted Business with Merchants Associated with High-Risk Activities (2015).
20. Letter from Floyd Robinson, Deputy Gen. Couns., Fed. Deposit Ins. Corp., to David H. Thompson, Cooper & Kirk, (May 22, 2019) (https://www.fdic.gov/news/press-releases/2019/pr19040a.pdf) (to resolve the litigation for Advance America, Cash Advance Centers, Inc. v. FDIC).
21. *See, e.g.*, 86 Fed. Reg. 6880, 6883 (Jan. 21, 2021).

The FDIC recently established the OSA as an independent function within the FDIC, free from conflicts of interest and politicization. This action was correct and well received by banks and the public alike. The OSA relied on experienced bank supervisors who, importantly, were former government officials, not current ones.[22] This reliance helped ensure that those sitting on an appeals panel were independent and free from pressure to side with either party.

The sudden return to the previous SARC structure is a step backward in terms of independence of the participants and confidence in the process. Though the FDIC's board member who serves as chair of the SARC and the two other members of the SARC will presumably be technically independent, they have an ongoing relationship with the supervisory staff. This presents a real risk that SARC members will find it difficult to look at supervisory determinations with the necessary objectivity, given that as FDIC leadership and management, they must also show trust and support for the very staff whose judgement may be in question. Also, if board members are setting the agency's regulatory and supervisory tone, they could find themselves questioning their own policy initiatives.

This issue of adequate SARC representation is particularly acute now. The FDIC board comprises an acting chair and two outside board members, one of whom also is acting, and all of whom are from the same political party. This is inconsistent with Congress's intent that the FDIC board be occupied by five Senate-confirmed members and have bipartisan representation. Thus, the SARC's membership also will be skewed.

Under the reestablished SARC, the acting FDIC director will presumably serve as the chair of the SARC and then appoint two additional members. This arrangement presents clear issues regarding meaningful independence of the SARC and its insulation from real or perceived political pressure. Contrast this arrangement with the OSA regime that uses nonpolitical former examiners whose presence provides both real and apparent independence.

Additionally, there is risk that the SARC will lack the same level of relevant experience that the OSA would have. Whereas previous bank supervisory experience was a requirement to sit on an OSA panel, there is no such requirement to sit on the SARC panel. This lack of experience risks hampering the ability of the SARC to make fully informed judgments.

CONCLUSION

The FDIC's decision to abandon the OSA and reestablish the SARC risks decreasing the legitimacy of the appeals process, the quality of review, and the willingness of regulated institutions to avail themselves of a statutorily granted right to appeal for fear of reprisal. The FDIC should restore the OSA, or at the very least suspend its action until there is a robust comment period where the public can express its views.

22. 86 Fed. Reg. 6885.