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FDIC Significantly Revises Intra-Agency Appeals Guidelines

Jeffrey Alberts, Pinchus D. Raice, and Dustin N. Nofziger*

The authors discuss the significant changes in the intra-agency appeals guidelines recently revised by the Federal Deposit Insurance Corporation.

The Federal Deposit Insurance Corporation ("FDIC") has significantly revised its intra-agency appeals guidelines.

The FDIC's appeals guidelines allow insured depository institutions ("banks") to appeal the FDIC's material supervisory determinations, including examination ratings and matters requiring Board attention.

The revised guidelines (the "New Guidelines"),[1] once effective, will make several significant changes that are positive for banks.

Specifically, the New Guidelines strengthen the appeals process by:

- Specifying that the FDIC division director who hears first-level appeals should not defer to the judgments of examiners;
- Providing that second-level appeals will be heard by a new, independent Office of Supervisory Appeals (the "Office") comprised of reviewing officials who are not otherwise employed by the FDIC rather than by a panel of high-level FDIC officials;
- Providing banks with a new right to review communications between FDIC supervisory staff and the second-level appellate authority;
- Clarifying that banks may request extensions of deadlines and that appeals deadlines do not fall on weekends or holidays; and
- Providing for the annual publication of new statistical data, including data regarding outcomes at the first (division director) level of appeal that have not been previously reported.

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[1] FDIC, Guidelines for Appeals of Material Supervisory Determinations, 86 Fed. Reg. 6,880, 6,885–88 (Jan. 25, 2021).

The New Guidelines will take effect once the new Office is "fully operational." Until then, the FDIC's current appeals guidelines (the "Current Guidelines")[2] will remain in effect.[3]

As noted below, several of the changes implemented by the FDIC in the New Guidelines were originally proposed in a comment letter from the New York League of Independent Bankers ("NYLIB").[4]

REVIEW BY THE DIVISION DIRECTOR WILL BE NONDEFERENTIAL

In both the Current Guidelines and the New Guidelines, a bank makes an initial or first-level appeal to the director of the FDIC division that made the material supervisory determination in question (the "Division Director"). Depending on the determination being appealed, the Division Director is either the director of the FDIC's Division of Risk Management Supervision ("RMS"), the director of the FDIC's Division of Depositor and Consumer Protection ("DCP"), or the director of the FDIC's Division of Complex Institution Supervision and Resolution ("CISR"). Where Current Guidelines and the New Guidelines differ, however, is that the New Guidelines provide that the Division Director should not defer to the judgments of the division staff who made the material supervisory determination being appealed.

Specifically, the New Guidelines provide that the Division Director will "[r]eview the appeal, considering whether the material supervisory determination is consistent with applicable laws, regulations, and policy, [and] *make his or her own supervisory determination without deferring to the judgments of either party.*"[5]

In other words, under the New Guidelines, the Division Director must not defer to the judgments of "either party"—i.e., the appealing financial institution or the division staff (e.g., examiners) that made the material supervisory determination being appealed.

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[2] FDIC, Guidelines for Appeals of Material Supervisory Determinations, 82 Fed. Reg. 34,522, 34,526–28 (July 25, 2017).

[3] 86 Fed. Reg. 6,885.

[4] Letter from Edward T. Lutz, President, NYLIB, to Robert E. Feldman, Executive Secretary, FDIC (October 20, 2020) ("NYLIB Letter"), *available at* https://pryorcashman.gjassets.com/content/uploads/2020/10/2020.10.20-NYLIB-Comments-re-Proposed-Changes-to-Appeals-Process.pdf. In this regard, NYLIB was advised by Pinchus Raice and Dustin Nofziger of Pryor Cashman.

[5] 86 Fed. Reg. at 6,886 (emphasis added).

In contrast, the Current Guidelines do not specify whether the Division Director may defer to the judgments of the division staff that made the material supervisory determination, providing only that "[t]he Division Director will review the 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."[6]

The Current Guidelines thus leave open the possibility that the Division Director may defer to the judgments of division staff rather than performing a de novo review of the material supervisory determination being appealed.

The new, nondeferential standard of review is a win for banks. The change to an explicit de novo standard brings the FDIC's guidelines in line with approach recently adopted by the Board of Governors of the Federal Reserve System ("Board"). As we noted in a prior article in *The Banking Law Journal*, the Board issued its own revised appeals procedures last year.[7] The Board's revised procedures provide that the decision-making panel at the first level of appeal "shall make its own supervisory determination and shall not defer to the judgment of the Reserve Bank staff that made the material supervisory determination."[8]

SECOND-LEVEL APPEALS WILL BE HEARD BY A NEW, INDEPENDENT OFFICE OF SUPERVISORY APPEALS

Perhaps the most significant change effected by the New Guidelines is to provide for a new, "independent" appellate authority at the second and final level of review.

Under the Current Guidelines, second-level appeals are heard by the Supervisory Appeals Review Committee ("SARC").[9] Each three-person SARC panel is comprised of one inside FDIC Board member (either the FDIC chairperson, vice chairperson, or director), who serves as the SARC Chairperson.[10] In the last SARC appeal argued by the authors' firm, the FDIC chairperson served on the SARC panel as the SARC chairperson. The other two members

[6] 82 Fed. Reg. at 34,527.

[7] Pinchus D. Raice, Jeffrey Alberts, & Dustin N. Nofziger, *Federal Reserve Board Significantly Revises Intra-Agency Appeals Procedures*, The Banking Law Journal, July–August 2020, 355.

[8] *Id.* at 360 (quoting Board, Internal Appeals Process for Material Supervisory Determinations and Policy Statement Regarding the Ombudsman for the Federal Reserve System, 85 Fed. Reg. 15,175, 15,180 (Mar. 17, 2020)).

[9] 82 Fed. Reg. at 34,526.

[10] *Id.*

of the SARC panel are deputy or special assistants to the two inside FDIC Board members who do not serve on the particular SARC panel.[11]

The New Guidelines replace the SARC with a new Office of Supervisory Appeals. Once the Office has been established and staffed with reviewing officials, second-level appeals will be heard by a three- or five-member panel from the Office.[12] The Office will be staffed by "reviewing officials who have bank supervisory or examination experience."[13] These reviewing officials will be hired for specific lengths of time (terms), and only former (as opposed to current) government officials will be eligible to serve as reviewing officials.[14]

Thus, while a former FDIC Board member or supervisory official could be eligible to join the Office and hear appeals, a current FDIC Board member or supervisory official would not. Decisions regarding which reviewing officials will serve on which panels will be decided by the Office rather than by FDIC supervisory staff.[15] While the FDIC did not adopt the recommendation from the NYLIB[16] and other commenters that each review panel should include one or more bankers or private practice bank attorneys, it did note that it "appreciates that industry perspective can be valuable and accordingly will generally view relevant industry experience favorably."[17]

In its request for comment regarding the proposed changes to the Current Guidelines, the FDIC had asked whether the FDIC chairperson or Board should have the opportunity to review Office decisions before issuance.[18] NYLIB[19] and other commenters generally opposed providing the chairperson or the Board with the opportunity to review decisions before issuance, fearing that it would undermine the independence of the new Office.[20]

Ultimately, the FDIC chose not to allow the FDIC chairperson or Board to review Office decisions before issuance, noting that "[t]he FDIC proposed to

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[11] *Id.*

[12] 86 Fed. Reg. at 6,885–87.

[13] *Id.* at 6,885.

[14] *Id.* The New Guidelines' provision that reviewing officials will be hired for "terms" was in direct response to NYLIB's comment letter, which noted that hiring reviewing officials for terms would protect them against potential retaliation for issuing decisions in favor of banks. NYLIB Letter 2.

[15] 86 Fed. Reg. at 6,885.

[16] NYLIB Letter 2.

[17] 86 Fed. Reg. at 6,882.

[18] *Id.* at 6,882.

[19] NYLIB Letter 1.

[20] 86 Fed. Reg. at 6,882.

establish the Office with authority to consider and resolve appeals of material supervisory determinations in order to promote independence."[21]

The Office is charged with "mak[ing] independent supervisory determinations."[22] Like the SARC, it will review 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."[23]

While the establishment of a new, independent Office comprised of individuals not otherwise employed by the FDIC appears to be a win for banks, time will tell whether the new Office will be more likely to rule in banks' favor than the SARC.

Interestingly, the FDIC provided in the New Guidelines that the FDIC Legal Division will review each decision of the Office prior to issuance "for consistency with applicable laws, regulations, and policies of the FDIC," and that the Office "will" revise its decision if the Legal Division determines that the Office's decision would be contrary to a law, regulation, or policy of the FDIC.[24] Legal Division review of Office decisions prior to issuance was not proposed in the FDIC's September 2020 request for comment.[25] In the authors' judgment, if the FDIC had proposed Legal Division review of Office decisions in its request for comment, commenters representing industry would have opposed Legal Division review prior to issuance as potentially undermining the independence of the Office.

PROHIBITION ON *EX PARTE* COMMUNICATIONS BY FDIC SUPERVISORY STAFF

The Current Guidelines do not provide that a bank appealing from a decision of the Division Director to the SARC has the right to review written comments, briefs, or materials submitted by the Division Director or other supervisory staff to the SARC. In fact, the Current Guidelines are entirely silent on whether the Division Director or other supervisory staff may submit written comments, briefs, or materials to the SARC—although the authors presume that such submissions are commonplace, although not shared with the appealing institution. NYLIB proposed in its comment letter that a bank

[21] *Id.*

[22] *Id.* at 6,887.

[23] *See* 82 Fed. Reg. at 34,528 (SARC); 86 Fed. Reg. at 6,887 (Office).

[24] 86 Fed. Reg. at 6,887.

[25] *See* 85 Fed. Reg. 54,377–83 (Sept. 1, 2020).

appealing to the Office be provided with any such materials, noting that "[a]n appealing institution cannot be expected to respond effectively to secret arguments or evidence."[26]

In response to the comments of NYLIB and others, the New Guidelines provide that "[a]ny communications between the Office and either supervisory staff or the appealing institution will be shared with the other party to the appeal, subject to limitations on disclosure."[27] The FDIC explained that this change was made to address due process and fairness concerns that would arise from *ex parte* communications between supervisory staff and the Office during an appeal.[28]

While the New Guidelines' change to allow banks to review materials submitted by the Division Director or other supervisory staff to the Office is positive, it is unclear what the FDIC intends by providing that such rights are subject to "limitations on disclosure." It is the authors' hope that this vague language will not be abused and that limitations on disclosure will only be found to apply in rare and legitimate circumstances.

CLARIFICATIONS REGARDING EXTENSIONS AND DEADLINES

NYLIB also commented that the FDIC should permit extensions of appeals deadlines in appropriate circumstances and clarify that when an appeals deadline falls on a weekend or federal holiday, the deadline moves to the next business day.[29] The FDIC adopted these recommendations in the New Guidelines.

While these changes may seem trivial, attorneys and banks facing appeals deadlines falling on weekends and federal holidays certainly will appreciate the clarification that the deadline moves to the next business day.

In addition, although it has been the FDIC's practice to allow extensions of deadlines in appropriate circumstances, nothing in the Current Guidelines indicates that extensions are possible. Clarifying that extensions may be granted in appropriate circumstances will encourage banks and attorneys who need extensions to request them.

The clarification also will prevent the FDIC from ever taking the position that because its guidelines do not mention extensions, the agency is without

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[26] NYLIB Letter 3.

[27] 86 Fed. Reg. at 6,887.

[28] *Id.* at 6,883.

[29] NYLIB Letter 3.

power to grant extensions in appropriate circumstances (the authors are aware of at least one occurrence when another federal agency took this position in response to a request for an extension of the agency's first-level appeals deadline). In the authors' experience, extensions are most often needed when a bank retains counsel to handle an appeal shortly before the deadline for a first-level appeal.

PUBLICATION OF STATISTICAL DATA

Another of NYLIB's comments was that the FDIC should publish statistical data on first-level appeals.[30] As NYLIB noted, without the publication of such data, "there is no way for the industry to assess whether first-level appeals are successful or whether appeals are resolved in an institution's favor outside of the formal appeals process (e.g., because the FDIC withdraws or revises a report of examination)."[31] (Indeed, in the authors' experience, a federal banking agency once withdrew an entire report of examination that contained factual errors after an appeal filed by the authors' firm, and no first- or second-level appeals decision was ever issued.)

In response to NYLIB's comment, the FDIC "agree[d] that the transparency of the appeals process could be enhanced by providing summary statistics on the outcomes of appeals."[32] The New Guidelines provide that in addition to publishing redacted versions of Office decisions, "[a]nnual reports on the Office's decisions and Division Directors' decisions with respect to institutions' requests for review of material supervisory determinations will also be published."[33] While it sounds as if the annual report may not include information on appeals filed and resolved (or mooted) without a Division Director's decision, the publication of data regarding first-level appeals decisions is an important step that will provide banks and their counsel with increased clarity regarding the efficacy of the appeals process.

CONCLUSION

The FDIC's changes to the appeals process in the New Guidelines are generally thoughtful and positive for banks. While the FDIC did not adopt all of the recommendations of industry commentators such as NYLIB, it is clear that the FDIC carefully considered the comments received and that significant changes were made in response.

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[30] *Id.* at 4.

[31] NYLIB Letter 5.

[32] 86 Fed. Reg. at 6,884.

[33] *Id.* at 6,887.

Once the Office is established and staffed, banks facing unwarranted or erroneous material supervisory determinations should give serious consideration to utilizing the FDIC's new and improved appeals process.