

Federal Banking Regulators Invite Public Comment on Proposed Rule Clarifying the Role of Supervisory Guidance in Enforcement

October 23, 2020

On October 20, 2020, the Federal Deposit Insurance Corporation (the “FDIC”) approved a notice of proposed rulemaking (“NPR”)¹ to be jointly issued by the FDIC, the Federal Reserve Board (the “FRB”), the National Credit Union Administration (the “NCUA”), the Office of the Comptroller of the Currency (the “OCC”) and the Bureau of Consumer Financial Protection (collectively, the “Agencies”) that would revise and codify the Agencies’ 2018 statement clarifying the appropriate role of supervisory guidance (the “2018 Statement”).²

Like the 2018 Statement, the revised statement (the “Proposed Statement”) would clarify that supervisory guidance does not create binding, enforceable legal obligations and that the Agencies will not issue supervisory criticisms (as defined below) or enforcement actions based on a violation or non-compliance with supervisory guidance. The NPR also would make the Proposed Statement binding on the Agencies. Below we provide brief background on the NPR and highlight some of the NPR’s more salient features. A blackline showing the NPR’s proposed changes to the 2018 Statement is attached as the Appendix.

Background

The 2018 Statement was issued after, and it would appear in response to, inquiries from Congress and others regarding whether the Agencies’ use of certain supervisory guidance (e.g., the Interagency Guidance on Leveraged Lending³) was consistent with administrative law standards. The 2018 Statement addresses one of the primary inquiries: whether the Agencies treat non-binding guidance as binding, legally enforceable rules (often referred to as “regulations”).⁴ In 2019, the Agencies⁵ received a

¹ FDIC, Role of Supervisory Guidance (Oct. 20, 2020), available [here](#).

² See Interagency Statement Clarifying the Role of Supervisory Guidance (Sept. 11, 2018), available [here](#).

³ 78 Fed. Reg. 17766 (Mar. 22, 2013), available [here](#).

⁴ Although also a matter of congressional inquiry, neither the 2018 Statement nor the Proposed Statement address whether, or under what conditions, supervisory guidance would be submitted to Congress under the Congressional Review Act. See, e.g., Government Accountability Office, *Applicability of the Congressional Review Act to Interagency Guidance on Leveraged Lending*, B-329272 (Oct. 19, 2017), available [here](#).

petition for rulemaking (the “Petition”) requesting that the Agencies codify the 2018 Statement with certain changes.⁶ The NPR responds, in part, to the Petition.⁷

Key features

Scope of the NPR

The NPR applies to “supervisory guidance,” which the Proposed Statement explains “outlines the [A]gencies’ supervisory expectations or priorities and articulates the [A]gencies’ general views regarding appropriate practices for a given subject area.” The Proposed Statement does not formally define the scope of supervisory guidance subject to the NPR. Rather, it provides a list of types of supervisory guidance, including: “interagency statements, advisories, bulletins, policy statements, questions and answers, and frequently asked questions.”⁸

However, the NPR notes **significant limits on the scope of the Proposed Statement:**

- The NPR makes clear that the Agencies’ do not consider all of their interagency statements, bulletins, FAQs and the like to be supervisory guidance or, therefore, subject to the Proposed Statement.⁹ The NPR goes on to specifically exclude all **interpretive rules**¹⁰ from the Proposed Statement, notwithstanding recommendations from the Administrative Conference of the United States (“ACUS”) that such interpretive rules, like supervisory guidance, should not form an

⁵ The Petition was not submitted to the NCUA because it has no supervisory authority over the financial institutions that are represented by the petitioners.

⁶ See Petition for Rulemaking on the Role of Supervisory Guidance (November 5, 2018), available [here](#).

⁷ The Petition was submitted under a provision of the Administrative Procedure Act (the “APA”) that gives interested persons the right to petition for the issuance, amendment or repeal of a rule. 5 U.S.C. § 553(e). The issuance of the NPR may suggest that petitions for rulemaking could prove an effective means of encouraging agency action. However, it is important to note that the APA does not require any significant action from an agency when it chooses not to act on a petition. The APA (5 U.S.C. § 555(e)) requires an agency to respond to a petition, giving “prompt notice” of a denial, and, although such decisions are reviewable by courts, courts are generally deferential to agency decisions denying such petitions. See *Massachusetts v. Environmental Protection Agency*, 549 U.S. 497 (2007) (finding reviewable a denial of a petition for rulemaking); see, e.g., Richard J. Pierce, Jr. & Kristin E. Hickman, *Administrative Law Treatise* §4.10 (6th Edition, 2020-2 Cum. Supp. 2018); but see *American Horse Protection Ass’n, Inc. v. Lyng*, 812 F.2d 1 (D.C. Cir. 1987) (setting aside agency decision declining to issue rule prohibiting intentional injuring of show horses on basis that agency did not engage in reasoned decision making). Moreover, it is not clear how many rulemaking petitions the Agencies have denied or otherwise not acted upon.

⁸ Role of Supervisory Guidance, pg. 26 (Oct. 20, 2020).

⁹ *Id.*, fn. 4.

¹⁰ Interpretive rules are “issued by an agency to advise the public of the agency’s construction of the statutes and rules which it administers.” *Mortgage Bankers Ass’n*, 575 U.S. at 97 (citing *Shalala v. Guernsey Memorial Hospital*, 514 U.S. 87, 99 (1995)).

independent basis for agency action.¹¹ For example, an FAQ that one of the Agencies deems to be an “interpretive rule” would not be subject to the Proposed Statement.

- The NPR also would allow the Agencies to treat the **“Interagency Guidelines Establishing Standards for Safety and Soundness”**¹² (the “Safety and Soundness Guidelines”) and other **“guidelines”** authorized by statute as bases for supervisory criticism—noting that the NPR would not alter the “legal status of [such] guidelines . . . to create binding legal obligations.” Although the scope of such other guidelines is unclear, one likely candidate would be “Interagency Guidelines for Establishing Standards for Safeguarding Customer Information.”¹³

Supervisory Criticism

Definition

The Proposed Statement provides that examiners will not criticize a supervised financial institution for, and the Agencies will not issue an enforcement action on the basis of, a “violation” of or “non-compliance” with supervisory guidance. In response to concerns expressed about the ambiguity of the 2018 Statement, the Proposed Statement identifies the specific agency actions that would constitute supervisory criticism: matters requiring attention (“MRAs”), matters requiring immediate attention, matters requiring board attention, documents of resolution and supervisory recommendations. However, the Proposed Statement includes the 2018 Statement’s important caveat that the Agencies may continue to reference (including in writing) supervisory guidance to provide examples of safe and sound conduct, appropriate consumer protection and risk management practices and other actions for addressing compliance with laws or regulations.

Specificity Requirement

The Agencies also acceded to the Petition’s request that supervisory criticisms not be allowed to be based on generic or conclusory assertions about “safety and soundness.”

¹¹ ACUS, Recommendation 2019-1, Agency Guidance Through Interpretive Rules (adopted June 13, 2019), available [here](#) (recommending, among other things, that “noncompliance with an interpretive rule should not form an independent basis for action in matters that determine the rights and obligations of any member of the public”).

¹² See, e.g., 12 CFR part 30, Appendix A; 12 CFR part 208, Appendix D-1. Section 39 of the Federal Deposit Insurance Act (the “FDI Act”) permits the FRB, FDIC and OCC to adopt safety and soundness standards either by “regulation or guideline” but provides greater flexibility to agencies if the standards are identified as guidelines. 12 U.S.C. 1831p-1(d)(1), (e)(1). The Safety and Soundness Guidelines were issued as “guidelines” using notice and comment pursuant to the statutory authority under section 39 of the FDI Act and appear to be deemed by the Agencies to be regulations. Role of Supervisory Guidance, fn. 10 (Oct. 20, 2020).

¹³ E.g., 12 CFR part 225, Appendix F. The OCC, for example, has characterized the Interagency Guidelines for Establishing Standards for Safeguarding Customer Information as regulations in recent enforcement actions. The Gramm-Leach-Bliley Act provides that such guidelines should be prescribed in the same manner, to the extent practicable, as the Safety and Soundness Guidelines. 15 U.S.C. § 6805(b).

As such, the Proposed Statement adds that supervisory criticism should still continue to be “specific as to practices, operations, financial conditions, or other matters that could have a negative effect on the safety and soundness of the financial institution, could cause consumer harm, or could cause violations of laws, regulations, final agency orders, or other legally enforceable conditions.”

This new standard requires specificity but declines the Petition’s request that supervisory criticism require a showing that the criticized conduct was a “demonstrably unsafe or unsound practice” pursuant to section 8(b) of the FDI Act.¹⁴ Instead, this standard allows supervisory criticism even where matters “could” negatively affect the safety and soundness of the institution, harm consumers or cause violations of law. This “could” standard would appear to apply a considerably lower threshold than that of section 8(b). Although courts have interpreted an unsafe or unsound practice for purposes of section 8(b) to require an imprudent act that places an *abnormal* risk of financial loss or damage on a banking institution,¹⁵ this “could” standard may be read to allow supervisory criticisms based on risks to the safety and soundness of the institution that fall below this threshold.¹⁶ The Agencies justified this standard on their belief that early identification of deficient practices serves the interest of the public and of supervised institutions.¹⁷

Ongoing Efforts to Clarify

The Proposed Statement reiterates the 2018 Statement’s statements regarding the Agencies’ other ongoing efforts to clarify the role of supervisory guidance, such as:

- **Limiting the use of numerical thresholds or other “bright-lines”** in describing expectations in supervisory guidance (except with respect to the applicability of guidance to supervised institutions);
- **Continuing to seek public comment** on supervisory guidance; and
- **Reducing the issuance of multiple supervisory guidance documents on the same topic.**

¹⁴ 12 USC 1818(b).

¹⁵ See *Matter of Seidman*, 37 F.3d 911, 928 (3d Cir. 1994); *MCorp Fin., Inc. v. Bd. of Governors Fed. Reserve System of U.S.*, 900 F.2d 852, 862 (5th Cir. 1990), *aff’d in part, rev’d in part sub nom. Bd. of Governors of Fed. Reserve System v. MCorp Fin., Inc.*, 502 U.S. 32 (1991).

¹⁶ The Agencies appear to justify this authority based on their “visitorial powers,” noting that “Congress has conferred upon the [A]gencies the authority to exercise visitorial powers with respect to supervised institutions” and that “the Supreme Court has indicated support for a broad reading of the [A]gencies’ visitorial powers.” *Role of Supervisory Guidance*, fn. 12 (Oct. 20, 2020). This suggests that the Agencies may rely on their “visitorial powers” to issue supervisory criticisms in addition to, or in lieu of, section 8(b) of the FDI Act.

¹⁷ *Role of Supervisory Guidance*, pg. 13 (Oct. 20, 2020).

Public Comment

The NPR seeks public comment on all aspects of the NPR, including whether:

- examiners should reference supervisory guidance to provide examples of safe and sound conduct, appropriate consumer protection and risk management practices and other actions for addressing compliance with laws or regulations when criticizing a supervised financial institution and, if so, whether there are specific situations where providing such examples would be appropriate or specific situations where providing such examples would not be appropriate; and
- the NPR is sufficiently clear as to the types of agency communications that constitute supervisory guidance, and if not, what steps could the agencies take to clarify this.

Comments on the NPR are due 60 days from publication in the Federal Register.

Conclusion

The NPR could be seen as a positive development in a few respects. For example, it would bind the agencies to the Proposed Statement—essentially requiring the Agencies to complete another rulemaking process in order to amend or rescind the statement. It also would confirm that MRAs and similar actions are within the scope of agency actions that may not be based on supervisory guidance alone. Moreover, the NPR adds that supervisory criticisms must be specific—general or conclusory statements referencing safety and soundness concerns would not appear to be sufficient. In addition, it suggests that the Agencies may be willing to further revise the Proposed Statement based on comments, including how examiners may or may not reference supervisory guidance in their criticisms.

However, the NPR also signals meaningful potential limits to the Proposed Statement. Many agency statements may not be within the scope of the Proposed Statement; the NPR does little to help identify the agency statements that would be excluded or to clarify whether the Agencies would make such status clear at the time of issuance of a statement. Moreover, the NPR does not appear to provide a meaningful threshold regarding the significance of the risk that can give rise to a supervisory criticism; any practice that could potentially pose a safety and soundness concern (or other enumerated concern) may become a supervisory criticism if the examiner can state the concern with some degree of specificity.

As with the 2018 Statement, it remains to be seen whether the NPR, if finalized, would meaningfully change the practice of the Agencies or whether supervisory engagement will continue to be “business as usual.” Nonetheless, the NPR does appear to clarify current practice of the Agencies regarding supervisory criticisms, or at least the Agencies’ intent of the Agencies’ 2018 Statement.

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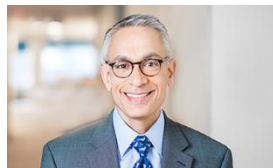


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Appendix

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Interagency Statement Clarifying the Role of Supervisory Guidance

The Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, and Office of the Comptroller of the Currency (together, the “prudential agencies”) are responsible for promoting safety and soundness and effective consumer ~~compliance~~protection at supervised institutions. The Bureau of Consumer Financial Protection (“Bureau,” and, with the prudential agencies, the “agencies”) is generally responsible for regulating the offering and provision of consumer financial products or services under the federal consumer financial laws. The agencies are issuing this statement to explain the role of supervisory guidance and to describe the agencies’ approach to supervisory guidance.

Difference between supervisory guidance and laws or regulations

The agencies issue various types of supervisory guidance, including interagency statements, advisories, bulletins, policy statements, questions and answers, and frequently asked questions, to their respective supervised institutions. A law or regulation has the force and effect of law.¹ Unlike a law or regulation, supervisory guidance does not have the force and effect of law, and the agencies do not take enforcement actions based on supervisory guidance. Rather, supervisory guidance outlines the agencies’ supervisory expectations or priorities and articulates the agencies’ general views regarding appropriate practices for a given subject area. Supervisory guidance often provides examples of practices that the agencies generally consider consistent with safety-and-soundness standards or other applicable laws and regulations, including those designed to protect consumers. Supervised institutions at times request supervisory guidance, and such guidance is important to provide insight to industry, as well as supervisory staff, in a transparent way that helps to ensure consistency in the supervisory approach.

Ongoing agency efforts to clarify the role of supervisory guidance

The agencies are clarifying the following policies and practices related to supervisory guidance:

- The agencies intend to limit the use of numerical thresholds or other “bright-lines” in describing expectations in supervisory guidance. Where numerical thresholds are used, the agencies intend to clarify that the thresholds are exemplary only and not suggestive of requirements. The agencies will continue to use numerical thresholds to tailor, and

¹ Government agencies issue regulations that generally have the force and effect of law. Such regulations generally take effect only after the agency proposes the regulation to the public and responds to comments on the proposal in a final rulemaking document.

otherwise make clear, the applicability of supervisory guidance or programs to supervised institutions, and as required by statute.

- Examiners will not criticize (through the issuance of matters requiring attention, matters requiring immediate attention, matters requiring board attention, documents of resolution, and supervisory recommendations) a supervised financial institution for and agencies will not issue an enforcement action on the basis of a “violation” of or “non-compliance” with supervisory guidance. ~~Rather, any citations will be for violations of law, regulation, or non-compliance with enforcement orders or other enforceable conditions. During examinations and other supervisory activities, examiners may identify unsafe or unsound practices or other deficiencies in risk management, including compliance risk management, or other areas that do not constitute violations of law or regulation.~~ In some situations, examiners may reference (including in writing) supervisory guidance to provide examples of safe and sound conduct, appropriate consumer protection and risk management practices, and other actions for addressing compliance with laws or regulations.
- Supervisory criticisms should continue to be specific as to practices, operations, financial conditions, or other matters that could have a negative effect on the safety and soundness of the financial institution, could cause consumer harm, or could cause violations of laws, regulations, final agency orders, or other legally enforceable conditions.
- The agencies also have at times sought, and may continue to seek, public comment on supervisory guidance. Seeking public comment on supervisory guidance does not mean that the guidance is intended to be a regulation or have the force and effect of law. The comment process helps the agencies to improve their understanding of an issue, to gather information on institutions’ risk management practices, or to seek ways to achieve a supervisory objective most effectively and with the least burden on institutions.
- The agencies will aim to reduce the issuance of multiple supervisory guidance documents on the same topic and will generally limit such multiple issuances going forward.
- The agencies will continue efforts to make the role of supervisory guidance clear in their communications to examiners and to supervised financial institutions, and encourage supervised institutions with questions about this statement or any applicable supervisory guidance to discuss the questions with their appropriate agency contact.