

April 27, 2018

Via Electronic Mail

Ann E. Misback, Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue NW  
Washington, DC 20551

Re: Internal Appeals Process for Material Supervisory Determinations and Policy Statement Regarding the Ombudsman for the Federal Reserve System (Docket No. OP-1597)

Ladies and Gentlemen:

The Clearing House Association L.L.C.<sup>1</sup> and the Financial Services Roundtable<sup>2</sup> appreciate the opportunity to comment on the Board of Governors of the Federal Reserve System's proposed amendments to its internal appeals process for material supervisory determinations and to its Ombudsman Policy.

We applaud the Federal Reserve for developing and seeking public comment on the proposed amendments to its internal appeals process, which are "designed to improve and

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<sup>1</sup> The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Association L.L.C. is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system. Its affiliate, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by launching a new, ubiquitous, real-time payment system. The Payments Company is the only private-sector ACH and wire operator in the United States, clearing and settling nearly \$2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume.

<sup>2</sup> The Financial Services Roundtable represents the largest banking and payment companies financing the American economy. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO.

expedite the appeals process” in a manner that would “strike an equitable balance among accommodating the interests of the institutions the Federal Reserve supervises in a substantive review of material supervisory determinations, the institutions’ interest in achieving a swift resolution of any material supervisory determination in dispute, and the interests of both an appealing institution and the Federal Reserve in the efficient use of limited resources.” Similarly, we welcome the proposed amendments to the Federal Reserve’s Ombudsman Policy.

The proposed amendments are also particularly timely. Both the Federal Reserve’s appeals process and its Ombudsman Policy were established over two decades ago and have not been reassessed since. Furthermore, since the financial crisis, the scope of regulation and supervision has expanded exponentially – thus providing more actions that may warrant an appeal – and the implications of adverse supervisory actions, including ratings downgrades, have grown more severe. Thus, the availability of a substantive appeals process for institutions to obtain an independent review of significant supervisory matters is more important than ever before.

As a first principle, we very much agree with the Board’s view that concerns about supervisory determinations should first be raised by institutions during the course of an inspection or examination. This kind of robust supervisory dialogue can serve as an appropriate forum to address concerns without firms having to resort to the formal appeals process. Thus, we also suggest it be strengthened in conjunction with the proposed amendments to the Federal Reserve’s formal appeals process.

As The Clearing House noted in its comment letter in response to the Federal Reserve’s proposed LFI Rating Framework, it is important that firms have meaningful opportunities to engage with Federal Reserve staff—both on-site examiners and Federal Reserve Board subject-matter experts—on a regular basis and throughout the supervisory cycle. As The Clearing House suggested in that comment letter, the Federal Reserve should institute a process to provide institutions with regular interim updates by on-site examiners and Federal Reserve Board subject-matter experts during the course of examinations. Such updates would allow firms to clarify factual misunderstandings and remediate issues in real time, as opposed to deferring all findings to the end of the examination cycle. For example, one possible approach may be for the Federal Reserve to require that the senior supervisory officer (“SSO”) for each firm provide a draft of the ratings determination to the firm a reasonable period of time (for example, four weeks) before the ratings letter is formally issued. The draft would be provided with the understanding that the firm would be permitted to correct any factual misstatements, to respond to any proposed adverse findings, and to request that the SSO reconsider any specific component ratings before the letter and ratings are formally issued.<sup>3</sup>

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<sup>3</sup> In its comment letter, The Clearing House also recommended that the Federal Reserve provide additional procedural safeguards prior to a rating downgrade that would result in the loss of “well managed” status in light of the impact the loss of this status would have on a firm’s operations and ability to pursue its strategic objectives. Under such a review process, before a downgrade that would result in loss of “well

Below, we make specific recommendations for changes to the proposal that would further the Federal Reserve’s goals of providing a more transparent, efficient, and independent review process for material supervisory determinations that institutions will use in practice in appropriate circumstances.<sup>4</sup>

## **I. Institutions Should be Able to Appeal MRAs/MRIAs through the Internal Appeals Process.**

Section 309 of the Riegle Community Development and Regulatory Improvement Act of 1994 requires the Board (as well as the other Federal banking agencies) to establish an independent, intra-agency appellate process that is available to institutions to seek review of “material supervisory determinations.”<sup>5</sup> The relevant statute provides that the term “material supervisory determinations” “includes determinations relating to— (i) examination ratings; (ii) the adequacy of loan loss reserve provisions; and (iii) loan classifications on loans that are significant to an institution.”<sup>6</sup> In implementing its internal appeals process in 1995, the Board provided that the term “includes, but is not limited to, material determinations relating to examination or inspection composite ratings, the adequacy of loan loss reserves and significant loan classifications.”<sup>7</sup>

However, the Federal Reserve does not explicitly provide that “matters requiring attention,” or MRAs, and “Matters Requiring Immediate Attention,” or “MRIAs,” are appealable under its internal appeals process.

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managed” status, the firm should be given notice and an explanation of the reasons for the potential downgrade, and the firm should have an opportunity to correct any factual misstatements and respond to any proposed adverse findings. As part of this review process, firms should have the opportunity to meet with the leadership and senior staff of the Federal Reserve’s Division of Supervision and Regulation and Legal Division. Only after such a review is completed and the Federal Reserve has determined that loss of “well managed” status is warranted should the downgrade be finalized.

<sup>4</sup> Nothing herein should be construed as conflicting with The Clearing House’s position that CAMELS and other supervisory ratings are subject to judicial review, as set forth in The Clearing House’s amicus brief in connection with *Builders Bank v. FDIC*. In that brief, we expressed no opinion as to whether an institution must exhaust its options under the relevant agency’s intra-agency appeals process prior to seeking such judicial review.

<sup>5</sup> 12 U.S.C. 4806 et. seq.

<sup>6</sup> 12 USC 4806(f)(1). The statute provides that the term does not include a determination . . . to appoint a conservator or receiver for an insured depository institution . . . or a decision to take [an enforcement action].”

<sup>7</sup> 60 Fed. Reg. 16470, 16473 (March 30, 1995) (emphasis added). The Federal Reserve further provided that “[t]he term does not include any supervisory determination for which an independent right of appeal exists. Such actions include prompt corrective action directives issued pursuant to section 38 of the Federal Deposit Insurance Act, as amended (the FDI Act), actions to impose administrative enforcement actions under the FDI Act and the Bank Holding Company Act of 1956, as amended (the BHC Act), capital directives, and orders issued pursuant to applications under the BHC Act.”

An MRA is the vernacular by which bank examiners communicate criticisms to a bank's management or the board of directors.<sup>8</sup> Traditionally, MRAs were used by bank examiners to direct banks to remediate unsafe and unsound practices or significant violations of law identified during the examination; other, less important, criticisms were included in an examination report or supervisory letter, but not so labeled.<sup>9</sup> Post-crisis, both the Federal Reserve and the OCC have issued guidance that defines what constitutes an MRA.<sup>10</sup>

The Federal Reserve has stated that "MRIAs<sup>11</sup> arising from an examination, inspection, or any other supervisory activity are matters of significant importance and urgency that the Federal Reserve requires banking organizations to address immediately."<sup>12</sup>

The stakes surrounding MRAs and MRIAs are high: supervisors have made abundantly clear that the failure to resolve MRAs can result in management downgrades or escalation to formal or informal enforcement actions. MRAs and MRIAs can lead to ratings downgrades and enforcement actions, which can have significant implications for institutions, and there is not another avenue available for MRAs and MRIAs to be appealed. Indeed, both the OCC and FDIC have recognized the importance of the ability to appeal MRAs and have explicitly provided that they are appealable.<sup>13</sup> Consistent with the purpose

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<sup>8</sup> MRAs originated as an informal convention in the examination process, and have since taken formal root. Presumably MRAs are issued pursuant to the banking agencies' statutory authority to prohibit unsafe and unsound practices or violations of law set forth in section 8 of the Federal Deposit Insurance Act. For more discussion of MRAs and suggestions for reforms thereto, see Greg Baer and Jeremy Newell "The MRA is the core of supervision, but common standards and practices are MIA," available at: <https://www.theclearinghouse.org/advocacy/articles/2018/02/02-09-2018-mra-core-supervision>

<sup>9</sup> The documentary origin of the MRA appears to have been the introduction of a "Matters Requiring Board Attention" page to the then-four Federal banking agencies common core Report of Examination. See Interagency Policy Statement of the Uniform Common Core Report of Examination (1993), available at [www.occ.gov/static/news-issuances/bulletins/pre-1994/examining-bulletins/eb-1993-7a.pdf](http://www.occ.gov/static/news-issuances/bulletins/pre-1994/examining-bulletins/eb-1993-7a.pdf).

<sup>10</sup> See Supervisory Considerations for the Communication of Supervisory Findings, SR 13-13 (2013), available at: <https://www.federalreserve.gov/supervisionreg/srletters/sr1313a1.pdf>.

<sup>11</sup> An "MRIA," or "Matter Requiring Immediate Attention," is a variant of MRA unique to the Federal Reserve, and is self-evidently an MRA that is considered to be more urgent." We note that the Federal Reserve has recently proposed to rescind and replace SR 13-13 in the context of its proposed guidance on supervisory expectations for boards of directors (82 Fed. Reg. 37219 (Aug, 9, 2017), but the relevant definitions remain effectively identical under that proposal.

<sup>12</sup> The Federal Reserve's guidance provides that MRIAs include: matters that have the potential to pose significant risk to the safety and soundness of the banking organization; matters that represent significant noncompliance with applicable laws or regulations; repeat criticisms that have escalated in importance due to insufficient attention or inaction by the banking organization; and, in the case of consumer compliance examinations, matters that have the potential to cause significant consumer harm. The guidance also provides that "MRAs constitute matters that are important and that the Federal Reserve is expecting a banking organization to address over a reasonable period of time, but when the timing need not be 'immediate.'"

<sup>13</sup> In 2013, the OCC stated in its revised examination appeals guidelines that a bank could appeal "material supervisory determinations such as matters requiring attention . . ." See OCC Bulletin 2013-15, Banks Appeals Process. Guidance for Bankers. Available at: <https://www.occ.treas.gov/news->

of the internal appeals process to allow institutions to appeal “material determinations relating to examination or inspection composite ratings,” and with the appeals processes at the other federal banking agencies, the Federal Reserve should confirm that MRAs/MRIAs are appealable under its internal appeals process.

## **II. Institutions should be able to appeal directly to the Ombudsman or another independent party outside of the supervisory and examination function.**

The available data reveals that banks seldom win their appeals.<sup>14</sup> We believe that one very likely cause is that appeals are decided by the same Reserve Bank whose decision is being appealed. One way to address this would be to allow institutions to appeal directly to the Federal Reserve’s Ombudsman or to another party outside of the supervisory and examination function, which neither the current system nor the proposed amendments would authorize. By contrast, the OCC allows institutions to appeal material supervisory determinations to either the Deputy Comptroller or the agency’s Ombudsman.<sup>15</sup> We believe appointing adjudicators from the Federal Reserve Bank or supervision function responsible for the supervisory action being appealed -- even if the particular individuals on the appeals committee were not involved in the relevant matter -- does not provide for sufficient separation of the decision maker. Further, the Federal Reserve is revising its examination approach to make greater use of horizontal reviews conducted by teams of Board and multi-Federal Reserve Bank staff. In light of this change in examination approach, the ability of an institution to appeal directly to the Ombudsman is particularly necessary, as the Ombudsman possesses the requisite clout to overrule what is effectively a Board staff or multi-Reserve Bank decision.

## **III. Publicly Released Decisions Should Not Allow Individual Banks to be Identifiable.**

The proposal provides that the decision of the second review panel would be made public and that certain safeguards would be used to “avoid disclosure of exempt information.” As an initial matter, we appreciate the Board’s proposal to publish its final appeals decisions, as the Federal Reserve’s appeals processes, are not transparent. The regulators “keep much of the information about appeals, including some decisions, secret.”<sup>16</sup>

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[issuances/bulletins/2013/bulletin-2013-15.html](https://www.fdic.gov/news-issuances/bulletins/2013/bulletin-2013-15.html). In 2017, the FDIC amended its guidelines to provide that “[m]aterial supervisory determinations include . . . matters requiring board attention.” See Guidelines for Appeals of Material Supervisory Determinations. 82 Fed. Reg. 34522 (July 25, 2017). Available at: <https://www.gpo.gov/fdsys/pkg/FR-2017-07-25/pdf/2017-15466.pdf>

<sup>14</sup> See Julie Andersen Hill, When Bank Examiners Get It Wrong: Financial Institution Appeals of Material Supervisory Determinations, 92 Wash. U. L. Rev. 1101, 1106, (2015). Available at: <http://openscholarship.wustl.edu/law-lawreview/vol92/iss5/5>.

<sup>15</sup> See Bank Appeals Process, OCC Bulletin 2013-15 (June 7, 2013) available at: <http://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-15.html>, archived at <http://perma.cc/BS84-4CLH>.

<sup>16</sup> See Hill at 1105.

Publishing decisions, in redacted form, would serve the important goal of providing institutions with greater transparency regarding the standards and analyses that the Board employs in considering appeals.

However, the Federal Reserve should recognize that public disclosure would likely act as a significant disincentive for any institution to move past the first stage of review in the appeals process. This deterrent effect would thwart the purposes of the Riegle Community Development and Regulatory Improvement Act of 1994 and the Board's appeals process implemented thereunder to provide institutions with the ability to contest material supervisory findings – not only in theory, but in practice. Thus, the Board should confirm that any information that could potentially reveal the identity of the appealing institution would be redacted from the published decision. This practice also would be consistent with the protections from disclosure afforded by the Freedom of Information Act, under which information “contained in or related to examination, operating, or condition reports” prepared by an agency are exempt from disclosure.<sup>17</sup>

#### **IV. An Institution's Management Should be Responsible for Authorizing an Appeal.**

The Federal Reserve's current appeals guidelines require any appeal to be approved by the institution's board of directors, and the proposal would not alter this requirement. However, this decision is more appropriately made by the institution's senior management, such as its CEO. Indeed, as the Board acknowledged in its proposed Guidance on Supervisory Expectations for Boards of Directors,<sup>18</sup> there is a crucial distinction between the board's duty of oversight and management's responsibility for the operations of the banking organization. In addition, the Board acknowledged the importance of eliminating unnecessary regulatory requirements for board approval, action or review so that the board can focus on oversight of the execution of the company's strategy and its other principal responsibilities. The decision to pursue an appeal falls within management's role to conduct the day-to-day operations of the institution, and it would be appropriate for Management to keep the board apprised of any such decision, consistent with the board's oversight role.<sup>19</sup>

#### **V. Recommendations Regarding the First and Second Review Panels**

The proposal would allow an institution to meet with the review panels and present oral evidence only if the panel, in its discretion, decides to hold such a meeting. In addition,

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<sup>17</sup> 5 U.S.C. § 552(b)(8).

<sup>18</sup> Federal Reserve System, Proposed Guidance on Supervisory Expectations for Boards of Directors, 82 Fed. Reg. 37219 (Aug. 9, 2017).

<sup>19</sup> As The Clearing House noted in its comment letter responding to the Federal Reserve's Proposed Guidance on Supervisory Expectations for Boards of Directors, the Federal Reserve should broadly recognize that a board may delegate its functions to a board committee in the appropriate exercise of the board's oversight duties.

the proposal provides that the second review panel would be limited to considering only the information submitted to the first review panel. As described above with respect to the importance of institutions' having the ability to meet with examination and supervisory staff throughout the examination cycle, it is important that institutions be permitted in all instances to meet with each of the review panels if the institution requests such a meeting in a timely manner, consistent with fundamental principles of fairness and due process. For the same reasons, the second review panel should be able to review any evidence that was not available at the time of the first panel's consideration of the appeal. To not allow newly available evidence to be considered also would be at odds with the Federal Reserve's objective to provide institutions with a fair assessment of a material supervisory determination.

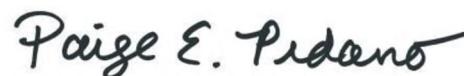
**VI. The Federal Reserve Should Provide More Concrete Safeguards Against Federal Reserve Staff Retaliation Against Institutions That Pursue Appeals.**

While the Federal Reserve's appeals process and Ombudsman Policy provide for "Safeguards against Retaliation," there is little clarity regarding those safeguards, including the consequences for Federal Reserve staff that engages in retaliatory behavior. The Federal Reserve should clearly articulate its procedures for educating examination staff about the types of actions that would constitute retaliation and the penalties to which retaliating staff will be subject. Furthermore, instances in which such disciplinary action is taken should be made known to supervisory and examination staff to serve as a deterrent for future retaliatory actions.

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The Clearing House and the Financial Services Roundtable appreciate the opportunity to comment on the proposal. If you have any questions, please contact Paige Pidano by phone at (202) 649-4619 or by email at [paige.pidano@theclearinghouse.org](mailto:paige.pidano@theclearinghouse.org), or Richard Foster by phone at (202) 589-2429 or by email at [Richard.Foster@FSRoundtable.org](mailto:Richard.Foster@FSRoundtable.org).

Respectfully submitted,



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A handwritten signature in black ink that reads "Rich Foster". The signature is written in a cursive, slightly slanted style.

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