

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date: October 19, 2020
To: Board of Governors
From: Staff¹
Subject: Interagency Proposed Rule on the Use of Supervisory Guidance

ACTION REQUESTED: Staff seeks approval to invite public comment on the attached draft proposal to codify the September 2018 interagency statement on the use of supervisory guidance, which affirmed the principle that guidance does not have the force and effect of law. The proposal would in part grant and in part deny a petition related to the 2018 Statement interagency statement. Staff also seeks authority to make technical, nonsubstantive changes to the attached materials to prepare them for publication in the *Federal Register*.

EXECUTIVE SUMMARY:

- In September 2018, the Board, Consumer Financial Protection Bureau, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and National Credit Union Administration issued the Interagency Statement Clarifying the Role of Supervisory Guidance.²
- The statement reiterated the distinction between law, regulations, and guidance based on principles of administrative law. 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 violations of supervisory guidance.
- The proposal responds to a petition submitted in November 2018 regarding the 2018 statement.³ The proposal codifies the statement with certain clarifications and invites public comment on it.

¹ Legal Division (Mark Van Der Weide, Laurie Schaffer, Benjamin McDonough, Steve Bowne, Christopher Callanan, Kelley O'Mara, and David Imhoff); Division of Supervision and Regulation (Mike Gibson, Anna Lee Hewko, Teresa Scott, Jinai Holmes, and David Palmer); and Division of Consumer & Community Affairs (Eric Belsky, Suzanne Killian, Carol Evans, Jeremy Hochberg, and Dana Miller).

² SR 18-5/CA 18-7 (September 12, 2018), available at <https://www.federalreserve.gov/supervisionreg/srletters/sr1805.htm>.

³ Bank Policy Institute and American Bankers Association "Petition for Rulemaking on the Role of Supervisory Guidance" (November 5, 2018), available at

- The proposal would grant the petition’s requests to (1) codify the 2018 statement in a regulation and (2) clarify that the agencies will not issue matters requiring attention (MRAs) or other supervisory criticism based on “violations” of supervisory guidance.
- To provide certainty and transparency to regulated financial institutions, the proposal clarifies that the agencies’ supervisory criticisms identify the 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 proposal would deny the petition’s request for the agencies to limit the use of MRAs, examination rating downgrades, and memoranda of understanding to only those instances involving a violation of a statute, regulation, or order.

DISCUSSION: As the agencies highlighted in their 2018 statement, supervisory guidance outlines the agencies’ supervisory expectations or priorities and articulates their 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. The agencies issue various types of supervisory guidance, including interagency statements, bulletins, policy statements, questions and answers, and frequently asked questions, to their respective supervised institutions. Supervised institutions at times request supervisory guidance, and such guidance is important to provide insight on supervisory perspectives and practices to industry and supervisory staff in a transparent way that helps to ensure consistency in supervisory approach.

Under well-established administrative law, federal agencies may issue supervisory guidance outside of the notice and comment rulemaking procedures. Supervisory guidance does not have the force and effect of law. Agency policies that are intended to have the force and effect of law generally must be adopted as regulations through notice and comment procedures.

The 2018 statement affirms the principle that supervisory guidance does not have the force and effect of law and that guidance instead outlines the agencies’ supervisory expectations

<https://www.aba.com/advocacy/policy-analysis/bpi-aba-joint-petition-rulemaking>. The petition was sent to the federal banking agencies and Consumer Financial Protection Bureau but not the National Credit Union Administration.

or priorities and general views regarding appropriate practices for a given subject area. In addition, the 2018 statement describes ongoing agency efforts to clarify the role of supervisory guidance.

In particular, the 2018 statement, which is nonbinding, indicates that the agencies intend to limit the use of numerical thresholds or other “bright-lines” in guidance; examiners will not criticize a supervised financial institution for a “violation” of supervisory guidance; the agencies may seek public comment on supervisory guidance; the agencies will aim to reduce the issuance of multiple guidance documents on the same topic; and the agencies will continue efforts to make the role of supervisory guidance clear.

Response to petitioners’ requests

In November 2018, the Bank Policy Institute and American Bankers Association submitted a petition to request that the agencies (1) codify the 2018 statement as a rule binding on their staff; and (2) clarify that the federal banking agencies will not issue MRAs based on violations of guidance and provide that MRAs, examination ratings downgrades, memorandums of understanding (MOUs), or “any other formal examination mandate or sanction” will only be issued where there is a “violation of a statute, regulation, or order.” The petition requests further that MRAs based on safety and soundness concerns only be issued if the MRAs meet the threshold of an “unsafe and unsound” practice[s] under the Board’s enforcement authority⁴ rather than including “generic” or “conclusory” references to safety and soundness. As noted, staff believes that the Board should grant the petition in part and deny the petition in part through the proposal.

Grant of petitioners’ request

The proposal would grant the petition’s request for the agencies to codify the 2018 statement as a binding regulation. The core message of the 2018 statement is that supervisory guidance does not have the force and effect of law, restating a well-established principle of administrative law. Codifying the statement would reaffirm and strengthen the Board’s commitment to the appropriate use of supervisory guidance.

The proposal would also grant the petition’s request for the agencies to clarify that MRAs and similar supervisory criticism will not be based on “violations” of supervisory guidance. This

⁴ 12 U.S.C. 1818(b)(1).

clarification would be consistent with the agencies' original intent in the 2018 statement and current supervisory practice.

Revisions to 2018 Statement

The proposal would make limited changes to the 2018 statement, including by adding a discussion of the agencies' practices regarding supervisory criticisms. Specifically, the proposal would state that:

[s]upervisory 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.

Staff believes that this would address, at least in part, some of the concerns raised in the petition while maintaining the ability of examiners to address practices that could cause a violation of law or regulation, an unsafe and unsound practice, or consumer harm. To provide more certainty, the proposal would also remove two sentences from the 2018 statement as it relates to the agencies' standards for issuing supervisory feedback, such as MRAs.⁵

Denial of petitioners' request

The proposal would not grant the petition's request for the agencies to restrict their authority to issue MRAs, downgrade examination ratings, enter into MOUs, or otherwise issue any formal examination mandate or sanction to instances where there is a violation of a statute, regulation, or order or unsafe and unsound practice that would invoke the agencies' enforcement authority. Staff believes that this aspect of the petition's request could restrict supervision by limiting the issuance of MRAs to only those matters for which the agencies could bring an enforcement action.

Consistent with the proposal, MRAs would continue to serve as a tool for the early identification of deficient practices. Identifying deficient practices before they become more serious issues serves both the interest of the public and of supervised institutions. The

⁵ These sentences stated that "any citations will be for violations of law, regulation, or non-compliance with enforcement orders or other enforceable conditions" and "examiners may identify unsafe and unsound practices or other deficiencies in risk management, including compliance risk management, or other areas that do not constitute violations of law or regulation."

petitioners' request that MRAs only be issued for violations of law could restrict examiners' ability to have supervised institutions address deficient practices before they rise to the level of a violation of law or unsafe and unsound practice. Moreover, MRAs are not enforcement actions, and staff believes that the standard for issuing an MRA should not be conflated with the standard for bringing an enforcement action.⁶ Accordingly, the proposal would not implement this aspect of the petition's request.

RECOMMENDATIONS: Staff recommends that the Board approve the attached proposal and delegate authority to staff to make technical, nonsubstantive changes to the attached materials to prepare them for publication in the *Federal Register*.

Attachments

⁶ The petition asserts that the federal banking agencies rely on their enforcement authority to issue MRAs. However, Congress has conferred upon the agencies broader visitorial powers through statutory examination and reporting authorities, which form the basis for the agencies' legal authority to issue MRAs and similar supervisory criticism. The Supreme Court has indicated support for a broad reading of these visitorial powers. *See, e.g., Cuomo v. Clearing House Assn L.L.C.*, 557 U.S. 519 (2009); *United States v. Gaubert*, 499 U.S. 315 (1991); and *United States v. Philadelphia Nat. Bank*, 374 U.S. 321 (1963).