

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date: March 12, 2021
To: Board of Governors
From: Staff¹
Subject: Final Rule on the Role of Supervisory Guidance

ACTIONS REQUESTED: Staff requests (1) approval of a draft final rule to codify the Interagency Statement Clarifying the Role of Supervisory Guidance (2018 Statement), which affirmed the principle that supervisory guidance does not have the force and effect of law or regulation; and (2) partial approval and partial denial of a petition for rulemaking regarding the 2018 Statement. Staff also seeks authority to make minor and technical changes to the draft final rule prior to 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 (collectively, the agencies) issued the 2018 Statement,² which affirmed the principle of administrative law that guidance does not have the force and effect of law or regulation.
- The draft final rule would codify the 2018 Statement as an Appendix to the Board’s Rules of Procedure with certain clarifications. The draft final rule would reflect partial denial and partial approval of a petition for rulemaking³ that was submitted in connection with the 2018 Statement:

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

² SR 18-5/CA 18-7, “Interagency Statement Clarifying the Role of Supervisory Guidance” (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 <https://www.aba.com/advocacy/policy-analysis/bpi-aba-joint-petition-rulemaking>. The petition was sent to the Board, Consumer Financial Protection Bureau, Federal Deposit Insurance

- The draft final rule would reflect the requests in the petition to (1) codify the 2018 Statement in a regulation, and (2) clarify that the agencies will not issue matters requiring attention or other supervisory feedback based on “violations” of supervisory guidance.
- The draft final rule would not reflect the request in the petition to limit the use of matters requiring attention, examination rating downgrades, and memoranda of understanding to only those instances involving a violation of a statute, regulation, or order.
- To provide certainty and transparency to regulated financial institutions, the draft final rule would clarify that any supervisory criticism should identify the practices, operations, financial conditions, or other matters that could have a negative effect on the safety and soundness of financial institutions, cause consumer harm, or violate laws, regulations, final agency orders, or other legally enforceable conditions.

DISCUSSION:

A. Background on the Proposed Rule

The 2018 Statement, which was issued by Board staff and staff of the other agencies, reiterated the distinction between statutes, regulations, and guidance based on principles of administrative law and the proper use of guidance in the supervisory process. The 2018 Statement indicated that the agencies intend to limit the use of numerical thresholds or other “bright lines” in guidance and that examiners will not criticize a supervised financial institution for a “violation” of supervisory guidance. The 2018 Statement also highlighted that the agencies may seek public comment on supervisory guidance, will aim to reduce the issuance of multiple guidance documents on the same topic, and will continue efforts to make the role of supervisory guidance clear.

In November 2018, the Bank Policy Institute and American Bankers Association submitted a petition for rulemaking (petition) to request that the Board, Consumer Financial Protection Bureau, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency (1) codify the 2018 Statement as a rule binding on agency staff, (2) not issue matters requiring attention based on violations of guidance, and (3) provide that matters requiring attention, examination ratings downgrades, memorandums of understanding, or any other formal

Corporation, and the Office of the Comptroller of the Currency, but not to the National Credit Union Administration.

examination mandate or sanction will be issued only where there is a violation of a statute, regulation, or order. The petition also requested that a matter requiring attention based on safety and soundness concerns be issued only if it meets the threshold of an unsafe and unsound practice under the Board's enforcement authority⁴ rather than including generic or conclusory references to safety and soundness.

On November 5, 2020, the agencies issued a proposed rule that would have codified the 2018 Statement, with clarifying changes. The proposed rule would have included an amended version of the 2018 Statement as an Appendix to the Board's Rules of Procedure and accordingly would have been binding on the Board.

The agencies received approximately 30 comments on the proposed rule. Commenters included trade associations for banking institutions and other businesses, state bankers' associations, financial institutions, an organization for state banking regulators, one member of Congress, and public interest advocacy groups. Many commenters expressed general support for the proposed rule, although some commenters questioned the need to codify the 2018 Statement and opposed the rulemaking. Some commenters also suggested changes to the proposed rule, as described below. While the agencies issued a joint proposal, the agencies decided to issue separate final rules in order to address comments specific to each particular agency. The draft final rule and the final rules issued by the other agencies are identical, except for their scope of application.

B. Draft Final Rule

The preamble to the draft final rule would respond to material concerns raised by commenters, as described below.

Grant of petitioners' request

The draft final rule would reflect the petition's request for the agencies to codify the 2018 Statement as a binding regulation, with respect to the Board's supervisory authority. 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. The draft final rule would reaffirm the Board's commitment to the appropriate use of supervisory guidance.

⁴ 12 U.S.C. 1818(b)(1).

The draft final rule also would reflect the petition's request for the agencies to clarify that matters requiring attention and similar supervisory feedback will not be based on "violations" of supervisory guidance. This clarification would be consistent with the proposed rule, the original intent in the 2018 Statement, and current supervisory practice.

Denial of petitioners' request

As noted, and consistent with the proposed rule, the draft final rule would not reflect the petition's request for the agencies to limit the use of matters requiring attention, examination rating downgrades, and memoranda of understanding to only those instances involving a violation of a statute, regulation, or order. This aspect of the petition's request could restrict supervision by limiting the issuance of matters requiring attention to only those matters for which the agencies could bring an enforcement action.

Under the draft final rule, matters requiring attention would continue to serve as a tool for the early identification of deficient practices. Identifying deficient practices before they become more serious serves the interests of both the public and supervised institutions. Limiting matters requiring attention only to violations of law could restrict the Federal Reserve's ability to have supervised institutions address deficient practices early, before they become a violation of law or an unsafe and unsound practice. Moreover, because matters requiring attention are not enforcement actions, it would be confusing to conflate the standard for issuing a matter requiring attention with the standard for bringing an enforcement action. Accordingly, the draft final rule would not implement this aspect of the petition's request.

Revisions to the 2018 Statement

Consistent with the proposed rule, the draft final rule would make limited changes to the 2018 Statement, including by adding a discussion of the agencies' approaches to supervisory feedback, such as criticisms of deficient practices. Specifically, the draft final rule would state that 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. This modification would address 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.

Public comments

Some commenters suggested that the rule describe the circumstances under which the agencies can issue supervisory findings. Similar to the petition, some commenters requested that the issuance of matters requiring attention and other supervisory criticisms be limited to violations of law, regulation, or order. One commenter asserted that matters requiring attention should not be solely based on “reputational risk,” but rather on the underlying conduct giving rise to concerns. Other commenters opposed applying any restrictions on the issuance of supervisory criticism and highlighted the need for supervisors to proactively address potential issues at regulated institutions. In line with the proposed rule, the draft final rule would focus on the appropriate use of supervisory guidance in the supervisory process, rather than set forth standards for supervisory criticism. Accordingly, the draft final rule would not incorporate the standards that some commenters advocated for the issuance of supervisory findings.

Some commenters suggested that the rule cover interpretive rules in addition to supervisory guidance. Interpretive rules clarify ambiguities in statutes and regulations and are distinct from supervisory guidance under administrative law. The draft final rule would not cover interpretive rules because supervisory guidance and interpretive rules have different purposes and characteristics.⁵

RECOMMENDATIONS: For the reasons discussed above, staff recommends that the Board (1) approve the attached draft final rule, and (2) approve in part and deny in part the petition. Staff also recommends that the Board authorize staff to make minor or technical changes to the draft final rule prior to publication in the Federal Register.

Attachments

⁵ For example, unlike supervisory guidance, interpretive rules may use mandatory language to describe an agency’s interpretation of what a statute or rule requires, and an agency may intend for its staff to treat an interpretive rule as binding.