January 4, 2021

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Comment Intake
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RE: Role of Supervisory Guidance (OCC Docket ID OCC–2020– 0005; Federal Reserve Docket No. R–1725; FDIC RIN 3064-AF08; Docket No. CFPB–2020–0033)

To Whom It May Concern:

The Americans for Financial Reform Education Fund (AFR) appreciates the opportunity to comment on the above referenced Proposed Rule (the "Proposal") concerning the role of supervisory guidance by the various financial regulators (the "Agencies"). Members of the AFR Education Fund include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.[1]

We are concerned that this rule, which apparently seeks to accommodate requests by the large bank lobby to restrict supervisory discretion, will have negative consequences on the ability to assure safety and soundness, protect consumers, and address systemic risk. It appears to add unnecessary confusion and restrictions to the ability of field supervisors to criticize the actions of financial institutions.

Failures in bank supervision played a central role in the 2008 financial crisis. Post-crisis investigations found that systemic and widespread failure of Federal banking agencies to exercise their supervisory in a timely and aggressive manner was a key contributor to a global financial crisis that cost tens of trillions in wealth and millions of jobs.[2] Preserving the ability

[1] A list of coalition members is available at: http://ourfinancialsecurity.org/about/our-coalition/

[2] See, for example, "Final Report of the National Commission on the Causes of the Financial and Economic Crisis of the United States", February, 2011, available at https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf; Beim, David and Christopher McCurdy, "Report on Systemic Risk and Bank Supervision", Federal Reserve Bank of New York, August 2009 Discussion Draft, available at https://info.publicintelligence.net/FRBNY-BankSupervisionReport.pdf.

and discretion of supervisors to act rapidly and forcefully when needed is critical to preventing a future crisis, as well as protecting consumers and the public in general. The need to issue this new rule is not justified in the Proposal, except by reference to a petition for rulemaking by major banks. Such a petition is not in itself enough to justify the rule. Given that the rule is unnecessary and may be harmful, we urge that it be withdrawn.

Financial supervision differs fundamentally from other forms of regulation, in that supervisors are empowered to make discretionary enforcement determinations regarding broad issues of safety and soundness and consumer protection that may not be precisely anticipated in written rules. As a Federal Reserve Bank of New York analysis states:[3]

> "Supervision is closely related to, but distinct from, regulation of banking organizations. Regulation involves the development and promulgation of the rules under which banking organizations operate, as well as their enforcement in the court of law. Supervision is closely related to regulation to the extent that it is often entrusted with compliance with regulation. But a key feature of supervision is ensuring that banks don't engage in "unsafe and unsound" practices. "Safety and soundness" is not hard-coded into law, reaches far beyond written rules, and crucially involves judgment in assessing whether a bank may be engaging in excessive risk….In practice, supervisory activities involve monitoring banks and using this information to request corrective actions from banks should their conditions or practices be deemed unsafe or unsound."

Supervisory discretion is vital for ensuring that supervisors in the field can meet statutory goals by taking action in specific cases. Unavoidably, the exact details of such specific cases may not be precisely spelled out in statue or regulation. Guidance documents provide valuable information to field supervisors as to how their discretion should be exercised. Without the ability to provide formal and informal guidance to field supervisors it would be difficult or impossible for banking agencies to meet their statutory mandates.

The significance of guidance is recognized at several points in statutory banking law. For example, 12 USC 1831p-1 specifically incorporates guidelines as well as regulations in its direction for implementing standards of bank safety and soundness. 12 USC 1818(a)(8) holds banks responsible for meeting capital guidelines as well as formal regulations. More importantly, 12 USC 1818(b) specifies that regulators may issue cease and desist orders based on a reasonable cause to believe that an institution has engaged, is engaging or is about to engage in an unsafe and unsound practice, separately and apart from whether the institution has technically violated a law or regulation.[4] This indicates that Congress entrusted the banking agencies with

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[3] Eisenbach, Thomas, David Lucca, and Robert Townsend, The Economics of Bank Supervision, Staff Report No. 769, Federal Reserve Bank of New York, March 2016 (Revised January 2017). https://nyfed.org/2VytJor

[4] The statutory passage states that a banking agency may issue a cease and desist order "if the agency has reasonable cause to believe that the depository institution…is about to engage, in an unsafe or unsound practice in conducting the business of such depository institution, ***OR*** is violating or has violated, or… is about to violate, a law, rule, or regulation, or any condition imposed in writing by a Federal banking agency" [Emphasis added]. The passage then further states that if "the agency shall find that any violation ***OR*** unsafe or unsound practice specified in the notice of charges has been established, the agency may issue and serve upon the depository institution an

discretionary power to determine whether practices are unsafe and unsound and attempt to halt such practices through supervision, even if a specific case may not constitute a violation of a written law or regulation.

In addition, several legal scholars have forcefully made the case that "internal administrative law" by its nature has the force of law. This is because it is necessary for the agency to issue internal rules and communication to effectively implement statutory law, including by informing agency field personnel such as supervisors of policy interpretations. As recent work by Gillian Metzger of Columbia Law School and Kevin Stack of Vanderbilt Law School states[5]:

> "We argue that many internal measures, ranging from substantive guidelines to management structures that allow for oversight of agency operations, qualify as forms of law. These measures not only bind and are perceived as binding by agency officials; they also encourage consistency, predictability, and reasoned argument in agency decision making. They frequently involve traditional lawmaking activity, including interpretation and enforcement of statutes, regulations, executive orders, treaties, and the Constitution. Put together, they have many of the paradigmatic features of legal norms even if they lack the element of enforcement through independent courts."

Given the many powerful reasons to believe supervisory guidance should be considered a necessary part of the implementation of the powers granted to financial regulators by Congress, the question arises as to why the Agencies felt it necessary to issue this rule at all. We are concerned that political pressure from large banks who wished the weaken the stronger supervisory practices emerging out of the 2008 financial crisis played a significant role in the decision to issue this rule. This would be an inappropriate motivation for a rule. We know of no evidence that the use of supervisory guidance following the financial crisis led to inappropriate or harmful actions on the part of supervisors, nor is any specific evidence on such matters offered in the Proposal. Instead, only the rulemaking petition supported by major banks is cited.

With all that said, in the Proposal the Agencies do show some awareness of the dangers of excessively restricting supervisory discretion. Crucially, in this Proposal the Agencies have declined to follow the petition request to restrict supervisory criticism or sanctions, including Matters Requiring Attention/Immediate Attention (MRAs), to explicit violations of law or regulation. Instead, the Agencies make clear that supervisory criticism may be based on practices that are unsafe, unsound, or harmful to consumers but do not currently violate explicit law or regulation.

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order to cease and desist from any such violation ***OR*** practice". The repeated use of "or" in this authority clearly indicates that Congress wished to entrust the banking agencies with the discretionary power to address practices that in their view were unsafe and unsound regardless of whether such practices constituted a formal or technical violation of laws, rules, or regulations.

[5] Metzger, Gillian E. and Stack, Kevin M., Internal Administrative Law (February 5, 2018). Michigan Law Review, Vol. 115, No. 8, 2017, Columbia Public Law Research Paper No. 14-586, Vanderbilt Law Research Paper No. 18-08, Available at SSRN: https://ssrn.com/abstract=3118646

That is the right thing to do. We believe this rule should be withdrawn entirely. However, if agencies decide to proceed with this flawed rule, this position must at least be maintained in any final rule. Requiring supervisors to wait for an explicit violation of law before issuing criticism would effectively erase the line between supervision and enforcement. It would eliminate the space for supervision as an intermediate practice of oversight and cooperative problem-solving between banks and the regulators who support and manage the banking system. It would also clearly violate the intent of the law in 12 USC 1818(b) which explicitly requires supervisors to anticipate *future* violations of law or regulation instead of waiting for such violations to take place. 12 USC 1818(b) also clearly asks supervisors to act not only based on violations of law but on a supervisory judgement that practices are "unsafe or unsound" or may become so, which would be impossible if the ability to criticize banks was limited to explicit violations of law.

In addition, the Proposal includes a rule of construction preserving the statutory role of guidance under 12 USC 1831p-1 (although we do not believe the Agencies would have the legal authority to eliminate this role in any case).

However, we remain seriously concerned that this Proposal is too broad and creates unnecessary and confusing ambivalence concerning supervisory guidance and the authority of supervisors. The Proposal makes fine conceptual distinctions between, for example, issuing supervisory criticisms "on the basis of" guidance (which is apparently forbidden) and issuing supervisory criticisms that make "reference" to supervisory guidance (which continues to be permitted). This is an exceedingly fine distinction that it may be difficult for human beings to parse in practice. A rule that makes such a distinction is likely to have a chilling effect on supervisors attempting to implement policy in the field. At the very least it places an unnecessary administrative and interpretive burden on the internal operations of the Agencies when directing supervisors as to when and how they should act. Since speed is often of the essence in acting before an unsafe or unsound practice has a negative effect on consumers or the banking system, creating these artificial roadblocks to action requires a strong justification beyond a petition from regulated entities. No such justification is offered in the Proposal.

There are other examples of such confusing distinctions in the Proposal. For example, the Proposal suggests that the Agencies will "limit" the use of numerical or bright-line thresholds in guidance, and when they are used will clarify that their use is "exemplary only and not suggestive of requirements". What exactly does it mean for something to be "exemplary" but not even "suggestive" of a requirement? When considering a numerical figure given in a guidance, how exactly can a field supervisor determine the line between using the figure in a manner that provides a useful example of when a criticism would be justified (apparently permitted), vs. using the figure in a manner that "suggests" a requirement (apparently banned)? This seems to add pointless confusion to the supervisory process. It appears likely to constrain or prevent effective supervisory action. .

We agree with the Agencies that the supervisory process should not consist simply of mechanical application of rigid instructions in guidance, since the point of supervision is to permit

judgement and flexibility in unanticipated circumstances (including acting quickly to stop an unsafe and unsound practice even if the bank has managed to avoid triggering explicit quantitative boundaries). But the fine distinctions made in this Proposal add pointless confusion to the supervisory process and appear to unnecessarily restrict both supervisory discretion and the ability of the Agencies to coordinate supervisory policy through guidance. We therefore urge that the Proposal be withdrawn, especially since a similar policy statement already exists.

Thank you for the opportunity to comment on this Proposal. If you have questions, contact Marcus Stanley, AFR's Policy Director, at 202-466-3672 or marcus@ourfinancialsecurity.org

Sincerely,
Americans for Financial Reform Education Fund