

Client Alert

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The Regulators and Guidance: Thou Doth Protest Too Much

In our recent article in *The Banking Law Journal*, we discussed bank regulatory “guidance” that the U.S. Government Accountability Office (“GAO”) determined should have been reported to Congress and subject to review under the Congressional Review Act (“CRA”).¹ We discussed how such GAO determinations brought into question the validity of the banking agencies’ approach to guidance. We noted that Congress might use the CRA as a tool to invalidate guidance. This prediction came true in May 2018 when Congress first used the CRA to invalidate the Consumer Financial Protection Bureau (“CFPB”) Bulletin on *Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act*.² We also predicted that such GAO determinations were likely to have a chilling effect on the issuance of new guidance. While the accuracy of that prediction is still unknown, it is safe to say that the regulators have taken notice.

On September 11, 2018, the Board of Governors of the Federal Reserve System (“Federal Reserve”), Federal Deposit Insurance Corporation (“FDIC”), National Credit Union Administration (“NCUA”), Office of the Comptroller of the Currency (“OCC”), and CFPB issued an *Interagency Statement Clarifying the Role of Supervisory Guidance* (the “Statement”) with the expressed intent of describing the agencies’ approach to supervisory guidance. The Statement begins by describing “supervisory guidance” as including interagency statements (ironically, the guidance on guidance), advisories, bulletins, policy statements, questions and answers, and frequently asked questions. The agencies then proclaimed that:

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.

The agencies believe that guidance plays an important role in the regulatory scheme applicable to banks by providing transparency and insight to industry. Guidance also educates supervisory staff as to practices that their leadership generally consider consistent with safety-and-soundness standards and other applicable laws and regulations, thereby promoting consistency in supervisory approach. However, when guidance is applied with the effect of law, it can end run protections afforded from regulatory overreach. Based on their public statements, Joseph M. Otting and Jelena McWilliams appear to agree. Specifically, in her first public remarks as chairman of the FDIC, Ms. McWilliams stated her opposition to the use of agency guidance in place of formal rules.³ Now, the agencies have expressed their intention in the Statement to reign in their use of guidance while indicating their belief that guidance still has important uses.

¹ See Peter Weinstock & Marysia Laskowski, “If It Walks Like A Duck . . .”: *The Demise Of The Guidance Masquerade*, 135 THE BANKING LAW JOURNAL 215 (April 2018), available at <https://www.hunton.com/images/content/3/6/v2/36602/if-it-walks-like-a-duck-the-demise-of-the-guidancemasquerade.pdf>.

² Pub. L. No. 115–172, 132 Stat. 1290 (May 21, 2018), available at <https://www.congress.gov/115/plaws/publ172/PLAW-115publ172.pdf>.

³ In remarks to the to the Prudential Regulation Conference, Ms. McWilliams stated that regulators have a duty to explain the reasoning behind their actions and that the role of guidance is to explain regulations and statutes already in place, not to impose

In an effort to draw a brighter line as to when guidance should not trigger the GAO's opinion that guidance is subject to the CRA, the regulators have first indicated their plan to "limit the use of numerical thresholds or other 'bright-lines' in describing expectations in supervisory guidance" and clarified that, where thresholds are used, such thresholds "are exemplary only and not suggestive of requirements." Here, the agencies appear to be not-so-subtly referring to the *Interagency Guidance on Leveraged Lending* issued by the Federal Reserve, FDIC, and OCC in March 2013, which is extremely heavy on numerical thresholds and bright-line tests. Given that the head of one of the agencies that authored that guidance (Mr. Otting) has taken the stance that banks can essentially "do what they want" in terms of leveraged lending, in spite of the guidance, as long as they have the capital to support it, one might wonder if the leveraged lending guidance faces the same fate as the CFPB's indirect auto lending bulletin.⁴

In the Statement, the agencies have also committed not to criticize a supervised financial institution for a "violation" of supervisory guidance. Instead, any citations will be for violations of law, regulation, or noncompliance with enforcement orders or other enforceable conditions. We noted in our article that, while the agencies do not generally reference guidance in enforcement actions, they are more likely to do so in examination findings, such as in a "Matter Requiring Attention."⁵ Now, there is even more room to push back to the extent that guidance is referenced or relied on in examination findings. That being said, the agencies left themselves ample room to "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" during examinations and other supervisory activities. Additionally, still at the regulators' disposal are the penalty provisions under Section 8 of the Federal Deposit Insurance Act (FDIA), which allow regulators to impose civil money penalties for unsafe and unsound banking practices⁶ and breaches of fiduciary duty and not just violations of law.

Also significant is the agencies' commitment in the Statement to limit and reduce the issuance of multiple supervisory guidance documents on the same topic. Ms. McWilliams has previously made statements to this effect as well. On September 10, 2018, one day before the issuance of the Statement, the FDIC issued a financial institution letter ("FIL") seeking comment on a proposal to retire to an inactive status 374 of the 664 risk management supervision-related FILs issued between 1995 through 2017.⁷ According to the FDIC, the proposal is part of a continuing effort to reduce regulatory burden and to update and streamline guidance.

new standards. Accordingly, she has asked staff to provide a list of guidance and rulemakings that may be good candidates to be reopened, with a clear priority to guidance that has never been subject to notice and public comment. Ms. McWilliams considers cost benefit analysis (such as that required under the CRA) to be an important tool to determining the appropriateness of regulations as well as increasing transparency of the agency's thinking. See Kristina Whittaker & Neil Bloomfield, *What To Expect From The FDIC's New Chief*, LAW360, available at <https://www.law360.com/articles/1060792/what-to-expect-from-the-fdic-s-new-chief>.

⁴ See Eleanor Duncan, *Banks can 'do what they want' in leveraged lending: Otting*, Reuters (Feb. 28, 2018), available at <https://www.reuters.com/article/us-usa-banks-lending-otting/banks-can-do-what-they-want-in-leveraged-lending-otting-idUSKCN1GC0B5>.

⁵ *Supra* note 1 at 225.

⁶ "Generally speaking, an 'unsafe or unsound practice' embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk of loss or damage to an institution, its shareholders, or the agencies administering the insurance funds." 112 Cong. Rec. 24984 (1966); *id.* at 26474.

⁷ *FDIC Seeks Comment on Proposed Retirement of Certain Financial Institution Letters*, FIL-46-2018 (Sep. 10, 2018), available at <https://www.fdic.gov/news/news/financial/2018/fil18046.html>.

The agencies also use the Statement to reserve their right to seek public comment on supervisory guidance, proclaiming that doing so does not mean that the guidance is intended to be a regulation or have the force and effect of law. Looking to the future, the agencies end the Statement by committing to continue efforts to make the role of supervisory guidance clear in their communications to examiners and supervised financial institutions, and by encouraging supervised institutions with questions about the Statement or any specific guidance to discuss such questions with their appropriate agency contact. Banks should accept the foregoing invitation enthusiastically.

It is too soon to know what practical effect, if any, the Statement will have on the state of bank regulatory guidance. However, in light of the GAO's recognition of the broad reach of the CRA, the Statement is not likely to serve what appears to be the agencies' main regulatory aim of preserving intact the guidance framework, even if on a more limited basis, and warding off Congressional review.⁸

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⁸ Note, the Securities and Exchange Commission ("SEC") also recently issued a statement clarifying the difference between supervisory guidance and laws or regulations. See Chairman Jay Clayton, *Statement Regarding SEC Staff Views*, SEC (Sep. 13, 2018), available at <https://www.sec.gov/news/public-statement/statement-clayton-091318>.