

Interagency Statement on Supervisory Guidance Could Result in Meaningful Changes to Supervisory Practices

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Guidance is guidance, and rules are rules. This straightforward statement was reiterated by Treasury Secretary Mnuchin, Federal Reserve Vice Chairman for Supervision Randal Quarles and Comptroller of the Currency Joseph Otting in separate Congressional hearings earlier this year.¹ Nevertheless, for at least the past ten years, the failure to be in compliance with some guidance has often been treated as binding on banking organizations. It has often been used as the basis for matters requiring attention (**MRAs**) and matters requiring immediate attention (**MRIs**) in examination reports and even for enforcement and other supervisory actions, sometimes with retroactive effect, without giving banking organizations prior notice of or a fair opportunity to comment on the guidance or a reasonable transition period to comply with it before being subject to penalties for noncompliance. The misuse of guidance has lessened accountability and transparency and is inconsistent with fundamental principles of due process.² On the other hand, when used properly, supervisory guidance is quite helpful to both supervised institutions and to supervisory staff.³

The muddled state of supervisory guidance practices was highlighted by the Government Accountability Office's (**GAO's**) opinion in October 2017 pointing out that the [leveraged lending guidance](#) issued by the Federal Reserve, FDIC and OCC was effectively a rule for purposes of the Congressional Review Act because the guidance was an agency statement of future effect designed to implement, interpret or prescribe law or policy.⁴ Now, after nearly a year of mulling over past practices, the Federal Reserve, FDIC, OCC, National Credit Union Administration and CFPB (the **Agencies**) have, at long last, issued a thoughtful [statement](#) (dare we call it guidance) meant to clarify the role of supervisory guidance (**Interagency Statement**), which we read as largely a tone at the top communication to their supervisory and examination staffs.

The Agencies begin by setting out the key distinction between supervisory guidance on the one hand and laws and regulations on the other: unlike a law or regulation, supervisory guidance “does not have the force and effect of law.” As a result, “the [A]gencies do not take enforcement actions based on supervisory guidance.” In the context, we believe that the Agencies must have meant to include MRAs and MRIs, as well as supervisory rating downgrades or failure to update such ratings based on failure to comply with supervisory guidance, in the concept of “enforcement actions” although they are not usually seen as formal or informal enforcement actions.

With these principles established, the Interagency Statement makes the following commitments:

- The Agencies intend to limit the use of numerical thresholds or other “bright-lines” in supervisory guidance. When numerical thresholds are used, thresholds should serve only as examples and should not be treated as suggestive of requirements.
- Examiners will not criticize a financial institution under their supervision for violations of supervisory guidance. Citations issued as the result of examinations will be based only on violations of law or regulation, or non-compliance with enforcement orders or other enforceable conditions.
- Soliciting public comments on supervisory guidance is helpful to the Agencies, and the Agencies may continue to seek such comments, but soliciting comments does not mean that supervisory guidance is intended to have the force and effect of law.
- The Agencies will seek to reduce the issuance of multiple supervisory guidance documents on the same topic.⁵

- The Agencies will continue to make the role of supervisory guidance clear in their communications to examiners and to supervised institutions. Supervised institutions with questions about supervisory guidance are encouraged to discuss those questions with the Agencies.

The Interagency Statement has the potential to lead to meaningful changes in supervisory practices at the Agencies. We offer the following preliminary observations.

No Violations Based on Supervisory Guidance: Real Progress or an Unsteady Commitment? As noted, the Agencies state that examiners will not criticize supervised institutions for “violations” of supervisory guidance. The quote marks around the term “violations” in the Interagency Statement are a clear signal that there is no longer any such thing as a “violation” of supervisory guidance. There can only be a violation of laws, regulations, enforcement orders or other enforceable conditions. The Agencies go on to note in the same paragraph that supervisory guidance “often provides examples of practices that the Agencies generally consider consistent with safety-and-soundness standards or other applicable laws and regulations.” Although some might argue that this reference to safety and soundness means that examiners could use that concept to reimport the concept of “violations” of guidance, we think there are limits. The term safety and soundness is not a magical incantation without limits, despite its long and hallowed history in banking regulation. Safety and soundness standards must tie to the safety and soundness standards laid out in their governing statute,⁶ and the regulations issued thereunder.⁷ Proposals to strengthen the ombudsman role and to make examination appeals more meaningful will also play a role.⁸

The Interagency Statement also states that examiners may note examples of “unsound practices or other deficiencies in risk management, including compliance risk management, or other areas that do not constitute violations of law or regulation. In some situations, examiners may reference (including in writing) supervisory guidance to provide examples of safe and sound conduct, appropriate consumer protection and risk management practices, and other actions for addressing compliance with laws or regulations.” There is, of course, a difference between noting in writing and enforcement. How the Interagency Statement plays out in the field remains to be seen. The current group of Agency leaders have demonstrated a genuine commitment to recalibrating supervisory practices, and the Interagency Statement is another step in that positive direction, particularly given the express commitment the Agencies have made to continuing to communicate the role of supervisory guidance to examiners.

The Shadow of the Leveraged Lending Guidance. Though not mentioned in the Interagency Statement, it is impossible to read the Agencies’ commitment to limiting the use of bright-line numerical thresholds and the Agencies’ disavowal of the use of supervisory guidance to support enforcement actions without immediately thinking of the leveraged lending guidance. Those guidelines specified a numerical threshold of leverage higher than 6x total EBITDA as one that would “raise concerns for most industries.” According to [public reports](#), the leveraged lending guidance was also used as the basis for the issuance of MRAs and MRIAs. Following the GAO report referenced above, but only after much pressing from Congress and a significant period of uncertainty for financial institutions, leadership at the Federal Reserve, FDIC and OCC acknowledged the nonbinding nature of the leveraged lending guidance in informal statements.⁹ The Interagency Statement is a more definitive endorsement of these earlier statements.

Benefits of Public Comments. The Agencies acknowledge in the Interagency Statement that submitting supervisory guidance for public comment may improve the Agencies’ “understanding of an issue” and thus allow the Agencies to “achieve a supervisory objective most effectively and with the least burden on institutions.” This recognition of the benefits of public comments on supervisory guidance is consistent with certain recent Agency actions. For example, this year the Federal Reserve and FDIC for the first time made their resolution planning guidance subject to notice and comment.¹⁰ The resolution planning guidance comment process will, we hope, lead to a reduction in inefficiencies and the application of more refined, rationalized and consolidated guidance in the 2019 filing cycle. The notice and comment process should be used to bring similar benefits to bear on other supervisory guidance.

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- ¹ Semi-Annual Testimony on the Federal Reserve's Supervision and Regulation of the Financial System, Hearing Before the House Financial Services Committee (Apr. 17, 2018); Financial Industry Regulation: the Office of the Comptroller of the Currency, Hearing Before the House Financial Services Committee (June 13, 2018); The Annual Testimony of the Secretary of the Treasury on the State of the International Financial System, Hearing Before the House Financial Services Committee (July 12, 2018).
- ² For more, see Margaret E. Tahyar, Are Bank Regulators Special?, TCH Banking Perspectives (Quarter 1 2018) ([link](#)).
- ³ As the Agencies note in the Interagency Statement, "Supervised institutions at times request supervisory guidance, and such guidance is important to provide insight to industry, as well as well as supervisory staff, in a transparent way that helps to ensure consistency in the supervisory approach."
- ⁴ GAO, Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation—Applicability of the Congressional Review Act to Interagency Guidance on Leveraged Lending (Oct. 19, 2017) ([link](#)). The GAO observed that the Congressional Review Act definition of rule is broad and "includes both rules requiring notice and comment rulemaking and those that do not, such as general statements of policy."
- ⁵ The FDIC's proposal to retire to inactive status 374 risk management supervision-related financial institution letters, many of them duplicative, is a step in this direction. FDIC Financial Institution Letter 46-2018, FDIC Seeks Comment on Proposed Retirement of Certain Financial Institution Letters (Sept. 10, 2018) ([link](#)).
- ⁶ 12 U.S.C § 1831p-1.
- ⁷ The banking agencies' Interagency Guidelines Establishing Standards for Safety and Soundness are found at 12 C.F.R. Part 208 Appendix D-1 (Federal Reserve), 12 C.F.R. Part 570 Appendix A (OCC) and 12 C.F.R. Part 364 Appendix A (FDIC).
- ⁸ Federal Reserve, Internal Appeals Process for Material Supervisory Determinations and Policy Statement Regarding the Ombudsman for the Federal Reserve System, 83 Fed. Reg. 8391 (Feb. 27, 2018) ([link](#)).
- ⁹ For instance, Comptroller Otting memorably [observed](#) that banks can "do what they want" in leveraged lending so long as that leveraged lending does not impair safety and soundness.
- ¹⁰ Federal Reserve and FDIC, Resolution Planning Guidance for Eight Large, Complex U.S. Banking Organizations, 83 Fed. Reg. 32856 (July 16, 2018) ([link](#)). Additional examples of guidance submitted for public comment include the Federal Reserve's proposed Board Effectiveness Guidance and proposed Management Guidance. Our visual memorandum discussing that proposed guidance is available [here](#).