IN SUPPORT OF SUPERVISORY GUIDANCE

Todd Phillips

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Todd Phillips[*]

Abstract

The role and appropriateness of bank supervisory guidance is widely misunderstood. Some have argued that supervisory guidance is used in lieu of notice-and-comment rulemakings, binding banks to policies on which they had no opportunity to comment. This claim, however, misunderstand that the Federal banking agencies have wide latitude to interpret and apply the banking statutes during examinations and that guidance serves to narrow *the universe of possible enforcement actions regulators may take while simultaneously providing regulated entities predictability. This essay argues in support of and encourages regulators to issue bank supervisory guidance, placing it within the administrative law framework governing bank examinations. It also discusses supervisory guidance's benefits to banks, examiners, and the public. This essay concludes by arguing that the banking agencies should not be concerned that Congress may use the Congressional Review Act to overturn their guidance.*

[*] Director, Financial Regulation and Corporate Governance, Center for American Progress. The views expressed in this article are the author's and not necessarily those of the Center. For helpful comments and conversations, the author thanks Jeremy Kress, Ron Levin, David Zaring, and the participants of the Wharton Financial Regulation Workshop.

INTRODUCTION

A debate is taking place between the covers of law reviews and within the halls of power over an issue that is fundamental to bank regulation today: the role and appropriateness of bank supervisory guidance and the application of administrative law to bank supervision generally. At a time when Supreme Court justices question the legal foundations upon which this guidance relies,[1] bankers' allies argue that the "legal process has broken down in the regulation and examination of banks"[2] with regulators' ostensibly non-binding "guidance or other policy statements . . . being enforced as rules."[3] In response to a growing movement against guidance generally and the use of bank supervisory guidance specifically, regulators have enacted new rules purporting to limit their use of guidance.[4] Scholars have also begun working to ground bank supervision firmly within administrative law.[5]

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[1] *See, e.g.*, Kisor v. Wilkie, 139 S. Ct. 2400, 2434 (2019) (Gorsuch, J., concurring) ("Under *Auer*, courts must treat as 'controlling' not only an agency's duly promulgated rules but also its mere interpretations—even ones that appear only in a legal brief, press release, or guidance document issued without affording the public advance notice or a chance to comment. For all practical purposes, 'the new interpretation might as well be a new regulation.'").

[2] *Guidance, Supervisory Expectations, and the Rule of Law: How do the Banking Agencies Regulate and Supervise Institutions?: Hearing Before the Comm. on Banking, Hous., & Urb. Affs.*, S. Hrg. 116–25, at 5 (2019) [hereinafter *Guidance Hearing*] (statement of Greg Baer, President and CEO, Bank Policy Institute).

[3] *Id*. at 23 (statement of Sen. Mike Crapo, Chairman, S. Comm. on Banking, Hous., & Urb. Affs.).

[4] *See* Role of Supervisory Guidance, 86 Fed. Reg. 12079 (Mar. 2, 2021) (codified at 12 C.F.R. pt. 302, App. A) (FDIC); Role of Supervisory Guidance, 86 Fed. Reg. 9253 (Feb. 12, 2021) (codified at 12 C.F.R. pt. 4, Subpt. F, App. A) (Dep't Treas. Off. of the Comp. of the Currency); Role of Supervisory Guidance, 86 Fed. Reg. 18173 (Apr. 8, 2021) (codified at 12 C.F.R. pt. 262, App. A) (Bd. of Governors of the Fed. Rsrv. Sys.) [collectively and hereinafter *Rule on Supervisory Guidance*]. The FBAs adopted identical rules; only the agency names are changed between documents.

[5] *See, e.g.*, Daniel K. Tarullo, *Bank Supervision and Administrative Law*, COLUM. BUS. L. REV. (forthcoming) (manuscript at 59), https://papers.ssrn.com/sol3/papers.cfm ?abstract_id=3743404 (positing that rather than focusing on whether a particular action is "practically binding" on private entities in order to determine whether notice-and-comment was required, courts should "focus less on the specific action being challenged and more on the process that produced it"); Lev Menand, *Why Supervise Banks? The Foundations of the American Monetary Settlement*, 74 VAND. L. REV. 951, 1009 (2021) (arguing that the

These debates stem from bank regulation's uniqueness. Because banks may engage in overly-risky activities as a result of their explicit deposit insurance backstop from the government and because their failures may propagate to other industries, regulators work to stop actions that could harm banks, their depositors, and the real economy before those activities get out of hand.[6] As a result and unlike other businesses, banks, other insured depository institutions, and their holding companies are subject to "prudential" regulation that "focus[es] less on compliance with specific regulatory rules . . . and more on the soundness of the bank's management practices with regard to controlling risk."[7]

The framework for prudential regulation consists not only of having the Federal banking agencies (the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), and the Federal Deposit Insurance Corporation (FDIC); collectively, the FBAs) enforce statutes and regulations, but also examine the operations and financials of each bank on a periodic or ongoing basis. Examiners engage in a "process of comment and response" with their banks in which the institutions "agree to change some aspect of [their] operation or accounting" to ensure they act in safe and sound manners and that overly-risky or unlawful activities that could put their continued operation in jeopardy are nipped in the bud in exchange for keeping enforcement actions at a minimum.[8] Statute requires that each bank be examined at least every 18 months[9] and some of the largest banks have examiners housed inside their buildings that keep a constant eye over their activities and can answer questions as to whether, for example, a particular activity is permissible before the bank takes it.[10]

The debate over supervisory guidance is about how bank examiners use guidance,[11] and it strikes at the very heart of this comment-and-response process.

FBAs may ignore large swaths of the APA because their actions are unreviewable by courts because "the APA's procedural protections are triggered by formal actions," and the FBAs generally "proceed informally" and thus do not trigger judicial review of many of their actions).

[6] *See generally* Menand, *supra* note 5.

[7] FREDERIC S. MISHKIN, PRUDENTIAL SUPERVISION: WHAT WORKS AND WHAT DOESN'T 14 (2001).

[8] *In re* Subpoena Served Upon the Comptroller of the Currency, 967 F.2d 630, 634 (D.C. Cir. 1992).

[9] *See* 12 U.S.C. § 1820(d) (2018).

[10] *See* Ryan Tracy, *Regulator Plans to Move Some Bank Examiners Out of Banks*, WALL ST. J., May 28, 2014.

[11] *See generally Guidance Hearing*, *supra* note 2 (discussing how bank examiners use and should use supervisory guidance).

Supervisory guidance—generally issued by political appointees or high-ranking civil servants of the FBAs without undergoing the notice-and-comment process required of binding regulations—is a relatively new phenomenon that has developed only over the past few decades as banking has transitioned from the 3-6-3 model[12] to something much more complicated.[13] As such, debate exists as to whether examiners merely take into consideration the guidance offered as they use their grants of broad discretion to ensure the resiliency of any institution they supervise,[14] or whether examiners enforce guidance on financial institutions as though they are law.[15] Critically, using supervisory guidance to merely advise examiners (and bankers) to developing issues is perfectly legal, whereas mandating or proscribing activities on the part of bankers or examiners is not.

Critics of the way the FBAs use supervisory guidance have identified a number of concerns, arguing that financial institutions and their lawyers are

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[12] *See* John R. Walter, *The 3-6-3 Rule: An Urban Myth?*, 92 FED. RSRV. BANK OF RICHMOND ECON. Q. 51, 51 (2006) ("Observers often describe the banking industry of the 1950s, 1960s, and 1970s as operating according to a 3-6-3 rule: Bankers gathered deposits at 3 percent, lent them at 6 percent, and were on the golf course by 3 o'clock in the afternoon.").

[13] For purposes of this essay, the term "supervisory guidance" does not include letters, such as Matters Requiring Attention, or verbal guidance issued by examiners to a single institution to address the examiners' concerns in lieu of bringing an enforcement action.

[14] This is generally considered the "fire warden" view, in which the job of examiners "is to ensure financial institutions are well managed and strong enough that if they catch fire, they don't burn down." Lee Reiners, *Carmen Segarra and Competing Visions of Bank Supervision*, THE FINREG BLOG (Oct. 25, 2016), https://sites.law.duke.edu/thefinregblog/2016/10/25/carmen-segarra-and-competing-visions-of-bank-supervision/. *See also* Randal K. Quarles, Vice Chair for Supervision, Bd. of Governors of the Fed. Rsrv. Sys., Address at the Federal Reserve Board, Harvard Law School, and Wharton School Conference: Bank Supervision: Past, Present, and Future 5 (Dec. 11, 2020), https://www.federalreserve.gov/newsevents/speech/quarles20201211a.htm ("Supervision, in contrast to regulation, looks at firm-specific issues, such as how a firm's idiosyncratic risks are evaluated under our regulations, and at risk-management frameworks that cannot easily be assessed through standardized risk measures. For example, while our capital rules require banks to hold a specific level of capital, our exams focus on subjects such as the plans of management to make sure they can meet those capital requirements on an ongoing basis.").

[15] This is generally considered the "cops-on-the-beat" view, in which examiners are "out to stop illegal or unsafe conduct, ideally before it happens." Reiners, *supra* note 14.

frequently unable to obtain the guidance provided to examiners,[16] that the documents themselves are incomprehensible and at odds with previously promulgated guidance,[17] and that banking agencies frequently use guidance unlawfully as a way to dictate policy.[18] Further, critics have expressed concern that even if examiners do not consider guidance to be binding, the way examiners write or talk about guidance "may leave many supervised institutions with the strong impression that meeting supervisory expectations will require strict adherence to the supervisory guidance."[19]

Although the banking agencies have—sometimes admittedly[20]—been guilty of these charges at some point or another in the past, left unsaid by these naysayers is that supervisory guidance is quite *beneficial*—particularly for banks. Whereas bankers may frequently consider guidance an imposition, the alternative may be

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[16] *See* Randal K. Quarles, Vice Chair for Supervision, Bd. of Governors of the Fed. Rsrv. Sys., Remarks at the Open Board Meeting (April 23, 2019), https://www.federalreserve.gov/mediacenter/files/open-board-meeting-transcript-20190423.pdf (noting that at least one policy used by the FRB could "not be discovered except through supplication to a small handful of people who have spent a long apprenticeship in the subtle hermeneutics of Federal Reserve lore, receiving the wisdom of their elders through oral tradition in the way that gnostic secrets are transmitted from shaman to novice in the culture of some tribes of the Orinoco."); *see also Guidance Hearing*, *supra* note 2, at 41–44 (statement of Margaret E. Tahyar, Partner, Davis Polk and Wardwell LLP).

[17] *Guidance Hearing*, *supra* note 2, at 43 (statement of Tahyar) ("The first set of public guidance was issued without advance warning or notice and comment and stated that all previous guidance, public and private continued to apply. For those working on living wills, figuring out which parts of which years' private guidance no longer applied—because it was not aligned with the public guidance—was a puzzle.")

[18] *See id.* at 29 (statement of Baer) ("Banks generally treat all [supervisory guidance] as legally binding because a 'violation' of any of them can form the basis for an MRA.").

[19] Letter from Shaun Kern, Senior Council at the Am. Bankers Ass'n, to Chief Counsel's Office, Off. of the Comptroller of the Currency et al. (Jan. 4, 2021), https://www.aba.com/-/media/documents/comment-letter/aba-letter-on-role-of-supervisory-guidance-01042021.pdf?rev=d9fc9b65b11e455bb7ba2931e747c6e7 ("[P]resenting relevant supervisory guidance alongside formal criticisms on the same topic may leave many supervised institutions with the strong impression that meeting supervisory expectations will require strict adherence to the supervisory guidance.").

[20] *See, e.g.*, Randal K. Quarles, Vice Chair for Supervision, Bd. of Governors of the Fed. Rsrv. Sys., Address at the American Bar Association Banking Law Committee Meeting 2020: Spontaneity and Order: Transparency, Accountability, and Fairness in Bank Supervision (Jan. 17, 2020), https://www.federalreserve.gov/newsevents/speech/quarles20200117a.htm.

braving the broadly-written banking statutes that "leave considerable room for agency interpretation and discretion" with no guidance at all.[21] Administrative law permits the FBAs to apply their statutes through administrative adjudication,[22] and guidance allows them to articulate publicly their interpretations of statute or how they will or will not go about enforcing those statutes before they are applied.[23] Guidance serves to narrow the universe of actions an agency may take and allows regulated entities predictability not otherwise offered.[24]

The banking industry admits as much, albeit in a roundabout way. In criticizing the use of supervisory guidance, the head of an industry trade association criticized that "examiners generally cite 'safety and soundness'" when "[a]sked for the legal basis for" issuing supervisory criticisms such as Matters Requiring Attention.[25] Yet the banking statutes explicitly allow regulators to take action against institutions that engage in "unsafe or unsound practices" or are in "an unsafe or unsound condition," including the revocation of deposit insurance.[26] Regulators are certainly permitted to cite safety and soundness concerns, and knowing what concerns those might be in advance is certainly helpful to institutions.[27]

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[21] Tarullo, *supra* note 5, at 51.

[22] *See* SEC v. Chenery Corp. (*Chenery II*), 332 U.S. 194 (1947).

[23] *See* Aaron L. Nielson, *Beyond Seminole Rock*, 105 GEO. L. J. 943, 987 (2017) ("At least in part, the reason regulated parties care about guidance documents where the agency has not promulgated a rule is because *Chenery II* looms in the background. If an agency could not punish regulated parties directly under the statute, but instead could only promulgate rules, regulated parties would have less reason to worry about a guidance document when the agency has not promulgated a rule. As it is now, however, agencies can bring an enforcement action under the statute itself, thus forcing regulated parties to pay attention to the agency's guidance.").

[24] Further, the U.S. Constitution's promise of due process prohibits agencies from acting in ways they publicly indicated they would not; so, if an agency indicates it will not pursue certain enforcement actions, private entities can rely on that. *See* FCC v. Fox TV Stations, Inc., 567 U.S. 239, 253–55 (2012).

[25] *Guidance Hearing*, *supra* note 2, at 5 (statement of Baer).

[26] 12 U.S.C. § 1818 (2011).

[27] *See* Gulf Fed. Sav. & Loan Ass'n v. Fed. Home Loan Bank Bd., 651 F.2d 259, 267 (5th Cir. 1981) ("The 'unsafe or unsound practice' provision[] refers only to practices that threaten the financial integrity of the association."); Seidman v. Off. of Thrift Supervision (*In re* Seidman), 37 F.3d 911, 928 (3d Cir. 1994) (holding that an unsafe or unsound practice "must pose an abnormal risk to the financial stability of the banking institution").

In addition to being useful for banks, the use of guidance is beneficial for society generally, given the importance of the banking system to non-banking activities. As the collapse of individual banks or the banking system as a whole can cause harm to the real economy, it is imperative that agency officials provide to examiners up-to-date and readily-available information on the state of the banking system and on new and developing risks as they ensure the safety and soundness of their institutions.

Although there are ways for the FBAs to improve their guidance practices, even after they promulgated a rule providing that they will "not take enforcement actions based on supervisory guidance,"[28] the use of these documents is a form of agency action for which banks and society at large are better off.

This essay defends the use of supervisory guidance in the bank regulatory process. Part I discusses the benefits of the FBAs using guidance to advise, but not bind, examiners and institutions. Part II then discusses how the regulators may legally issue and use guidance. This part discusses the administrative law governing how agencies may use guidance and provides its own guidance to agencies about how to use supervisory guidance in examining for the general safety and soundness of institutions. It also discusses banks' recourse if they believe their regulator has violated the principles of administrative law. Finally, part III discusses the Congressional Review Act's treatment of supervisory guidance and encourages the FBAs to draft supervisory guidance for optimal policy results, rather than to avoid Congressional review under the Act.

I. BENEFITS OF USING GUIDANCE TO ADVISE, NOT BIND, EXAMINERS

Although guidance generally does not have the force and effect of law,[29] agencies can provide "great value to agencies and the public alike"[30] by "using these documents to inform staff members, as well as the public, about the manner in which the agency contemplates implementing its programs."[31] Of particular

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[28] *See Rule on Supervisory Guidance*, *supra* note 4.

[29] *See* Chrysler Corp. v. Brown, 441 U.S. 281, 302 n.31 (1979) (noting that guidance documents "do not have the force and effect of law").

[30] Notice of Adoption of Recommendations, 82 Fed. Reg. 61,728, 61,734 (Dec. 29, 2017) [hereinafter *Recommendation 2017-5*] (adopting five recommendations at the Administrative Conference of the United States' sixty-eighth plenary session, including Recommendation 2017-5, *Agency Guidance Through Policy Statements*).

[31] Ronald M. Levin, *Rulemaking and the Guidance Exemption*, 70 ADMIN. L. REV. 263, 286 (2018).

importance to regulated entities, guidance can "make agency decisionmaking more predictable and uniform and shield regulated parties from unequal treatment, unnecessary costs, and unnecessary risk."[32] In a recent study consisting of 135 interviews to learn how agencies and the public utilize guidance, Professor Nicholas Parrillo found that "guidance is a much-needed resource that [regulated parties] would not want to do without—and may actively demand."[33]

To truly understand the benefits of guidance, it is important to recognize that agencies are generally permitted to articulate policy through either rulemaking or administrative adjudication. While many today are familiar with the notice-and-comment rulemaking process used to clarify statutory requirements, the Supreme Court case *Chenery II* holds that (unless otherwise prohibited by statute) agencies may also clarify ambiguous statutes or apply them to novel fact patterns in the course of adjudications against regulated entities, developing policy in a manner similar to how courts develop the common law.[34] The rationale for the authority to develop the law in a case-by-case nature is quite simple: "Not every principle essential to the effective administration of a statute can or should be cast immediately into the mold of a general rule,"[35] and allowing a lawbreaker to escape

[32] *Recommendation 2017-5*, *supra* note 30. The Administrative Conference of the United States also notes the ways in which using guidance benefits agencies: using guidance "can make agency decisionmaking faster and less costly" and, because issuing guidance "often takes less time and resources than legislative rulemaking, [it] free[s] up the agency to, for instance, take other action within its statutory mission." *Id*.

[33] NICHOLAS R. PARRILLO, REPORT TO THE ADMIN. CONF. OF THE U.S., FEDERAL AGENCY GUIDANCE: AN INSTITUTIONAL PERSPECTIVE 35 (Oct. 12, 2017). *See also Guidance Hearing*, *supra* note 2, at 49 (statement of Patricia A. McCoy, Professor of Law, Boston College Law School) (asserting that guidance may "provide a useful possible roadmap for compliance, while leaving companies free to propose alternative models or interpretations or consideration of additional facts").

[34] *Chenery II*, 332 U.S. 194, 203 (1947) ("There is . . . a very definite place for the case-by-case evolution of statutory standards. And the choice made between proceeding by general rule or by individual, ad hoc litigation is one that lies primarily in the informed discretion of the administrative agency.").

[35] *Id*. at 202 ("[P]roblems may arise in a case which the administrative agency could not reasonably foresee, problems which must be solved despite the absence of a relevant general rule. Or the agency may not have had sufficient experience with a particular problem to warrant rigidifying its tentative judgment into a hard and fast rule. Or the problem may be so specialized and varying in nature as to be impossible of capture within the boundaries of a general rule. In those situations, the agency must retain power to deal with the problems on a case-to-case basis if the administrative process is to be effective.").

scrutiny "merely because there was no general rule or regulation covering the matter would be unjustified."[36]

This authority has significant implications for banking. Congress recognized that the nation's credit system will only work if there is "confidence" in the banking system, and there will only be confidence when "people believe that their money is safe when in a bank."[37] But "finance is a shape shifter" in which "[r]egulatory arbitrage is endemic," and because many different types of transactions can have the same economic effect, legislating with any specificity would simply be playing "whack-a-mole" in a manner that leaves the public with less-than-optimal confidence in the financial system.[38] Instead, Congress decided to largely defer to the FBAs' determinations of which banking activities are unsafe or unsound, rather than articulating each and every prohibited action itself, and because of *Chenery II*, the FBAs may generally articulate those activities through either regulation or adjudication.

For example, the FDIC may terminate a bank's deposit insurance if the bank or its directors "have engaged or are engaging in unsafe or unsound practices in conducting the business of the depository institution" or if the bank itself "is in an unsafe or unsound condition."[39] Courts have interpreted the phrase "unsafe or unsound practice" as a practice "that pose[s] a reasonably foreseeable undue risk to the institution,"[40] but also "as a flexible concept which gives the administering agency the ability to adapt to changing business problems and practices in the regulation of the banking industry"[41] and one that "is to be liberally construed."[42] As such, the FDIC's Board of Directors is granted wide latitude in determining

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[36] *Id.* at 201. *See also id.* at 202 ("[A]ny rigid requirement to that effect would make the administrative process inflexible and incapable of dealing with many of the specialized problems which arise.").

[37] H.R. REP. NO. 73-150, at 6 (1933) (quoting statement of Dr. Thomas Nixon Carver).

[38] PAUL TUCKER, UNELECTED POWER: THE QUEST FOR LEGITIMACY IN CENTRAL BANKING AND THE REGULATORY STATE 469 (2018). *See generally* Menand, *supra* note 5, at 969–70 (explaining how supervision can be thought of as "gap-fillers" of regulation).

[39] 12 U.S.C. §§ 1818(a)(2)(A)(i)–(ii).

[40] Landry v. Fed. Deposit Ins. Corp., 204 F.3d 1125, 1138 (D.C. Cir. 2000) (quotation marks omitted) (citation omitted).

[41] *In re* Seidman, 37 F.3d 911, 927 (3d Cir. 1994). *See also* Groos Nat'l Bank v. Comptroller of the Currency, 573 F.2d 889, 897 (5th Cir.1978) ("The phrase 'unsafe or unsound banking practice' is widely used in the regulatory statutes and in case law, and one of the purposes of the banking acts is clearly to commit the progressive definition and eradication of such practices to the expertise of the appropriate regulatory agencies.").

[42] Indep. Bankers Ass'n v. Heimann, 613 F.2d 1164, 1169 (D.C. Cir. 1979).

which specific practices are unsafe or unsound or what financials would qualify a bank as in an unsafe or unsound condition. The FDIC's Board of Directors could certainly promulgate regulations to do this, but it could also adjudicate actions brought by the agency's Legal Division to terminate banks' insurance without rules being enacted, articulating the standards it will use for the first time at the adjudication.[43] The OCC and Federal Reserve may similarly use adjudication to clarify their interpretations of their statutes.[44]

Although banks could wait until after the FDIC brings an enforcement action to learn that the agency believed a particular practice to be unsafe and unsound, they would certainly prefer to know in advance; one interviewee told Professor Parrillo that "banks were not 'anti-regulation' or 'pro-regulation' but rather 'pro-clarity' and 'pro-consistency'" so that they may "devise a business model" and plan for the future.[45] By advising bankers as to how their examiners think about an issue, supervisory guidance gives banks the clarity they desire that may not be available from reviewing the text of a statute—and without their regulator having

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[43] To terminate a bank's deposit insurance, the Board of Directors of the FDIC or its delegate must hear evidence presented at an on-the-record hearing. 12 U.S.C. § 1818(a)(3). If, on the basis of this evidence, the FDIC "finds that any unsafe or unsound practice or condition . . . has been established," it may order the bank's insurance be terminated. *Id.* This order may be appealed to the court of appeals for the D.C. Circuit or for the circuit in which the bank's home office is located. *Id*. § 1818(a)(5), (h). Clearly, the FDIC maintains authority to decide at the time of the hearing what constitutes an unsafe or unsound practice. *See also* Heidi Mandanis Schooner, *Fiduciary Duties' Demanding Cousin: Bank Director Liability for Unsafe or Unsound Banking Practices*, 63 GEO. WASH. L. REV. 175, 188 (1995) (noting that "neither Congress nor the federal banking agencies could (or should) attempt to regulate specifically each and every bank activity," and it would be "prohibitively costly" to do so).

Note also that the FDIC may be granted *Chevron* deference through both regulations that it issues and through formal adjudication. *See* United States v. Mead Corp., 533 U.S. 218, 219 (2001) ("[T]he overwhelming number of our cases applying *Chevron* deference have reviewed the fruits of notice-and-comment rulemaking or formal adjudication.").

[44] *See*, *e.g.*, 12 U.S.C. § 24 (providing that the OCC may decide the "incidental powers . . . necessary to carry on the business of banking"); 12 U.S.C. § 1843(j)(2)(A) (authorizing the FRB to permit bank holding companies to engage in non-financial activities that "can reasonably be expected to produce benefits to the public").

[45] PARRILLO, *supra* note 33, at 97. However, courts require the public to have advance warning of which activities are prohibited before they can be penalized in an adjudication. *See* Todd Phillips, *A Change of Policy: Promoting Agency Policymaking by Adjudication*, 73 ADMIN. L. REV. 495, 502–06 (collecting cases).

to begin an enforcement action against one institution to put the rest of the industry on notice.[46]

Similarly, banks benefit when supervisory guidance helps ensure examiner consistency. Bank examiners' activities are informal adjudications under the Administrative Procedure Act,[47] in which they use the facts uncovered by examinations to determine whether banks have violated the banking laws.[48] Like all adjudicators, examiners are permitted to interpret statutes, regulations, and precedents in order to apply them to the facts at hand and, again like all adjudicators, different examiners may come to different conclusions. Some examiners may recognize a particular practice or type of transaction as presenting a safety and soundness concern while others may not; given the banking laws' wide grants of latitude to agencies, it is not difficult to imagine, for example, that

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[46] Agencies are generally not permitted to depart from their guidance documents in ways that negatively affect regulated parties. *See* infra notes 85–89, 112–15 and accompanying text.

[47] *See* 5 U.S.C. § 554(a)(3) (providing that the APA's formal adjudication procedures are unnecessary for "proceedings in which decisions rest solely on inspections"). *See also* Christopher J. Walker & Melissa F. Wasserman, *The New World of Agency Adjudication*, 107 CALIF. L. REV. 141, 153 (2019) ("Despite administrative law's fixation on APA-governed formal adjudication, the vast majority of agency adjudications and federal regulatory actions do not involve APA-governed formal adjudications before an [administrative law judge] or the agency itself.").

Some argue that "[s]upervision is a form of governance distinct from rulemaking, adjudication, and guidance," Menand, *supra* note 5, at 953, or that the legality of banking agencies' actions should "appropriately reflect the necessarily iterative nature of bank supervision," Tarullo, *supra* note 5, at 58. Though it may be useful in some situations to conceptualize bank supervision as distinct—bank supervision is truly unlike the activities in which other regulatory agencies engage—Congress did not provide a bank supervision "carveout" from the APA. It understood how bank supervision functions, *see, e.g.*, FINAL REPORT OF ATTORNEY GENERAL'S COMMITTEE ON ADMINISTRATIVE PROCEDURE, S. DOC. NO. 8, at 141–43 (1941), and the courts have made clear that there is limited, if any, administrative exceptionalism. The law of bank supervision *must* be grounded in contemporary administrative law if it is to survive judicial review.

[48] *See* Tarullo, *supra* note 5, at 50 ("Early supervision originated in the right to examine banks to determine if bank behavior warranted certain legal consequences – whether a bank's Federal charter should be revoked, or specific bank officials should be removed from the bank, or – later – whether Federal deposit insurance should be terminated. These consequences would ensue after an adjudicatory proceeding, either judicial or administrative. Thus the broad 'visitorial' powers of banking agencies to gain access to bank premises for purposes of examining its books and records helped them to make informed decisions on initiating one of these actions.").

one examiner would deem a particular asset to require a 100% risk-weighted asset charge while another examiner would grant the same asset a 200% charge. The bank with the second examiner would be put at a competitive disadvantage by being required to hold twice as much capital against the asset as the first, and should certainly desire that guidance be issued so that examiners view assets equally.

Finally, the use of guidance documents and the clarity provided allows banks to avoid litigation and its associated costs. Parrillo's interviewees identified four "costs" of litigation, even if a business is ultimately victorious:[49] the costs of "being investigated and mounting a defense," including not only "[d]irect legal bills," but also the costs associated with "the seizure of computers and records, which by itself could put some firms out of business," and "the opportunity cost[s] of defense;"[50] negative effects of the "bad publicity" that comes from being charged with violating the law;[51] costs to litigate "follow-on lawsuits by state attorneys general or class-action plaintiffs;"[52] and the deadweight loss associated with employees becoming risk-adverse when a project's legality is ambiguous.[53] An additional cost frequently articulated by the banking industry is that of reprisal for challenging examiners' decisions.[54]

There are, of course, avenues for banks to appeal supervisory determinations such that examiners may be overruled and all banks will be treated equally, but

[49] Parrillo was concerned with instances in which "[a] regulated party [may have] a legal theory for why its behavior violates the guidance but not the legislative rule," but the same logic applies to instances in which no guidance is initially offered. *See* PARRILLO, *supra* note 33, at 66.

[50] *Id.*

[51] *Id*.

[52] *Id*. at 68.

[53] *Id*. Parrillo noted that, because "an enforcement action can cause a bank to abandon whatever financial product is the target of that action, damaging the careers of whichever bank employees had developed the product. This means that bank employees are reluctant to develop new products unless there is some assurance from the agency that they are lawful, which the agency may not be willing to provide before it sees the product in action. The result is that employees hold back, following existing guidance unless the agency changes it." *Id*. at 69.

[54] *See* Barbara A. Rehm, *Going Beyond the Anecdote to Grade Bank Examiners*, AM. BANKER (Jan. 18, 2012), https://www.americanbanker.com/bank-examinations-aba-utah-bankers-association-1045825-1.html ("Retribution. Say the word to anyone in banking and they immediately get the context: bankers fearing a backlash if they complain about examiners.").

banks may still face limitations on their activities while their appeals are pending.[55] Although all banks may be treated similarly after rounds of litigation, some banks may operate at a competitive disadvantage to others during the appeals process. Guidance avoids this entirely. As one interviewee told Professor Parrillo, regulated entities "may not like [a guidance document's] policy" and may believe it to be "arbitrary," but "at least it's applied the same across all cases."[56]

Given the harms that the collapse of banks or the banking system can impose on the real economy, supervisory guidance is important not only for banks but also for society as a whole. It is imperative that the FBAs ensure the safety and soundness of individual financial institutions and the banking system as a whole *before* they fail, rather than attempt to address the consequences of collapse *after*. This is one reason why the supervisory relationship "calls for [ongoing] adjustment, not [after-the-fact] adjudication."[57] Examiners dig deep into a bank's financials and interview its staff to understand where risks may lie, ensuring that unsafe and unsound practices are identified before they can metastasize into something worse.[58] This is perhaps why the Supreme Court deemed bank supervision as "one of the most successful systems of economic regulation" and the reason for "the virtual disappearance of bank failures from the American economic scene."[59] In order to examine banks effectively, examiners must be well-informed and with the latest and most up-to-date information about the industry and developing issues.

To accomplish their many goals, the FBAs have issued written supervisory guidance in a number of different forms. Their guidance has included examination manuals, which are necessary as training devices and references for which examiners may refer during the course of an examination;[60] guidelines and policy

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[55] This is certainly warranted. If an action may be a safety and soundness issue, we would not want a bank to continue engaging in that activity—potentially putting the safety and soundness of the institution or the financial system at risk—while their appeal is being heard.

[56] PARRILLO, *supra* note 33, at 94.

[57] *In re* Subpoena Served Upon the Comptroller of the Currency, 967 F.2d 630, 634 (D.C. Cir. 1992).

[58] Tarullo, *supra* note 5, at 1 (asserting that examiners and banks engage in an "iterative process of communication [that] involves the identification of potentially unsafe and unsound practices").

[59] United States v. Phila. Nat'l Bank, 374 U.S. 321, 330 (1963) (quoting KENNETH CULP DAVIS, ADMINISTRATIVE LAW TREATISE (1st ed. 1958), § 4.04) (alteration omitted).

[60] *See, e.g.*, OFF. OF THE COMPTROLLER OF THE CURRENCY, CAPITAL AND DIVIDENDS, COMPTROLLER'S HANDBOOK (2018).

statements, which provide bankers and examiners with the FBAs' senior leadership's analyses of developing issues;[61] legal interpretations, applying the law to particular facts or circumstances to advise whether the FBAs' lawyers would recommend or discourage enforcement actions;[62] and even simple letters to all banks or a subset of banks with general information that the FBAs think is important.[63]

In sum, "guidance is a legitimate tool of administration"[64] that benefits both bankers and society. Supervisory guidance provides bankers information as to how regulators may enforce the law, allowing bankers to plan appropriately and avoid unnecessary litigation costs, and ensures consistency between examiners. Guidance also ensures that examiners have the information necessary to spot banks' safety and soundness issues before they metastasize and threaten the real economy.

II. HOW REGULATORS MAY APPROPRIATELY ISSUE AND USE GUIDANCE

If banking regulators are to use guidance, they must do so in compliance with the law. Although the FBAs recently issued a rule "explain[ing] the role of supervisory guidance" and "describ[ing] [their] approach to supervisory guidance,"[65] this rule did little more than restate current law.[66] This part details the administrative law governing agencies' use of guidance and applies that to banking in order to discuss how regulators may effectively and legally use the documents. It also explains the protections the law provides to banks.

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[61] *See, e.g.*, Capital; Risk-Based Capital Guidelines, 54 Fed. Reg. 4186 (Jan. 27, 1989).

[62] *See, e.g.*, Letter from Mark E. Van Der Weide, Gen. Couns., Fed. Rsrv. Bd., to Alan W. Avery, Latham & Watkins LLP (Dec. 30, 2020), https://www.federalreserve.gov/supervisionreg/legalinterpretations/bhcchangeincontrol20201230-national-bank-of-canada.pdf.

[63] *See, e.g.*, Financial Institution Letters (FDIC), Supervision and Regulation Letters (FRB), Bulletins (OCC).

[64] Levin, *supra* note 31, at 286.

[65] *See Rule on Supervisory Guidance*, *supra* note 4.

[66] According to the *Rule on Supervisory Guidance*, "supervisory guidance does not have the force and effect of law," but instead "outlines the [agencies'] supervisory expectations or priorities and articulates the [agencies'] general views regarding appropriate practices for a given subject area. Consequently, "the [agencies do] not take enforcement actions based on supervisory guidance." *Id*.

A. The Administrative Law of Guidance

Before diving into the law, some terms must first be defined. Legislative rules, also known as regulations or substantive rules, are those agency pronouncements that "have the force and effect of law" and are legally binding on the public, on agencies, and on the courts.[67] The Administrative Procedure Act (APA) requires that legislative rules generally be issued according to the notice-and-comment process.[68] Guidance is comprised of "policy statements," which are "statements issued by an agency to advise the public prospectively of the manner in which the agency proposes to exercise a discretionary power," and interpretive rules, which are "issued by an agency to advise the public of the agency's construction of the statutes and rules which it administers."[69] Policy statements are never legally binding (i.e., issuing agencies are not required to comply with their policy statements), interpretive rules are legally binding in the rarest of circumstances (i.e., courts may be required to interpret statutes in accordance with agencies' interpretive rules in instances of genuinely-ambiguous regulations that interpret genuinely-ambiguous statutes), and neither is subject to notice-and-comment requirements.[70]

Because of the binding nature of legislative rules, courts are frequently asked to determine whether a particular agency pronouncement is a legislative rule or guidance document, generally in order to determine whether the agency promulgated and applied it appropriately. "The distinction between legislative rules and guidance is routinely described as 'fuzzy,' 'tenuous,' 'blurred,' and 'enshrouded in considerable smog,'"[71] and courts use two relatively ill-defined and

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[67] ATTORNEY GENERAL'S MANUAL ON THE ADMINISTRATIVE PROCEDURE ACT 30 n. 3 (1947) [hereinafter *AG Manual*], *cited in* Chrysler Corp. v. Brown, 441 U.S. 281, 302 n.31 (1979) ("The [Attorney General's] Manual refers to substantive rules as rules that 'implement' the statute. 'Such rules have the force and effect of law.' In contrast it suggests that 'interpretive rules' and 'general statements of policy' do not have the force and effect of law.").

[68] 5 U.S.C. § 553.

[69] *AG Manual*, *supra* note 67, at 30 n. 3.

[70] *See* Kisor v. Wilkie, 139 S. Ct. 2400, 2415 (2019) ("[A] court should not afford *Auer* deference [to an agency's interpretation of its own regulation] unless the regulation is genuinely ambiguous . . . [a]nd before concluding that a rule is genuinely ambiguous, a court must exhaust all the 'traditional tools' of construction.").

[71] Levin, *supra* note 31, at 266 (citations omitted) (quoting Cmty. Nutrition Inst. v. Young, 818 F.2d 943, 946 (D.C. Cir. 1987)).

inconsistently-applied tests to differentiate the two: the "force-of-law" and the "practically-binding" tests.[72]

Under the force-of-law test, a "substantive rule establishes a standard of conduct which has the force of law[, whereas a] general statement of policy . . . does not establish a 'binding norm.'"[73] A document that has the force of law or that is said to be binding must be followed by "tribunals outside the agency,"[74] such as courts. Documents lacking the force of law, such as policy statements, "do[] not impose any rights and obligations" that may be enforced by a court on either the public or the promulgating agency.[75] As such, policy statements "must leave the [agency head] free to exercise his informed discretion."[76]

The practically-binding test is similar to the force-of-law test in that courts evaluate "whether the [document] . . . imposes any rights and obligations," but it also requires courts to evaluate whether the document "genuinely leaves the agency and its decision-makers free to exercise discretion."[77] One court, for example, determined that a document was a legislative rule as it "repeatedly says and implies 'the Commission will;' it nowhere says or implies 'the Commission may.'"[78] Another court held that "[e]ven if [the guidance] arguably inclines . . .

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[72] *See* Cass R. Sunstein, *"Practically Binding": General Policy Statements and Notice-and-Comment Rulemaking*, 68 ADMIN. L. REV. 491, 495 (2016) ("Broadly speaking, there are two imaginable views.").

[73] Pac. Gas & Elec. Co. v. Fed. Power Comm'n, 506 F.2d 33, 38 (D.C. Cir. 1974). *See also* Ass'n of Flight Attendants v. Huerta, 785 F.3d 710, 717 (D.C. Cir. 2015) (quoting Nat'l Mining Ass'n v. McCarthy, 758 F.3d 243, 252 (D.C. Cir. 2014) ("The most important factor in differentiating between binding and non-binding actions is 'the actual legal effect (or lack thereof) of the agency action in question.'"); *Cmty. Nutrition Inst.*, 818 F.2d at 950–53 (Starr, J., concurring and dissenting) (noting that courts look at "whether the pronouncement has the force of law in subsequent proceedings").

[74] Splane v. West, 216 F.3d 1058, 1064 (Fed. Cir. 2000).

[75] Am. Bus Ass'n v. United States, 627 F.2d 525, 529 (D.C. Cir. 1980) (quoting Texaco v. Fed. Power Comm'n, 412 F.2d 740, 744 (3d Cir. 1969)). *See also Ass'n of Flight Attendants*, 785 F.3d at 717 ("Agency action that creates new rights or imposes new obligations on regulated parties or narrowly limits administrative discretion constitutes a legislative rule.").

[76] Guardian Federal Sav. & Loan Ass'n v. Federal Sav. & Loan Ins. Corp., 589 F.2d 658, 666 (D.C. Cir. 1978).

[77] Texas v. United States, 809 F.3d 134, 171 (5th Cir. 2015), *aff'd by an equally divided court*, 136 S. Ct. 2271 (2016).

[78] *Am. Bus Ass'n*, 627 F.2d at 532. *See also Ass'n of Flight Attendants*, 785 F.3d at 717 ("[A] document that reads like an edict is likely to be binding [and] one riddled with

inspectors toward certain outcomes . . . it does not constrain their discretion enough to create a binding norm."[79] The case law for this test is extraordinarily muddled, but it is clear that agencies may not "treat[] a guidance document as determinative" and must offer "affected person[s] a fair opportunity to contest the document and responded meaningfully to significant arguments" made by agency staff.[80] This requirement "ensur[es] that parties and the public can respond fully and in a timely manner to an agency's exercise of authority."[81]

Importantly, under both tests, guidance may have a "substantial impact" on the public without being considered binding.[82] If an agency announces it will likely pursue a policy, regulated entities will invariably react, even if the agency has not legally bound itself to that policy and gives staff discretion as to whether or when to implement it.[83] Further, both tests allow for agencies to bind some employees to

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caveats is not."); *Nat'l Mining Ass'n*, 758 F.3d at 252–53 (finding a document that "repeatedly states that it 'does not impose legally binding requirements' [and] that it is 'not intended to direct the activities of any [third party]'" to be a non-binding guidance document); Catawba Cnty. v. EPA, 571 F.3d 20, 34 (D.C. Cir. 2009) (per curiam) (declaring a document to be guidance as it "'encouraged' states to address all nine factors EPA identified, but did not require them to do so"); Gen. Elec. Co. v. EPA, 290 F.3d 377, 384 (D.C. Cir. 2002) (finding mandatory language in a document that, for example, "gives applicants the option of calculating risk in either of two ways" and prohibits "an application based upon a third way" makes the document likely to be binding).

[79] *Ass'n of Flight Attendants*, 785 F.3d at 718.

[80] Levin, *supra* note 31, at 297.

[81] Dept. of Homeland Sec. v. Regents of Univ. of Cal., 140 S. Ct. 1891, 1909 (2020).

[82] Cabais v. Egger, 690 F.2d 234, 237 (D.C. Cir. 1982) ("Simply because agency action has substantial impact does not mean it is subject to notice and comment if it is otherwise expressly exempt under the APA."). *See also* Panhandle Producers & Royalty Owners Ass'n v. Econ. Regul. Admin., 822 F.2d 1105, 1110 (D.C. Cir. 1987) ("An agency pronouncement is not deemed a binding regulation merely because it may have some substantive impact, as long as it leave[s] the administrator free to exercise his informed discretion.") *quoted in Ass'n of Flight Attendants*, 785 F.3d at 718.

[83] *See, e.g.*, GOV'T ACCOUNTABILITY OFF., B-330843, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM—APPLICABILITY OF THE CONGRESSIONAL REVIEW ACT TO SUPERVISION AND REGULATION LETTERS (Oct. 22, 2019) (noting that in two instances, "the agency actions at issue led to changes to what businesses and other regulated entities could expect from the agency, which could lead to changes in the regulated entities' internal operations and polices as needed").

the guidance so long as members of the public can appeal those employees' decisions to adjudicators not bound by the guidance.[84]

Even though guidance documents are not legally binding, there are some instances in which courts may allow members of the public to rely on them and have legal recourse if agencies depart from what had previously been stated. It is a fundamental principle that "[w]here the rights of individuals are affected, it is incumbent upon agencies to follow their own procedures,"[85] and courts have held that, "even when an agency's rules lack the force of law, it may still be compelled to follow them" if the agency has treated the document as binding on itself.[86] Similarly, if an agency "announces and follows . . . a general policy by which its exercise of discretion will be governed, an irrational departure from that policy (as opposed to an avowed alteration of it) could" be grounds for overturning contrary

[84] *See* Erringer v. Thompson, 371 F.3d 625 (9th Cir. 2004) (allowing Medicare to require its contractors follow a policy statement as the policy was not binding on administrative law judges to whom the contractors' decisions were appealed); *see, e.g.*, Nat'l Mining Ass'n v. Sec'y of Labor, 589 F.3d 1368, 1372 (11th Cir. 2009) (finding a document that provided a "general policy procedure for district managers to follow" when granting exceptions to be a policy statement); *see also* Warder v. Shalala, 149 F.3d 73, 82 (1st Cir. 1998) ("An interpretative rule binds an agency's employees, including its [administrative law judges], but it does not bind the agency itself."). *But see* Appalachian Power Co. v. EPA, 208 F.3d 1015, 1021 ("*If an agency acts as if a document issued at headquarters is controlling in the field*, if it treats the document in the same manner as it treats a legislative rule, if it bases enforcement actions on the policies or interpretations formulated in the document, . . . then the agency's document is for all practical purposes 'binding.'") (emphasis added).

[85] Morton v. Ruiz, 415 U.S. 199, 235 (1974). *See also* United States v. Caceres, 440 U.S. 741, 757–58 (Marshall, J., dissenting) (listing cases); Lopez v. FAA, 318 F.3d 242, 247 (D.C. Cir. 2003) (discussing cases to explain that courts are unwilling to allow agencies to depart from "procedural rules benefitting the party otherwise left unprotected by agency rules"). Of course, "[a]gencies are free to relax procedural rules . . . when the ends of justice require it," such as when an individual would benefit from an agency's departure. Onslow Cnty. v. Dept. of Labor, 774 F.2d 607, 611 (4th Cir. 1985).

[86] Hudick v. Wilkie, 755 F. App'x 998, 1006 (Fed. Cir. 2018) (describing the holding in *Morton v. Ruiz* and requiring an agency to apply adjudication standards articulated in an employee manual). *See also* Steenholdt v. FAA, 314 F.3d 633, 639 (D.C. Cir. 2003) (refusing to apply this doctrine as the "violations are without prejudice, let alone substantial prejudice"); Frizelle v. Slater, 111 F.3d 172, 177 (D.C. Cir. 1997) (requiring adherence to the Coast Guard Personnel Manual); Home Health Care, Inc. v. Heckler, 717 F.2d 587, 592 (D.C. Cir. 1983) (requiring adherence to a letter interpreting a regulation); Morton v. Ruiz, 415 U.S. 199 (1974).

decisions.[87] In sum, if an agency has articulated a general policy by guidance and has consistently followed it without deviation, the public may rely on that guidance until the agency states otherwise.[88] Agencies may not penalize members of the public "for past actions which were taken in good-faith reliance on [agency] pronouncements."[89]

B. Applying Administrative Law to Bank Supervisory Guidance

Just like other forms of guidance, although bank supervisory guidance is "not supposed to have the force of law and agencies should not treat them as if they were binding," it is "a legitimate tool of administration, and [an FBAs can use] these documents to inform staff members, as well as the public, about the manner in which the agency contemplates implementing its programs."[90] Although the FBAs cannot and should not use supervisory guidance to legally bind banks—if the FBAs wish for banks to engage in or stop engaging in a particular activity without turning to litigation, they would be required to issue legislative rules—they may use supervisory guidance to articulate non-binding interpretations of statutes and regulations, such as whether a particular type of activity or facet of a transaction inherently presents safety and soundness concerns; to advise banks and examiners of current and future issues facing individual banks and the banking system, such as whether banks across the board are seeing losses from a particular type of activity; and to aid examiners as they use their discretion in effectuating the banking laws, such as whether to pay close attention to a particular asset type in banks' portfolios.

An example helps demonstrate how supervisory guidance may be appropriately used by the FBAs and their examiners, and how that use differs from their use of legislative rules. Section 39 of the Federal Deposit Insurance Act requires the FBAs to prescribe standards relating to the safety and soundness of banks by either regulation (regulation standards) or guideline (guideline standards), and provides different enforcement mechanisms depending on how the

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[87] Immigr. & Naturalization Serv. v. Yang, 519 U.S. 26, 32 (1996).

[88] *See* Menendez-Gonzalez v. Barr, 929 F.3d 1113, 1118 (9th Cir. 2019) (quoting Park v. Att'y Gen. of the U.S., 846 F.3d 645, 653 (3d Cir. 2017)) (providing that the policy must be "'clearly defined' so the [agency's] discretion can be 'meaningfully reviewed'"); Thompson v. Barr, 959 F.3d 476, 487 (1st Cir. 2020) (quoting *Park*, 846 F.3d at 654) (noting that "one favorable exercise of discretion does not a settled course make").

[89] NLRB v. Bell Aerospace Co., 416 U.S. 267, 295 (1974).

[90] Levin, *supra* note 31, at 285–86.

standards were issued.[91] If a bank fails to comply with regulation standards, the appropriate FBA "*shall* require the institution to submit" and implement a plan to correct the deficiency."[92] However, if a bank violates guideline standards, the appropriate FBA "*may* require the institution to submit" a correction plan."[93] The FBA then adjudicates that plan's adequacy; if it is inadequate or not implemented, the FBA may force the bank to undertake particular remedying actions to ensure its safety and soundness.

Although the standards promulgated under Section 39 may read as primarily binding or guiding *banks*, the statute intends for these standards to bind or guide *bank examiners*. Congress enacted Section 39 during the Savings and Loans Crisis in 1991 as one in a suite of provisions designed to address concerns that the FBAs had failed to curb excessive risk-taking by supervised institutions by primarily focusing on capital levels at the expense of management practices, despite having knowledge that issues with those practices were brewing.[94] Section 39 originally required the FBAs to promulgate standards only by regulation and to demand correction plans whenever banks violated those standards[95] as Congress intended that whenever standards were violated, the FBAs would be *compelled* to act.[96] Yet,

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[91] 12 U.S.C. § 1831p-1. Subsections (a), (b), and (c) require the FBAs to prescribe standards to address operational, managerial, asset quality, earnings, stock valuations, and compensation standards for banks. Subsection (d) provides that "[s]tandards under subsections (a), (b), and (c) shall be prescribed by regulation or guideline." Subsection (e) provides the enforcement mechanisms. Although section 39 applies to all insured depository institutions supervised by the FBAs, this paper will call them banks.

[92] *Id.* § 1831p-1(e) (emphasis added).

[93] *Id.* (emphasis added).

[94] *See* Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102–242, §§ 111, 131–32, 105 Stat. 2236, 2240, 2253–270 (1991) (requiring the FBAs to conduct annual on-site examinations of most supervised institutions, creating the prompt corrective action system for undercapitalized institutions, and implementing binding standards for safety and soundness for banks and holding companies); *see also* U.S. GEN. ACCT. OFF., GAO/GGD-91-26, DEPOSIT INSURANCE: A STRATEGY FOR REFORM 44 (1991) (finding that the FBAs had "identified unsafe practices but did not use formal enforcement tools to remedy them").

[95] *See* 12 U.S.C. § 1831p-1(d)–(e) (1991) (providing that the "[s]tandards under subsections (a), (b), and (c) shall be prescribed by regulation," and that if a bank "fails to meet any standard prescribed . . . the agency shall require the institution or company to submit an acceptable [correction] plan to the agency").

[96] *See* S. REP. NO. 102-167, at 33 (1991) (expressing "concern[] that regulators have too often delayed in resolving the problems of troubled institutions" and "identified such

pushback against Section 39 was swift and fierce,[97] and Congress in 1994 reversed course,[98] amending Section 39 "to give the [FBAs] greater flexibility in implementing standards."[99]

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delay as a significant factor in the problems of both the thrift and commercial banking industries"); *see also* Lawrence G. Baxter, *The Rule of Too Much Law? The New Safety/Soundness Rulemaking Responsibilities of the Federal Banking Agencies*, 47 CONSUMER FIN. L. Q. REP. 210, 212 (1993) ("[T]he regulators were no longer trusted to exercise their discretion regarding banking prudence [and] if they and the industry could not get it right in the first place, Congress would have to do it for them.").

[97] Regulators criticized section 39 as being unnecessarily burdensome and unfair. *See Simplifying the Regulatory Burden on Well-Run Financial Institutions: Hearing Before the Subcomm. on Fin. Inst. Supervision, Regul., & Ins. of the H. Comm. on Banking, Fin., & Urb. Affs.*, H. Hrg. 102-131, at 51 (1992) [hereinafter *Simplifying the Regulatory Burden*] (statement of Rep. Frank Annunzio, Chairman, Subcomm. on Fin. Inst. Supervision, Regul., & Ins. of the H. Comm. on Banking, Fin., & Urb. Affs.) ("I believe, however, that there has been basic unfairness in the manner in which we have approached some of our corrective measures"); *id.* at 10 (statement of John P. LaWare, Governor, Fed. Rsrv. Sys. Bd. of Governors) ("Congress must revisit its general approach to developing banking laws by establishing a more direct process for balancing the benefits of proposals with the burdens they impose."). Bankers argued that section 39 unduly affected their abilities to operate their businesses. *See id.* at 5 (statement of Rep. Doug Bereuter, member, Subcomm. on Fin. Inst. Supervision, Regul., & Ins. of the H. Comm. on Banking, Fin., & Urb. Affs.) (asserting the law "put . . . both the banks and their regulators in a regulatory straitjacket"). Scholars panned the law as contrary to the principles of bank regulation. *See* Baxter, *supra* note 96, at 218 ("The congressional wish-list of standards contained in section 39 betrays a simplistic concept of banking regulation."). A congressional report found that "[m]any expressed the fear that this laundry list [of requirements in section 39] would lead to thoroughgoing micro-management" of banks by the FBAs. BANK REGULATION AND BANK LENDING TO SMALL BUSINESS, SEVENTH REPORT BY THE COMM. ON GOV'T OPERATIONS, H. REP. NO. 103–410, at 14 (1993). *See generally* Baxter, *supra* note 96, at 218–19 (collecting sources).

[98] *See* Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. No. 103-325, § 318, 108 Stat. 2160, 2223 (1994). The law also removed section 39's applicability to holding companies. *Id*.

[99] 140 CONG. REC. H6642, H6687 (1994). *See also id.* (explaining that, with these changes, "[w]hen an agency implements these standards by guideline, the agency can decide whether or not to compel institutions that fail to meet the guideline to submit compliance plans"); 139 CONG. REC. H10500, H10516 (statement of Rep. Henry Gonzales) (stating that the change resulted in the "[r]emoval of regulatory micromanagement"), 140 CONG. REC. H6782, H6794 (statement of Rep. Bruce Vento) (claiming that changes to section 39 and others "reduce[d] red tape to allow banks to efficiently conduct their

With Section 39 today, if an FBA wished to bind its examiners into enforcing specific safety and soundness practices, it would issue regulation standards with a fairly straightforward enforcement process, and an examiner that finds a bank to have contravened the standard must require the bank to draft and implement an improvement plan. The bank can only contest the examiner's factual findings, arguing that it *did* adhere to the standard and not that the standard is inappropriate in that instance. For example, a regulation could require that all banks ensure their third-party contractors maintain insurance. If an examiner learns that a bank's contractor does not carry insurance, she must require the bank to develop an improvement plan to ensure that all contractors carry insurance in the future.

Alternatively, if an FBA wished to provide examiners discretion in enforcing safety and soundness standards, it could issue guideline standards,[100] and an examiner that finds a bank to have contravened a guideline standard could require the bank to draft and implement an improvement plan. However, the bank could contest not only the examiner's factual findings, but *may also* argue that it satisfied the standard's policy goals through an alternative course of action and that the application of the standard is inappropriate in that instance, or even that the standard is simply unwise and should never be followed.[101] An examiner would then evaluate and respond meaningfully to the bank's critiques.[102] If she decided that enforcing the guideline standard would be unnecessary in a particular case, that is the end of the matter as the examiner exercised her discretion in the bank's

business"); 140 CONG. REC. S11039, S11040 (statement of Sen. Donald Riegle, for whom the RCDRIA was named) (declaring that the amendments and provisions would "eliminate unnecessary restrictions while maintaining effective supervision [and] the safety and soundness of the banking system.").

[100] Until now, the FBAs have decided to codify their guidelines as appendices to the *Code of Federal Regulations*. However, they could just as easily issue guideline standards as they do other pieces of guidance.

[101] Levin, *supra* note 31, at 297 ("[T]he determination as to whether an agency has treated a guidance document as determinative (which is improper) or merely instructive (which is entirely proper) turns on whether it gave affected person[s] a fair opportunity to contest the document and responded meaningfully to significant arguments.").

[102] *See* Am. Mining Cong. v. Mine Safety & Health Admin., 995 F.2d 1106, 1111 (D.C. Cir. 1993) ("[A]gency personnel at every level act under the shadow of judicial review. If they believe that courts may fault them for brushing aside the arguments of persons who contest the rule or statement, they are obviously far more likely to entertain those arguments. And, as failure to provide notice-and-comment rulemaking will usually mean that affected parties have had no prior formal opportunity to present their contentions, judicial review for want of reasoned decisionmaking is likely, in effect, to take place in review of specific agency actions implementing the rule.").

favor. But if the examiner decided that enforcement was warranted, she could require the bank to create and implement an improvement plan.[103] For example, a standard could provide that all banks should ensure their third-party contractors maintain insurance *where appropriate*. Perhaps a contractor was performing an activity unrelated to banking and insurance would be unnecessary. If the examiner agreed, no improvement plan would be required.

Section 39 effectively demonstrates one use of supervisory guidance: as the FBAs' tool for advising examiners in the exercise of their discretion in interpreting and effectuating the law during examinations. But other uses exist as well, ranging from the trivial (e.g., to alert banks to information that may legally be ignored but may nevertheless be important or helpful)[104] to the significant (e.g., to articulate processes for appealing material supervisory determinations).[105] So long as the FBAs use supervisory guidance to inform (about the agencies' legal interpretations, their plans for the future, or information they believe to be beneficial for the intended audience to know), they are acting not only appropriately but also in a manner valuable to the public.

C. Legal Protections for Banks

Banks and their allies argue that guidance creates significant inequities: Although banks must "generally treat all of those utterances as legally binding because a 'violation' of any of them can form the basis for an" enforcement action—because the FBAs have broad authority to determine what safe and sound

[103] Under both regulation and guideline standards, examiners or other employees of the FBA would then determine whether improvement plans are adequate and, if approved, are being implemented. The law governing this determination is only section 39(e), which requires that if a plan is deemed inadequate, the FBA "shall require the institution to correct the deficiency" and "may [impose a number of penalties] until the deficiency has been corrected." 12 U.S.C. § 1831p-1(e)(2). A bank may contest the factual finding that its plan is inadequate, but once that finding is made, it *must* correct the deficiency. It may, however, also argue that other penalties are unwarranted.

[104] *See, e.g.*, Financial Institution Letters (FDIC), Supervision and Regulation Letters (FRB), Bulletins (OCC).

[105] *See* Guidelines for Appeals of Material Supervisory Determinations, 86 Fed. Reg. 6880 (Jan. 25, 2021); OFF. OF THE COMPTROLLER OF THE CURRENCY, BANK APPEALS PROCESS: GUIDANCE FOR BANKERS: OCC BULLETIN NO. 2013-15 (2013) [hereinafter OCC BULLETIN NO. 2013-15], https://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-15.html; Internal Appeals Process for Material Supervisory Determinations and Policy Statement Regarding the Ombudsman for the Federal Reserve System, 85 Fed. Reg. 15175 (Mar. 17, 2020).

activities are, enforcement actions easily turn nonbinding guidance into binding legal interpretations—regulators need not undertake the required processes to make their guidance legally binding.[106] Despite the obvious legal issues with this argument—the least of which is that enforcement actions may be brought for reasons not uttered in guidance—it is worth discussing the protections that banks have against improper uses of supervisory guidance.

First, and as discussed above, in all adjudications the FBAs must provide banks with opportunities to contest the application of any guidance document to their particular facts or circumstances, allowing them to argue that they complied with existing statutes and regulations if not the guidance or that effectuating the policy articulated by the guidance would have negative consequences. Just as how banks are given an opportunity to provide comment before the FBAs finalize legislative rules, this legal right to contest the application of guidance provides a similar opportunity for comment. This opportunity must either be before examiners make their determinations or on appeal to the examiners' supervisors.[107] Further, the FBAs must demonstrate that they do not treat guidance as binding.[108] In addition to examining a guidance document's text, when a court reviews an agency's actions to see if officials treated guidance as binding, it looks at the record created by the agency explaining its rationale for acting as it did. Although "a guidance document can legitimately play an influential role that does not rise to the level of being 'binding,'"[109] agencies must articulate "contemporaneous explanations" for why their actions conform with binding legal requirements for

[106] *Guidance Hearing*, *supra* note 2, at 6 (statement of Baer).

[107] This appeal could be made through the regulators' material supervisory determination appeals process, to the Office of Financial Institution Adjudication administrative law judges, or even to the presidentially-appointed Senate-confirmed agency heads themselves. Although there may be reasons for the banking agencies to compel examiners to comply with supervisory guidance (doing so might allow higher-ranked officials within an agency to take a look at every one of a particular class of transactions, for example), it is this author's opinion that the banking agencies should not do so as it would impose additional and likely unnecessary costs on banks and examiners alike. Proper training of examiners, frequent guidance as to developing issues, and examinations of sufficient frequency (in relation to a bank's riskiness or size) should be sufficient to ensure that safety and soundness issues are identified.

[108] *See supra* notes 77–81 and accompanying text.

[109] Levin, *supra* note 31, at 297 (first citing Ass'n of Flight Attendants v. Huerta, 785 F.3d 710, 718 (D.C. Cir. 2015); then citing Prof'ls & Patients for Customized Care v. Shalala, 56 F.3d 592, 599 (5th Cir. 1995); and then citing Brock v. Cathedral Bluffs Shale Oil Co., 796 F.2d 533, 537 (D.C. Cir. 1986)).

courts to examine.[110] Agencies must "support the [effectuated] policy just as if the policy statement had never been issued," and failing to do so when decisions are first made could result in enforcement actions being overturned.[111]

Second, the FBAs cannot depart from longstanding policies on which banks have come to rely without first giving notice. Due process requires that "regulated parties should know what is required of them so they may act accordingly,"[112] and agencies "must be cognizant that longstanding policies may have engendered serious reliance interests that must be taken into account."[113] As such, courts may

[110] Dept. of Homeland Sec. v. Regents of Univ. of Cal., 140 S. Ct. 1891, 1909 (2020). Providing such contemporaneous arguments "instills confidence that the reasons given are not simply 'convenient litigating position[s]'" that cannot be gained from "*post hoc* rationalizations." *Id.* (citing Christopher v. SmithKline Beecham Corp., 567 U.S. 142, 155 (2012).

[111] Pac. Gas & Elec. Co. v. Fed. Power Comm'n, 506 F.2d 33, 38 (D.C. Cir. 1974) (footnote omitted). *See also* Am. Hosp. Ass'n v. Bowen, 834 F.2d 1037, 1057 n.4 (D.C. Cir. 1987) ("A policy initially classed as a general statement is not immunized from subsequent judicial review for conformity with the APA if later developments show the agency to be using it as binding policy."); Nat'l Mining Ass'n v. McCarthy, 758 F.3d 243, 253 (D.C. Cir. 2014) ("Our cases also have looked to post-guidance events to determine whether the agency has applied the guidance as if it were binding on regulated parties."); Nat'l Ass'n of Home Builders v. Norton, 415 F.3d 8, 17 (D.C. Cir. 2005) ("There have been no enforcement actions that indicate whether the [agency] considers itself bound by survey results."); Levin, *supra* note 31, at 298 ("It means that they must make delicate inquiries into whether a document's 'influential' effect rises to the level of being impermissibly 'binding.'").

[112] FCC v. Fox TV Stations, Inc., 567 U.S. 239, 253 (2012) (citing Grayned v. City of Rockford, 408 U.S. 104, 108–09 (1972)). Policies must be drafted such that they "provide a person of ordinary intelligence fair notice of what is required," and they must be declared with such "precision" that courts can ensure "that those enforcing the law do not act in an arbitrary or discriminatory way." *Id*.

[113] Regents of Univ. of Cal., 140 S. Ct. at 1913 (quoting Encino Motorcars, LLC v. Navarro, 579 U. S. 211, 221–22 (2016) (internal quotations omitted). *See* Thomas W. Merrill, *The Accardi Principle*, 74 GEO. WASH. L. REV. 569, 598 (2006) ("Nonlegislative rules, like agency precedents, are subject to the general administrative common law duty of reasoned explanation, alluded to by Justice Frankfurter in *Vitarelli*. Thus, the agency may choose not to comply with these sorts of regulations, but only if it provides a reasoned explanation for its departure from the rule or precedent. Failure to provide a reasoned explanation for departure renders the agency action 'arbitrary and capricious,' which means the court may vacate and remand the action for a proper explanation.") (noting Vitarelli v. Seaton, 359 U.S. 535 (1959)). *See also* Levin, *supra* note 31, at 286 ("Indeed,

prohibit regulators from penalizing behavior that they had previously identified as lawful[114] or unlawful but unworthy of enforcement.[115] And when agencies do rescind such guidance, they must ensure that the recissions are not arbitrary and capricious by determining "whether there was 'legitimate reliance' on the" documents and "weigh any such interests against competing policy concerns."[116] Applied to banking, the FBAs cannot, for example, depart from longstanding interpretations of whether particular acts or practices are unsafe and unsound without issuing guidance announcing the departure and analyzing whether they must accommodate banks' longstanding reliance on those prior interpretations.

Lastly, banks have the right to speak openly and frankly with their regulators to express concern with how examiners are using guidance. In addition to having the general First Amendment right to petition the government, the APA grants banks "the right to petition [the FBAs] for the issuance, amendment, or repeal of a rule"[117] and the banking statutes require each FBA to appoint an ombud to "act as a liaison between the agency and [banks] with respect to any problem . . . in dealing

agencies *should* adhere to the positions expressed in their guidance documents to the extent necessary to honor expectation interests.")

[114] Rollins Envtl. Servs., Inc. v. United States EPA, 937 F.2d 649, 653, (D.C. Cir 1991) ("when agency personnel give conflicting advice to private parties about how to comply with [the law], and when the agency's chief legal officer finds the regulatory language equally supportive of one of two possible constructions, it is arbitrary to find the regulation "clear.").

[115] In *Fox TV*, for example, the statute provided "[w]hoever utters any obscene, indecent, or profane language by means of radio communication shall be fined . . . or imprisoned not more than two years, or both." 18 U.S.C. § 1464. The FCC, in a policy statement that built on its adjudicatory opinions, articulated that one of its considerations as to indecency was "whether the material dwells on or repeats at length descriptions of sexual or excretory organs or activities." Industry Guidance on the Commission's Case Law Interpreting 18 U.S.C. 1464 and Enforcement Policies Regarding Broadcast Indecency, 66 Fed. Reg. 21.984 (May 2, 2001). In 2003, the FCC brought an action against Fox Television for a "fleeting expletive" that did not fit the policy statement. The Court held that the FCC's "policy in place at the time of the broadcasts gave no notice to Fox" that the fleeting expletive "could be actionably indecent," and "failed to provide a person of ordinary intelligence fair notice of what is prohibited." *Fox TV Stations, Inc.*, 567 U.S. at 255 (quoting United States v. Williams, 553 U.S. 285, 304 (2008)). *See also* PARRILLO, *supra* note 33, at 105 n.351 (collecting articles that defend this practice).

[116] Regents of Univ. of Cal., 140 S. Ct. at 1899 (quoting Smiley v. Citibank (S.D.), N. A., 517 U. S. 735, 742 (1996)). Agencies are generally required to "consider . . . important aspect[s] of" issues they are attempting to address. Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983).

[117] 5 U.S.C. § 553(e).

with the agency" and to "assure that safeguards exist to encourage complainants to come forward and preserve confidentiality."[118] Although the FBAs may not necessarily agree with banks, processes exist to allow banks to attempt to convince the FBAs to change their practices around guidance. It was this process, in fact, that resulted in the agencies' rule on the *Role of Supervisory Guidance*.[119]

Underlying these three arguments is the presumption that banks are willing to litigate if they believe their rights have been violated, when evidence shows that banks are largely unwilling to do so.[120] Two primary justifications have been provided for banks being reticent to sue: First, that courts afford banking regulators significant deference when sued,[121] and second, that suing a regulator welcomes retribution.[122]

As discussed above, it is no surprise the FBAs are accorded broad deference to their interpretations of statutes and application of banking laws to the facts at hand; the banking statutes are extraordinarily broad. However, the banking regulators must adhere to constitutional and administrative law principles the same as any other regulatory agency.[123] To the extent that an agency prohibits a bank

[118] 12 U.S.C. § 4806(d)(2).

[119] *See* Role of Supervisory Guidance, 86 Fed. Reg. 9253, 9254 n. 7 (Feb. 12, 2021) (codified at 12 C.F.R. pt. 4) (citing Petition for Rulemaking on the Role of Supervisory Guidance (Nov. 5, 2018), https://bpi.com/wp-content/uploads/2018/11/BPI_PFR_on_Role_of_Supervisory_Guidance_Federal_Reserve.pdf).

[120] *See generally* David Zaring, *Banks, Corporatism, and Collaboration in the Administrative State* at 17–25 (draft on file with author).

[121] *See id.*, at 17–18, *noting* Michael S. Barr et al., FINANCIAL REGULATION: LAW AND POLICY 169 (2d ed. 2018).

[122] *See id.*, at 18–19, *noting* Julie Andersen Hill, *When Bank Examiners Get It Wrong: Financial Institution Appeals of Material Supervisory Determinations*, 92 WASH. U. L. REV. 1101, 1174–75 (2015) (noting that appeals can "take two to five years" during which "the regulator continues to examine the bank, making additional material supervisory determinations and requesting or demanding additional changes"). Zaring also notes that the Federal Reserve faced 16 lawsuits in the period between 2010 and 2020 involving administrative and constitutional law issues (as opposed to others like FOIA, employment discrimination and benefits, and golden parachute payments), and of those, only two were filed by a bank "as an individual plaintiff," rather than by an interest group. *Id*. at 20.

[123] *See e.g.*, Webster Groves Trust Co. v. Saxon, 370 F.2d 381, 387–388, (8th Cir. 1966) (noting that the Comptroller of the Currency "must be subordinate to the law from which he received his authority, and is subject to the limitations imposed by that law. Therefore, if he acts in excess of his statutory grant of power, acts arbitrarily or

from objecting to the application of guidance, fails to provide notice, or penalizes an institution for exercising its constitutional and administrative law rights, the FBA will lose in court on procedural grounds.

Next, no doubt some examiners attempt to retaliate against institutions for questioning their judgment; although the FBAs strive to maintain a professional workforce, it is unimaginable to think that any workforce could be perfect all the time. However, banks have many avenues for addressing retaliation and rectifying its consequences. The Riegle Community Development and Regulatory Improvement Act of 1994 required all three FBAs to establish ombudsman offices to liaise between banks and the agencies regarding conflict "resulting from the regulatory activities of the agency" and to "assure that safeguards exist to encourage complainants to come forward and preserve confidentiality."[124] All three FBAs also allow banks to officially appeal examiners supervisory determinations up multiple levels, in addition to simply asking an examiner's supervisor for an informal review.[125] And, of course, banks may ask their

capriciously, abuses his discretion, or unlawfully discriminates in violation of the Constitution, he is certainly subject to restraint by the courts.").

[124] § 309(d), Pub. L. No. 103-325, 108 Stat. 2160, 2219 (codified at 12 U.S.C. § 4806(d)).

[125] *See* Internal Appeals Process for Material Supervisory Determinations and Policy Statement Regarding the Ombudsman for the Federal Reserve System, 85 Fed. Reg. 15175 (Mar. 17, 2020); OCC Bulletin 2013-15; Guidelines for Appeals of Material Supervisory Determinations, 86 Fed. Reg. 6880 (Jan. 25, 2021).

Unfortunately, the FBAs have articulated a standard of review for appeals of material supervisory determinations that may not be appropriate. Examiners are to ensure banks comply with the law (*e.g.*, operate in a safe and sound manner) and/or effectuate the decisions articulated by their superiors in guidance. Appellate review should, therefore, ensure that examiners have made determinations consistent with the law, if examiners are granted discretion; and ensure that application of guidance to the facts is appropriate, if examiners are not granted discretion. However, the FBAs have enacted appellate processes that generally review for reasonableness. *See* Internal Appeals Process for Material Supervisory Determinations and Policy Statement Regarding the Ombudsman for the Federal Reserve System, 85 Fed. Reg. 15,175, 15,177 (Mar. 17, 2020) (providing an FRB process with two panels; the first reviews the decision of reserve bank examiners and "make[s] its own supervisory determination," and the final panel reviews the first's decisions for "whether the decision . . . is reasonable."); OCC BULLETIN NO. 2013-15 (providing an OCC review standard of "whether the examiners appropriately applied agency policies and standards."); Guidelines for Appeals of Material Supervisory Determinations, 86 Fed. Reg. 6,880, 6,883 (Jan. 25, 2021) (providing an FDIC process with review for "consistency with the policies, practices, and mission of the FDIC and the overall reasonableness of, and the support offered for, the positions advanced").

regulators to send alternate examiners if any appears biased, though the FBAs are under no obligation to fulfill the request.

III. SUPERVISORY GUIDANCE AND THE CONGRESSIONAL REVIEW ACT

In 2017, the Government Accountability Office (GAO) determined that Congress could use the Congressional Review Act (CRA) to disapprove of the FBAs' leveraged lending guidance.[126] This declaration—as well as Congress's decision the next year to overturn a Consumer Financial Protection Bureau (CFPB) bulletin[127]—has made the FBAs skittish with regard to releasing guidance documents that may fall within the CRA's ambit.[128] They seem to have misinterpreted the CRA's limitations when it comes to supervisory guidance, and should not be concerned. The CRA is not a true limitation on the FBAs' ability to issue strong supervisory guidance and the agencies should draft guidance for optimal policy impact, not CRA avoidance.

The CRA allows Congress to disapprove of (i.e., effectively nullify) agency rules in an expeditious manner and without disapproval being subject to filibuster in the Senate. Under the CRA, agencies must submit each promulgated rule to both chambers of Congress and the GAO before it may take effect.[129] If Congress enacts a joint resolution to disapprove of a rule within 60 legislative days and the President concurs, the rule "shall not take effect." Additionally, the CRA provides that the disapproved rule "may not be reissued in substantially the same form, and a new rule that is substantially the same as such a rule may not be issued."[130]

In addition to applying to legislative rules, the CRA also applies to guidance. It defines the term "rule" as having "the meaning given such term in [5 U.S.C. §] 551,"[131] excluding "rule[s] of particular applicability," "rule[s] relating to agency

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[126] U.S. GOV'T ACCOUNTABILITY OFF., B-329272, 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).

[127] Pub. L. No. 115–172, 132 Stat. 1290 (2018).

[128] It is this author's experience that the FBAs make an effort to draft guidance in ways that avoid triggering submission under the CRA.

[129] 5 U.S.C. § 801(a)(1)(A).

[130] *Id.* § 801(b).

[131] *See id.* § 551(4) ("[T]he whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law

management or personnel," "rule[s] of agency organization, procedure, or practice that does not substantially affect the rights or obligations of non-agency parties," and "rules that concern monetary policy proposed or implemented by the [FRB] or the Federal Open Market Committee."[132] Because the term in Section 551 includes guidance documents, all guidance (including supervisory guidance) not meeting an exception are subject to the CRA.

However, the FBAs should not generally be concerned with whether any particular supervisory guidance document is a rule under the CRA or whether Congress may disapprove of it. With the exception of guidelines under Section 39, the CRA has the most miniscule effect on supervisory guidance. As described above, a supervisory guidance document's effects stem from its ability to inform banks of the FBA's proposed course of action or its legal interpretation because, with the minute exception of *Auer* deference, it has no binding legal effect on the agency, banks, or courts. Although supervisory guidance provides examiners with the information necessary to identify transactions or activities that may be of cause for concern, they must base their findings in their agency's statutes and regulations, not on the text of the guidance. Accordingly, a disapproval resolution declaring that supervisory guidance "shall not take effect" does nothing of legal substance; it simply signals Congress's disapproval of the guidance.

Although some scholars disagree with this assertion, their arguments lack merit. For example, although one has argued that the CRA can be used to overturn the legal arguments articulated in guidance because courts give deference to agency interpretive rules under *Auer v. Robbins*[133] and because "a CRA disapproval resolution has the effect of amending the underlying statute on which the agency relied to adopt its rule," these arguments do not track with the plain language of the statute.[134] Notably, a CRA disapproval resolution in no way amends the statutes or regulations underlying disapproved rules. The CRA disapproval process accomplishes its goal of allowing Congress to overturn a rule through a three-pronged approach: preventing a rule from going into effect before Congress can review it, allowing Congress to overturn the rule, and prohibiting the agency from reissuing the rule or issuing a new rule that is substantially the same as the old. These three prongs must be read together in a process that halts or

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or policy or describing the organization, procedure, or practice requirements of an agency.").

[132] *Id*. §§ 804(3), 807.

[133] Auer v. Robbins, 519 U.S. 452 (1997).

[134] *See, e.g.*, Paul J. Larkin, Jr., *The Value of the CRA for Agency Guidance*, THE REG. REV. (Sept. 3, 2019), https://www.theregreview.org/2019/09/03/larkin-value-cra-for-agency-guidance/.

overturns legislative rules (i.e., rules that courts are legally bound to follow), but each step fails to stop or overturn the legal reasoning articulated in interpretive rules or proposed future actions articulated in statements of policy.

The first prong provides that "[b]efore a rule can take effect, the Federal agency promulgating such rule shall submit" it to Congress.[135] This provision is clearly referring to the legislative rules' legal effects, not guidance's "real-world" effects, as it places no restrictions or requirements on private actors' responses to agency statements. Because guidance does not have legal effect (i.e., guidance cannot "take effect"), these documents are not affected by this provision. If Congress had intended for the CRA to affect guidance, it should have written the statute to say something like "before a rule can take effect, courts may adopt its legal reasoning, or agencies may act in accord with it . . . "

The second prong provides that any disapproval resolution that Congress enacts to read, "'That Congress disapproves the rule submitted by the __ relating to __, and such rule shall have no force or effect.' (The blank spaces being appropriately filled in)."[136] Similar to the first prong, the text of disapproval resolutions clearly refers to the legal force and effect of legislative rules, as guidance has no "force of law."[137] To overturn the legal reasoning underpinning guidance or to stop an agency from pursuing a course of action articulated in guidance, the statute should have required resolutions to read something like "such rule shall have no force or effect, its legal reasoning shall not be effected, and/or the promulgating agency or agencies shall not pursue its articulated policies."

The final prong provides that a disapproved rule "may not be reissued in substantially the same form, and a new rule that is substantially the same as such a rule may not be issued."[138] These "two prohibitions need to be read with each other," and together get at the very specific problem of the issuing agency overriding Congress's disapproval *with a new rule*.[139] The CRA only prohibits the agency from reenacting the law through a rulemaking, and does not prohibit the agency from re-effectuating the law through other means, such as formal adjudication. To prevent an agency from rearticulating the legal reasoning underpinning guidance or the court adopting that reasoning themselves, the CRA statute should have provided that a disapproved rule "may not be reissued in

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[135] 5 U.S.C. § 801(a)(1)(A).

[136] *Id.* § 802(a).

[137] Pac. Gas & Elec. Co. v. Fed. Power Comm'n, 506 F.2d 33, 38 (D.C. Cir. 1974).

[138] 5 U.S.C. § 801(b)(2).

[139] Adam Levitin, *Congressional Review Act Confusion: Indirect Auto Lending Guidance Edition (a/k/a The Fast & the Pointless)*, CREDIT SLIPS (Apr. 17, 2018), https://www.creditslips.org/creditslips/2018/04/congressional-review-act-confusion.html.

substantially the same form, a new rule that is substantially the same as such a rule may not be issued, and the statutes upon which the rule was issued shall not be read as permitting the interpretation adopted by the rule," or something similar.

Courts will also recognize that when Congress makes policy via a CRA resolution, it is making an affirmative decision to use the CRA over other equally valid methods of policymaking. For example, instead of using the CRA to overturn a substantive regulation interpreting a statute, Congress could amend the underlying statute itself in such a way that the regulation would no longer be a valid interpretation of the statute (i.e., it would now fail *Chevron* step 1). Although there may be prudent procedural reasons for using the CRA over another method—such as preventing the resolution from being filibustered in the Senate—its decision to use the CRA can be read only as implying that Congress wanted to overturn that regulation, not change the statute. Similarly, when using the CRA with nonbinding guidance, Congress could have enacted a law amending the underlying statutes or regulations, but it chose a different path. Although Congress's action may certainly sow confusion among the public—an agency may still pursue the policies it indicated it would pursue or maintain the legal interpretations it articulated in disapproved guidance even though private actors may expect the agency to refrain from doing so—a CRA resolution should not be read as amending the law providing the basis for guidance.

Take, for example, the CFPB's indirect auto-lending guidance, which is the only guidance document to have been disapproved of under the CRA. In 2013, the CFPB issued a bulletin discussing the application of the Equal Credit Opportunity Act (ECOA) and Regulation B to indirect auto lenders.[140] In the guidance, the CFPB explained that "ECOA defines a 'creditor' to include . . . 'any assignee of an original creditor who participates in the decision to extend, renew, or continue credit;'" that "Regulation B further provides that 'creditor' means 'a person, who, in the ordinary course of business, regularly participates in the decision of whether or not to extend credit,'" and that, as a result, "indirect auto lenders are creditors under the ECOA and Regulation B if, in the ordinary course of business, they regularly participate in a credit decision."[141] It also offered guidance that "[i]nstitutions subject to CFPB jurisdiction, including indirect auto lenders, should take steps to ensure that they are operating in compliance with the ECOA and Regulation B as applied to dealer markup and compensation policies."[142] Congress, with President Trump's assent, disapproved of the bulletin in 2018.

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[140] CONSUMER FIN. PROT. BUREAU, CFPB BULL. NO. 2013-02, INDIRECT AUTO LENDING AND COMPLIANCE WITH THE EQUAL CREDIT OPPORTUNITY ACT (2013).

[141] *Id.* at 2.

[142] *Id.* at 4.

Congress's disapproval of this guidance did not change the text of the statute and regulation in any way and should not be read as having done so. The enacted resolution only provides that the guidance "shall have no force or effect,"[143] which it never had, and the CRA prohibits the CFPB from reissuing the guidance "in substantially the same form" or in a new document "that is substantially the same" as the old,[144] which is unnecessary to effectuate the underlying policy. Congress could have enacted a new statute amending ECOA and Regulation B to provide that they do not apply to auto lenders, but it chose not to. As a result, despite the disapproval resolution, indirect auto lenders can still fall into the definitions of "creditor" under ECOA and Regulation B, and those institutions that do still "should take steps to ensure that they are operating in compliance with" the law, as the CFPB's guidance encouraged.[145]

Applying this logic to supervisory guidance issued by the FBAs, it is clear that the FBAs should not worry about their guidance documents being disapproved. For guidance discussing an FBA's expected course of future action, disapproval does not prevent the agency from engaging in that course of action because Congress did not amend the underlying statute to prohibit it. Similarly, for guidance discussing the application of law to a particular set of facts, the most a CRA disapproval resolution can do is prevent an FBA from being granted *Auer* deference to its interpretation by the courts, though a court can certainly find that the interpretation is valid nonetheless.[146]

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[143] Pub. L. No. 115–172, 132 Stat. 1290 (2018).

[144] 5 U.S.C. § 801(b)(2) (1996).

[145] *See* Keith Bradley & Larisa Vaysman, *CRA Resolutions Against Agency Guidance Are Meaningless*, THE REG. REV. (Sept. 20, 2018), https://www.theregreview.org/2018/09/20/bradley-vaysman-cra-resolutions-agency-guidance-meaningless/ ("In short, if the CFPB still wanted to pursue the policies outlined in the bulletin, a lender potentially liable for discriminatory conduct should take little comfort from the CRA resolution disapproving the bulletin.").

[146] *See* United States v. Mead Corp., 533 U.S. 218, 234 (2001) (holding that "an agency's interpretation may merit some deference whatever its form, given the 'specialized experience and broader investigations and information' available to the agency, and given the value of uniformity in its administrative and judicial understandings of what a national law requires" (quoting Skidmore v. Swift & Co., 323 U.S. 134, 139–40 (1944))); *see also* Kisor v. Wilkie, 139 S. Ct. 2400, 2404 (2019) ("[A]n agency's reading of a rule must reflect 'fair and considered judgment' to receive *Auer* deference. That means, we have stated, that a court should decline to defer to a merely 'convenient litigating position' or '*post hoc* rationalizatio[n] advanced' to 'defend past agency action against attack.'" (quoting Christopher v. SmithKline Beecham Corp., 567 U.S. 142, 155 (2012))).

To demonstrate, say that Congress used the CRA to disapprove of an OCC supervisory guidance document providing that a dozen or more practices are likely "unsafe or unsound practice[s],"[147] including stealing from banks' vaults, because it disliked one of the other designated practices. After that disapproval, the OCC issued an order to remove an institution-affiliated party that "engaged or participated in" the stealing from a bank, and that party appealed to a Federal court on the grounds that stealing from the bank is not unsafe or unsound because Congress disapproved of the supervisory guidance.[148] Although a reviewing court would find that the OCC's guidance "ha[s] no force or effect,"[149] (which it never had in the first place), the court could, *of course*, still find that stealing from the bank is an unsafe or unsound practice under the statute.

Importantly, Congress did not amend the underlying statute to say that any or all practices identified in the supervisory guidance were not "unsafe or unsound." From an FBA's perspective, issuing interpretive rules makes sense: Not only will banks generally adhere to what the FBA articulated in its supervisory guidance, but even if Congress disapproves of the document, courts may even find the logic articulated in the guidance for why a particular practice is unsafe and unsound to be helpful.

And finally, to paraphrase one judge, for as many supervisory guidance documents that an FBA issues, Congress can't disapprove of them all.[150] The FBAs might as well issue guidance as they see fit and if Congress disapproves of one or two, so be it.

The only supervisory guidance that may truly be overturned by Congress are those issued by the FBAs under Section 39 of the FDIA. As discussed above, Section 39 provides that examiners may require banks that violate guideline standards to submit correction plans.[151] Before examiners can do so, however, the FBAs must have valid guideline standards for banks to violate. In these cases, Congress's disapproval of guideline standards under the CRA would have legal effect.

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[147] 12 U.S.C. § 1818(e)(1)(A)(ii).

[148] *Id*.

[149] 5 U.S.C. § 802(a) (1996).

[150] *See* Linda Greenhouse, *Dissenting Against the Supreme Court's Rightward Shift*, N.Y. TIMES (Apr. 12, 2018), https://www.nytimes.com/2018/04/12/opinion/supreme-court-right-shift.html ("[A] student asked [Judge Stephen Reinhardt] what the point was of issuing decision after decision that the Supreme Court would predictably overturn. The question was a challenge, but Judge Reinhardt took it with a smile. 'They can't catch 'em all,' he said.").

[151] *See* 12 U.S.C. § 1831p-1(e).

Taking all of this together, unless they are issuing Section 39 guideline standards, the CRA should be of no concern to the FBAs. They should craft guidance to be as effective as possible, rather than to avoid the CRA.

CONCLUSION

The law governing supervisory guidance may be complex, but bankers would be well-served to appreciate supervisory guidance for its benefits and to learn the limits of its uses by regulators. The use of supervisory guidance provides a more uniform regulatory system for banks that allows them to compete with each other based on their merits, rather than on who is their examiner, and helps banks avoid unnecessary litigation risk by providing certainty as to the regulators' expectations. At the same time, because guidance is not legally binding, banks may argue for its non-application to their particular circumstances and require examiners to evaluate the merits of the banks' activities, rather than whether it complies with, say, a multifactor test.

In sum, although bankers may be concerned that the FBAs are regulating by guidance, they should understand that the likely alternative would be worse for them, and that they have legal recourse when guidance is used inappropriately.

At the same time, the FBAs should implement procedural reforms to ensure their uses of guidance do not inadvertently stray into the realm of "binding-ness" and that bankers have access to the rights afforded them by the APA, as doing so will mitigate litigation risk. Rather than "provide a rule-like basis for determining whether the bank's approach is consistent with its safe and sound operation," supervisory guidance should "describe[] the considerations and experience that will inform supervisory assessment" of banks.[152] In other words, supervisory guidance should provide notice to banks and examiners alike of how an FBA's management thinks about an issue and base it in the law.[153] To that end, it has become a best practice that guidance "prominently state that it is not binding on

[152] Tarullo, *supra* note 5, at 43.

[153] Policy statements should "invoke some underlying purpose" for examiners to consider, rather than provide "a definite factual trigger" that deems an act or practice permissible or not. Bryan Lammon, *Rules, Standards, and Experimentation in Appellate Jurisdiction*, 74 OHIO STATE L.J. 423, 442–44 (2013). Interpretive rules should not "create a standard independent of the statute or legislative rule it interprets." Notice of Adoption of Recommendations, 84 Fed. Reg. 38,927, 38,927 (Aug. 8, 2019) [hereinafter *Recommendation 2019-1*] (adopting four recommendations at the Administrative Conference of the United States' seventy-first plenary session, including Recommendation 2019-1, *Agency Guidance Through Interpretive Rules*).

members of the public and explain that a member of the public may take a lawful approach different from the one set forth in the [guidance] or request that the agency take such a lawful approach."[154] And consistent with that prominent statement, the FBAs should ensure that examiners and other agency staff treat supervisory guidance in a legal manner.[155]

Supervisory guidance is an important tool in the regulators' toolbelts, and both regulators and banks should understand its benefits and its limits.

[154] *Recommendation 2017-5*, *supra* note 30. *See also Recommendation 2019-1*, *supra* note 153, at 38,929 ("An agency should prominently state, in the text of an interpretive rule or elsewhere, that the rule expresses the agency's current interpretation of the law but that a member of the public will, upon proper request, be accorded a fair opportunity to seek modification, rescission, or waiver of the rule.").

[155] *See generally id.* at 38,929–30.