Decision of the

Supervision Appeals Review Committee

In the Matter of * * *

Case No. 2023-03

Summary

After consideration of the timely filed written submissions of the parties and the record of this case, and following the deliberative meeting of the Supervisory Appeals Review Committee (SARC), the SARC upholds the determination of the Director of the Division of Risk Management and Supervision (RMS).

Procedural History

In this appeal, * * * (Bank) contests the interim downgrade of the Management component of its Uniform Financial Institutions Rating System (UFIRS) ratings from a "3" to a "4." The interim downgrade was issued by the FDIC's * * * Office in a letter dated July 31, 2023.

On August 14, 2023, the Bank filed a request for review of the interim downgrade with the RMS Director. In a letter dated September 28, 2023, the RMS Director upheld the rating as consistent with the FDIC's examination policies regarding UFIRS ratings.[1]

The Bank timely filed an appeal with the SARC on October 27, 2023. In accordance with the FDIC's *Guidelines for Appeals of Material Supervisory Determinations* (*Guidelines*),[2] the SARC reviewed the appeal for consistency with the policies, practices, and mission of the FDIC, and the reasonableness of, and the support offered for, the positions of the parties. Under the *Guidelines*, the burden of proof rests with the Bank. The SARC met to consider the appeal and hear oral presentation from the parties on January 18, 2024.

The Bank's Position

The Bank asserts that the interim downgrade of the Bank's Management component rating is not supported under FDIC policy regarding the assignment of UFIRS ratings, and that the

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[1] RMS's Risk Management Manual of Examination Policies (available at https://www.fdic.gov/resources/supervision-and-examinations/examination-policies-manual/).
[2] 87 Fed. Reg. 77112 (Dec. 16, 2022) (available at https://www.fdic.gov/resources/regulations/appeals-of-material-supervisory-determination).

supervisory concerns and external audit determinations used to support the interim downgrade have been largely corrected or are not sufficiently material.

The Bank reads FDIC policy to indicate that the Management component rating is influenced by the other component ratings (*i.e.*, capital adequacy, asset quality, earnings sufficiency, liquidity position, and sensitivity to market risk), and that such interaction requires an unfavorable determination on at least one other component rating for the Management component rating to be downgraded. In addition, the Bank states that under FDIC policy, a Management component rating of "4" is reserved for situations where immediate remedial action is necessary to preserve the soundness of the institution. At the time of the downgrade, the Bank was assigned a "2" rating across all other UFIRS component ratings and received a "Satisfactory" Community Reinvestment Act rating. In the Bank's view, those ratings reflect its overall strength and the performance of Bank management.

The Bank objects to the use of supervisory criticisms and external audit determinations regarding its * * * lending, fair lending compliance program, and risk management program for anti-money laundering/countering the financing of terrorism (AML/CFT) as support for the interim rating downgrade. With respect to its * * * lending, the Bank acknowledges that certain control enhancements may have been warranted, but argues the FDIC failed to give appropriate consideration to the broader context in which the * * * was implemented. Moreover, the adverse external audit determinations regarding internal controls for financial reporting of * * * were largely immaterial and, in any event, the auditors issued unqualified opinions on the Bank's financial statements. With respect to the Bank's * * * lending, its fair lending compliance program, and AML/CFT risk management framework, the Bank notes that it has taken significant corrective actions to address any supervisory concerns identified by the FDIC, most of which had either received or were pending supervisory approval at the time of the interim downgrade. In addition, with respect to the Bank's fair lending program, the Bank asserts that the FDIC has not identified any substantiated violation of law.

The Bank also claims the interim rating downgrade is inappropriate as a procedural matter, because it was issued during the middle of a safety and soundness examination of the Bank and while multiple visitations remained ongoing. As a result, the Bank states that the interim rating downgrade was based on an incomplete record that does not consider information shared with the FDIC during the remainder of the examination and the full course of those visitations. According to the Bank, such information would have weighed against the issuance of the interim rating downgrade.

RMS's Position

RMS states that its decision to expedite the downgrade of the Management component rating through the issuance of an interim rating downgrade was due to the Bank's excessive level of problems, repeated risk management failures, and the Board and management's inability to comprehensively and sustainably address supervisory concerns.

Specifically, RMS asserts that the Bank's substantial expansion of * * * and other business activities without proper risk management practices has resulted in significant safety and soundness, compliance, and AML/CFT challenges; multiple and repeat citations of apparent violations of law and nonconformance with Appendix A of Part 364 of FDIC Rules and Regulations – Interagency Guidelines Establishing Standards for Safety and Soundness; and several * * *. Moreover, external audits for years 2020, 2021, and 2022 resulted in adverse opinions on internal controls. RMS argues that, as a general matter, management and the Board have not been proactive in addressing deficiencies, and actions taken to address supervisory and audit concerns have been inadequate.

In addition, RMS claims that the Bank has not accompanied its * * * expansion and asset growth with proper mitigating controls and oversight. In recent years, the Bank * * *. RMS further argues that the Bank's risk management and compliance programs were not commensurate with its rapid growth and increasing risk in its business model, resulting in numerous internal control weaknesses with respect to its * * * lending, AML/CFT, and fair lending programs.

The SARC's Findings

The Federal Financial Institutions Examination Council (FFIEC) first adopted the UFIRS in 1979. The UFIRS was created to "evaluat[e] the soundness of financial institutions on a uniform basis and [to] identif[y] those institutions requiring special supervisory attention or concern."[3]

While the purpose of UFIRS was to create uniform standards for evaluating financial institutions, assigning supervisory ratings inevitably involves a degree of subjectivity and judgment on the part of examiners. As noted in the FFIEC's 1996 update to the UFIRS, "[s]ince its inception, the UFIRS has always contained elements of subjectivity and examiner judgment when assigning a rating, particularly as it relates to qualitative assessments of policies, practices, processes, and systems. Subjectivity and judgment cannot be eliminated but, as in the past, it can be reasonably applied based on the examiner's experience and knowledge, and their familiarity with the unique characteristics of the institution being examined."[4] Furthermore, ratings – in particular the Management component rating – are based on a range of factors specific to each institution.

The *Guidelines* provide that "[t]he burden of proof as to all matters at issue in the appeal . . . rests with the institution."[5] In this case, the SARC does not find that the Bank provided sufficient evidence to overturn the interim Management component rating downgrade. While the SARC acknowledges the Bank appears to have made meaningful progress on remediating a

[3] 61 Fed. Reg. 67021 (Dec. 19, 1996) (available at https://www.fdic.gov/news/financial-institution-letters/1996/fil96105.pdf).
[4] *Id.*
[5] *See Guidelines*, at G.3.

number of regulatory and compliance issues, the SARC also notes that the Bank has experienced an excess number of problems over the past several years. [6]

With respect to the timing of the downgrade, the SARC acknowledges that an interim downgrade in the middle of an examination is not typical and questions whether RMS could have waited to issue the interim downgrade at the end of the onsite examination activities – which occurred just two weeks after the interim downgrade – to ensure all relevant factors were incorporated into the rating. Nonetheless, the SARC believes interim downgrades can be appropriate under certain circumstances. The SARC also agrees with the Bank and other stakeholders[7] that the FDIC should make every effort to issue Reports of Examination in a timely manner consistent with the size, complexity, and risk profile of the institution.

Regarding the Bank's * * *, the SARC acknowledges the Bank's concern regarding the possibility that * * *. However, the SARC does not need to reach that issue, as the Bank has experienced a number of issues related to * * *, unrelated to the original guidance.

The Bank notes that the FDIC's examination manual describes an institution with a Management component rating of "4" as having "[p]roblems and significant risks" that "require immediate action by the board and management to preserve the soundness of the institution."[8] The SARC acknowledges that RMS has not presented evidence suggesting that immediate action is required to "preserve the soundness of the institution." However, the SARC notes that "preserv[ing] the soundness of the institution" is one of several differences between the descriptions of a Management component rating of "3" versus "4." It is not the FDIC's practice to require evidence that every aspect of the description of a rating is satisfied before a change in rating (up or down) can occur.

Finally, the SARC notes that the *Guidelines* provide that "[t]he SARC's review will be limited to the facts and circumstances as they existed prior to, or at the time the material supervisory determination was made, even if later discovered, and no consideration will be given to any facts or circumstances that occur or corrective action taken after the determination was made."[9] As a result, the SARC considered all facts and circumstances as they existed at the time of the downgrade to be within scope for review.

By direction of the Supervision Appeals Review Committee of the FDIC, dated March 13, 2024.

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[6] For example, the Bank received adverse opinions on internal controls for the 2020, 2021, and 2022 external audits, and repeat findings from the 2021 safety and soundness exam and 2022 AML/CFT visitation cited the need to address weaknesses in the Bank's administration of its AML/CFT program.

[7] *See, e.g.,* FDIC Office of Inspector General, *Material Loss Review of Signature Bank of New York* at 30-32, FDIC OIG (October 23, 2023), https://www.fdicoig.gov/sites/default/files/reports/2023-12/EVAL-24-02.pdf.

[8] RMS Examination Manual § 4.1-19. This description is identical to that found in the FFIEC's UFIRS notice.

[9] *See Guidelines*, at G.7.