



October 24, 2023

TO: Board of Directors

FROM: Doreen R. Eberley
Director

Jim McGraw
Acting Director

SUBJECT: Proposed Revisions to the FDIC's Section 19 Regulations

EXECUTIVE SUMMARY

The Divisions of Risk Management Supervision (RMS) and Complex Institution Supervision and Resolution (CISR) recommend that the Board of Directors (Board) revise regulations concerning Section 19 of the Federal Deposit Insurance (FDI) Act to conform to the Fair Hiring in Banking Act (FHBA). (The FHBA is contained within the James M. Inhofe National Defense Authorization Act for Fiscal Year 2023, Pub. L. No. 117-263, § 5705.) The FHBA became effective on December 23, 2022. Among other provisions, the FHBA excluded or exempted categories of otherwise covered offenses from the scope of Section 19, including certain older offenses and “designated lesser offenses.” The FHBA also clarified several definitions in Section 19 and provided application-processing procedures. Staff considers most of the proposed revisions to the Section 19 regulations to be required by the FHBA. Other proposed revisions reflect the FDIC’s interpretation of Section 19 in light of the FHBA. The proposed revised regulations are attached as Exhibit A. In addition, RMS and CISR recommend that the Board authorize the General Counsel and Executive Secretary to publish the Notice of Proposed Rulemaking in the *Federal Register*, attached as Exhibit B, which describes the proposed changes in detail. Exhibit C is the revised statutory text.

The FDIC will solicit comments on all aspects of its interpretation of the proposed changes to Section 19. In addition, it will request comments as to specific questions regarding the following topics: the appropriate offense date for a covered offense; the definition of the phrase “sentencing occurred”; whether Section 19 encompasses foreign convictions and pretrial diversions; the standard for expungements, sealings, and dismissals; the degree to which Section 19 covers offenses involving controlled substances; and *de minimis* offenses. By seeking public comment, the FDIC can consider the views of the industry and other interested parties about the appropriateness and functionality of the proposed changes to the regulations and help clarify the definitions of key terms contained in the FHBA.

Concur:

Harrel M. Pettway

BACKGROUND

Section 19 of the FDI Act, 12 U.S.C. § 1829 (Section 19), prohibits, without the prior written consent of the FDIC, a person convicted of any criminal offense involving dishonesty, breach of trust, or money laundering, or who has entered into a pretrial diversion or similar program in connection with a prosecution for such an offense (collectively, covered offenses), from becoming or continuing as an institution-affiliated party; owning or controlling, directly or indirectly, an insured institution; or otherwise participating, directly or indirectly, in the conduct of the affairs of an insured institution. Further, the law forbids an insured institution from permitting such a person to engage in any conduct or to continue any relationship prohibited by Section 19.

From 1998 until 2020, the FDIC had a Statement of Policy that was issued under Section 19, occasionally revised, and published in the *Federal Register*. The purpose of the Statement of Policy was to “provide[] the public with guidance relating to section 19 and the FDIC’s application of this statute.”¹ In 2020, following notice and comment, the FDIC revised and codified the Statement of Policy into the FDIC’s Filing Procedures under part 303, subpart L, and Rules of Practice and Procedure under part 308, subpart M.²

On December 23, 2022, the President signed into law the FHBA, which significantly revised Section 19 and was effective immediately. The notable changes to Section 19 under the FHBA are discussed below.

ANALYSIS OF THE PROPOSED AMENDMENTS

The proposed revisions to the FDIC’s Section 19 regulations are primarily intended to align the regulations with the FHBA’s provisions. The proposed revisions address, among other topics, the types of offenses covered by Section 19, the effect of the completion of sentencing or pretrial-diversion program requirements in the context of Section 19, and the FDIC’s procedures for reviewing applications filed under Section 19. The preamble to the *Federal Register* Notice for the proposed rulemaking details these changes. The most significant changes to the Section 19 regulations due to the FHBA, in staff’s view, are as follows.

Certain older offenses. The FHBA excludes certain offenses from the scope of Section 19 based on the amount of time that has passed since the offense occurred or since the individual was released from incarceration. If an individual has a covered offense and (1) it has been seven years or more since the offense occurred³ or (2) the individual was incarcerated with respect to the offense and it has been five years or more since the individual was released from incarceration, the Act excludes such an offense from the scope of Section 19.⁴ That is, no

¹ See 85 Fed. Reg. 51,312, 51,312 (Aug. 20, 2020) (Final Rule revising and codifying the Statement of Policy into the Code of Federal Regulations).

² See *id.*

³ Legal staff interprets the term “offense occurred” to mean the “last date of the underlying misconduct.” In instances with multiple offenses, “offense occurred” means the last date of any of the underlying offenses.

⁴ 12 U.S.C. § 1829(c)(1)(A).

Proposed Revisions to the FDIC’s Section 19 Regulations

consent application is required. Moreover, if an individual (1) committed a covered offense when the individual was 21 years of age or younger and (2) if it has been more than 30 months since the sentencing for that offense occurred, the Act excludes the offense from the scope of Section 19.⁵ All of these revisions mark a paradigm shift concerning Section 19. Until the passage of the FHBA, individuals with covered offenses on their records faced potentially a lifetime ban from banking without the FDIC’s consent. The revised language means that all state offenses and the vast majority of federal offenses will be removed from the scope of Section 19 after seven years—at the latest.

Expunged, sealed, and dismissed criminal records. The Act excludes certain convictions from the scope of Section 19 that have been expunged, sealed, or dismissed.⁶ The FDIC’s current regulations contain interpretative language concerning such offenses, but the statute has now codified the notion that certain expunged, sealed, or dismissed convictions are excluded from the scope of Section 19. The proposed rule would modestly broaden the statutory language concerning such offenses. The statute addresses expungements, sealings, or dismissals through court order; it is silent as to such actions by operation of law. The proposed rule would include expungements and sealings by operation of law, which would harmonize the FDIC’s current regulations concerning expunged and sealed records with the statutory language and provide a more comprehensive framework as to such records.

Designated lesser offenses. The FHBA excludes certain “lesser offenses” from the scope of Section 19 including the use of fake identification, shoplifting, trespass, fare evasion, driving with an expired license or tag (and such other low-risk offenses as the FDIC may designate), if one year or more has passed since the applicable conviction or program entry.⁷

Criminal offenses involving dishonesty. The FHBA excludes certain offenses from the definition of “criminal offenses involving dishonesty,” including (1) misdemeanor criminal offenses committed more than one year before the date on which an individual files an application, excluding any period of incarceration, and (2) “an offense involving the possession of controlled substances.”⁸ Historically, the FDIC has required an application as to drug-related offenses—aside from simple-possession offenses.⁹ The rationale the FDIC has relied on has been that such non-simple-possession offenses (e.g., trafficking and manufacturing) inherently involve dishonesty, breach of trust, or money laundering. In light of the FHBA, however, staff believes that Congress intended to exclude, *at least*, the offenses of simple possession and possession with intent to distribute from the “involving dishonesty” category because of the statute’s use of the phrase “involving the possession of controlled substances.” Additionally, staff believes that the FDIC should shift from the presumption that other drug-related offenses are necessarily subject to Section 19 as crimes involving dishonesty, breach of trust, or money laundering. It is *possible* that the elements of a drug-related crime could implicate one of those three categories

⁵ 12 U.S.C. § 1829(c)(1)(B). The statutory revisions concerning all of these older offenses do not affect the specific federal offenses listed under 12 U.S.C. § 1829(a)(2) (e.g., money laundering).

⁶ See 12 U.S.C. § 1829(c)(2).

⁷ 12 U.S.C. § 1829(c)(3)(D).

⁸ 12 U.S.C. § 1829(g)(2)(C).

⁹ See 85 Fed. Reg. at 51,313 (“The FDIC maintains that an application is required for it to determine the nature of the offense and elements of the crime and therefore it will continue the current requirement that an application be filed, unless the offense is *de minimis*.”)

Proposed Revisions to the FDIC's Section 19 Regulations

(and if so, an application would be required), but it is not *necessarily* so. Because this proposed rulemaking implements the new statutory language concerning “involving possession,” this proposed rulemaking provides an opportunity for the FDIC to treat drug offenses the same as all other types of crimes—which do not automatically trigger the need for an application. Moving away from that presumption of coverage under Section 19 would also align the FDIC with the FRB’s treatment of drug-related offenses; the FRB does not presume that drug-related offenses are subject to Section 19 and instead looks at the statutory elements of such crimes like any other form of criminal conduct.

Standards for FDIC review of Section 19 applications. The FHBA prescribes standards for the FDIC’s review of applications submitted under Section 19.¹⁰

The proposed rule seeks public comment and would provide for a 60-day comment period. By seeking public comment on the proposed revisions, the Agency may receive input from the banking industry and interested parties about how the FDIC could better apply the requirements of Section 19, areas of confusion for the public and industry, or other feedback that would be useful in the Agency’s exercise of its statutory obligations. The FDIC will consider such comments and may make changes to the regulations based upon such feedback.

Lastly, the FHBA requires the FDIC to “consult and coordinate” with the NCUA “as needed to promote consistent implementation [of the Act] where appropriate.”¹¹ Accordingly, throughout this year, staff has worked with staff from the NCUA, as well as staff from the FRB and OCC, in an effort to ensure consistent interpretation and implementation of the FHBA.

RECOMMENDATION

In summary, staff considers most of the proposed revisions to the Section 19 regulations to be required by the FHBA. Other proposed revisions reflect staff’s interpretation of Section 19 in light of the FHBA. Comments received through the rulemaking process will allow the FDIC to consider the views of the industry and other interested parties about the appropriateness and functionality of the proposed changes to the regulations and the FDIC’s application procedures under Section 19. For these reasons, staff recommends approval of the attached Notice of Proposed Rulemaking and its publication in the *Federal Register*.

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¹⁰ See 12 U.S.C. § 1829(f).

¹¹ 12 U.S.C. § 1829(f)(9).