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Fear of Retaliation Stifles Banks' Appeals to Regulators

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Twenty-one years ago, Congress enacted a statute requiring all bank regulators to construct an appeals process that allows bankers to remedy — or at least attempt to remedy — contested examination findings. The Riegle Community Development and Regulatory Improvement Act of 1994 was lawmakers' way of recognizing that regulators generally are quick to downgrade their assessment of an institution's risk profile and slow to upgrade it. At the time, the U.S. economy was recovering from recession of the early 1990s and banks were increasing loan activity accordingly. But regulatory agencies were examining banks from the jaded view of the past distressed economy. This screamed for an effective appeals process.

Unfortunately, each of the regulatory agencies crafted their own appeals structure. The process of appealing to the Federal Deposit Insurance Corp. as opposed to the Office of the Comptroller of the Currency or the Federal Reserve varies according to the agency, as does what banks can appeal. For example, some agencies allow a bank to appeal findings relevant to regulatory orders, while others do not.

The biggest problem with the current appeals process, however, is the constant threat of regulatory retaliation. Regulators claim it doesn't exist, or that they have procedures in place to ensure it doesn't happen. But any banker considering filing an appeal will first and foremost weigh the drawbacks of irking regulators. Most bankers believe the risk of retaliation overwhelms any possible benefit of the appeals process.

It's easy to understand this reasoning. Imagine you are driving to work and receive a speeding ticket.

You believe the ticket is inappropriate and consider disputing it in court. The court even tells you that you can dispute this ticket without any concern of police retaliation.

But then reality sinks in: You must drive the exact same route every day. You know that the police are somewhere on your fixed route. And you realize that the police have wide discretion and can give you another speeding ticket for going just one mile over the speed limit. Since you know that you will encounter the same police every single day, and retaliation is extremely difficult to prove, maybe you opt to pass on fighting the ticket.

I wonder if that is happening within the regulatory appeals process. There should be more appeals, given the industry data. I spent 26 years as a regulator and have the highest regard for the ability and integrity of examiners, but I also know that examiners can make mistakes. Examiners must understand a staggering amount of material, and banks are becoming more complex every day. No one, even regulators, gets things right 100% of the time.

The OCC, for example, supervises more than 1,600 national banks. Almost all of these banks are examined every year. Yet when one looks at the data for 2010, 2011, and 2012, the number of OCC Ombudsman appeals is overwhelmingly limited. Over those three years, the OCC Ombudsman handled only 22 appeals. If we assume during this time period that the OCC performed approximately 4,800 examinations, only 0.5% of banks filed an appeal. (This data is drawn from Julie Andersen Hill's article presented at the 2014 Federal Reserve Bank of St. Louis symposium, "When Bank Examiners Get It Wrong.")

Equally disturbing are the Fed's numbers, also drawn from Hill's article. The Fed, which supervises approximately 850 state member banks, introduces an element of appeals complexity in that each of its 12 district banks can have their own unique procedures for filing an appeal. Most banks are examined every year. The data for 2010, 2011, and 2012 show that state member banks filed a total of 15 appeals, or a miniscule 0.6% of the roughly 2,550 examinations over the three-year period.

The FDIC's data, as presented by Hill, may be the most troubling. The FDIC supervises approximately 4,300 state nonmember banks. Since many of these banks are small, let's assume that only 75% are examined on an annual basis. This assumption would suggest that from 2010 through 2012, the FDIC performed 9,675 examinations. However, during this timeframe, it appears that the FDIC's supervision appeals review committee handled only six appeals. My calculator doesn't produce a meaningful percent for this ratio.

I suspect that the many smart people at the regulatory agencies can very capably explain these numbers, and quite frankly they would be correct in some of their views. Many appealable items are resolved through discussions with the examiner in charge. Other disagreements may ultimately get resolved at the regional/district level.

Part of the problem is that no one keeps track of these items. It seems to me that if a bank has to keep track of every consumer complaint, even if it is resolved at the local level, then we should not expect any less from our regulators.

The big question, however, is how to navigate the issue of regulatory retaliation. The scant number of appeals suggests that the fear of retaliation is a major obstacle to fulfilling Congress' intent from the

Riegle Community Development and Regulatory Improvement Act. My suggestions are simple and easy to implement.

First, examination standards and findings should be the same regardless of an FDIC, OCC, or FRB examination team.

Second, appeals should be reviewed and resolved by an interagency group of senior executives.

Third, appeals should have all names and identifiable information redacted before submission to the interagency group. Decisions should be made based on the facts of the case.

Lastly, the appeal finding should be public. Bankers need to know what is, and is not, working within the regulatory community.

No one is always right — including bankers and regulators. We need to move the appeal process away from an antagonistic approach and toward a constructive process that will benefit the entire industry.

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