

COMPARISON OF PROPOSED AND CURRENT SOPs FOR SECTION 19 OF THE FDI ACT
ARNOLD & PORTER KAYE SCHOLER LLP

FDIC Statement of Policy for Section 19 of the FDI Act

Section 19 of the Federal Deposit Insurance Act (12 U.S.C. 1829) prohibits, without the prior written consent of the Federal Deposit Insurance Corporation (FDIC), a person convicted of any criminal offense involving dishonesty or breach of trust or money laundering (covered offenses), or who has agreed to enter into a pretrial diversion or similar program ([program entry](#)) in connection with a prosecution for such offense, from becoming or continuing as an institution-affiliated party, owning or controlling, directly or indirectly an insured depository institution (insured institution), or otherwise participating, directly or indirectly, in the conduct of the affairs of the insured institution. In addition, the law forbids an insured institution from permitting such a person to engage in any conduct or to continue any relationship prohibited by ~~section~~[Section](#) 19. It imposes a ten-year ban against the FDIC's consent for persons convicted of certain crimes enumerated in Title 18 of the United States Code, absent a motion by the FDIC and court approval.

Section 19 imposes a duty upon ~~the~~[an](#) insured institution to make a reasonable inquiry regarding an applicant's history, which consists of taking steps appropriate under the circumstances, consistent with applicable law, to avoid hiring or permitting participation in its affairs by a person who has a conviction or program entry for a covered offense. The FDIC believes that at a minimum, each insured institution should establish a screening process that provides the insured institution with information concerning any convictions or program entry pertaining to a job applicant. This would include, for example, the completion of a written employment application that requires a listing of all convictions and program entries. [In the alternative, for the purposes of Section 19, an FDIC-supervised institution may extend a conditional offer of employment contingent on the completion of a background check satisfactory to the institution and to determine if the applicant is barred by Section 19. In such a case, the job applicant may not work for or be employed by the insured institution until such time that the applicant is determined to not be barred under Section 19.](#) The FDIC will look to the circumstances of each situation [for FDIC-supervised institutions](#) to determine whether the inquiry is reasonable. ~~Upon notice of a conviction or program entry, an application seeking the FDIC's consent prior to the person's participation must be filed.~~

Section 19 applies, by operation of law, as a statutory bar to participation absent the written consent of the FDIC. [Upon notice of a conviction or program entry, an application must be filed seeking the FDIC's consent prior to the person's participation.](#) The purpose of an application is to provide the applicant an opportunity to demonstrate that, notwithstanding the bar, a person is fit to participate in the conduct of the affairs of an insured institution without posing a risk to its safety and soundness or impairing public confidence in that institution. The burden is upon the applicant to establish that the application warrants approval.

A. Scope of Section 19

Section 19 covers institution-affiliated parties, as defined by 12 U.S.C. 1813(u) and others who are participants in the conduct of the affairs of an insured institution. This Statement of Policy applies only to insured institutions, their institution-affiliated parties, and those participating in the affairs of an insured depository institution. Therefore, all employees of an insured institution fall within the scope of Section 19. In addition, those deemed to be de facto employees as determined by the

COMPARISON OF PROPOSED AND CURRENT SOPs FOR SECTION 19 OF THE FDI ACT
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FDIC based upon generally applicable standards of employment law, will also be subject to Section 19. Whether other persons who are not institution-affiliated parties are covered depends upon their degree of influence or control over the management or affairs of an insured institution. For example, Section 19 would not apply to persons who are merely employees of an insured institution's holding company, but would apply to its directors and officers to the extent that they have the power to define and direct the ~~polieies~~management or affairs of the insured institution. Similarly, directors and officers of affiliates, subsidiaries or joint ventures of an insured institution or its holding company will be covered if they participate in the affairs of the insured institution or are in a position to influence or control the management or affairs of the insured institution. ~~Those who exercise major policymaking functions of an insured institution would be deemed participants in the affairs of that institution and covered by section 19.~~ Typically, an independent contractor does not have a relationship with the insured institution other than the activity for which the insured institution has contracted. ~~Under 12 U.S.C. 1813(u), independent contractors are institution-affiliated parties if they knowingly or recklessly participate in violations, unsafe or unsound practices or breaches of fiduciary duty which are likely to cause significant loss to, or a significant adverse effect on, an insured institution.~~ In terms of participation, an independent contractor who influences or controls the management or affairs of the insured institution, would be covered by Section 19. Further, “person” for purposes of Section 19 means an individual, and does not include a corporation, firm or other business entity.

Individuals who file an application with the FDIC under the provisions of Section 19 who ~~are participating~~also seek to participate in the affairs of a bank or savings and loan holding company may ~~also~~ have to comply with any filing requirements of the Board of the Governors of the Federal Reserve System under 12 U.S.C. ~~§ 1819(d) in the case of a bank holding company, and the Office of Thrift Supervision under 12 U.S.C. § 1819(e), in the case of a savings and loan holding company until the Transfer Date as that term is used in the Dodd-Frank Wall Street Reform Act (Pub. L. 111-203, § 311, July 21 2010).~~ Upon the Transfer Date applications related to savings and loan holding companies should be filed with the Board of Governors of the Federal Reserve System 1819(d) & (e).

Section 19 specifically prohibits a person subject to its coverage from owning or controlling an insured institution. For purposes of defining “control” and “ownership” under Section 19, the FDIC has adopted the definition of “control” set forth in the Change in Bank Control Act (12 U.S.C. 1817(j) (8)(B)). A person will be deemed to exercise “control” if that person has the power to vote 25 percent or more of the voting shares of an insured institution (or 10 percent of the voting shares if no other person has more shares) or the ability to direct the management or policies of the insured institution. Under the same standards, person will be deemed to “own” an insured institution if that person owns 25 percent or more of the insured institution's voting stock, or 10 percent of the voting shares if no other person owns more. These standards would also apply to an individual acting in concert with others so as to have such ownership or control. Absent the FDIC's consent, persons subject to the prohibitions of ~~section~~Section 19 will be required to divest their control or ownership of shares above the foregoing limits.

COMPARISON OF PROPOSED AND CURRENT SOPs FOR SECTION 19 OF THE FDI ACT
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B. Standards for Determining Whether an Application Is Required

Except as indicated in paragraph (5), below, an application must be filed where there is present a conviction by a court of competent jurisdiction for a covered offense by any adult or minor treated as an adult, or where such person has entered a pretrial diversion or similar program regarding that offense. Before an application is considered by the FDIC, all of the sentencing requirements associated with a conviction or conditions imposed by the pretrial diversion, or similar program, including but not limited to, imprisonment, fines, condition of rehabilitation, and probation requirements, must be completed, and the case must be considered final by the procedures of the applicable jurisdiction.

(1) Convictions. There must be present a conviction of record. Section 19 does not cover arrests, pending cases not brought to trial, acquittals, or any conviction that has been reversed on appeal. A conviction with regard to which an appeal is pending ~~will require~~requires an application ~~until or unless reversed~~. A conviction for which a pardon has been granted will require an application. A conviction that has been completely expunged is not considered a conviction of record and will not require an application. For an expungement to be considered complete, no one, including law enforcement, can be permitted access to the record even by court order under the state or ~~federal~~Federal law that was the basis of the expungement. Further, the jurisdiction issuing the expungement cannot permit the use of the expunged conviction in any subsequent proceeding or review of the person's character or fitness. Expungements of pretrial diversion or similar program entries will be treated the same as those for convictions. Convictions that are set aside or reversed after the applicant has completed sentencing will be treated consistent with pretrial diversions or similar programs unless the court records reflect that the underlying conviction was set aside based on a finding on the merits that such conviction was wrongful.

(2) Pretrial Diversion or Similar Program. Program entry, whether formal or informal, is characterized by a suspension or eventual dismissal of charges or criminal prosecution often upon agreement by the accused to treatment, rehabilitation, restitution, or other noncriminal or ~~nonpunitive~~non-punitive alternatives. Whether a program constitutes a pretrial diversion or similar program is determined by relevant ~~federal~~Federal, state or local law, and ~~will be considered, if not so designated under applicable law then the determination of whether it is a pretrial diversion or similar program will be made~~ by the FDIC on a case-by-case basis. Program entries prior to November 29, 1990, are not covered by Section 19.

(3) Dishonesty or Breach of Trust. The conviction or program entry must be for a criminal offense involving dishonesty, breach of trust or money laundering. “Dishonesty” means directly or indirectly to cheat or defraud; to cheat or defraud for monetary gain or its equivalent; or wrongfully to take property belonging to another in violation of any criminal statute. Dishonesty includes acts involving want of integrity, lack of probity, or a disposition to distort, cheat, or act deceitfully or fraudulently, and may include crimes which ~~federal~~Federal, state or local laws define as dishonest. “Breach of trust” means a wrongful act, use, misappropriation or omission with respect to any property or fund that has been committed to a person in a fiduciary or official capacity, or the misuse of one's official or fiduciary position to engage in a wrongful act, use, misappropriation or omission.

COMPARISON OF PROPOSED AND CURRENT SOPs FOR SECTION 19 OF THE FDI ACT
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Whether a crime involves dishonesty or breach of trust will be determined from the statutory elements of the crime itself. All convictions or program entries for offenses concerning the illegal manufacture, sale, distribution of, or trafficking in controlled substances shall require an application unless they fall within the provisions for *de minimis* offenses set out in (5) below.

(4) Youthful Offender Adjudgments. An adjudgment by a court against a person as a “youthful offender” under any youth offender law, or any adjudgment as a “juvenile delinquent” by any court having jurisdiction over minors as defined by state law does not require an application. Such adjudications are not considered convictions for criminal offenses. Such adjudications do not constitute a matter covered under Section 19 and is not an offense or program entry for determining the applicability of the *de minimis* offenses exception to the filing of an application.

(5) *De minimis* Offenses.

(A) In General

Approval is automatically granted and an application will not be required where the covered offense is considered *de minimis*, because it meets all of the following criteria:

- There is only one conviction or program entry of record for a covered offense;
- The offense was punishable by imprisonment for a term of one year or less and/or a fine of \$2,500 or less, and the individual served three (3) days or less of ~~actual jail time;~~ jail time. The FDIC considers jail time to include any significant restraint on an individual's freedom of movement which includes, as part of the restriction, confinement where the person may leave temporarily only to perform specific functions or during specified times periods or both.
- The conviction or program was entered at least five years prior to the date an application would otherwise be required; and
- The offense did not involve an insured depository institution or insured credit union.

(B) Additional Applications of the De Minimis Offenses Exception to Filing

Age at Time of Conviction or Program Entry

- A covered conviction or program entry of record that occurred when the individual was 21 years of age or younger at the time of conviction or program entry that otherwise meets the general *de minimis* criteria in (a) above, will be considered *de minimis* if the conviction or program entry was entered at least 30 months prior to the date an application would otherwise be required and all sentencing or program requirements have been met.

Convictions or Program Entries for Insufficient Funds Checks

- Convictions or program entries of record based on the writing of a “bad” or insufficient funds check(s) shall be considered a *de minimis* offense under this provision ~~even if it~~ and will not be

**COMPARISON OF PROPOSED AND CURRENT SOPs FOR SECTION 19 OF THE FDI ACT
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considered as having involved an insured depository institution ~~or insured credit union~~ if the following applies:

- ~~All other requirements of the *de minimis* offense provisions are met;~~
- ~~The~~ There is no other conviction or program entry subject to Section 19 and the aggregate total face value of ~~the all~~ “bad” or insufficient funds check(s) cited ~~in~~ across all the conviction ~~was \$1000 or less;~~ (s) or program entry(ies) for bad or insufficient funds checks is \$1,000 or less and;
- ~~No~~ insured depository institution or insured credit union was a payee on any of the “bad” or insufficient funds checks that were the basis of the conviction (s) or program entry(ies).

Convictions or Program Entries for Small-Dollar, Simple Theft

- A conviction or program entry based on a simple theft of goods, services and/or currency (or other monetary instrument) where the aggregate value of the currency, goods and/or services taken was \$500 or less at the time of conviction or program entry, where the person has no other conviction or program entry under Section 19, and where it has been five years since the conviction or program entry (30 months in the case of a person 21 or younger at the time of the conviction or program entry) is considered *de minimis*. Simple theft excludes burglary, forgery, robbery, identity theft, and fraud.

Any person who meets the ~~foregoing~~ criteria under (5) above shall be covered by a fidelity bond to the same extent as others in similar positions, and shall disclose the presence of the conviction or program entry to all insured institutions in the affairs of which he or she intends to participate.

Further, no conviction or program entry for a violation of the Title 18 sections set out in 12 U.S.C. 1829(a)(2) can qualify under any of the *de minimis* exceptions to filing set out in 5 above.

C. Procedures

When an application is required, forms and instructions should be obtained from, and the application filed with, the appropriate FDIC Regional Director. The application must be filed by an insured institution on behalf of a person (bank-sponsored) unless the FDIC grants a waiver of that requirement (individual waiver). Such waivers will be considered on a case-by-case basis where substantial good cause for granting a waiver is shown. The appropriate Regional Office for an individual filing for a waiver of the institution filing requirement is the office covering the state where the person resides.

D. Evaluation of Section 19 Applications

The essential criteria in assessing an application are whether the person has demonstrated his or her fitness to participate in the conduct of the affairs of an insured institution, and whether the affiliation, ownership, control, or participation by the person in the conduct of the affairs of the insured institution may constitute a threat to the safety and soundness of the insured institution or

COMPARISON OF PROPOSED AND CURRENT SOPs FOR SECTION 19 OF THE FDI ACT
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the interests of its depositors or threaten to impair public confidence in the insured institution. In determining the degree of risk, the FDIC will consider, in conjunction with the factors set out in 12 CFR 308.157:

- (1) ~~The~~ Whether the conviction or program entry and the specific nature and circumstances of the covered offense are a criminal offense under Section 19;
- (2) Whether the participation directly or indirectly by the person in any manner in the conduct of the affairs of the insured institution constitutes a threat to the safety and soundness of the insured institution or the interests of its depositors or threatens to impair public confidence in the insured institution;
- (3) Evidence of rehabilitation including the person's reputation since the conviction or program entry, the person's age at the time of conviction or program entry, and the time that has elapsed since the conviction or program entry;
- ~~(34)~~ The position to be held or the level of participation by the person at an insured institution;
- ~~(45)~~ The amount of influence and control the person will be able to exercise over the management or affairs of an insured institution;
- ~~(56)~~ The ability of management of the insured institution to supervise and control the person's activities;
- ~~(67)~~ The ~~degree~~ level of ownership the person will have of the insured institution;
- ~~(7-8)~~ The applicability of the insured institution's fidelity bond coverage to the person; ~~(8) The opinion or position of the primary Federal and/or state regulator~~; and
- (9) Any additional factors in the specific case that appear relevant including but not limited to the opinion or position of the primary Federal and/or state regulator.

The foregoing criteria will also be applied by the FDIC to determine whether the interests of justice are served in seeking an exception in the appropriate court when an application is made to terminate the ten-year ban under 12 U.S.C. 1829(a)(2) for certain Federal offenses, prior to its expiration date.

Some applications can be approved without an extensive review because the person will not be in a position to constitute any substantial risk to the safety and soundness of the insured institution. Persons who will occupy clerical, maintenance, service, or purely administrative positions, generally fall into this category. A more detailed analysis will be performed in the case of persons who will be in a position to influence or control the management or affairs of the insured institution. ~~Approval~~ All approvals and orders will be subject to the condition that the person shall be covered by a fidelity bond to the same extent as others in similar positions. In cases in which a waiver of the institution filing requirement has been granted to an individual, approval of the application will also be conditioned upon that person disclosing the presence of the conviction (s)

**COMPARISON OF PROPOSED AND CURRENT SOPs FOR SECTION 19 OF THE FDI ACT
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or program entry(ies) to all insured institutions in the affairs of which he or she wishes to participate. When deemed appropriate, ~~approval orders~~ bank sponsored applications are to allow the person to work in a specific job at a specific bank and may also be subject to the condition that the prior consent of the FDIC will be required for any proposed significant changes in the person's duties and/or responsibilities. ~~Such~~ In the case of bank applications such proposed changes may, in the discretion of the Regional Director, require a new application. In situations in which an approval has been granted for a person to participate in the affairs of a particular insured institution and who subsequently seeks to participate at another insured depository institution, ~~approval does not automatically follow. In such cases,~~ another application must be submitted.

By ~~order~~ Order of the Board of Directors.

Dated at Washington, DC, the 19th day of December ~~11, 2012,~~ 2017.

Federal Deposit Insurance Corporation.