

# FDIC Statement of Policy for Section 19 of the FDI Act

## FDIC Law, Regulations, Related Acts

### 5000 - FDIC Statements of Policy

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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 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 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 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 which 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 which requires a listing of all convictions and program entries. The FDIC will look to the circumstances of each situation 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. 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. 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 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 policies 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 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. In addition, "person" for purposes of section 19 means an individual, and does not include a corporation, firm or other business entity.

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 {{12-31-98 p.5156}}an insured institution (or ten 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 ten 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 19 will be required to divest their ownership of shares above the foregoing limits.

## **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.

(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 which has been reversed on appeal. A conviction for which a pardon has been granted will require an application. A conviction which has

been completely expunged is not considered a conviction of record and will not require an application.

(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 upon agreement by the accused to treatment, rehabilitation, restitution, or other noncriminal or nonpunitive alternatives. Whether a program constitutes a pretrial diversion is determined by relevant federal, state or local law, and will be considered 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, 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 which 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. Whether a crime involves dishonesty or breach of trust will be determined from the statutory elements of the crime itself. All convictions for offenses concerning the illegal manufacture, sale, distribution of or trafficking in controlled substances shall require an application.

(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.

(5) De minimis Offenses. 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 less than one year and/or a fine of less than \$1000, and the individual did not serve time in jail;
- 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.

Any person who meets the foregoing criteria 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.

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### 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 unless the FDIC grants a waiver of that requirement. Such waivers will be considered on a case-by-case basis where substantial good cause for granting a waiver is shown.

### 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 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:

- (1) The conviction or program entry and the specific nature and circumstances of the covered offense;
- (2) 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 which has elapsed since the conviction or program entry;
- (3) The position to be held or the level of participation by the person at an insured institution;

- (4) The amount of influence and control the person will be able to exercise over the management or affairs of an insured institution;
- (5) The ability of management of the insured institution to supervise and control the person's activities;
- (6) The degree of ownership the person will have of the insured institution
- (7) 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.

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 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 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 be conditioned upon that person disclosing the presence of the conviction to all insured institutions in the affairs of which he or she wishes to participate. When deemed appropriate, approval orders 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 proposed changes may, in the discretion of the Regional Director, require a new application. Insituations in which an approval has been granted for a person to participate in the affairs of a particular insured institution and subsequently seeks to participate at another insured institution, approval does not automatically follow. In such cases, another application must be submitted.

By order of the Board of Directors, November 16, 1998.

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