CBA Regulatory Compliance Bulletin

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Court May Hear Appeal of Bank's Assigned CAMELS Rating

It has long been assumed that a bank may not contest its supervisory rating in court, or at least it is not feasible to do so. Given the costs and length of time to file suit, obtain a ruling, and endure the probability of undergoing an appeal, it made sense to seek administrative remedies with the same agency or just address the agency's concerns and prepare for the next examination 12 or 18 months later. But a small bank with just $100 million in assets may have changed that assumption after it received a composite CAMELS rating of "4" from the FDIC after its June 2015 examination and then decided to sue the agency in federal court. In January this year the U.S. Court of Appeals for the Seventh Circuit reversed the lower court's dismissal of the bank's suit.

Builders Bank, an Illinois community bank, argued in federal district court that the FDIC should have given it a composite rating of "3" and that the FDIC's action was arbitrary and capricious. The FDIC countered that its assignment of a CAMELS rating is unreviewable by courts under 12 U.S.C. 3907(a)(2).[1] Federal agencies have absolute discretion to set appropriate levels of capital, and discretionary actions of agencies are not reviewable under the Administrative Procedures Act (APA). The lower court agreed and dismissed the case for lack of jurisdiction, and the bank appealed.

The Seventh Circuit Court of Appeals reversed. First it affirmed that APA review is available but is limited to final agency actions. It asked whether the assignment of a CAMELS rating is a final agency decision in the same way that the issuance of a cease and desist order under 12 U.S.C. 1818(b) is final. Additionally, it is unknown whether Builders Bank had exhausted all available administrative remedies, notably by using the FDIC's Supervision Appeals Review Committee process pursuant to the interagency Guidelines for Appeals of Material Supervisory Determinations.[2]

If the bank should satisfy these conditions, judicial review of the FDIC's determination is available under 5 U.S.C. 702 and 28

[1] 12 U.S.C. 3907(a)(2 states in part, "Each appropriate Federal banking agency shall have the authority to establish such minimum level of capital for a banking institution as the appropriate Federal banking agency, in its discretion, deems to be necessary or appropriate in light of the particular circumstances of the banking institution."

[2] See 77 Fed. Reg. 17055–2 (Mar. 23, 2012).

U.S.C. 1346(a)(2).[3] The Court agreed with the FDIC that 12 U.S.C. 3907(a)(2) makes the agency's determination of a bank's capital adequacy "committed to agency discretion" or in other words non-reviewable. But the CAMELS rating is also composed of other factors unrelated to capital, that is, asset quality, management, earnings, liquidity, and sensitivity to risk. Any final agency action is subject to review under the "arbitrary and capricious" standard of the APA.

The Court further stated that even where an agency action is non-reviewable by statute, a court may still exercise a degree of review without setting aside the agency's judgment. In this case a court may hypothetically review a challenge to the FDIC's calculations without replacing the court's own judgment with regard to the minimum amount of capital that is required by the bank. The Court instructed the lower court to explore whether the FDIC's action was a final agency action and whether Builders Bank had exhausted its administrative remedies. Under the right circumstances, the lower court has jurisdiction to entertain the bank's complaint.

Banks may find that taking the judicial route to challenge their supervisor's assignment of the CAMELS rating is not something that they will use often. Nevertheless, this decision provides an important check against administrative overreaching in the same way that the *PHH v. Consumer Financial Protection Bureau* decision in the federal D.C. Circuit should serve as a check against CFPB overreach. Agencies will also have to treat bank administrative appeals seriously, knowing that a federal court may be looking over their shoulder if a bank believes the agency is not acting fairly with respect to the supervisory rating or other action. The case is *Builders Bank v. FDIC*.

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[3] 5 U.S.C. 702 states: "A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof." 28 U.S.C. 1346 states that federal district courts have jurisdictions of claims against the United States.