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New FDIC Regulations to Ease Section 19 Criminal History Hiring Restrictions Take Effect October 1

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New revisions to the Federal Deposit Insurance Corporation (FDIC) regulations that will ease the restrictions on financial institutions hiring individuals with criminal histories—even for some with criminal offenses related to possession with the intent to distribute illegal drugs—are set to take effect on October 1, 2024.

Quick Hits

- The FDIC approved a new final rule revising regulations to align with changes made by the Fair Hiring in Banking Act in December 2022.
- The law eased restrictions Section 19 placed on financial institutions hiring job candidates with criminal records.
- The final rule expands the types of drug-related offenses that may no longer require an FDIC waiver to include possession with intent to distribute.

On July 30, 2024, the FDIC approved a new final rule revising its regulations regarding Section 19 of the Federal Deposit Insurance Act to align them with changes made by the Fair Hiring in Banking Act (FHBA), which President Joe Biden signed into law in December 2022 as part of the James M. Inhofe National Defense Authorization Act for Fiscal Year 2023. The FHBA narrowed the types of convictions that constitute a bar to employment under Section 19 absent a written waiver from the FDIC.

Notably, the FDIC's final rule will exclude criminal drug offenses "involving the simple possession of controlled substances and possession with intent to distribute a controlled substance" and require covered financial institutions to make a "reasonable, documented inquiry" to verify an applicant's criminal history.

Here is a breakdown of the key changes.

Certain Older Offenses

The FHBA excludes certain older offenses from Section 19: (1) where *seven years or more* have passed since the *offense occurred*; (2) where the individual was incarcerated and *five years or more* have passed since the individual was *released*; or (3) the offense was committed when an individual was twenty-one years of age or younger and it has been at least thirty months since the date a court imposed a sentence. None of these exceptions apply to the federal offenses subject to the ten-year ban.

The final rule clarifies the definitions of "offense occurred" and "offense committed" to mean the "last date of the underlying misconduct" and, in instances with multiple offenses, the "last date of any of the underlying offenses." The final rule further clarifies that "sentence occurred" is "the date on which a court imposed the sentence (as indicated by the date on the court's sentencing order), *not the date on which all conditions of sentencing were completed*." (Emphasis added.)

Expunged, Sealed, and Dismissed Criminal Records

The FHBA excludes criminal offenses where there has been "an order of expungement, sealing, or dismissal" and it is "intended by the language in the order itself, or in the legislative provisions under which the order was issued, that the conviction shall be destroyed or sealed from the individual's" record.

The final rule further clarifies that the expungement, sealing, or dismissal may be the result of an "operation of law." The FDIC stated in the rule that it "sought to harmonize its current regulations concerning expunged and sealed records with the statutory language to provide a more comprehensive framework as to such records."

De Minimis Offenses

The FHBA significantly amended the FDIC's prior treatment of de minimis offenses—which includes "designated lesser offenses"—as not requiring an application for a waiver because it was deemed to be automatically approved to completely exclude such offenses from Section 19 entirely. Such designated lesser offenses "include 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 1 year or more has passed since the applicable conviction or program entry."

The FDIC's final rule does not specify other "designated lesser offenses," but the rule does set forth a series of criteria for determining whether an offense may be considered de minimis and therefore excluded, including that the offense "must not have been committed against an [insured depositor institution] or insured credit union."

Drug-Related Offenses

The FHBA expanded the offenses excluded from the definition of "criminal offenses involving dishonesty," excluding (1) certain criminal offenses committed more than one year prior, and (2) "offense[s] involving the possession of controlled substances."

According to the final rule, the FDIC interprets the phrase "offense involving the possession of controlled substances" to apply to "at a minimum, criminal offenses involving the simple possession

of controlled substances and possession with intent to distribute a controlled substance" and potentially "also apply to other drug-related offenses depending on the statutory elements of the offenses or from court determinations that the statutory provisions of the offenses do not involve dishonesty, breach of trust, or money laundering."

"This revised regulatory language marks a shift from the FDIC's current section 19 regulations, which require an application for all convictions and pretrial diversions concerning the illegal manufacture, sale, distribution of, or trafficking in controlled substances," the FDIC explained.

The final rule arguably represents a significant expansion or departure from the language passed by the U.S. Congress in the FHBA and may be ripe for a legal challenge, especially in the wake of the Supreme Court of the United States' recent ruling in *Loper Bright Enterprises v. Raimondo* that questioned agency rulemaking. At least one commenter on the proposed rules argued that the FDIC's new language is overly broad and contrary to the intent of Congress and that it could cause banks reputational harm if they hire individuals who have previously been convicted of drug possession with the intent to distribute.

Documented Inquiry

The final rule clarifies that covered financial institutions must make a "reasonable, documented inquiry" to verify an applicant's criminal history. Previously, the regulations did not explicitly require such an inquiry. However, the final rule does not define what qualifies as a "reasonable, documented inquiry." Instead, the FDIC explained that reasonable inquiries may vary and that it is best left to each institution's business judgment.

Next Steps

Financial institutions covered by Section 19 may want to review their hiring policies to ensure they are making employment decisions in conformance with the changes of the FHBA and FDIC regulations, as well as other federal, state, and local laws. Institutions may further want to ensure they take steps to reasonably verify an applicant's criminal history as will be required by the new final rule.

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