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Enforcement 2013

Enforcement

Enforcement Actions Continue Three-Year Decline; DOJ Emerges as Major Player

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Overall Trends & Outlook

From an enforcement standpoint, 2013 was another historic year in a number of important ways beyond the sheer number of cases, which were again significant. Federal banking agencies[1] issued 701 formal enforcement actions,[2] representing more than a fifty percent reduction in enforcement actions since the high water mark in 2010. Nevertheless, relative to more normal periods, such as 2004 to 2008, this still suggests a bumper crop of enforcement actions. While the relative decrease in recent enforcement activity reflects the banking industry's recovery from the financial crisis, regulators imposed record financial penalties in 2013. This is an ominous trend for financial institutions.

Other notable trends in 2013 are the continued emergence of the Department of Justice (''DOJ'') as a *de facto* banking regulator,[3] a heightened focus on risk management, the development of requirements that compel banks to know their customers and their customers' customers, and a continuing ramp up of en-

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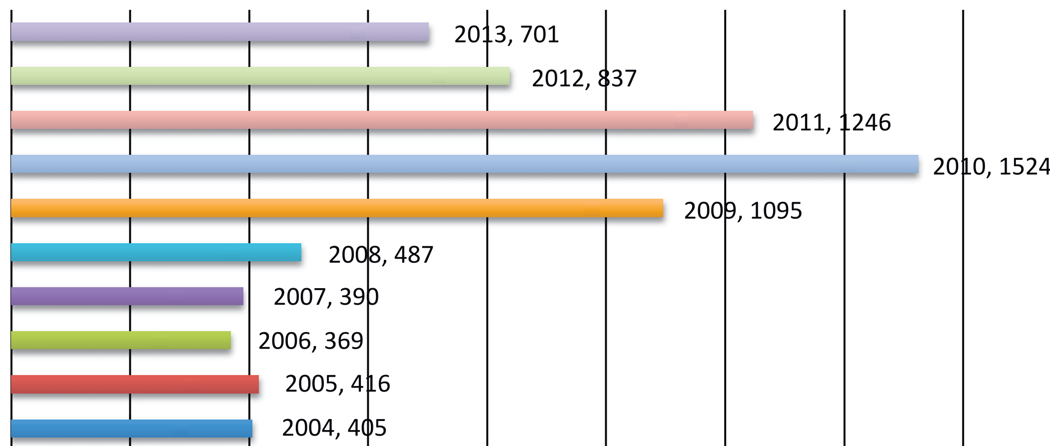
[1] ''Federal banking agencies'' include the Federal Deposit Insurance Corporation (''FDIC''), Office of the Comptroller of the Currency (''OCC''), Consumer Financial Protection Bureau (''CFPB''), and Board of Governors of the Federal Reserve System (''FRB'').

[2] These formal enforcement actions include cease and desist orders, consent orders, assessments of civil money penalties, prompt corrective actions, removal and prohibition orders, written agreements, adjudications, and section 19 orders. These numbers do not take into account the thousands of informal actions issued over the years, which are not required to be disclosed to the public.

[3] *See* Thomas P. Vartanian, *How Many Bank Supervisors Do We Need?*, AMERICAN BANKER - BANK THINK (Mar. 17, 2014), *available at* http://www.americanbanker.com/bankthink/how-many-bank-supervisors-do-we-need-1066286-1.html.



forcement activity by the CFPB. Regulators continue to focus on Bank Secrecy Act violations, and the FRB is increasingly relying on its ''source of strength'' doctrine. Finally, as we predicted in our enforcement survey of 2012,[4] there is continuing pressure on regulators to hold individuals accountable.

DOJ as a De Facto Banking Regulator

The experience of 2013 underscores that the DOJ is aggressively using 12 U.S.C. § 1833a to pursue enforcement actions against banking organizations. That section of the law provides civil authority to the DOJ thanks to the Financial Institutions Reform Recovery and Enforcement Act (''FIRREA'') of 1989. During the late 1990s and 2000s, there had been little use of section 1833a by the DOJ. However, the DOJ's new-found reliance on section 1833a has made it a *de facto* regulator of financial institutions. Because the DOJ's presence marks the entry of yet another regulator into a field already overseen by numerous federal agencies (and their inspectors general) and state banking, securities and consumer protection agencies, this trend merits close attention as the failure to take the DOJ's newly-flexed enforcement powers into account could lead to severe consequences.

In the aftermath of the Savings and Loan Crisis in 1989, Congress enacted 12 U.S.C. § 1833a as part of FIRREA, authorizing the DOJ to use broad civil litigation powers to ''recover a civil penalty'' from ''whoever violates'' a list of criminal statutes through activities ''*affecting* a federally insured financial institution.''[5] While originally thought of as a measure to protect banking organizations from violations committed by third parties, the DOJ has recently succeeded in convincing several courts to interpret the term ''affecting'' to mean that a banking organization can also be a violator (against itself) under section 1833a.[6]

Such a broad interpretation of section 1833a has expanded the DOJ's capacity to investigate and pursue actions against banking organizations for several reasons. First, section 1833a allows the DOJ to meet a lower burden of proof (compared with criminal actions) by allowing the DOJ to obtain civil monetary penalties for proving criminal offenses by a ''preponderance of the evidence.'' Second, section 1833a provides the DOJ with extensive subpoena powers and a ten-year statute of limitations. The DOJ's use of section 1833a has largely been in connection with its role as part of President Obama's Financial Fraud Task Force.

On November 18, 2013, the DOJ, along with other federal and state partners, announced a $13 billion settlement with a major bank to resolve inquiries arising from the alleged improper packaging, marketing, and issuance of residential mortgage-backed securities (''RMBS'') by the bank prior to 2009.[7] Of the record-setting settlement against a single entity, the bank was required to pay $2 billion to resolve charges brought by the DOJ under section 1833a. As the settlement became final, an Assistant Attorney General for the Civil Division commented that ''[t]oday's global settlement underscores the power of FIRREA and other civil enforcement tools for combating financial fraud. The Civil Division, working with the U.S. Attorney's Offices and our

[4] Thomas P. Vartanian et al., *2012 Bank Enforcement Actions Still High, But Significantly Lower Than 2010-11*, BNA's Banking Report 5–6, *available at* http://www.dechert.com/files/Publication/2f2be83c-dd32-4050-9aad-8a3fd2b0a54f/Presentation/PublicationAttachment/85f87a18-c8f4-4e3a-8af4-8cb304342b60/PDFArtic.pdf.

[5] Penalties generally will not exceed $1 million per violation. However, in the case of continuing violations, the DOJ may seek penalties equaling the lesser of $1 million dollars per day or $5 million in total. In addition, any of the foregoing limits may be exceeded to the extent a violation results in pecuniary loss to a person other than the violator. *See* 12 U.S.C. § 1833a(b)(1)-(2).

[6] *See* Case No. 1:11-cv-06969 (S.D.N.Y. Apr. 24, 2013) (denying the defendant's motion to dismiss and ruling that ''affecting'' should not be interpreted synonymously with ''victimizing''); *see also* Case No. 1:12-cv-01422 (S.D.N.Y. Aug. 16, 2013) (similarly denying the defendant's motion to dismiss and adopting a plain English interpretation of the term ''affecting'').

[7] *See* DOJ Press Release (Nov. 19, 2013), *available at* http://www.justice.gov/opa/pr/2013/November/13-ag-1237.html.

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state and agency partners, will continue to use every available resource to aggressively pursue those responsible for the financial crisis.''[8]

The DOJ also brought a case under section 1833a against another major bank (and certain of its affiliates) in August of 2013, alleging that it violated section 1833a by making misrepresentations to investors regarding the risk of mortgage loans backing certain RMBS, intentionally failing to conduct appropriate levels of due diligence, and selling a disproportionate amount of especially risky loans originated through third-party mortgage brokers.[9] Potentially defrauded investors in connection with the $850 million in RMBS sold by the bank included federally insured financial institutions. On March 27, 2014, a U.S. Magistrate Judge recommended dismissal of the DOJ's case against the bank. Along with questioning whether certain statements made by the bank were ''material,'' the Magistrate called into question the application of section 1833a to securities regulation.[10] The Western District of North Carolina will now consider the Magistrate's recommendation and could provide an indication of whether courts may be disposed to dismissing DOJ claims under section 1833a.

Also significant in 2013 was the DOJ's introduction of its ''Operation Choke Point,'' which is geared at limiting access to financial services and payment systems to business that are, in its view, engaged in questionable business practices. That list includes payday lenders, debt relief services, and false government grant providers.[11] Through the Bank Secrecy Act, FIRREA, and other statutes, the DOJ is seeking to eliminate these fraudulent businesses' access to the U.S. financial system (*i.e.*, by creating various choke points to stop the flow of money).

The DOJ brought its first suit under Operation Choke Point in January 2014 against a small bank in North Carolina for processing payments for payday lenders through an unidentified third-party payment processor.[12] In its complaint, the DOJ alleged that the bank ''knew or was deliberately ignorant of the use of its accounts . . . in furtherance of a scheme to defraud investors.''[13] The bank settled with the DOJ one day after the agency brought its complaint, agreeing to a $1.2 million payment.

While the DOJ has been an active regulator for many years in fair lending cases and has been using the False Claims Act to obtain penalties from financial institutions for knowingly making false statements with regard to claims presented to the federal government, the use of yet another broad set of enforcement authorities by the DOJ is proving to be quite significant. Section 1833a's ten-year statute of limitations, allowance of sizable civil monetary penalties and civil standard burden of proof provides the DOJ with significant enforcement authority over financial institutions. While it remains to be seen whether the DOJ's presence under section 1833a is a permanent one, recent enforcement actions by the DOJ have been significant and deserve close consideration.

CFPB Continues to Ramp up Enforcement Efforts

The CFPB, after taking over official responsibility for consumer issues in mid-2011, demonstrated its impact on financial institutions in 2012 by bringing five significant enforcement actions and conducting extensive examinations of a wide variety of financial companies. In 2013, the CFPB continued to ramp up its enforcement efforts by bringing significantly more enforcement actions on a wider variety of federal consumer financial protection laws. It continued, however, its trend toward holding banks accountable for the actions of their service providers.

Compared with 2012, the CFPB in 2013 targeted a wider array of misconduct at financial companies. In 2012, the CFPB's enforcement activities focused on how credit providers sold their products, whether directly or through third party vendors. In 2013, while continuing to focus on misleading and deceptive practices relating to the provision of credit, the CFPB brought cases against financial services companies for violations of the Equal Credit Opportunity Act, the Military Lending Act, and the Home Mortgage Disclosure Act.

The CFPB and other federal regulators ordered a major credit company's three subsidiaries to refund an estimated $85 million to approximately 250,000 customers for illegal credit card practices. The CFPB, FDIC and other agencies alleged that at every stage of the consumer experience, from marketing, to enrollment, to payment, to debt collection, the company violated consumer protection laws.[14] For example, the company allegedly deceived consumers about its rewards program, it charged unlawful late fees, it failed to submit consumer complaints to the authorities, and it misled consumers about debt collection processes. The action was particularly interesting because the original investigation was conducted by the FDIC and the Utah Department of Financial Institutions, where certain alleged misconduct was uncovered at one particular subsidiary. The CFPB continued to pursue the investigation and discovered similar misconduct at two other subsidiaries.

The CFPB also ordered a U.S. bank to pay $309 million in refunds in connection with its billing and administration of identity protection products to consumers.[15] The CFPB alleged that the bank had engaged in unfair practices by charging consumers for certain credit card ''add-on products'' for credit monitoring services that the consumers did not receive. Specifically, the bank al-

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[8] *Id.*

[9] *See* Case No. 3:13-cv-446 (W.D.N.C. 2013).

[10] *See id.* (claiming that section 1833a traditionally applied to traditional banking and customer activities, such as loans).

[11] *See* DOJ Press Release (Mar. 20, 2013), *available at* http://www.justice.gov/iso/opa/doj/speeches/2013/opa-speech-130320.html.

[12] *See* Case No. 5:14-cv-00014, (E.D.N.C. Jan 8, 2014).

[13] *Id.*

[14] CFPB Consent Order 2013-0011 (Dec. 24, 2013), *available at* http://files.consumerfinance.gov/f/201312_cfpb_consent_amex_centurion_011.pdf; CFPB Consent Order 2013-0012 (Dec. 24, 2013), *available at* http://files.consumerfinance.gov/f/201312_CFPB_0012_AEBFSB_Stipulation.pdf; CFPB Stipulation and Consent Order 2013-0013 (Dec. 24, 2013), *available at* http://files.consumerfinance.gov/f/201312_CFPB_AMEX_Travel_Related_Services_013_Stipulation.pdf.

[15] CFPB Consent Order 2013-0007 (Sept. 19, 2013), *available at* http://files.consumerfinance.gov/f/201309_cfpb_jpmc_consent-order.pdf.

legedly enrolled consumers in a credit card product that was promised to monitor consumer credit and alert them to potentially fraudulent activity. Consumers, however, must provide written authorization for such services, but the bank did not obtain the necessary written authorization to perform these monitoring services.

In December 2013, the CFPB ordered a national bank and its credit card subsidiary to refund up to $34.1 million to victims of the bank's allegedly deceptive credit card enrollment tactics.[16] The CFPB alleged that a subsidiary enrolled consumers in a credit card product at doctors' and dentists' offices on the assumption the credit cards they were signing up for were interest free. The CFPB found, however, the cards were accruing interest that was charged to the consumer if their full balance was not paid at the end of the promotional period. In addition, the CFPB found that the subsidiary failed to provide consumers written or other notification that they would be charged an APR of 26.99% at the end of the promotional period.[17]

The CFPB also brought its first public enforcement action under the Military Lending Act, alleging that a payday lender had robo-signed court documents in debt collection lawsuits and violated the Military Lending Act by illegally overcharging service members and their families.[18]

In March 2013, the CFPB issued guidance on compliance with the fair lending requirements of the Equal Credit Opportunity Act (ECOA) and its implementing regulation, Regulation B, for indirect auto lenders that allow dealers to increase interest rates charged to consumers and compensate those dealers with a percentage of the increase.[19] Under ECOA and Regulation B, it is illegal to discriminate in any aspect of a credit transaction because of race, color, religion, national origin, sex, marital status, age, or receipt of income from any public assistance program. The CFPB stated in its guidance that certain practices of indirect auto lenders may likely constitute participation in a credit decision under ECOA and Regulation B and open them up to liability for discriminatory credit pricing. The CFPB stated:

An indirect auto lender's markup and compensation policies may alone be sufficient to trigger liability under the ECOA if the lender regularly participates in a credit decision and its policies result in discrimination. The disparities triggering liability could arise either within a particular dealer's transactions or across different dealers within the lender's portfolio. Thus, an indirect auto lender that permits dealer markup and compensates dealers on that basis may be liable for these policies and practices if they result in disparities on a prohibited basis.[20]

Perhaps most significantly, in December 2013, the CFPB and DOJ ordered a bank holding company and its subsidiary to pay $80 million in damages to harmed African-American, Hispanic, and Asian and Pacific Islander borrowers, and $18 million in penalties in one such indirect auto lending case.[21] The bank and its subsidiary had allegedly put in place markup policies that resulted in illegal discrimination against over 235,000 African-American, Hispanic, and Asian and Pacific Islander borrowers. Through their investigation, the CFPB and DOJ determined that hundreds of thousands of minority borrowers paid higher interest rates for their auto loans due to the company's discriminatory credit pricing system. The $98 million dollar order represents the federal government's largest auto loan discrimination settlement in history and displays the potentially enormous liability associated with indirect auto lending.[22]

CFPB Opens Channels of Communication

The CFPB continued to demonstrate a willingness and ability to work with other federal regulatory agencies in bringing enforcement actions. Many of its enforcement actions during the year involved joint efforts with the DOJ, FDIC, and OCC. The CFPB has also demonstrated a willingness and ability to work with state and local regulatory authorities. The CFPB worked with authorities in 49 states, and the District of Columbia in bringing one action for mortgage servicing fraud. In another, the CFPB brought an enforcement action based on an initial investigation of, and referral from, the Utah Department of Commerce, Division of Real Estate.

The CFPB regularly receives tips from consumers regarding potential misconduct via a prominently displayed link on the homepage of its website titled ''Submit a Complaint.'' In one action against a credit card company for deceptive credit card enrollment practices, the CFPB began its investigation after receiving hundreds of complaints from consumers.[23] During the year, the CFPB worked with local government entities to help connect consumers with the CFPB in order to submit complaints. For example, the CFPB partnered with both the City of Jackson, Mississippi and the City of Columbus, Ohio to help connect local consumers with the CFPB to ask questions and submit complaints about financial products and services.[24] In those cities, citizens can dial 311 and be connected to the CFPB. A similar partnership was formed between the CFPB and St.

[16] CFPB Consent Order 2013-0009 (Dec. 10, 2013), *available at* http://files.consumerfinance.gov/f/201312_cfpb_consent-order_0009.pdf.

[17] *Id.* at 5.

[18] CFPB Stipulation and Consent Order 2013-0008 (Nov. 21, 2013), *available at* http://files.consumerfinance.gov/f/2013-cfpb_0008_stipulation.pdf.

[19] CFPB Bulletin, 2013-002, (March 21, 2013) *available at* http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf.

[20] *Id.* at 3.

[21] CFPB Consent Order 2013-0010 (Dec. 20, 2013), *available at* http://files.consumerfinance.gov/f/201312_cfpb_consent-order_ally.pdf.

[22] CFPB Press Release (Dec. 20, 2013), *available at* http://www.consumerfinance.gov/newsroom/cfpb-and-doj-order-ally-to-pay-80-million-to-consumers-harmed-by-discriminatory-auto-loan-pricing/.

[23] CFPB Consent Order 2013-0009 (Dec. 10, 2013), *available at* http://files.consumerfinance.gov/f/201312_cfpb_consent-order_0009.pdf; see also CFPB Press Release (Dec. 10, 2013), *available at* http://www.consumerfinance.gov/newsroom/cfpb-orders-ge-carecredit-to-refund-34-1-million-for-deceptive-health-care-credit-card-enrollment/.

[24] CFPB Press Release (Nov. 12, 2013), *available at* http://www.consumerfinance.gov/newsroom/the-cfpb-and-city-of-columbus-team-up-to-help-local-consumers-with-questions-and-complaints/; CFPB Press Release, (Sep. 20, 2013), *available at* http://www.consumerfinance.gov/newsroom/cfpb-and-jackson-ms-team-up-to-help-local-consumers-with-questions-and-complaints/.

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Louis, Missouri.[25] The CFPB is quickly opening up various channels of communication between itself and federal agencies, states agencies, local authorities, and consumers to discover potential misconduct.

Focus on Risk Management

In the wake of the financial crisis, risk management continues to be a hot regulatory topic of discussion. A prime example includes an important enforcement action brought by the OCC against a bank in connection with charges of fraud brought by regulators against employees in one of the bank's derivative trading units for allegedly hiding losses eventually reaching approximately $6 billion.[26] On January 14, 2013, the OCC issued a cease and desist consent order against the bank that alleged numerous concerns within the bank's risk management system.[27] The order alleged that certain weaknesses (*e.g.*, failures in reporting mechanisms) left the bank unaware of the substantial losses in its derivatives portfolios for much of 2012.

The OCC's order also required the bank to comply with several conditions designed to remedy its various internal control deficiencies. Most of the conditions focused on ensuring robust oversight by the bank's board of directors (*e.g.*, the creation of a compliance committee required to report to the board of directors periodically).[28] However, the terms of the order also required the bank to ensure proper reporting at lower levels, especially in regard to risk exposures resulting from trade positions and any material changes in trading strategies.[29] In addition, the bank was required to establish proper valuation controls, which were subject to review by the OCC.[30]

The OCC followed its cease and desist consent order on September 19, 2013, with a $300 million civil money penalty against the bank.[31] The OCC collaborated with a host of other agencies, including the U.S. Securities and Exchange Commission (''SEC''), FRB, and the United Kingdom's Financial Conduct Authority (''FCA''), in this effort. In total, the bank faced penalties of approximately $920 million, with $200 million going to the SEC,[32] $200 million going to the FRB,[33] and $220 million going to the FCA.[34] Importantly, the bank was required to admit wrongdoing as part of its settlement with the SEC, which marked the beginning of a new policy by the SEC to require such admissions for egregious violations.

It can be expected that regulators will continue to focus on internal governance issues which impact risk management for the foreseeable future. The OCC has already issued a new proposal to establish heightened governance standards for large banking organizations,[35] under which boards of directors and senior management will face increased accountability for raising an organization's risk-management controls (*e.g.*, resolving reporting weaknesses within the organization). The OCC's guidelines require board members to demonstrate that they understand the risks facing the organization, and that they possess sufficient authority to effectively address any questionable risk management practices.

The OCC's proposed guidelines represent just one example of an increased focus by regulators on governance issues and future developments should be monitored closely. In connection with these risk management issues, as well as other compliance issues, regulators continue to assess larger and larger civil money penalties in cases where large banks engage in conduct that violates the law or otherwise causes significant harm.

AML/Bank Secrecy Act Violations & Virtual Currencies

During 2013, banking regulators continued to focus on violations of the Bank Secrecy Act (''BSA'') and the enforcement of Anti-Money Laundering (''AML'') regulations as they had in 2012. Similar to 2012, financial companies' AML policies, procedures and programs were the subject of heightened scrutiny. AML/BSA compliance continues to be extraordinarily difficult to achieve due to the complexities associated with the rules, as well as the difficulty in setting up policies and procedures that can effectively comply with those rules and monitor a wide array of customer account activity and fund flows. Another continuing trend is the importance of Office of Foreign Assets Control violations for banks that deal either directly or through affiliates with sanctioned countries.

While the trend of the last decade to vigilantly enforce AML/BSA rules continues, the government's efforts in this regard reflect the changes occurring in payments systems as electronic currency attempts to find its niche. We wrote extensively about electronic money almost 20 years ago when Mondex and Digicash launched their pilot programs.[36]

In May 2013, the United States Attorney for the Southern District of New York, Preet Bharara, and the

[25] CFPB Press Release (Oct. 31, 2013), *available at* http://www.consumerfinance.gov/newsroom/cfpb-and-st-louis-team-up-to-help-local-consumers-with-questions-and-complaints/.

[26] *See* SEC Press Release (Aug. 14, 2013), *available at* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539776091#.Uz3rs_ldXAl.

[27] *See* OCC Consent Order AA-EC-13-01 (Jan 14, 2013) *available at* http://www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-7a.pdf.

[28] *Id.* at 4.

[29] *Id.* at 11.

[30] *Id.* at 12–16.

[31] *See* OCC Press Release (Sept. 19, 2013), *available at* http://www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-140.html.

[32] *See* SEC Press Release (Sept. 19, 2013), *available at* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539819965#.Uz3t-PldXAm.

[33] *See* FRB Press Release (Sept. 19, 2013), *available at* http://www.federalreserve.gov/newsevents/press/enforcement/20130919a.htm.

[34] *See* FCA Press Release (Sept. 19, 2013), *available at* http://www.fca.org.uk/news/consumers/jpmorgan-chase-bank-na-fined.

[35] *See* OCC Proposed Rulemaking, *Heightened Standards for Large Banks* (proposing minimum risk governance framework standards for large banking organizations), *available at* http://www.occ.gov/news-issuances/news-releases/2014/nr-occ-2014-4a.pdf.

[36] *See* Thomas P. Vartanian et al., *Echoes of the Past with Implications for the Future: The Stamp Payments Act of 1862 and Electronic Commerce*, 67 BNA's Banking Report 464 (1996); Thomas P. Vartanian & Robert H. Ledig, *The Business of Banking in the Age of the Internet: Fortress or Prison,* 15 No. 5 Banking Pol'y Rep. 7 (1996).

DOJ announced charges against one of the world's largest digital currency exchange companies and seven of its principals and employees for running an alleged $6 billion money laundering scheme.[37] 2013 also saw the explosion in popularity of Bitcoin and other "cryptocurrencies" or "virtual currencies." The price of a Bitcoin exploded during the year, reaching a high of over 1000 dollars a Bitcoin. In addition, other copycat cryptocurrencies began gaining acceptance. As cryptocurrencies have risen in popularity, they have attracted increased regulatory attention due their increased usage by ordinary individuals as well as their perceived link to organized crime.

In March 2013, FinCEN issued guidance to exchangers, administrators and users of virtual currencies in order to clarify how the regulations implementing the BSA as applied to money services businesses ("MSBs") apply to these market participants. Under the guidance, a "user" who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not an MSB under FinCEN's regulations.[38] An online merchant that accepts virtual currency as a form of payment would also qualify as a "user" and thus would not be an MSB. Under the guidance, an "administrator" (a person engaged as a business in issuing a virtual currency, and who has the authority to redeem such virtual currency) or "exchanger" (a person engaged as a business in the exchange of virtual currency for real currency, funds, or other virtual currency) that (1) accepts and transmits a convertible virtual currency or (2) buys or sells convertible virtual currency for any reason is a money transmitter and therefore an MSB under FinCEN's regulations.[39] This determination means that administrators and exchangers of virtual currency are subject to the extensive reporting, recordkeeping and registration requirements, as well as the requirement to adopt and maintain an anti-money laundering compliance program. Specifically, these market participants must:

(1) Establish written AML programs that are reasonably designed to prevent the MSB from being used to facilitate money laundering and the financing of terrorist activities; (2) file Currency Transaction Reports ("CTRs") and Suspicious Activity Reports ("SARs"); and (3) maintain certain records, including those relating to the purchase of certain monetary instruments with currency, transactions by currency dealers or exchangers (to be called "dealers in foreign exchange" under this rulemaking), and certain transmittals of funds.[40]

Adopting and maintaining an AML program and SAR and CTR reporting and recordkeeping programs can be complicated and costly. If virtual currencies continue to grow in usage and popularity, FinCEN will likely focus significant enforcement resources on these administrators and exchangers of virtual currency to ensure compliance with the BSA and to combat terrorism, criminal acts and other illicit activity.

[37] U.S. Attorney's Office S.D.N.Y. Press Release, (May 28, 2013), *available at* http://www.justice.gov/usao/nys/pressreleases/May13/LibertyReservePR.php.

[38] Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies, FIN-2013-G001 (March 18, 2013).

[39] *Id.*

[40] 76 Fed. Reg. 43585.

Source of Strength – Inadequate Capital In the aftermath of the recent financial crisis, and in a new world focused on capital adequacy, the FRB has refocused on its "source of strength" doctrine to require bank holding companies ("BHCs") to serve as sources of financial strength to their bank subsidiaries.[41] Typical agreements entered into with the FRB have placed limits on the ability of BHCs and their bank subsidiaries to declare or pay dividends, guarantee debt, and/or redeem shares of stock – often requiring FRB approval before such actions are taken. In addition, BHCs are often called to ensure that their bank subsidiaries maintain specified capital requirements and comply with any applicable orders issued by federal or state agencies. The new focus on stress tests is also creating additional capital augmentation actions.

The FRB brought approximately 19 "source of strength" enforcement actions in 2013, which is down from an approximate total of 46 in 2012. While the number of enforcement actions may be decreasing, the "source of strength" doctrine continues to be an important enforcement tool for the FRB.[42]

Federal banking regulators, including the OCC and FDIC, also continued to issue consent orders requiring troubled banks to increase their capital in 2013. Under the terms of such consent orders, banks typically must adopt capital plans to designed to meet specific requirements determined by the issuing regulator (*e.g.*, leverage ratio and risk-based capital minimums).[43] As such, banks that come under scrutiny can continue to expect regulators to focus on increased capital requirements in order to protect the bank's depositors.

FDIC Lawsuits Against Directors and Officers of Failed Institutions

The FDIC continued to focus on individual accountability in 2013, bringing 40 lawsuits against 316 directors and officers ("D&Os"). In its role as receiver for failed institutions, the FDIC may bring suits against professionals, including D&Os, who may have contributed to the failure of a particular institution[44]. As noted in our prior surveys, FDIC actions against individual directors and officers spiked after the financial crisis.[45]

[41] In section 616 of the Dodd-Frank Act, Congress codified the "source of strength" doctrine and required the appropriate federal banking agencies to issue implementing rules which has not yet occurred.

[42] For example, 2013 saw the FRB use its "source of strength" doctrine to address financial instability in a major bank, which had just incurred substantial trading losses. *See* FRB Consent Order 13-001 (Jan. 14, 2013), *available at* http://www.federalreserve.gov/newsevents/press/enforcement/enf20130114a1.pdf.

[43] *See e.g.*, OCC Consent Order 2013-11 (Feb. 27, 2013), *available at* http://www.occ.gov/static/enforcement-actions/ea2013-011.pdf; *see also* FDIC Consent Order 12-574b (Jan. 14, 2013).

[44] For a in depth discussion on FDIC D&O theories, cases and defenses, *see* Dechert LLP's *Bank D&O Manual*, *available at* http://www.dechert.com/files/Publication/7f7fad0c-600b-4f85-8cab-461dc3e08b49/Presentation/PublicationAttachment/0f32f58c-b774-4c95-9c37-118103b6d303/Bank%20DO%20Defense%20Manual_May2012.pdf.

[45] Vartanian et al., *supra* note 4, at 5–6.

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While the total number of failed institutions has steadily declined since 2010,[46] the number of D&O suits brought continues to be high since the FDIC has a statute of limitations of three years for tort claims and six years for breach of contract claims.[47] Consistent with prior years, many of the suits involved failed institutions from Georgia and Florida, as bank failures in these two states were among the highest in the country during the recession.[48]

[46] Characteristics of FDIC Lawsuits against Directors and Officers of Failed Financial Institutions, Cornerstone Research 2 (Sept. 2013), *available at* http://www.cornerstone.com/getattachment/a6315fce-2429-43fd-a0bb-aedd86f72e71/Characteristics-of-FDIC-Lawsuits-against-Directors.aspx.

[47] *Professional Liability Lawsuits*, FDIC (Apr. 25, 2014), http://www.fdic.gov/bank/individual/failed/pls/

[48] *See* Case No. 4:2013-cv-00245 (S.D. Ga. Nov. 8, 2013); *see also* Case No. 4:2013-cv-00416 (N.D. Fla. Jul. 31, 2013).

Year	Number of D& Suits Brought by the FDIC	Number of Authorized D & O Defendants
2010	2	98
2011	16	264
2012	26	369
2013	40	316

The DOJ Marijuana Memorandum In August 2013, the DOJ released guidance to federal prosecutors concerning marijuana enforcement under the Controlled Substances Act (''CSA'') after certain state ballot initiatives legalized the possession of small amounts of the drug and provided for regulation of the production, processing and sale of the drug.[49] The memorandum recites the federal government's position that marijuana is a dangerous drug, and it makes clear that federal prosecutors are to continue to prosecute conduct that interferes with the federal government's priorities in reducing use of the drug, regardless of inconsistent state law.[50] As a result, banking organizations questioned whether they could permissibly provide financial services to state-licensed marijuana businesses without engaging in BSA, unlicensed transmitter and money-laundering violations.

Both the DOJ and FinCEN released follow-up guidance in February 2014 that provided banking organizations some indication that they could provide such services without the threat of federal enforcement action. The DOJ's guidance directs prosecutors to consider a list of enforcement priorities before bringing marijuana-related enforcement actions with respect to federal money laundering, unlicensed transmitter, and BSA offenses.[51] FinCEN's guidance clarifies how banking organizations can provide services to marijuana-related businesses consistent with their BSA obligations.[52] FinCEN explained that ''[t]horough customer due diligence is the critical aspect'' in any decision to ''open, close, or refuse any particular account or relationship . . .''[53] Proper diligence involves verifying that the business is duly licensed by the appropriate state authority and monitoring for additional information on the business as it becomes available.[54] Furthermore, financial institutions should also monitor for suspicious activities and file suspicious activities reports for all activities involving marijuana-related businesses.[55]

While the DOJ and FinCEN provided some comfort to banking organizations through their respective February releases, it is important to note that they did not guarantee against federal enforcement action. This will be an area fraught with regulatory peril. It may be subject to after-the-fact prosecutions and recriminations that may be impacted by various political and journalistic pressures, which are related to the particular facts and circumstances at the time. Financial institutions should develop a clear and complete record of due diligence and corporate oversight if they provide financial services to businesses in this new industry.

[49] DOJ, Guidance Regarding Marijuana Enforcement (August 29, 2013) *available at* http://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf.

[50] *Id.*

[51] DOJ Guidance Regarding Marijuana Related Financial Crimes (Feb. 14, 2014), *available at* http://www.dfi.wa.gov/banks/pdf/dept-of-justice-memo.pdf.

[52] FinCEN Guidance: BSA Expectations Regarding Marijuana-Related Businesses (Feb. 14, 2014), *available at* http://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2014-G001.pdf.

[53] *Id.* at 2.

[54] *Id.* at 2–3.

[55] Since financial institutions are required to file suspicious activity reports when the institution knows, suspects, or has reason to suspect that a transaction involves funds derived from an illegal activity and federal law prohibits the distribution and sale of marijuana, FinCEN concluded that all transactions with marijuana-related businesses should be reported. *See Id.* at 3.