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Bank Enforcement 2016: Enforcement Actions Return To Pre-Financial Crisis Levels With a Focus on Major Actions

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Overall Trends & Outlook

In 2016, the number of formal enforcement actions brought by federal banking agencies (i.e., the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), and the Consumer Financial Protection Bureau (CFPB) decreased to the lowest level since 2007, the year before the financial crisis. They issued a more normal 426 formal enforcement actions. This contrasts to a high of 1,524 actions in 2010, and is a 33 percent decrease from the 638 actions brought in 2015. This decline in significant part reflects the fundamental strengthening of the banking industry since the 2008 crisis.

The actions brought in 2016 lead us to conclude the following:

1. High profile enforcement actions will continue to be brought to assert standards of conduct which may expand the law, and the size of civil money penalties (CMPs) will continue to increase.

2. The actions and status of the CFPB continue to receive a great deal of attention from the courts, Congress and now the new administration. Change in the CFPB's enabling statute as proposed by the Financial CHOICE Act, or in its leadership could significantly alter its direction, jurisdiction, and levels of activity.

3. The Department of Justice (DOJ) continues to occupy a prominent position as a *de facto* banking regulator. Although much of its activity in this area has been related to the residential mortgage backed securities (RMBS) disclosure and fraud cases arising out of the financial crisis which have largely been resolved, we do

not expect DOJ activity to disappear from the banking industry. History indicates that regulatory jurisdiction rarely shrinks and is more likely in such circumstances to migrate to new areas of concern.

4. The possibility that institutions will likely have to face multiple civil, regulatory and criminal government agencies on both the federal and state level over the same facts continues. However, the Trump administration appears to share the concerns that we have expressed in these reports for many years. The Treasury's June 2017 report "A Financial System That Creates Economic Opportunities: Banks and Credit Unions" proposes to address this issue by authorizing the Financial Stability Oversight Council to assign a lead regulator where agencies have conflicting or overlapping jurisdiction to reduce piling on and increase efficiency.

5. Regulators have begun to focus enforcement attention on the laws and rules related to the proper handling of confidential supervisory information.

6. Bank regulators are focusing and will continue to focus on consumer protection more than before the financial crisis, perhaps in competition with the CFPB.

7. Strict vendor management continues to be a high priority for regulators.

8. Oversight of compensation arrangements and the corresponding incentives they create is becoming a more focused concern of regulators, particularly when corporate goals, operations and results go askew.

Federal Reserve Board Enlarges its Enforcement Horizons

Throughout 2016, the FRB brought several actions related to corporate conduct that violated law or appropriate standards of conduct. It brought an action against a bank holding company whose subsidiary allegedly operated a hiring program in which candidates were referred by foreign government officials and existing or prospective commercial clients. Despite those who were referred often being less qualified than other candidates, the bank holding company's subsidiary offered them internships or other employment opportunities.

In a related action, the Securities and Exchange Commission (SEC) stated that during a seven year period, the company allegedly hired approximately 100 interns or full-time employees at the request of foreign government officials, enabling the company to win or retain business resulting in more than \$100 million in rev-

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enues to the company. The FRB stated that federal law and the organization's firm-wide policies, as well as laws in many foreign jurisdictions where the firm conducted business, prohibited these practices. The FRB alleged that the firm had failed to appropriately implement an effective and comprehensive compliance risk management framework with respect to the hiring practices in question. The FRB's order required the company to take a series of remedial actions and assessed a \$61.9 million CMP. [See FRB Consent Order (Nov. 17, 2016).] The company also settled SEC charges regarding the referral hiring practices under the Foreign Corrupt Practices Act. The company agreed to pay \$105 million in disgorgement and \$25 million in interest. [See SEC Press Release, (Nov. 17, 2016).]

In another novel situation, the FRB brought an action against a bank holding company for alleged criminal theft of confidential supervisory information and dissemination to other firm employees. It further alleged that firm employees used information prepared by bank regulators to solicit business from current and prospective clients. The FRB assessed a \$36.3 million CMP and required the company to take remedial actions. [See FRB Consent Order (Aug. 2, 2016); and FRB Press Release (Aug. 3, 2016).]

The FRB assessed its largest CMP in 2016 against a bank holding company for alleged deficiencies in the institution's foreclosure processing and residential mortgage loan servicing. It alleged that, among other things, (i) the company filed inaccurate or improper affidavits in courts, (ii) took actions against borrowers without confirming that the relevant documentation was in order, and (iii) failed to respond in a sufficient and timely manner to an increased level of foreclosures by increasing resources to deal with such foreclosures. Under the consent order, the FRB assessed a \$131 million CMP. [See FRB Consent Order (Feb. 5, 2016).]

Separately, and consistent with the trend toward multiple agency enforcement, the company and its mortgage servicing subsidiaries entered into a settlement agreement with the DOJ, the CFPB and certain state Attorneys General to settle mortgage servicing claims by providing \$370 million of consumer relief and other forms of assistance and make a \$100 million payment to the United States. The FRB permitted these amounts paid to reduce the amount of the FRB-imposed CMP. [See FRB Consent Order (Feb. 5, 2016).]

In another notable enforcement action, the FRB assessed a \$27 million CMP against a foreign bank and a U.S. subsidiary, alleging that between 2008 and 2013, the subsidiary exceeded revenue limits on certain of its securities underwriting and dealing activities under the FRB order authorizing these activities. The FRB stated that the companies took significant steps to comply with the company's commitments and the terms and conditions of the FRB authorization following the discovery of the conduct. [See FRB Consent Order (Dec. 19, 2016).]

OCC Pursues Consumer Protection-Related Actions

Since the adoption of the Dodd-Frank Act and the establishment of the CFPB, there has been a quiet competition to bring consumer protection actions. In 2016, a national bank was assessed a \$35 million CMP for bill-

ing customers for credit monitoring services that were allegedly never received by customers in violation of the Section 5 of the Federal Trade Commission Act. Under the C&D, the bank was required to take certain remedial actions and to reimburse certain amounts to eligible customers who were harmed by the bank's practices. [See OCC Consent Order (Apr. 12, 2016).]

In other consumer-related cases, the OCC imposed CMPs of \$48 million and \$70 million, alleging that the banks involved had violated a prior consent order and filed inaccurate or untimely payment change notices, among other things, under the Bankruptcy Rules. [See OCC Consent Order, (Jan. 4, 2016) and OCC Consent Order, (May 24, 2016).]

CFPB in the Spotlight

In a matter that attracted wide attention and resulted in a high profile congressional hearing, the CFPB assessed a \$100 million CMP, its largest penalty to date, on a bank for allegedly engaging in unfair and abusive practices by opening unauthorized deposit and credit card accounts allegedly to reach sales targets and compensation incentives. [See CFPB Press Release, (Sept. 8, 2016).] In addition to the CMP, the bank agreed to implement a compliance plan to address the improper practices and to segregate at least \$5 million to provide redress to customers who incurred fees and charges due to improper practices. [See CFPB Consent Order (Sept. 4, 2016)]. The bank also agreed to pay \$50 million to the City and County of Los Angeles in regard to the unauthorized accounts. The bank also entered into a C&D with the OCC to address what the OCC described as deficiencies in the bank's oversight of its sales practices and was assessed \$35 million CMP. [See OCC Consent Order (Sept. 6, 2016).] This case is likely to cause financial institutions to carefully review the incentives that may arise from their employee performance goals and compensation programs.

The legal status of the CFPB itself became a significant issue when, in October 2016, a panel of the U.S. Court of Appeals for the D.C. Circuit found that the CFPB was unconstitutionally structured because it is an independent agency headed by a single director who is not removable at the will of the president. [See *PHH Corporation v. CFPB*, 839 F.3d 1 (D.C. Cir 2016).] The court fashioned a narrow remedy, concluding that it could sever the improper provision in the law so that the Director serves at the will of the President.

The specific enforcement issues in the *PHH* case involved what the court concluded was a retroactive interpretation of the Real Estate Settlement Procedures Act, which was found to have violated PHH's due process rights. The D.C. Circuit has agreed to review the CFPB's appeal *en banc* and has vacated the panel's decision. In a split with the CFPB's position, the DOJ under the new administration has asked the appeals court to follow the reasoning of the appeals panel.

Throughout 2016, the CFPB pursued enforcement actions for a range of alleged violations with regard to mortgage lending, debt collection, payment processing, third-party service provider oversight, and other fraudulent and abusive practices. It filed suit against a payment processor for unfair acts and practices for allegedly ignoring red flags about transactions involving debits to consumer bank accounts that the company was processing. These included warnings about poten-

tial fraud or illegality raised by banks involved in the transactions, unusually high return rates, state and federal law enforcement actions against processor clients, and repeated consumer complaints. [See CFPB Press Release (Jun. 6, 2016), CFPB Press Release (Jun. 6, 2016)]. In March 2017, U.S. District Court Judge Ralph Erickson dismissed the CFPB's complaint finding that the agency had failed to present enough evidence. [See *Consumer Financial Protection Bureau v. Intercept Corporation, d/b/a InterceptEFT, et al.*, No. 16-00144 (D.N.D., March 17, 2017).]

The CFPB continued its focus on deceptive marketing of ancillary products to customers of financial institutions. It ordered a bank to pay a \$10 million CMP for alleged deceptive acts or practices by the bank's telemarketing vendor in marketing overdraft services to consumers and signing up certain customers without their approval. [See CFPB Consent Order (Jul. 14, 2016).]

In a similar action, a bank was accused of using deceptive marketing practices to cause credit card customers to obtain debt cancellation products and charged consumers for credit monitoring services the customers never received and ordered it to pay a \$4.5 million CMP and \$27.8 million in restitution to over 250,000 customers. [See CFPB Consent Order (Aug. 25, 2016).]

A bank was ordered to pay penalties and/or reimburse customers where the bank allegedly sold credit card debt with overstated rates and failed to promptly forward payments received from customers to the debt purchasers. [See CFPB Consent Order (Feb. 23, 2016)] and CFPB Consent Order (Feb. 23, 2016). Also see CFPB Press Release, (Feb. 23, 2016)].

DOJ Continues to Act as a De Facto Banking Regulator

As we have discussed in previous enforcement reports, DOJ's authority under 12 U.S.C. § 1833a (Section 1833a) remains subject to challenge on a range of grounds including that it often involves a claim that a bank has defrauded itself. In May 2016, the U.S. Court of Appeals for the Second Circuit reviewed a jury verdict under Section 1833a and upheld a challenge to the Government's theory of liability. It found that a contractual promise can constitute a fraudulent misrepresentation only if the promisor never intended to perform. Applying this principle, the court found that the Government never argued nor proved at trial that the contractual representations were executed with contemporaneous intent never to perform and thus did not support a violation of Section 1833a. [See *U.S. ex rel. O'Donnell v. Countrywide Home Loans, Inc.*, 822 F.3d 650 (2d Cir. 2016).]

Separately, in February 2016 another banking organization entered into an agreement with the DOJ under which it paid a \$2.6 billion penalty pursuant to Section 1833a as part of an agreement to resolve allegations

that it made representations to prospective investors about the characteristics of the subprime mortgage loans underlying the RMBS with which it did not comply. The DOJ noted that together with other settlements with the SEC, the FDIC, the National Credit Union Administration (NCUA) and the States of New York and Illinois the organization paid nearly \$5 billion in connection with its sale of RMBS. [See DOJ Press Release, (February 11, 2016).]

In April 2016, another banking organization settled similar claims by the DOJ and other parties related to the marketing, structuring, arrangement, underwriting and issuance of RMBS. The banking organization agreed to pay a \$2.4 billion CMP to the DOJ and to make payments totaling \$875 million to the NCUA, the States of New York, Illinois and California and to two Federal Home Loan Banks, as well as pay \$1.8 billion in consumer relief. [See DOJ Press Release (April 8, 2016).]

These types of cases reflect that institutions often end up fending off many different regulators in what some have described as regulatory "piling on." As noted, this is an issue that the Treasury's recent Report would suggest this Administration wants to address.

Also of importance to financial institutions is how the DOJ has been pursuing claims against lenders under the False Claims Act (FCA). In April 2016, the DOJ announced a \$1.2 billion settlement for FCA violations in which a bank acknowledged and accepted responsibility for, among other things, certifying ineligible residential mortgage loans to the Department of Housing and Urban Development for Federal Housing Administration (FHA) insurance. [See DOJ Press Release, (April 8, 2016).] A similar settlement under the FCA in April 2016 by another lender involved a payment of \$113 million. [See DOJ Press Release (April 15, 2016).]

Bank Secrecy Act/Anti-Money (BSA/AML) Laundering Violations

One set of recent regulatory actions underscores the importance of promptly correcting findings of noncompliance with BSA requirements and the issues raised by overlapping enforcement actions for the same non-compliant conduct.

In February 2016, the OCC assessed a CMP of \$2.5 million against a community bank for alleged BSA violations, noting that the bank had previously entered into a consent order but had failed to comply with the BSA/AML requirement that it imposed. [See OCC Consent Order, (Feb. 22, 2016).] As may occur in these cases, FinCEN also alleged that the bank violated BSA requirements by failing to adopt appropriate procedures to detect potential money laundering and assessed a CMP of \$4 million. [See FinCEN Press Release, (Feb. 25, 2016).] When such actions, especially those which also involve the DOJ, are not prosecuted simultaneously, agreeing to and budgeting for a global settlement present additional problems.