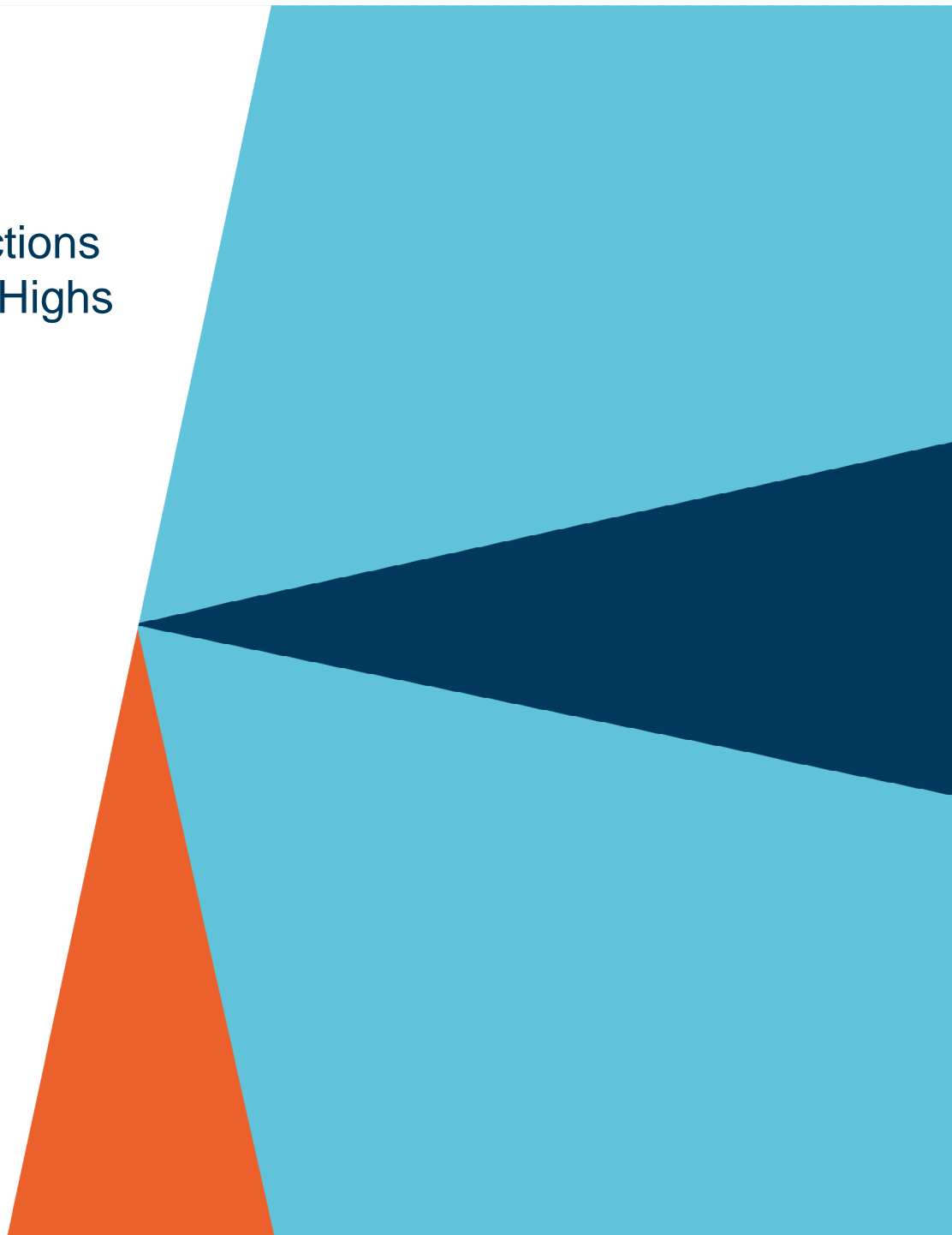


Federal Bank Enforcement Actions Decline but Fines Hit Historic Highs

October 13, 2015

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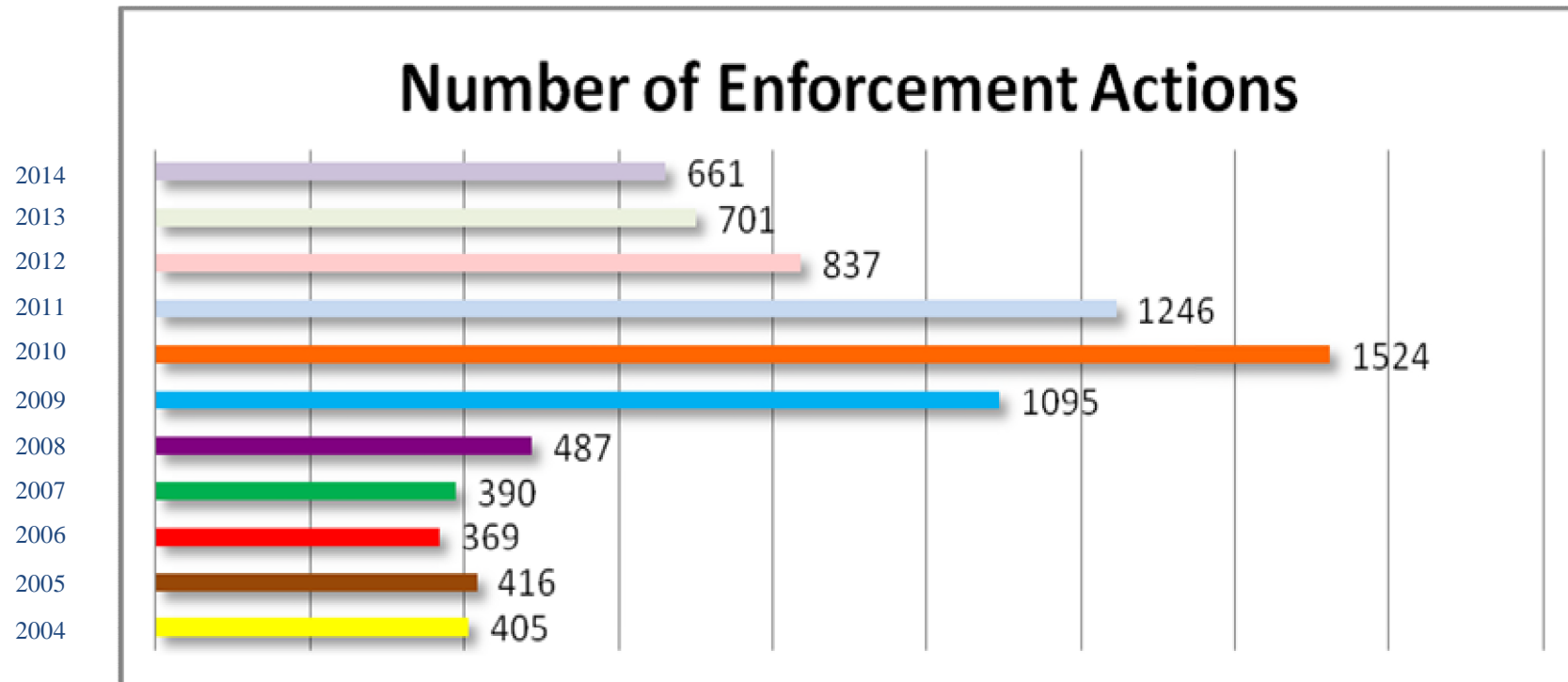
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Overview: Bank Enforcement Trends in 2014

- ▶ DOJ Continues Role as De Facto Regulator
- ▶ Year Marked by Historic Civil Money Penalties
- ▶ CFPB Continues to Ramp Up Enforcement Efforts
- ▶ Operation Choke Point Comes Under Scrutiny
- ▶ FDIC Lawsuits Against D&Os of Failed Institutions

Overview: Number of Enforcement Actions



- ▶ Federal banking agencies issued 661 formal enforcement actions – a 55% reduction since the high water mark in 2010

DOJ Continues Role as *De Facto* Regulator

- ▶ 2013 – DOJ emerged as prominent *de facto* banking regulator through its use of FIRREA
- ▶ 2014 – DOJ issued two historic settlements with banking entities
 - Both involved the sale of residential mortgage-backed securities (RMBS)

DOJ Continues Role as *De Facto* Regulator: Settlement #1 July 14, 2014

- ▶ DOJ announced \$7 billion settlement with a major bank holding company
 - DOJ Claim: alleged improper packaging, securitization, marketing, sale, and issuance of RMBS
 - Settlement included \$4 billion civil penalty
 - DOJ stated “we hold [the bank] accountable for its contributing role in creating the financial crisis, not only by demanding the largest civil penalty in history, but also by requiring innovative consumer relief that will help rectify the harm caused by [the bank’s] conduct.”

DOJ Continues Role as *De Facto* Regulator: Settlement #2 August 21, 2014

- ▶ DOJ announced \$16.65 billion settlement with a major bank holding company
 - DOJ Claim: alleged improper packaging, securitization, marketing, sale, and issuance of RMBS
 - Settlement included \$5 billion civil penalty to DOJ under FIRREA

DOJ Continues Role as *De Facto* Regulator: Issues Created

- ▶ Questions about whether the use of section 1833a is appropriate where the allegation is essentially that the bank defrauded itself
- ▶ Appropriateness of so many regulators attempting to enforce alleged violations

Jamie Dimon, the Chairman and CEO of JP Morgan Chase to Annual Shareholders

- ▶ “Part of the issue around legal costs is that banks are now frequently paying penalties to five or six different regulators (both domestic and international) on exactly the same issue. This is an unprecedented approach that probably warrants a serious policy discussion – especially if those regulators (as at least some of them have acknowledged) don’t take into account what is being paid to the others. For now, it’s simply a reality for big banks, and certainly for us, that when one or more employees do something wrong, we’ll hear from multiple regulators on the subject.”

Year Marked by Historic Civil Money Penalties: Office of Comptroller of the Currency

- ▶ OCC remained active in bringing enforcement actions against institutions and individuals in 2014
- ▶ OCC brought over 50% more enforcement actions against institutions in 2014 than in 2013
- ▶ OCC enforcement actions against individuals in 2014 remained on par with 2013

OCC Enforcement Actions: Bank Secrecy Act/Anti-Money Laundering

- ▶ OCC entered into \$350 million civil money penalty relating to BSA/AML
 - In 2013, OCC entered into cease and desist order with bank regarding the bank's BSA/AML compliance program
 - In 2014, OCC entered into consent order for the assessment of a civil money penalty based upon allegations of numerous deficiencies in the bank's BSA/AML compliance program
 - ▶ Failure to correct previously reported BSA/AML violations

OCC Enforcement Actions: FX Trading Violations

- ▶ Two large settlement cases in 2014
- ▶ OCC Claims:
 - Banks' FX business exhibited alleged deficiencies and unsafe or unsound practices related to the bank's wholesale FX business in which it acted as principal
 - Banks' FX traders discussed engaging in potential misconduct with traders from other banks or market participants in attempts to manipulate FX rates
- ▶ #1 – Civil money penalty of \$250 million
- ▶ #2 – Civil money penalty of \$350 million

Federal Reserve Board: U.S. Sanctions Law Violation

- ▶ FRB ordered large foreign bank to pay a \$508 million penalty for violation of U.S. sanctions law
 - Single largest penalty ever assessed by the FRB
- ▶ FRB alleged that the bank engaged in unsafe and unsound practices to ensure that activities conducted at offices outside of U.S. complied with U.S. Treasury regulations
- ▶ Cease and desist order with the regulator in the bank's home country

CFPB Continues To Ramp Up Enforcement Actions

- ▶ Overview of the upward trend in CFPB enforcement actions
- ▶ Will this trend continue?
- ▶ 2014 enforcements actions relate to, among other matters, apparent violations of debt collection practices, mortgage origination activities, sales of credit card “add on” products and payday lending practices
- ▶ First enforcement action under the CFPB’s mortgage servicing rules
 - Based on alleged failures relating to the handling of loan modification applications.

CFPB Enforcement Actions

- ▶ Two large settlement cases in 2014
- ▶ CFPB Claims
 - First Action – The Bank used misleading sales scripts that resulted in 1.9 million customer accounts being charged for credit monitoring and other credit reporting services that were never received.
 - Second Action – Largest credit card discrimination settlement in history. The Bank failed to extend certain debt cancellation offers to consumers who requested that communications be in Spanish or consumers that had a mailing address in Puerto Rico
- ▶ #1 – \$727 million in relief to consumers
- ▶ #2 - \$225 million in refunds to consumers

Recent CFPB Action – Discriminatory Auto Loan Pricing

- ▶ CFPB and DOJ investigated Honda's auto lending activities' compliance with the Equal Credit Opportunity Act
- ▶ Allegations
 - Honda allowed dealer markups of up to 225 basis points;
 - Honda's practices resulted in minority buyers paid higher dealer markups;
 - African-American borrowers charged approximately 36 basis points more than similarly-situated white borrowers;
 - Honda did not monitor whether prohibited discrimination was occurring or have controls to prevent it.
 - Honda's policy of allowing dealer markups without adequate controls is not justified by legitimate business need.
- ▶ CFPB Order –
 - Provides three options for addressing fair lending concerns in future operations
 - Pay \$24 million in damages for consumer injury

Fair Lending – Disparate Impact

- ▶ Supreme Court decision in *Texas Dept. of Housing v. Inclusive Communities Project*
 - Significant controversy regarding disparate impact liability under the Fair Housing Act (FHA).
 - HUD issues a rule codifying disparate impact liability under the FHA in 2013.
 - Court ruled that liability under the FHA could be based on disparate impact.
 - Majority stressed limitations on making such findings.
 - Implications for lenders.

Operation Choke Point

- ▶ 2011 – FDIC published a list of risky merchant categories that warranted heightened bank attention
- ▶ 2013 – DOJ initiates “Operation Choke Point” to limit access to the financial system for those deemed to be engaged in questionable business practices
- ▶ January 2014 – DOJ brought its first lawsuit to settlement against North Carolina bank
 - Program’s enforcement relatively dormant up until then
 - Charges brought under Anti-Fraud Injunction Act and FIRREA
 - Civil money penalty of \$1.2 million to Treasury

Operation Choke Point (cont'd)

- ▶ Trade associations asserted that the program is intended to pressure banks to restrict access to legitimate businesses
 - *i.e.*, payday lenders, gun shops, etc.
- ▶ Banks did cut ties with certain types of businesses
- ▶ FDIC withdrew the “high-risk” list in July 2014
- ▶ Several staff reports of the program issued by House Committee on Oversight and Government Reform

Operation Choke Point (cont'd)

- ▶ DOJ has reached settlements with two more banks under the program
 - Both brought under the Anti-Fraud Injunction Act and FIRREA
 - Civil money penalty of \$1 million to Treasury for each
- ▶ In July 2015, DOJ's Office of Professional Responsibility finds no evidence that DOJ is improperly targeting payday lenders or other lawful businesses

FDIC Lawsuits Against D&Os of Failed Institutions

- ▶ From January 2009 through March 2015, the FDIC filed 106 D&O lawsuits against 800 former D&Os
- ▶ FDIC was very active in 2012 and 2013, but 2014 exhibited a substantial decline in the number of D&O lawsuits

Year	Number of D&O Suits Brought by the FDIC
2011	16
2012	26
2013	40
2014	19

Judicial Skepticism Regarding One FDIC D&O Lawsuit

- ▶ “[T]he Court will briefly discuss the FDIC’s claim that the ‘Great Recession’ was not only foreseeable, but was actually foreseen by the defendants. The Court discusses this claim only due to the absurdity of the FDIC’s position. . . . [T]he FDIC claims that defendants were not only more prescient than the nation’s most trusted bank regulators and economists, but that they disregarded their own foresight of the coming crisis in favor of making risky loans. Such an assertion is wholly implausible.”
 - *FDIC v. Willetts*, 48 F. Supp. 3d 844, 852-53 (E.D. N.C. Sept. 11, 2014)

FDIC v. Willetts: Mixed Results on Appeal in Federal Court

- ▶ 4th Circuit Court of Appeals reversed District Court's grant of summary judgment to bank directors and officers for FDIC's claims of ordinary negligence and breach of fiduciary duty
 - Remanded claims to district court
 - Officer's not protected by business judgment rule
- ▶ Appeals court upheld summary judgment rulings dismissing claims of gross negligence against directors and officers and bad faith on the part of the directors

FDIC v. Willetts: Court of Appeals Less Willing to Fault Great Recession

- ▶ “Certainly, it is convenient to blame the Great Recession for the failure of [Bank], and in turn for the losses sustained by the FDIC-R when it took over the Bank. However, there is evidence in the record, as outlined above, that suggests that ‘in the exercise of reasonable care,’ the Bank officers could have ‘foreseen that some injury would result from [their] act[s] or omission[s], or that consequences of a generally injurious nature might have been expected.’ Even before the Recession, exam reports from both of [the Bank’s] regulators indicated that the Bank was utilizing unsafe practices. And while the Recession undoubtedly contributed to the failure of the Bank, it may have been only one of many contributing factors. This is a genuine issue of material fact, and thus this is a question for a jury.”

— *FDIC v. Rippey*, 2015 U.S. App. LEXIS 14474 (4th Cir. Aug. 18, 2015).

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