LAW AND REGULATION IN BANKING

“The Regulation of Banks is a Swinging Pendulum . . .”

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The Regulation of Banks is a Swinging Pendulum…

“Regulatory relief: When the pendulum swings...be careful or it will smack you when it swings back.”

-Lucy Griffin, CRCM
President, Compliance Resources, Inc.

“Regulation is important. Getting the balance right is tough, because it’s politicized. I think there’s a happy medium somewhere in the middle.”

“Banks are like snowflakes. They’re not like raindrops.”

-Clifford Rossi
Executive-in-residence and Professor of
University of Maryland’s Robert H. Smith
School of Business
Which Came First?

Law/Regulation or Violation!??!!?

Per FDIC several years ago, laws have the following purposes:
1) Protect consumers from harm/abuse
2) Provide consumers with helpful information
3) Ensure fair access to all

Issues – the ‘80s

1980 – Depository Institution Deregulation & Monetary Control Act
1982 – Garn-St. Germain Depository Institutions Act
1987 – Competitive Equality Banking Act (CEBA)
1989 – Financial Institutions Reform, Recovery & Enforcement Act (FIRREA)
Issues – the ‘90s

1991 – Federal Deposit Insurance Corporation Improvement Act (FDICIA)
1993 – RTC Completion Act
1994 – Riegle Community Development & Regulatory Improvement Act
1994 – Riegle-Neal Interstate Banking & Branching Efficiency Act
1996 – Economic Growth & Regulatory Paperwork Reduction Act (EGRPRA)
1999 – Gramm-Leach-Bliley Act (GLB)

Issues – the ‘00s

2001 – International Money Laundering Abatement & Financial Anti-Terrorism Act
2001 – USA PATRIOTAcl
2002 – Sarbanes-Oxley Act
2003 – Fair & Accurate Credit Transactions Act (FACTA)
2003 – Check 21
2010 – Dodd-Frank Wall Street Reform & Consumer Protection Act (DFA)
Why Dodd-Frank??

- Housing Bubble Burst
- Default of subprime home loans
- Predatory lending
- Derivatives, Mortgage-Backed Securities, Collateral Debt Obligations

Some Dodd-Frank Points

- Increase in FDIC insurance coverage
- Creation of Bureau of Consumer Financial Protection (CFPB)
- Merge OCC & OTS
- Create “Prudential Supervision”
- Place most of mortgage markets under CFPB
- Revise debit card interchange fees
- Issue rules on swaps/derivatives
- Restrictions on employee compensation
- SEC rules on “Corporate Governance”
- Creation of Financial Stability Ownership Council (FSOC)
- “Systemic Supervision” of financial industry
Current decade???

- Aggressive Dodd Frank Act regulatory implementation stalled by a change in administration;
- Attempting to balance the pendulum- Passage of the Economic Growth, Regulatory Relief, and Consumer Protection Act;
- Increased Bank Secrecy Act requirements-
  - Operation Choke Point
  - On-going risk assessments
  - Customer Due Diligence and Beneficial Ownership.

Economic Growth, Regulatory Relief and Consumer Protection Act Highlights-

- Designates mortgages held in portfolio as Qualified Mortgages (limited to banks with less than $10 billion in assets);
- Rolls back HMDA expansion for banks originating 500 or fewer mortgage loans each year;
- Eliminates required HPML escrow for banks with less than $10 billion that originate 1000 or fewer first mortgage loans;
- Simplifies capital calculations for banks with less than $10 billion;
- Provides an exception for reciprocal deposits being considered “brokered deposits”;
- Provides for a short form Call Report for banks with $5 billion or less in assets.
Will History Repeat?

- What is the future of mortgage lending?
- Will the BCFP (CFPB) further regulate overdraft, add-on products, deposit fees?
- Will regulators delay bank mergers/sales?
- Will regulators recognize unfair ‘size’ competition?
- Will there continue to be a blurring between credit unions, farm credit & banks?
- Will a UDAAP violation be in the “eye of the beholder”?
- Will Congress continue to pursue structural changes for the BCFP(CFPB)?
- How will future Supreme Court decisions impact bank regulation?
- Will it ever start/stop raining? (The impact of weather on banking.)
- Where will technology take banking and when will laws/regulations catch up?
- How will bank litigation affect products and services?
- What can bank lobbyists actually do about any of the above?

The Uproar

Cause of uproar in banking laws/regulations:
- Technology
- Competition
- Changing customer patterns/demographics
- Public pressure
- Perception
The Role of the Bank’s Board

- Board must set the bank’s risk management “culture” & “tolerance.”
- Compliance risk must be included!

“A bank’s board of directors plays a critical role in the successful operation of the bank. The health of a bank depends on a strong, independent, and attentive board. Bank directors are ultimately responsible for the conduct of a bank’s affairs. They also are accountable to the bank’s shareholders as well as its depositors, regulators, and the communities served by the bank.”
- “OCC The Directors Book” Preface

Board of Directors and Executive Management Must Understand The Primary Compliance Risks:

- Financial
- Operational
- Reputational
- Competitive
What every director and executive officer should know the basics of:

- Operational - FCRA/Red Flags, HMDA, TIS, UDAAP;
- Financial - Insider Transactions/Ethics, Flood, Bank Security, TIL;
- Reputational - Fair lending, BSA/AML/OFAC, Employment Laws, Privacy, Overdraft Programs; and
- Competitive - CRA, RESPA.

Compliance hot spots?

- Cybersecurity;
- Vendor management;
- Regulatory uncertainty;
- Employee experience and training;
  - Bank Secrecy Act;
  - UDAAP/ Fair Lending;
- Failure to understand risk of products/services/locations.
On-going Risk Assessment is Key to Managing Compliance Risk:

- Measures the organization’s vulnerability;
- Lax policy enforcement, inadequate policy development or a complete lack of policy may create vulnerability;
- Risk assessments should be formalized and on-going, not informal and haphazard;
- Additional risk assessments should be used any time the financial institution introduces new products or lines of business and during any restructuring on a company-wide basis, as well as at the line-of-business level.

Litigation teaches us important lessons, such as:

- Poor decision-making can lead to BIG PROBLEMS!

- Bank located in Plains, Kansas- population of 1,000;
- Long-time customers, George and Agatha Enns (ages 69 and 67, respectively) from Meade, Kansas (pop. 1,700) allegedly laundered $6.8 million on behalf of La Linea, which was at one time the paramilitary enforcer wing of the Juarez drug cartel;
- Transactions took place 2011-2014, with many transactions being detected by the bank’s monitoring system;
- President, Cashier and Loan Officer indicted for multiple counts of failing to file Suspicious Activity Reports (and for the President, 29 counts of money laundering);
- President receives one-year probation, Cashier and Loan Officer receive diversion.

BSA Enforcement Actions –

- FinCEN; AML/BSA Penalty (2018)
  - U.S. Bank assessed a $185 million civil money penalty for willfully violating AML/BSA requirements.
    - Intentionally manipulated their software to cap the number of suspicious activity alerts against AML staff’s warning.
    - Inadequate devotion of resources and inadequate procedures to handle high-risk customers.
- U.S. Dept. of Treasury v. Haider; BSA-AML (2017)
  - Haider, the compliance officer for MoneyGram, agreed to pay $250,000 for related anti-money laundering violations due to the willful participation in MoneyGram’s failure to implement an effective AML program.
  - MoneyGram also paid $13 million in settlement claims.
Operations (Deposits)- Gutierrez et al., v. Wells Fargo Bank, N.A., 9th Circuit Court of Appeals (cert. denied) (2016)-

**Question:** Did the bank intentionally manipulate the payment order of items (paying high to low) in order to maximize fee income, and if so, was this an unfair and fraudulent business practice (under California law)?

**Holding:** District Court found in favor of plaintiffs:
- Paying high to low was not in the best interest of the customer because many of the items were “must pay” items and could not be returned, even if there was an overdraft;
- Federal preemption did not apply because it does not protect a national bank from a claim of bad faith or engaging in unfair or deceptive practices, nor did the bank consider the factors required for preemption to be effective.

Court found Wells Fargo liable for $203 million in restitution to customers. Wells Fargo Appealed. Ninth Circuit upheld in part and reversed in part. District Court reinstated $203 million in restitution. Wells Fargo appealed again. Ninth Circuit upheld District Court’s decision. Wells Fargo appealed to the U.S. Supreme Court, which denied to hear the appeal.


**Question:** Is a store’s website a “public accommodation” and therefore required to be accessible to visually impaired persons under the ADA?

**Holding:** The Court found that Winn-Dixie violated Gil’s, a visually impaired individual, rights under the ADA, and ordered Winn-Dixie and Gil to come up with an agreement/timeline to make its website accessible.

**Bottom Line:** This case reminds banks, as “public accommodations”, to provide an ADA accessible website.
Operations (IT)- ADA Website Litigation Carroll v. New People’s Bank, Case No. 1:17CV00044, E.D. Va, April 5, 2018

- Banks motion to dismiss plaintiff's ADA website claim as “moot” was granted because bank had already engaged a third party vendor to fix website accessibility programs.

Corporate activities- CFPB v. Wells Fargo Bank, N.A. (September 2016)

- Bank paid $142 million for widespread illegal banking practices, in which employees attempted to meet sales targets and compensation incentives;
- Violations included:
  - Opening deposits and transferring funds without authorization;
  - Applying for credit card accounts without authorization;
  - Issuing and activating debit cards without authorization; and
  - Creating phony email addresses to enroll consumers in online-banking services.
- CFPB and other regulators have warned that financial incentive programs must be monitored carefully.
CFPB reiterated need to monitor incentive programs to avoid harm to consumers; While incentive programs can attract and retain high performing individuals who can, in turn, be helpful for consumers, these programs can also create unattainable expectations, resulting in sales techniques that are detrimental to consumers through over aggressive marketing, sales, servicing or collection tactics;

Examples of potential problems:
- Sales goals encourage employees to, either directly or indirectly, open accounts or enroll consumers in services without knowledge or consent;
- Sales benchmarks may encourage deceptive marketing of products;
- Paying more compensation for some types of transactions than for others, which can encourage steering of consumers to inappropriate products;
- Unrealistic quotas to sign consumers up for financial services, without consent or by means of deception.

Banks expected to implement robust compliance management systems (CMS) in order to detect and prevent violations of consumer financial laws.

The CMS should include:
- Board of directors and management oversight;
- Policies and procedures that cover transparency, controls for managing risk, identification of potential conflicts of interest for supervisory personnel who are covered by the incentive, but are also responsible for quality of customer treatment/satisfaction;
- Training;
- Monitoring;
- Corrective action;
- Consumer complaint management program;
- Independent compliance audit.
**Lending- In Re Motors Liquidation Co. v. JP Morgan Chase Bank, N.A., 2nd Circuit Court of Appeals, Docket No. 13-2187 (2015)**

- **Question:** Is the unintentional release of a UCC-1 effective?

- **Holding:** Yes, if a secured party of record authorizes the filing of a UCC-3 termination statement, that filing is effective regardless of whether the secured party intended or understood the effect of that filing.
  - Court determined JP Morgan never intended to terminate the UCC-1 filings on the second loan; however, it did authorize the UCC-3 termination statement filing which released the collateral.
  - $1.5 billion loan left unsecured and GM subsequently filed bankruptcy.

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**Lending- Bank of America Corp. et al. v. City of Miami, U.S. Supreme Court, 2017 U.S. Lexis 2801, 137 S. Ct. 1296 (2017)**

- **Facts:** Miami claimed discriminatory lending led to, among other things, increased foreclosures, impaired racial integration, decreased property tax revenue.

- **Question:** Can a city sue for alleged financial harm resulting from discriminatory lending practice under the Fair Housing Act?

- **Holding:** Yes, a city does fall within the zone of interest that the FHA protects. The city is an “aggrieved person.”
  - Case was remanded to determine if there were sufficient facts to show that the city suffered a financial harm.
As part of the marketing-services-kickback scheme, Genuine Title offered loan officers valuable services to increase the amount of loan business generated. Genuine Title conducted this scheme at several financial institutions:

- The services the company offered included purchasing, analyzing, and providing data on consumers and creating letters with the banks’ logos that the company had printed, folded, stuffed into envelopes, and mailed;

- In return, the banks’ loan officers would increase Genuine Title’s profits by referring homebuyers to the company for closing services;

- This scheme was especially profitable for the loan officers, who generally are paid by commission.

Wells Fargo:

- The Bureau’s investigation identified more than 100 Wells Fargo loan officers in at least 18 branches, largely in Maryland and Virginia, who participated in this scheme;

- The Bureau alleges that these loan officers referred thousands of loans to Genuine Title over the course of the scheme. The Bureau alleges that, despite the fact that Wells Fargo had multiple warnings of the illegal arrangements between its loan officers and Genuine Title – including a federal lawsuit explicitly alleging the existence of such agreements – the bank failed to take action to stop the practices and did not have an adequate system in place to identify these violations;

- Wells Fargo required to pay $10.8 million in redress and $24 million in civil penalties.
JP Morgan Chase

- The Bureau alleges that at least six Chase loan officers in three different branches in Maryland, Virginia, and New York were involved;

- These officers referred settlement business to Genuine Title on almost 200 loans;

- The Bureau also alleges that Chase did not have an adequate system in place to ensure that its loan officers were following the law;

- Chase ordered to pay approximately $300,000 in redress and $600,000 in civil penalties.

The effect of “self-policing:”

- In addition to the loan officers at Wells Fargo and JPMorgan Chase, several loan officers at another financial institution also participated in the scheme with Genuine Title;

- While Wells Fargo and JPMorgan Chase did not identify or address the illegal conduct, that institution self-identified the problematic practices and terminated the loan officers involved;

- The institution also cooperated with the CFPB’s investigation and self-initiated a remediation plan. Based on the institution’s behavior, the CFPB has resolved that investigation without an enforcement action, consistent with the CFPB’s Bulletin on Responsible Business Conduct.
CFPB Bulletin 2013-06; June 25, 2013
Responsible Business Conduct: Self-Policing, Self-Reporting, Remediation, and Cooperation

“A party may proactively self-police for potential violations, promptly self-report to the Bureau when it identifies potential violations, quickly and completely remediate the harm resulting from violations, and affirmatively cooperate with any Bureau investigation above and beyond what is required. If a party meaningfully engages in these activities, which this bulletin refers to collectively as “responsible conduct,” it may favorably affect the ultimate resolution of a Bureau enforcement investigation.”

Lending Enforcement Actions (2017) –

- Pastor v. Bank of America; $1.65 million to affected customers for the unauthorized pulling of credit reports, in violation of FCRA, when the customers had zero balance accounts, accounts had been discharged in bankruptcy, or accounts had been sold to third party;

- In re: Peoples Bank ($865 million in assets); $2.8 million to Federal Reserve (penalty) for charging discount points, but not providing lower rates.

- **Question:** Does the Business Judgment Rule provide protection for claims against officers and directors who act in the best interests of the company, in good faith, with the care that a reasonably prudent person would use, and with a reasonable belief that they are acting in the best interests of the bank?

- **Answer:** Yes. However, the Court found that the officers of the bank appeared to have acted in a grossly negligent manner, and therefore the Business Judgment Rule’s requirements may not have been met. The case was remanded to the lower court for a hearing on the officers’ actions.

**Why?**

- Bank’s leadership approved a growth strategy (focusing on commercial real estate lending) to go from $443 million to $1 billion in just a few years;

- Senior leadership approved 86 commercial loans from January 2007 and April 2008, of “questionable quality;”

- Bank failed in 2009;

- FDIC found that 66% of the money lent through the aggressive lending program was lost;

- Bad loan losses caused the FDIC (as insurer) $216 million;

- FDIC alleged that managers specifically ignored or acted counter to prior warnings from regulators regarding improper loan underwriting.