CLIENT UPDATE

THE RISE IN FOREIGN BANK ENFORCEMENT ACTIONS IN NEW YORK

NEW YORK
Eric R. Dinallo[1]
edinallo@debevoise.com

Paul L. Lee
pllee@debevoise.com

Gregory J. Lyons
gjlyons@debevoise.com

Paul D. Patton
pdpatton@debevoise.com

Philip A. Fortino
pafortino@debevoise.com

Eric P. Alpert
epalpert@debevoise.com

WASHINGTON, D.C.
Satish M. Kini
smkini@debevoise.com

The enactment and ongoing implementation of Dodd-Frank understandably has consumed much of the attention of the US and foreign banking communities over the past several years. Significant regulatory and supervisory developments also have been occurring at the state level, however. Particularly since the financial crisis, states have become increasingly active in enforcing state and in some cases federal law, especially if they believe that federal regulators are not acting forcefully or quickly enough to address perceived problems.

Regulatory changes in New York, home to approximately 90 percent of foreign bank assets in the US, should be of particular relevance to the foreign banking community.[2] The New York Department of Financial Services ("DFS"), which since its creation in 2011 has overseen both banking and insurance operations, and the New York Office of the Attorney General ("OAG") each have brought high-profile enforcement actions against both the state-licensed branches of foreign banks and New York state-chartered banks (in the case of DFS) and federally-chartered banks (in the case of the

---

1 Mr. Dinallo previously was a bureau chief of the New York Attorney General's office and Superintendent of a predecessor to DFS.

2 *Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks*, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM http://www.federalreserve.gov/econresdata/releases/assetliab/current.htm

OAG). Even foreign banks not subject to enforcement actions have reported enhanced examination activity, as well as informal and formal inquiries, by DFS. Many of these inquiries and actions relate to traditional US "hot buttons," like the adequacy and effectiveness of Bank Secrecy Act ("BSA") and anti-money laundering ("AML") compliance programs and US sanctions programs administered by the Office of Foreign Assets Control ("OFAC"),[3] as well as consumer and small business protection. Other inquiries and actions are derivative of the actions of foreign regulators.

In light of recent enforcement activity, many foreign banks have questions about the structure of DFS and the OAG and their apparently more aggressive approach. This article first outlines the jurisdiction of DFS and the OAG and the general approach of the latter agency. The second section provides greater insight into how both increased enforcement authority (by virtue of statutory changes) and an increased enforcement mindset (by virtue of ex-OAG staff now populating senior levels of DFS) have caused DFS to become more proactive in enforcement. Recent DFS actions have shown that it will not be content to follow, or even stand beside, other state, federal or international regulators. Rather, DFS plainly intends to engage in "healthy competition in financial regulation"[4] by acting preemptively to address perceived issues and establish remediation frameworks designed to serve as models for compliance enforcement nationally and internationally.

Based on the types of actions arising with DFS and our experience in these matters with both DFS and the OAG, in the final section we provide some practical guidance to foreign banks with state licenses or charters on how to minimize the likelihood of adverse effects from this DFS transformation. In sum, the enhanced enforcement authority and mindset of DFS requires foreign banks with New-York-licensed branches and banks to take seriously all inquiries and actions of DFS. Indeed, DFS now appears at least as likely as federal regulators to bring public, costly claims against these institutions in order to fulfill its Superintendent's stated objective of "shin[ing] a spotlight wherever we think it needs shining."[5]

---

3 Indeed, evidencing the strong global focus on these issues, on June 27, 2013 the Basel Committee on Banking Supervision released a Consultative Document entitled "Sound management of risks related to money laundering and financing of terrorism" (June 2013) discussing the "serious risks" inherent in this area.

4 Superintendent of Financial Services Benjamin M. Lawsky, Remarks at the 22nd Annual Hyman P. Minsky Conference on the State of the U.S. and World Economies in New York City (Apr. 18, 2013) ("Superintendent Lawsky's April Speech").

5 Superintendent Lawsky's April Speech.

THE NEW YORK ENFORCEMENT FRAMEWORK AND THE ROLE OF THE OAG

New York has two primary agencies able to bring enforcement actions against the banking industry—DFS and the OAG. The enforcement authority and approach of DFS is more fully described in the next section, but its oversight and enforcement authority is generally limited to state-licensed branches or agencies and state-chartered bank subsidiaries of foreign banks. In addition, DFS' authority to commence an administrative enforcement proceeding likely is preempted in the case of proceedings against federally chartered banks.

The re-affirmation by the Office of the Comptroller of the Currency ("OCC") after Dodd-Frank that it alone generally has "visitorial powers" over federally-chartered institutions largely precludes DFS from examining and bringing administrative enforcement actions against the federal branches and agencies and federally-chartered bank and thrift subsidiaries of foreign banks. As is discussed in the next section, however, DFS does have express authority to refer possible actions to the OAG and other agencies.

Unlike DFS, which pursues enforcement actions through a state administrative process that is subject to preemption in the case of a federal charter, the OAG may enforce laws in judicial proceedings.[6] As a result, the OAG may bring enforcement actions against both federally chartered banks or federally licensed foreign banks and state-chartered banks or state-licensed foreign banks in the State of New York. The OAG has brought a number of high-profile cases against both state and federal banking institutions, either because of issues arising elsewhere or because of the ability of DFS to refer information to the OAG.

One recent example of the OAG's enforcement authority with respect to subsidiaries of foreign banks is its action against HSBC Bank USA (a national bank) and HSBC Mortgage Corporation (collectively, "HSBC") alleging improper foreclosure practices.[7] The OAG brought the action under Executive Law Section 63(12), which is not a banking law but nonetheless empowers the agency to seek relief when any entity has "engage[d] in repeated fraudulent or illegal acts or [has] otherwise demonstrate[d] persistent fraud or illegality in the carrying on, conducting or transaction of business." The case is pending, with an appearance scheduled for late July 2013.

The HSBC case is the most recent of a long list of high-profile actions by the OAG against federal and state banking institutions with a presence in New York. For example, the OAG

---

6 *See, e.g.*, 12 CFR 7.4000(b).

7 *People v. HSBC Bank USA, National Association, and HSBC Mortgage Corporation (USA)*, Index No. 2013-1660 (N.Y. Sup. Ct. 2013).

was a signatory to the National Mortgage Settlement, yet still sued three national banks separately for foreclosure-related activities that had been carved out of the national settlement. In our experience defending some of these cases, we have found the OAG to be aggressive and willing to act independently and creatively, particularly in connection with mortgage-related issues.

Given the changes in DFS described below, experience with the OAG now provides a useful reference point as to both the increased occurrences of, and possible responses to, DFS inquiries and enforcement actions.

THE NEW ENFORCEMENT POWERS AND MINDSET OF DFS

Structural Changes and New Powers

For over 150 years, the New York State Banking Department ("Banking Department") and the New York Insurance Department ("Insurance Department") co-existed as separate agencies regulating and enforcing laws concerning their respective industries. The enactment of the state Financial Services Law ("FSL") in 2011 changed this longstanding bifurcated regime by merging the Banking and Insurance Departments under a new umbrella agency, DFS.

The FSL also ushered changes in oversight to state-regulated financial institutions far beyond merging the two agencies. It granted DFS enforcement authorities unavailable to either of its predecessor agencies. Among other things, the FSL created a new sub-department of DFS called the Financial Frauds and Consumer Protection Division ("FFCPD"), which succeeded to the powers of the Insurance Frauds Bureau and the Criminal Investigations Bureau of the Insurance Department and the Banking Department, respectively, as well as obtaining brand new enforcement authorities. The stated mission of DFS is to "reform the regulation of financial services in New York to keep pace with the rapid and dynamic evolution of these industries, to guard against financial crises, and to protect consumers and markets from fraud."[8] In pursuing its mission, the Superintendent, acting through the FFCPD, is empowered to:

- "investigate" when it has a reasonable suspicion that there has been a violation of the banking law, insurance law or other applicable laws;[9]
- "assist" any other entity in the investigation involving a violation of law;[10] and

---

8 *Mission*, NEW YORK DEPARTMENT OF FINANCIAL SERVICES, http://www.dfs.ny.gov/about/mission.htm

9 N.Y. Fin. Serv. Law § 404(b).

- in addition to any civil or criminal penalty provided by law, impose civil money penalties for any (i) intentional fraud or intentional misrepresentation of a material fact with respect to a "financial product or service," (ii) violation of state or federal fair debt collection practices or fair lending laws and (iii) violation of the FFCPD's authorizing chapter or implementing regulations.[11]

These authorities are subject to the caveat that penalties applicable to regulated persons under the banking or insurance law are left unchanged.[12] In effect, these provisions merely enhance, rather than constrain, the authority granted to the FFCPD. Thus, the FSL provides DFS ample authority to pursue perceived wrongs and protect New York businesses and citizens.

Staffing and Approach

At least as important as DFS' new structure and powers is the enforcement background and mindset of DFS' senior personnel. The Superintendent of DFS, Benjamin M. Lawsky, previously served as the deputy counselor and special assistant to then Attorney General (now Governor) Andrew Cuomo. Prior to that time, Superintendent Lawsky was an assistant US attorney in the Southern District of New York. Moreover, the DFS general counsel and the heads of four major divisions of DFS (Financial Frauds and Consumer Protection, Capital Markets, Banking and Insurance) all at one time served in the OAG.

In addition to the deputy superintendents' enforcement credentials, many of the other senior DFS staff are OAG veterans. In the aggregate, this staff brings a perspective honed by the expansive scope of proactive, independent enforcement activity developed by the OAG in the Spitzer and Cuomo eras, including a willingness to bring enforcement actions in areas previously thought to be directed by federal agencies. Indeed, during these eras, the OAG prided itself on its capacity to bring innovative claims to pursue issues that federal authorities purportedly either missed or were slow in enforcing.

That DFS has fully adopted this OAG proactive enforcement mindset perhaps first became clear in a far-reaching April 2013 speech by DFS Superintendent Lawsky.[13] Near the outset of the speech, he praised the "deep well of institutional knowledge and expertise" possessed by the federal bank regulators. However, he then raised the concern that "[i]nstitutional inertia can stymie even the most well-intentioned of watchdogs," and

---

10 N.Y. Fin. Serv. Law § 404(b).

11 N.Y. Fin. Serv. Law § 408(a)(1) – (2).

12 N.Y. Fin. Serv. Law § 408(a)(3).

13 Superintendent Lawsky's April Speech.

highlighted that a "key attribute of DFS" is that "We're nimble. And we're agile. And we're able to take a fresh look at issues across the financial industry – both new and old." Superintendent Lawsky then praised DFS' ability to "take swift action" to address bank practices that may threaten the economy, to "move rapidly to right [the] wrongs" if consumers are being abused, and to take those actions even if "that means DFS may be out in the lead on a particular issue." The next section demonstrates how the former members of OAG now leading DFS have quickly and forcefully put the enforcement mantra of this speech into practice.

DFS Enforcement Approach in Practice

As is detailed below, DFS has shortly after its formation adopted an enforcement approach similar to the OAG. As is described in the final section, this suggests the need for a strong, proactive response to DFS inquiries similar to that which banks historically have used to respond to OAG actions.

Use of Aggressive Enforcement Measures and Eagerness to Be an Enforcement "First Mover"

In September 2012, DFS settled a claim against Standard Chartered Bank ("SCB") principally relating to transactions settled at the bank's New York branch that DFS alleged violated US economic and trade sanctions programs. DFS threatened SCB with the agency's ultimate weapon, the revocation of the license of the bank's New York branch.[14] The revocation of this license could have had a cataclysmic effect on SCB's role as a major international correspondent bank. And as to the penalty, in addition to requiring SCB to take actions to further enhance its BSA/AML and OFAC compliance procedures at the New York branch, DFS required a monetary payment of $340 million, a settlement amount more than tripling that received by the Federal Reserve Board ("FRB").[15]

Nonetheless, while the enforcement threat and fine both serve as testimony to the heightened enforcement mentality of DFS, the SCB case is perhaps even more noteworthy for other foreign banks because of the process DFS employed in obtaining the settlement. It was reported that DFS and federal regulators were initially in talks "aimed at presenting a united front" against SCB.[16] These discussions, however, did not preclude DFS' own enforcement action, nor did DFS defer to a coordinated settlement with federal regulators.

---

14 *In re Standard Chartered Bank, New York Branch*, Order Pursuant to Banking Law § 39, August 6, 2012.

15 *In re Standard Chartered Bank, New York Branch*, Order Pursuant to Banking Law § 44, September 21, 2012.

16 Liz Rappaport, Max Chochester, Damian Paletta, *Regulators Seek Unity in U.K. Bank Talks*, THE WALL STREET JOURNAL, August 10, 2012.

In his April 2013 speech, Superintendent Lawsky confirmed that the concerns raised by some about the preemptive action by DFS would not deter similar future action, stating that "Initially, there was what we believed to be a misplaced focus on the fact that DFS had acted more quickly, more robustly, and more independently than some people were used to from a state bank regulator…Ultimately, though, we certainly stimulated a debate nationally and internationally on this issue."[17] Superintendent Lawsky's speech, and the subsequent DFS enforcement actions, make clear that DFS remains undeterred by the substantial controversy caused by its go-it-alone approach. The SCB enforcement action also evidences that BSA/AML and OFAC controls will be particular sources of DFS focus with foreign banks.

Broad Interpretation of Statutory Authority to Set New Standards

Last month, DFS reached a settlement with Deloitte Financial Advisory Services LLP ("Deloitte FAS") arising out of Deloitte FAS' engagement with SCB concerning AML compliance issues at the bank's New York State branch.[18] Notably, in a different, earlier matter, the OCC had tried to bring an action against a bank consulting firm but had failed due to the court's finding that it lacked jurisdiction.[19]

Demonstrating its willingness to be aggressive in its application of law, it is reported that DFS "seized upon an obscure state banking law to try to compel changes" in the financial consulting industry.[20] That law could have precluded consultants from obtaining regulatory documents necessary to perform their underlying services. Deloitte FAS ultimately agreed to a commitment to a new DFS- and Deloitte FAS-developed framework applicable to consultants in bank engagements, which DFS intends to be a national model; a short-term voluntary abstention from engagements that would require DFS to approve Deloitte FAS as an independent consultant while Deloitte FAS implements the new framework; and a monetary payment of $10 million.[21] Superintendent Lawsky had presaged both the expansive use of DFS authority in this case and the agency's far reaching objectives in this area in his April 2013 speech in which he stated: "You will likely see some

---

17 More generally, Superintendent Lawsky's April Speech.

18 In re *Deloitte Financial Advisory Services LLP*, Agreement Pursuant to Banking Law § 36.10 and Financial Services Law § 302(a), June 18, 2013.

19 *Grant Thornton v. Office of the Comptroller of this Currency*, 514.F.3d 1328 (D.C. Cir. 2008).

20 Ben Protess and Jessica Silver-Greenberg, *Regulators Are Divided Regarding Consultants*, N.Y. TIMES, June 18, 2013.

21 Perhaps encouraging DFS to continue to pursue such far-ranging objectives, last month Senator Brown sent a letter to Chairman Bernanke and Comptroller Curry urging them to adopt financial consultant reforms similar to those now required in New York. Letter from Sherrod Brown, United States Senator, to Benjamin Bernanke, Chairman, Board of Governors of the Federal Reserve and Thomas Curry, Comptroller of the Currency, Office of the Comptroller of the Currency (June 21, 2013), *available at* http://www.brown.senate.gov/newsroom/press/release/brown-calls-on-federal-regulators-to-enact-standards-to-increase-oversight-of-independent-consultants-work-for-financial-services-industry

innovative initiatives from DFS in the [independent consultant] area in the coming weeks and months. And we expect that those actions will help propel reform at both the state and federal levels."[22]

Revisiting and Increasing Penalties Previously Issued by Federal Regulators

DFS also showed last month a willingness to revisit and impose greater penalties than those previously issued by federal regulators concerning alleged OFAC violations, perhaps in pursuit of what Superintendent Lawsky referred to as a "recalibration of the regulatory playing field going forward in this area." The Bank of Tokyo-Mitsubishi UFJ, Ltd ("BTMU") last year agreed to remit $8.6 million to settle alleged violations during 2006 and 2007 of various sanctions and an Executive Order. This year, DFS revisited the issue and, employing a broader scope under state law,[23] required BTMU to make a monetary payment to DFS of $250 million as well as to take certain actions enhancing its compliance procedures.[24] The combined amounts collected by DFS in the SCB case, discussed above, and the BTMU case amount to more than half a billion dollars, a quantum change from the past and a significant amount for any regulator, state or federal.

Pursuit of Issues Raised by Other Banking Agencies

DFS also has demonstrated a willingness to "mine" the work of other bank regulators to pursue its own investigations in New York. In this regard, we are aware of DFS inquiries to foreign banks largely derivative of corresponding inquiries by home country regulators outside the US.

On the whole, these enforcement actions all support a singular proposition: while DFS may look to other regulators' investigations for source material for possible enforcement actions (be they foreign or domestic), DFS does not feel constrained to follow their paths in reaching settlements. Rather, these actions, all taken shortly after its formation, demonstrate that DFS will continue along the more proactive enforcement path charted by the OAG during the Spitzer and Cuomo eras, and therefore it should be expected to continue to independently, creatively and aggressively enforce New York and other laws on foreign banks subject to its jurisdiction or (with the assent of the OCC) influence.

---

22 Superintendent Lawsky's April Speech.

23 Jeff Horwitz and Maria Aspan, *Global Ripple Effect of N.Y. Action Against Japan Bank*, AMERICAN BANKER, June 21, 2013.

24 *In re Bank of Tokyo-Mitsubishi UFJ, Ltd., New York Branch*, Order Pursuant to Banking Law § 44, June 19, 2013.

SUGGESTED GENERAL APPROACHES TO ENGAGING WITH DFS

In light of the foregoing, a foreign bank with a US presence, particularly a state-licensed branch or bank presence, now would be well-advised to provide DFS at least equal consideration as the FRB. Each situation is unique, and approaches to DFS must be tailored appropriately. Nonetheless, in light of our experience and negotiation of settlements with DFS, and our representation of several banking clients before the OAG, we offer the following general guideposts to assist foreign banks in navigating the new, more proactive New York regulatory environment.

On a day-to-day basis

Recognize that DFS expects a state branch or bank to consider it as co-equal with your US federal bank regulator, and evaluate broadly circumstances where engaging DFS may be appropriate. For example, many foreign banks with branches or state-chartered bank subsidiaries in New York are subject to the federal "living will" requirements. Dodd-Frank and its implementing regulations only require FRB and Federal Deposit Insurance Corporation involvement in this process. However, because New York law governs what happens to a state branch or agency when stress arises and will undoubtedly play an important role in the resolution of a New-York-chartered branch or agency of a foreign bank, senior DFS officials have informed us that they expect to be consulted about a foreign bank's living will during the process and believe that their input ultimately will be critical to the establishment of a "credible" living will. This type of engagement also permits a greater dialogue with DFS as to its expectations of those under its jurisdiction.

During Examinations

Many of our foreign bank clients are reporting a heightened DFS focus on branch examinations. DFS does not have a separate examination manual, but rather generally follows the approach of the FRB. This argues in favor of carefully reviewing recent FRB exam findings and "hot topics," and preparing to discuss any issues. As Superintendent Lawsky's statements and recent DFS enforcement actions demonstrate, BSA/AML and OFAC are issues of particular agency scrutiny.

The DFS exam process is, however, at least as important as its substance. Unlike with a FRB exam, senior DFS personnel have an enforcement background. Well-intentioned but imprecise comments in response to agency inquiries therefore are much more likely to have negative ramifications. Similar to an OAG investigation, careful review and preparation of materials prior to an examination, and centrally reviewed and provided responses during the examination, are likely to lead to the most satisfactory results.

If Inquiries/Enforcement Actions Arise

Given DFS' actions to date, almost any inquiry should be treated as having the potential to lead to an enforcement action. This means that significant time and attention should be given to what may at first appear to be relatively routine or benign inquiries. We generally first suggest a thorough internal inquiry to determine whether any potential violation exists, and if so, any defenses that may be available. Assuming a concern exists that in fact raises the possibility of an enforcement action, then in our experience the process most likely will proceed much like an OAG negotiation. Handling any matter with extreme care from the outset is critical to minimizing the potential of reputation-damaging, expensive public DFS actions.

CONCLUSION

Changes in law, structure and personnel have resulted in DFS having an enhanced enforcement agenda, more akin to the OAG than its predecessor agencies. Not surprisingly, after a brief transition period, DFS has been involved in many high-profile banking enforcement actions. In our experience with DFS and the OAG, a heightened sensitivity to DFS (as well as the OAG) involvement and compliance is necessary to minimize the risk of an expensive enforcement action, both in terms of finances and reputation, in this new environment.

* * *

Please do not hesitate to contact us with any questions.

July 1, 2013