

# Client Update The Outlook in Enforcement Actions against Foreign Banks at the New NYDFS

**NEW YORK**

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On June 15, Maria Vullo was confirmed as the new Superintendent of the New York State Department of Financial Services (“NYDFS”), solidifying the first permanent change in leadership at the agency. Since the departure last summer of former Superintendent Benjamin Lawsky, the financial services industry has been watching carefully to see whether, under a new Superintendent, NYDFS will continue with the same enforcement orientation it has become known for, or whether it will adopt a different approach towards supervised institutions. Although Ms. Vullo’s leadership brings the potential for change, there are also indications that the agency may maintain the stance that was the hallmark of Mr. Lawsky’s tenure.

This Client Update reviews NYDFS’ enforcement framework, along with some of the most significant actions taken under the leadership of Mr. Lawsky, outlines the changes that the agency has undergone since Mr. Lawsky stepped down in 2015, and considers how Ms. Vullo’s confirmation as Superintendent will shape agency policy concerning foreign banks. Finally, while each institution’s experience deserves unique focus, based on our extensive experience with the NYDFS, including having a partner who formerly served as Superintendent of its predecessor, this Client Update provides certain recommendations to NYDFS-regulated institutions to reduce enforcement risk.

**NYDFS ENFORCEMENT FRAMEWORK**

Since the NYS Banking and Insurance Departments were combined in 2011 to form the NYDFS, the agency has established itself as an aggressive, independent regulator. In 2013, we published a Client Update describing NYDFS’ enforcement framework, new statutory authority, and the increasingly enforcement-focused mindset of the agency. There, we commented on some of the main reasons we

believed that foreign banks should be sensitive to the regulatory authority and efforts of NYDFS, including the unique enforcement tools available to the agency, the policy statements made by Superintendent Lawsky, the high profile actions that NYDFS initiated between 2011 and 2013, and the fact that many NYDFS leaders had prior careers at the New York Office of the Attorney General (“OAG”). Based on these factors, we believed that NYDFS would quickly become an aggressive financial regulator.

NYDFS did not disappoint: From 2011 to 2015, the agency imposed \$6 billion in fines and penalties.<sup>1</sup> The enforcement actions underlying this figure were largely against foreign banks or associated entities, and NYDFS not only imposed fines on these institutions, but ordered suspensions, reforms to policies and procedures, and also mandated the termination or separation of multiple high-level employees. For example, NYDFS required a number of banks to review and update their Bank Secrecy Act and anti-money laundering (“BSA/AML”) compliance programs, including retaining independent consultants. It also, consistent with Superintendent Lawsky’s advocacy for “new and creative corporate penalties,”<sup>2</sup> suspended two consulting firms from accepting engagements at financial institutions regulated by NYDFS for periods of time—one, for two full years. It instructed multiple institutions to terminate heads of departments or compliance divisions, and promoted the resignation of the Executive Chairman of a major mortgage servicer.<sup>3</sup> Significantly, NYDFS took some of the more noteworthy actions without coordinating with federal regulators, indicating its intent to be a first mover among enforcers. The NYDFS has been so aggressive in pursuing monetary penalties against foreign banks that it has occasionally butted heads with the OAG, as the two agencies have adopted divergent enforcement strategies.<sup>4</sup>

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<sup>1</sup> Greg Farrell, *Vullo Nomination Signals Shift at N.Y. Dept. of Financial Services*, BLOOMBERG NEWS, Jan. 25, 2016.

<sup>2</sup> Remarks of Superintendent Benjamin M. Lawsky on Fin. Regulatory Enforcement at the Exchequer Club, Washington, D.C. (Mar. 19, 2014).

<sup>3</sup> New York Department of Financial Services, Press Release, *NYDFS Announces Ocwen Chairman to Resign from Firm and Related Companies; Ocwen to Provide Direct Homeowner Relief and Undertake Significant Operational Reforms* (Dec. 22, 2014).

<sup>4</sup> See Karen Freifeld & Aruna Viswanatha, *Cuomo Intervened in BNP Deal to get \$1 Billion More for NY State Fund*, REUTERS, July 30, 2014 (detailing several instances in which the NYDFS threatened to withhold its consent to settlement agreements in order to procure larger monetary penalties for the state).

NYDFS has also demonstrated its focus on wide-ranging reform through regulatory and examination requirements. As part of its efforts to improve cyber security across the financial services industry, in 2014, NYDFS incorporated new cyber security questions into its examination process.<sup>5</sup> These new questions require financial institutions to provide information about the Security Officers employed at their firms, the due diligence process employed in selecting and monitoring third-party service providers, any significant changes to the institution's IT portfolio over the previous 24 months, and a host of other topics that must be addressed as part of the new cyber security examination process.<sup>6</sup> Particularly for foreign banks with a larger NYC presence, it has also significantly expanded the exam process and duration. In addition, as detailed in another Client Alert,<sup>7</sup> NYDFS announced a proposed rule in 2015 that would require all banks chartered or licensed under the New York Banking Law to install a Transaction Monitoring Program and a Watch List Filtering Program as part of their compliance programs, and would also require Chief Compliance Officers to submit annual certifications verifying that the bank's compliance program accords with statutory and regulatory requirements. This final requirement of the proposed rule would subject Compliance Officers to criminal liability if they filed an "incorrect or false" Annual Certification, and it reflects the agency's push to assign personal liability when banks fail to comply with BSA/AML requirements.

Much of this activity by NYDFS is attributable to the efforts of Benjamin Lawskey himself, who regularly spoke out in support of the agency's path-making approach to banking regulation.<sup>8</sup> He directed regulators "to take a good, long, hard look in the mirror and ask whether *we* are part of the problem,"<sup>9</sup> and admonished that they "should not just be rubber stamps."<sup>10</sup> He also refused to

<sup>5</sup> Memorandum from the N.Y. Dep't of Fin. Servs. on New Cyber Security Examination Process (Dec. 10, 2014).

<sup>6</sup> *Id.*

<sup>7</sup> See Satish M. Kini & David O'Neil, et al., Debevoise & Plimpton [Client Update](#), *NYDFS Proposes New Anti-Money Laundering Requirements, Liability for Compliance Officers* (Dec. 7, 2015).

<sup>8</sup> Remarks of Superintendent Benjamin M. Lawskey at the New York Bankers Association Annual Meeting and Economic Forum in New York City (Feb. 12, 2014).

<sup>9</sup> Remarks of Superintendent Benjamin M. Lawskey on Fin. Regulatory Enforcement at the Exchequer Club, Washington, D.C. (Mar. 19, 2014).

<sup>10</sup> Excerpts from Sup. Lawskey's Remarks on Non-Bank Mortgage Servicing in New York City (Feb. 12, 2014).

move at what he perceived to be the slower pace of federal regulators, and instead took the view that “healthy competition”<sup>11</sup> was appropriate in financial regulation.<sup>12</sup> His approach earned him a reputation as the “toughest cop on Wall Street”<sup>13</sup> and the driving force behind the agency’s efforts to exceed federal regulation of foreign banks.<sup>14</sup>

In May 2015, Mr. Lawsky announced his decision to step down, setting off intense speculation as to the future of the agency that he had shaped.

### TURNOVER AND UNCERTAINTY AT NYDFS

Mr. Lawsky’s resignation was followed by a wave of other departures. During a six-month period in 2015, six other senior staffers also left NYDFS—including the Chief Legal Officer and the Executive Deputy Superintendent for Insurance.<sup>15</sup> Mr. Lawsky’s immediate successor, Acting Superintendent Anthony Albanese, resigned shortly after taking office, along with the chief spokesman for NYDFS, amid reported disagreements with the Governor’s office.<sup>16</sup>

At the same time, the criticisms leveled against NYDFS for its aggressive approach<sup>17</sup> were supplemented with calls for a new leadership that would take a

<sup>11</sup> Remarks of Superintendent Benjamin M. Lawsky at the 22nd Annual Hyman P. Minsky Conf. on the State of the U.S. and World Economies in New York City (Apr. 28, 2013).

<sup>12</sup> Remarks of Superintendent Benjamin M. Lawsky 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).

<sup>13</sup> David Dayen, *The Toughest Cop on Wall Street You’ve Never Heard Of: How Benjamin Lawsky’s making big banks pay*, NEW REPUBLIC, Apr. 16, 2014, at <https://newrepublic.com/article/117377/benjamin-lawsky-toughest-cop-wall-street>.

<sup>14</sup> See Robert Anello, *A Small Barracuda in a Big Pond: New York’s Department of Financial Services*, FORBES, Feb. 26, 2015 (depicting Mr. Lawsky as the driving force behind DFS enforcement actions), and Christopher Matthews, *New York State Bank Regulator Lawsky Likely to Leave Post Next Year*, WALL ST. J., Nov. 11, 2014 (describing Mr. Lawsky as “New York state’s top banking regulator and one of Wall Street’s most dogged pursuers”).

<sup>15</sup> Matthew J. Gaul, *New York Governor Andrew Cuomo Names Anthony Albanese Acting Superintendent of Financial Services*, Lexology, June 12, 2015, at <http://www.lexology.com/library/detail.aspx?g=ec580666-f7b9-463e-89a7-aa481f682d6f>.

<sup>16</sup> Erica Orden & Christopher Matthews, *New York Bank Regulators Exit After Clash with Governor Cuomo’s Office*, WALL ST. J., Oct. 26, 2015.

<sup>17</sup> *Id.* See also Erica Orden, *N.Y. Gov. Andrew Cuomo Nominates Former Aide as Banking Regulator*, WALL ST. J., Jan. 21, 2016 (explaining that the Cuomo administration has faced pressure to relax its oversight of the financial and insurance industries).

more conciliatory approach with supervised institutions by someone who “doesn’t think of themselves as a prosecutor or an enforcement agent.”<sup>18</sup> In addition, during this period, those in the banking industry increasingly appealed to the Governor’s office directly when they received an adverse ruling or pronouncement from NYDFS, and some suggested that the Governor’s office was taking a more active role in overseeing the agency’s enforcement actions.<sup>19</sup>

### SUPERINTENDENT MARIA VULLO AND THE FUTURE OF NYDFS

On January 21, 2016, Governor Andrew Cuomo nominated Maria Vullo to serve as the second Superintendent for NYDFS,<sup>20</sup> potentially providing the agency with a chance to re-frame its goals and relationship with the industry, and work more effectively with the Governor’s office in developing regulatory policy. Ms. Vullo has enjoyed a distinguished career in private practice at Paul, Weiss, Rifkind, Wharton & Garrison, LLP, where she represented a wide variety of corporate clients in the firm’s White Collar & Regulatory Defense practice group, including some financial institutions that are currently regulated by NYDFS.<sup>21</sup> Ms. Vullo also has prior government experience, overseeing the Economic Justice Division in the OAG during Governor Cuomo’s tenure as Attorney General.<sup>22</sup> While at the OAG, Ms. Vullo brought actions against a hedge fund manager and an investment management company for alleged fraud relating to Bernard Madoff’s Ponzi scheme, and against a large consulting company for losses to investors resulting from the bankruptcy of Lehman Brothers.<sup>23</sup> In her confirmation hearings before the New York State Senate, Ms. Vullo proved to be an experienced and knowledgeable attorney, as she outlined her goals for

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<sup>18</sup> Quote from Kathryn Wylde, President of Partnership for New York City in Christopher Matthews and Erica Orden, *With New York Bank Regulator in Flux, Wall Street Seeks Softer Touch*, WALL ST. J., Dec. 18, 2015.

<sup>19</sup> *Supra* note 16.

<sup>20</sup> Office of the Governor, Press Release, *Governor Cuomo Nominates Maria Vullo as Superintendent of New York State Department of Financial Services* (Jan. 21, 2016).

<sup>21</sup> Suzanne Barlyn & Karen Freifeld, *New York Has a New Top Financial Regulator*, BUSINESS INSIDER, Jan. 21, 2016.

<sup>22</sup> *Supra* note 20.

<sup>23</sup> *Supra* note 20.

regulating financial services such as online lending, subprime auto lending, and check cashing.<sup>24</sup>

Despite her prosecutorial experience, much of the attention surrounding Ms. Vullo's appointment has centered on her work defending large corporate clients. Many suggest that this experience will make her—and, by extension, the agency—more sensitive to the difficulties that financial institutions encounter in complying with evolving regulatory requirements, and that, as a result, NYDFS will bring fewer or less severe enforcement actions.<sup>25</sup> Some have also suggested that, since Ms. Vullo has close professional ties with Governor Cuomo, her appointment as Superintendent indicates that NYDFS will be more susceptible to oversight from the Governor's office.<sup>26</sup> Finally, some have speculated that Ms. Vullo's appointment represents an attempt by Governor Cuomo to redefine the relationship between NYDFS and other regulators and prosecutors, some of whom bristled at the agency's headline-grabbing actions.<sup>27</sup>

Although Ms. Vullo's background gives reason to anticipate significant changes at the agency, including a new approach to enforcement, the result for financial institutions is likely to be mixed. There are a variety of indications that NYDFS will continue some of Ben Lawsky's approach under Ms. Vullo's leadership.

First, the agency has added several federal prosecutors since Ms. Vullo's appointment was announced. The new General Counsel of NYDFS, Celeste Koeleveld, spent nearly two decades at the United States Attorney's Office for the Southern District of New York and served as Chief of the Criminal Division and Chief Appellate Attorney while there.<sup>28</sup> The new Executive Superintendent for Enforcement, Matthew Levine, served as an Assistant U.S. Attorney in the

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<sup>24</sup> New York Senate Standing Committee, Banks Meeting (June 8, 2016).

<sup>25</sup> See Tanaya Macheel, *Women in Banking: PwC's High-Heel Hullabaloo; Maria Vullo's Wait*, AMERICAN BANKER, May 13, 2016 (speculating that Ms. Vullo will take a more conciliatory approach to enforcement actions).

<sup>26</sup> See Jimmy Vielkind, *Cuomo Nominates Ex-Aide to Head Department of Financial Services*, POLITICO, Jan. 21, 2016 (suggesting that Ms. Vullo was selected in part for her ability to accommodate management direction from the Governor's office).

<sup>27</sup> Ben Protess, *Cuomo Picks Maria Vullo as State's Top Financial Watchdog*, N.Y. TIMES, Jan. 21, 2016.

<sup>28</sup> New York Department of Financial Services, Press Release, *Celeste Koeleveld Appointed General Counsel at New York State Department of Financial Services* (Apr. 11, 2016).

District of Columbia and in the Eastern District of New York.<sup>29</sup> These appointments may reflect a desire to work more in tandem with federal regulatory and law enforcement agencies, but also signals a continued commitment to enforcement.<sup>30</sup> Ms. Vullo herself also served in the same OAG office as many of the NYDFS staff responsible for the creative and path-making enforcement actions against financial institutions under Mr. Lawskey's leadership.<sup>31</sup> In addition, Ms. Vullo's nomination was supported by Mr. Lawskey himself.<sup>32</sup>

Second, Ms. Vullo has already initiated significant actions against foreign banks in her role as acting superintendent. In April, the agency ordered 13 foreign banks to provide communications, telephone logs and records of other transactions between their New York branches and employees of the law firm Mossack Fonseca & Co., the Panamanian law firm implicated in the Panama Papers data leak.<sup>33</sup> NYDFS issued this order despite that the U.S. Attorney's Office for the Southern District of New York is conducting its own criminal investigation into the matter, suggesting that NYDFS will still act independently of federal agencies and prosecutors in bringing enforcement actions.<sup>34</sup> The NYDFS subpoena sent to an online lending company in May provides further evidence that the agency will continue to push the envelope of state-level financial regulation.<sup>35</sup>

Lastly, NYDFS, although often unpopular with the financial services industry, has earned a reputation among others as just the type of tough regulator that Wall Street needs. In addition, its enforcement actions have become an

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<sup>29</sup> *Id.*

<sup>30</sup> See Jacob Passy, *N.Y. State Banking Regulator Picks New Top Lawyer*, AMERICAN BANKER, Mar. 29, 2016; *N.Y. Gov. Announces 3 Appointments to Department of Financial Services*, INSURANCE JOURNAL, Feb. 2, 2016.

<sup>31</sup> *Supra* note 20.

<sup>32</sup> *Supra* note 20 ("She's smart as a whip, strong-willed and exceedingly hardworking, and clearly will want DFS to continue carrying out the governor's vision for a robust and innovative financial regulator").

<sup>33</sup> Greg Farrell, Tom Schoenberg and Katherine Chiglinsky, *New York Wants Foreign Banks to Hand over Panama Records*, BLOOMBERG, Apr. 20, 2016.

<sup>34</sup> *Id.*

<sup>35</sup> Suzanne Barlyn, *New York Financial Regulator Gearing up to Probe Online Lenders*, REUTERS, May 26, 2016.



important source of funding for the state, adding to the state budget \$6.5 billion that has funded infrastructure investments and economic development subsidies across the state.<sup>36</sup> Enforcement actions against foreign banks specifically have been lauded as important sources of funding for initiatives like the NYPD's "mobility initiative," which equipped all New York City police officers with smartphones and tablets.<sup>37</sup> Although the Governor's office may exert more control and oversight of the agency going forward, it is not unthinkable that it will also want NYDFS to continue to be the most aggressive reformer in financial services regulation.

### CERTAIN RECOMMENDED RESPONSES

Given this volatile environment, tailored responses to interfacing with the NYDFS are critical. That said, based on the experience of our attorneys from outside and inside the NYDFS and OAG, including a Deputy General Counsel of one of the largest banks subject to its jurisdiction, certain historical "best practices" are more important than ever. First and foremost, seeking to avoid issues that raise enforcement concerns—via enhanced exam preparation, establishment of examination protocols, and diligent post-exam follow-up as necessary—is more critical than ever. If concerns nonetheless arise, we have found that proactively engaging with the NYDFS or OAG to aggressively address the issues can reduce the likelihood of enforcement, or at least mitigate its burdens. Finally, if an enforcement action nonetheless occurs, establishing a comprehensive, documented remediation strategy can facilitate restoration of well-managed status as promptly as practical.

### CONCLUSION

While the appointment of Ms. Vullo may provide the NYDFS an opportunity to repair its relationship with the financial community, clients should continue to tread carefully with NYDFS. Foreign banks, in particular, remain under intense scrutiny, and NYDFS still possesses the tools and institutional experience to bring the same types of costly enforcement actions that the agency has brought over the last five years.

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Please do not hesitate to contact us with any questions.

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<sup>36</sup> *Supra* note 27.

<sup>37</sup> Gary Silverman, *NYPD Gains from Fines Paid by European Banks*, FINANCIAL TIMES, June 5, 2016.