

What Not to Do When a Regulator Arrives

April 18, 2016 | Elizabeth C. Yen

Recent federal and state consent agreements shed interesting light on how some regulated entities may have inadvertently exacerbated their working relationships with regulators by not being immediately cooperative and forthcoming when responding to examiners' questions. For example, the Federal Reserve Board recently announced what appeared to be a fairly routine Bank Secrecy Act/Anti-Money Laundering cease and desist order with the consent of Habib Bank Limited, a foreign bank, and its New York branch. However, unlike more typical cease and desist agreements, this particular order includes a requirement to submit to the Board "written policies and procedures that govern the conduct of ... personnel in all supervisory and regulatory matters, including, but not limited to, interaction with and requests for information by examiners ..., acceptable to the Reserve Bank. The policies and procedures shall, at a minimum, ensure that all ... personnel provide prompt, complete, and accurate information to examiners and provide for employee training that emphasizes the importance of full cooperation with banking regulators by all employees."

The importance of providing prompt, complete, and accurate information to examiners upon their request is not limited to banks and their interactions with federal examiners. For example, the Connecticut Department of Banking recently announced a temporary cease and desist order against, and license suspensions of, a nonbank mortgage broker and its two principals (who were licensed mortgage loan originators), together with the Department's intent to permanently revoke those licenses and impose civil penalties, after a recent attempt by the Department to "conduct a routine, unannounced examination." Department examiners asked the mortgage broker for a complete list of loan files for calendar years 2014 and 2015 and were given a list identifying 99 files. Department examiners then randomly selected 21 of these files for audit, but the licensee apparently was unable to locate four of the requested files. While reviewing two of the remaining 17 files, Department examiners "determined that documents had been fraudulently altered, in that a borrower's original signature was physically cut from one document and taped onto another document, to make a document copy appear as an original or that a borrower had signed or executed a document when the borrower had not." The examiners then asked for all of the remaining 2014-2015 files (approximately 78 files), but the licensee was apparently unable to produce all of the requested files. The licensee also "provided loan files for loans that it did not initially disclose in its initial list," calling the accuracy of the initial list of 99 files into question, as well as the licensee's original diligence in compiling the initial list.

As part of the notice of intent to permanently revoke licenses and impose civil penalties, the Department noted that failure to produce requested loan files during an examination constitutes wrongful withholding of books, records, and other information from the Department; a failure to compile Department-requested reports and information; and also a failure to cooperate with the Department, giving the Department sufficient grounds to revoke the licenses of the mortgage broker and its two principals. The alleged conduct of the two principals also gives the Department reason to believe that the mortgage brokerage will not be operated honestly, fairly, and efficiently, giving the Department additional grounds to revoke the licenses. In Connecticut, the Department of Banking may seek civil penalties of up to \$100,000 for each violation of relevant statutes enforced by the Department of Banking that apply to licensees and other Department-regulated entities. Part of the temporary cease and desist and license suspension order includes an order to provide the Department with payroll records and bank statements from January 1, 2014, to the present.

Similar arguments could have been raised if the licensed entity being examined had been a sales finance company instead of a mortgage broker. In Connecticut, licensed sales finance companies are required to comply with statutory recordkeeping requirements and must make all required records available to the Department of Banking upon request. Licensees also are statutorily required to comply with Department of Banking demands for information relating to whether the sales finance company business is being conducted in a lawful manner. The Commissioner of Banking may suspend or revoke a sales finance company license if, for example, the Commissioner determines that the principals of the business are not operating the business soundly and efficiently, in the public interest.

Norm Champ, a former Director of the Division of Investment Management at the U.S. Securities and Exchange Commission, recently gave the keynote address at the CFO Compliance & Regulation Summit about how to build effective relationships with regulators. Champ recommends showing examiners courtesy and respect, for example, by giving "the examiners a comfortable place to work" instead of "the worst conference room you have that is so small that the examiners' knees bump under the table." He also included the following advice about dealing with regulators during an examination: "Examiners are a skeptical bunch. [...] They are going to want to see records and files and have interviews to back up your description of your compliance program." For example, "[a]fter one particularly good compliance presentation, examiners then went in to the trade room and asked the firm's head trader about allocation procedures. The head trader said that he was told to describe allocations a certain way but that wasn't what the firm really did. Do not fall into this trap. You are better off admitting a shortcoming in your compliance efforts than having it discovered by examiners."

Failing to respond promptly, completely, and accurately to a regulator's request for information creates the impression that a licensee is not fully engaged in the regulatory examination process. Giving a regulator inconsistent answers to the same question, or providing files that contradict earlier answers to questions, may encourage a regulator to dig deeper into a licensee's files. Making a regulator's examination staff work hard to get answers to routine examination questions does not help a licensee demonstrate its competence and good faith and suggests that the licensee might not be treating its

license or the examination process (or the regulator) with appropriate seriousness.

Despite the temptation to give examiners short shrift (in an attempt to minimize disruption to ongoing business activities), a well-organized, focused, and thoughtful response to examiners' questions could help reduce the size or scope of random file sampling requests. Giving examiners undivided attention and full cooperation may put a licensee in a better position with the regulator if regulatory compliance issues are ultimately discovered. For example, the Consumer Financial Protection Bureau has indicated that it may take into account any meaningful affirmative cooperation with the Bureau that exceeds basic legal requirements while the Bureau is investigating potential violations of consumer protection laws. "In order to receive credit for cooperation in this context, a party must take substantial and material steps above and beyond what the law requires in its interactions with the Bureau."

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