#2014-126
Terminates **#N11-004** and **#N12-001**

UNITED STATES OF AMERICA
DEPARTMENT OF THE TREASURY
OFFICE OF THE COMPTROLLER OF THE CURRENCY

In the Matter of **Patrick Adams** Former President and Chief Executive Officer T Bank, N.A. Dallas, Texas	**FINAL DECISION** OCC AA-EC-11-50

THOMAS J. CURRY, Comptroller of the Currency:

FINAL DECISION TERMINATING ENFORCEMENT ACTION

This is an enforcement action brought by the Enforcement and Compliance Division ("Enforcement Counsel") of the Office of the Comptroller of the Currency ("OCC") against Patrick Adams ("Respondent" or "Adams"), former President and Chief Executive Officer of T Bank, N.A., Dallas, Texas ("T Bank" or "the Bank"). Pursuant to 12 U.S.C. § 1818(b) and § 1818(i)(2), Enforcement Counsel has sought an order to cease and desist and an assessment of a civil money penalty of $100,000 against Adams in connection with his role from 2005 to 2007 in T Bank's inadequate management of risks related to processing remotely created checks ("RCCs")[1] for numerous merchants.

The Notice of Charges, filed September 26, 2011, charged that Adams engaged in unsafe or unsound practices by: 1) failing to ensure that the Bank performed adequate and ongoing due diligence before and after opening accounts for merchants to deposit RCCs; 2) failing to ensure that the Bank had adequate policies, procedures, systems, and internal controls in place to manage and mitigate the risks associated with the Bank's relationship with those merchants; 3) failing to ensure that the Bank had adequate policies, procedures, and controls for tracking, investigating, and responding to consumer complaints of, *inter alia*, unauthorized RCCs; and 4) allowing the continued deposit of RCCs into those merchants' accounts despite the possibility that consumers were being harmed. Enforcement Counsel issued a subsequent Amended Notice of Charges adding the allegation that Adams' removal of documents constituting non-public OCC information from the Bank was, *inter alia*, a violation

[1] For a definition of RCCs, see the Bank Secrecy Act Manual of the Federal Financial Institutions Examination Council at https://www.ffiec.gov/bsa_aml_infobase/pages_manual/OLM_063.htm (last visited Sept. 22, 2014): "A remotely created check (sometimes called a 'demand draft') is a check that is not created by the paying bank (often created by a payee or its service provider), drawn on a customer's bank account. The check often is authorized by the customer remotely, by telephone or online, and, therefore, does not bear the customer's handwritten signature."

of regulation. On the basis of the allegations, Enforcement Counsel sought a cease-and-desist order and an assessment of a civil money penalty in the amount of $100,000 against Adams.

A hearing was conducted before Administrative Law Judge ("ALJ") C. Richard Miserendino in January and February, 2012 in Fort Worth, Texas. Both sides filed Post-Hearing Briefs. On November 8, 2012, the ALJ issued a recommended decision ("Recommended Decision" or "RD") containing Recommended Findings of Fact and Recommended Conclusions. Those findings and conclusions were predominantly favorable to Adams and unfavorable to Enforcement Counsel. Ultimately, the ALJ recommended that both the cease-and-desist order and civil money penalty actions be dismissed. In response, Enforcement Counsel filed exceptions. Adams did not. In March 2013, the Comptroller certified that the record of the proceeding was complete.

Upon review of the record, the Recommended Decision incorporating Recommended Findings of Fact and Conclusions, and Enforcement Counsel's Exceptions, the Comptroller hereby declines to adopt the ALJ's Recommended Findings of Fact and Recommended Conclusions. Instead, the Comptroller reaches conclusions of law that reflect substantial agreement with Enforcement Counsel's exceptions and consistency with past OCC legal positions. The ALJ's Recommended Findings of Fact, predicated upon incorrect legal standards, including the deference due testimony of bank examiners, do not form an adequate basis for the Comptroller to reach final findings of fact. In order to do so, it would be necessary for the Comptroller to remand the matter to the ALJ to reconsider his Recommended Findings of Fact under the Comptroller's corrected standards. In light of the further extension of time that would be necessary to effect a remand, however, the Comptroller will not remand, and will not reach final findings of fact. Instead, in an exercise of his plenary discretion over remedies, the Comptroller hereby orders the action terminated, and the outstanding Notices of Charges and Assessment dismissed.

As outlined in the following Summary of the Legal Analysis, this Final Decision addresses three distinct issues of law and attendant deference questions. For each issue, the analysis is preceded by a Statement of the Case describing the ALJ's Recommended Decision and the positions of the parties. While not reaching findings of fact, the Comptroller reviews the evidence in the record that supported the agency in initiating and prosecuting this action.

THE COMPTROLLER'S CONSIDERATION OF LEGAL ISSUES PRESENTED

SUMMARY OF THE LEGAL ANALYSIS IN THIS FINAL DECISION

This case presents three issues for the Comptroller's decision: first, whether the ALJ used the proper legal standard in evaluating whether Respondent engaged in "unsafe or unsound practices" within the meaning of the enforcement provisions of the Federal Deposit Insurance Act ("FDI Act");[2] second, whether the ALJ used the proper legal standard in determining whether Respondent had committed a violation of law within the meaning of those provisions; and, third, whether the ALJ erred in withholding deference from the opinions offered by the OCC's examiners in their hearing testimony.

For the reasons outlined in this Summary and explained in detail below, the Comptroller reaffirms the OCC's long-held interpretation, consistent with that of the other Federal banking agencies, of the phrase "unsafe or unsound practice." In addition, the Comptroller adheres to the dominant interpretation of the FDI Act requirements for a violation of law, and reemphasizes the standards for deference to examiner testimony.

Standard for Unsafe or Unsound Practice.

The FDI Act contains no definition of the phrase "unsafe or unsound practice." The authoritative definition of the term derives from material provided to Congress in 1966 in support of the legislation that employed the term. John E. Horne, then Chairman of the Federal Home Loan Bank Board ("FHLBB"), described the term as including:

> any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.[3]

The OCC and the other Federal banking agencies consistently have relied on this definition in bringing enforcement cases in the decades since then.

The courts, however, have not uniformly applied the Horne definition. Some federal circuit courts of appeals have adhered to the Horne standard without material deviation. Some have discussed the application of a standard more restrictive than Horne but without relying on a more restrictive standard as the basis for decision in any case. Finally, a minority of circuits apply the Horne definition with a restrictive gloss that serves to narrow the circumstances under

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[2] 12 U.S.C. §§ 1818(b), 1818(i)(2).

[3] *Financial Institutions Supervisory Act of 1966: Hearings on S. 3158 Before the House Comm. on Banking and Currency*, 89th Cong., 2d Sess. 49 (1966) (statement of John E. Horne, Chairman of the FHLBB), 112 CONG. REC. 26,474 (1966).

which enforcement actions may be taken. The ALJ relied on cases in this last category – principally the Fifth Circuit's *Gulf Federal* decision[4] – to establish the standard for determining whether Respondent had engaged in unsafe or unsound practices.

In *Gulf Federal*, decided in 1981, the Fifth Circuit considered a case in which the FHLBB alleged that a Federal savings association had engaged in an unsafe or unsound practice and a violation of law in miscalculating the interest due on loans under a method that was inconsistent with the method specified in the loan documents to the detriment of its borrowers. The FHLBB issued a cease-and-desist order directing the thrift to recalculate the interest as called for by the loan agreements and to reimburse borrowers for the difference. The Fifth Circuit held that the FHLBB lacked cease-and-desist authority in these circumstances, limiting the term "unsafe or unsound practice" only to practices "that threaten the financial integrity of the association." Citing *Gulf Federal* (and other cases including cases from the Third and D.C. Circuits that relied upon *Gulf Federal*), the ALJ concluded that an unsafe or unsound practice includes:

> conduct that, at the time it was engaged in, was contrary to generally accepted standards of prudent operation (that is, it constituted an imprudent act), the possible consequences of which, if continued, created an abnormal risk or loss or damage to the **financial stability** of the Bank.

In this decision, the Comptroller rejects *Gulf Federal* as the standard for determining whether an unsafe or unsound practice has occurred. The reasons for the Comptroller's decision include these, among others:

- *Gulf Federal*'s restrictive gloss, which requires that a practice produce specific effects that threaten an institution's financial stability, conflicts with the text and structure of the statute;

- the *Gulf Federal* standard is inconsistent with the Horne definition, which contemplates that a practice may be unsafe or unsound, and therefore warrant sanction and remediation, even if it does not threaten the continued viability of the institution;

- in the *De la Cuesta* case,[5] decided the year after *Gulf Federal*, the Supreme Court expressly rejected a key reason for the Fifth Circuit's decision that the thrift's failure to adhere to the terms of its agreements with its borrowers was not an unsafe or unsound practice – the lower court's understanding that the FHLBB lacked the authority to supervise thrifts' relationships with their borrowers; and

- later-enacted legislation, including amendments to the FDI Act that expressly authorize the OCC (and the other Federal banking agencies) to seek affirmative relief, including

[4] *Gulf Federal Savings & Loan Ass'n v. Federal Home Loan Bank Board*, 651 F.2d 259 (5th Cir.1981).

[5] *Fidelity Federal Sav. & L Ass'n v. De la Cuesta*, 458 U.S. 141 (1982).

restitution, cannot be squared with *Gulf Federal*'s holding that conduct cannot be redressed unless it threatens an institution's financial stability.

Further, the Comptroller declines to conclude, as recommended by the ALJ, that the OCC is obligated by the Law of the Circuit Doctrine to conform to the legal standards of the Fifth and D.C. Circuits, the two circuits available to Respondent to file a petition for review of the Comptroller's decision. First, the cases cited by the ALJ to support application of the Law of the Circuit Doctrine are inapposite. In addition, the federal system for national banks and federal thrifts, as other financial institution supervisory regimes, requires uniformity in the predicates for enforcement actions. More important, in the *Brand X*[6] case, the Supreme Court has recognized that a judicial construction of an ambiguous statutory term in a statute that an agency is responsible for administering does not preclude the agency from reaching a contrary statutory interpretation otherwise entitled to deference under the *Chevron*[7] doctrine so long as the judicial ruling is not based on the plain meaning of the statute. Because "unsafe or unsound practice" has never been determined to have a plain meaning, the Comptroller is not bound by contrary caselaw so long as *Brand X* applies, *i.e.,* so long as the Comptroller's statutory interpretation is entitled to *Chevron* deference. Accordingly, *Brand X* would apply in judicial review of an agency interpretation in the Fifth Circuit.

The Comptroller has reviewed caselaw from all of the other circuits that have construed the term "unsafe or unsound practice," including cases from the Third Circuit (where caselaw adopts a restrictive gloss); the Second, Eighth, and Eleventh Circuits (where cases support the Horne standard); and the Seventh, Ninth, and Tenth Circuits (where cases discuss a standard more restrictive than Horne but do not rely on such a standard as the basis for a decision). As the detailed discussion below demonstrates, this review results in no basis for the Comptroller to depart from the Horne standard. Furthermore, several of those circuits expressly recognize *Chevron* deference to interpretations of the FDI Act, and only the Second Circuit has (inconsistently) adopted the D.C. Circuit doctrine of withholding deference from agency interpretations of statutes, such as the FDI Act, implemented by multiple agencies (described below). Thus, any meaningfully contrary authority in other circuits would be subject to *Brand X* on judicial review.

In the D.C. Circuit, the precise formulation of the unsafe or unsound practice standard has varied. The Comptroller also has reviewed the D.C. Circuit caselaw in detail. While the status of a 1996 case adopting a more stringent standard is unclear, the prevailing standard is the one articulated in subsequent cases – that is, that an unsafe or unsound practice is one that poses a "reasonably foreseeable undue risk to the institution." This later caselaw equates foreseeability with "increased risk of some kind." To the extent that "foreseeability" means "increased risk of some kind," this formula is consistent with Horne, and the Comptroller adopts that understanding. This reading of the present state of the law in the D.C. Circuit suggests consistency with Horne and thus with the Comptroller's interpretation of unsafe or unsound practice.

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[6] *National Cable & Telecommunications Ass'n v. Brand X Internet Services*, 545 U.S. 967 (2005).

[7] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

Alternatively, if there were a conflict between the D.C. Circuit standard and the Horne standard, the Comptroller would decline to adopt the ALJ's recommendation for the same reasons this decision declines to accept the view of the Fifth Circuit. The departure from that analysis, though, is that while the Fifth Circuit (and almost all other circuits) would apply *Brand X* to review of agency interpretations of the FDI Act, the D.C. Circuit, which has repeatedly declined to apply *Chevron* to agency interpretations of the FDI Act, would presumably not apply *Brand X* under present law.

The prevailing rationale in the D.C. Circuit for withholding *Chevron* deference embraces policy concerns stemming from the possibility of incidental overlap of agency supervisory authority under the FDI Act: that a single term might be given different meanings by different agencies, or that a single supervised party might be subject to conflicting guidance from different agencies. As explained below, concerns about these adverse consequences likely are misplaced as a practical matter. Even if there were significant areas of agency overlap, in the Comptroller's view, reconsideration of the doctrine of withholding of deference from agencies interpreting the FDI Act would be timely and warranted for important reasons, including: the doctrine's tension with the test for *Chevron* application repeatedly stated by the Supreme Court and the *Chevron* policies repeatedly reaffirmed by the Court; the circuit split with other courts of appeals that continue to apply *Chevron* to interpretations of the FDI Act; and the D.C. Circuit's acknowledged inconsistency in applying the doctrine.

Violation of Law.

As a predicate for the cease-and-desist order and civil money penalty it sought, Enforcement Counsel charged Respondent with a violation of a regulation that governs the protection of non-public OCC information. In the Recommended Decision, the ALJ noted that the statutory term "violation" is defined broadly, but applied a restrictive gloss to the statutory term in reliance on the Fifth Circuit's *Bellaire* decision,[8] which purported to adopt the *Gulf Federal* test and apply it to the independent statutory predicate violation of "law, rule, or regulation." In that case, the Fifth Circuit found the test met because there was a "direct relationship" between compliance with the statute at issue and the bank's financial soundness.

Here, the ALJ concluded that the regulation at issue "does not bear any relation to the financial stability of the Bank, and [Adams'] actions in taking nonpublic information did not threaten the Bank's integrity." Again applying the Law of the Circuit Doctrine, the ALJ followed *Bellaire* and ruled that the law that Respondent is alleged to have violated "must bear a relationship to the financial soundness of the Bank in order to support a cease-and-desist order."

The Comptroller declines to adopt the ALJ's recommended standard. The meaning of the statute is plain. A cease-and-desist order may be predicated on a violation of a "law, rule, or regulation." The FDI Act defines "violation" as "any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding and

[8] *First National Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674 (1983).

abetting a violation." There is no statutory text that supports a limitation upon the unqualified violation of law as a predicate for remedies, including that suggested by the ALJ. Moreover, the weight of more recent law, including in the Fifth Circuit, supports the rejection of the *Bellaire* gloss. The *Bellaire* restriction is contrary to the plain meaning of the statutory term, statutory structure, caselaw, and policy. A violation of the OCC's regulation justifies imposition of a cease-and-desist order without a showing of the relationship to the institution's financial integrity.

Deference to Examiner Opinions.

As explained in the decision, the ALJ departed from long-established caselaw in adopting a nondeferential standard of review of examiner judgments. The Comptroller declines to adopt that standard and adheres to the current standard, derived from *Sunshine State Bank v. FDIC*.[9]

Moreover, to the extent that the Recommended Decision purports to require that formal guidance be issued before examiners may testify that practices are contrary to generally accepted standards of prudent operation, the Comptroller concludes that that requirement is error. Caselaw supports the conclusion that the OCC's bank supervisors cannot be precluded from acting with respect to novel banking practices until such time as the agency has issued formal guidance. It is sufficient that supervisors can identify more general risks that cause those practices to depart from generally accepted standards of prudent operation even if the specific practices at issue are novel. Enforcement Counsel argues that the "weight of authority is that examiners must establish what acts were imprudent, not establish affirmative standards of what constituted adequate due diligence, sound policy, or prudent risk management." The Comptroller does not completely agree. The Horne definition requires a showing that the conduct be "contrary to generally accepted standards of prudent operation." Accordingly, Enforcement Counsel must make some showing as to the relevant standards and the departure from those standards. The novelty of a given practice cannot be permitted to preclude such a showing so long as more general relevant standards apply.

[9] *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (11th Cir. 1986).

STATUTORY AND PROCEDURAL BACKGROUND

The FDI Act authorizes the "appropriate Federal banking agency" to impose various remedies for misconduct by a banking institution or an institution affiliated party ("IAP") such as Respondent. 12 U.S.C. §§ 1813(u)(1), 1818(b)(1). Congress has designated the OCC as the appropriate Federal banking agency under the FDI Act with respect to national banks and Federal savings associations. 12 U.S.C. § 1813(q)(1).[10]

Under the FDI Act, the alternative predicates for a cease-and-desist order include, *inter alia*: 1) engaging in an unsafe or unsound practice and 2) violating a law, rule, regulation, or a condition imposed in writing. 12 U.S.C. § 1818(b)(1). If the agency finds that the record made at the hearing before the ALJ establishes the required basis, the agency may impose an order to cease and desist from the violation or practice. The agency may also order a party to take "affirmative action" to correct the conditions resulting from any such violation or practice. 12 U.S.C. § 1818(b)(6). An additional remedy is the imposition of civil money penalties for specified infractions, categorized into three escalating "tiers" of penalties ranging from a maximum of $5,000 per day in the First Tier, to $25,000 per day in the Second Tier, to $1 million per day (or one percent of the assets of the institution) in the Third Tier. Here, Enforcement Counsel alleged that Adams "recklessly engaged in an unsafe or unsound practice" that was part of a "pattern of misconduct" as the basis for a total Second Tier civil money penalty of $100,000 against Adams.[11]

The FDI Act calls for the Comptroller to review the record established at the hearing to determine whether, in his judgment, Enforcement Counsel has met its burden of supporting its allegations by a preponderance of the evidence in the record. 5 U.S.C. § 556(d); *Steadman v. SEC*, 450 U.S. 91 (1981). The Comptroller is free to accept or reject the ALJ's recommendations; a reviewing court defers to the factual interpretations of the agency, rather than to the ALJ. *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 853 (D.C. Cir. 1970); *Stanley v. Board of Governors*, 940 F.2d 267, 272 (7th Cir. 1991). The agency acts within its discretion when it rejects the credibility findings of the ALJ where the agency bases its decision on substantial evidence. *Id.*

The OCC's Final Decision is subject to appellate review by the filing of a petition for review in either the U.S. Court of Appeals for the D.C. Circuit or the court of appeals for the circuit in which the home office of the institution is located. 12 U.S.C. § 1818(h)(2). In this case, because the institution is located in Dallas, Texas, a petitioner would have a choice of

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[10] The OCC is also the appropriate Federal banking agency with respect to Federal branches and agencies of foreign banks. The FDIC has backup authority that allows it to recommend that the appropriate Federal banking agency take any enforcement action against an institution or IAP that is authorized under 12 U.S.C. § 1818 as well as other statutory provisions and authorizes the FDIC to take action if the appropriate Federal banking agency fails to do so. 12 U.S.C. § 1818(t).

[11] The agency may seek a Second Tier civil money penalty for conduct constituting a violation of law, regulation, or certain orders, reckless engagement in an unsafe or unsound practice, or a breach of fiduciary duty, which forms a pattern of misconduct, causes or is likely to cause more than a minimal loss to the institution, or results in pecuniary or other gain to the individual. 12 U.S.C. § 1818(i)((2)(B).

either the Fifth Circuit or the D.C. Circuit as a venue for a petition for review. The substantive standards for review are provided by the Administrative Procedure Act, chapter 7 of Title 5 of the U.S. Code. *Id.* The agency's Final Decision will be upheld if it is supported by substantial evidence and it is not arbitrary and capricious or contrary to law. 5 U.S.C. § 706(2)(A), (E). The Comptroller has wide discretion in the choice of remedy. *Butz v. Glover Livestock Commission Co.,* 411 U.S. 182, 188 (1971); *Central Nat'l Bank of Mattoon v. U.S. Dep't of Treasury*, 912 F.2d 897, 904-05 (7th Cir. 1990); *Brickner v. FDIC*, 747 F.2d 1198, 1203 (8th Cir. 1984).

I. THE MEANING OF THE STATUTORY TERM "UNSAFE OR UNSOUND PRACTICE."

As explained above, the ALJ relied upon caselaw, primarily from the Fifth Circuit and D.C. Circuit, to impose a more stringent standard for finding an unsafe or unsound practice than that applied by the OCC and the other Federal banking agencies. Upon review of all of the relevant authority, including the statutory text and structure, the Comptroller finds this to be error and adheres to the OCC's definition of the term.

A. Statement of the Case.

1. The Recommended Decision.

The Recommended Decision surveys the legislative history of the FDI Act, the general interpretations of the term "unsafe or unsound practice," and the materially uniform interpretations of the banking agencies. RD 64-67.

Horne Definition. Because the term is not defined by the FDI Act, the RD notes that courts have long consulted the "authoritative definition" contained in the legislative history of the legislation that first employed the term as a predicate for these forms of enforcement remedies. In hearings before Congress preceding its adoption of the Financial Institutions Supervisory Act of 1966 ("FISA"), John E. Horne, the Chairman of the FHLBB, at that time the supervisory agency for savings associations,[12] provided a memorandum containing his interpretation of the phrase:

> Generally speaking, an 'unsafe or unsound practice' embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or[13] loss or damage to an institution, its shareholders, or the agencies

[12] The FHLBB was the predecessor to the Office of Thrift Supervision ("OTS"), most functions of which were transferred to the OCC in 2010 pursuant to Title III, section 312 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank Act") (codified at 12 U.S.C. § 5412(b)(2)(B)(i)).

[13] As noted below, there is some question whether the text should read "of" rather than "or."

administering the insurance funds.

Financial Institutions Supervisory Act of 1966: Hearings on S. 3158 Before the House Comm. on Banking and Currency, 89th Cong., 2d Sess. 49 (1966) (statement of John E. Horne, Chairman of the FHLBB), 112 CONG. REC. 26,474 (1966).

The RD notes that the banking supervisory agencies have adopted standards that remain close to the original Horne definition, and have rejected additional showings such as a requirement that the conduct in question must "threaten the bank's financial integrity" or "have a reasonably direct effect on its financial soundness." RD 68.

RD Survey of Caselaw in the Third, Fifth, Ninth, and D.C. Circuits. The RD surveys the courts of appeals decisions that have imposed a more stringent requirement, variously stated in terms such as the conduct must "threaten the bank's financial stability or integrity" or have a "reasonably direct effect on the bank's financial soundness." RD 69-73. Because any enforcement order issued by the Comptroller is subject to petitions for review in either the Fifth Circuit or the D.C. Circuit, the ALJ applied a "Law of the Circuit Doctrine" to follow the standards applied in those two courts. RD 74. The RD relies upon three cases in particular, two in the Fifth Circuit and one in the D.C. Circuit: *Gulf Federal, Bellaire*, and *Johnson v. OTS*, 81 F.3d 195 (D.C. Cir. 1996). RD 69-73. Melding the authority of those cases, the ALJ formulated the standard to be, at least for this case:

> conduct that, at the time it was engaged in, was contrary to generally accepted standards of prudent operation (that is, it constituted an imprudent act), the possible consequences of which, if continued, created an abnormal risk or loss or damage to the **financial stability** of the Bank.

RD 74 (emphasis added).

In *Gulf Federal*, as described in the RD, the relevant supervisory agency, the FHLBB, sought a cease-and-desist order under an agency-specific statutory provision analogous to the current cease-and-desist authority in 12 U.S.C. § 1818(b).[14] RD 69. The FHLBB alleged that the thrift had engaged in an unsafe or unsound practice and a violation of law in miscalculating the interest due on loans under a method that was inconsistent with the method specified in the loan documents and that disadvantaged its borrowers. *Gulf Federal*, 651 F.2d at 261. The FHLBB issued a cease-and-desist order directing the thrift to recalculate the interest as called for by the loan agreements and to reimburse borrowers for the difference. *Id.* The Fifth Circuit held that the FHLBB lacked cease-and-desist authority in these circumstances, limiting the term "unsafe or unsound practice" to practices that have "a reasonably direct effect on an association's financial soundness." RD 70.

Two years later, in *Bellaire,* the Fifth Circuit confirmed the *Gulf Federal* restrictive gloss on the definition of an unsafe or unsound practice and extended it to a violation of law.

[14] 12 U.S.C. § 1464(d)(2)(A).

"It is important to remember that both situations are limited to practices with a reasonably direct effect on a bank's financial stability." *Bellaire*, 697 F.2d at 681. RD 72. The court also rejected the OCC's argument that *Gulf Federal* should be limited to the FHLBB and not applied to the OCC.

In *Johnson v. OTS*, 81 F.3d 195 (D.C. Cir. 1996), the D.C. Circuit recited the *Gulf Federal* restrictive gloss in overturning an agency cease-and-desist order predicated upon a thrift's decision to appeal the denial of a charter change application. RD 72. The D.C. Circuit relied on "the weight of the case law" in stating that "the unsafe or unsound practice provision . . . refers only to practices that threaten the financial integrity of the institution." *Id.* at 204. RD 72.

The RD supported this conclusion with reference to an influential Third Circuit case, *Seidman v. OTS*, 37 F.3d 911, 928 (3d Cir. 1994) ("*Seidman*") that adopted and applied the stringent gloss. RD 73. The RD also cites two Ninth Circuit cases that relied on *Gulf Federal* in adopting the gloss that an unsafe or unsound practice must have a "reasonably direct effect on an association's financial soundness." *Hoffman v. FDIC*, 912 F.2d 1172, 1174 (9th Cir. 1990). *See also Simpson v. OTS*, 29 F.3d 1418, 1425 (9th Cir. 1994).

"Law of the Circuit Doctrine." Relying upon two courts of appeals cases, the RD concludes that the ALJ was obligated to conform to the standards of the Fifth and D.C. Circuits, the two courts available to Adams to file a petition for review of any adverse decision by the Comptroller. RD 74.

2. Adams' Position.

Adams did not file exceptions to the ALJ's Recommended Decision. In his Post-Hearing Brief, he urged the standard adopted by the ALJ, relying primarily upon *Gulf Federal* and *Bellaire*, but also surveying decisions in other circuits. Adams Br. 4-8. Adams argues that because the Bank was profitable during his tenure, his misconduct could not have satisfied the financial stability standard. Br. 8.

3. Enforcement Counsel's Exceptions on Standard for Unsafe or Unsound Practice.

In its Brief in Support of Exceptions ("EC Br."), Enforcement Counsel argues that the ALJ's proffered standard for an "unsafe or unsound practice" is erroneous as a matter of law because it is contrary to canons of statutory construction, because it is unsupported by relevant legislative history and the weight of authority, and because it would severely hamper enforcement authority. EC Br. 6-13. Enforcement Counsel argues that the unqualified Horne definition should remain the OCC's standard for "unsafe or unsound practice."

Statutory Language and Scheme. Enforcement Counsel argues that the ALJ's standard conflicts with canons of statutory construction that favor interpretations that give meaning to every term and disfavor surplusage. EC Br. 7. Enforcement Counsel points to

provisions of the FDI Act that contain **express** requirements that certain "effects" result from misconduct in order to establish the predicate for an enforcement order. Enforcement Counsel argues that the imposition of an extra-statutory "threat to financial integrity" standard for the misconduct element of "unsafe or unsound practice" represents a judicially created "effects" test that cannot be reconciled with express statutory "effects" requirements. EC Br. 8.

Legislative History**.** Enforcement Counsel argues that the ALJ's proposed standard is at odds with the legislative history of FISA. First, it is inconsistent with the Horne definition, which speaks to imprudent actions, the "possible consequences of which, if continued, would be abnormal risk or loss or damage" to an institution, its shareholders, or the insurance funds. EC Br. 9-10. The Horne definition does not require an effect on the "financial stability" of the institution. *Id.* Moreover, Enforcement Counsel points out that in considering the bill that became FISA, Congress considered and rejected a proposal from the thrift industry that would have imposed such a requirement. *Id.*

Enforcement Counsel also argues that a statutory amendment to the cease-and-desist provision in 1989 reflects a further statutory structure inconsistency with the ALJ's proposed standard. EC Br. 10.

Weight of Authority**.** Enforcement Counsel argues that the ALJ's proposed standard is contrary to the weight of authority expressed in courts of appeals decisions, final orders in agency enforcement adjudications, and recommended decisions by the ALJs of Office of Financial Institution Adjudication. EC Br. 10-13. Enforcement Counsel argues that the OCC has consistently rejected the *Gulf Federal* gloss since its first adjudication following the decision, *In the Matter of Citizens Nat'l Bank*, No. AA-EC-81-06 at 33 & n.84 (OCC June 17, 1982).

Law of the Circuit Doctrine**.** Enforcement Counsel challenges the primary rationale given by the ALJ for adopting the proposed standard, that he was bound to follow the authority of the Fifth and D.C. Circuits reflected in *Gulf Federal*, *Bellaire*, and *Johnson v. OTS,* notwithstanding the contrary positions of the OCC and the other banking agencies. EC Br. 26. Enforcement Counsel first argues that the two cases relied upon by the ALJ for that proposition are inapposite. EC Br. 27. Second, Enforcement Counsel argues that the proposition advanced by the ALJ is inconsistent with the Supreme Court decision in *Brand X,* which held that "prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision follows from the unambiguous terms of the statute and leaves no room for agency discretion." *Brand X*, 545 U.S. at 969. EC Br. 28. Because the term "unsafe or unsound practice" is undefined and ambiguous, Enforcement Counsel argues that the OCC is not bound by the cases relied upon by the ALJ, which did not declare that the interpretation they adopted proceeded from the plain meaning of the statute. Accordingly, Enforcement Counsel argues that the Comptroller is authorized to adopt his own interpretation of the statutory term. EC Br. 30-31.

In the courts of appeals that extend *Chevron* deference to banking supervisory agencies interpreting the FDI Act, including the Fifth Circuit, there is no threshold question whether

Brand X applies. The D.C. Circuit, however, in a string of cases stretching back to 1993, has withheld *Chevron* deference from the banking agencies' interpretations of the FDI Act on the ground that Congress directed that multiple agencies implement the same statute, potentially leading to conflicting and confused guidance. Enforcement Counsel argues that no such conflict would arise in this case because the banking agencies have not differed in their interpretations of the term "unsafe or unsound practice." EC Br. 31. Enforcement Counsel also points to caselaw within the D.C. Circuit giving deference to banking supervisory agencies' interpretations of other statutes notwithstanding that those statutes, like the FDI Act, were administered by multiple agencies. EC Br. 32.

Enforcement Counsel also argues that the ALJ's proposed Law of the Circuit Doctrine would be unworkable where the two courts of appeals that are potential venues for review do not agree upon the applicable standard. EC Br. 32-33. That is the case here, where the Fifth Circuit in *Gulf Federal* and the D.C. Circuit in *Johnson v. OTS* and other cases adopted somewhat different formulations in interpreting the statutory term. *Id.*

B. The Comptroller's Conclusions of Law Regarding the "Unsafe or Unsound Practice" Standard.

The Comptroller declines to adopt the ALJ's recommended test for unsafe or unsound practice for the reasons advanced by Enforcement Counsel and for additional reasons. Instead, the Comptroller adheres to the OCC's long-held definition of "unsafe or unsound practice" based upon the Horne definition. Thus, the Comptroller adopts the following interpretation of the term "unsafe or unsound practice" in the FDI Act: ***An unsafe or unsound practice includes any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.***

Because the term "unsafe or unsound practice" is an ambiguous term in a statute that the OCC is responsible for interpreting, the Comptroller is authorized by *Brand X* to assign meaning to the term, notwithstanding contrary judicial precedent so long as those courts did not conclude that the term was unambiguous. There are numerous reasons why the Comptroller declines to adopt the restrictive gloss imposed by *Gulf Federal* and the courts that have relied upon *Gulf Federal* including that: the gloss is in conflict with the statutory text and structure; it is inconsistent with Horne and with the statutory purpose; and a key component of *Gulf Federal*'s reasoning was rejected by the Supreme Court a year after it was decided.

The parties and the ALJ addressed the caselaw in three parts: 1) the Fifth Circuit; 2) the other circuit courts of appeals; and 3) the D.C. Circuit. Discussion of the Fifth Circuit's decision in *Gulf Federal* also has meaning nationwide because those cases that have adopted a standard other than Horne have invariably relied upon *Gulf Federal*. As discussed below, *Brand X* plainly applies in the Fifth Circuit and presumptively in the other circuits that have recited the *Gulf Federal* gloss, providing the Comptroller with clear authority to adhere to the Horne standard. The standard in the D.C. Circuit has been formulated variously over time, but

the Comptroller construes that standard as most recently articulated by the court to be consistent with Horne. To the extent that the standards cannot be harmonized, the Comptroller suggests that it would be appropriate for the D.C. Circuit to reconsider its resistance to applying *Chevron* deference, and hence *Brand X*, to the banking agencies' interpretations of the FDI Act. Ultimately, the Comptroller is unpersuaded that this caselaw provides sufficient reason to depart from the Horne standard.

***1. Background*.**

"Unsafe or unsound practice" generally. The term "unsafe or unsound practice" is widely used in banking statutes, regulations, and supervisory materials. Its first appearance in federal banking law has been traced to 1933, when it was adopted as a basis for the Board of Governors of the Federal Reserve System ("Federal Reserve") to remove a banking official from office, and it was subsequently used in two provisions dealing with termination of insurance. *See* T. Holzman, "Unsafe Or Unsound Practices: Is The Current Judicial Interpretation of the Term Unsafe Or Unsound?," 19 Ann. Rev. Banking L. 425, 428-29 (2000). The history of the term shows no attempt to define it prior to FISA, the pivotal 1966 legislation that provided the banking supervisory agencies with the power to issue cease-and-desist orders and more general power to issue removal-and-prohibition orders in addition to the existing authority to terminate deposit insurance.

FISA. The legislative history indicates that the FISA legislation was designed to provide supervisory agencies with more flexible supervisory tools than the existing, rarely used, power to terminate deposit insurance. "The Federal supervisory agencies have been seriously handicapped in their efforts to prevent irresponsible and undesirable practices by deficiencies in the statutory remedies. Experience has often demonstrated that the remedies now available to the banking agencies are not only too drastic for use in many cases, but are also too cumbersome to bring about prompt correction and promptness is very often vitally important . . ." S. Rep. No. 89-1482, at 5 (1966). FISA provided the banking agencies with the power to issue cease-and-desist orders and removal-and-prohibition orders against bank officers and directors. FISA also provided agencies with emergency authority to issue immediately effective cease-and-desist orders and removal-and-prohibition orders subject to stringent substantive requirements and expedited judicial review. The establishment of an unsafe or unsound practice forms one of the alternate predicates for cease-and-desist orders, prohibitions, and civil money penalties, making it a common denominator for relief.

***The Horne Definition*.** FISA did not provide a textual definition for the statutory term "unsafe or unsound practice," but the legislative history contains a memorandum from FHLBB Chairman John Horne that has been the touchstone for explicating the term:

> Generally speaking, an unsafe or unsound practice embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the

insurance funds.[15]

112 CONG. REC. 26,474 (1966).

Structure of the FDI Act. The FDI Act has been amended several times since FISA, most substantially in 1989 in the Financial Institutions, Reform, Recovery, and Enforcement Act ("FIRREA"), which strengthened agency enforcement powers in multiple respects.[16] The term "unsafe or unsound practice" as a basis for a cease-and-desist order has not been amended, but it takes additional meaning from the contemporary structure of the enforcement provisions of the FDI Act.

Those provisions offer agency enforcement staff a range of potential remedies, from the most basic, such as a cease-and-desist order requiring the cessation of conduct, to the severe, including prohibition of an individual from the financial services industry or civil money penalties in large amounts. This availability of graduated remedies reflects the ways in which Congress empowers the financial supervisory agencies to match remedies to the severity or persistence of the problem being addressed. The most basic remedies are textually predicated on misconduct, without more. Thus, a cease-and-desist order may be issued when the agency establishes the existence of an unsafe or unsound practice or a violation of law. 12 U.S.C. § 1818(b)(1). Heightened forms of remedy require the agency to establish additional elements of proof tied to the "effect" of the misconduct or the "culpability" it reflects. The distinct cease-and-desist remedies of restitution, reimbursement, indemnification, or guarantee against loss require a showing of unjust enrichment (a form of "effect" element) or that the misconduct involved a reckless disregard for the law (a form of "culpability" element). 12 U.S.C. § 1818(b)(6)(A). The severe remedy of prohibition requires the showing of at least one element in each of three tiers of alternative elements: misconduct (unsafe or unsound practice or violation of law, rule, or order, or breach of fiduciary duty); effect (financial gain or other benefit to the respondent or financial loss or other damage to the institution or prejudice to the depositors); and culpability (personal dishonesty or willful and continuing disregard for safety or soundness). 12 U.S.C. § 1818(e)(1). This same pattern is reflected in the escalating tiers of civil money penalties: simple misconduct supports the lowest level of penalty and the higher

[15] The Horne definition contains ambiguities that have not been explored in subsequent decisions. The original phrasing is "abnormal risk **or** loss or damage," and not "abnormal risk **of** loss or damage," as some subsequent formulations have stated it. *See* Holzman at 448-49. There is merit in this reformulation, as it answers the question of "risk of what?" that the original statement leaves hanging. It also resolves the question whether "abnormal" modifies "loss or damage" in addition to "risk." No reviewing court has parsed the formulation so closely that the choice of one or the other would likely have made a difference in the outcome of litigated cases.

[16] In 1989, Congress enacted FIRREA in response to the savings and loan crisis, which expanded agency enforcement authority in several respects. "Read in its entirety, the statute manifests a purpose of granting broad authority to financial institution regulators." *Akin v. OTS*, 950 F.2d 1180, 1184 (5th Cir. 1992). Among other things, FIRREA added express cease-and-desist authority for agencies to seek affirmative relief including, in certain circumstances, restitution. 12 U.S.C. § 1818(b)(6)(A). The legislative history shows that Congress intended to supersede contrary Seventh Circuit judicial authority in doing so. *Akin*, 950 F.2d at 1184 (citing H.R. Rep. No. 54(I), 101st Cong., 1st Sess. 467-68 (1989)); *see also FDIC v. Bank of Coushatta*, 930 F.2d 1122, 1126 (5th Cir. 1991) (noting express congressional purpose in FIRREA capital directive provision to supersede capital holding in *Bellaire*).

two penalty tiers require showings of effect or culpability. 12 U.S.C. § 1818(i)(2)(A)-(C).

Early Caselaw. One of the earliest cases to interpret the statutory term "unsafe or unsound practice" upheld an OCC cease-and-desist order predicated on unsafe and unsound practices. *First National Bank of Eden v. Department of the Treasury*, 568 F.2d 610 (8th Cir. 1978). The court observed: "Congress did not define unsafe and unsound banking practices in section 1818(b). However, the Comptroller suggests that these terms encompass what may be generally viewed as conduct deemed contrary to accepted standards of banking operations which might result in abnormal risk or loss to a banking institution or shareholder." *Id.* at 611 n. 2. Accordingly, the Eighth Circuit approved a version[17] of the Horne definition.

Similarly, in two early cases, the Fifth Circuit affirmed cease-and-desist orders issued by the OCC predicated on an "unsafe or unsound practice" defined consistently with Horne. In one case, the Fifth Circuit expressly endorsed the Eighth Circuit's *Eden* standard. *First Nat'l Bank of Lamarque v. Smith*, 610 F.2d 1258, 1265 (5th Cir. 1980). In another early case, the Fifth Circuit did not adopt a definition of the term, but indicated that courts should be deferential to the practical implementation of the term by the banking agencies: "The phrase 'unsafe or unsound banking practice' is widely used in the regulatory statutes and in case law, and one of the purposes of the banking acts is clearly to commit the progressive definition and eradication of such practices to the expertise of the appropriate regulatory agencies." *Groos Nat'l Bank v. Comptroller of the Currency,* 573 F.2d 889, 897 (5th Cir. 1978). Even before *Chevron*, therefore, the Fifth Circuit had endorsed a deferential review of agency implementation and interpretation of the term.

[17] Notably, the *Eden* formulation looks to risk or loss to a "banking institution or shareholder," but omits the original Horne mention of risk to the insurance funds. In practice, that omission may not matter, as any practice that threatens the insurance funds will almost certainly have also threatened both the institution or its shareholders earlier in time.

2. The Comptroller Rejects the Fifth Circuit Gulf Federal Standard, Which Restricts Unsafe or Unsound Practices to Conduct that Threatens the Financial Soundness of an Institution.

The *Gulf Federal* decision was an outlier when decided and criticized by the Supreme Court soon thereafter. Its resonance in later caselaw is unjustified.

a. Gulf Federal Imposes a Restrictive Gloss on the Horne Standard.

In *Gulf Federal*, the case principally relied upon by the ALJ, the Fifth Circuit held that a proposed cease-and-desist order was not authorized by the statutory provisions addressing "unsafe or unsound practice" or violation of law. The practice addressed in the enforcement action was the thrift's action in charging, for a period of years, interest calculated at a rate higher than that called for in the loan agreements. *Gulf Federal*, 651 F.2d at 261-62. The FHLBB instituted cease-and-desist proceedings against the thrift to take corrective action, alleging that it was an unsafe and unsound practice and a violation of law for the thrift to charge interest at a rate higher than contractually due and seeking corrective action. After a hearing, the FHLBB issued a cease-and-desist order directing that the thrift calculate interest consistently with its loan agreements and reimburse borrowers for the difference between what they paid and what they should have paid. *Id.*

Before the Fifth Circuit, the thrift argued that the FHLBB's statutory authority was limited to assuring "the financial stability" of savings and loan associations, and did not extend to the authority "to protect consumers from practices considered by [the FHLBB] to be unfair." *Id.* at 262. The FHLBB responded that its organic statute, the Home Owners' Loan Act ("HOLA"), gave it "cradle to grave" plenary authority over thrift institutions, including the authority to remedy the practice at issue. *Id*.

The Fifth Circuit endorsed the thrift's position that the FHLBB's authority was constrained.[18] The panel purported to endorse the Horne definition. The Court noted that both the House and Senate had referred to this definition as "authoritative." *Id.* at 264. Rather than relying upon Horne, however, the panel added a restrictive gloss that limited application of the statutory term to "practices with a reasonably direct effect on an association's financial soundness." *Id*. The Fifth Circuit identified the basis for this gloss in statements in the legislative history by individual members of Congress to the effect that the delegation of authority to the agency was not overly broad, related "strictly to the insurance risk," and was meant to assure the public of sound banking facilities. *Id.*

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[18] The *Gulf Federal* court refused to extend deference to the FHLBB in its statutory interpretation, saying that the definition of the limits of the agency's authority called for "judicial, not administrative expertise." *Id*. at 263. *Gulf Federal* in 1981 predated the Supreme Court's adoption of the *Chevron* doctrine in 1984. *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc*., 467 U.S. 837 (1984). Accordingly, this aspect of *Gulf Federal* implicitly has been overruled by succeeding Supreme Court and Fifth Circuit authority.

The court did not explicate the meaning of "a reasonably direct effect upon financial soundness," other than to deny that it applied to the risks identified in that case by the FHLBB, including the potential liability to repay overcharged interest and a "loss of public confidence" in the reputation of the thrift. "Such potential risks bear only the most remote relationship to Gulf Federal's financial integrity and the government's insurance risk. They are qualitatively different from the risks" identified by Chairman Horne. *Id.* The court acknowledged that the thrift's liability for repayment of overcharged interest could lead to financial loss but minimized that risk by comparing the ratio of that potential liability to the overall assets of the institution. The panel criticized the FHLBB for seeking relief – repayment to the Bank's customers of the amounts overcharged – that would cause losses to be realized rather than merely "contingent and remote." *Id.* The court also dismissed the FHLBB's "loss of public confidence" rationale, stating that that power would make the FHLBB "monitor of every activity of the association in its role of proctor for public opinion. This departs entirely from the congressional concept of acting to preserve the financial integrity of its members." *Id.* at 265. "We limit the 'unsafe or unsound practice provision' to an association's financial condition."[19] *Id.*

In a separate holding, the violation of law arguments advanced by the FHLBB as a basis for the issuance of the cease-and-desist order were rejected because the court determined that none of the cited laws were in fact violated.[20] Among the rejected violation of law arguments was that federal common law preempted state contract law and established the basis for liability based on the thrift's breach of contract. *Id.* at 266. Echoing its reasoning in the "unsafe or unsound practice" analysis, the Fifth Circuit stated that the authority relied upon by the FHLBB only established federal control over the internal management of Federal savings and loan associations. Because the mortgage contract issues did not implicate the sound management of thrifts, or the insurance liability of the government, and did not require a uniform federal rule, Louisiana contract law was not preempted. *Id.* Accordingly, the court's understanding of the limited scope of the FHLBB's authority underlay both the unsafe or unsound practice holding and a portion of the violation of law holding.

b. The Gulf Federal Gloss Is in Conflict with Statutory Text and Structure.

The restrictive addition to the Horne standard suggests that a practice display a specific degree of "effect" – a threat to the financial soundness of the institution – before the practice may be deemed unsafe or unsound. That proposition conflicts with the fundamental structure of the FDI Act by introducing an effects element, textually reserved as a predicate for more severe remedies, into the definition of an element of misconduct. Moreover, it would require a degree of effect much more severe than the express effects elements in other statutory provisions. For a prohibition remedy, for example, the statute specifies three tiers of

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[19] The *Gulf Federal* court used the terms "financial soundness," "financial integrity," and "financial condition" interchangeably and seemed to equate them with the formulation of "financial stability" used by the thrift in its argument.

[20] The Court also suggested, without holding, that its "financial integrity" gloss might similarly apply to the violation of law provision, without citing any additional authority for that proposition. *Id.* at 265 n.5. The succeeding decision in *Bellaire* converted this dictum into a holding. *Bellaire*, 697 F. 2d at 681.

alternative elements that must be established: "misconduct," "effect," and "culpability." The required statutory effect tier for prohibition may be satisfied by a showing of: financial gain to the individual; that the institution "suffered or probably will suffer financial loss or other damage;" or that the interests of the depositors could be prejudiced. 12 U.S.C. § 1818(e)(1)(B). Where, textually, therefore a prohibition can be imposed by a simple showing of "financial loss or other damage," *Gulf Federal* would require that such loss be of a magnitude that threatened the institution's integrity to warrant the less severe remedy of a cease-or-desist order. Even more disruptive to the statutory scheme, *Gulf Federal* would inject this elevated "effects" requirement into the "misconduct" definition of an unsafe or unsound practice, so that a higher degree of effect would need to be shown in the misconduct tier than in the effects tier. *Gulf Federal* is therefore in irreconcilable conflict with the statutory text and structure.

Gulf Federal would create similar conflicts with other statutory remedies. The requirements for a Second Tier civil money penalty may be satisfied if the misconduct at issue, *inter alia*, "causes or is likely to cause more than minimal loss" to the institution. 12 U.S.C. § 1818(i)(2)(B)(ii)(II). A temporary cease-and-desist order may be satisfied by a showing, *inter alia*, that the misconduct is likely to "weaken the condition of the institution." 12 U.S.C. § 1818(c)(1). In each instance, where the remedy sought is predicated on the misconduct element of unsafe or unsound practice, the *Gulf Federal* gloss would impose a steeper effects test at the misconduct tier than the textually specified effects requirements for that remedy.

c. The Gulf Federal Gloss Is Inconsistent with Horne.

While characterizing the Horne definition as "authoritative," *Gulf Federal* adopted a standard that is inconsistent with Horne in fundamental respects. Horne: "Generally speaking, an unsafe or unsound practice embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds." Insofar as the *Gulf Federal* gloss requires a risk to the insurance funds – which implies that the institution be at risk of failure – it is plainly inconsistent with the Horne standard, which also embraces risks to the institution and its shareholders. Such risks can be posed by practices with potential consequences much less severe than those that would threaten the stability or soundness of the institution. Another crucial difference is that Horne directs attention to the nature of the practice and not necessarily any already-realized actual effect from the practice: it is sufficient that it be of a type "the possible consequences of which, if continued" would be abnormal risk or loss or harm.

Under the Horne definition, accordingly, the misconduct at issue in *Gulf Federal*, an institution cheating its borrowers, can represent risks to the institution in the form of compensatory and perhaps punitive liability as well as reputation risk,[21] even if those risks

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[21] The OCC formally recognizes "reputation risk" as a species of "safety or soundness" concern. As set out in the Comptroller's Handbook for Large Bank Supervision, the OCC identifies eight different categories of risk that may have an impact on the safety or soundness of a financial institution: credit risk, interest rate risk, liquidity risk, price risk, operational risk, compliance risk, strategic risk, and reputation risk. As defined in the Handbook:

would not necessarily directly affect the institution's soundness.

d. The Supreme Court Expressly Rejected the Limits upon FHLBB Authority Identified in Gulf Federal.

The Supreme Court expressly rejected a fundamental part of the reasoning of *Gulf Federal* only a year after it was decided, authority that has not been acknowledged by the courts that have relied upon *Gulf Federal*. *Gulf Federal*'s unsafe or unsound practice holding was based in substantial part on the Fifth Circuit's understanding that the FHLBB lacked the power to supervise thrifts' relationships with borrowers. "If the [FHLBB] can act to enforce the public's standard of fairness in interpreting contracts, the [FHLBB] becomes the monitor of every activity of the association in its role of proctor of public opinion. This departs entirely from the congressional concept of acting to preserve the financial integrity of its members." *Gulf Federal,* 651 F.2d at 265. That understanding also controlled the *Gulf Federal* preemption holding. *Id.* at 266. *See supra* p. 18.

In *Fidelity Federal Sav. & L Ass'n v. De la Cuesta*, 458 U.S. 141 (1982), the Court upheld the authority of the FHLBB to promulgate a preemptive regulation governing due-on-sale provisions in thrift mortgage contracts. In reaching that conclusion, the Court rejected the argument that the statutory authority of the FHLBB was insufficiently broad to permit it to regulate mortgage contracts. "Thus in [HOLA], Congress gave the [FHLBB] plenary authority to issue regulations governing federal savings and loans. . . ." *Id.* at 160. "The broad language of [HOLA] expresses no limits on the [FHLBB's] authority to regulate the lending practices of federal savings and loans." *Id.* at 161.

In *De la Cuesta,* the Supreme Court criticized *Gulf Federal*'s limited view of FHLBB authority twice in reaching that conclusion. First, a footnote collecting cases acknowledged the FHLBB's authority to issue preemptive regulations and identified *Gulf Federal* as one of only two decisions that erroneously reached the contrary conclusion. *Id.* at 151 n.9. The Court identified in a parenthetical the *Gulf Federal* proposition it thought wrong: "[FHLBB] has authority only over internal management of savings and loans, and not over disputed loan agreement provisions." *Id.* Second, more directly, the Court stated: "**We therefore reject appellees' contention that the [FHLBB's] power to regulate federal savings and loans extends only to the associations' internal management and not to any external matters, such as their relationship with borrowers.** Although one federal and one state court have

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> Reputation risk is the risk to current or anticipated earnings, capital, or franchise or enterprise value arising from negative public opinion. This risk may impair a bank's competitiveness by affecting its ability to establish new relationships or services or continue servicing existing relationships. Reputation risk is inherent in all bank activities and requires management to exercise an abundance of caution in dealing with customers, counterparties, correspondents, investors, and the community.

Comptroller's Handbook, Large Bank Supervision (January 2010) (Updated May 2013), p. 63, available at http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/lbs.pdf (last visited Sept. 24, 2014).

drawn this distinction [*citing Gulf Federal* and a state case], we find no support in the language of the HOLA or its legislative history for such a restriction on the [FHLBB]'s authority." *Id.* at 170 n.23 (emphasis added).

While both of the Supreme Court's citations are to the *Gulf Federal* preemption holding, that holding relied upon precisely the same proposition as that substantially underlying the unsafe or unsound practice analysis: that the FHLBB's authority was limited to internal management and did not extend to a thrift's mortgage contracts. The Supreme Court's flat rejection of that proposition accordingly undermined a primary basis for the restrictive gloss in *Gulf Federal* just a year after *Gulf Federal* was decided.[22] For those courts that have relied upon *Gulf Federal* in the enforcement context, the failure to acknowledge the necessary effect of *De la Cuesta* on the authority of *Gulf Federal* undermines the authoritativeness of those decisions.

e. The Policy Implications of the Gulf Federal Gloss Conflict with the Statutory Purpose of FISA.

As noted above, the legislative history indicates that the FISA legislation was designed to provide supervisory agencies with more flexible supervisory tools than the previously existing, rarely used, power to terminate deposit insurance. S. Rep. No. 89-1482, at 5 (1966). The provision of cease-and-desist authority to the agencies furthered the Congressional intent to permit agencies greater flexibility to intervene before a bank's deteriorated condition became irreversible. That purpose cannot be reconciled with the *Gulf Federal* requirement that agencies cannot act upon an unsafe or unsound practice until such time as the conduct threatens an institution's stability.[23]

f. Later-Enacted Legislation Supersedes Gulf Federal.

Even if *Gulf Federal* were good law at the time, Congress' later addition of enforcement tools in subsequent legislation would strongly indicate congressional intent to supersede *Gulf Federal*, even though the statutory term in 1818(b)(1) has not been amended. In 1989, Congress enacted FIRREA in response to the savings and loan crisis, which expanded agency enforcement authority in several respects. "Read in its entirety, the statute manifests a purpose of granting broad authority to financial institution regulators." *Akin v. OTS*, 950 F.2d 1180, 1184 (5th Cir. 1992). Among other things, FIRREA added express cease-and-desist authority

[22] A Fifth Circuit decision in a preemption case in 1994 acknowledged that *Gulf Federal* was not good law on this point. *First Gibraltar Bank v. Morales*, 19 F.3d 1032, 1051 (5th Cir. 1994) (federal statutes and regulations preempt state homestead law). The *First Gibraltar Bank* court concluded "*Gulf Federal* is not good authority for the proposition that the power delegated to the FHLBB was limited solely to the internal management of federal savings associations in light of *De la Cuesta*." *Id.*

[23] To the extent that the legislative history of FISA is entitled to weight, Enforcement Counsel is correct that the thrift industry proposed a statutory test resembling the *Gulf Federal* gloss that was not enacted. *Hearings on S. 3158 Before the House Comm. on Banking and Currency*, 89th Cong., 2d Sess. 320-21 (1966). An OCC adjudication cited that legislative history in rejecting the *Gulf Federal* gloss. *In re Citizens Nat'l Bank*, No. AA-EC-81-06 at 33 & n.84 (OCC June 17, 1982).

for agencies to seek affirmative relief, including, in certain circumstances, restitution. 12 U.S.C. § 1818(b)(6)(A).[24] This statutory authority to seek restitution is in direct conflict with *Gulf Federal*'s conclusion that the supervisory agency has no consumer protection authority, and thus supersedes that aspect of the *Gulf Federal* analysis. Any reliance on the FISA legislative history that controlled *Gulf Federal* must therefore be reconsidered in light of the intent of Congress in FIRREA and later-adopted legislation.

g. The Gulf Federal Gloss Has No Consistent Meaning.

The most potentially disruptive implication of the *Gulf Federal* analysis was the court's suggestion that the potential liability loss to the thrift must be weighed against its asset base to determine whether the practice causing the loss was unsafe or unsound. This suggestion implied that a practice could not be unsafe or unsound until the institution approached failure. It also implied that a large institution would have insulation from a charge of unsafe or unsound practices not available to identical conduct engaged in by a smaller institution. But in *Bellaire*, decided just two years later, the Fifth Circuit purported to apply the *Gulf Federal* gloss in reviewing a cease-and-desist order based on a "violation of law," and yet did so in a very different way. In *Bellaire*, it was not a realized threat to the financial soundness of the institution that mattered, but that the insider lending statute at issue was of **a type** that had a "direct relationship" with a "bank's soundness." So stated, the gloss appears to be consistent with Horne. Subsequent cases in other circuits quoting *Gulf Federal* have sometimes replicated this ambiguity between quantified threats to soundness on the one hand and generic relationship to **potential** risks on the other. *See, e.g.*, *Seidman v. OTS*, 37 F.3d 911 (3d Cir.1994) (discussed *infra* pp. 25-26).

h. Brand X Applies to the Comptroller's Interpretation in the Fifth Circuit.

The ALJ concluded that the Comptroller is bound by the authority of the Fifth Circuit under the "Law of the Circuit Doctrine." The Comptroller concludes otherwise and declines to adopt the ALJ's recommended conclusion on this point, in general for the reasons advanced by Enforcement Counsel.

First, the OCC is not bound by caselaw on the basis identified by the ALJ. The primary reason given by the ALJ for conforming to the restrictive gloss is what he identified as the "Law of the Circuit Doctrine," relying on two cases, *Hoffman v. FDIC*, 912 F.2d 1172 (9th Cir. 1990) and *Llapa-Singhi v. Mukasey*, 520 F.3d 897 (8th Cir. 2008). RD 74. Neither case stands for the proposition that either the ALJ or the agency must tailor its reasoning at the adjudication stage to the law of the courts in which a petition for review might be filed. The cases instead stand in relevant part for the proposition that circuit courts of appeals are not bound by the decisions of other courts of appeals. *See Hoffman,* 912 F.2d at 1175; *Llapa-Singhi*, 520 F.3d at 901.

Second, the OCC is responsible for interpreting statutes for national banks and federal

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[24] The legislative history shows that Congress intended to supersede contrary Seventh Circuit judicial precedent in doing so. *Akin*, 950 F.2d at 1184 (citing H.R. Rep. No. 54(I), 101st Cong., 1st Sess. 467-68 (1989)).

thrifts with home offices in states throughout the nation. It is neither practical nor appropriate for the OCC to adopt different statutory interpretations for institutions with home offices in different circuits, or alternatively, attempt to meld standards drawn from different courts. A fundamental characteristic of the national bank system is that the system's federal character enables implementation of uniform national standards. *See, e.g., Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 10-15 (2007). The same is true for the system of federal thrifts. *De la Cuesta*, 458 U.S. at 159-161. The OCC has long adhered to a definition of unsafe or unsound practice based upon Horne, as have the other banking regulatory agencies. It would be contrary to the systemic needs for uniformity, and for clear guidance to national banks and federal thrifts, for the OCC to attempt to tailor its standards to the circuit in which a given national bank or federal thrift is located. It would also be unworkable where the standards of the home circuit and the D.C. Circuit were not identical.

Most important, in the *Brand X* doctrine, the Supreme Court has recognized that: "A court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion." *Brand X*, 545 U.S. at 982. Because "unsafe or unsound practice" has never been determined to have a plain meaning, the Comptroller is not bound by contrary caselaw so long as *Brand X* applies.

The Fifth Circuit extends *Chevron* deference to banking agencies in interpreting the FDI Act. *See Akin v. OTS*, 950 F.2d 1180, 1185 (5th Cir. 1992); *Bullion v. FDIC*, 881 F.2d 1368, 1374 (5th Cir. 1989). There is therefore no threshold question whether *Brand X* would apply in judicial review of an agency interpretation in the Fifth Circuit.

3. Caselaw in the Courts Other than the Fifth and D.C. Circuits Provides No Basis for Departing from the Horne Standard.

In addition to the law of the Fifth Circuit and the D.C. Circuit, the ALJ relied upon cases in the Third and Ninth Circuits. A survey of "unsafe or unsound practice" definitions in the other courts of appeals reveals a nominal split in formulations. Some circuits have applied Horne without qualification. Others have added some form of a restrictive gloss. Examination of those cases, though, shows that the restrictive gloss has been the basis for a holding in only one case outside of the Fifth and DC Circuits, *Seidman*, a Third Circuit case analyzed below. Because those circuits have not elaborated upon their understanding of the gloss, and have not relied upon it to decide a case, they provide no compelling reason for the Comptroller to depart from Horne. Furthermore, several of those circuits expressly recognize *Chevron* deference to interpretations of the FDI Act, and only the Second Circuit has adopted the D.C. Circuit doctrine of withholding deference from statutes implemented by multiple agencies, so that any meaningfully contrary authority in other circuits would be subject to *Brand X* in judicial review.

a. Several Circuits Adhere to Horne.

The Eighth Circuit has consistently applied a version of the Horne definition for unsafe

or unsound practice, and has directly rejected modifying that standard to apply a restrictive gloss. One of the earliest cases to interpret the statutory term unsafe or unsound practice upheld an OCC cease-and-desist order predicated on unsafe and unsound practices on the basis of a version of the Horne definition. *First National Bank of Eden v. Department of the Treasury*, 568 F.2d 610, 611 n.2 (8th Cir. 1978). The Eighth Circuit has since adhered to this version of the Horne definition repeatedly. *See Northwest Nat'l Bank v. Department of the Treasury*, 917 F.2d 1111, 1115 (8th Cir. 1990) (*Eden* formulation); *Oberstar v. FDIC*, 987 F.2d 494, 502 (8th Cir. 1993) (*Eden* formulation); *Greene County Bank v. FDIC*, 92 F.3d 633, 636 (8th Cir. 1996) (*Eden* formulation); *cf. Van Dyke v. Board of Governors*, 876 F.2d 1377, 1380 (8th Cir. 1989) ("abnormal risk of loss or harm contrary to prudent banking practices") (construing "willful disregard for safety or soundness" in the prohibition provision). In *Greene County*, the Eight Circuit expressly rejected the argument that "unsafe or unsound practice" standard should be limited to practices "having a reasonably direct effect on the Bank's financial condition," notwithstanding its acknowledgment that courts in the Third, Ninth, and Fifth circuits had adopted that gloss, because it was "well-settled in this Circuit" that the *Eden* standard applied. *Greene County*, 92 F.3d at 636.

The Second and Eleventh Circuits have adopted versions of the Horne definition without the restrictive gloss. *See Gully v. NCUA,* 341 F.3d 155, 165 (2d Cir. 2003) (accepting Horne); *Cavallari v. OCC*, 57 F.3d 137, 142 (2d Cir. 1995) (accepting *Eden* formulation); *Doolittle v. NCUA*, 992 F.2d 1531, 1538 (11th Cir. 1993) (Eighth Circuit standard).

b. Several Circuits Have Recited a Restrictive Standard But Have Not Applied It.

In *Michael v. FDIC*, 687 F.3d 337, 352 (7th Cir. 2012), the Seventh Circuit appeared to adopt the Eighth Circuit standard, citing to *Van Dyke.* The Seventh Circuit also, then, cited to *Seidman*, without expressly adopting the restrictive gloss and also quoted the D.C. Circuit's *Landry* test ("reasonably foreseeable undue risk to the institution") without noting any tension between the standards.[25] *Michael*, accordingly, supports the proposition, discussed below, that the prevailing D.C. Circuit standard is consistent with Horne.

The Tenth Circuit, similarly, appears to have come down on both sides of the issue without indicating awareness that it was doing so. The Tenth Circuit firmly endorsed the Horne/Eighth Circuit standard in the context of the culpability term "disregard for safety and soundness" in *Grubb v. FDIC*, 34 F.3d 956, 962 (10th Cir. 1994). Much later, in a case that was deferential to the banking agency, the Tenth Circuit recited a restrictive gloss without indicating that it intended any change in its precedent and without placing weight on it: "[Horne definition plus] reasonably direct effect on an association's financial status." *Frontier State Bank v. FDIC*, 702 F.3d 588, 604 (10th Cir. 2012).

The Ninth Circuit has applied a "reasonably direct effect on financial soundness" test

[25] The Seventh Circuit applies the *Chevron* framework to interpretations of the FDI Act. *Larimore v. Comptroller*, 789 F.2d 1244, 1248 (7th Cir. 1986) (Step One). Accordingly, *Brand X* would apply to judicial review in the Seventh Circuit.

without explanation, but the gloss has not been the basis for a holding. *See Hoffman v. FDIC*, 914 F.2d 1172, 1174 (9th Cir. 1990) (quoting but not adopting *Gulf Federal*); *Simpson v. OTS***,** 29 F.3d 1418, 1425 (9th Cir. 1994). Notwithstanding its repetition of the gloss, the *Simpson* panel deferred to the agency under *Chevron* and sustained a cease-and-desist order. *See id.* at 1425. Another Ninth Circuit panel repeated the *Simpson* formulation, including the gloss, but applied the standard deferentially. *De La Fuente v. FDIC*, 332 F.3d 1208, 1222-23 (9th Cir. 2003). Because the panel recognized that "we may not substitute our judgment for that of the agency," the panel sustained the agency's sanctions based on an unsafe or unsound practice. *Id.* at 1225.[26]

Because the Seventh, Ninth and Tenth Circuits have not relied upon the restrictive gloss to decide a case, and have not provided a rationale for imposing the additional requirement, they provide no persuasive reason for the Comptroller to depart from Horne. Furthermore, the Seventh and Ninth Circuits recognize *Chevron* deference to interpretations of the FDI Act, and none of the three courts has adopted the D.C. Circuit multiple-agency doctrine, so that any meaningfully contrary authority would be subject to *Brand X* upon judicial review.

c. Seidman, Which Applied a Restrictive Standard, Relied upon Bad Law.

Seidman v. OTS, 37 F.3d 911 (3d Cir. 1994), was cited by the ALJ, relied upon by several other courts including the D.C. Circuit in *Johnson v. OTS*, and is notable in several respects. First, it is one of the few courts applying the *Gulf Federal* gloss to explain in any length its adoption of the restrictive standard, and has been relied upon by other courts that adopted the gloss without explication.[27] Second, *Seidman* applied the restrictive standard inconsistently, once in the *Gulf Federal* sense[28] and a second time in the *Bellaire* sense.[29] Third, a dissenting judge forcefully endorsed the standard applied by the banking agencies and Horne and would have upheld the agency charges of unsafe or unsound practices that the majority vacated. *Id.* at 940-45.

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[26] The Ninth Circuit recognizes *Chevron* deference to interpretations of the FDI Act, so that *Brand X* would apply in any judicial review in that circuit. *Simpson v. OTS*, 29 F.3d 1418 (9th Cir. 1994).

[27] One of the remedies sought by the OTS in *Seidman* was a cease-and-desist order predicated on an allegedly unsafe or unsound practice where a thrift officer approved a commitment for a mortgage where the chairman of the board had a conflict of interest. In interpreting the term unsafe or unsound practice, the court applied *Chevron* and adopted the Horne definition. *Seidman*, 37 F.3d at 924, 927. The court added a restrictive gloss, however: "The imprudent act must impose an abnormal risk to the financial stability of the institution." *Id.* at 928.

[28] The Third Circuit determined that on the facts of the case, the potential harm to the thrift did not rise to the level of an unsafe or unsound practice, but was rather more like the risks in *Gulf Federal*: "contingent, remote harms" that could ultimately result in minor financial losses to the institution, but did not pose such an abnormal risk that the thrift's financial stability was threatened. *Id.* at 929.

[29] The *Seidman* court found that an attempt to hinder the OTS investigation was inherently unsafe or unsound, without quantifying the risk. "Where a party attempts to induce another to withhold information from the agency, the agency becomes unable to fulfill its regulatory function. Such behavior, if continued, strikes at the heart of the regulatory function." *Id.* at 937. Accordingly, an attempt to hinder an agency investigation, without more, constitutes an unsafe or unsound practice.

Most important, the legal basis for the Third Circuit's adoption of the gloss is unsound. The court stated that it had derived that standard from four cases: *Gulf Federal* and the legislative history relied on there; the Fifth Circuit's decision in *MCorp Financial, Inc. v. Board of Governors*, 900 F.2d 852 (5th Cir. 1990), which had also relied on *Gulf Federal;* and two Eighth Circuit cases that applied the Horne standard without a gloss. The court's reliance on *Gulf Federal* was misplaced for the reasons stated above. Reliance on the Fifth Circuit's decision in *MCorp* was also error; the Supreme Court had previously reversed that decision for lack of jurisdiction. *Board of Governors v. MCorp Financial, Inc.*, 502 U.S. 32 (1991).[30] The Eighth Circuit cases do not support the restrictive standard. The Third Circuit decision therefore lacks a basis in viable authority for its adoption of the restrictive gloss.

Seidman's adoption of a form of restrictive gloss on the Horne definition has been influential with other courts. The infirmities in *Seidman*'s reasoning and the force of the dissent, however, undermine *Seidman* as a basis for any departure from Horne.[31]

[30] The Supreme Court in *MCorp* in 1991 had reversed the Fifth Circuit merits decision for lack of jurisdiction. *See MCorp*, 502 U.S. at 44-45). The Fifth Circuit has acknowledged this result. "The Supreme Court reversed this court's decision in *MCorp* for lack of jurisdiction, thereby vacating our ruling on the scope of § 1818." *Akin v. OTS*, 950 F.2d 1180, 1185 (5th Cir. 1992). Accordingly, no part of the *MCorp* Fifth Circuit merits opinion on unsafe or unsound practice remained good law when *Seidman* was decided in 1994.

[31] The Third Circuit applies *Chevron* deference to agency interpretations of the FDI Act. *Seidman*, 37 F.3d at 924. Accordingly, *Brand X* would apply to judicial review in the Third Circuit.

4. Caselaw in the D.C. Circuit Provides No Basis for Departing from the Horne Standard.

a. The D.C. Circuit Standard Is in Harmony with Horne.

In the D.C. Circuit, the precise formulation for unsafe or unsound practice has varied. The case relied upon by the ALJ, *Johnson v. OTS,* 81 F.3d 195 (D.C. Cir. 1996), departed from previous deferential D.C. Circuit authority and has been succeeded by other D.C. Circuit cases that seem to have adopted a different standard. Because one construction of the D.C. Circuit standard is consistent with Horne, the law of the D.C. Circuit does not provide a reason for the Comptroller to depart from the Horne standard.

Early cases. In two early cases, neither of them a review of an enforcement adjudication, the D.C. Circuit indicated that it would defer to the banking agencies in defining "unsafe or unsound practice." In 1979, the D.C. Circuit denied a challenge to an OCC regulation concerning credit life insurance because of the agency's authority to interpret section 1818(b). "The Comptroller's statutory duties require the closest monitoring and continuous supervision of [national banks]. Thus, the Comptroller's discretionary authority to define and eliminate 'unsafe and unsound conduct' is to be liberally construed." *Independent Bankers Ass'n of America v. Heimann*, 613 F.2d 1164, 1168-69 (D.C. Cir. 1979). Similarly, in denying a challenge based on *Gulf Federal* to an FDIC regulation as inconsistent with section 1818(b), the D.C. Circuit stated: "Authority to determine what constitutes an 'unsafe' or 'unsound' banking practice is firmly committed to the agency." *Investment Company Institute v. FDIC*, 815 F.2d 1540, 1550 (D.C. Cir. 1987).

Johnson v. OTS. The D.C. Circuit departed from that deferential approach, without acknowledging the departure, in *Johnson v. OTS*, 81 F.3d 195, 109 (D.C. Cir. 1996). The agency, which was seeking a cease-and-desist order based, *inter alia*, on unsafe or unsound practices, adopted a two-part definition consistent with the Horne definition. *Id.* at 201. The agency charged that this definition was satisfied by the thrift's officers' expenditure of legal fees to pursue an unsuccessful appeal of an agency decision, where the interests of the thrift insiders diverged from that of the thrift. *Id.* at 204. The D.C. Circuit concluded that this "perfunctory analysis" was at odds with the "weight of case law" holding that the "'unsafe or unsound practice' provision refers only to practices that **threaten the financial integrity** of the association." *Id.* (emphasis added). The only two cases identified by the D.C. Circuit as support for this proposition were *Gulf Federal* and S*eidman*. The court did not acknowledge the authority on the other side of the split in the circuits. The court did not elaborate on the meaning of the test, other than to observe that the actual loss caused by the conduct did not, by itself, establish an abnormal risk to the financial stability or integrity of the institution. *Id.*

The persuasiveness of this authority is compromised by the two cases that make up the "weight of authority" reasoning. First, for the reasons given above, *Gulf Federal* is unentitled to weight. Second, the Third Circuit's decision in *Seidman* has distinctive infirmities, as discussed above. In any event, subsequent D.C. Circuit caselaw suggests that the *Johnson* formulation is not the current D.C. Circuit standard.

Kaplan/Landry. A year after *Johnson*, the D.C. Circuit stated the test differently, again without extended analysis. At one point, the court observed that "it may also be true – assuming a breach of duty is a violation of a 'law' or an unsafe unsound practice under § 1818(b)(1) – that the bank regulating agencies administering § 1818 are entitled to obtain at least a cease-and-desist order against a bank director. . . **whether or not harm befalls the financial institution**." *Kaplan v. OTS*, 104 F.3d 417, 421 (D.C. Cir. 1997) (emphasis added). This formulation appears to be in tension with the "threat to financial integrity" *Johnson* standard. The *Kaplan* court elaborated that: "whether one speaks of a breach of fiduciary duty or an unsafe or unsound practice, the common element that OTS must show is behavior that creates an **undue risk to the institution**." *Id.* at 421 (emphasis added). "**Any such risk must of course be reasonably foreseeable**. That is not to say that the exact series of events that cause injury or loss to the institution must be perceived or even perceivable, but surely no director can be faulted for approving a management proposal that does not pose an **increased risk of some kind** to the financial institution." *Id.* (emphasis added). The court did not cite to *Johnson* or repeat the formulation used in *Johnson*. The court did not state a basis for the "reasonably foreseeable" additional requirement or explain it further. It is notable, though, that the quoted passage appeared to equate "reasonable foreseeability" with "increased risk of some kind."

In a succeeding case, the D.C. Circuit applied the *Kaplan* formulation rather than the *Johnson* formulation, though it did acknowledge *Johnson* on a related point. "In *Kaplan* we suggested that 'an unsafe or unsound practice' was one that posed a 'reasonably foreseeable' 'undue risk to the institution.'" *Landry v. FDIC*, 204 F.3d 1125, 1138 (D.C. Cir. 2000). While the *Landry* panel did not apply a restrictive gloss, it harmonized its approach with the Third Circuit in *Seidman,* which had. Factually, the bank in *Landr*y had been in a weakened condition, so that the conduct "created an undue and abnormal risk of insolvency," *id.*, but the *Landry* panel did not suggest that a risk of insolvency was required. To the contrary: "Landry argues that the continuing profitability of the Bank during the relevant period forecloses a finding of undue risk, but in so arguing he misconstrues the concept of risk, which is independent of the outcome in a particular case. Just as a loss, without more, does not prove an act posed an abnormal risk [citing to *Johnson*], a profit does not establish its absence." *Id.* The *Landry* panel's emphasis on abnormal risk to the institution, rather than to its stability or integrity, is consistent with Horne.[32]

Dodge. The most recent D.C. Circuit decision on point relies upon *Landry* and *Kaplan* for the applicable standard: "An unsafe or unsound practice is one that posed a reasonably foreseeable undue risk to the institution." *Dodge v. Comptroller of the Currency*, 744 F.3d 148, 156 (D.C. Cir. 2014) (internal quotations omitted). In addition, though, the *Dodge* court continues: "There was substantial evidence that Dodge's repeated reporting of certain

[32] A D.C district court decision characterized the *Kaplan* standard as the operative standard in the D.C. Circuit. "In this circuit, a Bank operates in an unsafe or unsound condition if it is in a condition or engaged in a practice that presents a reasonably foreseeable undue risk to the institution." *United Western Bank v. Office of the Comptroller of the Currency*, 928 F. Supp. 2d 70, 94 (D.D.C. 2013).

contributions as qualifying capital 'threatened the financial integrity of the [thrift]." *Id.* (quoting *Johnson v. OTS*). Accordingly, while the court relied upon the *Kaplan/Landry* standard, it also found the *Johnson* standard satisfied.

Read collectively, these cases suggest that, while the status of *Johnson* and the more stringent standard is unclear, *Kaplan/Landry* is the prevailing standard in the D.C. Circuit: an unsafe or unsound practice is one that poses a "reasonably foreseeable undue risk to the institution." As noted above, *Kaplan* equated foreseeability with "increased risk of some kind." The Ninth Circuit so understood *Kaplan*.[33] *De La Fuente*, 332 F.2d at 1223. To the extent that "foreseeability" means "increased risk of some kind," the *Kaplan* formula is consistent with Horne, and the Comptroller adopts that understanding.[34]

Accordingly, this reading of the present state of the law in the D.C. Circuit suggests consistency with Horne and thus with the Comptroller's interpretation of unsafe or unsound practice.

b. If a Conflict Were to Exist Between the Standard Adopted by the Comptroller and the Law of the D.C. Circuit, It Could Be Resolved by Application of Chevron and Brand X Deference to Agency Interpretations of the FDI Act.

Because the Comptroller does not identify a necessary conflict with the law of the D.C. Circuit, there is no need to consider the ALJ's recommendation that the Comptroller is bound by the Law of the Circuit Doctrine.

Alternatively, if such a conflict existed, the Comptroller would decline to adopt the ALJ's recommendation for the same reasons as addressed above for the Fifth Circuit: the cases cited for the Law of the Circuit Doctrine are inapposite, and the federal system for national banks and federal thrifts requires uniformity in the predicates for an enforcement action. The departure from the analysis for other circuits, though, is that while *Brand X* plainly

[33] This reading is further supported by the Seventh Circuit in *Michael v. FDIC*, 687 F.3d 337, 352 (7th Cir. 2012), which, as noted above, cited the Eighth Circuit standard and the *Landry* standard as consistent.

[34] Other constructions of "foreseeability" would produce conflict with statutory structure and function. For example, if foreseeability required a certain state of mind, it would introduce a culpability element into the definition of a form of misconduct. That would conflict with the structure of the statute, as outlined above, which addresses state of mind in such distinct culpability elements as "willful or continuing disregard" for safety or soundness, an alternate element supporting prohibition, 12 U.S.C. § 1818(C)(1)(c)(ii), or "recklessly engages" in an unsafe or unsound practice, an element of a Second Tier civil money penalty. 12 U.S.C. § 1818(i)(2)(B)(i)(II). The focus in identifying an unsafe or unsound practice is the nature of the practice, which exists independently of foreseeability. Alternatively, to the extent that "foreseeability" invokes equitable considerations, it is appropriately addressed by reviewing courts under the rubric of "arbitrary and capricious" rather than in the definition of misconduct. Even if foreseeability were cognizable under Horne, it would conflict with authority recognizing that a practice might reasonably be deemed unsafe or unsound, and subject to a cease-and-desist order, even if the risks were not previously apparent to the institution or the agency. *See Frontier State Bank v. FDIC,* 702 F.3d 588, 599-600 (10th Cir. 2012) (evolving understanding of practice by agency and industry does not preclude cease-and-desist order); *see also Kaplan*, 124 F.3d at 421 (exact sequence of events need not be perceived or perceivable).

applies to review of agency interpretations of the FDI Act in the Fifth Circuit and almost all other circuits, it would presumably not apply under present law in the D.C. Circuit, which has repeatedly declined to apply *Chevron* to agency interpretations of the FDI Act.

The D.C. Circuit's approach to C*hevron* and the FDI Act has evolved in at least three distinct phases. In the first, the circuit applied a deferential approach to expert banking agencies under the FDI Act, including the OCC's interpretation of "unsafe or unsound." In the second, in decisions in the 1990s, the court initially likened the banking agencies' interpretations of the FDI Act to agency interpretations of "generic" statutes, such as the Administrative Procedure Act or the Rehabilitation Act, in which no agency was given specific interpretive authority by Congress. The court has since receded from that characterization, acknowledging that the banking agencies have specialized expertise.[35] The prevailing D.C. Circuit rationale for withholding deference embraces policy concerns stemming from the possibility of incidental overlap of agency supervisory authority under the FDI Act: that a single term might be given different meanings by different agencies, or that a single supervised party might be subject to conflicting guidance from different agencies.

Those concerns are misplaced as a practical matter. None of the cases where deference was withheld under the FDI Act involved manifest conflicts among the agencies in defining statutory terms. In practice, because the FDI Act assigns primary supervisory responsibility to each agency for distinct supervised populations, the likelihood of conflicting guidance from different agencies to the same entity is minimized. Congress has designated the OCC as the appropriate Federal banking agency under the FDI Act in the case of national banks, federal branches and agencies of foreign banks, and Federal savings associations. 12 U.S.C. § 1813(q)(1). Overlapping statutory authority over the same institution is possible in only a small subset of the institutions supervised by the OCC.[36] Courts in the DC Circuit have at times showed consciousness of the tension between the guidance rationale for withholding deference and the Congressional assignment of distinct primary responsibilities that alleviate the risks of conflict.[37] That consciousness has not yet caused the court to reconsider its doctrine.

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[35] *See, e.g.*, *Collins v. NTSB*, 352 F.3d 1246, 1253 (D.C. Cir. 2003).

[36] While the FDI Act provision allocating agency responsibilities leaves open the general possibility that more than one agency may be the "appropriate Federal banking agency" with respect to an institution, that same section specifically assigns distinct responsibilities that are inconsistent with overlap. 12 U.S.C. § 1813(q). A narrow exception is presented by branches of foreign banks, which may be supervised by the Federal Reserve and the OCC, and with respect to insured branches, the FDIC. *See* 12 U.S.C. §§ 1813(q)(2)(B); 1813(q)(3)(B). With respect to the OCC's predominant supervised population, national banks and Federal savings associations, Congress has designated no other agency as the "appropriate Federal banking agency." While the FDIC has backup authority that allows it to recommend enforcement action by the primary supervisory agency, and authorizes the FDIC to act if the primary supervisor does not (12 U.S.C. § 1818(t)), that authority by its terms preserves the distinction between primary supervisor and backup authority, and therefore does not create confusion as to the primary source of guidance for the supervised institutions.

[37] *See, e.g., Rappaport v. OTS*, 59 F.3d 212, 221-22 (D.C. Cir. 1995) (Rogers, J. concurring) (delineation of agency responsibilities under the FDI Act responds to guidance concerns); *cf. Nat'l Home Equity Mortgage Ass'n v. OTS*, 271 F. Supp. 2d 264, 274-75 (D.D.C. 2003), *aff'd* 373 F.3d 1355, 1361 n.* (D.C. Cir. 2004) (deference extended to multiple agencies under the Parity Act because statute delineates distinct supervisory populations).

Even if there were a significant area of agency overlap, it could be addressed by the mechanisms the agencies employ for coordinating the interpretation and implementation of shared statutes, which has been the prevailing norm for over twenty years. Most recently, the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank Act") mandated a number of joint rulemakings. *See, e.g., id*. at Title VI, § 619, 124 Stat. 1620 (requiring the Federal banking agencies to issue joint regulations implementing prohibitions on proprietary trading) (codified at 12 U.S.C. § 1851(b)(2)(B)(i)(l)). Through the Dodd-Frank Act, Congress was attentive to delineating authority among agencies when, for example, it transferred the functions of the former OTS to other agencies and established a new agency in the Consumer Financial Protection Bureau ("CFPB").

The D.C. Circuit's reservation to the judiciary of interpretive authority over the FDI Act also creates disharmony with the Supreme Court's recent repeated reaffirmations of the policies underlying *Chevron*. Those policies include uniform standards of judicial review and preference for the uniformity created by deference to expert agency interpretations, in contrast to the disparate interpretations that can be caused by *de novo* review by multiple courts of appeals. The issue in this case illustrates that dysfunction. While the three banking agencies have adopted materially identical formulations of "unsafe or unsound practice," the courts of appeals have adopted a variety of different formulations. For an institution that operates nationally or regionally, as do many national banks and federal thrifts, there is accordingly far more prospect of conflicting guidance from the courts of appeals than from the supervisory agencies, especially as each institution has a single primary supervisor.

Reconsideration of the D.C. Circuit doctrine is warranted for good reasons, including: 1) tension with the test for *Chevron* stated by the Supreme Court and derogation from the C*hevron* policy favoring uniformity of agency interpretation; 2) the circuit split created and maintained with other courts of appeals that continue to apply *Chevron* to interpretations of the FDI Act; and 3) the court's inconsistency in applying the doctrine, as the D.C. Circuit itself has acknowledged.

Tension with Supreme Court Authority. The Supreme Court has not addressed whether *Chevron* deference should be withheld where Congress has assigned multiple agencies to administer a statute with respect to distinct supervised populations. But that proposition finds no support in the Supreme Court's recently reiterated threshold principle: "Under *Chevron*, we presume that when an agency-administered statute is ambiguous with respect to what it prescribes, Congress has empowered the agency to resolve the ambiguities." *Utility Air Regulatory Group v. EPA*, 134 S.Ct. 2427, 2439 (2014). "[T]he preconditions to deference under *Chevron* are satisfied because Congress has unambiguously vested the [agency] with general authority to administer the [statute] through rulemaking and adjudication,[38] and the agency interpretation at issue was promulgated in the exercise of that authority." *Arlington v. FCC*, 133 S.Ct. 1863, 1874 (2013).

[38] Accordingly, the Supreme Court has recently reaffirmed that adjudications are entitled to the same deference as rulemakings under *Chevron*.

Applying this test here, Congress has assigned the OCC plenary authority, with very limited exceptions, to adopt regulations "to carry out the responsibilities of the office. . . ." 12 U.S.C. § 93a. The FDI Act defines the term "appropriate Federal banking agency" to be the OCC with respect to adjudications involving national banks and Federal savings associations. 12 U.S.C. § 1813(q)(1). Accordingly, Congress has designated the OCC as the agency to administer the FDI Act with respect to national banks and Federal savings associations, and under the basic *Chevron* test, the OCC is empowered to resolve ambiguities in terms such as "unsafe or unsound practice" in actions with the requisite formality, such as rulemakings and adjudications.

In *Brand X*, the Supreme Court reiterated its preference that statutes be interpreted by agencies rather than courts. "[A]llowing a judicial precedent to foreclose an agency from interpreting an ambiguous statute . . . would allow a court's interpretation to override an agency's. *Chevron*'s premise is that it is for agencies, not courts, to fill statutory gaps." *Brand X*, 545 U.S. at 983. The Court warned that a contrary rule would lead to the "ossification" of much statutory law "by precluding agencies from revising unwise judicial constructions of ambiguous statutes. Neither *Chevron* nor the doctrine of *stare decicis* requires these haphazard results." *Id.*

Moreover, in a series of recent cases, the Supreme Court has resisted making exceptions to the application of *Chevron* where it was urged that special circumstances justified them. In each case, the Court indicated that, once the fundamental requirements of authority and formality had been satisfied, *Chevron* deference should not be withheld due to the specific context. While the Court has not addressed the exception for multiple agencies, such an exception runs counter to the Court's repeated expressions of policy with respect to *Chevron*.

Most recently, the Court rejected a carve-out for questions of agency "jurisdiction." *Arlington v. FCC*, 133 S.Ct. 1863 (2013). "No matter how it is framed, the question a court faces when confronted with an agency's interpretation of a statute it administers is always, simply, *whether the agency has stayed within the bounds of its statutory authority*." *Id.* at 1868 (emphasis in original). The *Arlington* majority also rejected the notion that the reviewing court must "search provision-by-provision to determine 'whether [that] delegation covers the 'specific provision' and 'particular question' before the court." "What the dissent needs, and fails to produce, is a single case in which a general conferral of rulemaking or adjudicative authority has been held insufficient to support *Chevron* deference for an exercise of that authority within the agency's substantive field. There is no such case . . . " *Id.* at 1874. The Court reiterated the policy articulated in *Brand X*. "Thirteen Courts of Appeals applying a totality-of-the-circumstances test would render the binding effect of agency rules unpredictable and destroy the whole stabilizing purpose of *Chevron*." *Id.*

Two years earlier, in *Mayo Foundation for Medical Education and Research v. United States*, 131 S.Ct. 704 (2011), the Court overruled earlier authority that had the effect of creating an exception from *Chevron* for Department of the Treasury tax regulations. "[The Petitioner] has not advanced any justification for applying a less deferential standard of review to Treasury Department regulations than we apply to the rules of any other agency. In the absence of such

justification, we are not inclined to carve out an approach to administrative review good for tax law only. To the contrary, **we have expressly recognized the importance of maintaining a uniform approach to judicial review of administrative action**." *Id*. at 713 (emphasis added and internal quotations and brackets omitted).

The *Mayo Foundation* Court noted that the principles underlying *Chevron*, including the reliance on an expert agency to resolve statutory gaps and ambiguities, apply fully in the tax context. "We see no reason why our review of tax regulations should not be guided by agency expertise pursuant to *Chevron* to the same extent as our review of other regulations." *Id*. The Court also departed from pre-*Chevron* precedent that drew a distinction between rules adopted pursuant to general authority and those issued under a specific grant of authority because "the administrative landscape has changed significantly." Deference is appropriate "when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority." *Id.* (quoting *U.S. v. Mead*, 533 U.S. 218, 226-27 (2001)). "Our inquiry in that regard does not turn on whether Congress's delegation of authority was general or specific." *Id.*[39]

Accordingly, in addition to the recently reaffirmed threshold principles that support *Chevron* deference to the OCC in interpreting the FDI Act, the Court has repeatedly rejected invitations to withhold *Chevron* deference for specific issues.[40] It has also reaffirmed principles that support reconsideration of the D.C. Circuit's disparate treatment of the banking agencies under the FDI Act, including "the importance of maintaining a uniform approach to judicial review of administrative action principle," and the importance of agency expertise.[41]

Split in the Circuits. Since 1993, only one other court of appeals has adopted the multiple-agency doctrine, while the weight of circuit authority is to the contrary. Courts of appeals for the Third, Fifth, Seventh, Eighth, and Ninth Circuits have extended deference to the banking agencies' interpretations of the FDI Act. *See*, *e.g.*, *Seidman v. OTS*, 37 F.3d 911, 924 (3d Cir. 1994); *Akin v. OTS*, 950 F.2d 1180, 1185 (5th Cir. 1992); *Bullion v. FDIC*, 881 F.2d

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[39] In the third recent case to reject a carve-out, the Court applied the *Chevron* framework to an agency regulation that it deemed preemptive in *Cuomo v. Clearing House, LLC*, 557 U.S. 519, 525 (2009).

[40] The Supreme Court has not articulated a principle for resolving the question of multiple agencies and *Chevron*, but, in practice, faced with actual conflicts of statutory interpretation, the Supreme Court has tended to assess which interpretation deserves deference rather than negating deference entirely. In *Martin v. Occupational Safety & Health Reg. Commission*, 499 U.S. 144 (1991), the Court held that deference was due the interpretation of the primary executive branch enforcer (the Secretary of Labor) rather than to that of the independent review board (the Occupational Safety and Health Review Commission). More recently, the Court reversed a decision by the Second Circuit blocking enforcement of an agency regulation that was admittedly in direct conflict with another agency regulation. Rather than withhold deference in the face of an actual conflict, the Court expressly applied *Chevron* deference to the agency's view as to which regulation controlled. *Long Island Care at Home v. Coke*, 127 S.Ct. 2339 (2007).

[41] More specifically, the Supreme Court in 1986 applied *Chevron* deference to an FDIC interpretation of the term "deposit" under a non-enforcement provision of the FDI Act. *FDIC v. Philadelphia Gear Corp.,* 476 U.S. 426, 439 (1986).

1368, 1374, (5th Cir. 1989); *Larimore v. Comptroller*, 789 F.2d 1244, 1248 (7th Cir. 1986) (Step One); *Oberstar v. FDIC*, 987 F.2d 494, 501 (8th Cir. 1993) (Step One); *Van Dyke v. Board of Governors*, 876 F.2d 1377, 1379 (8th Cir. 1989); *Simpson v. OTS*, 29 F.3d 1418, 1425 (9th Cir. 1994). In addition, the Tenth Circuit has extended *Chevron* deference to a banking agency in interpreting the Change-in-Bank-Control Act, which is also interpreted by multiple agencies. *Rapp v. OTS*, 52 F.3d 1510, 1518 (10th Cir. 1995).

Indeed, since the D.C. Circuit multiple-agency *Chevron* doctrine was first suggested in *dicta* in 1993, only one other circuit, the Second, has agreed with the doctrine, and it has done so inconsistently. In two cases, the Second Circuit reviewed FDI Act decisions *de novo*. *Cousins v. OTS*, 73 F.3d 1242, 1249 (2d Cir. 1996); *Greenberg v. Board of Governors*, 968 F.2d 164, 170 (2d Cir. 1992). In two others, the Second Circuit extended deference to agencies applying the FDI Act. *Hutensky v. FDIC*, 82 F.3d 1234, 1239 (2d Cir. 1996); *Cavallari v. OCC*, 57 F.3d 137, 142-43 (2d Cir. 1995). In two non-FDI Act multiple-agency cases, the Second Circuit gave less than full deference. *1185 Avenue of the Americas v. RTC*, 22 F.3d 494, 497 (2d Cir. 1994); *Lieberman v. FTC*, 771 F.2d 32, 37 (2d Cir. 1985).

The Seventh Circuit, in contrast, expressly declined to adopt the D.C. Circuit multiple-agency doctrine in a non-FDI Act case. *Board of Trade of City of Chicago v. SEC*, 187 F.3d 713, 718-19 (7th Cir. 1999) (Securities and Exchange Commission and Commodity Futures Trading Commission).

Accordingly, the pronounced weight of circuit caselaw is contrary to the D.C. Circuit's multiple-agency doctrine. Reconsideration by the D.C. Circuit would reduce a persistent split in the circuits.

Inconsistent Application of the Multiple-Agency Approach. In its most recent application, the D.C. Circuit took note that its FDI Act doctrine has not been applied consistently within the D.C. Circuit. "We have not been entirely consistent and unambiguous on this point." *DeNaples v. OCC*, 706 F.3d 481, 488 n.4 (D.C. Cir. 2013) (citing *Stoddard v. Board of Governors,* 968 F.2d 164, 170 (D.C. Cir. 1989) (*Chevron* framework applied to Federal Reserve interpretation of section 8(e) of FDI Act).[42] The *DeNaples* court also noted the contrary FDI Act *Chevron* practices of the Fifth Circuit (*Akin*) and Eighth Circuit (*Van Dyke*). *Id.*

As noted above, early applications of the multiple-agency doctrine to the FDI Act relied upon cases that withheld deference because the statutes involved were "generic" – the agency at issue had no special responsibility for interpreting the statute – overlooking the distinctions with the FDI Act, where the agencies have specialized expertise.[43] In 1995, the court in

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[42] The *DeNaples* court did not note that, even before *Stoddard*, the D.C. Circuit had deferred to agency interpretations of the FDI Act, as noted above. *Independent Bankers Ass'n of America v. Heimann*, 613 F.2d 1164, 1168-69 (D.C. Cir. 1979); *Investment Company Institute v. FDIC*, 815 F.2d 1540, 1550 (D.C. Cir. 1987) ("Authority to determine what constitutes an 'unsafe' or 'unsound' banking practice is firmly committed to the agency.").

[43] In *Wachtel v. OTS*, 982 F.2d 581, 585 & n.3 (D.C. Cir. 1993), the *Chevron* point was supported only by a

Rappaport v. OTS, 59 F.3d 212 (D.C. Cir. 1995), introduced a policy rationale for withholding deference: "The alternative would lay the groundwork for a regulatory regime in which either the same statute is interpreted differently by the several agencies or the one agency that happens to reach the courthouse first is allowed to fix the meaning of the text for all. Neither outcome is unthinkable, of course, but neither has the OTS suggested any reason to believe the congressional delegation of administrative authority contemplates such peculiar corollaries." *Id.* at 217 (citations omitted). The reasoning did not purport to apply the classic *Chevron* threshold test, accordingly, but instead relied upon hypothesized practical anomalies that could result from deferring to multiple agencies.

The court further developed the guidance rationale, and receded from the treatment of the FDI Act as a generic statute, in *Collins v. NTSB,* 351 F.3d 1246, 1253 (D.C. Cir. 2003). In *Collin*s, the court reviewed its jurisprudence on deference and multiple agencies and established three classes of shared-enforcement schemes. The first embraces generic statutes, such as the Administrative Procedure Act, Freedom of Information Act, and Federal Advisory Commission Act, where "broadly sprawling applicability undermines any basis for deference and courts must therefore review interpretive decisions de novo." *Id*. The court identified a second class for the FDI Act: "where the agencies have specialized enforcement responsibilities but their authority potentially overlaps – thus creating risks of inconsistency or uncertainty – de novo review may also be necessary." *Id.* In a third class: "But for statutes where expert enforcement agencies have mutually exclusive authority over separate sets of regulated persons," the guidance concerns do not negate *Chevron* deference. *Id*. *Collins* therefore represented a shift from categorizing the FDI Act with generic statutes, recognizing that the agencies have "specialized enforcement responsibilities," and rooting the lack of deference in the policy concerns of "inconsistency" and "uncertainty."

The court again applied, and again modified, the guidance rationale in *DeNaples*, which withheld deference from the Federal Reserve by denying application of the exclusive-authority third category identified in *Collins*. The case addressed the interpretations by the OCC and the Federal Reserve, in distinct but consistent adjudications, of a provision of the FDI Act, 12 U.S.C. § 1829. Because the FDI Act assigns to the Federal Reserve exclusive authority over the discrete set of bank holding companies, the Federal Reserve claimed *Chevron* deference for its interpretation under the exclusive-authority category identified in *Collins*. The court rejected the application of *Collins* because, even though the Federal Reserve has exclusive authority over individuals with respect to bank holding companies, other agencies have authority over the same individuals with respect to their relationships with other financial entities. *DeNaples*, 706 F.3d at 488.[44] Accordingly, *DeNaples* represents yet another

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citation to *Professional Reactor Operator Soc'y v. NRC*, 939 F.2d 1047, 1051 (D.C. Cir. 1991), withholding deference from interpretation of the Administrative Procedure Act, which governs all agencies. In *Rappaport v. OTS*, 59 F.3d 212 (D.C. Cir. 1995), the majority relied most heavily upon a Supreme Court case withholding deference where 27 agencies interpreted the Rehabilitation Act and thus no agency had relevant expertise. *Bowen v. American Hospital Ass'n*, 476 U.S. 610, 642 n.30 (1986). *Bowen* contrasted that absence of expertise with a case deferring to the Federal Reserve's expertise under the Bank Holding Company Act. *Id.* (citing *Board of Governors v. Investment Co. Inst.,* 450 U.S. 46, 56 and n. 21 (1981)).

[44] Moreover, the court found a compelling need for interpretive uniformity with respect to section 19, where a potential criminal penalty attached. *DeNaples*, 706 F.3d at 488.

evolution of the D.C. Circuit's multiple-agency doctrine.[45]

An answer to the guidance policy concerns was articulated in a concurrence by Judge Rogers in *Rappaport*. She noted that the FDI Act assigns primary responsibility to specific agencies for separate sets of supervised institutions, and that any potential overlap or conflicting guidance can be resolved between the agencies. "It appears too facile to conclude that deference is inappropriate simply because more than one agency is involved in administering a statute." 59 F.3d at 221-22. Under the FDI Act, "[t]he statute instructs how to determine the 'appropriate' entity for administering provisions of the statute. *See* 12 U.S.C. § 1813(q)(4) (the director of OTS is the 'appropriate Federal banking agency' in the case of any savings association or any savings and loan holding company). As is evident, Congress intended the several agencies that administer [the FDI Act] to agree regarding their respective roles and exercise their expertise accordingly." *Id.* Thus, "deference may nonetheless be appropriate where only expert banking agencies administer the statute and there is no disagreement among them about their respective responsibilities or the agency position under review." *Id*.[46] The panel majority made no response to Judge Rogers' arguments and the D.C. Circuit has not since expressly addressed them.[47]

In interpreting statutes other than the FDI Act, the D.C. Circuit has not consistently applied the multiple-agency doctrine. *See, e.g., Individual Reference Services Group, Inc. v. FTC*, 145 F. Supp. 2d 6, 23-24 (D.D.C. 2001), rejecting challenge to *Chevron* deference to regulations issued by six agencies, including banking agencies), *aff'd, Trans Union LLC v. FTC*, 295 F.3d 42, 50 (D.C. Cir. 2002); *National Home Equity Mortgage Ass'n v. OTS*, 271 F. Supp. 2d 264, 274-75 (D.D.C. 2003) (applying *Chevron* to statute interpreted by multiple agencies where divisions of agency responsibility nullified concerns about conflicting agency interpretations) *aff'd*, *National Home Equity Mortgage Ass'n v. OTS*, 373 F.3d 1355, 1361 n* (D.C. Cir. 2004) (multiple-agency argument not reached because not preserved on appeal).

As discussed above, resolution of the D.C. Circuit FDI Act *Chevron* doctrine is unnecessary to the resolution of this adjudication. For the foregoing reasons, however,

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[45] *Proffitt v. FDIC*, 200 F.3d 855 (D.C. Cir. 2000), an FDI Act enforcement case, primarily reviewed application of a statute of limitations, 28 U.S.C. § 2462, which no agency has authority to implement by regulation. *Id.* at 860. Accordingly, under the threshold *Chevron* test, *Chevron* deference was facially not applicable. The D.C. Circuit invoked its multiple-agency doctrine with respect to incidental consideration of the FDI Act. *Id.* at 860-65.

[46] More generally, the Seventh Circuit has expressed doubt about the severity of the policy concerns arising from inconsistent agency interpretation. "[I]t is possible to defer simultaneously to the two incompatible agency positions. . . . There's no problem of logical impossibility; the court could accept the position of whichever agency's order is under review." *Board of Trade of the City of Chicago v. SEC*, 187 F.3d 713, 719 (7th Cir. 1999).

[47] Judge Rogers reiterated some question about application of the multiple-agency doctrine in *dicta* in a case where the D.C. Circuit ruled for the agency in a case involving shared-statutory responsibility without resolving whether or not *Chevron* deference was due. *Bullcreek v. NRC*, 359 F.3d 536, 541 (D.C. Cir. 2004). In reviewing the support for deference, Judge Rogers cited to the Seventh Circuit's disagreement with *Rappaport* in *Board of Trade of City of Chicago*, *supra*, and to her own concurrence in *Rappaport*. *Id.*

including the Supreme Court's recent *Chevron* jurisprudence and the long-maintained split in the circuits, such reconsideration would be timely and warranted.

II. VIOLATION OF LAW.

A. Statement of the Case.

1. Recommended Decision.

As a predicate for the cease-and-desist order and civil money penalty, Enforcement Counsel charged Adams with a violation of a regulation that governs the protection of nonpublic OCC information, 12 C.F.R. § 4.36(d). In analyzing this statutory predicate, the ALJ noted that the statutory term "violation" is defined broadly. 12 U.S.C. § 1813(v); RD 74. The ALJ applied a restrictive gloss, however, to the statutory term in reliance on the Fifth Circuit's decision in *First Nat'l Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674, 681 (5th Cir. 1983). *Bellaire* purported to adopt the *Gulf Federal* test and apply it to the independent statutory predicate, violation of law, rule, or regulation. RD 76. "It is important to remember that both situations [*i.e.*, unsafe or unsound practice and violation of law] are limited to practices with a reasonably direct effect on a bank's financial stability." *Bellaire*, 697 F.2d at 681. In that case, the Fifth Circuit found the test met because there was a "direct relationship" between compliance with the statute at issue, 12 U.S.C. § 375(a), and the bank's financial soundness. *Id.* at 683; RD 76.[48]

In this case, the ALJ concluded that the regulation violated "does not bear any relation to the financial stability of the Bank, and [Adams'] actions in taking nonpublic supervisory information did not threaten the Bank's integrity." RD 76. Again applying the Law of the Circuit Doctrine, the ALJ followed *Bellaire* and ruled that the law that Adams is alleged to have violated "must bear a relationship to the financial soundness of the Bank in order to support a cease-and-desist order." RD 76.

2. Enforcement Counsel's Exceptions.

Enforcement Counsel argues that the weight of caselaw, prior interpretations by the OCC and the other banking agencies, and the statutory language, history, and statutory structure are at odds with the ALJ's interpretation of violation of law. EC Br. 14-16. Furthermore, Enforcement Counsel argues the interpretation would fundamentally hamper the ability of the banking agencies to pursue enforcement actions for violations of law before violations rise to the level of threatening the integrity of the institution. EC Br. 14.

Enforcement Counsel argues that the plain meaning of the statutory text precludes the ALJ's interpretation. EC Br. 15. The term "violation" is defined extremely broadly. 12 U.S.C. § 1813(v). The terms "law" and "regulation" are neither defined nor textually qualified

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[48] As discussed above, the *Bellaire* gloss was applied differently from that suggested in *Gulf Federal*. Where *Gulf Federal* suggested the need for a specific identified threat to financial soundness, *Bellaire* was satisfied where the statutory provision at issue was of a type that guarded against such threats.

in any way. Accordingly, the plain meaning of the statute is at odds with the restrictive test. Furthermore, just as with "unsafe or unsound practice," the structure of the FDI Act, which expressly states effects tests elsewhere, is in conflict with the judicially created restrictive test for "law." EC Br. 15. Caselaw supports Enforcement Counsel's interpretation. EC Br. 16. Enforcement Counsel also suggests that *Bellaire* has been abrogated by statute in light of the expansion of enforcement authority effected by FIRREA in 1989. EC Br. 16.

B. Comptroller's Conclusion of Law Regarding Violation of Law.

The Comptroller declines to adopt the ALJ's proffered standard for the reasons given by Enforcement Counsel. While all of the reasons advanced by Enforcement Counsel have merit, the strongest is that the meaning of the statute is plain. A cease-and-desist order may be predicated on a violation of "a law, rule, or regulation." 12 U.S.C. § 1818(b)(1). The FDI Act defines "violation" as "any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding and abetting a violation." 12 U.S.C. § 1813(v).[49] There is no statutory text that supports a limitation upon the unqualified violation of law as a predicate for a cease-and-desist order or other remedy, including the limitation suggested by the ALJ.

The Recommended Decision correctly states the applicable statutory law, and the caselaw broadly interpreting statutes addressing violations of law. See RD 74 (citing *Lowe v. FDIC*, 958 F.2d 1526, 1535 (11th Cir. 1992); *Del Junco v. Conover*, 682 F.2d 1338, 1342 (9th Cir. 1982) and *Lindquist v. Vennum v. FDIC*, 103 F.3d 1409, 1415 (8th Cir. 1997)).

The ALJ's erroneous departure from this line of cases was based solely upon *Bellaire*, decided two years after *Gulf Federal* and relying heavily upon its reasoning. The court invoked the FISA legislative history to suggest that the Comptroller's authority must be limited to protect against "arbitrary government action." *Bellaire*, 697 F.2d at 681. On that basis, without more, the Fifth Circuit purported to extend the *Gulf Federal* unsafe or unsound practice restrictive gloss to violations of law, rule or regulation. "It is important to remember that both situations [unsafe or unsound practices and violations of law] are limited to practices with a reasonably direct effect on a bank's financial stability." *Id.* (citing *dicta* in *Gulf Federal* at 264, 265 n.5). The ALJ determined that he was bound by this limitation upon agencies' cease-and-desist authority. RD 71-72.

Enforcement Counsel is correct that *Bellaire* stands alone among the courts that have construed the violation of law provision in applying a restrictive gloss. Adams has identified no other case that has applied the *Bellaire* gloss to a violation of law. Indeed, the reasoning of a subsequent Fifth Circuit case casts doubt on the continued viability of the *Bellaire* gloss even in the Fifth Circuit. In *Interamericas Investment, Ltd. v. Board of Governors*, 111 F. 3d 376 (5th Cir. 1997), the Federal Reserve imposed civil money penalties under the materially identical provisions of the Bank Holding Company Act ("BHCA") relating to a violation of law. "The BHCA defines a 'violation' of its provisions as 'any action . . . for or toward

[49] This definition was added by FIRREA in 1989, so that it may represent a legislative supersession of the *Bellaire* gloss.

causing, bringing about, participating in, counseling, or aiding or abetting a violation.' 12 U.S.C. § 1847(b)(5). There is no mention of scienter: the *action* alone constitutes the violation." *Interamericas*, 111 F.3d at 384 (emphasis in original). The *Interamericas* panel's reasoning – that the statute does not permit additional nontextual requirements – is inconsistent with *Bellaire*. Furthermore, the Fifth Circuit in *Interamericas* made no mention of *Bellaire*. *Interamericas* suggests that the prevailing Fifth Circuit standard for imposing a cease-and-desist order to remedy a violation of law under the banking statutes requires only establishing the violation of law.

The Ninth Circuit reached that conclusion, and explained at length why it rejected the argument that a threat to the financial stability of an institution must be shown for a cease-and-desist order predicated on a violation of law. *Saratoga Savings and Loan v. Federal Home Loan Bank Board*, 879 F.2d 689, 693 (9th Cir. 1989). "[T]he plain language of the statute contains no such requirement." *Id.* "The statute is unambiguous in providing the [FHLBB] with the power to issue cease and desist orders upon a finding of a regulatory violation. No other finding – of intent to violate, financial impact, or risk to the insurance fund – is required." *Id.*[50] Given that lack of ambiguity, the court declined to examine the FISA legislative history relied upon in *Bellaire*, but in any event, found that legislative history consistent with the FHLBB's view of its cease-and-desist authority. *Id.*

The *Saratoga* court rejected the argument that Adams advances here, and that the ALJ accepted – that the financial stability gloss is supported by *Bellaire* and *Gulf Federal*. "[The thrift] cites no authority that requires the [FHLBB] to find that a specific violation will have an effect on the financial stability of the bank or the fund. Instead, the cases upon which it relies merely require that the underlying regulation have the financial stability of the bank as its purpose." *Id.* (citing *Bellaire*, 697 F.2d at 683). The *Saratoga* panel also distinguished *Gulf Federal*, pointing out that the violation of law holding in *Gulf Federal* did not apply a restrictive gloss, but simply found that no law had been violated. *Id.* The court also endorsed the agency's policy argument: "To interpret the statute as [the thrift] suggests would strip the [FHLBB] of its authority to curtail abuses *before* they harm the institution." *Id*. (emphasis in original). The Ninth Circuit found it immaterial that the violations were "technical, isolated, unintentional, and not likely to be repeated." *Id.* "When violations occur, the [FHLBB] is within its discretion in issuing such an order and we review only to determine whether the order is arbitrary, capricious, or an abuse of discretion." *Id.*

Other courts have repeatedly resisted suggestions that nonstatutory additional elements be added to the statutory requirement. *See, e.g.*, *Del Junco v. Conover*, 682 F.2d 1338, 1342 (9th Cir. 1982) ("On its face, section 1818(b)(1) requires no knowledge on the part of the wrongdoer."); *Lindquist & Vennum v. FDIC*, 103 F.3d 1409, 1415 (8th Cir. 1997) (condition of bank and motives of prospective stock purchasers irrelevant to violation of law). *Cf. Lowe v. FDIC*, 958 F.2d 1526, 1535 (11th Cir. 1992) (materially identical "violation" definition "clearly includes any action, intentional or inadvertent by which a party participates in" a violation); *Fitzpatrick v. FDIC*, 765 F.2d 569, 577-78 (6th Cir. 1985) (good faith relevant only to amount

[50] The court noted, in contrast, that an effect is textually required for a temporary cease-and-desist order. *Id*.

of a penalty, not to existence of violation under materially identical definition of "violate"). The Second Circuit also resisted an attempt to apply another sort of gloss to the plain meaning of violation of law. *Cousin v. OTS*, 73 F. 3d 1242, 1251 (2d Cir. 1996) ("The [agency's] determination that the misconduct prong may be met by violations of any law, banking-related or otherwise, is clearly supported by the statute.").

Accordingly, the weight of more recent law, including in the Fifth Circuit, supports the rejection of the *Bellaire* gloss. Enforcement Counsel is correct that the *Bellaire* restriction is contrary to the plain meaning of the statutory term, statutory structure, caselaw, and policy. A violation of the OCC's regulation justifies imposition of a cease-and-desist order without any additional showing.

III. DEFERENCE TO EXAMINER OPINIONS.

The ALJ proposed a departure from long-established caselaw in adopting a nondeferential standard of review of examiner judgments. The Comptroller declines to adopt that standard and adheres to the current standard, derived from *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (11th Cir. 1986).

A. Statement of the Case.

1. The Recommended Decision.

The OCC offered the testimony of six current or former National Bank Examiners ("NBEs") in the hearing. In considering the weight to be given their testimony, the ALJ purported to apply the controlling case authority on the issue of deference due to bank examiners, *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (11th Cir. 1986), RD 77-80, but applied it incorrectly. The ALJ concluded that, "while each examiner in this case was qualified to testify as an expert, their predictive evaluations of the risks presented by [Adams'] conduct by and large lack a sufficient factual or legal basis to warrant deference under *Sunshine State*." RD 77-78.

In support of this conclusion, the ALJ first determined that the question whether conduct is "an unsafe or unsound practice" is ultimately a question of law exclusively within the province of the ALJ, so that no deference is due the examiners on that point. RD 78. Second, because the examiners were applying the OCC's definition of "unsafe or unsound practice," and not the ALJ's, the ALJ reasoned that deferring to their opinions would be to negate his role in the adjudicatory process. RD 78. Third, the ALJ found that the OCC had insufficiently defined the standards of prudent operation bearing upon the conduct alleged in this case, so that a constituent element of "unsafe or unsound practice" was undeveloped before the conduct occurred. RD 79. He reasoned that the judgments of the examiners therefore represented retrospective assessments to which he could not defer. RD 79.

2. Adams' Position.

Adams did not take a position on the issue in his Post-Hearing Brief.

3. Enforcement Counsel's Exceptions.

Enforcement Counsel argues that the ALJ was in error in each of the three reasons given for withholding deference, and that those errors, combined with his other errors of law, led to his overall erroneous findings and conclusions. EC Br. 19-26. Enforcement Counsel argues that the *Sunshin*e standard distinguishes between objectively verifiable facts, which may be reviewed by the ALJ *de novo*, and exercises of judgment by examiners, which should not be disregarded in the absence of compelling evidence that they lack a rational basis. EC Br. 20 (citing *Sunshine*, 783 F.2d at 1583). Enforcement Counsel reviews numerous administrative adjudication decisions by the OCC, FDIC, and OTS, applying the *Sunshine* standard that have indicated that, while the ALJ ultimately makes findings on whether the conduct constitutes an unsafe or unsound practice, deference is due examiners' opinions on the issue. EC Br. 21-22. Enforcement Counsel points out that the ALJ's position represents a departure from his previous recommendations and rulings. EC Br. 22

Enforcement Counsel argues that the ALJ's determination that no deference is due the examiners because he disagreed with the substantive standards being applied represents a

misapplication of *Sunshine*. EC Br. 24. Enforcement Counsel argues that safety and soundness determinations are at the heart of bank supervision and therefore within the agency's realm of expertise. Enforcement Counsel submits that the ALJ did not make the determinations required by *Sunshine* as a basis for rejecting the examiners' opinions – that the opinions were arbitrary and capricious or outside the zone of reasonableness. EC Br. 24-25. Enforcement Counsel also argues that the ALJ departed from accepted banking agency standards of proof in requiring that formal guidelines be issued as to a particular practice before opining that conduct departed from standards of prudent operation. EC Br. 25-26. Enforcement Counsel argues that the burden is on the examiners to establish what acts were imprudent, not establish affirmative standards of what constituted adequate due diligence, sound policy, or prudent risk management. EC Br. 25.

B. The Comptroller's Conclusions of Law on Deference to Examiner Opinions.

The Comptroller accepts Enforcement Counsel's exceptions in large part, largely for the reasons advanced by Enforcement Counsel.

The ALJ erred in concluding that examiners are not entitled to deference on questions of safety and soundness because they are purely questions of law. Enforcement Counsel is correct that settled caselaw and Federal banking agency decisions establish that the "judgment" component of examiners' safety and soundness determinations is entitled to deference from the ALJ.

In *Sunshine*, the Eleventh Circuit held: "the unique experience of the bank examiners involved in this examination leads to the conclusion that their classifications were entitled to deference and could not be overturned unless they were shown to be arbitrary and capricious, or outside a 'zone of reasonableness.'" *Sunshine*, 783 F.2d at 1581. As to "objectively verifiable facts," which "require no particular training or expertise, the ALJ as fact finder is entitled to reach his own *de novo* conclusions as to the correctness of these underlying factual findings." *Id.* at 1583.

Accordingly, the standard set by *Sunshine*, and applied by the Federal banking agencies since, reduces to: 1) objectively verifiable facts may be reviewed by the ALJ *de novo*; 2) examiner judgments based on those facts may not be rejected unless there is a finding that they are a) without an objective factual basis, or b) outside the zone of reasonableness or arbitrary and capricious. This is the standard that has repeatedly been applied by the Federal banking agencies. *See* EC Br. at 21-22 (collecting administrative decisions).

The ALJ erred in failing to defer to the judgment of the examiners in identifying unsafe or unsound practices. The conclusion that given conduct is an unsafe or unsound practice is ultimately an application of a legal standard to evidence, including examiner judgment, and deference is due that judgment within the limits recognized in *Sunshine*. The Comptroller finds the ALJ's contrary ruling to be in error.

The Comptroller also does not accept the ALJ's second reason for failing to defer to the

examiners, for which he stated two bases. First, the ALJ thought the examiners were applying an erroneous standard for unsafe or unsound practices, to which it would be improper to defer. As discussed above, the Comptroller concludes that the standard recommended by the ALJ is erroneous. Second, the ALJ suggested that it is not the place of the examiners to express an opinion on the ultimate legal question to be determined but rather that examiner testimony be limited to the constituent element of the standards for prudent banking. RD 77. The Comptroller concludes that the issue of the proper legal standard for unsafe or unsound practice is a pure question of law that is ultimately for the Comptroller, and as to which no deference is due the examiners – or the ALJ. The application of that legal standard to the conduct at issue represents an application of law to evidence, including examiner judgment, where the allocation of deference is governed by *Sunshine*, as discussed above. The expression of expert judgment as to whether a given set of facts represents an unsafe or unsound practice is very much within the competence of the OCC's NBEs.

The Comptroller adopts Enforcement Counsel's exceptions as to the ALJ's third ground for withholding deference from the examiners, with one exception noted below. To the extent that the ALJ purports to require that formal guidance must have been issued as to a specific banking product before examiners may testify that practices related to that product are contrary to generally accepted standards of prudent operation, that requirement is error. OCC supervision cannot be precluded from acting with respect to novel banking practices until such time as it has such experience with those practices as to issue formal guidance. *See Frontier State Bank v. FDIC*, 702 F.3d 588, 599-600 (10th Cir. 2012) (bank properly ordered to cease and desist from relying on faulty data even though agency earlier suggested such reliance, where change in agency position due to evolving agency and industry knowledge). It is sufficient that supervisors can identify more general risks that cause practices to depart from generally accepted standards of prudent operation even if the specific practices at issue are novel. *See Groos Nat'l Bank v. Comptroller of the Currency*, 573 F.2d 889, 897 (5th Cir. 1978) ("The phrase 'unsafe or unsound banking practice' is widely used in the regulatory statutes and in case law, and one of the purposes of the banking acts is clearly to commit the progressive definition and eradication of such practices to the expertise of the appropriate regulatory agencies.")

Enforcement Counsel argues that the "weight of authority is that examiners must establish what acts were imprudent, not establish affirmative standards of what constituted adequate due diligence, sound policy, or prudent risk management." EC Br. 25. The Comptroller does not completely agree. The Horne definition requires a showing that the conduct be "contrary to generally accepted standards of prudent operation." Accordingly, Enforcement Counsel must make some showing as to the relevant standards and the departure from those standards, as it has in this case. *See infra* pp. 51-53, 56-57, 60, 63-67. The novelty of a given practice will not preclude such a showing so long as more general relevant standards apply.

THE COMPTROLLER'S REVIEW OF THE EVIDENCE IN THE RECORD

As noted above, the Comptroller, in his discretion, declines to make any findings of fact leading to the imposition of any penalties on Adams and declines to remand the case to the ALJ for new findings based on the corrected legal standards enunciated in this opinion. Were the case to be remanded, however, the record evidence could support the conclusion that Respondent engaged in unsafe or unsound practices in the management of the Bank's remotely created check business and committed a violation of law by taking non-public OCC information without prior authorization from the OCC warranting imposition of a cease-and-desist order pursuant to 12 U.S.C. § 1818(b). Additionally, the record evidence could provide a basis for imposing a Second Tier civil money penalty under 12 U.S.C. § 1818(i)(2)(B) for reckless engagement in unsafe or unsound practices establishing a pattern of misconduct.[51]

I. OVERVIEW OF THE RCC BUSINESS AT T BANK.

T Bank opened for business in November 2004 after receiving a charter from the OCC to operate as a national bank. Hearing Transcript ("Tr.") 135:9-10 (Adams), 1775:16-19 (Basso). Adams was the Bank's first President and Chief Executive Officer ("CEO"); he served as CEO until July 2007 and as President and as a director of the Bank until his resignation in July 2010. Joint Stipulations ("Jt. Stips.") ¶¶ 1-2; Tr. 135:4-19 (Adams). In this capacity, Adams had responsibility for ensuring the Bank was being operated in a safe and sound manner and in compliance with all applicable laws, rules, and regulations. Jt. Stips. ¶ 3.

From December 2005 to August 2007, T Bank opened and maintained an account relationship with a third-party payment processor named Giact Systems, Inc. ("Giact") and approximately 60 merchant retail businesses for which Giact processed payments ("Giact Merchant-Clients" or "Merchant Clients"). Jt. Stips. ¶¶ 4-5, 8; Tr. 142:14-145:12 (Adams); Joint Exhibit ("Jt. Ex.") 102/2. Using a payment system called remotely created checks ("RCCs"), Giact facilitated the transfer of funds from consumers' bank accounts to the accounts of the Giact Merchant-Clients in exchange for goods and services sold over the internet and by mail order such as merchant finance cards, credit repair services, discount travel clubs, prepaid debit cards, herbal and nutritional supplements, pay day lending, skin care and weight loss products, post office exam preparatory courses, and gas additive products. Tr. 181:21-183:11, 189:2-18, 193:8-194:19, 220:17-222:15, 608:16-610:6 (Adams), 704:20-705:4 (Stamm); Jt. Ex. 102/4-5. (Relationship collectively defined as the "RCC business" or the "Giact business.")

W. Carter Messick, National Bank Examiner, testified as an expert on payment systems that RCCs are a payment device created when a consumer holder of a checking account provides the account and routing number of the consumer's checking account and authorizes a payee, either verbally or through a web-based authorization, to draw a check without the

[51] Consistent with the Comptroller making no findings of fact, this Review of the Evidence in the Record is not intended to be a comprehensive account of all of the record evidence that might relate to whether a cease-and-desist order or civil money penalty should be imposed against Adams. In this discussion, the Comptroller specifically rejects certain ancillary factual conclusions expressed in the Recommended Decision. To the extent this decision is silent with respect to other factual observations of the ALJ or other evidence in the record, such silence should not be construed as expressing a view regarding that evidence.

consumer actually signing the check. Tr. 21:3-24:22 (Messick); *see also* Jt. Stips. ¶ 7, Jt. Ex. 102/3. Giact processed payments by creating RCCs using consumers' bank account information supplied by the Merchant Clients; the checks were then deposited electronically into the Merchant Clients' accounts at T Bank. Tr. 144:13-145:12 (Adams). A bank into which an RCC is deposited, such as T Bank, is termed "the bank of first deposit" and is liable to reimburse consumers for any unauthorized RCCs. Tr. 67:22-71:2 (Messick). There is a greater risk of fraud posed by RCCs as compared to other forms of payment because RCCs are often utilized by high-risk merchants, such as internet merchants, because there is lesser ability for payment processors and regulators to detect fraud committed using RCCs, and because of the higher volume of payments that can be processed using RCCs. Tr. 58:5-61:3, 62:21-64:16, 117:11-118:12 (Messick). Failing to conduct adequate due diligence on merchants such as the Merchant Clients could cause a bank to unknowingly process payments for illegal or unsavory clients. Jt. Stips. ¶ 10.

A significant percentage of the RCCs originally deposited in accounts of the Merchant Clients at T Bank were returned to T Bank and charged back[52] to the Merchant Clients after being presented to the consumers' banks for payment due to reasons including unauthorized transactions. Tr. 926:7-929:4 (Bermingham). Returned RCCs generated fee income for T Bank, paid by the Merchant Clients, at the rate of three to five dollars per return. Tr. 147:22-149:10 (Adams). Between 2005 and 2007, T Bank generated approximately $1.9 million in income through the processing of RCCs, mostly comprised of return fee income, allowing the Bank to be profitable over this period of time. Tr. 1369:12-1376:11 (Fronk). At the time T Bank entered the Giact business, Adams was aware that a high number of returns, as well as complaints from consumers concerning unauthorized RCCs, could be an indication of potential fraudulent activity. Jt. Stips. ¶ 9. Additionally, a lack of appropriate monitoring of account activity, management of returns, and timely corrective action in a relationship with a merchant, such as one of the Merchant Clients, could result in operational losses for a bank. Jt. Stip. ¶ 2.

With the Giact relationship under increasing scrutiny from the OCC, on July 25, 2007 T Bank's Board of Directors voted to terminate the Giact business. Tr. 201:1-6, 250:10-251:7 (Adams). By the end of August 2007, T Bank had ceased processing RCCs for the Giact Merchant-Clients. Tr. 201:1-6, 250:10-251:7 (Adams). Effective April 15, 2010, the OCC and the Bank entered a Formal Agreement that required the Bank to pay restitution to certain customers of Giact Merchant-Clients to address unfair practices in connection with the Giact and Merchant-Client accounts and remediate possible harm suffered by consumers. Tr. 565:15-566:22 (Adams); Jt. Ex. 122. The Bank ultimately paid out approximately $2.8 million in restitution and related expenses. Tr. 1380:12-15 (Fronk). The Formal Agreement also required that T Bank appoint a compliance committee and develop policies, procedures, and standards for future payment processor relationships to ensure compliance with safe and sound banking practices and all applicable laws including the Federal Trade Commission Act. Jt. Ex. 122.

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[52] This Final Decision uses the terms "return" and "chargeback" interchangeably to describe the RCCs returned to T Bank and charged back to the Merchant Clients.

II. EVIDENCE IN THE RECORD INDICATING UNSAFE OR UNSOUND PRACTICES ASSOCIATED WITH MANAGEMENT OF T BANK'S RCC BUSINESS AND A VIOLATION OF LAW.

As explained above, the Comptroller finds as a matter of law that the Horne definition provides the standard for determining whether conduct constitutes an "unsafe or unsound practice" within the meaning of 12 U.S.C. § 1818. *See supra* p. 16. Under the Horne definition, an unsafe or unsound practice is "any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds." Under this correct definition of unsafe or unsound practice, which rejects the *Gulf Federal* effects tests, *see supra* pp. 16-29, a finder of fact could conclude that the conduct described in the evidence warranted imposition of an order to cease and desist.

Testimony from former Bank employees (including Respondent and his former Compliance Officer), documentary evidence from the Bank's own files and systems as well as the OCC's supervisory communications to the Bank, and the fact and expert testimony of six current and former NBEs provide evidence of multiple failures in connection with the processing of RCCs at T Bank. These included (a) failure to conduct adequate, industry standard due diligence on the Giact Merchant-Clients (all of which were high-risk account holders) and take appropriate action with respect to accounts in light of derogatory information; (b) failure to obtain anticipated chargeback data and other data, monitor accounts, and establish a reserve policy and thereby ensure adequate reserves on the Giact Merchant-Clients' accounts; and (c) failure to develop a formal system for tracking, responding to, and investigating consumer complaints. This record evidence could allow the conclusion that these management failures exposed the Bank to abnormal and undue risks and constituted unsafe or unsound practices and that Respondent, as President and CEO of the Bank, bore the ultimate and undelegable responsibility for these failures. Tr. 136:15-142:12 (Adams), 1382:12-18, 1400:2-16, 1430:18-21 (Fronk), 1219:2-11 (McKnight).

In addition, the record evidence could support the conclusion that Adams violated the OCC's regulation found at 12 C.F.R. § 4.36(d) when he removed non-public OCC information from the Bank without prior authorization. As detailed above, *see supra* pp. 38-40, the Comptroller rejects the *Bellaire* formulation that would require a violation of law to have an effect on the financial stability of an institution before a cease-and-desist order could be imposed under 12 U.S.C. § 1818(b)(1).

A. Record Evidence of Insufficient Initial and Ongoing Due Diligence on the Merchant Clients and Failure to Take Appropriate Action on Accounts with Derogatory Information.

The record in this matter contains evidence that Adams failed to ensure that T Bank conducted adequate due diligence on the Giact Merchant-Clients thereby exposing the Bank to undue risk. The ALJ based his conclusion that Enforcement Counsel failed to meet its burden of proof with respect to unsafe or unsound practices on an incorrect definition of unsafe or unsound practices. RD 98-99. The Comptroller has corrected this legal interpretation. *See supra* p. 16. Additionally, the ALJ's analysis of the record evidence is flawed, in large part because of his failure to give the testimony of NBEs the deference due to it as a matter of law under *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (11th Cir. 1986). *See supra* pp. 42-43.

The ALJ concluded that in the absence of generally accepted standards or supervisory guidance, Adams undertook reasonable due diligence efforts and developed a risk-based approach to managing the Giact Merchant-Clients' accounts. RD 23. In short, the ALJ determined that "the Bank, under Respondent's direction, did as much as it could under the circumstances." RD 86. The record, however, contains evidence that Respondent's due diligence efforts were incomplete and inadequate and exposed the Bank to undue risk. Considerable published guidance contained in and referenced in the evidentiary record is generally applicable to RCCs, *see infra* pp. 63-67, and negates the ALJ's conclusion that there were no generally accepted standards of prudent operation of an RCC business. The expert testimony of OCC examiners further explains and corroborates that generally accepted standards of prudent operation of an RCC business were discernable from the published guidance.

1. T Bank Did Not Collect or Review Complete Due Diligence Information Required by Its Own Checklists.

In email correspondence admitted into evidence and in his testimony at trial, Adams acknowledged that the Giact Merchant-Client accounts were high-risk accounts, but initially, in 2006, he took no steps to ensure that T Bank had policies and procedures governing due diligence for high-risk accounts. Jt. Ex. 99/3; Tr 147:7-21, 150:14-20; 159:15-19 (Adams).[53] In April 2006, after several Merchant Clients' accounts had already been opened, Adams developed an internal checklist of due diligence items to be collected concerning each Merchant Client, including basic business organization and financial information, personal financial information regarding the principals of the business, and agreements and forms between the Merchant and the Bank and the Merchant and Giact. Jt. Ex. 12; Tr. 157:5-18; 329:10-11 (Adams). This first due diligence checklist came into use in May 2006. Tr. 155:22-156:1 (Adams). Susan Bermingham, former First Vice President, Compliance Officer, and Operations Officer at T Bank, created a revised and expanded checklist specifying the required

[53] Respondent testified that he believed T Bank was ultimately obtaining the due diligence required for high-risk accounts prior to developing the due diligence checklists. Tr. 157:19-158:10, 159:9-11 (Adams). But a review of the due diligence collected for two of the first Giact Merchant-Clients, Safepay and Bio Performance, indicates that information ultimately required under the Bank's checklists was not obtained for Safepay or Bio Performance. *See* Jt. Exs. 13 and 18, Tr. 289:13-290:2, 349:14-16, 637:12-21 (Adams). After T Bank had been processing RCCs for Bio Performance, a seller of "gas pills," for two or three months, the Texas Attorney General issued a freeze on the account and brought suit against Bio Performance leading to T Bank seeking legal advice on its management of the Giact business from the law firm Haynes & Boone ("H&B"). Tr. 299:17, 307:7-15, 308:7-13, 445:20-446:3 (Adams).

due diligence items and preferred items; a checklist that was finalized and came into use on July 26, 2006. Respondent's Exhibit ("Resp. Ex.") 95/3-4, Jt. Ex. 42/128,[54] Tr. 337:1-7 (Adams); 888:1-12 (Bermingham). The General Assurances Agreement ("GAA") entered into between T Bank and Giact in August 2006 required Giact to conduct "industry standard due diligence with respect to the Merchant Clients, including with respect to their Merchant's business practices, procedures, credit standing, history of consumer complaints, lawsuits, and judgments." Jt. Ex. 32/1; *see also* Jt. Stips. ¶ 6. Both the May 2006 and the July 2006 checklists required the Bank to collect Giact's due diligence documentation on each Merchant Client. Jt. Ex. 12; Resp. Ex. 95/3-4, Jt. Ex. 42/128.

Although the contents of the GAA and the Bank's due diligence checklists reflect Respondent's understanding that generally accepted standards of prudent banking operation called for collecting certain information on the Merchant Clients to complete adequate due diligence, he, by his own admission, failed to ensure that the Bank obtained the due diligence specified on the checklists. Tr. 156:7-18; 160:7-16 (Adams). Moreover, Compliance Officer Bermingham was highly critical of T Bank's due diligence efforts. She believed that the documentation that the Bank collected for the Giact Merchant-Clients was insufficient, given the higher-risk transactions involved. Tr. 888:13-891:5 (Bermingham). On May 15, 2006, she emailed Adams to inform him that she was uncomfortable with the Bank's lack of documentation and basic due diligence information on the Giact Merchant-Clients. Jt. Exs. 10-20; Tr. 892:10-13 (Bermingham). For example, she found articles of incorporation, financial information of the businesses, website information, and three months of prior bank statements missing for many Merchant Clients. Jt. Exs. 10-20; Tr. 894:9-13; 895:1-12 (Bermingham). When she raised her concerns about the lack of information on the Merchant Clients, she described Adams as "kind of lackadaisical . . . not real concerned." Tr. 895:13-896:17 (Bermingham).

At some point in 2006, Compliance Officer Bermingham began reviewing the due diligence information collected at account opening by Lee Ann Stamm, T Bank's former Customer Relation Manager ("CRM"), in an effort to verify that the proper documentation was being obtained and analyzed prior to approving the new Giact Merchant Clients' accounts for RCC processing. Tr. 884:21-886:1 (Bermingham). CRM Stamm testified that Giact was "upset" when Compliance Officer Bermingham was reviewing the due diligence files because it could take as long as seven days for her to approve an account to process RCCs and Giact wanted the accounts able to process RCCs within 24 to 48 hours. Tr. 692:2-695:5 (Stamm).

In a June 22, 2006 email from a Giact representative to Adams, Giact expressed the desire to direct additional RCC business to T Bank if the Bank was able to "turn the accounts around quickly." Jt. Ex. 22. After a time, Adams instructed that Merchant-Clients' accounts be allowed to process RCCs prior to Compliance Officer Bermingham reviewing the due

[54] The revised July 2006 checklist required T Bank to collect a Merchant Client's articles of incorporation, bylaws, certificate of good standing, and website information; the principals' drivers licenses and credit reports; and several other forms, agreements, and other documents. Resp. Ex. 95/3-4. Preferred items included in the July 2006 checklist were the Merchant Client's and principals' current financial statements and prior tax returns from two years, the Merchant Client's merchant processing statements from the prior three months, and bank statements from the prior three months. Resp. Ex. 95/3-4.

diligence and, at times, without the Bank having received the minimum information required. Tr. 886:4-887:11; 900:15-902:12 (Bermingham). In an August 3, 2006 email, Adams instructed Compliance Officer Bermingham to allow a new Merchant Client to begin processing RCCs although it had not yet provided written consent to establish reserves, an item required under the due diligence checklist, because, in Respondent's words, T Bank "need[ed] the deposits." Jt. Ex. 31/1. Adams had the final say on what accounts would be opened. Tr. 1430:1-17 (Fronk). Compliance Officer Birmingham could not recall one Giact Merchant for whom the Bank had obtained all of the information called for on the Bank's due diligence checklist. Tr. 897:9-17; 898:3-9; 922:2-11; 976:16-22 (Bermingham).

2. Enhanced Due Diligence Efforts Were Minimal and the Bank Allowed Merchant Clients to Process RCCs Despite Derogatory Information.

As for T Bank's efforts at enhanced due diligence, the evidence shows they were partial and ineffective because Respondent failed to ensure that the Bank properly consider and act on some of the negative information uncovered about certain Giact Merchant-Clients. In October 2006, T Bank requested that the law firm of Haynes and Boone ("H&B") carry out due diligence reviews on some existing and some new Giact Merchant-Clients. Tr. 165:10-166:5 (Adams).[55] But in March 2007, H&B ceased carrying out enhanced due diligence and preparing reports on any other existing or new Merchant Clients. Tr. 169:12-21. In total, H&B prepared reports on no more than 15 to 17 potential or existing Merchant Clients, whereas 66 Merchant Clients opened accounts at T Bank for initiating RCCs. Tr. 425:2-3; 561:19-562:1, 634:9-17 (Adams).[56]

In many instances, H&B uncovered derogatory information about Merchant Clients, but Respondent allowed the Merchant Clients to process RCCs through the Bank anyway. Tr. 907:10-21, 908:16-21 (Bermingham). For example, Respondent allowed Merchant Client Momentum Direct, an internet seller of nutrition supplements, to continue to process RCCs through T Bank although H&B reported that the Merchant was "not financially stable" and was "possibly not [] a genuine business at all." Jt. Ex. 63; Tr. 1390:3-1391:4 (Fronk). Respondent allowed another Merchant Client, Global Life Enhancements, which he described as a mail order seller of herbal supplements and diet pills, to open an account for RCC processing, although H&B reported that the business was the subject of numerous complaints on consumer websites such as Ripoff Report and Better Business Bureau; H&B warned T Bank that Global Life Enhancements may not be a genuine business. Jt. Ex. 46/1-2; Tr. 194:8-19 (Adams). H&B also reported that Global Life Enhancements operated a business called Herbal Smoke Shop which sold drug paraphernalia and herbal mixes as substitutes for illegal narcotics and that there was a "significant chance" it could become the target of a Food and Drug Administration investigation. Jt. Ex. 46/1. In another example, H&B reported that Enterprise Technology Group, d/b/a Ameritrust, was potentially breaking the law by requiring customers to pay money

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[55] H&B did not carry out enhanced due diligence on all of the Merchant Clients already processing RCCs through T Bank. Tr. 166:1-5 (Adams).

[56] *See also* 425:14-426:21 (Adams) (identifying Joint Exhibits 46, 57, 59, 63 and Respondent's Exhibits 12-14, 17, 18, 21, 23, 25, and 26 as due diligence reports prepared by H&B).

in order to obtain loans. Resp. Ex. 18/1. H&B warned that the Merchant Client may not be a genuine business, but rather, a credit-card scammer who used the name of a nationally known company to enhance his credibility. *Id.* H&B warned that the CEO of another Merchant Client, SMFI Advanced Business Concepts, was suspected of involvement in a pyramid marketing scheme and that the operations and functions of his company were unknown. Jt. Ex. 59. Nevertheless, Respondent allowed these accounts to be opened for RCC processing.

3. T Bank's External Consultants Also Found Due Diligence Inadequacies.

T Bank's external consultants and auditors Delong Consulting ("Delong") and RLR Consulting ("RLR") made findings that concurred with Compliance Officer Bermingham's views on the inadequacy of T Bank's due diligence. Jt. Exs. 61, 62, 76, 112. Delong noted in its Bank Secrecy Act review for T Bank, as of March 12, 2007, that the Bank's files were missing due diligence information obtained by Giact for three out of five Giact Merchants sampled; four of the five accounts were missing Giact account applications, checklists, and/or risk assessments required under the Bank's Customer Identification Program, among other policy exceptions. Jt. Ex. 62:2-3, 6-7. In its Bank Secrecy Act Compliance Audit Report, dated May 11, 2007, Delong concluded that additional account monitoring and due diligence were required to enable the Bank to determine "return/chargeback percentages in relation to deposits, and assess[] whether return volume is consistent with anticipated activity." Jt. Ex. 76/3, 4-5. Additionally, better "evaluation of whether certain Giact Merchant accounts should be closed and suspicious activity reports filed as a result of high chargeback/return percentages and unsatisfactory Better Business Bureau reports" was required. Jt. Ex. 76/5. As a result of its Customer Due Diligence review, as of March 12, 2007, Delong found derogatory information about Giact Merchant-Clients My Clean Start and Enterprise Technology Group, similar to what was reported by H&B. Jt. Ex. 61/4-5. Additionally, Delong reported that another Merchant Client, Virtual Works, LLC ("Virtual Works"), a purveyor of a "virtual" debit card, had an "F" rating with the Better Business Bureau due to consumer complaints about misleading advertising and unauthorized charges to consumers. Jt. Ex. 61/3-4.

In its Summary of T Bank Engagement as of July 25, 2007, RLR stated that all of the six Merchant Clients' due diligence files it audited were missing corporate bylaws, a required item under the Bank's due diligence checklist, and that financial information was listed as only a "preferred" item on the current due diligence checklist instead of "required." Jt. Ex. 112/13. RLR further criticized T Bank's lack of periodic follow up with respect to financial information. Jt. Ex. 112/8. It further found that "[d]ocumentation for . . . procedures . . . was not complete, was located in different places and was very subjective." Jt. Ex. 112/4, 13.[57]

4. OCC's Examiners Testified that These Due Diligence Failures Were

[57] RLR determined that T Bank was lacking needed documentation for High Risk Merchant Account Policy and Procedures, CCX PayFormer Service Policy and Procedures, Risk Assessment Rating Matrix for High Risk Merchant Accounts, Underwriting Matrix for calculation of credit risk and reserve requirements, and High Risk Merchant/CCX PayFormer Client Checklist. Jt. Ex. 112/2.

Unsafe or Unsound Practices.

As discussed above, testimony from Adams and the Bank's own Compliance Officer and the Bank's own internal documents show that the due diligence T Bank carried out on the Giact Merchant-Clients was inconsistent, incomplete, and overall inadequate. Additionally, the testimony of OCC NBEs[58] regarding their observations and findings as supervisors of the Bank corroborates the inadequacy of the due diligence efforts at T Bank.

Ronald P. Algier, National Bank Examiner and Examiner-in-Charge of T Bank for the OCC's 2006 Examination ("2006 Exam"), Tr. 986:7-988:2 (Algier), described in the Report of Examination ("ROE") for the 2006 Exam and in his testimony that Adams emphasized profitability of the Bank at the expense of safety and soundness considerations and was insensitive to or had insufficient knowledge of risk management techniques. Jt. Ex. 34/4, Tr. 990:7-994:7 (Algier). These deficiencies applied to his management of the RCC business. Tr. 994:12-995:19 (Algier).

Lesa Kay Fronk, National Bank Examiner,[59] was Portfolio Manager for T Bank at the time of the OCC's 2005 Examination ("2005 Exam") and during reviews of the Bank following-up on the 2005 Exam; she was again involved with supervision of T Bank in 2007. Tr. 1356:3-1357:1; 1381:3-13 (Fronk). NBE Fronk testified that the Bank did not consistently receive the basic information about the Merchant Clients that Giact was required to provide; nevertheless, Respondent allowed the accounts to process RCCs. Tr. 1385:21-1386:7, 1386:22-1387:5 (Fronk). She also testified that Respondent allowed accounts to be opened despite negative information having been received from H&B about certain Merchant Clients.

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[58] The ALJ expressed doubt as to the credibility of certain OCC witnesses on the subject of why the OCC increasingly scrutinized the RCC business at T Bank, implying that it was due solely to political pressure following concerns about RCC processing at another institution. *See, e.g.,* RD 46 n.30, 52 n.35. The ALJ acknowledged correctly, however, that "[i]f the practices Respondent and the Bank were engaged in were in fact 'unsafe or unsound' it should make no difference why the OCC turned its attention to them." RD 46 n.30. Moreover, witnesses did explain the reasons for the OCC's increased focus, as time went on. For example, activity in the Merchant Clients' accounts had increased in 2007. Tr. 1192:16-18 (McKnight). Also, the OCC became concerned that the risks associated with the Giact relationship could not be mitigated to a satisfactory level. Tr. 1078:20-1079:3 (Algier). Moreover, an OCC witness testified that it would make sense for a regulator concerned about problems at one institution to conduct follow-up at a different institution in a similar situation, and disagreed with the notion that the OCC had had no regulatory interest in the Giact relationship until after an RCC controversy had emerged at another institution. Tr. 1070:6-1073:1 (Algier). *See infra* pp. 62-63 (discussing supervisory attention to the RCC business during the OCC's 2006 Examination of T Bank and in the Memorandum of Understanding that followed).

[59] The ALJ criticized NBE Fronk for not fully answering questions more than once, implying she lacked forthrightness. *See, e.g.*, RD 52 n.35, RD 58-59. But a review of the transcript indicates that her answers, criticized by the ALJ, were appropriate in context. In one instance, Respondent's Counsel asked her a question in which he falsely identified her as the author of an email and then abandoned his line of questioning after Enforcement Counsel objected to his mischaracterizing question. Resp. Ex. 61, Tr. 1603:7-15. In another instance, Respondent's Counsel asked her general questions about her views, as expressed once in a specific email, prior to counsel confronting her with or otherwise identifying the email and thereby refreshing her recollection. Tr. 1570:6-13 (Fronk). Respondent's Counsel's technique could understandably fail to elicit complete information from a witness. When Respondent's Counsel eventually showed her the email, she acknowledged her statements in it. Resp. Ex. 73, Tr. 1622:2-1625:4 (Fronk).

Tr. 1389:19-1390:2 (Fronk). Respondent also failed to ensure that Bank personnel conducted ongoing due diligence. Tr. 1397:4-21 (Fronk).

David Pennell, National Bank Examiner, participated in a follow-up interim review of T Bank in July 2007 and in the OCC's 2007 Examination ("2007 Exam"). Tr. 1126:15-1127:15 (Pennell). During the interim review, NBE Pennell reviewed a sample of approximately 39 individual files for the Giact Merchant-Clients and found that the Bank had no satisfactory program to identify high-risk accounts, to identify the risks inherent in the associated businesses, or to carry out the required ongoing enhanced due diligence of the Merchant Clients' accounts. Tr. 1128:19-1135:17, 1136:1-11, 1176:21-1177:17 (Pennell); OCC's Exhibit 10. NBE Pennell found in his file review that T Bank was missing "significant pieces" of due diligence information. Tr. 1136:5-7 (Pennell). Items required by Bank policy, *e.g.*, Giact and Bank forms, were missing from the due diligence files. Tr. 1139:10-1143:4 (Pennell); OCC's Exhibit ("OCC Ex"). 10. The Bank was not properly documenting the accounts and assessing the risks that they posed before opening them and was not doing "any additional follow-up beyond that." Tr. 1143:16-1144:2 (Pennell). For example, the Bank was not comparing actual transaction volumes through accounts to anticipated transaction volumes documented in the due diligence. Tr. 1144:2-11 (Pennell). The files were incomplete for a large percentage of the portfolio. Tr. 11458-13 (Pennell). Specifically, 14 accounts lacked historic or estimated chargeback levels, leaving the Bank with no starting point from which to monitor actual chargebacks. Tr. 1146:11-1147:4 (Pennell). NBE Pennell concluded that T Bank's "enhanced due diligence [policy] didn't exist [and that t]he original customer due diligence program was inadequate and insufficient"; T Bank was "not adequately complying with [its customer due diligence] policy. They were not getting documentation . . . or monitoring the information that they had against the accounts that existed." Tr. 1148:11-19, 1155:3-12 (Pennell). T Bank was also failing to supplement the information on existing Merchant Clients in its files as it expanded its due diligence requirements. Tr. 1174:12-21 (Pennell).

The examiners explained that these due diligence failures created reputation risk, compliance risk, transactional (or operational) risk related to liability for fraudulent items, and litigation and financial risk for the Bank generally. *See* Tr. 1395:14-1396:16, 1399:14-1400:1 (Fronk). NBE Pennell testified that the Bank's insufficient risk identification and deficient due diligence on Giact Merchant-Clients created reputational, transactional, and compliance risk. Tr. 1147:5-15; 1174:22-1175:11 (Pennell). *See also infra* pp. 63-67 (detailing relevant risks identified in regulators' published guidance and by NBE Messick).

NBE Fronk testified that it was unsafe or unsound to fail to obtain the required due diligence on the Merchant Clients before opening accounts because failure to understand a Merchant Client's business and any derogatory information about them created abnormal risk for the Bank. Tr. 1387:6-1388:7 (Fronk). She testified that ongoing monitoring of the Merchant Clients was required in the form of internet, Better Business Bureau, and Federal Trade Commission research; the Bank, however, did not do this and this failure was unsafe or unsound. Tr. 1396:17-1398:3 (Fronk). She also testified that it was unsafe or unsound and contrary to standards of ordinary care to open or allow accounts to remain open after receiving

derogatory information about a Merchant Client. Tr. 1390:3-1391:4, 1391:10-14, 1393:7-1394:2, 1395:4-13 (Fronk). NBE Algier testified that it was unsafe or unsound for a bank to enter a business area without first identifying the risks entailed and determining whether it could adequately manage the risk and that the management of the RCC business at T Bank was unsafe or unsound. Tr. 1005:18-1006:14, 1029:16-1030:5, 1049:9-1050:15 (Algier).[60]

B. Record Evidence of Failure to Ensure Policies, Procedures, Systems, and Internal Controls to Adequately Mitigate the Risks Associated with the Giact RCC Business.

There also exists evidence in the record upon which a fact finder could conclude that Adams failed to ensure that policies, procedures, systems, and internal controls at T Bank were adequate to mitigate the risks posed by the Giact business. As with the due diligence related charges, the ALJ concluded that Enforcement Counsel failed to meet its burden of proof with respect to unsafe or unsound risk mitigation practices, citing an incorrect definition of unsafe or unsound practices. RD 110. Under the corrected legal standard, *see supra* p. 16, the record evidence could support the conclusion that, under Respondent's leadership, T Bank failed to obtain data on the Merchant Clients needed to monitor chargeback activity and failed to monitor accounts adequately, exposing the Bank to abnormal risks and constituting unsafe or unsound practices.

The Comptroller also disagrees with the ALJ's conclusion that there is no evidence that generally accepted standards of prudent operation required T Bank to have more thoroughly tracked RCC returns, to have adopted a policy on when accounts should be closed for excessive chargebacks, or to have better determined the amount and ensured the availability of adequate reserves. RD 102, 107, 113. On the contrary, the record evidence indicates that the internal control failures and the absence of a policy for establishing reserves, resulted in the Bank maintaining inadequate reserves to mitigate the risks posed by the RCC business, which in the opinion of the OCC's examiners were unsafe or unsound practices. Because the testimony of the OCC's examiners is entitled to deference, *see supra* pp. 42-43, a finder of fact could conclude that unsafe or unsound practices occurred with respect to internal controls and maintenance of reserves to mitigate risks associated with the Giact business.

1. Testimony from Respondent and Other Bank Witnesses, as Well as Bank Documents, Are Evidence of Inadequacy in the Bank's Internal Controls.

With respect to internal controls, Adams testified that T Bank had no system for tracking or monitoring the ratios of RCC returns to deposits for individual Giact Merchant-Clients and that there were no chargeback or transaction limits for Merchant Clients' accounts. Tr. 170:18-175:1, 177:22-179:3 (Adams); *see also* Jt. Ex. 95/1. He acknowledged,

[60] Respondent's Counsel objected to NBE Algier's testimony on safety and soundness in connection with identification of risks associated with new products. The ALJ overruled the objection stating "I'll allow his testimony. He's a board-certified examiner. I think he knows what safe and sound is." Tr. 1006:11-14 (Miserendino). The ALJ also allowed testimony from NBE Algier, over objection, that the management of the Giact relationship was unsafe or unsound. Tr. 1029:21-22 (Miserendino).

for example, that several Merchant Clients had chargeback rates ranging from approximately 50 percent to 65 percent in May 2007 and one (My Clean Start, a credit repair service) had a chargeback rate of 75 percent in May 2007. Jt. Ex. 75, Tr. 189:2-194:19, 222:4-18 (Adams). The Bank had no written policy or procedure for monitoring why consumers' banks were returning RCCs, Tr. 187:1-20 (Adams), and no written policy indicating what level of excessive chargeback rate would result in the Bank closing a Merchant Client's account, Tr. 219:2-220:10 (Adams). The Bank created no reports comparing anticipated or historic return volume to actual return volume. *Id.* The Bank also had no written policies for setting adequate reserves for accounts. Tr. 183:15-186:1, 216:2-6 (Adams), 1544:19-1545:2 (Higgs); *see also* Jt. Exs. 95/1, 113/2.

CRM Stamm described in her testimony that T Bank kept track of returns from "an income standpoint" only and that she prepared monthly income reports related to returns at the request of Adams. Tr. 729:4-730:22 (Stamm). These reports tracked the total amount of returns, but did not examine returns as a percentage of a Merchant Client's deposit balance or through comparison to projected rates of return until close to the end of the Giact relationship. *Id.*, *see also* Tr. 713:1-6 (Stamm). T Bank did not track the reasons for returns until June 2007. Tr. 727:2-18 (Stamm).[61]

Sue Higgs, T Bank's former Chief Financial Officer ("CFO") and Cashier, testified that she shared responsibility with CRM Stamm for processing RCC returns and responding to complaints about unauthorized RCC transactions; she stated that T Bank had no policy or standards for when it would open an account for a Giact Merchant-Client or policies or procedures for closing the accounts of Giact Merchant-Clients, based on volume of returns, complaints, or any other factor. Tr. 1531:16-1532:3; 1542:11-1543:21 (Higgs). This absence of policy existed despite the fact that Adams was aware that the RCC business would involve a high level of returns and a high level of return fee income, the fee income being the purpose of the RCC business for T Bank. Tr. 1543:22-1544:18 (Higgs). CRM Stamm testified that CFO Higgs complained to Adams that the Giact business was resulting in an inordinate amount of returns, but that he "really liked this business and wanted to develop it;" he "wanted the bank to keep processing these kinds of merchants because it was an electronic business . . . and he really wanted to expand that for the bank." Tr. 763:6-764:3 (Stamm).

Compliance Officer Bermingham noted that "in a traditional banking environment," a bank would close [an] account pretty rapidly" with a volume of returned checks similar to what was occurring in the Merchant Clients' accounts with RCC returns. Tr. 895:13-896:10 (Bermingham). But T Bank had no policy on a level of unacceptable chargebacks. Tr. 916:16-20 (Bermingham); *see also* Jt. Ex. 95/1. When she raised her concerns about the volume of RCCs being returned, like with her complaints about inadequate due diligence, Adams' response was "a little lackadaisical . . . not real concerned." Tr. 896:11-17 (Bermingham).

2. The Bank's External Auditors Stated that Internal Controls Related to

[61] When the OCC asked T Bank for this information in June 2007, the Bank had to request this information from Giact because the Bank did not have it. Jt. Ex. 89.

Account Monitoring and Reserves Were Inadequate.

In its 2007 review, the Bank's external auditor Delong found that risk-mitigating controls, including monitoring returns of RCCs for the Giact Merchant-Clients, were not consistently applied. Jt. Ex. 76/3. Delong also concluded that risk-rating scores for Giact Merchant-Clients with high chargebacks and high risk business areas did not "appear in line with actual risks" and no procedures were established to periodically reassess and document risk ratings. Jt. Ex. 76/3. Delong observed that Merchant Client Virtual Works had a projected return rate of 2 percent at account opening, but an actual return rate of 63 percent, and Merchant Client Ameritrust had a projected return rate of 2 percent, but an actual return rate of 73 percent. Jt. Ex. 61/3-4.[62] Delong also observed that the Bank's only tracking of chargebacks looked at number of returns per week with no tracking of trends or the relation of chargebacks to total deposits. Jt. Ex. 76/4, Jt. Ex. 62/2.

In another 2007 review, the Bank's outside consultant RLR criticized that "T Bank ha[d] no procedure for closing accounts with excessive unauthorized returns." Jt. Ex. 112/11. Moreover, fraud monitoring was insufficient with respect to returns in particular. Jt. Ex. 112/6, 9. "Risk assessments, underwriting scoring and reserve requirements were arrived at too subjectively and need[ed . . .] more structure and consistency." Jt. Ex. 112/4, 7-8.[63] RLR was also critical of T Bank's account hold practices because after the initial 30 days an account was open, all accounts reverted to a standard hold without any individualized assessment of whether an extended hold should be maintained. Jt. Ex. 112/5.[64, 65]

3. OCC Witnesses Testified that Internal Controls Failures Were Unsafe or Unsound Practices.

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[62] In another example, Merchant Client Global USI reported a historic return rate of 2 percent to 3 percent at account opening, Jt. Ex. 21/48, but experienced a return rate of 87 percent in May through June of 2007, OCC Ex. 9/2. The reserve on this account of $5,853 was insufficient to mitigate the risk posed by this high level of returns. Tr. 1412:2-1413:2 (Fronk); Jt. Exs. 86, 88.

[63] For example, the Bank required no reserve for Merchant Client LowPay which had a return rate of 50 percent. Tr. 1414:1-13 (Fronk), Jt. Ex. 49/1.

[64] Respondent testified that T Bank's Board of Directors never had the opportunity to implement RLR's recommendations because the Board voted to end the Giact business the same day it was presented with the RLR report. Tr. 417:15-418:2 (Adams). He acknowledged on cross-examination, however, that some of the points raised by RLR were addressed by the OCC previously in the 2006 Exam. Tr. 639:7-641:2 (Adams).

[65] Delong also recommended a separation of duties for persons responsible for Giact Merchant-Client account relationships and Giact Merchant-Client monitoring. Jt. Ex. 76/3. Similarly, RLR criticized that the client relationship manager, CRM Stamm, was performing too many roles in relation to due diligence and monitoring the Giact business. Jt. Ex. 112/3, 6. CRM Stamm was the only bank employee responsible for tracking returns and monitoring the Giact Merchant-Clients' accounts. Tr. 188:6-12 (Adams). One of the OCC's examiners testified that insufficiently staffing day-to-day handling of the Giact relationship with one employee created conflicts of interest and was also an unsafe or unsound practice for which Respondent was responsible as president and CEO of the Bank. Tr. 1214-19, 1282-87 (McKnight); *see also* Tr. 1430:7-9 (Fronk).

NBE Pennell testified that the absence of due diligence data covering historical or anticipated chargebacks and average and maximum transaction sizes made the Bank unable to set proper reserves for accounts, vulnerable to monetary loss risk, and unable to identify suspicious activity in accounts. Tr. 1147:5-1148:10, 1169:15-1170:16 (Pennell). NBE Fronk testified that the failure to monitor the reasons for and the rates of returns, to close accounts for excessive returns, or to establish a policy in this regard were unsafe or unsound practices and contrary to ordinary standards of care. Tr. 1400:17-1408:11 (Fronk). Respondent, as President and CEO of the Bank, was responsible for this failure. *Id.*, Tr. 1430:10-13 (Fronk). She also testified that inadequate reserves exposed T Bank to potential overdrafts and financial losses,[66] that it was impossible to set adequate reserves without analyzing return rates, and that it was unsafe or unsound and contrary to standards of ordinary care to have insufficient reserves. Tr. 1408:12-1409:4, 1418:17-1420:5 (Fronk). NBE Fronk testified that it was unsafe or unsound and contrary to standards of prudent operation to have no specific policy on setting reserves for Giact Merchant-Clients and that Respondent, as President and CEO of the Bank, was responsible for this failure. Tr. 1413:18-1415:3 (Fronk). *See also infra* pp. 63-67.

Louis A. Thompson, the OCC's Deputy Chief Accountant, Tr. 1487:6-14, 1490:9-12 (Thompson), testified as an expert in accounting concerning the deficiency in reserves identified by the Bank's Controller, Amy Birt, in June 2007. Jt. Exs. 103, 104. Deputy Chief Accountant Thompson concluded that the deficiency in reserves of $835,303.51 represented approximately 125 percent of the Bank's net income and more than 6.4 percent of the Bank's tier one capital for the most recent financial reporting quarter; this was a substantial and material deficiency. Tr. 1490:16-1497:18 (Thompson).[67, 68]

C. Record Evidence that T Bank Had No Formal Systems for Monitoring and Responding to Consumer Complaints.

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[66] In a memo dated April 17, 2006, the law firm H&B warned T Bank that it would be liable for returned items. Jt. Ex. 8/4.

[67] The ALJ did not find that reserves maintained by the Bank were inadequate after crediting and accepting the testimony of Respondent that Controller Birt's calculations of the deficiency were a "worst case scenario," hypothetical, and never adopted by the Bank. RD 111-12 (citing Tr. 475-478 (Adams)). While the ALJ is correct that Controller Birt presented her methodology as "open for discussion" with her Bank colleagues, she also stated in an email, as the Bank's Controller, that "it is clear that overall reserves are inadequate to mitigate risks associated with several high risk accounts." Jt. Ex. 104.

[68] The Comptroller is unpersuaded by the ALJ's conclusion that T Bank sufficiently mitigated the Bank's risk exposure through procedures other than reserve accounts for specific Merchant Clients, including the Bank's own reserve against potential loss, 8-day holds on accounts, and the existence of a Giact money market account with T Bank. RD 11-12, 27, 110. The Bank's reserve consisted of Bank money, not money put in reserve by the Merchant Clients, and therefore credit risk remained present. Tr. 1413:3-17 (Fronk). There is no evidence that permanent holds were in place on the Merchant Clients' accounts; the evidence indicates that extended holds were temporarily imposed when an account was opened and reverted to standard holds after 30 days. Tr. 294:10-18, 442:9-17 (Adams); Jt. Ex. 112/5. With respect to the Giact money market account, there is no evidence that T Bank ever obtained a guaranty providing it access to the money market account to cover losses from any Merchant Client specifically or all of the Merchant Clients generally. Tr. 1391:5-22 (Fronk).

The record evidence could support the conclusion that T Bank had no formal policies, procedures, or systems for monitoring or responding to consumers' complaints related to the Giact Merchant-Clients and RCCs debited from the consumers' accounts. The ALJ's legal conclusion that the lack of a proper monitoring and response system was not unsafe or unsound was based on his mistaken view that an unsafe or unsound practice must have an adverse effect on a bank's financial stability. RD 122. Under the correct legal standard for unsafe or unsound practices, *see supra* p. 16, testimony from the OCC's examiners indicates that T Bank's insufficient complaint monitoring and response system was contrary to standard banking practices and exposed the Bank to undue risks and constituted an unsafe or unsound practice. Tr. 1193:3-1197:4, 1218:4-1219:16, 1273:14-1282:11 (McKnight). Under the correct legal standard requiring deference to the testimony of NBEs, *see supra* pp. 42-43, there exists record evidence of unsafe or unsound practices in connection with deficient complaint monitoring and response systems under Respondent's leadership at T Bank.[69]

1. Bank Witnesses Testified that There Were No Systems to Ensure an Adequate Response to Consumer Complaints.

Adams was aware as early as 2006 that T Bank was receiving complaints from consumers that the Giact Merchant-Clients were making unauthorized deductions from consumers' accounts using RCCs deposited into the Merchant Clients' T Bank accounts; the volume of complaints "ramped up" in the Fall of 2006. Tr. 197:20-200:22, 202:12-16 (Adams). In addition to these complaints received directly from consumers[70] and returns coming to the Bank via the payment system, T Bank received complaints of unauthorized charges to consumer accounts directly from consumers' banks. Tr. 207:14-208:1 (Adams). Respondent testified, however, that the Bank had no written formal policies on monitoring, tracking, or responding to complaints directly from consumers or complaints of non-authorized

[69] The ALJ's conclusion that the lack of a formal policy was irrelevant because T Bank refunded money to consumers in response to all consumer complaints, RD 96, 116-17, 118, 123, is unsupported by the evidentiary record. The record contains testimony and documentary evidence related to consumer complaints and returns of different types. The record evidence covers the distinct issues of (1) the Bank's responses to RCCs returned through the payment system for insufficient funds or unauthorized transaction, *see, e.g.,* Tr. 196:10-197:2 (Adams), 1531:2-15 (Higgs); (2) complaints received from consumers directly regarding unauthorized transactions or other problems , *see, e.g.,* Tr. 202:12-205:12 (Adams), 738:4-744:8 (Stamm); Jt. Ex. 120/7; and (3) complaints from consumers' banks (not through the payment system) concerning unauthorized transactions, *see, e.g.,* Tr. 560:18-561:18 (Adams). The ALJ repeatedly cites an exchange between Respondent's Counsel and NBE Fronk in which NBE Fronk is questioned, "you're aware that the bank had a policy of refunding virtually all disputed transactions, even before any investigation. Isn't that correct?" She answered, "Yes, I am aware of that." Tr. 1726:15-19 (Fronk); *see* RD 96, 117, 118, 123. This agreement with Respondent's Counsel's general question conflating returns, consumer complaints, and consumers' banks' complaints into one category does not establish that every complaint of every kind resulted in a refund. Adams testified that all RCCs returned for insufficient funds through the payment system resulted in refunds that were charged back to the Merchant-Client without questions or investigation. Tr. 196:10-197:2 (Adams). However, the evidence did not establish that T Bank always provided refunds in response to complaints from consumers directly or complaints from their banks. On the contrary, according to CRM Stamm, refunds normally were made in response to bank complaints with consumer affidavits only if a transaction was "indeed fraudulent." *See* Jt. Ex. 115.

[70] NBE Fronk explained that consumers were contacting the Bank, instead of the Merchant Clients, with complaints because consumers did not have access to correct contact information for the Merchant Clients. Tr. 1424:7-1427:1 (Fronk).

transactions from consumers' banks. Tr. 202:12-205:12, 207:14-211:10 (Adams). At the time, Respondent attributed consumer complaints, including returns through the payment system, to "buyer's remorse." Tr. 1421:7-1422:1 (Fronk); Tr. 923:19-927:6 (Bermingham). Regarding complaints received directly from consumers, according to CRM Stamm the volume was as high as five to ten a week, but there was no formal process, policy, or procedure for tracking, monitoring, or handling those complaints. Tr. 739:4-746:3 (Stamm). She noted that the bank "did do some refunds" in response to complaints received from consumers' banks, but would not provide a refund if proof of authorization was available. Tr. 746:4-749:6 (Stamm).[71]

2. T Bank's Consultants Criticized T Bank's Inadequate Complaint Response Systems.

Adams testified that for one Merchant Client, Virtual Works, the Bank would refund "anything that came back on their account as a did not authorize . . . Immediately, without even checking the authorization." Tr. 561:12-18 (Adams). The Bank's consultant Delong, however, questioned why, according to Compliance Officer Bermingham, Virtual Works had stopped payment on most of the refund checks that appeared on its February 2007 T Bank account statement. Jt. Ex. 61/3. At the same time, Delong also raised concern that Compliance Officer Bermingham had identified returns charged back to multiple Giact Merchant-Clients from the same consumer, indicating inappropriate sharing of consumer information among the Merchant Clients and possible fraud. *Id.* at 3-5.

In the same vein, the Bank's consultant RLR found that documentation and research on complaint processing was missing from the files on the Merchant Clients and the Bank kept no statistics on complaints of unauthorized transactions received from consumers' banks. Jt. Ex. 112/8, 10-11. RLR criticized T Bank for its practice of responding to bank complaints of unauthorized debits by sending out a form letter[72] which claimed that the disputed transaction was authorized without having first researched it with Giact or the Merchant Client; T Bank would only obtain the authorization (or process a refund) if a consumer's bank followed up on the form letter with a second complaint containing an affidavit from the consumer. *Id.*; *see also* Tr. 209:17-212:15, 560:17-561:18, 645:2-13 (Adams); Tr. 746:4-749:6 (Stamm).

[71] CRM Stamm testified that the volume of complaints from banks that debits were unauthorized was difficult to keep up with and she would sometimes fall two weeks behind in responding due to the high volume. Tr. 755:8-756:22 (Stamm). In response to her requests for assistance, Adams did not hire or assign any additional operations staff to assist CRM Stamm. Tr. 761:3-22 (Stamm).

[72] Among her criticisms of the form letter, NBE McKnight noted that it was unusual for a bank to respond to such complaints with such a general form letter which did not identify the consumer or include a complaint number or any other way to track, monitor, or review the complaint response process for any individual complaint. Tr. 1202:9-1206:3 (McKnight). *See* Jt. Ex. 65 (sample form letter).

3. The OCC's Examiners Testified that Failure to Ensure Adequate Systems to Monitor and Respond to Consumer Complaints Was an Unsafe or Unsound Practice.

Mary McKnight, National Bank Examiner, Southern District Lead Compliance Expert, participated in the 2007 Exam, Tr. 1184:21-1185:6 (McKnight), and testified as an expert witness on safety and soundness and compliance with OCC laws and regulations, specifically unsafe or unsound practices with respect to consumer complaint response systems and staffing at T Bank. Tr. 1218:4-1219:16, 1282:22-1287:8 (McKnight). In the OCC's 2007 Examination of T Bank, NBE McKnight found an unsafe or unsound lack of monitoring, investigation, response to, or aggregate review of customer complaints concerning the Giact Merchant-Clients and an absence of policies and procedures before (or after) entering the RCC business. Tr. 1196:8-1197:4, 1214:2-1219:16 (McKnight). These unsafe or unsound practices exposed the Bank to compliance risk (with respect to Bank Secrecy Act and Suspicious Activity Report filing compliance and unfair or deceptive practices), legal risk, and reputation risk to the Bank, impacting the Bank's earnings and capital and financial safety and soundness. Tr. 1273:14-1282:11 (McKnight). NBE Fronk concurred that T Bank's lack of a formal system to track and monitor complaints was unsafe or unsound. Tr. 1422:18-1423:21 (Fronk). Based on this testimony, a finder of fact could conclude in this case that unsafe or unsound practices occurred at T Bank under Respondent's leadership in connection with deficient complaint monitoring and response systems. The OCC's examiners testified that preventing these deficiencies was Respondent's responsibility as President and CEO of the Bank. Tr. 1211:21-1216:3 (McKnight); 1423:1-4 (Fronk). *See also infra* pp. 63-67.

D. Record Evidence that the Taking of Non-Public OCC Information Without Prior Authorization Is a Violation of Law.

For the reasons noted above, the Comptroller makes no findings of fact and imposes no penalty with respect to Respondent Adam's removal of non-public OCC information from the Bank upon his departure. The record contains evidence, however, that a violation of 12 C.F.R. § 4.36(d) took place when Respondent, as admitted in his testimony, copied his hard drive shortly after his resignation and took a copy home. Tr. 227:1-13 (Adams). The ALJ concluded that although Respondent's removal of this information from the Bank was inadvisable, no violation of law took place warranting imposition of a cease-and-desist order because a violation of law, within in the meaning of 12 U.S.C. 1818(b), requires an effect on the financial stability of the institution and no such impact occurred as a result of Respondent's failure to abide by OCC regulation. RD 139. The Comptroller has determined that no such effects test exists under 12 U.S.C. 1818(b). *See supra* pp. 38-40. Admission that he removed the copied hard drive from the Bank constitutes evidence that Respondent knowingly removed non-public OCC information[73] from the Bank including ROEs and supervisory correspondence without authorization in violation of law. RD 126; Tr. 228:16-21, 234:22-235:3 (Adams), Tr.

[73] The regulations define non-public OCC information as including records "created or obtained" by the OCC "in connection with the OCC's performance of its responsibilities, such as a record concerning supervision, licensing, regulation, and examination of a national bank . . ." 12 C.F.R. § 4.32(b)(1)(i). "A report of examination" and "supervisory correspondence" constitute non-public OCC information. 12 C.F.R. § 4.32(b)(1)(iii).

1462:6-1465:20 (Fronk). Based upon this admission, a finder of fact could determine that the grounds for imposing a cease-and-desist order had been met in this case.

OCC regulations state that "[a]ll non-public OCC information remains the property of the OCC. . . . Except as authorized by the OCC, no person obtaining access to non-public information under this section may make a copy of the information and no person may remove non-public OCC information from the premises of the institution, agency, or other party in authorized possession of the information." 12 C.F.R. § 4.36(d). It is the OCC's policy that non-public OCC information "is confidential and privileged." 12 C.F.R. § 4.36(b). Maintenance of the proper confidentiality of OCC supervisory information is essential to the effectiveness of the OCC's supervisory mission. It is therefore essential that all individuals and entities with access to non-public OCC information comply with the regulations prohibiting unauthorized use or disclosure of this information. *See* 12 C.F.R. §§ 4.36(d), 4.37(b)(1)(ii). Under the correct legal standard for a violation of law, *see supra* pp. 38-40, the evidence supporting the conclusion that Respondent took non-public OCC information in violation of 12 C.F.R. § 4.36(d) could persuade the finder of fact that the conduct warranted imposition of a cease-and-desist order.

III. EVIDENCE IN THE RECORD OF RECKLESS ENGAGEMENT IN UNSAFE OR UNSOUND PRACTICES FORMING A PATTERN OF MISCONDUCT AND WARRANTING A SECOND TIER CIVIL MONEY PENALTY.

The Comptroller makes no findings of fact supporting imposition of a civil money penalty and declines to impose a civil money penalty on Respondent for the reasons discussed above. Upon the record evidence, however, a finder of fact could conclude that Respondent recklessly engaged in unsafe or unsound practices forming a pattern of misconduct that could warrant imposition of a Second Tier civil money penalty. *See* 12 U.S.C. § 1818(i)(2)(B). For the purpose of a Second Tier civil money penalty, conduct is deemed "reckless" when it is "done in disregard of, and evidencing a conscious indifference to, a known or obvious risk of a substantial harm." *Cavallari v. Comptroller of the Currency*, 57 F.3d 137, 142 (2d Cir. 1995) (citing *Simpson v. Office of Thrift Supervision*, 29 F.3d 1418, 1425 (9th Cir. 1994)) (applying interpretation of "reckless disregard for the law" under 12 U.S.C. § 1818(b)(6)(A)(ii) as "when: (1) the party acts with clear neglect for, or plain indifference to, the requirements of the law, applicable regulations or agency orders of which the party was, or with reasonable diligence should have been, aware; and (2) the risk of loss or harm or other damage from the conduct is such that the party knows it, or is so obvious that the party should have been aware of it.").

While RCCs may have been a new banking product being offered to retailers at the time T Bank entered the Giact business, the record evidence indicates that the OCC's examiners provided T Bank with supervisory guidance on how to identify and manage risks associated with the RCC business. Additionally, published guidance on relevant subjects such as merchant processing generally, new products and services, third-party relationships, and Bank Secrecy Act ("BSA")/Anti-Money Laundering ("AML") requirements for banking high-risk customers were all applicable to T Bank's management of its RCC business. Indeed, Adams'

own Compliance Officer, other Bank employees, and external advisors hired by the Bank warned him of the risks T Bank faced in undertaking the RCC business. *See supra* pp. 48-50, 55, 58. This record evidence could support the conclusion that Respondent recklessly engaged in unsafe or unsound practices that would support imposition of Second Tier civil money penalty within the meaning of 12 U.S.C. § 1818(b)(6)(A)(ii).

A. Evidence that the OCC Provided a Supervisory Response Critical of the Giact Business Starting During Its 2006 Examination of T Bank and Addressed Deficiencies in the RCC Business in a 2007 Memorandum of Understanding.

The record contains evidence that the OCC's examiners communicated to T Bank that its management of the Giact business was deficient and required improvement in order to operate the Bank in a safe and sound manner.[74] The ROE for the 2006 Exam cited Giact by name with respect to the need for better analysis of deposits returned to the Bank and improved customer activity reports and monitoring of deposits in the context of AML compliance. Jt. Ex. 34/40. The 2006 Exam ROE indicated that these Giact-related concerns were addressed by actions called for in the Matters Requiring Attention ("MRA") section of the ROE. Jt. Ex. 34/40. The BSA/AML MRA states specifically, "management needs to expand the monitoring of the high risk Giact-related deposit accounts . . . ." Jt. Ex. 34/12. The vendor management MRA explicitly mentioned the need for increased due diligence with respect to Giact and the need for a standard reserve analysis for all Giact customers. Jt. Ex. 34/15.[75] Additionally, NBE Algier testified that sections of the 2006 Exam ROE dealing with improvements needed in the rollout of new products and services [76] and in the Bank's risk management controls and compliance management risk structure applied to the Giact business. Jt. Ex. 34/4-6, 8, 23-25, Tr. 996:7-17, 998:16-1000:20, 1004:16-1005:14, 1008:18-1009:22, 1010:4-1011:5 (Algier). As the examiner-in-charge at the 2006 Exam, NBE Algier discussed the Giact relationship with

[74] The ALJ faulted the OCC for not commenting on the sufficiency of the Bank's due diligence or monitoring and tracking of accounts during the 2006 Exam, RD 25, n.20, 27-28, 37-38, 44-45, and criticized an OCC enforcement document for not mentioning Giact by name, RD 35. The ALJ was persuaded by Adams and other T Bank witnesses that the OCC had offered no contemporaneous guidance to the Bank on managing the Giact business. RD 9-10. In the view of the Comptroller, this factual conclusion is unsupported by the record evidence.

[75] NBE Algier confirmed the applicability of these MRAs to the Giact RCC business and explained that the OCC does not, in its ROEs and MRAs, tell a bank specifically what steps it should take to address risks; rather, it is the responsibility of management and the board of directors of a bank to develop their specific risk management practices because the bank managers and officers are in the best position to do so with reference to relevant published guidance from bank regulators. Tr. 1013:5-1014:18, 1017:22-1019:20, 1027:9-1028:6, 1060:2-1061:8 (Algier).

The ALJ's view that BSA/AML risk concerns can only exist in relation to potential money laundering (and no other criminal activity, such as fraud), RD 26 n.21, is an overly narrow view of the requirements of the law and the proper functioning of a proper suspicious activity monitoring function. NBE Pennell testified, for example, that his review of T Bank's compliance with the BSA evaluated whether the Bank was establishing and following policies and procedures to identify its customers, *i.e.*, the Giact Merchant-Clients, and the nature of their businesses to evaluate the risk of money laundering or other transactions taking place. Tr. 1128:8-1129:13, 1136:16-1137:11 (Pennell).

The ALJ's preoccupation with whether Giact was properly denominated as a third-party *vendor* in relation to the examiners' requirement that a proper reserve analysis be established, RD 34-35, is similarly misplaced. The fundamental point of the MRA was that a reserve analysis was required to mitigate risks associated with the Giact business. NBE Algier testified that analysis of returns for setting reserves was still required and BSA/AML concerns were still present even if (as the Bank argued) the Giact Merchant-Clients' accounts were normal customer accounts and not part of a vendor relationship *per se*. Tr. 1022:15-1024:20 (Algier).

[76] The RCC business with Giact was not part of T Bank's business plan included in its charter application. Tr. 1010:14-20 (Algier).

Respondent "numerous times" including in an exit meeting at the conclusion of the exam. Tr. 988:13-990:6 (Algier). NBE Algier recounted discussions he held with Adams about the designation of Giact Merchant-Clients' accounts as high risk, the need for monitoring those accounts, and identifying and managing risks associated with new products and services, including BSA/AML risks. Tr. 1000:21-1002:18, 1010:4-1013:4, 1013:5-1015:22 (Algier).

Following the 2006 Exam, on April 12, 2007, the OCC and T Bank executed an enforcement document, Memorandum of Understanding between T Bank and the OCC, with the aim of correcting deficiencies the OCC's examiners found during the 2006 Exam ("the MOU"). The words "Giact" and "RCC" do not appear in the MOU; NBE Algier explained that it is usual for the OCC to draft enforcement documents broadly, without specific references of that kind, because of the potential broad distribution of the document and also to avoid narrowly focusing a bank on specific areas of concern to the exclusion of other areas that may raise similar concerns. Tr. 1073:2-19 (Algier).[77] His testimony confirmed that the MOU articles relating to new product development risk management, BSA/AML compliance,[78] and vendor management[79] were connected to the RCC business, although, as is customary, the MOU did not identify Giact or RCCs by name. Tr. 1062:18-1064:9 (Algier).

B. Evidence of Published Supervisory Guidance and Standards of Prudent Operation Applicable to Managing an RCC Business at the Time T Bank Entered and Continued the RCC Business.

When banks are introducing novel services and products, as T Bank did with RCCs from 2005 to 2007, banks *must* be guided by more general or analogous published guidance (as well as criticisms from examiners) in establishing proper policies and procedures to mitigate the often abundant risks associated with novel services and products. *See supra* p. 43. In April 2008, the OCC published bulletin OCC Bulletin 2008-12, entitled Payment Processors, Risk Management Guidance. Resp. Ex. 77. This bulletin makes specific reference to RCCs.[80]

[77] NBE Fronk testified similarly that enforcement actions are typically not worded with the specificity that would be found in an ROE; for this reason, she directs banks to look at recent ROEs in order to understand the relevant detail of a related enforcement action. Tr. 1361:8-13, 1554:21-1555:9 (Fronk).

[78] Documentary evidence establishes that T Bank understood the MOU article on BSA/AML compliance to pertain to the Giact business. The Bank's June 12, 2007 report on compliance with the MOU referenced and attached a report prepared by Delong Consulting Services, L.C. that discussed BSA/AML compliance deficiencies in connection with the Giact relationship. Resp. Ex. 40/11, 121.

[79] The Bank's June 12, 2007 report on compliance with the MOU again made clear the Bank's knowledge that the MOU addressed Giact. The Bank recounted its objection to the OCC's examiners identifying Giact as a vendor in the Bank's response to the vendor management article of the MOU. Resp. Ex. 40/17.

[80] In addition to incorrectly concluding that the OCC's supervisory activities did not address the Giact relationship, the ALJ was mistaken in his failure to recognize the OCC published guidance generally applicable to RCCs and the Giact business and erred in his conclusion that there was no relevant supervisory guidance available to Respondent to guide him in his management of the RCC business. *See* RD 79-80 n.41. The Comptroller rejects the view that OCC published guidance must specifically address a payment system instrument, such as RCCs or any other, by name in order for the guidance to be applicable. The ALJ erred in concluding that the OCC's supervisory and enforcement functions are limited only to products and activities specifically identified in prior guidance when our

Although this was the first OCC bulletin to specifically mention RCCs, there existed at the time T Bank entered and remained in the RCC business published guidance applicable to the merchant processing services the Bank was offering.[81] In this regard, W. Carter Messick, National Bank Examiner, Lead Expert for Operational Risk and Enterprise Governance, Mid-Size Bank Supervision, Tr. 19:14-18, 31:3-17 (Messick), testified that he had been unaware of RCCs being utilized in the retail market until 2007. Tr. 127:15-19 (Messick). Nevertheless, as an expert on safety and soundness issues involving electronic payments, Messick testified that more general guidance incorporated and applied to managing an RCC business, including the OCC's Merchant Processing Comptroller's Handbook (December 2001) ("Merchant Processing Handbook"),[82] Tr. 74:17-78:1, 108:4-110:4, 113:8-114:20 (Messick), and OCC Bulletin 2004-20, Risk Management of New, Expanded, or Modified Bank Products and Services, Risk Management Process, May 10, 2004 ("2004 New Product Guidance"),[83] Tr. 78:2-16, 108:4-110:4, 113:8-114:20, 127:22-128:14 (Messick). He also

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examiners identify unsafe or unsound practices in connection with novel banking products or services. *See supra* p. 43.

[81] Indeed, the 2008 Payment Processor bulletin states that the principles and procedures outlined in the OCC's 2001 Merchant Processing Handbook, *see infra* n.82, "are also applicable to the processing of other payment instruments, including RCCs and [Automated Clearing House ("ACH")] transactions." Resp. Ex. 77/2 n.5.

[82] The 2001 version of the Merchant Processing Handbook warns banks to consider the strategic risk at stake in merchant processing in connection with a bank's liability for fraud and chargeback losses and highlights that "[c]redit risk arising from chargebacks is a significant risk to . . . earnings and capital" and identifies reputation and transaction risks involved. Merchant Processing Handbook at 17-21. The handbook stresses the importance of an antifraud system to monitor each merchant's daily activity and describes primary methods for controlling risk including risk management processes that include written policies and procedures, staffing levels commensurate with workload, monitoring of sales activity, chargebacks, and fraud, and a formal merchant underwriting and approval policy which requires obtaining certain minimum due diligence information. *Id.* at 22-24, 30-31. "Higher risk" merchants should "undergo far greater [underwriting] analysis" and be continually monitored. *Id.* at 25, 27. In the case of internet merchants, banks should determine whether "heightened fraud and chargeback risk warrants the use of additional risk mitigation techniques, such as delaying settlement or establishing reserves." *Id.* at 26. Banks with payment processing relationships should monitor each merchant's daily chargeback activity and establish reserves to mitigate credit risk. *Id.* at 31-32, 73.

The ALJ took administrative notice of the 2001 Merchant Processing Handbook but refused to attribute knowledge of it to Adams. RD 9-10, n.7; Tr. 1763:18-1764:4 (Miserendino). Adams indicated in his testimony, however, that he was aware of the Merchant Processing Handbook and believed that its guidance applied to management of T Bank's RCC business because, according to Respondent's testimony, the Bank did collect the due diligence prescribed by the handbook. Tr. 328:15-17, 352: 2-6 (Adams).

[83] Available at http://www.occ.gov/news-issuances/bulletins/2004/bulletin-2004-20.html (last visited Sept. 4, 2014).

The 2004 New Product Guidance identifies failure to establish effective risk management processes with respect to new, expanded, or modified products and services as an unsafe or unsound banking practice. Effective risk management processes include (1) adequate due diligence prior to introducing product, (2) developing and implementing controls and processes to measure, monitor, and control risk, (3) developing and implementing appropriate performance monitoring and review systems. The guidance warns of the risks to earnings and capital embedded in the strategic, reputation, credit, transaction, and compliance risks potentially associated with new products and services.

indicated that prior to banks beginning to process RCCs for retailers, banks utilized Automated Clearing House ("ACH") payment processing which was analogous to RCCs and the subject of explicit OCC guidance on risk management.[84] Tr. 110:11-111:7, 113:8-16, 123:20:-128:14 (Messick).

NBE Messick described the type of due diligence that the Merchant Processing Handbook directs a bank to undertake to identify high-risk customers including "collect[ing] identifying information on the principals of a company, what business they're in, what the products, goods and services that they sell are, and what their past banking relationship was, what their payment volumes were, what their return volumes were or chargeback volume on credit cards, and looking at that, make a determination of whether they're high risk or not." Tr. 74:17-78:1 (Messick). He explained that the merchant processing guidance requires deeper due diligence with respect to high-risk merchants. Before processing for a high-risk merchant, a bank may take the due diligence deeper by "sampling the telemarketing scripts, looking at web-based ads and doing deeper . . . due diligence, to understand the credibility of the company." *Id.* He explained that the 2004 New Product Guidance "lays out the expectation that banks have strong due diligence and approval processes for any new third party relationships, and any policies and procedures, expertise already in existence as they're moving into new business lines, new products and services." Tr. 78:2-16 (Messick). He also noted that the Bank Secrecy Act Manual of the Federal Financial Institutions Examination Council ("FFIEC's BSA/AML Manual") was relevant guidance for establishing due diligence procedures to identify and monitor higher-risk accounts in the RCC context. Tr. 58:5-15, 110:11-111:3 (Messick); *see also* Tr. 1733:7-16 (Fronk).[85]

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[84] *See, e.g.*, OCC Bulletin 2002-2, ACH Transactions Involving the Internet, Guidance and Examination Procedures, January 14, 2002; OCC Bulletin 2006-39, Automated Clearing House Activities, September 1, 2006 (replaces OCC Bulletin 2002-2), available at http://www.occ.gov/news-issuances/bulletins/2006/bulletin-2006-39.html (last visited Sept. 4, 2014).

OCC Bulletin 2006-39 warns that engaging "in new ACH activities" without "implement[ing] appropriate controls . . . is an unsafe or unsound practice and can result in increased credit, compliance, reputation, strategic, and transaction risks, and, in some cases, deterioration in the bank's condition." "[E]ffective ACH risk management" requires "written policies and procedures, strong internal controls, and a risk-based audit program." The guidance identifies "credit-repair services, certain mail order and telephone order (MOTO) companies," among others, as "inherently more risky" and likely to have more "incidents of unauthorized returns." Increased monitoring is required with these companies as a "high level of unauthorized returns is often indicative of fraudulent activity."

The ALJ sustained an objection by Respondent's counsel to the relevance of this guidance and did not allow Respondent to be questioned on it, although Respondent acknowledged that he should have received this guidance. Tr. 651:18-655:10. (Adams).

[85] Although various past revisions of the manual referenced by the witnesses are not exhibits in the record, the FFIEC's BSA/AML Manual address risks associated with RCCs specifically starting with the manual's 2006 revisions in the section dealing with Third-Party Payment Processors and instructs that banks should have an understanding of chargeback history for RCCs as part of effective monitoring. *Id.* at 205-06 & n.173. The current version of the manual continues to discuss RCCs specifically and is available at https://www.ffiec.gov/bsa_aml_infobase/pages_manual/OLM_063.htm (last visited Sept. 4, 2014).

FFIEC's BSA/AML requirements for categorizing banking activity as high risk were discussed with T Bank

In the 2006 Exam, the OCC's examiners directed T Bank management to OCC Bulletin 2001-47, Third-Party Relationships, Risk Management Principles, November 1, 2001 ("2001 Third Party Guidance), Jt. Ex. 1, Jt. Ex. 34/6, Jt. Ex. 51/3, which also contains guidance on managing risks in relationships with third parties in a safe and sound manner.[86] The guidance warns banks that "management and the board must exercise due diligence prior to entering the third-party relationship and effective oversight and control afterwards." Jt. Ex. 1/4.[87]

NBE Messick described the risks connected to processing RCCs for retailers to include credit risk related to settling transactions (a risk exacerbated in the case of a high level of returns for which a bank may be held ultimately liable), compliance risk related to unfair and deceptive practices, reputation risk, and operational risk related to potential fraud. Tr. 61:4-64:16, 67:18-71:2, 72:8-74:16, 74:17-76:10 (Messick). He explained that the risk of fraud is higher when processing RCCs than with ACH payments which can be monitored more closely by the bank, bank regulators, and the clearing house processing the payment. Tr. 63:21-64:16 (Messick). NBE Messick testified that to manage risks involved in merchant processing, banks must put in place procedures for underwriting (*i.e.*, carrying out due diligence on) new merchants which examine a merchant's industry, volume of transactions, financial condition, creditworthiness, and background of principals; set limits on the volume of payments and returns as well as limits on returns as a percentage of payment volume; and institute processes for monitoring merchants to identify those who exceed those limits and escalation and audit procedures that would allow review of consumer audio and website authorizations, and termination procedures to manage merchants who exceed established limits. Tr. 83:21-84:14, 92:1- 96:17 (Messick). NBE Messick testified that it is unsafe or unsound for a bank to accept RCCs from high-risk merchants without these adequate procedures, policies, systems, and controls to mitigate and manage risk. Tr. 96:11-17 (Messick). NBE Messick's testimony on

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management in the course of the 2006 Exam. Tr. 1013:10-1014:20 (Algier). The 2005 version of the FFIEC's BSA/AML Manual includes requirements for customer due diligence, enhanced due diligence for high-risk customers, and ongoing due diligence of the customer base in support of suspicious activity reporting. *Id.* at 37, 41. A section on third-party payment processors warns that "some processors may be vulnerable to money laundering, identity theft, and fraud schemes" creating the risk of "processing illicit or sanctioned transactions." *Id.* at 121. To effectively monitor such accounts a bank should have an understanding of processor information including "chargeback history." *Id.* at 122.

[86] The 2001 Third Party Guidance highlighted that "credit risk for some . . . third-party programs may be shifted back to the bank if the third party does not fulfill its responsibilities or have the financial capacity to fulfill its obligations." Jt. Ex. 1/6. The guidance directs banks to establish policies for risk assessment, proper due diligence, and ongoing controls and oversight to mitigate strategic, reputation, compliance, and transaction risk posed by third parties.

[87] The ALJ accuses Enforcement Counsel of misrepresenting the text of OCC Bulletin 2001-47 when it paraphrased this line. RD 97. Enforcement Counsel did not convey a materially different meaning in its paraphrase which was not in quotation marks or otherwise represented as the actual text of the guidance. EC's Post-Hearing Brief at 71. In at least two other places in the brief, Enforcement Counsel accurately quoted the passage. EC's Post-Hearing Brief at 13-14, 97.

the standards for prudent management of a payment processing business are rooted in the guidance articulated in the published supervisory guidance discussed above.[88]

As discussed above, evidence exists in the record that Respondent knew or should have known of the applicability of published guidance to the new line of business he developed for the Bank. Evidence exists that Adams, however, disregarded or failed to give proper consideration to the regulatory guidance and the risks of which he was aware or should have been aware and instead recklessly entered the RCC business with insufficient due diligence, account monitoring and reserves, and complaint monitoring and response policies, procedures, and systems in place. The evidence referenced above could support the conclusion that Respondent engaged in unsafe or unsound practices forming a pattern of misconduct despite warnings from Compliance Officer Bermingham and other Bank staff as well as the OCC's Examiners that greater efforts were required to mitigate the risks associated with the RCC business. Based on the record therefore, under the correct legal standards set forth in this opinion, a fact finder could conclude that the evidence supported imposition of a Second Tier civil money penalty against Adams.

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[88] *See supra* pp. 63-66.

CONCLUSION

For the foregoing reasons, the legal standards recommended by the ALJ are rejected. The Comptroller states above the correct legal standards applicable in this case with respect to the meaning of unsafe or unsound practices and a violation of law under 12 U.S.C. § 1818(b) and § 1818(i)(2) and with respect to the deference due to the testimony of national bank examiners. The Comptroller declines to remand the case to the ALJ for new findings of fact and imposition of penalties for the reasons stated above. The charges against Patrick Adams are dismissed.

IT IS SO ORDERED, this 30th day of September, 2014.

/s/ Thomas J. Curry
THOMAS J. CURRY
COMPTROLLER OF THE CURRENCY