IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

ADVANCE AMERICA, CASH ADVANCE CENTERS, INC., et al.,

Plaintiffs,

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, et al.,

Defendants.

Civil Action No. 14-953-TNM

APPENDIX VOLUME I

Date: October 12, 2018

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INDEX

78	FDIC0062575	App.426
79	FDIC0062582	App.427
80	FDIC0062555–56	App.428
81	FDIC0062553–54	App.430
82	FDIC0055751–53	App.432
83	FDIC0055739–41	App.435
84	FDIC0055760–62	App.438
85	FDIC0062438–42	App.441
86	FDIC0062667–69	App.446
87	FDIC0062670–73	App.449
88	FDIC0062674–79	App.453
89	FDIC0062479–80	App.458
90	FDIC0124505–09	App.461
91	FDIC0061915–18	App.466
92	FDIC0079013–14	App.470
93	FDIC0064330–31	App.472
94	FDIC0067052–55	App.474
95	FDIC0067086–88	App.478
96	FDIC0067925–32	App.481
97	FDIC0119430–31	App.489
98	FDIC0119432–33	App.491
99	FDIC0119467	App.493
100	FDIC0062474	App.494
101	FDIC0119607–08	App.495
102	FDIC0052994–95	App.497
103	FDIC0053293	App.499
104	FDIC0110884	App.500
105	FDIC0067496–98	App.501
106	FDIC0069914–15	App.504
107	FDIC0120132–36	App.506
108	FDIC0062475	App.511

EXHIBIT 1

No. 14-953-TNM

Alderson®
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Transcript of **Glenn Bassett**

Tuesday, April 24, 2018

Advance America, et al. v. Federal Deposit Insurance Corporation, et al.

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Alderson Reference Number: 78061

services. The first is check cashing?
A. Yes.
Q. What is that?
A. Check cashing is when a customer comes in that would like to cash a check with us. We cash that check through reviewing the check to make sure that it is okay to cash, and then there is a small fee that we charge them to cash the check.
Q. How do you derive income from check cashing?
A. With a small fee.
Q. What percentage of NorthState's income is derived from this check cashing service?
A. I would say right now, probably around 55 to 60 percent.
Q. And the second item on here is payday loans?
A. Uh-huh.
Q. What does that mean?
A. Payday loans are when a customer comes in that needs money, they can write a check to us which we hold on to, basically for 30 days, and then they

09:55:36 pay that back and there is a fee that we get for
09:55:40 doing that transaction.
09:55:42 Q. How does NorthState derive income from
09:55:45 that service?
09:55:45 A. With the fees.
09:55:46 Q. What percentage of income does NorthState
09:55:54 derive from that service?
09:55:55 A. Right now, I would say roughly around
09:55:59 probably 40, I think probably 30 to 35 percent.
09:56:08 Q. And the next item is Western Union?
09:56:12 A. Yes.
09:56:12 Q. What does that mean?
09:56:13 A. They are a money transmitter and people
09:56:19 send and receive money.
09:56:22 Q. And how does NorthState derive income from
09:56:25 that service?
09:56:26 A. There is a commission for each
09:56:29 transaction.
09:56:30 Q. Is that a percentage of the transaction?
09:56:31 A. Yes.
09:56:35 Q. What percentage of income does NorthState
09:56:37 derive from the Western Union service?

10:27:51 Q. And it became an analysis business
10:27:52 checking account at TriCounties ending in 5386?
10:27:56 A. Yes.
10:27:58 Q. What was the purpose of that account?
10:28:00 A. That was our Western Union paid. It was
10:28:03 specifically for customers that we paid out through
10:28:05 Western Union.
10:28:07 Q. When did the income in that account come
10:28:10 from?
10:28:11 A. Through a commission program through
10:28:14 Western Union.
10:28:17 Q. Were there any other uses besides the
10:28:19 Western Union paid?
10:28:20 A. No.
10:28:20 Q. The next account is a Positively Free
10:28:23 Business Checking Account ending in 3604 at North
10:28:29 Valley that became a basic business checking account
10:28:30 at TriCounties ending in 5311?
10:28:34 A. Yes.
10:28:35 Q. What did you use that account for?
10:28:36 A. That was our payroll account.
10:28:41 Q. Did you use it for anything besides

10:31:45 Commercial Line of Credit ending in 1093 at North
10:31:49 Valley that became a commercial line of credit ending
10:31:52 in 0440 at TriCounties?
10:31:54 A. Yes.
10:31:54 Q. What was that?
10:31:55 A. That was a $200,000 line of credit that we
10:32:01 used for cash flow purposes.
10:32:06 Q. You held the $200,000 line of credit at
10:32:08 North Valley?
10:32:09 A. Yes.
10:32:09 Q. And you also held it at TriCounties?
10:32:13 A. Yes, it was transferred over.
10:32:14 Q. The same line of credit transferred from
10:32:16 North Valley to TriCounties?
10:32:17 A. Yes.
10:32:19 Q. Looking at the accounts between pages 207
10:32:26 and 208, it appears that there are six accounts, is
10:32:33 that right?
10:32:33 A. Yes.
10:32:33 Q. And one line of credit?
10:32:37 A. Yes.
10:32:38 Q. I want to direct your attention to the

14:25:00 as that I had been using as a depository account, but
14:25:04 I had to open up an investment account and use that
14:25:08 for my payday loans.
14:25:09 [redacted]
14:25:11 at is you went directly from Wells Fargo to Edward
14:25:15 Jones with no time gap in between?
14:25:19 [redacted]
14:25:25 Q. Now I want to talk about what Edward Jones
14:25:27 [redacted]
14:25:29 So what is Edward Jones?
14:25:30 [redacted]
14:25:33 [redacted]
14:25:38 [redacted]
14:25:42 [redacted]
14:25:44 [redacted]
14:25:48 [redacted]
14:25:53 [redacted]
14:25:54 [redacted]
14:25:58 [redacted]
14:26:08 [redacted]
14:26:11 money. Say it's the $115. Since Edward Jones will
14:26:16 [redacted]

14:26:21 [redacted]
14:26:24 [redacted]
14:26:29 [redacted]
14:26:32 Q. And how do you turn it into a money order?
14:26:34 A. We just take the cash and purchase the
14:26:36 money order.
14:26:37 [redacted] [redacted]
14:26:40 the Edward Jones account?
14:26:41 [redacted] [redacted]
14:26:41 [redacted] [redacted]
14:26:50 [redacted]
14:26:53 [redacted]
14:26:55 your account at Edward Jones and your accounts at
14:26:59 TriCounties and Wells Fargo?
14:27:00 A. I think the only difference would be the
14:27:04 relationship with the payday lending.
14:27:06 Q. What do you mean the relationship of the
14:27:08 payday lending?
14:27:09 A. How we can't use it exactly like we were
14:27:12 using the account at TriCounties.
14:27:14 Q. So that's the turning it into the money
14:27:17 order process that you were just describing?

14:27:19 A. Yes.
14:27:19 Q. Apart from that, is there any other
14:27:21 difference?
14:27:21 A. Not that I know of.
14:27:23 Q. Okay. Going back to Exhibit 5, I'm going
14:27:36 to direct your attention to paragraph 4.
14:27:38 You wrote, "NorthState has been able to
14:27:41 continue in business and stay afloat at substantial
14:27:45 additional costs by using an account with Edward
14:27:47 Jones for the payday lending side of NorthState's
14:27:50 business." Do you see that?
14:27:51 A. Yes.
14:27:52 Q. What are those substantial additional
14:27:54 accounts?
14:27:54 A. In regards to that, I was talking about
14:28:02 the compliance expenses, the cost of the money
14:28:06 orders, because we have to pay for the money orders,
14:28:13 the costs of a compliance manager, just everything
14:28:15 derived from the cost in the way we had to change
14:28:18 doing business.
14:28:21 Q. So I want to unpack your answer. You
14:28:23 referred to the money orders and how you have to pay

14:39:54 intend to terminate your relationship?
14:39:58 A. No.
14:39:58 [redacted]
14:40:01 either TriCounties or Edward Jones intends to
14:40:03 [redacted]
14:40:07 [redacted] [redacted]
14:40:07 (Bassett Exhibit No. 13 was
14:40:41 marked for identification.)
14:40:41 BY MS. MARGOLIS:
14:40:42 Q. The court reporter has handed you
14:40:44 Exhibit 13 to your deposition. Do you recognize this
14:40:47 document?
14:40:47 A. Yes.
14:40:48 Q. What is it?
14:40:49 A. This was a document in regards to the
14:40:58 banks that declined me to do business for payday
14:41:02 loans.
14:41:02 Q. Who created this document?
14:41:03 A. I did.
14:41:03 Q. For what purpose?
14:41:05 A. To show the banks that did not want to
14:41:15 have a relationship with a payday loan company.

14:41:18 Q. Was it created for this litigation?
14:41:20 A. I believe so.
14:41:22 Q. When was it created?
14:41:27 A. I think during the first interrogatories,
14:41:43 I believe. I think it was one of the questions.
14:41:47 Q. Was it created within the last year?
14:41:53 A. If that's what the interrogatories are.
14:41:59 Q. This document says at the top, "Banks that
14:42:05 decline to do business with us due to payday loans."
14:42:09 Do you see that?
14:42:10 A. Yes.
14:42:10 Q. What did you mean by that statement?
14:42:11 A. I meant that I would either phone or go
14:42:18 in. Number one, for example, I met with the branch
14:42:21 manager, Karen, Five Starr Bank. She thought she
14:42:25 could do business with us but after contacting upper
14:42:28 management, she realized that we did payday loans and
14:42:31 she was informed by upper management that she could
14:42:33 not do business with us.
14:42:35 Q. What is the reason she gave you for not
14:42:39 being able to do business with you?
14:42:40 A. Because we were a payday loan company.

14:42:43 Q. Did she mention any regulators?
14:42:44 A. Not specifically, no. No.
14:42:53 Q. The next bank is Bank of America.
14:42:57 A. Same conversation. Same answer.
14:43:03 Q. Did you go to a Bank of America branch?
14:43:06 A. Yes, I did.
14:43:06 Q. And you spoke with someone named Jennifer?
14:43:08 A. Yeah, the branch manager.
14:43:11 Q. What did Jennifer tell you?
14:43:14 A. That Bank of America does not bank with
14:43:19 payday loan companies.
14:43:20 Q. Did Jennifer mention any regulators?
14:43:23 A. No.
14:43:23 Q. The next bank is Cornerstone Bank. Did
14:43:27 you have a conversation with Cornerstone Bank?
14:43:28 A. Yes.
14:43:29 Q. Was it in person?
14:43:29 A. Yes.
14:43:30 Q. At a Cornerstone Bank branch?
14:43:32 A. Yes.
14:43:32 Q. Do you recall who you had the conversation
14:43:34 with?

A. It was -- I don't believe it was the branch manager but it was an account representative on the commercial side.

Q. And what was the substance of the conversation?

A. To see if they would bank a payday loan company.

Q. What was the answer?

A. No.

Q. Did the individual who you spoke to from Cornerstone Bank mention any regulators?

A. No.

Q. The fourth bank is Bank of California?

A. Yes.

Q. Did you have a conversation with an individual named Jennifer from Bank of California?

A. Yeah. That was a phone conversation and she had to contact upper management. She contacted me back and said they didn't bank payday customers.

Q. Did she give you any additional --

A. No.

Q. Did she mention any regulators?

14:44:28 A. No.

14:44:29 Q. The fifth bank is US Bank?

14:44:30 A. I met with Josh, the branch manager, at
14:44:36 the branch. Same conversation. US Bank was
14:44:41 terminating most of their accounts with payday loan
14:44:49 customers and he said he wouldn't be able to bank us.

14:44:52 Q. Did he mention any regulators?

14:44:54 A. No.

14:44:54 Q. Sixth bank is Redding Bank of Commerce?

14:44:56 A. That was a phone call. That was a real
14:44:57 brief one. They just said no, they didn't bank
14:45:00 payday loan customers.

14:45:02 Q. Any mention of any regulators?

14:45:03 A. That wasn't in the discussion, no.

14:45:05 Q. The seventh bank is Sierra Central Credit
14:45:10 Union. Did you have a conversation with them?

14:45:11 A. A phone call conversation, and I don't
14:45:15 remember the person's name that I spoke with but they
14:45:18 said they didn't bank payday loans.

14:45:20 Q. Did they mention regulators?

14:45:21 A. No.

14:45:22 Q. Eighth bank is Members First Credit Union.

14:45:26 Did you speak with someone named Zach who works
14:45:28 there?
14:45:29 A. I did. I believe that was a phone call
14:45:34 and he didn't bank payday loan customers either.
14:45:37 Q. Did he mention regulators?
14:45:39 A. No.
14:45:39 Q. The ninth bank is Merchants Bank of
14:45:44 California.
14:45:44 A. I did contact, I believe he was a bank
14:45:54 executive and I can't think of his name, but he did
14:45:58 tell me that due to the scrutiny put forth on his
14:46:06 bank in regards to payday loan customers through the
14:46:14 regulation process, he would not be able to bank us.
14:46:17 Q. Did he specifically mention any
14:46:22 regulators?
14:46:22 A. No.
14:46:23 Q. When you say scrutiny, did he tell you
14:46:27 what he was referring to?
14:46:29 A. He just went on to just tell me that due
14:46:35 to the climate of rules and regulations, that I
14:46:42 should seek offshore accounts in regards to payday
14:46:47 loans.

Q. Did he elaborate further on the climate of rules and regulations?
A. No.
Q. Tenth bank is MB Financial Bank.
A. I did meet with them at a convention in San Francisco, spoke with them briefly and they said they don't bank payday loan customers.
Q. Did they mention any regulators?
A. No, they didn't.
Q. Eleventh bank is Republic Bank of Chicago.
A. Again, I did not -- that was at the same convention and they did not bank payday loan customers. I did have a short conversation with that person but no specific regulators were mentioned.
Q. What did that short conversation entail?
A. Just that they have to adhere to the rules and regulations that are brought forth to them.
Q. The twelfth bank, the last one, is National Check and Currency. Did you have a conversation with them?
A. That was a phone conversation and I was just reaching out and they said they didn't bank

14:47:56 payday loan customers and didn't mention regulators.

14:47:59 Q. Apart from -- strike that.

14:48:03 When did you have these conversations with

14:48:05 these 12 banks?

14:48:10 A. This was prior to the opening of Edward

14:48:16 Jones, right when I was going to have to seek an

14:48:22 account elsewhere.

14:48:24 Q. So you contacted these 12 banks to ask

14:48:26 them if they would take on your payday lending

14:48:29 business?

14:48:30 A. Yes.

14:48:30 Q. Taking back out Exhibit 7, looking at

14:49:10 page 7, the first paragraph.

14:49:21 A. Yes.

14:49:21 Q. Starting on the second line, it says,

14:49:24 "Plaintiff responds that after the termination of

14:49:26 NorthState Check Exchange's Wells Fargo relationship,

14:49:31 NorthState Check Exchange contacted Five Star Bank,

14:49:33 Cornerstone Bank and Republic Bank about opening an

14:49:34 account." Do you see that?

14:49:35 A. Yes.

14:49:36 Q. And that's in the same time frame as you

15:29:07 terminations.

15:29:08 A. Uh-huh.

15:29:09 Q. Did TriCounties' decision to terminate
15:29:13 your account impact your income from your payday line
15:29:15 of business?

15:29:16 A. Yes.

15:29:16 Q. How?

15:29:17 A. Because it changed the way that we did
15:29:23 business with our customers. It became an
15:29:26 inconvenience to our customers to have to come back
15:29:28 in and pay their check. Before it was convenient for
15:29:33 them for us just to deposit it.

15:29:36 Q. So that didn't start until November of
15:29:41 2015, is that right?

15:29:43 A. I believe so.

15:29:51 Q. And yet there is an over $80,000 decline
15:29:54 in between 2014 and 2015?

15:29:57 A. Yeah. Again, it was the stigma we were
15:30:00 facing in regards to payday loans and advances.

15:30:05 Q. So it wasn't the bank terminations?

15:30:07 A. Well, a small part of it was.

15:30:10 Q. A small part of it was the bank

EXHIBIT 2

No. 14-953-TNM

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

COMMUNITY FINANCIAL SERVICES ASSOCIATION OF AMERICA, LTD., et al., Plaintiffs, v. FEDERAL DEPOSIT INSURANCE CORPORATION, et al., Defendants.	Civil Action No. 14-953-GK

<u>EXPERT REPORT OF CHARLES W. CALOMIRIS</u>

January 11, 2017

I. Professional Qualifications of Charles W. Calomiris and Questions Addressed in This Report.

I am the Henry Kaufman Professor of Financial Institutions at Columbia Business School, and a Professor of International and Public Affairs at Columbia's School of International and Public Affairs. I also am the Director of the Program on Financial Studies at Columbia Business School, and I co-direct the Hoover Institution's Program on Regulation and the Rule of Law, and the Manhattan Institute's program on financial regulation. I also serve as a Research Associate of the National Bureau of Economic Research, a member of the Financial Economists' Roundtable, a Consultant to the Office of Financial Research at the U.S. Treasury, and a member of the Shadow Open Market Committee. I have taught many courses on financial regulation and its consequences for the economy, including in 2016 a new course entitled Creative Destruction in the Financial Services Industry.

I have served as a member of various committees on regulatory matters (including the Advisory Scientific Committee of the European Union's European Systemic Risk Board, the Centennial Advisory Committee of the Federal Reserve System, and the Shadow Financial Regulatory Committee). I was a member of the 1999-2000 International Financial Institutions Advisory Commission, also known as the Meltzer Commission (a Congressional Commission charged with evaluating the structure and efficacy of the World Bank, IMF, regional development banks, the Bank for International Settlements, or BIS, and the World Trade Organization, or WTO). I have testified before the U.S. Congress numerous times on financial regulatory issues, and have served as a Consultant for regulatory bodies on the design of financial regulation (including for the International Monetary Fund, the World Bank, the BIS, most of the U.S. Federal Reserve Banks, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the central banks or financial regulatory bodies of many countries, including Argentina, Brazil, China, Colombia, El Salvador, France, Hong Kong, Japan, Mexico, the UK, and Uruguay).

For the past four years, I have served as co-managing editor of the Journal of Financial Intermediation, which is the top academic journal specializing in the analysis of financial institutions. Over more than three decades of academic work on financial institutions and their regulation, I have published many articles and books on various topics related to financial regulation, and I have served on numerous academic journal editorial boards and conference planning committees, and as a referee for numerous journals in the fields of finance and economics.

With respect to industry experience, for nine years I served as Chairman of the Board of a community bank, Greater Atlantic Financial Corporation, which operated as a thrift institution regulated by the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision. I also have been qualified as an expert witness in several cases pertaining to financial institutions regulation that appeared in arbitrations and in federal courts, including "Winstar" cases that dealt with the regulatory actions by the federal government after 1989, cases involving the tax consequences of regulatory issues, and cases involving many other topics.

A full listing of my professional experience, including appointments, publications, teachings, and speaking engagements, can be found in my Curriculum Vitae, which is attached to this report as Appendix C.

Plaintiffs' counsel has asked me to address two questions in this report:

(1) What accounts for the recent spate of terminations of Payday Lenders' relationships with U.S. banks, and what role has regulation played in causing those terminations to take place?

(2) What does recent research by financial economists have to say about the social benefits of Payday Lending and the social costs of the government actions (including regulatory actions) that have sought to reduce it? Specifically, what are the consequences for consumers, for banks, and for society at large?

In addressing those questions, I have consulted numerous sources, which are listed in one of the appendices to this report. *See* Appendix B: Sources Consulted. The remainder of this report consists of the following parts: Section II addresses the first of the two questions I was asked to consider. Section III addresses the second question. Section IV concludes. Appendix C is my Curriculum Vitae. Appendix B lists the Sources Consulted in this report. Appendix A provides a detailed review of the academic literature on Payday Lending, which is discussed more briefly in Section III of the report. Appendix D includes evidentiary sources I considered (i.e., declarations and letters from banks to payday lenders) that are not otherwise before the Court.

II. Regulatory Actions Caused the Withdrawal of Banks from Payday Lenders.

To summarize my opinion from the outset, regulatory actions have played a key role in the decisions of banks to terminate relationships with Payday Lenders. First, many banks have discontinued their relationships with Payday Lenders. Second, the economic literature on Payday Lending strongly indicates that this is a viable industry, and therefore, it is not plausible to argue that this wave of terminations reflects fundamental economic problems with Payday Lending.

Third, the timing of these terminations coincides closely with the actions of regulators to discourage banks' relationships with Payday Lenders. Fourth, testimony about the reasons for termination (based on the statements of market participants, and the Inspector General of the FDIC) has pointed directly to the actions of regulators in causing terminations. Fifth, it is clear that regulators have been very active participants in the political movement against Payday Lending.

All businesses rely on banks for basic services of payments clearing and credit, and the two are often intertwined (e.g., revolving lines of credit provide liquidity insurance if cash balances are insufficient to meet payments needs). It is widely recognized in the finance literature that customers that cannot maintain basic banking relationships, including access to credit, operate at a severe disadvantage, and are subject to greater liquidity risk (the risk of being unable to cover their short-term cash disbursement needs) and greater risk of failure.

As the academic literature also shows—as documented, for example, in my recent book with Stephen Haber, entitled *Fragile By Design: The Political Origins of Banking Crises and Scarce Credit* (Princeton University Press, 2014) ("*Fragile By Design*")—the chartering and regulation of banks almost always is used by governments as a means of controlling the allocation of resources in the economy, frequently in the pursuit of political objectives to favor some firms and consumers or to disfavor others. This has been a consistent theme of the history of financial regulation, in the United States and elsewhere for the last several centuries.

The political and regulatory attack on Payday Lending since 2008 is a recent example of this phenomenon. The Obama Administration has targeted Payday Lenders through legal actions brought by the Department of Justice, which have produced litigation risk for banks that provide

Case 1:14-cv-00953-GK Document 107-3 Filed 01/12/17 Page 6 of 288

services to Payday lenders, and by a political campaign to encourage regulators to impose regulatory costs on banks that maintain relationships with Payday Lenders. Both of these actions by the Obama Administration have led bank regulators to impose regulatory costs on banks that maintain relationships with Payday Lenders. Regulators have identified relationships with Payday Lenders as a source of "reputation risk" for banks, and the regulators punish banks for that elevated "reputation risk" in a variety of ways. Many banks have responded by refusing to continue their relationships with Payday Lenders.

The Department of Justice's campaign against Payday Lending provides some of the basis for regulators' concerns about banks' involvement in Payday Lending because litigation risk can be a major concern for banks. Even if a bank believes that it ultimately will prevail in a criminal case, nonetheless indictment generally is seen by bankers and bank analysts as a source of operational risk that may lead counterparties to refuse to renew interbank transactions (such as interbank loans, derivatives contracts, etc.). If counterparties withdraw from participating in such transactions, banks can face dire consequences. For that reason, banks seek to avoid litigation risk, and often are willing to settle cases brought by the Department of Justice, even when bankers believe the accusations against them have little merit.

Nonetheless, the actions of regulators have gone far beyond what could be regarded as responses to litigation risk. In essence, regulators' have invented a "reputation risk" that, for the most part, does not exist, based on their prejudices about the financial riskiness of Payday Lending and about alleged adverse consequences of Payday Lending for customers – which are contrary to the empirical evidence of serious academic studies of the industry.

To my knowledge, there are no laws or regulations established under the formal rule making procedures of the Administrative Procedure Act that identify providing financial services to Payday Lenders as a violation, or that enumerate penalties for banks that maintain relationships with Payday Lenders. In my opinion, it would be very difficult for opponents of Payday Lending to have succeeded in enacting such laws or formal rules because the empirical evidence would not support the view that Payday Lending is harmful to banks, to consumers, or to society at large (as documented in Section III below, and in Appendix A). Political opponents of Payday Lending, therefore, have relied on a combination of Department of Justice lawsuits and political pressures on regulators to impose informal regulatory "guidance" to achieve their objectives.

What is the form that regulatory guidance has taken with respect to banks' relationships with Payday Lenders? First, the key expressed concern under which doing business with Payday Lenders is purported to be relevant is "reputation risk." As traditionally understood in the banking industry and as previously defined by the prudential regulators, "reputation risk" reflected the impact on a bank's safety and soundness that could come from potential negative publicity:

> Reputation risk reflects "the potential that negative publicity regarding an institution's business practices, whether true or not, will cause a decline in the customer base, costly litigation, or revenue reductions."[1]
>
> Reputation risk is the risk to earnings or capital arising from negative public opinion.[2]

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[1] Letter from the Board of Governors of the Federal Reserve System to the Officer in Charge of Supervision at Each Federal Reserve Bank at 15 (May 24, 1996)

[2] OCC, "Risk Management Guidance: Third Party Relationships," OCC Bull. No. 2001-47 at 4 (Nov. 1, 2001).

Case 1:14-cv-00953-TNM Document 190-7 Filed 10/11/18 Page 8 of 128

> Reputational risk is the risk that potential negative publicity about a financial institution's business practices will cause a decline in the customer base, costly litigation, or the loss of revenue.[3]

To manage reputation risk, prior to 2008 banks were expected to adopt and adhere to professional and ethical business practices designed to meet their customers' needs.[4] In 2008, the FDIC redefined reputation risk to encompass purported risks to a bank's reputation posed by bad publicity surrounding a third-party provider, even when that publicity was entirely unrelated to the work that the provider performed in the name of the bank.[5]

In the summer of 2011, the FDIC issued a Supervisory Insight article entitled "Managing Risks in Third-Party Payment Processor Relationships." The article warned banks of heightened risks, including reputation risks, associated with doing business with certain types of merchants, including Payday Lenders. The article offered a list of 30 merchant categories (shown below), including Payday Lending and numerous other lawful businesses, that the agency deemed to involve "high-risk" activities.[6]

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[3] FDIC, "Guidance for Financial Institutions on the Use of Foreign-Based Third-Party Service Providers," FIL-52-2006 at 2 (June 21, 2006).

[4] *See* OCC, "Risk Management of New, Expanded, or Modified Bank Products," OCC Bull. No. 2004-20 (May 10, 2004), which observed that reputation risk is heightened when a bank fails adequately to supervise third parties who provide services to its customers.

[5] In its "Third Party Risk: Guidance for Managing Third Party Risk," the FDIC defined reputation risk as "the risk arising from negative public opinion," and noted that "any negative publicity involving the third party, whether or not the publicity is related to the institution's use of the third party, could result in reputation risk." FDIC, "Third Party Risk: Guidance for Managing Third Party Risk," FIL-44-2008 at 3 (June 6, 2008).

[6] FDIC, *Managing Risks in Third-Party Payment Processor Relationships*, *Supervisory Insight* (Summer 2011). I understand that in July 2014, shortly after the initial complaint in this case was filed, the FDIC issued a statement "clarifying" its guidance by "removing the lists of examples of merchant categories from its official guidance and informational article." *See* FDIC, "FDIC Clarifying Supervisory Approach to Institutions Establishing Account Relationships with Third-Party Payment Processors," FIL-41-2014 (July 28, 2014). The FDIC, however, left in place its underlying guidance on "reputation risk" stemming from customer relationships, making clear that banks would continue to be required to assess their ability to "properly manage customer relationships." It reiterated that the industries on the lists, including Payday Lending, "had been associated by the payments industry with higher-risk activity when the guidance and article were released." Therefore, despite the removal of the lists of discouraged customers from official guidance documents, banks had every reason to continue to be concerned that they would be subjected to enhanced regulatory oversight and other adverse regulatory consequences from continuing to service Payday Lenders.

Ammunition Sales	Life-Time Memberships
Cable Box De-scramblers	Lottery Sales
Coin Dealers	Mailing Lists/Personal Info
Credit Card Schemes	Money Transfer Networks
Credit Repair Services	On-line Gambling
Dating Services	**PayDay Loans**
Debt Consolidation Scams	Pharmaceutical Sales
Drug Paraphernalia	Ponzi Schemes
Escort Services	Pornography
Firearms Sales	Pyramid-Type Sales
Fireworks Sales	Racist Materials
Get Rich Products	Surveillance Equipment
Government Grants	Telemarketing
Home-Based Charities	Tobacco Sales
Life-Time Guarantees	Travel Clubs

On January 31, 2012, the FDIC issued another guidance document updating the November 2008 Financial Institutional Letter ("FIL"), and further explaining the nature of discouraged activities and the consequences banks could face for not adhering to the guidance:

> Examples of telemarketing, online businesses, and other merchants that may have a higher incidence of consumer fraud or potentially illegal activities or may otherwise pose elevated risk include [sic] credit repair services, debt consolidation and forgiveness programs, online gambling-related operations, government grant or will-writing kits, payday or subprime loans, pornography, online tobacco or firearms sales, pharmaceutical sales, sweepstakes, and magazine subscriptions. This list is not all-inclusive . . .
>
> Financial institutions should ensure that their contractual agreements with payment processors provide them with access to necessary information in a timely manner. These agreements should also protect financial institutions by providing for immediate account closure, contract termination, or similar action, as well as establishing adequate reserve requirements to cover anticipated charge backs . . .
>
> The FDIC expects a financial institution to adequately oversee all transactions and activities that it processes and to appropriately manage and mitigate operational risks, Bank Secrecy Act (BSA) compliance, fraud risks, and consumer protection risks, among others . . .
>
> In addition, financial institutions should consider the potential for legal, reputational, and other risks, including risks associated with a high or increasing number of customer complaints and returned items, and the potential for claims of unfair or deceptive practices. *Financial institutions that fail to adequately manage these relationships may be viewed as facilitating a payment processor's or merchant client's fraudulent or unlawful activity and, thus, may be liable for such acts or practices.* In such cases, the financial institution and

Case 1:14-cv-00953-GK Document 107-3 Filed 01/12/17 Page 13 of 28

> responsible individuals have been subject to a variety of enforcement and other actions. Financial institutions must recognize and understand the businesses and customers with which they have relationships and the liability risk for facilitating or aiding and abetting consumer unfairness or deception under Section 5 of the Federal Trade Commission Act . . .
>
> Under Section 8 of the Federal Deposit Insurance Act, the FDIC has authority to enforce the prohibitions against Unfair or Deceptive Acts or Practices (UDAP) in the Federal Trade Commission Act. **UDAP violations can result in unsatisfactory Community Reinvestment Act ratings, compliance rating downgrades, restitution to consumers, and the pursuit of civil money penalties.**[7]

As growing, new literature in Law and Economics shows, there has been an increasing reliance on regulatory guidance by financial and other regulators, *see* Hamburger 2014, DeMuth 2014, Epstein 2014, and Calomiris 2015. Regulators find that they can use vaguely worded guidance to maximize their discretionary authority although doing so has adverse consequences for regulated institutions because of the consequent risks that this vagueness entails. The adverse consequences of vague regulations applied with ex post discretion include the unpredictability of regulatory costs and the potential discriminatory application of those costs. The reliance on guidance and ex-post-discretionary interpretations of violations of guidance constitute a major departure from the Rule of Law, with far-ranging costs and adverse consequences for our economy, for our political institutions and for our society.

Although there are no specified fines or other costs associated with a bank serving a Payday Lender, running afoul of regulatory guidance by providing services to Payday Lenders (or other targeted industries, such as gun, ammunition, or tobacco product merchants) can produce a number of costs to a bank that regulators identify as having increased its “reputation risk” because it defies guidance that discourages relationships with Payday Lenders. Regulators

[7] FDIC, “Payment Processor Relationships: Revised Guidance,” FIL-3-2012 at 1 & n.1, 2 (Jan. 31, 2012) (bolded emphasis added).

retain enormous discretionary power to punish banks as a consequence of perceived increases in "reputation risk," and it is not practically possible for banks to disprove regulatory judgments about increases in that risk or prevent regulators from punishing them on the basis of those judgments.

The consequences of running afoul of guidance can be directly or indirectly related to the stated regulatory concerns about "reputation risk." For example, direct consequences can entail discretionary decisions by regulators that are related to heightened "reputation risk." Regulatory agencies must approve bank merger and acquisition applications, and increases in "reputation risk" can serve as a basis for denying an application to acquire another bank. Regulators also can raise prudential requirements for loan provisioning and for minimum capital ratios that banks must maintain as a consequence about concerns regarding "reputation risk." Raising provisioning or capital ratio requirements typically entails severe costs for banks, Jiménez et al. 2012, Aiyar et al. 2015. Furthermore, supervisory reports about banks include a category of discretionary judgment about bank management practices and operational risks. If a bank is judged as operated in a risky or unsound manner, this could also reduce its regulatory rating, known as the CAMELS rating, with wide-ranging adverse consequences for the bank.

With respect to the direct regulatory costs associated with the approval of mergers and acquisitions or other bank requests, consider the Office of the Comptroller of the Currency's (OCC) discussion of risk and its use by regulators. First, the OCC defines risk as wide ranging and subject to regulatory discretion:

> The first component of capital planning is to identify and evaluate all material risks. Risks that can be quantified with reasonable confidence should be measured to determine how those risks affect the bank's overall capital adequacy. Banks should also consider qualitative factors that incorporate management's experience and judgment in evaluating

Case 1:14-cv-00953-TNM Document 179-3 Filed 01/12/18 Page 38 of 286

all risks. A qualitative assessment is especially critical in understanding and evaluating risks that cannot be reasonably quantified.

> Some of the risks to which a bank may be exposed include credit, operational, interest rate, liquidity, price, and compliance risks. Other risks, such as reputation risk and strategic risk, may be material for some banks. Risks may also arise from significant subsidiaries and operating units. Every bank should have a process in place that allows it to identify its material risks on an ongoing basis so that it can plan appropriately for those risks.[8]

The OCC explicitly points to third party relationships (such as relationships with borrowers) as sources of risk, and points to merger and acquisition approval (an area that research, including my book, *Fragile By Design*, has shown was particularly important for encouraging bank compliance with guidance in the 1990s and 2000s) as one of the potential consequences of high levels of risk perceived by regulators.

> A bank must recognize and understand existing risks and risks that may arise from new business initiatives, including risks that originate in nonbank subsidiaries and affiliates, third-party relationships, and those that arise from external market forces, or regulatory or statutory changes. Risk identification should be a continuing process, and should occur at both the transaction and portfolio level. A bank must also identify interdependencies and correlations across portfolios and lines of business that may amplify risk exposures. **Proper risk identification is critical for banks undergoing mergers and consolidations to ensure that risks are appropriately addressed**. Risk identification in merging companies begins with the establishment of uniform definitions of risk; a common language helps to ensure the merger's success.[9]

A bank's regulatory rating is also subject to impact from its relationships with Payday Lenders, if those are perceived as a source of "reputation risk." In December 2015, the OCC clarified the relationship between The Risk Assessment System (RAS) and bank CAMELS ratings.

> Supervision by risk focuses on evaluating risk, identifying existing and emerging problems, and ensuring that bank management takes corrective action before problems compromise the bank's safety and soundness. The RAS provides the framework to measure, document, and communicate the OCC's conclusions about the quantity of risk,

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[8] OCC, "Guidance for Evaluating Capital Planning and Adequacy," OCC Bull. No. 2012-6 (July 7, 2012), https://goo.gl/WuXSGs (footnote omitted).
[9] OCC, *Comptroller's Handbook: Large Bank Supervision* 5 (Jan. 2010), https://goo.gl/bH2WXc (emphasis added).

> quality of risk management, aggregate risk, and direction of risk for the eight risk categories.
>
> The RAS is structured in the OCC's examination procedures to evaluate separately the quantity of risk and the quality of risk management. The quantity of risk reflects the level of risk assumed in the course of doing business. The quality of risk management assesses whether the bank's risk management systems are capable of identifying, measuring, monitoring and controlling that amount of risk. This structure is intended to allow examiners to identify and take action on emerging risks in a timely manner, before such risks materialize in a bank's financial performance.
>
> The revised guidance reiterates and clarifies that the RAS provides both a current (aggregate risk) and a prospective (direction of risk) view of a bank's risk profile **that examiners incorporate when assigning CAMELS ratings**. The CAMELS rating system refers to the primary risk categories that examiners consider within each component area, as well as the quality of risk management practices. **The component ratings should reflect the level of supervisory concern reflected in the RAS assessment, particularly with risk management practices**. Additionally, examiners consider their assessments of risk management practices for each of the risk categories when assigning the management component rating. When the RAS and the rating system are used in this manner, they provide a holistic view of the bank's condition and support planned activities and supervisory findings.[10]

The OCC also announced, in December 2015, that it had expanded the categories of strategic and reputation risk:

> Previously, the OCC assessed only the aggregate level and direction of strategic and reputation risks. The revised guidance expands the assessment of strategic and reputation risks **to include both quantity of risk and quality of risk management**. Although measuring the quantity of these risks remains difficult, the revised guidance provides a means to better assess and communicate efforts to control these risks.
>
> Strategic risk is a key risk faced by banks and remains a top concern for the OCC. **Similarly, the OCC has long considered reputation risk to be an important factor that can affect the safety and soundness of its supervised institutions.** Examiners consider the presence of risk in a bank's activities when determining whether the risks a bank assumes are effectively managed, controlled, and consistent with safe and sound banking practices, not as a basis for prohibiting banks from engaging in permissible activities.[11]

These revisions to the examination procedure are explained in the Comptroller's Handbook, which makes clear that the RAS and CAMELS systems are used together, such that a finding

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[10] OCC, "Risk Assessment System: Updated Guidance," OCC Bull. No. 2015-48 (Dec. 3, 2015) (emphasis added). The principles contained in the RAS guidance apply to examinations of all national banks, federal savings associations, and federal branches and agencies.
[11] *Id.* (emphasis added).

that a bank bears reputation risks can affect the assessment of its asset quality, etc. As the following passage makes clear, concern about credit risk—or, more germane to our situation, reputation risk—can provide a reason to change a CAMEL component rating:

> The RAS and the CAMELS rating system **are used together during the supervisory process to evaluate a bank's financial condition and resilience**. The RAS provides both a current (aggregate risk) and a prospective (direction of risk) view of the bank's risk profile that examiners incorporate when assigning regulatory ratings. The CAMELS rating system, which includes forward-looking elements, references the primary risk categories that examiners consider within each component rating, as well as the quality of risk management practices. (Updated 12/03/2015)
>
> Under the RAS, for example, examiners may assess credit risk in a bank with insufficient risk management practices and increasing adverse trends as "moderate and increasing" or "high and increasing." **If the component rating for asset quality does not reflect the level of supervisory concern posed by credit risk as identified by the RAS, the component rating may be changed**. Additionally, examiners consider their assessments of risk management practices for each of the risk categories when assigning management component ratings. **Using the RAS and the CAMELS rating system in this manner provides an important verification of planned activities and supervisory findings**. (Updated 12/03/2015).[12]

More generally, given the plethora of regulations that banks are subject to, and the many potential costs of being judged as failing to comply with those regulations, banks that are perceived as troublesome by their regulators are often subject to *indirect* costs relating to more extensive and costly auditing as regulators punish the failure to cooperate on one dimension (such as complying with guidance about Payday Lender relationships) with stricter discretionary enforcement on all other regulations. There is narrative evidence corroborating these indirect regulatory costs associated with banks maintaining relationships with Payday Lenders.

Ironically, the Kafkaesque quality of regulatory costs related to discretionary judgments and guidance (rather than formal rules and pre-specified penalties) makes it harder to establish evidence of regulatory costs associated with running afoul of guidance. Banks seek to maintain

[12] OCC, *Comptroller's Handbook: Community Bank Supervision* 8 (Jan. 2010, as subsequently updated) (emphasis added).

good relationships with their regulators precisely because of the potential for regulators to abuse their discretionary power, and it is generally a losing proposition for bankers to complain publicly about regulatory abuses. In the case of Payday Lending, it is more cost effective for bankers simply to drop Payday Lenders from their client lists, accept the lost revenues from the loss of those relationships, and move on. For that reason, most of the available testimony showing the linkage between regulatory actions and the termination of banks' relationships with Payday Lenders has come from Payday Lenders themselves, who recount conversations with their bankers who explained to them that regulatory costs made it uneconomical for the bank to maintain its relationship with the Payday Lender.

Nevertheless, it is clear that regulatory actions have played a key role in the decisions of banks to terminate relationships with Payday Lenders. First, there is evidence that many banks have discontinued their relationships with Payday Lenders. Second, it is clear from the economic literature on Payday Lending that this is a viable industry, and therefore, it is not plausible to argue that this wave of terminations reflects fundamental economic problems with Payday Lending. Third, the timing of these terminations clearly has coincided with the actions of regulators to discourage banks' relationships with Payday Lenders. Fourth, testimony about the reasons for termination (mainly from Payday Lenders) has pointed directly to the actions of regulators. Fifth, it is clear that regulators have been very active participants in the political movement against Payday Lending; regulatory guidance against Payday Lending should be seen in the broader context of the zealous role played by regulators in opposing it, especially the role played by the FDIC. Based on these five types of evidence, it is clear that regulatory actions have played a key role in the termination of bank relationships with Payday Lenders.

It would be potentially possible and desirable to go beyond this evidence to construct a data base that would quantify the causal linkages between regulators' and supervisors' communications to banks about Payday Lending and bankers' actions to terminate relationships with Payday Lenders. Such data about bank loan relationships and regulatory communications, however, are proprietary and therefore are not currently available for empirical study. If a court required these data to be made available to empirical researchers, it would be fairly straightforward to establish a quantitative estimate of the extent to which regulatory actions have caused Payday Lender relationship terminations, and to identify the precise regulatory actions or threats that have been responsible for banks' actions. Making those secret regulatory communications public would also serve the important goal of preventing regulators from using the secrecy of the regulatory process to shield themselves from accountability for abuse of power. Until such data are made available, however, narrative and logical evidence (the five points noted above) are all that can be relied upon to draw causal inferences about the link between regulatory behavior as a whole and Payday Lender relationship termination. Nevertheless, that evidence is sufficient for me to conclude without reasonable doubt that regulatory actions have been a primary source of terminations of Payday Lenders' relationships with banks. Following is a summary of the evidence regarding each of the five points.

1. The Wave of Terminations of Bank Relationships with Payday Lenders.

Although there exists no comprehensive list of bank terminations of Payday Lenders, the recent wave of terminations of bank relationships with Payday Lenders has been dramatic and unprecedented. With the assistance of Plaintiffs' counsel, I assembled a partial list, based on available information, with sources noted for each item.

Case 1:14-cv-00953-GK Document 109-3 Filed 01/12/17 Page 47 of 286

Since 2013, many banks, both small and large, have decided to terminate their relationships with Payday Lenders. Evidence about these terminations is presented in declarations executed by payday lenders in connection with this litigation as well as statements made by banks to the general public and to individual payday lenders. Many of the payday lenders state that they had longstanding, complaint-free relationships with their banks before the recent spate of terminations.

The following banks have indicated that they will no longer provide account services to any participant in the Payday Lending industry:

> In August 2013, Bank of Kentucky notified Community Choice Financial that it was ending the Company's banking relationship "because bank regulators had directed the bank to terminate its relationship with all payday lenders."[13]
>
> In March 2014, Fifth Third Bank informed several Payday Lenders that "[d]uring recent reviews of the payday lending industry, we have determined that the services provided by clients in this industry are outside of our risk tolerance," and that the bank thus "will no longer be able to provide financial services to businesses that operate in that industry."[14]
>
> In March 2014, Capital One announced to a Payday Lender that the bank had "made the decision to exit the business of providing commercial banking services to check cashers and related businesses."[15]
>
> In May 2014, First Federal Bank announced to a Payday Lender that: "After much consideration and discussion, First Federal Bank has made the business decision to close all Money Service Business (MSB) Deposit accounts"—a category that, as the bank explained, includes Payday Lenders.[16]

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[13] *See* Declaration of Michael Durbin ¶ 5 (Oct. 2, 2014), Doc. 23-3 ("Durbin Decl.").
[14] *See* Letter from Megan S. Szewc & Kevin Lavender, Vice President & Senior Vice President, Fifth Third Bank, to Keith Wyler, CNG Financial Corporation (Mar. 2014), attached as Exhibit A to Declaration of Roger Dean (Oct, 2, 2014), Doc. 23-4 ("Dean Decl."). Fifth Third also terminated Advance America on March 3, 2014, Declaration of Christian Rudolph ¶ 7 (Oct. 2, 2014), Doc. 23-1 ("First Rudolph Decl."), and both Check Into Cash, Declaration of William S. Lane, ¶ 5.d (Jan. 9, 2017) ("Lane Decl."), and Community Choice Financial on March 5, 2014, Durbin Decl. ¶ 8 (Doc. 23-3). NCP Finance was terminated by Fifth Third Bank on March 18, 2014, again for the same stated reason. Declaration of Christopher Henn ¶ 5 (Jan. 10, 2017) ("Henn Decl.").
[15] *See* Letter from Jacob Viliere, Relationship Manager & Tammy Prats, Capital One, National Association, to Amy Lainge, Allied Cash Advance of Louisiana (Mar. 27, 2014), attached as Exhibit D to Dean Decl.
[16] Letter from Kevin Fitzpatrick, Director of BSA-AML, First Federal Bank, to a payday lender (May 1, 2014).

Case 1:14-cv-00953-GK Document 97-3 Filed 01/12/17 Page 18 of 286

In June 2014, Chemical Bank informed Advance America that, "[a]fter evaluating the Payroll Advance businesses serviced by Chemical Bank, and due to the overall risks associated with Money Services Business transactions, our financial institution has decided to reduce the services we provide to these types of business account."[17] This reduction in service entailed the closing of Advance America's accounts.

In August 2014, SunTrust issued a press release announcing that "[w]e have decided to discontinue banking relationships with three types of businesses – specifically payday lenders, pawn shops and dedicated check-cashers – due to compliance requirements."[18]

In August 2014, WesBanco Bank notified a Payday Lender that it "must reluctantly discontinue such account services to all payday lenders, which would include your accounts."[19]

In November 2014, First Tennessee informed a Payday Lender that it had "decided to discontinue and curtail providing account services to certain money service businesses ("MSBs"), payday lenders and other businesses that offer and engage in MSB-type transactions and activities."[20]

In April 2015, Tri Counties Bank informed Northstate Check Exchange that its accounts would be closed because "it is the policy of the Bank to not bank or lend money to Pay Day Lenders."[21]

In October 2016, FirstMerit Bank informed Advance America that it would exit their relationship with Advance America because "[w]e have decided to close your account because the business is in an industry in which we do not service, such as payday lenders."[22]

In December 2016, MainSource Bank informed Advance America by letter that the bank had "made the strategic decision to discontinue deposit account and banking services to businesses identified as money service businesses."[23]

[17] Letter from Robert S. Rathbun, Regional President, Chemical Bank, to J. Christian Rudolph, Vice President and Treasurer, Advance America (June 26, 2014).
[18] Press Release, SunTrust, SunTrust Statement on Certain Account Closures (Aug. 8, 2014), https://goo.gl/Tyytrv. See also Declaration of Integrity Funding ¶ 7 (Jan. 10, 2017) ("Integrity Decl.") (SunTrust bank officer explained to payday lender that "these terminations were occurring because of regulatory pressure the bank was receiving from federal regulators").
[19] Letter from Lisa Robinson Shaw, President, WesBanco Bank, Inc., to a Payday Lender (Aug. 18, 2014).
[20] Letter from Cathy Baker, Financial Center Manager II, First Tennessee Bank N.A., to a Payday Lender (Nov. 18, 2014).
[21] Declaration of Glenn Bassett ¶2 (Jan. 9, 2017) ("Bassett Decl.").
[22] Declaration of Christian Rudolph ¶ 8 (Nov. 23, 2016), Doc. 87-4 ("Second Rudolph Decl.").
[23] Letter from Chris Harrison, Executive Vice President—Chief Consumer Banking Officer, MainSource Bank, to J.C. Rudolph, Advance America (Dec. 7, 2016). *See also* Second Rudolph Decl. ¶ 16.

Case 1:14-cv-00953-GK Document 107-3 Filed 01/12/17 Page 19 of 258

The following banks have closed the accounts of multiple Payday Lenders. It is possible that some have ceased servicing the industry altogether, but I am not aware of definitive statements to that effect:

> In April 2013, PNC Bank terminated a Payday Lender without explanation.[24] PNC Bank terminated NCP Finance on August 18, 2014, because it was a Payday Lender.[25]
>
> Bank of America notified individual Payday Lenders in June 2014[26] and in October 2015[27] that it had decided, "based on the nature of your business and associated risks," and based on "pressure from regulators regarding reputational risk," to close their accounts. Bank of America also terminated Payday Lender customers in October 2013[28] and November 2013.[29]
>
> In June 2014, BBVA Compass terminated a Payday Lender without explanation.[30] BBVA Compass subsequently terminated Advance America in November 2016; once again, BBVA Compass provided no explanation for its decision.[31]
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> In June 2014, CitizensBank notified Advance America and another Payday Lender that it "will no longer be providing banking services to your organization due to a recent management decision."[32]

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[24] Letter from W. Leigh Pegues, Senior Vice President, PNC, to a Payday Lender (Apr. 9, 2013).
[25] Henn Decl. ¶ 4.
[26] Letter from Bank of America to Speedy Cash, Inc. (June 30, 2014), attached as Exhibit A to Declaration of Brian K. Lynn (Oct. 2, 2014), Doc. 23-7.
[27] Letter from Bank of America to a Payday Lender (Oct. 29, 2015).
[28] Letter from Bank of America to CNG Holdings, Inc. (Oct. 25, 2013); Letter from Bank of America to Eastern Specialty Finance, Inc. (Oct. 25, 2013); Letter from Bank of America to Ohio Specialty Finance, Inc. (Oct. 25, 2013); Letter from Bank of America to Southwestern & Pacific Specialty Finance Inc. (Oct. 25, 2013); Letter from Bank of America to Great Lakes Specialty Finance, Inc. (Oct. 25, 2013); Letter from Bank of America to Allied Cash Holdings, LLC (Oct. 25, 2013); Letter from Bank of America to Great Plains Specialty Finance Inc. (Oct. 25, 2013); Letter from Bank of America to Southern Specialty Finance, Inc. (Oct. 25, 2013), all attached as Exhibit C to Dean Decl.
[29] *See* Durbin Decl. ¶ 6.
[30] Letter from BBVA Compass to a Payday Lender (June 23, 2014).
[31] Second Rudolph Decl. ¶ 15.
[32] Letter from Karen McKinley, Bank Secrecy Act Officer, Citizens Bank, to a Payday Lender (June 16, 2014); Letter from Karen McKinley, Bank Secrecy Act Officer, Citizens Bank, to Jessica Pruitt, Advance America (June 16, 2014).

Wells Fargo has closed the accounts of Payday Lenders in March 2014,[33] September 2014,[34] May 2015,[35] September 2015,[36] October 2015,[37] January 2016,[38] and March 2016.[39]

U.S. Bank closed the accounts of Payday Lenders on several occasions since 2014, and terminations have continued through November 2016.[40]

Hancock Bank/Whitney Bank closed the account of a Payday Lender in February 2014, explaining that the bank was "unable to effectively manage your Account(s) on a level consistent with the heightened scrutiny required by our regulators for money service businesses due to the transactional characteristics of your business."[41] Hancock Bank closed the account of another Payday Lender in November 2015.[42]

The following banks have terminated at least one Payday Lender. I have been unable to ascertain either whether these banks have ever served other Payday Lenders or whether they had previously or have subsequently terminated other Payday Lenders:

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[33] Letter from C. Alan Chudoba, Business Banking Group Risk Manager, Wells Fargo Bank, N.A., to a Payday Lender (Mar. 3, 2014).

[34] Letter from C. Watson, Risk Management Services, Wells Fargo Bank, N.A., to 7SC dba Emergi-Cash (Sept. 2, 2014), attached as Exhibit 1 to Declaration of Joseph Riggs (Oct. 2, 2014), Doc. 23-8 ("Riggs Decl."); Letter from C. Watson, Risk Management Services, Wells Fargo Bank, N.A., to 8SC LLC (Sept. 2, 2014), attached as Exhibit 2 Riggs Decl.; Letter from C. Watson, Risk Management Services, Wells Fargo Bank, N.A., to 13SC (Sept. 2, 2014), attached as Exhibit 3 to Riggs Decl.; Letter from C. Watson, Risk Management Services, Wells Fargo Bank, N.A., to 3SC Inc. (Sept. 2, 2014), attached as Exhibit 4 to Riggs Decl.

[35] Letter from C. Watson, Risk Operations, Wells Fargo Bank, N.A., to a Payday Lender (May 19, 2015).

[36] Letter from C. Watson, Risk Management Services, to a Payday Lender, Wells Fargo Bank, N.A. (Sept. 22, 2015).

[37] Letter from C. Watson, Risk Management Services, Wells Fargo Bank, N.A., to Andrew Bassett, et al., Northstate Check X-Change (Oct. 28, 2015).

[38] Letter from C. Watson, Risk Operations, Wells Fargo Bank, N.A., to a Payday Lender (Jan. 1, 2016).

[39] Second Declaration of Dennis Shaul ¶ 6(c) (Nov. 23, 2016), Doc. 87-3 ("Second Shaul Decl.").

[40] Second Rudolph Decl. ¶¶ 9–14. The banking relationship between U.S. Bank and Advance America had lasted 14 years, and was generating over $3 million in annual fees for U.S. Bank. See also Henn Decl. ¶ 8 (account of NCP Finance terminated by U.S. Bank on November 3, 2016 after 11-year banking relationship). *See also* Letter from Pete Selenke, Vice President Manager, U.S. Bank, to a Payday Lender (Jan. 27, 2016). The bank provided this Payday Lender with 14 days in which to close its accounts. Letter from Pete Selenke, Vice President Manager, U.S. Bank, to a Payday Lender (Jan. 12, 2016). U.S. Bank closed the accounts of Check Into Cash on November 10, 2016. Lane Decl., ¶ 5 f. U.S. Bank had closed the accounts of four other Payday Lenders in June 2014, June 2015, October 2014, October 2015, and October 2016, again offering no explanation for its decision. *See* Letter from Pete Selenke, Vice President Manager, U.S. Bank, to a Payday Lender (June 3, 2014); Letter from Pete Selenke, Vice President Manager, U.S. Bank, to a Payday Lender (June 30, 2015); Integrity Decl. ¶ 3 (U.S. Bank terminated several dozen accounts); Letter from Pete Selenke, Vice President Manager, U.S. Bank, to a Payday Lender (Oct. 15, 2015); Letter from Roger Gross, Vice President, U.S. Bank, to a Payday Lender (Oct. 21, 2016).

[41] Letter from Christopher Estrade, Hancock Bank/Whitney Bank, to a Payday Lender (Feb. 26, 2014).

[42] Letter from Shirley Hamilton, Branch Manager/AVP, Hancock Bank to a Payday Lender (Nov. 4, 2015).

Case 1:14-cv-00953-GK Document 109-3 Filed 01/12/17 Page 21 of 258

In November 2013, JPMorgan Chase Bank, N.A., notified a Payday Lender that it would have to transfer its banking relationship to another financial institution.[43]

In December 2013, Bank of Hawaii informed a Payday Lender that it had made the business decision to close its accounts, citing specifically to the costs of servicing Payday Lenders.[44]

In December 2013, Huntington Bank closed the accounts of a Payday Lender; the bank had previously expressed no concerns about the relationship.[45]

In February 2014, Synovus Bank terminated Advance America.[46]

In March 2014, Umpqua Bank notified Advance America that it was closing its accounts.[47]

In April 2014, Cadence Bank notified Advance America that it was "unable to continue servicing your account."[48]

In July 2014, First Bank and Trust informed Advance America that it "will no longer be able to service your business deposit account."[49]

In 2016, Business Bank of Texas terminated its relationship with a Payday Lender.[50]

In April 2016, TD Bank closed the accounts of a Payday Lender without explanation.[51]

In October 2016, Your Community Bank notified Advance America that it would close Advance America's accounts.[52]

2. Evidence of Payday Lender Profitability

As discussed in Section III and Appendix A, Payday Lenders serve an important role in the financial system, and they do so quite successfully and competitively, or at least they did before the recent regulatory campaign against them. Given those favorable facts, there is no

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[43] Letter from Senior Vice President, JPMorgan Chase Bank, N.A., to Amy Lainge, CFO, CNG Financial (Nov. 12, 2013). *See* Dean Decl. ¶ 30.
[44] Letter from Larry Dressler, Business Banking Officer, Bank of Hawaii, to a Payday Lender (Dec. 6, 2013).
[45] Integrity Decl. ¶ 4.
[46] Declaration of Jose Gonzalez ¶ 3 (Oct. 2, 2014), Doc. 23-2.
[47] Letter from Umpqua Bank to Cash Advance Centers of California, LLC, dba Advance America (Mar. 11, 2014). *See also* First Rudolph Decl. ¶ 3.
[48] Letter from Lori Johnson, VP, Treasury Management Officer, Cadence Bank, N.A., to Advance America Cash Advance, LLC (Apr. 21, 2014). *See also* First Rudolph Decl. ¶ 3.
[49] Letter from Charles Blackwell, First Bank and Trust, to Express Check Advance of LA, LLC (July 18, 2014).
[50] Declaration of Ed Lette ¶¶ 6–9 (Nov. 23, 2016), Doc. 87-2.
[51] Letter from Amanda Major, Assistant Vice President, TDBank, to a Payday Lender (Apr. 28, 2016). *See also* Second Shaul Decl. ¶ 6(d).
[52] Second Rudolph Decl. ¶ 7.

Case 1:14-cv-00953-TSC Document 109-3 Filed 01/11/17 Page 24 of 26

fundamental weakness of the industry that could explain the wave of bank relationship terminations.

3. The Timing of Terminations

As the dates of terminations listed above show, there is a close connection between the post-2012 DOJ litigation and regulatory guidance actions against Payday Lending and the wave of terminations that occurred from 2013 to 2016. Although, by itself, this is not conclusive evidence, the evidence on the timing of terminations is consistent with the view that regulatory actions played a key role in banks' decisions to terminate their relationships with Payday Lenders.

4. Testimony About the Reasons for Termination and the Role of Regulators.

The following statements are the testimony of various Payday Lenders, in documents provided to me by Plaintiffs' counsel, explaining their understanding of the reasons banks terminated relationships with them.

One third-party payment processor informed a Payday Lender that their bank would no longer process ACH transactions for that Payday Lender because examiners had come into their bank. The bank was told by those examiners not to have anything to do with Payday Lenders.[53] One Payday Lender was told by a bank officer at Bank of America that the bank was "exiting the payday advance space." The bank officer expressed regret at the decision, and led the Payday Lender to believe that the termination decision reflected the fact that Speedy Cash Inc. was

[53] Declaration of Robert K. Zeitler, Sr. ¶10 (Oct. 2, 2014), Doc. 23-6.

Case 1:14-cv-00953-GK Document 109-3 Filed 01/11/17 Page 29 of 268

classified as a Payday Lender.[54] In another instance, Bank of America officials were said to have verbally communicated to a payday lender that its accounts were being closed because of "pressure from regulators regarding reputational risk."[55] One Payday Lender was reportedly told by the Bank of Kentucky that its accounts were being closed because bank regulators had directed the bank to terminate its relationships with all Payday Lenders.[56] Another Payday Lender reportedly was informed by a Fifth Third Bank employee that the termination of its accounts "was a result of a risk review performed by the bank and that our industry was not going to be serviced by the bank any longer."[57] According to another Payday Lender, Umpqua Bank informed them that it would be closing its accounts. The Umpqua bank manager reportedly made clear that she was being forced to close the account because of the pressure the bank was receiving from federal regulators not to do business with Payday Lenders.[58] A Payday Lender that had business with both Tri Counties and Wells Fargo reportedly learned from conversations with bank managers at both banks that the banks were closing its accounts because the regulatory pressure placed on them made continuing to do business with Payday Lenders untenable.[59]

While bankers generally have not spoken out publicly about the regulatory push to end their relationships with Payday Lenders (likely reflecting the potential reprisals that such public comments could produce from their regulators), there is one example of a banker describing regulatory pressure to terminate Payday Lender relationships:

> During a recent meeting with Scott Ward, an Assistant Deputy Comptroller in the OCC's San Antonio office, Mr. Ward pressured our bank to end our relationship with Power

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[54] Second Am. Compl. for Declaratory & Injunctive Relief ¶ 73 (Sept. 25, 2015), Doc. 64.
[55] Durbin Decl. ¶ 6.
[56] *Id*. ¶ 5.
[57] Dean Decl. ¶25.
[58] Declaration of Richard Naumann ¶ 3 (Jan. 9, 2017) ("Naumann Decl.").
[59] Bassett Decl. ¶¶ 2–3.

> Finance Texas. . . . Mr. Ward told me that, if Business Bank of Texas continued to provide ACH services to Power Finance Texas and other small lenders, the bank would incur a significant reputational risk. . . . Although I completely disagreed with this assessment, Mr. Ward left no doubt that the relationship would have to be ended. The pressure that was brought to bear on our bank by our regulator left us with no choice but to drop Power Finance Texas as a customer and close its accounts. . . . In the absence of this regulatory pressure, we would not have closed Power Finance Texas' accounts. In the absence of continuing regulatory pressure, I am confident that we would restore ACH and other banking services to Power Finance Texas.[60]

These statements confirm my analysis contained above, and more generally, there is nothing about these various statements that is implausible. Unfortunately, the regulatory behavior that they point to is not unique. Furthermore, despite the understandable unwillingness of bankers to publicly acknowledge the regulatory pressures they have experienced, bankers have done so in private. The September 2015 report by the Inspector General of the FDIC was informed by the Inspector General's discussions with numerous bankers, and that report corroborates the view that regulatory pressure caused banks to terminate their relationships with Payday Lenders.[61]

Unfortunately, despite the absence of any statute or formal rule prohibiting bank relationships with Payday Lenders, and despite any clearly stated regulatory penalties that have been publicly acknowledged by regulators for banks that maintain relationships with Payday Lenders, regulators have used their discretionary power to make the costs to banks of providing services to Payday Lenders prohibitive which has resulted in a wave of terminations of Payday

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[60] Declaration of Ed Lette ¶¶ 6–9 (Nov. 23, 2016), Doc.87-2. I understand that OCC has argued that Mr. Lette's declaration does "not stand up to scrutiny." Defendants' Memorandum in Opposition to Plaintiffs' Motion for Preliminary Injunction at 4 (Dec. 8, 2016), Doc. 90. I have not seen the declaration of Mr. Ward that is cited by OCC for this argument because it was filed under seal and OCC refused permission to Cooper & Kirk to share it with me. Even if Mr. Lette's account turned out to be incorrect, however, my opinion about the cause of the wave of terminations experienced by Payday Lenders would not change.

[61] *See generally* FDIC, Office of the Inspector General, *The FDIC's Role in Operation Choke Point and Supervisory Approach to Institutions that Conducted Business with Merchants Associated with High-Risk Activities*, Report No. AUD-15-008 (Sept. 2015) ("OIG Report").

Lender relationships with banks. The consequences for the industry have been dire, with some market participants already being forced to exit the business.[62]

5. The Zealous Participation of Regulators.

If regulators had been reluctant accomplices to the use of guidance to penalize banks for maintaining relationships with Payday Lenders, then the mere fact of anti-Payday Lender guidance, by itself, would not necessarily indicate the importance of guidance in affecting bank behavior. After all, regulators, not the Obama Administration, possess private information about the relationships of banks, and if they wished to use their discretion to ignore the presence of Payday Lenders on client lists, the fact of the Obama Administration litigation threats, per se, might not amount to much. It is, therefore, relevant to note the zeal with which regulators, especially the FDIC, have assisted the Administration's efforts to target Payday Lending.

In December of 2014, the U.S. House of Representatives Committee on Oversight and Government Reform issued a report entitled, "Federal Deposit Insurance Corporation's Involvement in 'Operation Choke Point' " (hereinafter "Rep."). According to the Report, the FDIC was preoccupied with how "large nationwide banks are facilitating payday lending,"[63] and sought actions to "take against banks that facilitate payday lending,"[64] looked for "a way to stop our banks from facilitating payday lending,"[65] and created new mechanisms for leveraging the

[62] Naumann Decl. ¶ 4 (Payday Lender forced to shut down its business in October 2014 after losing access to banking services); Second Declaration of Mark McDonald ¶ 3 (Jan. 10, 2017) (Payday Lender forced to sell out to competitor after being unable to obtain bank services).
[63] Email from to Surge Sen, Section Chief, Division of Consumer and Depositor Protection, FDIC, to Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, Legal Division, FDIC (Mar. 8, 2013, 9:11 AM), FDICHOGR00006055, attached as Exhibit B to Plaintiffs' Second Notice of Supplemental Support (Dec. 12, 2014), Doc. 52-2.
[64] Email from Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, FDIC, to two Counsel in Legal Division, FDIC (Mar. 8, 2013, 09:32), FDICHOGR00006907 *in* Rep. at 9 ("Mar. 8, 2013, 09:32AM").
[65] Email from Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, FDIC, to James L. Anderson, Assistant General Counsel, Consumer Section, Consumer, Enforcement/Employment, Insurance, and legislation Branch, FDIC (Feb. 22, 2013, 11:13), FDICHOGR00006907 *in* Rep. at 9 ("Feb. 22, 2013, 11:13AM").

FDIC's statutory authority over banks to "get at payday lending."[66] Consider this email from Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, Legal Division, Federal Deposit Insurance Corporation:

> I've received an inquiry from DCP about where we stand regarding our research into what avenues are available to the FDIC **to take action against banks that facilitate payday lending**. I have the memo you did a while back. Has that memo been updated? I know that after we met with Mark, you were going to explore **the BSA/Know Your Customer requirements to see if that would provide the FDIC with the means to get at payday lending (either by the bank's direct customer or through a third party payment processor).**[67]

Or this prior email from Marguerite Sagatelian to James L. Anderson, Assistant General Counsel, Consumer Section, Consumer, Enforcement/Employment, Insurance, and legislation Branch, FDIC:

> I just got off a lengthy conference call with Dianne and Pat (as well as Greg and John Bowman, the review examiner) regarding [REDACTED]. Dianne is concerned that we are putting a lot of resources into this case and that, unless we can show fraud or other misconduct by the payday lenders, we will not be able to hold the bank responsible. After much discussion, we agreed to: (1) complete our review of bank emails; (2) review the risk management exam report and draft consent order regarding BSA violations; and (3) find out more about the US Attorney's investigation (that office obtained copies of the bank's emails right after we did). Once that is done, we will reevaluate our game plan. We have to let Dianne know next week the timetable for completing the email review. During the course of the discussion, I mentioned our **meeting with Mark and his interest in trying to find a way to stop our banks from facilitating payday lending.**[68]

High-level agency officials, including FDIC Chairman Gruenberg, intended for the "high risk" industry list released in 2011 to be understood and applied by the regulators as it has been understood and applied: as a list of industries, including payday lending, of which the FDIC disapproves and with which banks should be strongly encouraged to cease doing business. This informal guidance was subjected to "months-long internal deliberations and multi-tiered review;"

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[66] Mar. 8, 2013, 09:32AM.
[67] Mar. 8, 2013, 9:32AM (emphasis added).
[68] Feb. 22, 2013, 11:13AM (emphasis added).

a review that involved then-acting Chairman Gruenberg, and that entailed extensive strategizing by FDIC officials about how best to publicize the list and make sure that the banks "got the message" about payday lenders.[69] The FDIC even "stripped" from the final version of the list "language advising banks to manage each relationship 'according to its own facts and circumstances,' as well as language recognizing that merchants in the named categories may be legitimate." Rep. at 6–7.

The FDIC incorporated this list into several Memoranda of Understanding and Consent Orders as a list of "prohibited businesses":

> It is difficult to understate the significance and impact of the high-risk merchant list. In addition to influencing both regulators' examination policy and banks' private business decisions**, the list was often directly incorporated into FDIC-mandated Memorandums of Understanding (MOUs) and Consent Orders as "prohibited businesses."**[70]
>
> The experience of one entry on the list – firearms and ammunitions merchants – effectively traces the downstream influence of the high-risk merchants list. MOUs between supervised banks and FDIC Regional Offices, as well as bank policies submitted pursuant to FDIC Consent Orders, variously "prohibit" payment processing for firearms merchants, characterize loans to firearms dealers as "undesirable," and generally subject firearms and ammunitions merchants to significantly higher due diligence standards.[71]

The House Report makes clear that regulators' actions were motivated by the personal biases and prejudices of agency officials against the Payday Lending industry. In particular, the House Committee concluded from the evidence "that senior policymakers in FDIC headquarters

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[69] The House Report details how this official "attempted the extremely unusual step of including the list on the FIL's cover page, in an effort to 'grab some attention." Staff of H. Comm. On Oversight and Government Reform, 113th Congress, *FDIC's Involvement in "Operation Choke Point"* (Comm. Print Dec. 8, 2014) ("Rep.") (quoting Email from a Senior Examination Specialist, Div. of Depositor and Consumer Protection, to the Chief, Cyber- Fraud and Financial Crimes Section, Div. of Risk Management Supervision, FDICHOGR00002173). The official was concerned about "putting anything later in the document as the reader may not get the message." *Id.* at 6.
[70] *Id.* at 7 (citing Letter from unnamed bank to Thomas Dujenksi, Regional Director, Federal Deposit Insurance Corporation, Aug. 1, 2013 (concerning terms of Sections 15(a) and 15(b) Consent Order, revising the bank's ACH policy to prohibit certain businesses; name of bank redacted by FDIC), FDICHOGR00004062).
[71] *Id.* (citing to FDICHOGR00004097; FDICHOGR00004101; FDICHOGR00004092; FDICHOGR00004190).

oppose payday lending on personal grounds," and that FDIC personnel regard payday lending as "a particularly ugly practice"[72] and "unsavory."[73] Indeed, one senior FDIC official admitted that he "literally can not stand pay day lending" and "sincerely" and "passionate[ly]" believes that payday lenders "are abusive, fundamentally wrong, hurt people, and do not deserve to be in any way associated with banking."[74] The House Committee Report concludes that FDIC's regulatory campaign against Payday Lenders reflects not legitimate concerns for the safety and soundness of financial institutions, but rather "emotional intensity" and "personal moral judgments," and has thus been "entirely outside of FDIC's mandate."[75]

The zeal of the FDIC's leadership to stamp out Payday Lending even included carefully orchestrated political theater:

> In one egregious example, the DCP's Deputy Director for Policy & Research insisted that Chairman Gruenberg's letters to Congress and talking points always mention *pornography* when discussing payday lending, in an effort to convey a "good picture regarding the unsavory nature of the businesses at issue."[76]

This FDIC official insisted on associating payday lending with pornography even in the face of counsel's concern that the agency would seem to be passing moral judgments on the industry because he felt "strongly that including payday lenders in the same circle as pornographers and on-line gambling businesses will ultimately help with the messaging on this issue."[77]

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[72] *Id.* at 8, 10 (citing Email from a Counsel, Legal Division, FDIC, to Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, FDIC (Mar. 9, 2013, 2:53PM), FDICHOGR00005178).
[73] Rep. at 10 (citing Email from a Counsel, Legal Division, FDIC, to Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, FDIC (Aug. 28, 2013, 9:32AM), FDICHOGR00007424).
[74] Email from Thomas J. Dujenski, Regional Director, Atlanta Region, FDIC, to Mark Pearce, Director, Division of Consumer Protection, FDIC (Nov. 27, 2012, 4:47PM), FDICHOGR00006585 *in* Rep. at 14.
[75] Rep. at 10, 15. An FDIC spokesman has acknowledged that "[s]ome of the pushback from the Hill is that it is not up to the FDIC decide what is moral and immoral, but rather what type of lending is legal." *Id.* at 11 (alteration in original) (citing Email from David Barr, Assistant Director, Office of Public Affairs, FDIC to Mark Pearce, Director, Division of Depositor and Consumer Protection, FDIC (Sept. 13, 2013 10:38AM), FDICHOGR00005240).
[76] *Id.* at 10 (citing Email from Counsel, Legal Division, FDIC, to Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, FDIC (Aug. 28, 2013 9:32AM), FDICHOGR00007424).
[77] Email from Counsel, Legal Division, FDIC, to Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, FDIC (Aug. 28, 2013 9:32), FDICHOGR00007424 *in* Rep. at 11.

Case 1:14-cv-00953-GK Document 107-3 Filed 01/11/17 Page 29 of 286

The FDIC's Inspector General also completed a September 2015 Report analyzing the role of the FDIC in pushing banks to end relationships with Payday Lenders, and it found that the FDIC had successfully pressured banks to terminate relationships with Payday Lenders based on significant animus against Payday Lending. Indeed, far from being a reluctant participant in the new guidance against Payday Lending relationships, from the beginning of the Obama Administration's efforts against Payday Lenders, FDIC staff had been working closely with the Department of Justice to identify banks' relationships with Payday Lenders, which (contrary to the FDIC's own financial interests and duties) likely served to make litigation risk *greater* for banks with Payday Lending relationships.[78]

Clearly, the new guidance against bank relationships with Payday Lenders was intended by regulators as a tool to strongly discourage banks from maintaining relationships with Payday Lenders. The regulators had the power to impose their will by using vague language and the veil of secrecy, which protects their communications with banks from becoming public. That veil of secrecy was meant to preserve the confidentiality of bona fide discussions, in the interest of banking system safety and soundness, but in the case of the campaign against Payday Lending it was used as a tool to protect regulators who abused their authority.

Summary

In summary, the evidence clearly shows that the unprecedented wave of bank terminations of relationships with Payday Lenders coincided with, and was caused by, regulatory actions, working through guidance and alleged concerns about "reputation risk," which successfully discouraged banks from maintaining relationships with Payday Lenders that were

[78] OIG Report.

profitable and viable. This is a judgment shared by the FDIC's Inspector General, the House Committee that investigated the motives and consequences regulatory guidance against Payday Lender relationships, and numerous market participants.

<u>III. The Social Costs of the Regulatory Targeting of Banks' Payday Lending Relationships.</u>

In recent years, financial economists have completed numerous studies of the effects of the existence of Payday Lending on consumers, banks, and the financial system. These studies have been undertaken by scholars working at universities and regulatory bodies, and many of them have been published in academic journals and other respected outlets for empirical work.

Following the rise of payday loans as an alternative source of consumer credit, the Payday Lending industry has come under immense scrutiny from policy makers and the media. With respect to their effects on consumers, several questions have been examined: Do Payday Lenders target minorities? Does Payday Lending trap borrowers in a cycle of indebtedness? Does it drive borrowers to bankruptcy? Are the implicit interest rates on Payday Loans exploitative? Do Payday Lenders make extraordinary profits at the expense of borrowers? In response to each of these questions, the answer provided by the empirical academic literature, summarized in detail in Appendix A of this Report, is a resounding no.

In recent years, bank regulators have also characterized bank lending to Payday Lenders as risky. Is it true that Payday Lenders are risky borrowers from banks? The academic literature shows that, contrary to the concerns of regulators, Payday Lenders tend to be profitable and stable.

In light of these conclusions, the political and regulatory attempt to discourage banks from lending to Payday Lenders has been a source of social cost, not social benefit. The beneficial services of Payday Lenders are being constrained. Banks are foregoing revenues. Consumers are losing valuable borrowing options. Beneficial competition in the financial sector among lenders is being limited. The political and regulatory campaign against Payday Lending acts as a drag on national income, business profit, and consumer welfare.

Other Social Costs of the Attack on Payday Lending.

If the attack against Payday Lending had been presented in Congress, or as part of formal rule making—both of which entail deliberation, extensive opportunities for debates and comments—then the evidence contained in the academic literature on Payday Lending would have exerted a significant check on the passions and prejudices of politicians and regulators who assumed, without evidence, that Payday Lending tends to harm consumers, banks, and the financial system.

The decisions by politicians and regulators to rely on litigation and regulatory guidance as back-door means of legislating not only have caused harm to Payday Lenders, banks, and consumers; they have also harmed our political process and our democracy. When regulators abuse their discretion to impose their personal biases on the business of banks, and use the veil of regulatory secrecy to protect themselves from accountability, we as a society are deprived of the honest and open debate that produces legitimate legislation and rule making under a system of the Rule of Law. We get laws that are not subject to the will of the people, and they are administered through vague and discretionary guidance which is neither predicable nor non-discriminatory. This approach to regulation deprives our society of the due process that serves as a constructive check against prejudice and personal bias, and produces unaccountable enforcement of regulation, which is unpredictable and may be used to discriminate against certain parties. There is a large literature showing that a diminution of the Rule of Law lowers income growth and unnecessarily increases risk, but there is a more fundamental loss from adopting this approach to regulation. The absence of Rule of Law diminishes the degree of justice achieved within a society, a cost that is greater than its consequences for income growth, and one that defies quantification.

Charles W. Calomiris
January 10, 2017

Case 1:14-cv-00953-GK Document 97-3 Filed 01/11/17 Page 34 of 286

Appendix A: The Academic Literature on Payday Lending.

Following the rise of payday loans as an alternative source of consumer credit, the Payday Lending industry has come under immense scrutiny from policy makers and the media. With respect to their effects on consumers, several questions have been examined: Do Payday Lenders target minorities? Does Payday Lending trap borrowers in a cycle of indebtedness? Does it drive borrowers to bankruptcy? Are the implicit interest rates on Payday Loans exploitative? Do Payday Lenders make extraordinary profits at the expense of borrowers? In response to each of these questions, the answer provided by the empirical academic literature, summarized here, is a resounding no.

Regulators have characterized bank lending to Payday Lenders as risky. Is it true that Payday Lenders undertake risky loans, and are themselves risky borrowers from banks? The academic literature shows that, contrary to the concerns of regulators, Payday Lenders tend to be profitable and stable.

This Appendix summarizes a nascent but growing set of studies in the academic literature that analyzes the Payday Lending industry and its economic impact on borrowers. The evidence in these studies shows that Payday Lending provides individuals and households that are often excluded from mainstream credit markets an alternative source of liquidity. By easing these borrowers' credit constraints, Payday Lending allows them to smooth consumption and weather adverse financial and other liquidity shocks, improving their economic welfare. Payday Loans are an important component of the set of credit options available to a significant portion of American households, regardless of the economic, racial, or other dimensions of a person's background.

Case 1:14-cv-00953-TSK Document 109-3 Filed 01/11/18 Page 51 of 286

After describing the characteristics of borrowers who use Payday Lending, I discuss the economic welfare-enhancing role played by Payday Lending in extending credit to otherwise rationed-out borrowers. Finally, I review evidence on the profitability of the Payday Lending industry and the nature of competition among Payday Lenders, and across Payday Lenders and other financial credit providers often seen as potential "close substitutes."

Payday lenders serve a clientele of constrained borrowers that have limited access to mainstream credit sources. One might expect candidates for Payday Lending to be confined to households with low personal income, but that is not a valid generalization. In order to obtain a Payday Loan, borrowers must have a steady source of income and a bank account in good standing. Those facts suggest that, by the very design of these facilities, Payday Loans do not target marginal, economically vulnerable members of society.

Candidates for Payday Loans may have been disqualified from cheaper sources of credit due to past delinquencies. Bhutta, Skiba, and Tobacman (2015) show that consumers apply for Payday Loans as a last resort, when they have limited access to mainstream credit. They find that at the time of the application for a Payday Loan, 80% of applicants have no credit available on their credit cards. Just prior to a Payday Loan application, a borrower is significantly more likely to have applied for mainstream credit (and been denied), and is more likely to have an account that has become delinquent. Prager (2014) finds that Payday Lenders tend to establish stores in rural areas that have low per-capita densities of bank branches, and are also more likely to establish stores in areas in which a higher proportion of the population has either no credit score or a sub-prime credit score. In summary, the available evidence suggests that Payday Lenders are agile market makers serving a clientele with significant current income, but that have limited access to traditional forms of consumer credit.

Empirical evidence contradicts the charge that Payday Lenders prey disproportionately on minorities. Morgan and Pan (2012) find that after controlling for economic and financial characteristics, members of ethnic minorities, including African-Americans and Hispanics, are no more likely to use payday loans. That conclusion is confirmed by Prager (2014), who shows that Payday Lending stores are, in general, no more likely to be located in areas with a higher concentration of ethnic minorities, controlling for economic conditions.

The evidence on the effects of payday lending on the economic welfare of borrowers also belies the notion that Payday Lenders exploit the weak, or that Payday Lenders worsen the financial health of their borrowers. The empirical evidence points to three main conclusions. First, Payday Lending does not lead borrowers into a “debt-trap,” in which financial distress becomes more likely. The main challenge in empirically testing this question is the fact that individuals who engage in Payday Borrowing are, on average, more likely to be financially distressed than those who do not. Thus, if one observes relatively higher subsequent debt accumulation and bankruptcy probability for Payday borrowers, that may simply reflect the fact that they were in worse financial shape when they became Payday borrowers, rather than the effect of borrowing from Payday Lenders.

Academic studies have attempted to solve this so-called “identification problem” by using various econometric techniques to isolate the causal effect of Payday Lending. One common approach is to compare economic outcomes in jurisdictions (states) in which Payday Lending was restricted by law with those in which Payday Lending continued unabated. Desai and Elliehausen (2016) compare border counties in states with restrictions on Payday Loans with neighboring counties in states with no restrictions. They find no statistically significant effect of Payday Loan usage on delinquencies in other forms of consumer credit. Bhutta (2014) uses a

Case 1:11-cv-00953-GK Document 1097-3 Filed 01/11/17 Page 37 of 286

similar empirical strategy that exploits within-state variation in restrictions on Payday Lending and finds no effect of access to Payday Loans on: 1) credit scores, 2) new delinquencies, or 3) the likelihood of overdrawing credit lines.

Stoianovici and Maloney (2008) revisit this question over a long sample period (from 1990 through 2006) using a comprehensive set of changes in state-level restrictions on Payday Lending. They, too, find no empirical evidence that Payday Lending leads to more bankruptcy filings in states where payday lending is unrestricted versus states in which it is limited; that estimate controls for a large set of economic and demographic differences.

Bhutta, Skiba, and Tobacman (2015) estimate the causal effect of Payday Lending by using a technique called "regression discontinuity design." This consists of comparing individuals who barely meet the eligibility cutoff threshold for getting a Payday Loan with individuals who barely miss it. This approach is grounded in the idea that these individuals in both groups are likely to be similar with respect to other relevant observable (and unobservable) dimensions, but for the fact that a Payday Loan was received quasi-randomly to one and not to the other. The authors find that the path of credit scores before and after application does not differ across treatment and control groups, implying that creditworthiness does not deteriorate because of making use of Payday Borrowing. To the extent that a credit score is a "highly sensitive summary measures of the entire liability side of the household balance sheet," this non-result is particularly strong evidence against the "debt-trap" argument. They also find no systematic effect on delinquencies from access to Payday Loans.[79]

[79] In a less well-identified study, Melzer (2011) reports negative effects of Payday Loans in terms of increased difficulty in paying other bills. However, the vast majority of evidence on this question suggests no causal negative effect of payday lending on future indebtedness of borrowers.

Case 1:14-cv-00953-GK Document 107-3 Filed 10/12/17 Page 36 of 228

The second main conclusion that has been robustly documented in the literature is that restrictions on Payday Lending drive borrowers towards **inferior substitutes,** including bounced-check protection, overdrafts, pawnshops, and both formal and informal bankruptcy. These alternatives are not only costlier than Payday Loans (Morgan and Strain, 2008), they also tend to increase inefficient liquidation of real-assets (pawnshops), and substantial risk to employment and economic well-being from being exposed to debt-collectors as part of informal bankruptcy.

The academic evidence on this question is overwhelming. Morgan and Strain (2008) compare states in which Payday Lending has been banned versus those in which it has not, or states in which it has never been allowed. They find that banning Payday Lending results in substitution by households into other forms of short-term, high cost financing including bounced checks, and pawnshops. Banning Payday Lending also leads to increased complaints about lenders and debt collectors to the Federal Trade Commission and increased bankruptcy filings. Their results suggest that the absence of Payday Lending pushes individuals into formal or informal bankruptcy.

Zinman (2010) surveys payday borrowers in Oregon, which instituted a ban on payday lending, and in Washington, in which there was no ban. He finds that the ban results in partial substitution into overdrafts and late bill payment. The ban caused a deterioration in overall financial condition of Oregon households, measured by unemployment, and negative subjective assessment on future financial prospects, relative to those in Washington.

Morgan, Strain, and Seblani (2012) similarly find that payday loan bans result in increased overdrafts and in Chapter 13 bankruptcy rates, but a simultaneous increase in complaints against lenders and debt-collectors, also suggesting a shift away from formal bankruptcy into informal bankruptcy. They robustly find that returned check numbers and overdraft fee income at banks increase post-ban, suggesting a substitution into costlier alternatives. Edmiston (2011) also finds evidence of substitution into costlier alternatives post-ban. Bhutta et al. (2015) document substitution into other forms of short-term lending, including pawnshops, but not traditional credit (e.g. credit-cards), in states with a ban on Payday Lending relative to unrestricted states.

The lack of substitution into credit cards is notable as it confirms that Payday Loan users are marginal borrowers, shut out of mainstream credit markets. By providing credit to constrained borrowers, Payday Lending provides a significant economic benefit as it helps those borrowers avoid far costlier, undesirable alternatives.

The third main conclusion from the academic evidence on Payday Lending is that it has a positive effect on economic welfare by allowing individuals without access to credit to gain access to it. The evidence further suggests that Payday Loans allow borrowers to smooth consumption and weather negative financial and other liquidity shocks.

Karlan and Zinman (2009) conduct a field experiment in South Africa in which Payday Loans were randomly assigned to some marginal borrowers and not to others. They find that access to payday credit produces benefits in terms of a wide range of outcomes including increased food consumption, economic self-sufficiency, mental health, and general outlook. Their experiment provides direct causal evidence that Payday Loans relax binding credit constraints for marginal borrowers, significantly enhancing their welfare.

Morse (2011) uses natural disasters as an exogenous negative financial shock to households, and finds that access to Payday Lending mitigates home foreclosures and larcenies (an extremely costly and risky, not to mention social-welfare reducing alternative) relative to areas subject to disasters in which households did not have access. To confirm that it is indeed Payday Lending driving these effects, she constructs a “placebo test” in which she considers disasters which were covered by home insurance and finds no effect of payday lending. This suggests a direct, beneficial role of payday lending in mitigating sudden and unexpected liquidity shocks.

Zaki (2016) exploits regulatory changes in the availability of Payday Lending to military personnel who are randomly allocated to different locations, and face varying but known waiting periods between receiving their wages. The results from this study show that access to Payday Lending allows military personnel to smooth consumption (measured by purchases of food), although it also leads to increased rates of temptation purchases.

There is further evidence suggesting the role of payday lending in funding temptation spending and that payday borrowing is undertaken by over-optimistic, cognitively-biased borrowers (Olafsson and Pagel, 2016). However, counter-evidence points to the fact that the majority of payday borrowers correctly anticipate the duration at which they will be able to repay their loans (Mann, 2013).

Are the ostensibly high implicit interest rates charged by payday lenders exploitative and, as a result, are Payday Lenders unusually profitable enterprises? Or, conversely, are they unprofitable and risky “fly-by-nights”? The academic evidence on these questions suggests two main conclusions: 1) Payday Lenders’ high interest rates are justified by higher fixed-costs that are necessary to operate storefronts, and cover higher expected loan losses, resulting in their being profitable and sound businesses, but no more profitable than comparable mainstream financial institutions. 2) The Payday Loan industry is competitive and this competition, like in any other credit market, benefits the borrower.

Case 1:14-cv-00953-GK Document 107-3 Filed 01/12/17 Page 46 of 286

Academic studies have evaluated the pricing and profitability of Payday Lenders in a number of ways. Flannery and Samolyk (2005) use store-level data from the FDIC to show that high fixed-costs (resulting from the fact that Payday Lenders must be located at highly-visible, high-traffic locations) and high loan loss rates justify a large part of the high APRs charged on Payday Loans. The business model for Payday Lending involves volume, yet loans from repeat borrowers are not particularly more profitable.

Huckstep (2007) compares accounting figures from publicly traded Payday Lenders with mainstream commercial lenders. Mainstream lenders had a profit margin that was, on average, higher than that of payday lenders. One major driver of this lower profitability is the fact that Payday Lenders face greater default risk. Skiba and Tobacman (2007) analyze the stock market performance of publicly traded Payday Lenders and find that their equity market returns, adjusted for risk, are no higher or lower than the returns for mainstream financial institutions.

Finally, with respect to the issue of competition within the Payday Lending industry, and between Payday Lenders and other alternative sources of credit, Canann and Evans (2015) find that Payday Lenders locate near substitutes (e.g., pawnshops), suggesting that physical proximity matters to consumers of alternative credit. Notably, they find that a higher degree of competition among payday lenders in a given region reduces average interest rates in that region. Melzer and Morgan (2015) point to the positive effect of competition between Payday Lenders and banks that provide overdraft credit for borrowers. They find that Payday Lenders compete with mainstream financial intermediaries through both price and non-price channels. Exploiting state-level restrictions on Payday Lending, the authors show that access to substitute credit (overdraft) falls as payday lending is banned, as competing institutions de-risk themselves, leaving a marginal clientele unserved. Adjusting for the reduction in supply, the per-unit price of credit increases after Payday Lending is banned.

Stango (2012) analyzes the competition between payday lenders and credit unions offering Payday Loans and finds that credit unions seem unable to undercut prevailing prices of Payday Lenders, suggesting competitive pricing. Furthermore, to maintain their Payday Loan offerings at a competitive level with pure-play Payday Lenders, credit unions ration riskier borrowers by restricting approvals. While Skiba and Tobacman (2009) find an increase in personal bankruptcy rates for individuals who just meet the approval threshold for Payday Loans versus those who just miss it, they find that competition largely mitigates that negative effect, explaining why, in general, there is no association between the availability of Payday Loans and greater bankruptcy. This result points to a key economic benefit of allowing competition in the Payday Loan industry. As in other industries, competition in the Payday Lending industry and between Payday Lenders and close substitutes is active and produces net gains for consumers.

In summary, the academic literature shows that Payday Loans have a positive impact on marginal, credit-constrained borrowers' ability to withstand financial distress. As a result of having a broader choice of credit options, those borrowers experience improvements in their economic well-being. Contrary to the critique that payday loans encourage further borrowing and lead recipients to fall into a "debt-trap," the literature reveals no causal effect of payday lending on future indebtedness and bankruptcy filing rates. In fact, subsequent to regulatory restrictions on Payday Lending, the preponderance of academic evidence points to an increased reliance by constrained borrowers on sources of credit that are substantially costlier than Payday Loans, including bounced-check protection, overdraft facilities, and pawnshops. In addition, in the absence of payday lending, such borrowers are more likely to fall into informal bankruptcy, characterized by forced liquidation of assets, wage garnishment, and targeting by debt-collectors.

Finally, academic studies show that the Payday Lending industry is competitive, and that lenders are on average no more profitable than mainstream financial institutions. The high implicit interest rates are needed to compensate for greater fixed-costs (part of their business marketing model) and greater loan losses faced by Payday Lenders. Taken together, the evidence points to a positive, welfare-enhancing role of Payday Lending.

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EXHIBIT 3

No. 14-953-TNM

American Banker:

Payday Crackdown Creates More Problems than It Solves

WILLIAM M. ISAAC

FEB 18, 2014 3:00pm ET

There are more payday loan stores in the U.S. than all the McDonald's and Starbucks stores combined. It's clear that tens of millions of consumers across the nation want and feel they need this product. It's equally clear that government policymakers believe they know what's best for consumers.

Recent actions taken by the federal government to eliminate a variety of short-term loan products suggest a strong bias against all such loans – period. If so, regulators need to reconsider before they destroy a critical source of credit for families and the economy as a whole.

I want to make a couple of things clear before proceeding. Until April when I reach mandatory board retirement age, I am chairman of Fifth Third Bancorp, which is one of four large banking companies to recently abandon very popular short-term lending products in response to regulatory pressure. Also, my consulting firm has done regulatory compliance work for one or more payday lending firms. I'm not speaking for those companies.

My motivation is to help millions of unbanked and underbanked individuals gain or maintain access to short-term credit on the best possible terms to meet emergency needs through reputable financial institutions. This is a subject I have written about for over a decade.

Recent actions by the Comptroller of the Currency essentially eliminated unsecured short-term consumer loans at national banks. The Department of Justice's "Operation Choke Point" attempts to prevent banks from lending to certain online lenders. The Consumer Financial Protection Bureau is apparently gearing up to take action against online lenders.

All of this is happening by regulatory fiat against activity that's clearly legal under federal and state laws without any involvement from the legislative branch of government and without explanation of the end game. How will consumers access much needed short-term credit? What are the rules and who will determine them?

Short-term consumer loans to borrowers without good credit histories can now be provided by only nonbank financial institutions. Before regulators go any further, they should open a public dialogue to make sure they don't do a lot more harm by eliminating the few lenders that remain.

Short-term, unsecured consumer loans to borrowers with weak or limited credit histories are necessarily expensive. The millions of people who use these loans are not irrational. To the borrowers, these loans are less expensive than a series of overdrafts. They are less painful than the consequences of defaulting on an auto loan or a mortgage. They are a better deal than having the electricity and heat turned off only later to pay for having them turned on again.

Research at the Federal Reserve Banks of New York and Kansas City both show that states that eliminate payday loans immediately experience a substantial rise in these costly outcomes. Significantly, these studies also find more households file for bankruptcy when payday loans are no longer available.

Are borrowers deceived by the terms of their payday loans? Clearly, guaranteeing transparency to the borrower is critical, but research done at Columbia University indicates that most borrowers understand the terms of payday loans and are pretty realistic about how many months it will take to repay the loans and at what cost.

Payday loans are heavily regulated by the states. Some states ban them. Other states regulate the terms in various ways, including the allowable amounts. It's not clear to me that we have done nearly enough research to determine which model is best and whether borrowers will be better protected by one federal model versus the many models used in the laboratory of states.

There is a role for federal regulators. Online lenders who avoid state law are violating state law, and federal regulators could help enforce those laws. Federal regulators have long had the power to punish false advertising, and they should continue to make the terms of loans transparent and understandable. More competition should keep loans as affordable as possible, and this is something federal bank regulators can and should be promoting.

It's important that government proceed cautiously and not take precipitous actions that will force millions of underbanked consumers into far more costly – not to mention unsavory and potentially dangerous – means of meeting their emergency financial needs. It's past time for a good, fact-based debate about the best way to satisfy this glaring societal need and then go about encouraging reputable, regulated institutions to deliver the goods at the lowest possible price.

It's easy for government to just say "no" to payday lending. A more responsible course is to encourage reputable bank and nonbank institutions to develop and offer quality services on the best terms possible, coupled with counseling for customers on how to better handle their finances and graduate to less costly, longer-term solutions.

I'm perplexed when I watch the government force banks out of the lawful business of providing short-term unsecured loans to meet emergency needs – telling the banks it represents too much "reputational risk" – while at the same time encouraging banks to provide services to marijuana dealers whose activities clearly violate federal and nearly all state laws.

"Curiouser and Curiouser!" Alice would proclaim.

William M. Isaac, former chairman of the Federal Deposit Insurance Corp., is global head of Financial Institutions for FTI Consulting, chairman of Fifth Third Bancorp and author of "Senseless Panic: How Washington Failed America." The views expressed are his own.

EXHIBIT 4

No. 14-953-TNM

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

COMMUNITY FINANCIAL SERVICES ASSOCIATION OF AMERICA, LTD., et al.,

Plaintiffs,

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, et al.,

Defendants.

Civil Action No. 14-953-GK

SECOND DECLARATION OF DENNIS SHAUL

Pursuant to 28 U.S.C. § 1746 and LCvR 11.2, I hereby declare as follows:

1. I am the chief executive officer for the Community Financial Services Association of America ("CFSA"). I became CFSA's CEO in October 2012. Before joining CFSA, I worked for more than ten years on Capitol Hill, where I served as senior advisor to Rep. Barney Frank (D-MA) on the House Financial Services Committee. I worked extensively on the Dodd-Frank Bill and on the development of practices regarding anti-money laundering. I was intimately involved in the drafting of the Dodd-Frank Bill as a whole, but specialized on matters relating to The Volcker Rule, "Too Big To Fail", and other issues relating to the size and influence of the banking industry.

2. I served as chief financial regulator in the state of Ohio under Governor John J. Gilligan. In this role, I implemented the state's first consumer protection law and revisions to the state security statute. I have a J.D. from Harvard Law School and a Master's degree in

Economics from Oxford University. I am a graduate of the University of Notre Dame and was a Rhodes Scholar.

3. Over the past three years, as CEO of CFSA, I have watched as an ever-growing number of CFSA members have been informed by their banks that they are no longer welcome as customers, that their accounts are to be closed, and that long-standing relationships are to be ended. It is now an open secret in both the payday lending and banking industries that federal regulators have been pressuring the banks to shut down our industry *in toto*.

4. Federal regulators have pressured banks to aid them in their campaign to attack our industry. This tactic is particularly effective in the case of our industry because payday lenders must rely on banking services to do business. A prospective borrower who applies for a short-term, small-dollar loan typically provides a post-dated check or electronic debit authorization for the value of the loan, plus a fee. The lender advances the customer the amount of the loan. After the term of the loan, which is usually coterminous with the borrower's next payday, the borrower typically returns to the storefront and repays the loan and the fee. In addition to meeting payroll and issuing checks to pay the bills, a payday lender needs access to banking services for cash management purposes, i.e., to deposit the cash and checks received in the course of its business. Sometimes, moreover, a borrower will not return to the storefront location. In this situation, the lender instead deposits the post-dated check or executes the debit authorization. In order to have and make good on the security for the loan, therefore, the lender must have a deposit account with a bank and be able to access the Automated Clearing House (ACH) network. Both services require a relationship with a bank.

5. As I described in my first declaration, the effort being undertaken by federal regulators to cut off CFSA members from the banking system has had grave consequences for

CFSA Members and our industry. In the two years that have since intervened, the situation has only grown worse. Our members are careful not to reveal their existing banking relationships lest federal regulators then single out those banks for heightened supervision, harassment, and threats in order to choke off these last sources of financial services.

6. Banks continue to capitulate to their regulators and to terminate both CFSA members and other lenders offering short-term, small-dollar loans. Recent terminations include:

a. On November 4, 2015, Hancock Bank terminated a CFSA Member in Mississippi.

b. On November 18, 2015, First Tennessee terminated a CFSA Member in Tennessee.

c. On March 8, 2016, Wells Fargo terminated a CFSA member in Idaho.

d. On April 28, 2016, TD Bank terminated a CFSA member in New Hampshire.

e. On February 10, 2016, U.S. Bank terminated a CFSA member in Missouri. The bank also closed the personal checking accounts of the employees and former employees of this CFSA member. The bank provided this CFSA member with only two-weeks notice.

f. On November 21, 2016, Business Bank of Texas notified Power Finance Texas Companies, a Texas-based CFSA member, that the OCC would not permit the bank to provide banking services to Power Finance because it is a payday lender. As a result, Power Finance will be required to close its bank accounts and completely sever its relationship with Business Bank of Texas by the end of the year. Earlier in the year, Business Bank of Texas had terminated Power Finance's ACH processing services but not its ability to hold a bank account.

Case 1:14-cv-00953-GK Document 9-3 Filed 11/23/16 Page 5 of 6

g. On November 2, 2016, the day after it had terminated its relationship with Advance America, U.S. Bank announced that it would be terminating its relationship with another CFSA member, NCP Finance Ohio, LLP. Just six weeks earlier, U.S. Bank had been attempting to interest NCP in additional services.

h. On November 10, 2016, U.S. Bank announced that it would be terminating its approximately 20-year relationship with a CFSA Board member. U.S. Bank had been providing banking services to 214 branch locations for this lender in addition to providing other organization-wide treasury services. For those locations where alternatives cannot be found, the branch location may close.

i. On November 22, 2016, I learned from one of the largest companies in our industry, that it had also recently been terminated by U.S. Bank. This termination resulted in the loss of banking services at a large number of the company's locations.

j. In the past month, Advance America, Inc., a CFSA member and our co-Plaintiff in this suit, has experienced five terminations: FirstMerit Bank on October 21, 2016; Your Community Bank on October 31, 2016; U.S. Bank on November 1, 2016; BBVA Compass Bank on November 7, 2016; and MainSource Bank on November 21, 2016.

7. The consequences for our industry have been dire. Numerous payday lenders have had to exit the industry after having been denied the ability to keep even a simple bank account open, much less access the ACH system that they need to carry out their day-to-day business operations. To date, CFSA members have been relatively successful in responding to the assault. But one of our members, DollarSmart Money Centers, LLC, whose CEO Mark McDonald submitted an affidavit in 2014 in support of our response to the first-round of motions to dismiss, unfortunately was forced out of business when it lost banking services entirely in late

Case 1:14-cv-00953-TNM Document 197-3 Filed 10/23/18 Page 85 of 686

2014. If Operation Choke Point is not enjoined, I firmly believe some CFSA members will be forced to curtail their operations dramatically and others will have to shut down all together.

8. CFSA members thus have had to continue incurring substantial costs of doing business in a hostile environment. These costs range from the time and labor associated with transferring an account relationship from one bank to another to the expenses associated with becoming cash-intensive businesses, including increased reliance on armored cars and the security costs associated with physically storing the capital needed to conduct businesses.

9. As I stated in my first declaration, I have never seen regulatory abuse comparable to Operation Choke Point, nor have I seen such fear of the government felt by legitimate and law-abiding American business people. Sadly, I must report that the situation, far from improving, has only grown worse.

I declare under penalty of perjury, that the foregoing is true and correct.

Dennis Shaul

November 23, 2016

EXHIBIT 5

No. 14-953-TNM

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COURT REPORTING

Transcript of **Joachim Christian Rudolph**

Wednesday, May 9, 2018

Advance America, et al. v. Federal Deposit Insurance Corporation, et al.

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the banking relations, basically is kind of what the title says, managing the banking relations of Advance America, both from a treasury perspective as well as from a lending perspective.

Q What's the difference when you say a treasury perspective versus a lending perspective?

A When I was referring to treasury perspective, I was referring to providing treasury services for the company. Treasury services could encompass a number of services such as payroll; AP, accounts payable; would involve setting up banking relationships for our center so they can transact, make deposits and disbursements. So that's what I was referring to when I said treasury services.

Q Then you said also a lending perspective. What does that mean?

A Providing credit to a company.

Q When you were banking relationship manager, did you sit within a particular division or department within the company?

A Yes. That was part of the treasury

come up with some kind of banking solutions in a very short period of time, and that really hasn't changed. Of the remaining banks, if they terminate a relationship, I'm not sure we could find a replacement easily or at all.

Q So November 23rd, 2016, when you filed this declaration, how many bank accounts did Advance America hold?

A I don't know the exact number, but let's say, 150.

Q 150. And while holding 150 bank accounts, you thought it was a true and accurate statement that "Advance America is on the verge of effectively being denied its right to hold a bank account"?

A Absolutely. The number of bank account is not really what's critical of managing your -- or fulfilling your cash management needs for over 2,000 locations. So if I have 150 bank accounts in one state and the rest of the country doesn't have a way to bank -- again, this is just hypothetical -- it really wouldn't help me.

account," and then in your January 2017 declaration, you say Advance America -- you continue to believe that Advance America has arrived at a point where its ability to hold a bank account is in jeopardy. Right?

A Yes. That jeopardy is very real and it continues to this day.

Q Okay. So we're in November 2016. Advance America has about 150 accounts. A few months later, we're now in January 2017, still about 150 accounts. What makes you at that point in time, quote unquote, continue to believe that Advance America's ability to hold a bank account in the United States is in jeopardy?

A Because we've seen one bank termination after another, and if that doesn't stop, you know, the company would no longer be viable.

Q In January 2017 how many different financial institutions would you say you had relationships with? The same number, 100?

A It could be -- it could actually be more than at the time of -- what was that date?

November?
Q Right.
A Right. Because we had to find banks to replace U.S. Bank. And those banks generally were local, small community banks that could provide limited services to us. But we never found a true replacement for U.S. Bank.
Q Right, but if I understand correctly -- so from November 2016 to January 2017, Advance America actually had relationships with more banks. The number of banks that Advance America had relationships with increased from November 2016 to January 2017. Is that right?
A The absolute number, but the type of banks has changed.
Q I understand that maybe they're not the major banks that Mr. O'Shaughnessy was referring to in his email, but --
MS. MOSS: Objection.
Q -- the number of bank relationships increased. Correct?
MS. MOSS: Sorry. Objection. I thought

[redacted]

[redacted] [redacted] [redacted]

[redacted]

[redacted] [redacted]

[redacted]

Q What is the dollar effect of losing relationships, banking relationships, that is, in 2016? Can you quantify that?

A As compared to prior period or --

Q Well, I mean, the gist of your declaration to the court is that you're losing banking relationships and that's having an impact, a financial impact on the business. Right?

A Correct.

Q So I'm asking in 2016, quantify that impact.

A The way I've looked at it, I compared kind of a banking cost of 2012 -- I know you asked me about 2016, but I've compared 2012 to 2017.

Over that period the banking cost increased approximately 2 and a half million per year. The biggest increase -- so that's the overall increase in costs.

Q That 2 million dollar figure comes from where exactly?

A I looked at our expenses related to banking fees. I looked at our expenses relating to armored courier, which has effectively replaced local banks. And I looked at fees we pay for processing debit card transactions.

So if you add those three components together, there was a 2 and a half million dollar annual increase.

Q Is it -- I see.

In terms of banking fees, is it fair to say that the fees charged by the larger banks are greater than the smaller banks?

A It all depends. Wells Fargo Bank was very expensive. So once we lost Wells Fargo, we initially saw a reduction in banking fees. U.S. Bank's, Fifth Third are very competitive. But as

EXHIBIT 6

No. 14-953-TNM

U.S. House of Representatives

Committee on Oversight and Government Reform

Darrell Issa (CA-49), Chairman

The Department of Justice's "Operation Choke Point": Illegally Choking Off Legitimate Businesses?

Staff Report
113th Congress

May 29, 2014

Key Findings

- Operation Choke Point was created by the Justice Department to "choke out" companies the Administration considers a "high risk" or otherwise objectionable, despite the fact that they are legal businesses. The goal of the initiative is to deny these merchants access to the banking and payments networks that every business needs to survive.

- Operation Choke Point has forced banks to terminate relationships with a wide variety of entirely lawful and legitimate merchants. The initiative is predicated on the claim that providing normal banking services to certain merchants creates a "reputational risk" sufficient to trigger a federal investigation. Acting in coordination with Operation Choke Point, bank regulators labeled a wide range of lawful merchants as "high-risk" – including coin dealers, firearms and ammunition sales, and short-term lending. Operation Choke Point effectively transformed this guidance into an implicit threat of a federal investigation.

- The Department is aware of these impacts, and has dismissed them. Internal memoranda on Operation Choke Point acknowledge the program's impact on legitimate merchants. Senior officials informed Attorney General Eric Holder that as a consequence of Operation Choke Point, banks are exiting entire lines of business deemed "high risk" by the government.

- The Department lacks adequate legal authority for the initiative. Operation Choke Point is being executed through subpoenas issued under Section 951 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. The intent of Section 951 was to give the Department the tools to pursue civil penalties against entities that commit fraud *against* banks, not private companies doing legal business. Documents produced to the Committee demonstrate the Department has radically and unjustifiably expanded its Section 951 authority.

- Contrary to the Department's public statements, Operation Choke Point was primarily focused on the payday lending industry. Internal memoranda and communications demonstrate that Operation Choke Point was focused on short-term lending, and online lending in particular. Senior officials expressed their belief that its elimination would be a "significant accomplishment" for consumers.

I. **Background**

Over the past year, the Department of Justice has initiated a wide-ranging investigation of banks and payment processors, known informally as "Operation Choke Point."[1] As of December 2013, the Department had issued over fifty subpoenas to banks and payment processors.[2] The ostensible goal of the investigation is to combat mass-market consumer fraud by foreclosing fraudsters' access to payment systems.[3] However, there is evidence that the true goal of Operation Choke Point is to target industries deemed "high-risk" or otherwise objectionable by the Administration.[4]

Following the launch of Operation Choke Point in spring 2013, a wide variety of fully lawful and legitimate businesses received notices that their bank accounts were being abruptly terminated. The terminations were often attributed to "regulatory trends" or "heightened scrutiny," and expressly disclaimed any negative assessment of the accountholder's financial risk.[5] The sheer breadth of industries affected – including firearms and ammunition sales,[6] adult entertainment,[7] check cashing,[8] and payday lending[9] – has generated significant concern with the objectives and scope of Operation Choke Point. William Isaac, a former Chairman of the Federal Deposit Insurance Corporation, has characterized the initiative an "attack on market economy," while *Techdirt* has warned of the propriety of forcing private banks into "dancing to a federal piper."[10]

Writing in *USA Today*, Glenn Reynolds expressed concern with the unforeseen consequences of allowing the Department of Justice to pressure banks to shut down the accounts of legal industries: "while abortion clinics and environmental groups are probably safe under the Obama Administration, if this sort of thing stands, they will be vulnerable to the same tactics if a different administration adopts this same thuggish approach toward the businesses that it dislikes."[11] Such a possibility is far from outlandish: at the same time the Administration is

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[1] Presentation by a Trial Attorney in the Consumer Protection Branch, U.S. Dep't of Justice, to the Federal Financial Institutions Examination Council, Sept. 17, 2013 (slides on file with Committee staff).

[2] HOGR-3PPP000497.

[3] *See* Letter from Peter J. Kadzik, Principal Deputy Assistant Attorney General, Office of Legis. Affairs, U.S. Dep't of Justice, to Rep. Blaine Luetkemeyer (Sept. 12, 2013) (stating "[t]he Department seeks to combat fraud and other unlawful practices in the payment system, and our efforts are focused on all those engaged in illegal activity."); Congressional staff briefing with the Deputy Assistant Attorney General for Consumer Protection, Civil Div., U.S. Dep't of Justice, on Sept. 20, 2013.

[4] HOGR-3PPP000458.

[5] *See, e.g., infra* text accompanying note 30.

[6] Kelly Riddell, *'High risk' label from feds puts gun sellers in banks' crosshairs, hurts business*, WASH.TIMES, May 18, 2014.

[7] Glenn Harlan Reynolds, *Justice Department shuts down porn money: Column*, USA TODAY, May 26, 2014.

[8] William Isaac, *'Operation Choke Point: Way Out of Control*, AMERICAN BANKER, Apr. 27, 2014.

[9] Jessica Silver-Greenberg, *Justice Department Inquiry Takes Aim at Banks' Business With Payday Lenders*, N.Y. TIMES, Jan. 26, 2014.

[10] William Isaac, *'Operation Choke Point: Way Out of Control*, AMERICAN BANKER, Mar. 21, 2014; Timothy Geigner, *DOJ Morality Police May Be Behind Chase Closing Bank Account of Adult Film Actors*, TECHDIRT, May 1, 2014.

[11] Glenn Harlan Reynolds, *Justice Department shuts down porn money: Column*, USA TODAY, May 26, 2014.

pressuring banks to terminate relationships with legal industries, it is providing formal guidance to banks on how to provide financial services to the marijuana industry.[12]

Concerned that both the goal and mechanisms of Operation Choke Point constitute a serious abuse of the Department's civil investigative authority, on January 8, 2014, Chairman Issa and Subcommittee Chairman Jordan requested documents and communications related to Operation Choke Point. In response, the Department of Justice provided 853 pages of internal memoranda, email communications, and presentations. These internal documents confirm that the Operation Choke Point is an inappropriate exercise of the Department's legal authorities, and is being executed in a manner that unfairly harms legitimate merchants and individuals.

II. <u>The Department Lacks Adequate Legal Justification for Operation Choke Point</u>

The Department is implementing Operation Choke Point through subpoenas issued under Section 951 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).[13] Section 951 authorizes the Attorney General to seek civil money penalties against entities that commit mail or wire fraud "affecting a federally insured financial institution."[14] The Attorney General is further authorized, in contemplation of such a proceeding, to issue administrative subpoenas for the production of documents and the deposition of witnesses. Such subpoenas are not subject to judicial authorization, and apply to all records and witnesses the Attorney General "deems relevant or material to the inquiry."[15] Congress enacted FIRREA – and its extraordinary grant of civil investigative authority – in response to the savings and loan crisis of the late 1980s. The intent of Section 951 was to give the Department the tools to pursue civil penalties against individuals and entities that commit fraud *against* depository institutions.[16]

Documents produced to the Committee indicate that, in furtherance of Operation Choke Point, the Department has radically and inappropriately expanded its own authority under FIRREA. In a memorandum on Operation Choke Point prepared for Stuart F. Delery, the Assistant Attorney General for the Civil Division, senior officials candidly discuss the legal authority for the program. The discussion begins by flatly conceding that "[Section 951] was not designed principally to address consumer fraud . . . FIRREA penalties are paid to the Treasury, and the statute does not include a provision for restitution to victims of fraud."[17] The memorandum further acknowledges that Section 951 requires that the alleged fraud "[affect] a federally insured financial institution." In an end-run around this requirement, the memorandum posits that providing normal banking services to an allegedly fraudulent merchant creates a variety of "risks," and that these risks may "affect" the institution. The memorandum even concedes that these risks are strictly hypothetical, candidly admitting that "[t]he financial

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[12] *See* Financial Crimes Enforcement Network, U.S. Dep't of the Treasury, Guidance: BSA Expectations Regarding Marijuana-Related Businesses, Feb. 14, 2014; *see also* Memorandum from James M. Cole, Deputy Attorney General, U.S. Dep't of Justice, to All United States Attorneys: Guidance Regarding Marijuana Enforcement (Aug. 29, 2013).
[13] 12 U.S.C. § 1833a.
[14] *Id.* at § 1833a(c)(2).
[15] *Id.* at § 1833a(f)(1)(C).
[16] Allyson B. Baker and Andrew Olmem, Venable LLP, *FIRREA: The DOJ's Expansive (and Expensive) Tool of Choice*, 29 WESTLAW J. OF CORP. OFFICERS AND DIRECTORS LIABILITY 3 (2013).
[17] HOGR-3PPP000336.

institutions we are investigating have not suffered any actual losses."[18] While the memorandum does cite a single recent court case, the Department's analysis clearly reflects the inherent legal error of using an anti-*bank fraud* statute to combat *merchant fraud*.

Frank Keating, president and CEO of the American Bankers Association and a former U.S. Attorney and Associate Attorney General, has called the Department's strategy "legally dubious."[19] In a recent op-ed in *The Wall Street Journal*, Mr. Keating explained:

> [The Department] is pressuring banks to shut down accounts without pressing charges against a merchant or even establishing that the merchant broke the law. It's clear enough that there's fraud to shut down the account, Justice asserts, but apparently not enough for the highest law-enforcement agency in the land to prosecute.
>
> . . .
>
> [The Department] is now blurring these boundaries and punishing the banks that help them fight crime. If a bank doesn't shut down a questionable account when directed to do so, Justice slaps the institution with a penalty for wrongdoing that may or may not have happened. The government is compelling banks to deny service to unpopular but perfectly legal industries by threatening penalties.[20]

Ultimately, the Department's tortured legal analysis has turned FIRREA on its head: Section 951 was intended to help the Department *defend* banks from fraud; instead, the Department is using it to *forcibly conscript* banks to serve as the "policemen and judges" of the commercial world.[21]

III. **<u>Impacts on Financial Services, Businesses, and Consumers</u>**

a. <u>Documents Show the Department is Targeting Legal Financial Services</u>

The Department has consistently stated that the goal of Operation Choke Point is to combat mass-market consumer fraud. In a letter to the American Bankers Association and the Electronic Transaction Association on January 22, 2014, Assistant Attorney General Delery was unequivocal: "The Department wishes to make clear that the aim of these efforts is to combat fraud. The Department has no interest in pursuing or discouraging lawful conduct."[22] The Department reaffirmed this position in a letter to Chairman Issa and Subcommittee Chairman Jordan on January 24, 2014.[23] Documents produced to the Committee call into question the

[18] *Id.*
[19] Frank Keating, Op-Ed., *Justice Puts Banks in a Choke Hold*, WALL ST. J., Apr 24, 2014.
[20] *Id.*
[21] *Id.*
[22] Letter from Stuart F. Delery, Assistant Attorney General, Civil Div., Dep't of Justice, to Jeff L. Plagge, Chairman, American Bankers Ass'n, and Jason Oxman, Chief Executive Officer, Elec. Transaction Ass'n (Jan. 22, 2014).
[23] Letter from Peter J. Kadzik, Principal Deputy Assistant Attorney General, Office of Legislative Affairs, Dep't of Justice, to Darrell Issa, Chairman, H. Comm. on Oversight and Gov't Reform, and Jim Jordan, Chairman,

accuracy of these statements. Specifically, internal memoranda on Operation Choke Point clearly demonstrate that the Department's primary target is the short-term lending industry – an indisputably lawful financial service.

The idea for the initiative originated in the Consumer Protection Working Group of the Financial Fraud Enforcement Task Force. The working group's mission statement included a list of priorities:

> [T]his new Working Group will examine a wide variety of areas where consumers may be vulnerable to fraud. Those may include: identity theft, third-party payment processors and other payment fraud, student-consumer fraud, cramming, business opportunity schemes, data privacy, payday lending, counterfeiting, and schemes targeting servicemembers and their families.[24]

There is no explanation for why payday lending and payment processing – two legal financial practices – are included in a list of explicitly fraudulent activities.

After Operation Choke Point was underway, regular status reports reflect the initiative's intense focus on short-term lending. The *Eight-Week Status Report* on Operation Choke Point, prepared for Assistant Attorney General Delery on April 17, 2013, framed payday lending as the primary target of the initiative. In fact, it is the sole type of financial service mentioned in the memorandum.[25] The *Four-Month Status Report* on Operation Choke Point, prepared for Assistant Attorney General Delery on July 8, 2013, expressly identifies Internet payday lending as a fraudulent "scam" being targeted by the initiative.[26]

The strongest evidence that the Department is targeting certain lawful financial practices can be found in internal discussions of settlement negotiations. In an email dated October 1, 2013, the Director of the Consumer Protection Branch and the Deputy Assistant Attorney General for Consumer Protection discussed ongoing negotiations with subpoenaed banks.[27] The email notes that the Department's settlement proposals have included "specific bans [on] doing business" with whole categories of lawful financial services.[28] The email describes "specific language" on payday lending, debt relief companies, foreclosure rescue companies, and credit repair companies:

Subcomm. on Economic Growth, Job Creation, and Regulatory Affairs, H. Comm. on Oversight and Gov't Reform (Jan. 24, 2014).
[24] HOGR-3PPP000001.
[25] HOGR-3PPP000048-52 (The conclusion of the memorandum, entitled "Related Areas of Inquiry," does include a brief discussion of other financial services and products: "In addition to evaluating the payday lending industry, we are attempting to develop a better understanding of consumer fraud risk posed by emerging payment systems.").
[26] HOGR-3PPP000166.
[27] HOGR-3PPP000401.
[28] *Id.*

From: Blume, Michael S.
Sent: Tuesday, October 01, 2013 10:55 AM
To: Frimpong, Maame Ewusi-Mensah (CIV)
Subject: TPPP

Maame

FYI – Rich, Joel, and I had a conversation about following up on Stuart's suggestions from last night. I'm happy to discuss in more detail, but the short of it is that they are already where Stuart wants them to be (i.e., pushing for the alternative, non-specific language rather than the specific language on payday lending). There are some nuances that we need to think through, which we are doing. For example, some proposals to banks have included specific bans doing business with debt relief companies, foreclosure rescue companies, and credit repair companies, and finding alternative, non-specific language presents unique challenges.

Mike

Such blanket prohibitions on entire industries are wholly inconsistent with the Department's repeated assertion it is merely pursuing fraudsters, and has "no interest" in discouraging lawful conduct.[29]

Operation Choke Point is having its desired effect –legitimate merchants in legal industries are being choked-off from the financial system. In a statement to the House Committee on Financial Services, a trade group of licensed money service businesses and lenders submitted recent account termination letters in which the bank explicitly attributed the termination to Operation Choke Point.[30] A sample of these letters includes:

- **Bank of America**: "[W]e reviewed the nature of your business in light of current regulatory trends affecting your industry. After careful consideration we've decided to close your existing Small Business checking account . . . ." (January 14, 2014)

- **Bank of Hawaii**: "Bank of Hawaii has made a business decision to close your above-referenced business deposit accounts. The primary reason for this account closure is the Bank's increasing business expenses involved with servicing this type of account for a customer that operates as a money service business and/or payday lender." (December 6, 2013).

- **Hancock Bank | Whitney Bank**: "We are unable to effectively manage your Account(s) on a level consistent with the heightened scrutiny required by our regulators for money service businesses due to the transactional characteristics of your business." (February 26, 2014)

- **Fifth Third Bank**: "During recent reviews of the payday lending industry, we have determined that the services provided by clients in this industry are outside of our risk

[29] *See supra* note 22.
[30] Statement of the Financial Service Centers of America to the U.S. House of Representatives Committee on Financial Services, Regarding the Impact of Recent Regulatory Supervisory and Enforcement Actions on Consumer Financial Services, Exhibit "A" (April 8, 2014).

> tolerance. As such, we will no longer be able to provide financial services to businesses that operate in that industry." (March 18, 2014)

Documents produced to the Committee demonstrate that this reaction is the precise goal of Operation Choke Point. The *Six-Month Status Report* on Operation Choke Point, prepared for Assistant Attorney General Delery on September 9, 2013, notes:

> Many of the banks that have received our FIRREA subpoenas have reported extensive relationships with Internet payday lenders, via payment processors. Several banks have informed us that, as a result of our subpoenas, they have taken a deeper look at these Internet payday lenders and their business practices. Finding substantial questions concerning the legality of the Internet payday lending business models and the loans underlying debits to consumers' bank accounts, **many banks have decided to stop processing transactions in support of Internet payday lenders. We consider this to be a significant accomplishment and positive change for consumers** . . . .[31] [emphasis added]
>
> . . .
>
> **Although we recognize the possibility that banks may have therefore decided to stop doing business with legitimate lenders, we do not believe that such decisions should alter our investigative plans.** Solving that problem – if it exists – should be left to legitimate lenders themselves who can, through their own dealings with banks, present sufficient information to the banks to convince them that their business model and lending operations are wholly legitimate.[32] [emphasis added]

Such an expectation – "if they are legitimate, they can prove it" – is patently absurd, and reminiscent of the formulation that "if one is *not* a witch, then they will sink rather than float." Furthermore, given that the Department has ordered banks to cease doing business with all short-term lenders in its settlement negotiations, no amount of evidence of legitimacy will be "sufficient" to secure a banking relationship.[33]

b. <u>Banks are Terminating Relationships with Legal Industries, Often Leaving Businesses with No Recourse</u>

Operation Choke Point threatens countless legal businesses well outside of consumer finance. The Department's radical reinterpretation of its authority under FIRREA, in conjunction with recent policy announcements by bank examiners, is compelling banks to terminate longstanding lending and depository relationships with a wide array of lawful businesses and individuals. In 2012, the Federal Deposit Insurance Corporation issued revised guidance for FDIC-supervised institutions concerning their relationships with payment processors.[34] The guidance identified a variety of businesses who pose "elevated . . . legal,

[31] HOGR-3PPP000333.
[32] HOGR-3PPP000335.
[33] *Id.*
[34] Federal Deposit Insurance Corporation, Financial Institution Letter, FIL-3-2012, Jan. 31, 2012.

reputational, and compliance risks" to depository institutions.[35] According to the FDIC, these businesses include:

> . . . credit repair companies, debt consolidation and forgiveness programs, online-gambling related operations, government grant or will-writing kits, payday or subprime loans, pornography, online tobacco or firearms sales, pharmaceutical sales, sweepstakes, and magazine subscriptions.[36]

An earlier announcement posted to the FDIC website provided an even more expansive list of "high-risk activity."[37]

> Some merchant categories that have been associated with high-risk activity include, but are not limited to:
>
> - Ammunition Sales
> - Cable Box De-scramblers
> - Coin Dealers
> - Credit Card Schemes
> - Credit Repair Services
> - Dating Services
> - Debt Consolidation Scams
> - Drug Paraphernalia
> - Escort Services
> - Firearms Sales
> - Fireworks Sales
> - Get Rich Products
> - Government Grants
> - Home-Based Charities
> - Life-Time Guarantees
> - Life-Time Memberships
> - Lottery Sales
> - Mailing Lists/Personal Info
> - Money Transfer Networks
> - On-line Gambling
> - PayDay Loans
> - Pharmaceutical Sales
> - Ponzi Schemes
> - Pornography
> - Pyramid-Type Sales
> - Racist Materials
> - Surveillance Equipment
> - Telemarketing
> - Tobacco Sales
> - Travel Clubs

As with the formal guidance, FDIC provided no explanation or warrant for the designation of particular merchants as "high-risk." Furthermore, there is no explanation for the implicit equation of legitimate activities such as *coin dealers* and *firearm sales* with such patently illegal or offensive activities as Ponzi schemes, racist materials, and drug paraphernalia.

Operation Choke Point rendered the FDIC's policy announcements extremely significant. The initiative is predicated on a radical reinterpretation of FIRREA – that merely providing normal banking services to certain merchants creates a "reputational risk" that is an actionable violation under Section 951.[38] As a consequence of this reformulation, Operation Choke Point effectively transformed the FDIC guidance into an implicit threat of a federal investigation. Suddenly, doing business with a "high-risk" merchant is sufficient to trigger a subpoena by the

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[35] *Id.* at 1.
[36] *Id.*
[37] Federal Deposit Insurance Corporation, Supervisory Insights, *Managing Risk in Third-Party Payment Processor Relationships* (Summer 2011).
[38] *See supra* text accompanying note 17.

Department of Justice. Banks are put in an unenviable position: discontinue longstanding, profitable relationships with fully licensed and legal businesses, or face a potentially ruinous lawsuit by the Department of Justice.

Documents produced to the Committee demonstrate that the Department was counting on this reaction. The initial internal proposal for Operation Choke Point argued that banks would be "sensitive" to the risk of a federal investigation, and could be expected to "scrutinize immediately" their relationships.[39] Recent news reports have detailed the consequences of this scrutiny. A May 18, 2014 article in *The Washington Times* describes how a number of firearms merchants – a category identified as "high risk" by the government – abruptly had their bank accounts frozen or terminated.[40] One such example is particularly telling:

> T.R. Liberti, owner and operator of Top Gun Firearms Training and Supply in Miami, has felt the sting firsthand. Last month, his local bank, BankUnited N.A., dumped his online business from its service.
>
> An explanatory email from the bank said: "This letter in no way reflects any derogatory reasons for such action on your behalf. But rather one of industry. Unfortunately your company's line of business is not commensurate with the industries we work with."[41]

The FDIC's policy statements on firearm and ammunition sales carry additional weight in light of FDIC's active involvement in Operation Choke Point. Documents produced to the Committee indicate that in April 2013, the head of the Compliance and Enforcement Group of FDIC's Division of Depositor and Consumer Protection reached out to the Department to discuss "potential investigative approaches" with respect to banks and payment processing.[42] Later, the FDIC volunteered two attorneys to assist in the Department's investigations.[43] The FDIC's close coordination with the Department was well-reported, and likely contributed to the banks' understanding that the FDIC policy statements carried with them the threat of a federal investigation.[44]

On May 7, 2014, the Department of Justice offered the following statement on Operation Choke Point: "Of course, we recognize that most of the businesses that use the banking system are not fraudsters. We're committed to ensuring that our efforts to combat fraud do not discourage or inhibit the lawful conduct of these honest merchants."[45] The experience of firearms and ammunition merchants – an industry far

[39] HOGR-3PPP000018.
[40] Kelly Riddell, *'High risk' label from feds puts gun sellers in banks' crosshairs, hurts business*, WASH.TIMES, May 18, 2014.
[41] *Id.*
[42] HOGR-3PPP000051.
[43] HOGR-3PPP000168.
[44] Alan Zibel and Brent Kendall, Probe *Turns Up Heat on Banks: Prosecutors Target Firms That Process Payments for Online Payday Lenders, Others*, WALL ST. J., Aug. 7, 2013.
[45] Posting of the Civil Division's Consumer Protection Branch to The Justice Blog, http://blogs.justice.gov/main/archives/3651 (May 7, 2014).

removed from consumer finance fraud – calls into question the sincerity of the Department's statements.

IV. <u>Frustration of Congressional Oversight</u>

The immediate and serious impact of Operation Choke Point prompted intense Congressional scrutiny. On August 22, 2013, Representative Blaine Luetkemeyer and thirty Members of Congress wrote a letter to Attorney General Holder and FDIC Chairman Gruenberg. Citing a recent article in the *Wall Street Journal*, the Members expressed concern that the Department's actions amounted to an effort to "choke off short-term lenders."[46] In its response of September 12, 2013, the Department expressly challenged the fundamental premise of Representative Luetkemeyer's letter – that Operation Choke Point was focused on online lending: "[t]he Department's efforts in this regard are not targeted at any one of these scams; rather, we are targeting fraud and unlawful practices in all of them."[47] Expressing a desire to "clarify an apparent misunderstanding," the Department accused the authors of misinterpreting the contents of the *Wall Street Journal* article.

Documents produced to the Committee demonstrate the accuracy of the Representative Luetkemeyer's interpretation, and call into question the sincerity of the Department's response. As an initial matter, the internal memoranda and status reports described above show that payday lenders, and online lenders in particular, were a primary target of Operation Choke Point. More damning, however, is that senior Department officials had <u>precisely the same</u> understanding of the *Wall Street Journal* article as did Representative Luetkemeyer. In a series of emails from August 6, 2013, senior officials in the Civil Division discussed the Department's cooperation with the *Wall Street Journal* reporter. The Director of the Consumer Protection Branch summarized the initial inquiry as follows:

> This is connected to our third party payment processing initiative, in which we have been starting to pay closer attention to banks and processors who deal with payday lenders**. My view is that getting the message out that DOJ is interested in on-line payday lenders and the potential abuses is important.**[48] [emphasis added]

The Deputy Assistant Attorney General for Consumer Protection further described the Department's cooperation with the *Wall Street Journal* inquiry:

> We want to give you a heads up that [the Director of the Consumer Protection Branch] is doing a background interview this afternoon at 4pm **on online pay day lending. As we described for you at last week's meeting, we are engaged in a third-party payment processor initiative in which we are looking into banks that deal with processors who work for payday lenders of all types.**[49]

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[46] Letter from Rep. Blaine Luetkemeyer, et al., to Attorney General Eric H. Holder, Jr. (August 22, 2013).
[47] Letter from Peter J. Kadzik, Principal Deputy Assistant Attorney General, Office of Legislative Affairs, Dep't of Justice, to Rep. Blaine Luetkemeyer (Sept. 12, 2014).
[48] HOGR-3PPP000307.
[49] HOGR-3PPP000308.

It is entirely unacceptable for the Department to formally accuse Members of Congress of "misunderstanding" the focus of a major Department initiative, when senior officials in charge of that initiative shared precisely the same understanding.

Nonetheless, such obfuscation was repeated at a Congressional staff briefing on September 20, 2013. In response to questions concerning the targets of Operation Choke Point, the Deputy Assistant Attorney General for Consumer Protection repeatedly stated that the target of Operation Choke Point was mass-market consumer fraud and that the Department was not singling out any particular industry.[50] Furthermore, the Deputy Assistant Attorney General refused to provide basic information unrelated to specific investigations, such as the level of return rate sufficient to trigger an investigation, or the identity of the individual to whom the Attorney General had delegated his Section 951 subpoena authority.

Documents produced to the Committee provide context for the nature of the Department's response to Congressional oversight. In a November 21, 2013 memorandum on Operation Choke Point addressed to the Office of the Attorney General, the Office of the Deputy Attorney General, and the Office of the Associate Attorney General, senior officials in the Civil Division indicated their belief that Congressional oversight of this matter was being "directed and funded primarily by the owner of a particular payment processor presently under investigation."[51] Such an accusation is both offensive and irresponsible, and reflects negatively on the Department's response to Congressional oversight of a major Department initiative.

V. <u>**Conclusion**</u>

Forceful prosecution of those who defraud American consumers is both responsible and admirable. However, Department of Justice initiatives to combat mass-market consumer fraud must be legitimate exercises of the Department's legal authorities, and must be executed in a manner that does not unfairly harm legitimate merchants and individuals.

Operation Choke Point fails both these requirements. The Department's radical reinterpretation of what constitutes an actionable violation under § 951 of FIRREA fundamentally distorts Congress' intent in enacting the law, and inappropriately demands that *bankers* act as the moral arbiters and policemen of the commercial world. In light of the Department's obligation to act within the bounds of the law, and its avowed commitment not to "discourage or inhibit" the lawful conduct of honest merchants, it is necessary to disavow and dismantle Operation Choke Point.

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[50] Congressional Staff Briefing with the Deputy Assistant Attorney General for Consumer Protection, Civil Div., U.S. Dep't of Justice, on Sept. 20, 2013.
[51] HOGR-3PPP000501.

EXHIBIT 7

No. 14-953-TNM

U.S. House of Representatives

Committee on Oversight and Government Reform

Darrell Issa (CA-49), Chairman

Jim Jordan (OH-04), Chairman, Subcommittee on Economic Growth, Job Creation and Regulatory Affairs

Federal Deposit Insurance Corporation's Involvement in "Operation Choke Point"

Staff Report
113th Congress

December 8, 2014

Key Findings

- The Federal Deposit Insurance Corporation, the primary federal regulator of over 4,500 banks, targeted legal industries. FDIC equated legitimate and regulated activities such as *coin dealers* and *firearms and ammunition sales* with inherently pernicious or patently illegal activities such as Ponzi schemes, debt consolidation scams, and drug paraphernalia.

- FDIC achieved this via “circular argument” policymaking: there was no articulated justification or rationale for the original list of “high-risk merchants.” Yet a list of “potentially illegal activities” included in FDIC’s formal guidance to banks justified itself by claiming that the categories had been previously “noted by the FDIC.”

- FDIC’s explicitly intended its list of “high-risk merchants” to influence banks’ business decisions. FDIC policymakers debated ways to ensure that bank officials saw the list and “get the message.”

- Documents produced to the Committee reveal that senior FDIC policymakers oppose payday lending on personal grounds, and attempted to use FDIC’s supervisory authority to prohibit the practice. Personal animus towards payday lending is apparent throughout the documents produced to the Committee. Emails reveal that FDIC’s senior-most bank examiners “literally cannot stand payday,” and effectively ordered banks to terminate all relationships with the industry.

- In a particularly egregious example, a senior official in the Division of Depositor and Consumer Protection insisted that FDIC Chairman Martin Gruenberg’s letters to Congress and talking points always mention *pornography* when discussing payday lenders and other industries, in an effort to convey a “good picture regarding the unsavory nature of the businesses at issue.”

- FDIC actively partnered with Department of Justice to implement Operation Choke Point, and may have misled Congress about this partnership.

I. Background on Operation Choke Point

Over the past year, the Committee on Oversight and Government Reform has been investigating a federal initiative forcing banks to terminate relationships with businesses deemed "high-risk" by federal regulators. Within the Department of Justice, this initiative is known as "Operation Choke Point." Pursuant to a January 8, 2014 request by Chairman Issa and Subcommittee Chairman Jordan, the Justice Department produced 853 pages of internal memoranda, communications, and presentations on Operation Choke Point.[1] On May 29, 2014, the Committee released a staff report on the preliminary findings of its investigation.[2] The report offered three primary conclusions:

1. Operation Choke Point is an abuse of the Department's statutory authority.

2. While broadly concerned with all industries deemed "high risk," the initiative is particularly focused on payday lending.

3. As a consequence of Operation Choke Point, banks are indiscriminately terminating relationships with legal and legitimate merchants across a variety of business lines.

This final conclusion is incontrovertible: documents produced by the Justice Department reveal that senior DOJ officials directly informed the Attorney General that as a result of Operation Choke Point, banks are "exiting 'high-risk' lines of business."[3]

Documents produced to the Committee reveal that DOJ actively partnered with the Federal Deposit Insurance Corporation in the prosecution of Operation Choke Point. FDIC is the primary federal regulator of state-chartered banks that are not members of the Federal Reserve System, and directly supervises and examines more than 4,500 depository institutions.[4] FDIC's participation in Operation Choke Point included requests for information about the investigation, discussions of legal theories and the application of banking laws, and the review of documents involving FDIC-supervised institutions obtained by DOJ in the course of its investigation.[5] Furthermore, FDIC originated the list of "high risk" industries included in the DOJ subpoenas.[6]

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[1] Letter from Darrell Issa, Chairman, H. Comm. on Oversight and Gov't Reform, and Jim Jordan, Chairman, Subcomm. on Economic Growth, Job Creation and Regulatory Affairs of the H. Comm. on Oversight and Gov't Reform, to Eric H. Holder, Jr., Att'y Gen., U.S. Dep't of Justice, Jan. 8, 2014; STAFF OF THE H. COMM. ON OVERSIGHT AND GOV'T REFORM, 113TH CONG., REPORT ON THE DEPARTMENT OF JUSTICE'S "OPERATION CHOKE POINT": ILLEGALLY CHOKING OFF LEGITIMATE BUSINESSES? (May 29, 2014).
[2] *Id.*
[3] E-mail from the Chief of Staff, Civil Division, U.S. Dep't of Justice, to the Assistant Attorney General, Civil Division, U.S. Dep't of Justice (Nov. 18, 2013, 20:51) (containing briefing points on Operation Choke Point for the Attorney General), HOGR-3PPP000458.
[4] Federal Deposit Insurance Corporation, Who is the FDIC?, *available at* https://www.fdic.gov/about/learn/symbol/.
[5] *The Department of Justice's "Operation Choke Point": Hearing before Subcomm. on Oversight and Investigations of the H. Comm. on Fin. Services*, 113th Cong. (July 15, 2013) (written statement of Richard J. Osterman, Jr., Acting General Counsel, Federal Deposit Insurance Corporation).
[6] *Guilty Until Proven Innocent? A Study of the Propriety & Legal Authority for the Justice Department's Operation Choke Point: Hearing before the H. Comm. On the Judiciary*, 113th Cong. (Jul. 17, 2014) (statement of Stuart F. Delery, Assistant Att'y Gen., Civil Division, U.S. Dep't of Justice, in response to a question from Rep. Darrell Issa).

In a letter to FDIC Chairman Martin J. Gruenberg on June 9, 2014, Chairman Issa and Subcommittee Chairman Jordan requested documents and communications concerning FDIC's role in Operation Choke Point and its supervisory policies with respect to "high risk" merchants. FDIC cooperated with the Chairmen's request, providing over 7,500 pages of internal communications, memoranda, and official correspondence with supervised institutions. The documents implicate deep failures in FDIC supervisory and examination policy, the consequence of which has been to foreclose bank access to legal and legitimate merchants.

II. <u>**FDIC's Delineation of "High Risk Merchants"**</u>

FDIC publishes *Supervisory Insights,* a quarterly journal intended to serve as informal and educational guidance for both FDIC examiners and private sector stakeholders.[7] The summer 2011 issue of *Supervisory Insights* included the article "Managing Risks in Third-Party Payment Processor Relationships."[8] The ostensible purpose of the article is to advise financial institutions on how to adequately monitor and manage the risks associated with payment processors and their merchant clients. The article argues that "[a]lthough many clients of payment processors are reputable merchants, an increasing number are not and should be considered 'high risk.' These disreputable merchants use payment processors for questionable or fraudulent goods and services."[9] The article identified the following industries as "high-risk":[10]

Some merchant categories that have been associated with high-risk activity include, but are not limited to:

- Ammunition Sales
- Cable Box De-scramblers
- Coin Dealers
- Credit Card Schemes
- Credit Repair Services
- Dating Services
- Debt Consolidation Scams
- Drug Paraphernalia
- Escort Services
- Firearms Sales
- Fireworks Sales
- Get Rich Products
- Government Grants
- Home-Based Charities
- Life-Time Guarantees
- Life-Time Memberships
- Lottery Sales
- Mailing Lists/Personal Info
- Money Transfer Networks
- On-line Gambling
- PayDay Loans
- Pharmaceutical Sales
- Ponzi Schemes
- Pornography
- Pyramid-Type Sales
- Racist Materials
- Surveillance Equipment
- Telemarketing
- Tobacco Sales
- Travel Clubs

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[7] *See, e.g.,* E-mail from FDIC Deputy Regional Director to FDIC officials (Apr. 17, 2011, 09:37) ("Step one is the article for the Supervisory Insights Journal which goes out to bankers and examiners"), FDICHOGR00002582.
[8] Michael Benardo, Chief, Cyber-Fraud and Financial Crimes Section, Div. of Risk Management Supervision, Federal Deposit Insurance Corporation, et al., *Managing Risks in Third-Party Payment Processor Relationships*, 8 SUPERVISORY INSIGHTS 3 (Summer 2011).
[9] *Id.* at 6.
[10] *Id.* at 7.

While the article provided no explanation for the inclusion of any single identified merchant category, it did offer four criteria associated with high-risk activity: 1) the consumer's lack of familiarity with the merchant, 2) uncertainty with respect to the quality of goods and services being offered, 3) online or telephonic sales, and 4) the consumer's ability to verify the identity or legitimacy of the merchant.[11] However, these vague standards provide no explanation for the implicit equation of such legitimate and regulated activities as *coin dealers* and *firearms and ammunition sales* with inherently pernicious or patently illegal activities such as Ponzi schemes, racist materials, or drug paraphernalia.

Documents produced to the Committee record the months-long internal deliberations and multi-tiered review of the *Supervisory Insights* article. Unfortunately, these documents reflect the total absence of a critical review of the high-risk merchant list. Preliminary drafts of the article were subject to an intensive agency-wide review process.[12] No official in FDIC's Division of Depositor and Consumer Protection, Division of Risk Management Supervision, the Legal Division, or the Office of the Chairman inquired into or commented on the list or on the inclusion of any particular merchant category. Similarly, no documents record or reference the agency's reasoning in creating the list. The lack of such a record raises the possibility it is little more than a haphazard and idiosyncratic reflection of the authors' personal opinions.

Furthermore, documents produced to the Committee reveal that FDIC officials explicitly intended the list to influence the FDIC examination process. In one email exchange, senior officials at FDIC headquarters request that an Assistant Regional Director join as a co-author of the article, in an effort to ensure that the list "gets attention by both [Risk Management] and [Depositor and Consumer Protection] examiners."[13] Offering feedback on the article, one Regional Office explicitly focused on how the high-risk merchant list would influence the examination process: "we believe the articles will assist examiners and others in understanding the broad risk considerations that are present **in these business lines** and will help focus more detailed analysis during examinations."[14] [emphasis added]

Following publication of the *Supervisory Insights* article, FDIC staff began the process of formalizing its prescripts into an official guidance document, known as a Financial Institution Letter (FIL).[15] FILs are understood by supervised institutions to be the formal policy of the FDIC, and are interpreted by bank compliance and legal officers as tantamount to compulsory

[11] *Id.* at 6.
[12] The author circulated the first draft in March 2011. *See* E-mail from Chief, Cyber-Fraud and Financial Crimes Section, Division of Risk Management Supervision, to Managing Editor, *Supervisory Insights*, Division of Risk Management Supervision (Mar. 30, 2011, 22:45), FDICHOGR00002079. FDIC published the summer 2011 issue of *Supervisory Insights* on July 14, 2011.
[13] E-mail from Chief, Cyber-Fraud and Financial Crimes Section, Division of Risk Management Supervision, to an Assistant Regional Director, Division of Depositor and Consumer Protection (Apr. 5, 2011, 15:33), FDICHOGR00002011.
[14] E-mail from Charlotte Territory Supervisor, on behalf of Atlanta Regional Director Thomas Dujenksi, to the Managing Editor of *Supervisory Insights* at FDIC headquarters (May 8, 2011, 21:06), FDICHOGR00002644.
[15] E-mail from FDIC Deputy Regional Director to FDIC officials (Apr. 17, 2011, 09:37) ("Step one is the article for the Supervisory Insights Journal . . . . Step two is a Financial Institution Letter which should be east to prepare now that the article is draft."), FDICHOGR00002582.

rules.[16] The earliest drafts of the FIL did not contain an enumerated list of high-risk merchants: an early draft from June 2011 does not specify any particular industry for heightened scrutiny.[17] However, by September 2011, a footnote appears on page 4: "Businesses with elevated risk may include offshore companies, online gambling-related operations, and online payday lenders. Other businesses with elevated risks include credit repair schemes, debt consolidation and forgiveness, pharmaceutical sales, telemarketing entities, and online sale of tobacco products."[18]

In November 2011, FDIC staff briefed then-Acting Chairman Gruenberg on the proposed FIL.[19] Documents produced to the Committee reveal that the Acting Chairman himself explicitly instructed FDIC staff to expand and emphasize the list of targeted industries.[20]

From: Benardo, Michael B.
Sent: Thursday, December 22, 2011 11:20 AM
To: Valdez, Victor J.
Cc: Jackson, Michael L.; Butler, Janice; Weatherby, Kathryn M.; Sawin, April D.
Subject: RE: TPPP FIL Meeting with Chairman

Better late than never...

Final Revised TPPP FIL (2011) ...

Here is the FIL with the language added to address the comments made by the Acting Chairman at his briefing. A footnote has been added to the first page of the guidance. It includes a list of the types of high risk merchants we are talking about.

DCP has approved this version to go forward to the 6th floor to see if this addresses the comments made.

Please let me know if you have any questions.

Thank you,

Mike

Further communications reveal the extraordinary significance that Chairman Gruenberg and FDIC staff attached to the high-risk merchants list. One official attempted the extremely unusual step of including the list on the FIL's *cover page*, in an effort to "grab some attention."[21] The

[16] Federal Deposit Insurance Corporation, Financial Institution Letters, *available at* https://www.fdic.gov/news/news/financial/.
[17] June 2011 draft of Financial Institution Letter concerning Payment Processor Relationships, FDICHOGR00002128.
[18] September 2011 draft of Financial Institution Letter concerning Payment Processor Relationships, FDICHOGR00002033.
[19] E-mail from a Senior Examination Specialist, Div. of Depositor and Consumer Protection, to the Chief, Cyber-Fraud and Financial Crimes Section, Div. of Risk Management Supervision, FDICHOGR00002173.
[20] E-mail from Chief, Cyber-Fraud and Financial Crimes Section, Div. of Risk Management Supervision, to the Deputy Director, Div. of Risk Management Supervision, FDICHOGR00002183.
[21] E-mail from a Senior Examination Specialist, Div. of Depositor and Consumer Protection, to the Chief, Cyber-Fraud and Financial Crimes Section, Div. of Risk Management Supervision, FDICHOGR00002173.

official even expressed concern about "putting anything later in the document as the reader **may not get the message**."[22] [emphasis added]

From: Bowman, John B.
Sent: Tuesday, November 15, 2011 9:46 AM
To: Benardo, Michael B.
Subject: TPPP FIL

Hi Mike:

I edited the FIL based on the recommendations from yesterday's briefing. I toyed with the idea of including a footnote on the first page but as you can see it moves things to the second page. So, I'm not so sure this is a workable solution. I also included a footnote on the second page, which is still upfront and should grab some attention. I'm just concerned with putting anything later in the document as the reader may not get the message. In any event, this is a starting point. Let me know what you think. Thanks.

<< File: Final Revised TPPP FIL (11-15-2011).doc >>

Regards,

John B. Bowman
Review Examiner - Washington Office

Following the Chairman's orders to explicitly include and emphasize the list of high-risk merchants, a December 2011 draft of the FIL included the following footnote on page 1:

> Example of telemarketing and online merchants that have displayed a higher incidence of consumer fraud or potentially illegal activities noted by the FDIC include: credit repair services, gambling, government grant or will writing kits, pay day or sub-prime loans, pornography, tobacco or firearm sales, sweepstakes, and magazine subscriptions. This list is not all-inclusive. The risks presented by each relationship must be measured according to its own facts and circumstances. While some of these activities might be legitimate, financial institutions should be aware of the increased risks associated with payments to such merchants.[23]

The circularity of the FDIC's policymaking is immediately apparent. As noted above, FDIC had no articulated rationale for including the "high risk" merchants list in the *Supervisory Insights* article.[24] Yet the FIL's footnote of "potentially illegal activities" justifies itself by claiming that the categories had been previously "noted by the FDIC."[25]

While the targeting of any legal industries is in and of itself pernicious, the qualifying language in the December 2011 draft demonstrates a modicum of restraint, and recognizes that the listed merchant categories are not inherently illegal or fraudulent. Unfortunately, the final draft of the FIL flatly rejected such restraint. The final release approved by Chairman Gruenberg stripped the language advising banks to manage each relationship "according to its own facts and circumstances," as well as the language

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[22] *Id.*
[23] Dec. 2011 draft of Financial Institution Letter concerning Payment Processor Relationships, FDICHOGR00002185.
[24] *See* text accompanying *supra* note 12.
[25] *See supra* note 23.

recognizing that merchants in the named categories may be legitimate.[26] Such a revision calls into question FDIC's assertions that it is merely advising banks to adopt reasonable "know your customer" due diligence standards, and lends credence to the argument that it is effectively proscribing the enumerated activities.

It is difficult to understate the significance and impact of the high-risk merchant list. In addition to influencing both regulators' examination policy and banks' private business decisions, the list was often directly incorporated into FDIC-mandated Memorandums of Understanding (MOUs) and Consent Orders as "prohibited businesses."[27] The experience of one entry on the list – firearms and ammunitions merchants – effectively traces the downstream influence of the high-risk merchants list. MOUs between supervised banks and FDIC Regional Offices, as well as bank policies submitted pursuant to FDIC Consent Orders, variously "prohibit" payment processing for firearms merchants, characterize loans to firearms dealers as "undesirable," and generally subject firearms and ammunitions merchants to significantly higher due diligence standards.[28]

The inclusion of firearm merchants on the high-risk list did not just impact the behavior of FDIC supervisory and enforcement staff. A number of private companies create and sell compliance and risk management training software for bank employees; at least two companies, AML Services International and MSB Compliance, directly incorporated the FDIC list into its designation of high-risk merchant and originator categories.[29] One training package offered by FIS Global educates and tests bank compliance officers for "Types of Higher Risk Individuals and Non-Individuals." The program includes the following entry:[30]

> **Arms and Ammunition Dealers**
>
> Arms and Ammunition Dealers are identified as higher risk businesses because they have a higher risk of being associated with terrorism and terrorist acts.

Such spurious claims are an inherent product of the list's opacity; in both the *Supervisory Insights* article and the Financial Institution Letter, FDIC did not justify or explain why it believes relationships with firearms and ammunition merchants present a "high risk" to supervised financial institutions.

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[26] Jan. 31, 2011 final draft of Financial Institution Letter concerning Payment Processor Relationships, FDICHOGR00002413.

[27] *See, e.g.*, Letter from unnamed bank to Thomas Dujenksi, Regional Director, Federal Deposit Insurance Corporation, Aug. 1, 2013 (concerning terms of a §§ 15(a) and 15(b) Consent Order, revising the bank's ACH policy to prohibit certain businesses; name of bank redacted by FDIC), FDICHOGR00004062.

[28] FDICHOGR00004097; FDICHOGR00004101; FDICHOGR00004092; FDICHOGR00004190.

[29] AML Services International Webinar, FDICHOGR00004147; MSB Compliance presentation, FDICHOGR00004167.

[30] FIS Global, AML and Sanctions, Types of Higher Risk Individuals and Non Individuals (on file with Committee staff).

III. **FDIC Targeted Legal Industries**

a. Officials in FDIC Headquarters were Determined to Eliminate Payday Lending

Documents produced to the Committee reveal that senior policymakers in FDIC headquarters oppose payday lending on personal grounds, and attempted to use FDIC's supervisory authority to prohibit the practice. In emails from February 2013, the Director of FDIC's Atlanta Region noted he was "pleased we are getting banks out of ach (payday, bad practices, etc). Another bank is gripping [*sic*] . . . but we are doing good things for them!"[31] Mark Pearce, the Director of FDIC's Division of Depositor and Consumer Protection, expressed agreement with the sentiment, and noted concern over "failure to be proactive" on the issue.[32]

From: Pearce, Mark (DCP)
Sent: Thursday, February 07, 2013 9:00 PM
To: Dujenski, Thomas J.
Subject: RE:

Glad we're on the same page. As you note, failure to be proactive on this will lead to enforcement agencies or reputational issues, which is not in best interest of our institutions.

Mark Pearce
Director, Division of Depositor and Consumer Protection Federal Deposit Insurance Corporation
[redacted]

-----Original Message-----
From: Dujenski, Thomas J.
Sent: Thursday, February 07, 2013 5:57 PM
To: Pearce, Mark (DCP)
Subject:

I am pleased we are getting the banks out of ach (payday, bad practices, etc). Another bank is gripping .... but we are doing good things for them! For example, the Redacted bank is going to hate doj being involved. We are doing the right thing for sure....one or two banks may complain next week when the florida banks come to dc as a group.

Additional documents confirm Director Pearce's opposition to payday lending, and determination to deploy FDIC's supervisory power to prohibit or discourage the practice. In an email dated February 22, 2013, a Senior Counsel in the Legal Division's Consumer Enforcement Unit informed an Assistant General Counsel there is top-level interest in stopping payday lending. The email describes how Director Pearce is interested "in **trying to find a way to stop our banks from facilitating payday lending**."[33] [emphasis added] The Senior Counsel even describes concern with this approach, noting that other officials cautioned that "…unless we can

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[31] Email from Thomas J. Dujenski, Atlanta Regional Director, Federal Deposit Insurance Corporation, to Mark Pearce, Director, Division of Depositor and Consumer Protection, Federal Deposit Insurance Corporation (Feb. 7, 2013 21:00), FDICHOGR00006898.
[32] Email from Mark Pearce, Director, Division of Depositor and Consumer Protection, Federal Deposit Insurance Corporation to Thomas J. Dujenski, Atlanta Regional Director, Federal Deposit Insurance Corporation (Feb. 7, 2013 21:00), FDICHOGR00006898.
[33] Email from Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, FDIC to James L. Anderson, Assistant General Counsel, Consumer Section, Consumer, Enforcement/Employment, Insurance & Legislation Branch, FDIC (Feb. 22, 2013 11:13), FDICHOGR00006907.

show fraud or other misconduct by the payday lenders, we will not be able to hold the bank responsible."[34]

From: Sagatelian, Marguerite
Sent: Friday, February 22, 2013 11:13 AM
To: Anderson, James L.
Subject: Bay Cities

I just got off a lengthy conference call with Dianne and Pat (as well as Greg and John Bowman, the review examiner) regarding Redacted Dianne is concerned that we are putting a lot of resources into this case and that, unless we can show fraud or other misconduct by the payday lenders, we will not be able to hold the bank responsible. After much discussion, we agreed to: (1) complete our review of bank emails; (2) review the risk management exam report and draft consent order regarding BSA violations; and (3) find out more about the US Attorney's investigation (that office obtained copies of the bank's emails right after we did). Once that is done, we will reevaluate our game plan. We have to let Dianne know next week the timetable for completing the email review.

During the course of the discussion, I mentioned our meeting with Mark and his interest in trying to find a way to stop our banks from facilitating payday lending.

Let me know if you have any questions.

On March 8, 2013, the Senior Counsel wrote two FDIC attorneys within the Legal Division and asked about ways the FDIC could "get at payday lending."[35] The email explains that Consumer Enforcement Unit received a request from Division of Consumer and Depositor Protection to look into "what avenues are available to the FDIC to take action against banks that facilitate payday lending":

From: Sagatelian, Marguerite
Sent: Friday, March 08, 2013 9:32 AM
To: [redacted].; [redacted]
Subject: Payday Lending

[redacted] and [redacted]

I've received an inquiry from DCP about where we stand regarding our research into what avenues are available to the FDIC to take action against banks that facilitate payday lending. I have the memo you did a while back. Has that memo been updated? I know that after we met with Mark, you were going to explore the BSA/Know Your Customer requirements to see if that would provide the FDIC with the means to get at payday lending (either by the bank's direct customer or through a third party payment processor).

Please let me know where things stand and send me any updated memo you have completed.

Thanks,
Marguerite

Marguerite Sagatelian
FDIC
Senior Counsel Consumer Enforcement Unit

[34] *Id.*
[35] Email from Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, Federal Deposit Insurance Corporation, to two Counsel in Legal Division, Federal Deposit Insurance Corporation (Mar. 8, 2013 09:32), FDICHOGR00006907.

This blanket call to target an entire industry is chilling: no reference is made to either safety and soundness or consumer protection. Accordingly, such actions are entirely outside of FDIC's mandate.[36] The Senior Counsel goes on to explain how the information requested would be included in talking points for Chairman Gruenberg as to how banks facilitate payday lending and why the FDIC is concerned:

From: [redacted]
Sent: Friday, March 08, 2013 2:53 PM
To: Sagatelian, Marguerite; [redacted]
Subject: RE: Payday Lending

Will do.

A note that both Joel Sweet (of DOJ) and Mike Benardo emphasized: although payday lending is a particularly ugly practice, it is only one of the TPPP problems out there. And as we have noted, Redacted *may* be one of them, where the non-bank part of the equation was misusing payroll taxes and apparently was quite well known in the lower echelons.

From: Sagatelian, Marguerite
Sent: Friday, March 08, 2013 10:49 AM
To: [redacted]; [redacted]
Subject: RE: Payday Lending

Thank you, both. What has prompted today's inquiry is that the Chairman is meeting with some bankers next week, and DCP wants to give the Chairman some "talking points" as to how banks facilitate payday lending and why the FDIC is concerned. I think your supplemental memo addresses that point. We have a few TPPP cases right now, two of which are with [redacted] and [redacted]. Please make sure that you coordinate your efforts with [redacted] and [redacted] so that we develop a consistent approach regarding TPPPs. Thanks.

An attorney within the Legal Division describes the very existence of payday lending as "a particularly ugly practice" in response to the Senior Counsel's email.[37]

Personal animus towards payday lending is apparent throughout documents produced to the Committee. In one egregious example, the DCP's Deputy Director for Policy & Research insisted that Chairman Gruenberg's letters to Congress and talking points always mention *pornography* when discussing payday lending, in an effort to convey a "good picture regarding the unsavory nature of the businesses at issue."[38] The email, sent by a Counsel in the Legal Division, outlines a meeting that occurred with the Deputy Director:

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[36] Federal Deposit Insurance Corporation, FDIC Mission, Vision, and Values, *available at* https://www.fdic.gov/about/mission/.
[37] Email from a Counsel, Legal Division, Federal Deposit Insurance Corporation to Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, Federal Deposit Insurance Corporation (Mar. 8, 2013 14:53), FDICHOGR00005178.
[38] Email from a Counsel, Legal Division, FDIC, to Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, FDIC (Aug. 28, 2013 9:32), FDICHOGR00007424.

From: [redacted]
Sent: Wednesday, August 28, 2013 9:32 AM
To: Sagatelian, Marguerite
Cc: [redacted]; [redacted]
Subject: Pornography

FYI:

I just got a call from Jonathan Miller regarding why we kept taking pornography out of their write up.

I explained that we felt there was a difference between on-line gambling and payday lending (which are illegal in some states) and pornography (which may be immoral, but which is not per se illegal). I noted that we didn't want to seem like we as a regulator were making moral judgments regarding the types of businesses with which our institutions deal. Rather, we wanted to make it clear that were making rational safety and soundness decisions by discouraging our institutions from engaging in or facilitating illegal transactions.

Jonathan heard where we were coming from, but nonetheless wants to retain a reference to pornography in our letters / talking points. He thinks it's important for Congress to get a good picture regarding the unsavory nature of the businesses at issue. He repeated that "one is judged by the friends one keeps," and he seems to feel strongly that including payday lenders in the same circle as pornographers and on-line gambling businesses will ultimately help with the messaging on this issue.

If you feel that there is legal argument beyond the one I made, and would like us to push back on this issue, please let me know.

[redacted]

[redacted] Counsel
Federal Deposit Insurance Corporation
Legal Division, Consumer Enforcement Unit

It appears senior officials recognized the inherent impropriety of FDIC's policy. In an email to DCP Director Mark Pearce, the FDIC spokesman described the basis for congressional oversight of the issue.[39] The spokesman noted that "[s]ome of the pushback from the Hill is that it is not up to the FDIC decide what is moral and immoral, but rather what type of lending is legal":

[39] Email from David Barr, Assistant Director, Office of Public Affairs, FDIC to Mark Pearce, Director, Division of Depositor and Consumer Protection, FDIC (Sep. 13, 2013 10:38), FDICHOGR00005240.

From:	Barr, David
Sent:	Friday, September 13, 2013 10:38 AM
To:	Pearce, Mark (DCP); Brueger, Kathleen S.; Spitler, Eric J.; Miller, Rae-Ann; Watkins, James C.
Cc:	Gray, Andrew; French, George; Plunkett, Sylvia H.; Eberley, Doreen R.; Miller, Jonathan N. (DCP); Brown, Luke H.
Subject:	RE: 3rd Party Payment Providers

I got a bit more background from Joe on this piece. They are looking at the on-line lending issue as a whole. Part of it will focus on regulators forcing banks out of relationships with payment processors who work with these on-line lenders. Joe bass heard second and third hand information that a senior FDIC official has called on-line lending immoral, according to a banker who heard it from an examiner. Some of the pushback from The Hill is that it is not up to the FDIC decide what is moral and immoral, but rather what type of lending is legal. The GOP is saying that the FDIC doesn't like on-line lending and is forcing banks to end their relationships with payment providers. This is hurting even the good "apples" out there. They agree that some of the on-line lenders are not good, but our widespread decision to force banks out of the business is cutting off credit to those that need it, and forcing even the good lenders to exit the business. Joe has also heard that there was a recent Hill briefing on this and we have denied that we are forcing banks to end these relationships. It's the same thing we said a couple of years ago when it was the brick-and-mortar payday lenders that we denied forcing out of banking relationships. Now it's on-line lenders.

--db

The spokesman continues by stating that the FDIC has denied that they are forcing banks to end relationships with payday lenders.[40] Documents obtained by the Committee prove this statement is false. As late as March 2013, FDIC officials were "**looking into avenues by which the FDIC can potentially prevent our banks from facilitating payday lending**."[41] [emphasis added] Ultimately, senior officials at FDIC headquarters were successful in choking-out payday lenders' access to the banking system. As of June 2014, over 80 banks have terminated business relationships with payday lenders as a result of FDIC targeting.[42]

b. <u>FDIC Field-level Examiners Ordered Banks to Cease Relationships With Payday Lenders</u>

While formal policy is formulated in the agency's Washington and Arlington headquarters, FDIC's supervisory and examination responsibilities are executed by the Regional Offices, and the agency conducts much of its business at the regional and field-office level.[43] There is evidence FDIC headquarters lacks effective institutional control over its examination staff. In fact, documents produced to the Committee confirm that senior officials are aware that FDIC examiners are injecting personal value judgments into the examination process.[44] In an email to DCP Director Mark Pearce concerning agency policy with respect to payday lending, a DCP Deputy Director observes, "I may have to confront the **issue of overzealous examiners**

[40] *Id*.
[41] Email from Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, Legal Division, Federal Deposit Insurance Corporation to Surge Sen, Section Chief, Division of Consumer and Depositor Protection, Federal Deposit Insurance Corporation (Mar. 8, 2013 11:15), FDICHOGR00006052.
[42] Victoria McGrane, *Regulators Seek Dismissal of 'Choke Point' Lawsuit*, WALL ST. J., Aug. 19, 2014.
[43] Federal Deposit Insurance Corporation, Who is the FDIC?, *available at* https://www.fdic.gov/about/learn/symbol/
[44] Email from Deputy Director, Division of Depositor and Consumer Protection, Federal Deposit Insurance Corporation to the Director, Division of Depositor and Consumer Protection, Federal Deposit Insurance Corporation (Sep. 5, 2013 18:13), FDICHOGR00005133.

(immoral issue). I would do so by making clear that it is not fdic [*sic*] policy to pass moral judgment on specific products."[45] [emphasis added]

Documents produced to the Committee justify these concerns: internal emails reveal that FDIC examiners were actively engaging in measures to prohibit or discourage relationships with payday lenders. In response to request for guidance on payday lending from the president of an unnamed bank, an FDIC Field Supervisor in the Atlanta Region wrote, "Even under the best circumstances, if this venture is undertaken with the proper controls and strategies to try to mitigate risks, since your institution will be linked to an organization providing payday services, your reputation could suffer."[46]

> As I stated earlier, the arrangement will receive close regulatory scrutiny from the FDIC and State Banking Department. In-depth BSA and IT reviews of this relationship will also take place. Even under the best circumstances, if this venture is undertaken with the proper controls and strategies to try to mitigate risks, since your institution will be linked to an organization providing payday services, your reputation could suffer.
>
> If the Board plans to go forward with this venture, please reduce your plans to writing by submitting a letter to the FDIC's Regional Director (Thomas J. Dujenski) and the Superintendent of Banks for the State of Alabama (John Harrison) outlining your proposal.

This communication is particularly troubling, as the Field Supervisor candidly acknowledges that *no amount* of monitoring, controls, and risk-mitigation will be sufficient for FDIC.[47]

In a far more glaring abuse of the examination process, a senior FDIC official effectively ordered a bank to terminate all relationships with payday lenders. On February 15, 2013, the Director of the Chicago Region wrote to a bank's Board of Directors and informed them the FDIC has found "that activities related to payday lending are unacceptable for an insured depository institution."[48]

> The focus of our visitation was on the risk associated with this relationship, compliance with consumer protection laws and regulations, and the effectiveness of Board and senior management due diligence and oversight of this relationship and the corresponding payday lending-related activities. It is our view that payday loans are costly, and offer limited utility for consumers, as compared to traditional loan products. Furthermore, the Reda relationship carries a high degree of risk to the institution, including third-party, reputational, compliance, and legal risk, which may expose the bank to individual and class actions by borrowers and local regulatory authorities. Consequently, we have generally found that activities related to payday lending are unacceptable for an insured depository institution.

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[45] *Id.*

[46] Email from Field Supervisor, Atlanta Region, Federal Deposit Insurance Corporation to unnamed bank (Mar. 6, 2014 09:43) (bank name redacted by FDIC), FDICHOGR00004249.

[47] *Id.*

[48] Letter from M. Anthony Lowe, Regional Director, Chicago Regional Office, FDIC to Members of the Board of Directors, unnamed bank (Feb. 15, 2013) (bank name redacted by FDIC), FDICICR0085.

Mr. Lowe is the Director of one of FDIC's six regional offices. His statements – particularly those in official communications to supervised institutions, under his signature – are understood by banks within the region to be FDIC's formal supervisory policy.

There is evidence examiners' campaign against payday lending even extended to threats. At a hearing before the Subcommittee on Regulatory Reform, Commercial and Antitrust Law of the House Judiciary Committee, Chairman Bob Goodlatte revealed that senior FDIC regulators went as far as threatening a banker with an immediate audit unless the bank severed all relationships with payday lenders. Chairman Goodlatte explained in his opening statement:

> For example, the committee obtained a jarring account of a meeting between a senior FDIC regulator and a banker contemplating serving a payday lending client. The official told the banker, "I don't like this product, and I don't believe it has any place in our financial system. Your decision to move forward will result in an immediate unplanned audit of your entire bank."[49]

Communications between the senior-most officials at FDIC provide critical context for the agency's documented actions with respect to payday lending. One email from Atlanta Regional Director Thomas Dujenski to DCP Director Mark Pearce, with the subject line "Confidential," is revealing:[50]

-----Original Message-----
From: Dujenski, Thomas J.
Sent: Monday, November 26, 2012 4:47 PM
To: Pearce, Mark (DCP)
Subject: Confidential

I have never said this to you (but I am sincerely passionate about this)...but I literally can not stand pay day lending. They are abusive, fundamentally wrong, hurt people, and do not deserve to be in any way associated with banking. I had extensive involvement with this group of lenders and was instrumental in drafting guidance on stopping abuses.

I really hope this bank we discussed truly gets out of this on their own as they are indicating.....I hope my persuasion skills are still effective :). I feel strongly we will do good things here!!!!

Sent from my BlackBerry Wireless Handheld

[49] *Guilty Until Proven Innocent? A Study of the Propriety & Legal Authority for the Justice Department's Operation Choke Point: Hearing before the H. Comm. On the Judiciary*, 113th Cong. (Jul. 17, 2014) (Oversight Committee staff have learned from a whistleblower that the remarks are attributed to Jim LaPierre, Regional Director of the Kansas City Region).

[50] E-mail from Thomas J. Dujenski, Regional Director, Atlanta Region, Federal Deposit Insurance Corporation, to Mark Pearce, Director, Division of Consumer Protection, Federal Deposit Insurance Corporation (Nov. 27, 2012, 20:40:05), FDICHOGR00006585.

Director Pearce responded with apparent agreement:

To: Dujenski, Thomas J.[TDujenski@FDIC.gov]
From: Pearce, Mark (DCP)
Sent: Tue 11/27/2012 8:40:05 PM
Subject: RE: Confidential

I remember!!

Thanks for the briefing today.

Mark Pearce
Director, Division of Depositor and Consumer Protection
Federal Deposit Insurance Corporation
(202) 898-7088

Notwithstanding the emotional intensity of their beliefs, it is entirely unacceptable for senior FDIC officials to inject personal moral judgments into the bank examination process. Writing in *USA Today*, Glenn Reynolds expressed concern with the unforeseen consequences of allowing the federal regulators to pressure banks to shut down the accounts of legal industries: "while abortion clinics and environmental groups are probably safe under the Obama Administration, if this sort of thing stands, they will be vulnerable to the same tactics if a different administration adopts this same thuggish approach toward the businesses that it dislikes."[51] It is entirely possible to conceive of an equally zealous Regional Director writing an email similar to Mr. Dujenski's, yet replacing "pay day lending" with "abortion providers."

IV. <u>**FDIC Actively Partnered With the Department of Justice to Implement "Operation Choke Point"**</u>

A primary concern for the Committee is FDIC's cooperation with the Department of Justice on Operation Choke Point. As described in the staff report of May 29, 2014, the Committee has serious concerns with the Department's motivations, legal theories, and investigative approach.[52] In their June 9, 2014 letter to FDIC Chairman Gruenberg, Chairman Issa and Subcommittee Chairman Jordan cited internal DOJ memoranda describing FDIC's participation in the initiative. For example, DOJ's initial proposal for Operation Choke Point described FDIC as a "partner agency" in the initiative.[53] A later memorandum describes how FDIC even went as far as to volunteer two of its attorneys for the program.[54]

Documents produced to the Committee by FDIC reveal the intensity of their collaboration with DOJ. Through March, April, and May 2013, senior officials within FDIC and

[51] Glenn Harlan Reynolds, *Justice Department shuts down porn money: Column*, USA TODAY, May 26, 2014.
[52] STAFF OF THE H. COMM. ON OVERSIGHT AND GOV'T REFORM, 113TH CONG., REPORT ON THE DEPARTMENT OF JUSTICE'S "OPERATION CHOKE POINT": ILLEGALLY CHOKING OFF LEGITIMATE BUSINESSES? (May 29, 2014).
[53] Memorandum from an Assistant United States Attorney, Eastern District of Pennsylvania, to the Acting Assistant Attorney General for the Civil Division, U.S. Dep't of Justice (Nov. 5, 2013), HOGR-3PPP00019.
[54] Memorandum from the Director of Consumer Protection Branch to the Acting Assistant Attorney General for the Civil Division, U.S. Dep't of Justice (July 8, 2013), HOGR3PPP000167.

DOJ held numerous meetings on how to combine efforts.[55] Officials such as Michael Bresnick, Executive Director of the President's Financial Fraud Enforcement Task Force and Joel Sweet, the DOJ Trial Attorney who initially proposed Operation Choke Point, frequently consulted with FDIC attorneys and senior officials. An FDIC Counsel within the Legal Division even went as far as to suggest a detail to DOJ as a Special Assistant United States Attorney.[56] A fundamental purpose of this collaboration was to jointly formulate legal investigative theories.[57]

The FDIC Legal Division's operational practices further reflect joint ownership of the program. In summer 2013, an FDIC attorney instructed staff to create a "matter" – an official file within FDIC's Advanced Legal Information System – specifically named "Operation Chokepoint."[58] This file allowed FDIC attorneys to review documents received in response to DOJ's subpoenas. Furthermore, DOJ began allowing two FDIC attorneys direct access to a confidential Justice Department system database named "Operation Choke Point."[59] Over the next several months, FDIC attorneys utilized this database to directly participate in the program.

The agencies' collaboration was so intense, in fact, that DOJ attached FDIC's list of "high-risk" merchants to the back of the subpoenas served upon banks and payment processors.[60] During a hearing before the Subcommittee on Regulatory Reform, Commercial and Antitrust law of the House Judiciary Committee, Representative Issa entered into the record one such subpoena provided by a whistleblower. The subpoena was identical to many of those that were served on over fifty financial institutions. In response to questions from Members of the Subcommittee, Assistant Attorney General Stuart Delery confirmed that DOJ stapled the FDIC guidance to the subpoenas issued under his signature.[61]

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[55] E-mail from a Counsel, Legal Division, Consumer Enforcement Unit, Federal Deposit Insurance Corporation, to Joel Sweet, Trial Attorney, Consumer Protection Branch, U.S. Dep't of Justice (Mar. 11, 2013 13:50), FDICHOGR00000724; E-mail from a Counsel, Legal Division, Consumer Enforcement Unit, Federal Deposit Insurance Corporation, to Joel Sweet, Trial Attorney, Consumer Protection Branch, U.S. Dep't of Justice (Apr. 23, 2013 12:15), FDICHOGR00000974; E-mail from a Counsel, Legal Division, Consumer Enforcement Unit, FDIC to Joel Sweet, Trial Attorney, Consumer Protection Branch, DOJ (May 20, 2013 10:26), FDICHOGR00001021.
[56] E-mail from a Counsel, Legal Division, Consumer Enforcement Unit, Federal Deposit Insurance Corporation to Joel Sweet, Trial Attorney, Consumer Protection Branch, U.S. Dep't of Justice (Apr. 29, 2013 13:12), FDICHOGR00000071; E-mail from Joel Sweet, Trial Attorney, Consumer Protection Branch, U.S. Dep't of Justice to Counsels, Legal Division, Consumer Enforcement Unit, Federal Deposit Insurance Corporation, and Michael Bresnick, Executive Director, Financial Fraud Enforcement Task Force (May 20, 2013 16:23), FDICHOGR00001029.
[57] E-mail from a Counsel, Consumer Enforcement Unit, Legal Division, Federal Deposit Insurance Corporation to Joel Sweet, Trial Attorney, Consumer Protection Branch, U.S. Dep't of Justice (Apr. 26, 2013 08:47), FDICHOGR00000980.
[58] E-mail from a Counsel, Consumer Enforcement Unit, Legal Division, Federal Deposit Insurance Corporation to staff within the Legal Division, Federal Deposit Insurance Corporation, (Jun. 27, 2013, 16:58), FDICHOGR00003533.
[59] E-mail from a Counsel, Consumer Enforcement Unit, Legal Division, Federal Deposit Insurance Corporation to official in Charles Dunn, Civil Division, U.S. Dep't of Justice (Jul. 31, 2013 16:51), FDICHOGR00001062.
[60] Memorandum from the Director of Consumer Protection Branch, Civil Division, U.S. Dep't of Justice, to the Acting Assistant Attorney General, Civil Division, U.S. Dep't of Justice (July 8, 2013), HOGR3PPP000167.
[61] *Guilty Until Proven Innocent? A Study of the Propriety & Legal Authority for the Justice Department's Operation Choke Point: Hearing before the H. Comm. On the Judiciary*, 113th Cong. (Jul. 17, 2014).

The inclusion of the FDIC guidance in DOJ's subpoenas effectively "weaponized" the high-risk merchants list. The implication was clear: banks were compelled to remove those clients from their portfolios, or risk a federal investigation by the Department of Justice. Tellingly, one FDIC counsel even described Operation Choke Point as "our DOJ/Spike Lee Joint."[62] Although meant facetiously, such phrasing inherently reflects the agencies' joint sense of ownership of the program.

V. **<u>FDIC Response to Congressional Oversight</u>**

Congressional oversight of FDIC's involvement in Operation Choke Point began in August 2013. Following an initial report on the program in the *Wall Street Journal*, Representative Blaine Luetkemeyer and thirty Members of Congress wrote to FDIC Chairman Gruenberg, expressing serious concern with FDIC's supervisory policies.[63] In a September 17, 2013 response, Chairman Gruenberg reaffirmed the list of "high-risk" merchants, and asserted that FDIC's focus is "the proper management of the banks' relationships with their customers, particularly those engaged in higher risk activities, and not underlying activities that are permissible under state and federal law."[64]

On April 7, 2014, FDIC's Acting General Counsel, Richard J. Osterman, testified at a House Financial Services Committee hearing on federal financial regulatory policy. Over the course of the hearing, Mr. Osterman repeatedly disclaimed any substantive involvement by the FDIC with Operation Choke Point. However, as evidenced in Chairman Issa and Subcommittee Chairman Jordan's letter to FDIC Chairman Gruenberg on June 9, 2014, internal DOJ documents produced to the Committee directly contradict Mr. Osterman's testimony.[65] Internal FDIC documents produced to the Committee provide further evidence of close collaboration between the two agencies and joint ownership of the initiative.[66]

On July 15, 2014, Mr. Osterman testified at a hearing before the Subcommittee on Oversight and Investigations of the House Financial Services Committee.[67] In light of the evidence presented in Chairman Issa and Subcommittee Chairman Jordan's letter of June 9th, Mr. Osterman revised his earlier testimony to the Financial Services Committee.[68] His written statement candidly concedes that FDIC staff closely cooperated in the prosecution of Operation Choke Point:

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[62] E-mail from Counsel, Consumer Enforcement Unit, Legal Division, to staff within the Legal Division, Consumer Section (Jul. 23, 2013, 16:02), FDICHOGR00003557.
[63] Letter from Rep. Blaine Luetkemeyer, et al., to Eric H. Holder, Jr., Att'y Gen., U.S. Dep't of Justice, and Martin J. Gruenberg, Chairman, Federal Deposit Insurance Commission, Aug. 22, 2013.
[64] Letter from Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation, to Rep. Blaine Luetkemeyer, Sept. 17, 2013.
[65] Letter from Darrell Issa, Chairman, H. Comm. on Oversight and Gov't Reform, and Jim Jordan, Chairman, Subcomm. on Economic Growth, Job Creation and Regulatory Affairs of the H. Comm. on Oversight and Gov't Reform, to Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation, June 9, 2014.
[66] See *supra* Section IV.
[67] *The Department of Justice's "Operation Choke Point": Hearing before Subcomm. on Oversight and Investigations of the H. Comm. On Fin. Services*, 113th Cong. (July 15, 2013).
[68] *Id.* (written statement of Richard J. Osterman, Jr., Acting General Counsel, Federal Deposit Insurance Corporation).

> Accordingly, FDIC staff communicated and cooperated with DOJ staff involved in Operation Choke Point based on an interest in DOJ's investigation into potential illegal activity that may involve FDIC-supervised institutions. FDIC attorneys' communication and cooperation with DOJ included requests for information about the investigation, discussions of legal theories and the application of banking laws, and the review of documents involving FDIC-supervised institutions obtained by DOJ in the course of its investigation.[69]

Unfortunately, there remain serious questions as to the truthfulness of Mr. Osterman's July 15th testimony. Specifically, Mr. Osterman repeatedly denied that FDIC singles out any particular merchant or business line for inappropriate scrutiny. At the conclusion of his opening statement, Mr. Osterman noted:

> [O]ur supervisory approach focuses on assessing whether financial institutions are adequately overseeing activities and transactions they process, and appropriately managing and mitigating risks. We're not focused on particular businesses.
>
> Each bank must decide the persons and entities with which it wants to have a customer or business relationship. Financial institutions that properly manage customer relationships, and effectively mitigate risks, are neither prohibited, nor discouraged, from providing payment-processor services to customers, regardless of the customers' business models, provided they're operating in compliance with applicable laws.[70]

Mr. Osterman maintained this assertion while replying to questions from Members of the Financial Services Committee. In response to a question from Representative Luetkemeyer, Mr. Osterman stated:

> Congressman Luetkemeyer, what we've done is we've tried to be very clear in putting out our guidance to say very publicly and clearly that as long as banks have appropriate risk-mitigation measures in place, we're not going to prohibit or discourage them from doing business with anyone who they want to do business with.[71]

As noted in Section III of this report, documents produced to Committee unequivocally demonstrate that FDIC officials did attempt to "prohibit or discourage" banks from serving particular merchants and business lines.[72] Furthermore, these efforts were prosecuted by both field-level examiners and policymakers in FDIC headquarters, including Mr. Osterman's own subordinates in the Legal Division.[73] It is possible FDIC may have intended to convey that it did not *currently* target specific industries, even if that had been its past policy. The Committee is

[69] *Id.*
[70] *Id.* (opening statement of Richard J. Osterman, Jr., Acting General Counsel, Federal Deposit Insurance Corporation).
[71] *Id.* (statement of Richard J. Osterman, Jr., Acting General Counsel, Federal Deposit Insurance Corporation in response to a question from Rep. Blaine Luetkemeyer).
[72] See *supra* Section III.
[73] *Id.*

hopeful that Mr. Osterman did not intentionally and evasively couch his language in the present tense, in a grammatical end-run around his personal and legal obligation to be fully candid in congressional testimony.[74]

Notwithstanding these concerns, the Committee recognizes FDIC's cooperation with Chairman Issa and Subcommittee Chairman Jordan's document request. Furthermore, FDIC does appear to be taking incremental steps to end the indiscriminate termination of whole industries by FDIC-supervised banks. On July 28, 2014, FDIC issued Financial Institution Letter 41-2014, "Clarifying Supervisory Approach to Institutions Establishing Account Relationships with Third-Party Payment Processors."[75] This FIL candidly acknowledges that lists of high-risk merchant categories "have led to misunderstandings regarding FDIC's supervisory approach to TPPPs, creating the misperception that the listed examples of merchant categories were prohibited or discouraged."[76] Accordingly, FDIC officially retracted the summer 2011 *Supervisory Insights* article and FIL-3-2012, and reissued them without the offending lists.[77] While this is a positive and important step, the implementation of this policy remains a critical concern for future congressional oversight. As FDIC has candidly acknowledged, agency policy is only effective to the degree it is reiterated to the Regional Offices and faithfully executed by field examiners.[78]

VI. **Conclusion**

The practical impact of Operation Choke Point is incontrovertible: legal and legitimate businesses are being choked off from the financial system. Confidential briefing documents produced to the Committee reveal that senior DOJ officials informed the Attorney General himself that, as a consequence of Operation Choke Point, banks are "exiting" lines of business deemed "high-risk" by federal regulators.[79]

The experience of firearms and ammunitions dealers – one of the most heavily regulated businesses in the United States – is a testament to the destructive and unacceptable impact of Operation Choke Point. TomKat Ammunition, a small business selling ammunition in the state of Maryland, holds a Type 06 Federal Firearms License from the Bureau of Alcohol, Tobacco, Firearms and Explosives, two Maryland State Licenses for Manufacturing and Dealing in Explosives, and a local business license.[80] Notwithstanding the extraordinary complexity of this regulatory regime, over the past year TomKat Ammunition has been systemically denied access to the financial system. One bank refused to provide payment processing services due to their

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[74] 18 U.S.C § 1001.
[75] Federal Deposit Insurance Corporation, Financial Institution Letter, FIL-41-2014, July 28, 2014.
[76] *Id.*
[77] *Id.*
[78] *See, e.g.,* Letter from Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation, to Rep. Blaine Luetkemeyer, Sept. 17, 2013 (". . . . we have reiterated to our Regional Directors, who will in turn communicate to our field examiners, that communications with banks in relationships with merchants engaged in higher-risk activities must be consistent with FDIC policy.").
[79] E-mail from the Chief of Staff, Civil Division, U.S. Dep't of Justice, to the Assistant Attorney General, Civil Division, U.S. Dep't of Justice (Nov. 18, 2013, 20:51) (containing briefing points on Operation Choke Point for the Attorney General), HOGR-3PPP000458.
[80] Letter from Kat O'Connor, TomKat Ammunition, LLC, to U.S. Consumer Coalition, *available at* http://usconsumers.org/wp-content/uploads/2014/10/TomKat-letter.pdf.

"industry." A large online payment processor informed TomKat that they "could not offer that service due to [their] line of work." Another credit card processor stated it would no longer allow businesses to process gun or ammunition purchases.

Media accounts record similar experiences. In South Carolina, Inman Gun and Pawn's longstanding checking accounts were terminated after the company was deemed a "prohibited business type."[81] In Wisconsin, Hawkins Guns LLC opened an account at a local credit union. The credit union terminated the account the very next day, informing the company that "they do not service companies that deal in guns."[82] In all three of these cases, the financial institutions and payment processors made no reference to the merchants' creditworthiness, individual risk profile, or due diligence findings. The sole basis for the terminations is their participation in an industry deemed "high risk" by federal regulators.

Recognizing the irreparable harm to legal and legitimate industries, even fellow regulators have taken the extraordinary step of criticizing the impacts of Operation Choke Point. In a major speech at a joint conference of the American Bar Association and the American Bankers Association on November 10, 2014, David Cohen, the Under Secretary for Terrorism and Financial Intelligence at the Treasury Department, warned of the dangers of "de-risking."[83] Mr. Cohen explained that de-risking occurs when a financial institution terminates or restricts business relationships simply to avoid perceived regulatory risk, rather than in response to an assessment of the actual risk of illicit activity.[84] The Under Secretary went as far as to characterize de-risking as "the antithesis of an appropriate risk-based approach," warning that the practice can "undermine financial inclusion, financial transparency and financial activity, with associated political, regulatory, economic and social consequences."[85]

At a minimum, Operation Choke Point is little more than government-mandated de-risking. FDIC, in cooperation with the Justice Department, made sure banks understood – or in their own language, "got the message" – that maintaining relationships with certain disfavored business lines would incur enormous regulatory risk.[86] The effect of this policy has been to deny countless legal and legitimate merchants access to the financial system and deprive them of their very ability to exist. Accordingly, Operation Choke Point violates the most fundamental principles of the rule of law and accountable, transparent government.

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[81] Jennifer Phillips, *Gun, pawn shop owner says bank targeted business*, FOX CAROLINA, Aug. 6, 2014.
[82] Donovan Slack, *Duffy to target financial regulators in new post*, THE POST-CRESCENT, Nov. 21, 2014.
[83] David S. Cohen, Under Secretary for Terrorism and Financial Intelligence, U.S. Dep't of the Treasury, Remarks at the ABA/ABA Money Laundering Enforcement Conference: Effectively Combating Money Laundering and Terrorist Financing (Nov. 10, 2014).
[84] *Id.*
[85] *Id.*
[86] *See supra* note 22.

EXHIBIT 8

No. 14-953-TNM

Communications from Supervised Financial Institutions related to payday lenders made to the FDIC's Office of the Ombudsman after the release of FIL-5-2015

OutreachID	Division	RecordDate	Nature	OutreachType	Satisfied with FDIC	Issue	State	Narrative
2015-02331	RMS	20-Jul-15	Unfair	Financial Institution Executive	Y	Exam PRIOR/GEN (Risk Management)	[redacted]	Bank believes it was a victim of operation choke-point. [redacted] The business line the bank was forced to terminate (backroom servicing for a payday lender) by the FDIC has since been moved to an OCC regulated bank. The OCC apparently has no objection to such activities. The banker is adamant that FDIC supervised banks are not on a level playing field with OCC banks.
2015-03156	RMS	28-Sep-15	Inefficient Operations	Financial Institution Executive	Y	Regulatory Process - Other	[redacted]	[redacted]
2016-00255	FDIC	28-Jan-16	N/A	Financial Institution Executive	Y	Banking Environment	[redacted]	[redacted]
2016-00273	DCP	01-Feb-16	Unfair	Financial Institution Executive	N	Exam PRIOR/GEN (Compliance)	[redacted]	The banker stated they were a target of the Operation Chokepoint initiative. The banker stated they were forced to discontinue a lending relationship with a customer who owned a payday lender even though they did not give the customer money to operate the business. The banker believes when they initially declined DCP's request to discontinue doing business with the customer, DCP referred them to the Justice Department because of pricing discrepancies between their Hispanic and non-Hispanic borrowers. [redacted] The bank was rated a [redacted] by DCP and placed under a Consent Order. The banker believed the treatment was unfair.
2016-02478	DCP	18-Jul-16	Burdensome	Financial Institution Executive	Y	Dodd Frank Wall Street Reform and Consumer Protection Act	[redacted]	[redacted]
2016-03203	NONE	22-Sep-16	Burdensome	Financial Institution Executive	Y	Banking Environment	[redacted]	[redacted]
2017-01537	DCP	01-Jun-17	Unfair	Financial Institution Executive	Y	Exam PRIOR/GEN (Compliance)	[redacted]	[redacted]

EXHIBIT 9

No. 14-953-TNM

[redacted]

From: Dixon, Dianne E. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=DIDIXON]
Sent: 10/25/2012 8:29:36 AM
To: Bowman, John B. [JBowman@FDIC.gov]
Subject: Re: [redacted] Bank, [redacted] PayDay Lending Connection

Sounds good. Thanks

From: Bowman, John B.
Sent: Thursday, October 25, 2012 08:15 AM
To: Dixon, Dianne E.
Subject: RE: [redacted] Bank, [redacted] PayDay Lending Connection

Will do.

I think the CFPB's only involvement is looking at Payday lenders in general and they noticed an apparent affiliation/relationship with one of our institutions. If it is OK, I will invite Ardie Hollifield from Policy to the call as she is the one who has been in contact with the CFPB and brought it to my attention. She will have more background information. I am out tomorrow so I will schedule a call for Monday.

Regards,

John

From: Dixon, Dianne E.
Sent: Thursday, October 25, 2012 8:12 AM
To: Bowman, John B.
Subject: Re: [redacted] Bank, [redacted] - PayDay Lending Connection

OK I believe that Phyllis is the acting DRD. Would you set up a conference call with Phyllis, Sherry, the EIC, you and me for tomorrow? I'm out today, but if you are off tomorrow, then make it Monday. In the meantime, send me any information you have on the bank and why is the CFPB is involved. Thanks.

From: Bowman, John B.
Sent: Thursday, October 25, 2012 07:28 AM
To: Dixon, Dianne E.
Subject: RE: [redacted] Bank[redacted] - PayDay Lending Connection

Absolutely. I was thinking that we should let Phyllis and Sherry know and have them communicate with the EIC. I believe Mike Dean (DRD for Atlanta) is here in DC on a detail to RMS. I do not know who is assuming his duties while he is on detail.

From: Dixon, Dianne E.
Sent: Thursday, October 25, 2012 7:24 AM
To: Bowman, John B.
Subject: Re: [redacted] Bank, [redacted] - PayDay Lending Connection

Thanks, John. We do need to catch these issues early, but we probably should alert regional management, not just the EIC about the issue. This is the Atlanta region?

From: Bowman, John B.
Sent: Thursday, October 25, 2012 06:12 AM
To: Dixon, Dianne E.; Cashman, Patricia I.

Cc: Hollifield, Ardie
Subject: RE[redacted]Bank, [redacted] [redacted] - PayDay Lending Connection

Hi Dianne:

The potential issue here is that one of our financial institutions may be engaging in similar activities to what [redacted] was involved in with the [redacted] product. We have not received a consultation from the Region nor have we received any complaints (that I am aware of). Rather, Ardie's friend at the CFPB, who is working on payday lending issues, brought to her attention that one of our banks may be involved in payday lending. In talking with Ardie, I told her that I would check to see if we conducted a recent examination and whether this issue was investigated. That is when I discovered that we are in the bank now doing an examination. So, I thought it might be a good opportunity to have our examination team gather more information on the nature of the bank's involvement and relationship with these payday lenders. I was thinking that we would want to catch issues of this nature early on in the process like we did at [redacted]. I hope that helps. Please let me know if you have any questions.

Regards,

John

From: Dixon, Dianne E.
Sent: Wednesday, October 24, 2012 4:04 PM
To: Bowman, John B.; Cashman, Patricia I.
Cc: Hollifield, Ardie
Subject: RE: [redacted] Bank, [redacted] [redacted] - PayDay Lending Connection

John: Can you give me a bit more background about what the issue(s) is here? Do we have an open consultation from the RO on this bank? Was there a complaint filed that was referred to us? Why is this on our plate? Thanks.

From: Bowman, John B.
Sent: Wednesday, October 24, 2012 1:36 PM
To: Dixon, Dianne E.; Cashman, Patricia I.
Cc: Hollifield, Ardie
Subject: [redacted] Bank,[redacted] [redacted] - PayDay Lending Connection

Hi Dianne/Pat:

Earlier this afternoon I spoke with Ardie Hollifield of the Policy Section regarding the subject bank. Ardie's friend at the CFPB provided the below links to Payday lenders which appear to have a relationship with the subject, which may or may not be similar to the one between [redacted]. However, the details of the relationship are unclear. Luckily, we are currently conducting a compliance/CRA examination, which started on [redacted], 2012. [redacted].

Can we reach out to the Atlanta Region while [redacted] is still on-site to gather details about the nature of this relationship? This is probably an area that should be explored during the examination anyway given the third-party and reputation risks involved. Thank you!

[redacted] (payday lender) is with either [redacted] (the bank involved with [redacted]) or [redacted] Bank

[redacted]

US Money Card, offered by Check into Cash. The card is from [redacted] and [redacted] Bank

http://usmoneycard.com/why-usmoneycard.html

Regards,

John

EXHIBIT 10

No. 14-953-TNM

Alderson®

COURT REPORTING

Transcript of **Ardie Hollifield**

Friday, May 4, 2018

Advance America, et al. v. Federal Deposit Insurance Corporation, et al.

Alderson Court Reporting
1-800-FOR-DEPO (367-9976)
Info@AldersonReporting.com
www.AldersonReporting.com

Alderson Reference Number: 78090

A I don't recall.

Q Okay. Did you ever receive information from CFPB about an individual supervised financial institution providing service to a payday lender or otherwise doing business with a payday lender?

A I believe so, yes.

[redacted]

EXHIBIT 11

No. 14-953-TNM

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

From: Curry, Thomas
Sent: Monday, April 15, 2013 8:03 AM
To: Pfinsgraff, Martin
Cc: Gardineer, Grovetta; Kelly, Jennifer; [redacted]
Subject: FW:

Marty,
Please discuss and share [redacted] charts with Jennifer and Grovetta. We seem to have some banks involved. Grovetta also should alert the Fed and FDIC regarding their banks' involvement.
Thanks.
Tom

From: [redacted]
Sent: Friday, April 12, 2013 10:44 AM
To: Curry, Thomas; Pfinsgraff, Martin
Subject:

Tom and Marty,

Thanks for your time on Wednesday – I thought it was a good meeting.

As a follow up to our conversation, attached are two pages summarizing data for payday lenders. The first page summarizes the total volume of payday lending ACH transactions that each bank originates to [redacted] deposit customers, and the second page lists payday lenders (and the bank that originates their ACH transactions) with the highest return rates.

I'm happy to discuss this data with you in more detail if you'd like.

Talk to you soon,

[redacted]

This communication is for informational purposes only. [redacted]

EXHIBIT 12

No. 14-953-TNM

Mission Statement for
Consumer Protection Working Group of the
Financial Fraud Enforcement Task Force

Co-Chairs:

Andre Birotte, United States Attorney, CDCA
Tony West, Assistant Attorney General, Civil Division, DOJ
Richard Cordray, Nominee for Director, Consumer Financial Protection Bureau
David Vladeck, Director, Bureau of Consumer Protection, FTC
Lanny Breuer, Assistant Attorney General, Criminal Division, DOJ

Members:

EOUSA, FBI, OCC, USPIS, FDIC, FRB, FinCEN, Treasury, DOEd-OIG, USTP, IRS-CI, NAAG (AG Roy Cooper--NC) and Greg Zoeller--IN), NACHA, and [USSS, NCUA--waiting for confirmation]

Working Group's Purpose and Priorities:

The Consumer Protection Working Group will fill a void of financial fraud cases not currently addressed by the Task Force. Financial fraud targeting consumers can cause billions of dollars in losses, financially cripple some of our most vulnerable consumers, wreak havoc on our economy, and, in some instances, threaten the safety and soundness of financial institutions. In an effort to address this burgeoning problem, this new Working Group will examine a wide variety of areas where consumers may be vulnerable to fraud. Those may include: identity theft, third-party payment processors and other payment fraud, student-consumer fraud, cramming, business opportunity schemes, data privacy, payday lending, counterfeiting, and schemes targeting servicemembers and their families.

Proposed Activities:

Enhance civil and criminal enforcement of consumer fraud through increased information-sharing among law enforcement and member agencies (including use of FBI's LEO system, the FTC's Consumer Sentinel Network system, and others); training and coordination among state and federal law enforcement, including creation and dissemination of a "best practices" tool-kit for DOJ and state AG's offices; and identification of legislative, regulatory, and policy initiatives.

Prevent fraud through public outreach and education, including articles, blogs, webinars, conferences, and media engagement.

Plan and execute national operations targeting specific types of consumer fraud, similar to the Mortgage Fraud Working Group's current initiative focused on foreclosure rescue scams.

Memorandum

Subject	**OPERATION CHOKE POINT**: A proposal to reduce dramatically mass market consumer fraud within 180 days	Date	November 5, 2012
To	Stuart F. Delery Acting Assistant Attorney General Civil Division	From	Joel M. Sweet Assistant United States Attorney

OPERATION CHOKE POINT

I propose that I be detailed to the Consumer Protection Branch to implement a strategy to attack Internet, telemarketing, mail, and other mass market fraud against consumers, by choking fraudsters' access to the banking system. This objective can be achieved promptly and efficiently through a proven strategy of incremental enforcement, which will:

- achieve results within months;
- provide prospective protection to the most vulnerable of victims;
- efficiently use resources;
- attract multi-agency support and cooperation (already pledged);
- promote a culture of compliance among banks regarding Bank Secrecy Act/Anti-Money Laundering obligations;
- provide groundwork for civil and criminal prosecutions against banks, payment processors, and fraudsters; and
- recover FIRREA penalties.

This proposal will substantially further the goals of the Consumer Protection Working Group of the Financial Fraud Enforcement Task Force, which has prioritized addressing third-party payment processor involvement in consumer fraud.

The Problem

Fraudulent merchants are able to take money from their victims' bank accounts only if they have a relationship with a bank, and thus access to the nation's banking system. Banks are reluctant to establish direct relationships with such merchants due to significant legal, financial, and reputational risks. To overcome this obstacle, fraudulent merchants create *indirect* relationships with banks through third-party payment processors. In many cases, these processors are unlicensed, unregulated, and owned or controlled by the fraudulent merchants. By using processors as conduits to gain access to the banking system, fraudulent merchants can evade and frustrate statutes and regulations designed to require banks to know their clients, and to prevent their clients from using the banking system to further criminal activity.

Consumers continue to endure substantial harm from fraudulent merchants who can operate only through third-party payment processors. I learned while civilly and criminally prosecuting a payment processor and its bank, namely Payment Processing Center, LLC, and Wachovia, N.A., that a single bank servicing only a few processors can result in a staggering number of fraud-tainted transactions in a short period. In that case, Wachovia Bank originated transactions for four payment processors and caused $162 million in consumer losses in an 18-month period. We believe that the Wachovia prosecution caused many larger banks to closely evaluate third-party processor risk, and that much of the illegal conduct may have migrated to smaller banks. This is supported by my experience prosecuting First Bank of Delaware (a FIRREA action anticipated to be resolved within days), where a small bank in Philadelphia originated transactions for five third-party payment processors and facilitated more than $150 million in suspected consumer losses during a 12-month period.[1] While we do not know the number of banks involved in this activity, we know that mass market consumer fraud continues, and that most victim losses pass through a bank. Operation Choke Point will powerfully affect the entire banking industry and will further limit fraudsters' ability to access consumers' bank accounts.

The government's efforts to address third-party payment processor-related consumer fraud would benefit substantially from a vertical investigation model, as well as greater and more intensive coordination with other agencies engaged in the fight against consumer fraud. For example, presently the FTC focuses its attention primarily on fraudulent merchants and processors. The FTC's considerable efforts are hampered, however, by inadequate civil injunctive remedies and by creative defendants who rapidly change corporate identifies so that they can continue to prey upon consumers. Bank regulators have begun to address third-party payment processor risk. But a regulatory examination approach is not intended or designed to identify and address consumer fraud. DOJ has not targeted fraudulent merchants and processors criminally (I suspect due to challenges that I am available to discuss with you), and there have been few civil actions in this area. By extending our investigations to include the fraudulent merchant, the payment processor, and the bank, and by focusing our efforts on choking off the flow of money to the fraudulent merchants, we can overcome existing limitations.

The Solution

In a short time and with relatively few resources, we can disrupt fraud-tainted payment channels and protect consumers from future harm by identifying banks with problematic third-party payment processor relationships. Banks are sensitive to the risk of civil/criminal liability and regulatory action. Where we have evidence that a bank is processing payments for fraudulent merchants, we can communicate with the bank – for example, by sending a letter to a

---

[1] In addition to consumer fraud, third-party payment processors pose a Bank Secrecy Act/Anti-Money Laundering risk. I am aware of a bank that transferred hundreds of millions of dollars to and from the United States and foreign countries though accounts of suspicious third-payment payment processors.

senior bank executive inquiring whether the bank is aware of its merchants' return rates (a red flag of potential fraud), or by serving a FIRREA subpoena for data concerning a suspected processor or merchant. If prior experience is a guide, we can expect the bank to scrutinize immediately its relationships with third-party payment processors and fraudulent merchants and, if appropriate, to take necessary action (which may include restitution to victims). Legitimate banks will become aware of perhaps unrecognized risk, and corrupt banks will be exposed. This approach can yield almost immediate prospective protection of the public at an extremely low cost. If we find a bank or processor that knew, or turned a blind eye, toward fraudulent transactions, my experience could be brought to bear to initiate legal action.

Eliminating even one bank's fraud-tainted payment channel can prevent hundreds of fraudulent merchants from accessing the bank accounts of hundreds of thousands of consumers. Moreover, by approaching a bank at the outset of an investigation with an opportunity to self-evaluate processor relationships and to cooperate with the government, we can obtain evidence without relinquishing potential civil and criminal prosecution opportunities. Depending on the evidence, banks may be subject to civil FIRREA claims (for civil money penalties) and criminal Bank Secrecy Act and/or wire fraud charges. Third-party payment processors may be subject to the same, as well as criminal charges for bank fraud and/or operating an illegal money transmission business.[2]

As further described below, I propose that we identify and engage ten suspect banks within 150 days. This alone is likely to cause banks to scrutinize their account relationships and, if warranted, to terminate fraud-tainted processors and merchants. Assuming cooperation of USAOs and our other partners, in 180 days we can dramatically curtail consumer fraud across the nation by choking the fraudulent merchants' ability to access victims' bank accounts. Moreover, our efforts will positively sensitize the banking industry to third-party payment processor risks.

DOJ, through the Consumer Protection Branch, should take the lead in implementing this strategy. Partner agencies should include the FTC, FDIC, OCC, FinCEN (Treasury), Federal Reserve Banks, NAAG, CFPB, FBI, and USPIS -- all of which are members of the President's Financial Fraud Enforcement Task Force, most of which have been my partners in past efforts, and several of which already support this proposal. We can reasonably expect partner agencies to provide investigative resources to the effort. For example, the FBI already has offered staff to review SARS for references to third-party payment processors. FinCEN has an agent willing to set up and maintain a LEO database. The FTC already works closely with me and others to identify banks that are processing fraud-tainted transactions. Likewise, I am engaged in a

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[2] Disrupting payment relationships between banks and fraudulent merchants provides immediate benefits to the public, and captures evidence that can be used to prosecute cases. In some case, where a conventional approach is preferred, we might request that a bank keep particular accounts open for investigative purposes. While that option always will remain available, it is not part of the strategy I am proposing because of the substantial time and investment of agent resources required.

productive discussion with the Federal Reserve Bank (Atlanta) to identify banks originating transactions for suspected fraudulent merchants.

Execution Time Line

We can achieve our objectives within this time frame:

60 days Identify ten (10) target banks by analyzing return rate data, flow of money from victims' accounts to fraudster accounts, and SAR review; create a Law Enforcement On-line (FBI) database to map relationships among fraudulent merchants (beneficial owners and trade names), third-party payment processors, and banks (FinCEN).

120 days After identifying target banks, reach out to USAOs in the jurisdictions of the banks and offer training to promote and support investigations. Training to include overview of: (1) mass marketing fraud schemes and payment systems; (2) relevant civil and criminal statutes (Anti-Injunction Statute, 18 U.S.C. § 1345; FIRREA, 31 U.S.C. § 1833a; Operating an Illegal Money Transmission Business, 18 U.S.C. § 1960; etc.); (3) regulatory guidance; (4) available investigative resources; (5) templates for subpoenas, complaints, settlement agreements, etc.

150 days Engage banks identified as having problematic practices: (1) to request opportunity to discuss banks' relationships with processors and/or fraudulent merchants; (2) request voluntary production of documents; or (3) if appropriate, to serve FIRREA subpoenas. Provide banks with existing regulatory guidance on processors (FDIC, FinCEN, OCC).

180 days For the 10 target banks, based on investigative results, decide whether to negotiate a prospective compliance agreement, file a FIRREA complaint, open a GJ investigation, or close the file; assess status of prosecutions (civil/criminal) against third-party payment processors and fraudulent merchants.

Detail to the Consumer Branch

I propose that I be detailed to the Consumer Protection Branch to implement this strategy. The Consumer Protection Branch has existing expertise to address third-party payment processors, as well as the capability to attack these schemes with both civil and criminal tools. I have been working with the Consumer Protection Branch, in particular with Assistant Director Richard Goldberg, to advance the Department's efforts at attacking unscrupulous payment processors. The Consumer Protection Branch lacks, however, an available prosecutor with the necessary experience, knowledge, and professional relationships who can dedicate himself/herself full time to this intensive effort. Michael Blume, Director of the Consumer

Protection Branch, is supportive of the strategy described above, and of my detail to the Consumer Protection Branch for this purpose.

I am qualified and well-suited to lead this effort. During nine years as an AUSA, I have led successful civil and criminal prosecutions of third-party payment processors and banks, including: (1) United States v. First Bank of Delaware (anticipated to be filed within days in the E.D. Pa.) (FIRREA action anticipated to result in $15 million CMP); (2) United States v. Hellinger, et al., Criminal Action No. 11-0083 (E.D. Pa.) (successful criminal prosecution under 18 U.S.C. § 1960 of six owners of a payment processor); (3) United States v. $2,562,618 in U.S. Currency, Civil Action No. 09-1603 (E.D. Pa.) (forfeiture action against $2.7 million in Internet gambling proceeds retained by third-party payment processor); (4) United States v. Wachovia Bank, N.A., 10-20165 (S.D. Fla.) (BSA charge resolved with deferred prosecution agreement in conjunction with DOJ's Asset Forfeiture Money Laundering Section and another USAO); and (5) United States v. Payment Processing Center, Civil Action No. 06-0725 (E.D. Pa.) (anti-fraud injunction against third-party processor under 18 U.S.C. § 1345, leading to $160 million in victim restitution). See also Faloney v. Wachovia Bank, N.A., 254 F.R.D. 204, 216 (E.D. Pa. 2008) (district court decision crediting class action plaintiffs' success, in part, to evidence uncovered during "Assistant United States [Attorney] Sweet's dogged pursuit of PPC, Wachovia, and the telemarketing industry.")

Currently, my open matters include civil and criminal investigations of banks and processors. I confer regularly with government attorneys and agents on consumer fraud issues. Moreover, I have close working relationships with our partner agencies, including the FTC, FDIC, and FinCEN. I lecture several times each year at the Financial Crimes Seminar of the Federal Financial Institutions Examination Council, where state and federal bank examiners learn about consumer fraud and risks posed by third-party payment processors.

I am prepared to accept a detail to the Consumer Protection Branch to implement this strategy. I am available at your convenience to discuss this matter further.

cc: Gary Grindler, Chief of Staff to the Attorney General
Michael Bresnick, Executive Director, Financial Fraud Enforcement Task Force
Michael S. Blume, Director, Consumer Protection Branch

EXHIBIT 13

No. 14-953-TNM

Message

From: Pearce, Mark (DCP) [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=MAPEARCE]
Sent: 8/10/2013 7:17:52 AM
To: Lipari, Elizabeth V. [ELipari@FDIC.gov]
Subject: RE: "Gatekeepers"

No, this is perfect.

Mark Pearce
Director, Division of Depositor and Consumer Protection
Federal Deposit Insurance Corporation

-----Original Message-----
From: Lipari, Elizabeth V.
Sent: Friday, August 09, 2013 08:07 PM Eastern Standard Time
To: Pearce, Mark (DCP)
Subject: "Gatekeepers"

Here's Senator Warren's question, which came after her question to Eric Wright, Staff Attorney, Maine Bureau of Consumer Credit Protection, and his response, about on line payday lenders and what can be done to deal with the issues/problems.

Senator Warren's Question: Could you comment on Mr. Wright's comments, not directly on the bill, but about what might be helpful at the Federal level to deal with payday lending?

Mark's Answer: I think Mr. Wright makes an important point about banks being really the gatekeepers of the processing networks. The FDIC has been active in this area to remind banks about their responsibilities to do due diligence in monitoring the transactions that go through the payment system and just last year we issued guidance that encourages institutions to be careful and attentive to higher risk types of transactions, whether they be online payday lending or there could be online gambling or different other kinds of activities and they have a role to monitor that and to make sure they are not illegal.

Mr. Wright didn't use the term "gatekeepers" in his response to Senator Warren's question. That was your phrase summing up Mr. Wright's response.

No "evil" in question either. Do you want me to transcribe the responses from Mr. Wright and Mr. Silberman to Senator Warren's question?

Beth Lipari
Secretary to Director Mark Pearce
Secretary to Deputy Director Jonathan Miller
Federal Deposit Insurance Corporation
Division of Depositor and Consumer Protection
[redacted]

EXHIBIT 14

No. 14-953-TNM

FDIC

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Financial Institution Letter
FIL-14-2005
March 1, 2005

PAYDAY LENDING PROGRAMS
Revised Examination Guidance

Summary: The FDIC is issuing the attached revised examination guidance on payday lending programs. The revisions provide more specific guidance to FDIC-supervised institutions to ensure that this high-cost, short-term credit product is not provided repeatedly to customers with longer-term credit needs. There is currently a small number of FDIC-supervised institutions engaged in payday lending.

Distribution:
FDIC-Supervised Banks (Commercial and Savings)

Suggested Routing:
Chief Executive Officer
Compliance Officer
Chief Lending Officer

Related Topics:
Guidelines for Payday Lending (July 2003)
Subprime Lending Guidance

Attachment:
Revised Guidelines for Payday Lending

Contact:
Serena Owens
Chief, Planning and Program Development
(202) 898-8996

Note:
FDIC financial institution letters (FILs) may be accessed from the FDIC's Web site at www.fdic.gov/news/news/financial/2005/index.html.

To receive FILs electronically, please visit http://www.fdic.gov/about/subscriptions/fil.html.

Paper copies of FDIC financial institution letters may be obtained through the FDIC's Public Information Center, 801 17th Street, NW, Room 100, Washington, DC 20434 (1-877-275-3342 or 202-416-6940).

Highlights:

- The revised guidance is being issued because the FDIC is concerned that FDIC-supervised banks are offering payday loans in a manner that is inconsistent with:
  - the short-term nature of the product;
  - the FDIC's previous guidance;
  - the payday lenders' marketing materials; and
  - industry best practices.
- The revised guidance provides information about payday lending and describes both safety and soundness and compliance considerations for the examination and supervision of state nonmember banks that have payday lending programs.
- The revised guidance states that banks should develop procedures to ensure that payday loans are not provided to customers who had payday loans outstanding from any lender for more than three months in the previous 12 months.

Financial Institution Letter
FIL-14-2005
March 1, 2005

PAYDAY LENDING PROGRAMS
Revised Examination Guidance

The Federal Deposit Insurance Corporation (FDIC) is issuing the attached revised examination guidance on payday lending programs. The revisions provide more specific guidance with respect to the appropriate limits on payday loan use to ensure that this high-cost, short-term credit product is not provided repeatedly to customers with longer-term credit needs.

Payday loans are small-dollar, unsecured, short-term advances that have high fees relative to the size of the loan. When used frequently or for long periods, the total costs can rapidly exceed the amount borrowed.

The FDIC initially issued guidance on payday lending in July 2003 because payday lending is a high-risk activity that presents significant safety and soundness and consumer protection concerns. The FDIC's concerns about payday lending have been heightened as it has observed payday lending conducted in a manner that is inconsistent with the July 2003 guidance and inconsistent with prudent lending practices. The FDIC believes that providing high-cost, short-term credit on a recurring basis to customers with long-term credit needs is not responsible lending; increases institutions' credit, legal, reputational, and compliance risks; and can create a serious financial hardship for the customer.

To reduce these risks and promote responsible lending, the revised guidance states that institutions should ensure that payday loans are not provided to customers who have had payday loans outstanding from any lender for a total of three months in the previous 12-month period. When a customer has used payday loans more than three months in the past 12 months, institutions should offer the customer, or refer the customer to, an alternative longer-term credit product that more appropriately suits the customer's needs. In any event, whether or not an institution is able to provide a customer alternative credit products, an extension of a payday loan is not appropriate under such circumstances. Other key provisions of the July 2003 guidance remain unchanged.

FDIC-supervised institutions engaged in payday lending have been instructed to submit plans detailing how they will address the revised guidance. In addition, the FDIC anticipates using a mystery shopper program in conjunction with its examination process of institutions involved in payday lending.

Michael J. Zamorski
Director
Division of Supervision and Congsumer Protection

Case 1:14-cv-00953-TNM Document 117-1 Filed 10/18/18 Page 3 of 9

Financial Institution Letters

Guidelines for Payday Lending

Purpose

This guidance provides information about payday lending, a particular type of subprime lending, and supplements and clarifies previously issued guidance about such programs, including the July 2003 Guidelines for Payday Lending.[1] It describes safety and soundness and compliance considerations for examining and supervising state nonmember institutions that have payday lending programs.

This guidance is necessitated by the high risk nature of payday lending and the substantial growth of this product. It describes the FDIC's expectations for prudent risk-management practices for payday lending activities, particularly with regard to concentrations, capital, allowance for loan and lease losses, classifications, and protection of consumers. The guidelines also address recovery practices, income recognition, and managing risks associated with third-party relationships.

When examiners determine hat management of safety and soundness or compliance risks is deficient, they should criticize management and ini iate correc ive action. Such actions may include formal or informal enforcement action. When serious deficiencies exist, enforcement actions may instruct institutions to discontinue payday lending.

Background

In recent years a number of lenders have extended their risk selection standards to attract subprime loans. Among the various types of subprime loans, "payday loans" are now offered by an increasing number of insured depository institutions.

Payday loans (also known as deferred deposit advances) are small-dollar, short-term, unsecured loans that borrowers promise to repay out of their next paycheck or regular income payment (such as a social security check). Payday loans are usually priced at a fixed dollar fee, which represents the finance charge to the borrower. Because these loans have such short terms to maturity, the cost of borrowing, expressed as an annual percentage rate (APR), is very high.[2]

In return for the loan, the borrower usually provides the lender with a check or debit authorization for the amount of the loan plus the fee. The check is either post-dated to the borrower's next payday or the lender agrees to defer presenting the check for payment until a future date, usually two weeks or less. When the loan is due, the lender expects to collect the loan by depositing the check or debiting the borrower's account or by having the borrower redeem the check wi h a cash payment. If the borrower informs the lender that he or she does not have the funds to repay the loan, the loan is often refinanced [3] through payment of an additional fee. If the borrower does not redeem the check in cash and the loan is not refinanced, the lender normally puts the check or debit authorization through the payment system. If the borrower's deposit account has insufficient funds, the borrower typically incurs a NSF charge on this account. If the check or the debit is returned to the lender unpaid, the lender also may impose a returned item fee plus collection charges on the loan.

Significant Risks

Borrowers who obtain payday loans generally have cash flow difficulties, and few, if any, lower-cost borrowing alternatives. In addition, some payday lenders perform minimal analysis of the borrower's ability to repay either at the loan's inception or upon refinancing; hey may merely require a current pay stub or proof of a regular income source and evidence that the customer has a checking account. Other payday lenders use scoring models and consult nationwide databases that track bounced checks and persons with outstanding payday loans. However, payday lenders typically do not obtain or analyze information regarding the borrower's total level of indebtedness or information from the major national credit bureaus (Equifax, Experian, TransUnion). In addition, payday lenders generally do not conduct a substantive review of the borrower's credit history. The combination of the borrower's limited financial capacity, the unsecured nature of the credit, and the limited underwriting analysis of the borrower's ability to repay pose substantial credit risk for insured depository institutions.

Insured depository institutions may have payday lending programs that they administer directly, using their own employees, or they may enter into arrangements with third parties. In the latter arrangements, the institution typically enters into an agreement in which the institution funds payday loans originated through the third party. These arrangements also may involve the sale to the third party of the loans or servicing rights to the loans.[4] Institutions also may rely on the third party to provide additional services that the bank would normally provide, including collections, advertising and soliciting applications. The existence of third party arrangements may, when not properly managed, significantly increase institutions' transaction, legal, and reputation risks.

Federal law authorizes federal and state-chartered insured depository institutions making loans to out of state borrowers to "export" favorable interest rates provided under the laws of the state where the bank is located. That is, a state-chartered bank is allowed to charge interest on loans to out of state borrowers at rates authorized by the state where the bank is located, regardless of usury limitations imposed by the state laws of the borrower's residence.[-] Nevertheless, institutions face increased reputation risks when they enter into certain arrangements with payday lenders, including arrangements to originate loans on terms that could not be offered directly by the payday lender.

Payday loans are a form of specialized lending not typically found in state nonmember institutions, and are most frequently originated by specialized nonbank firms subject to state regulation. Payday loans can be subject to high levels of transaction risk given the large volume of loans, the handling of documents, and the movement of loan funds between the institution and any third party originators. Because payday loans may be underwritten off-site, there also is the risk that agents or employees may misrepresent information about the loans or increase credit risk by failing to adhere to established underwriting guidelines.

Procedures

General

Examiners should apply this guidance to banks with payday lending programs that the bank administers directly or that are administered by a third party contractor. This guidance does ***not*** apply to situations where a bank makes occasional low-denomination, short-term loans to its customers.

As described in the *2001 Subprime Guidance*, a program involves the regular origination of loans, using tailored marketing, underwriting standards and risk selection. The *2001 Subprime Guidance* applies specifically to institutions with programs where the aggregate credit exposure is equal to or greater than 25% or more of tier 1 capital. However, because of the significant credit, operational, legal, and reputation risks inherent in payday lending, this guidance applies regardless of whether a payday loan program meets that credit exposure threshold.

All examiners should use the procedures outlined in the *Subprime Lending Examination Procedures*, as well as those described here. While focused on safety and soundness issues, segments of the *Subprime Lending Examination Procedures* also are applicable to compliance examinations. They will need to be supplemented with existing procedures relating to specific consumer protection laws and regulations.

Due to the heightened safety and soundness and compliance risks posed by payday lending, concurrent risk management and consumer protection examinations should be conducted absent overriding resource or scheduling problems. In all cases, a review of each discipline's examinations and workpapers should be part of the pre-examination planning process. Relevant state examinations also should be reviewed.

Examiners may conduct targeted examinations of the third party where appropriate. Authority to conduct examinations of third parties may be established under several circumstances, including through the bank's written agreement with the third party, section 7 of the Bank Service Company Act, or through powers granted under section 10 of the Federal Deposit Insurance Act. Third party examination activities would typically include, but not be limited to, a review of compensation and staffing practices; marketing and pricing policies; management information systems; and compliance with bank policy, outstanding law, and regulations. Third party reviews should also include testing of individual loans for compliance with underwriting and loan administration guidelines, appropriate treatment of loans under delinquency, and re-aging and cure programs.

Third-Party Relationships and Agreements

The use of third parties in no way diminishes the responsibility of the board of directors and management to ensure that the third-party activity is conducted in a safe and sound manner and in compliance with policies and applicable laws. Appropriate corrective actions, including enforcement actions, may be pursued for deficiencies related to a third-party relationship that pose concerns about either safety and soundness or the adequacy of protection afforded to consumers.

The FDIC's principal concern relating to third parties is that effective risk controls are implemented. Examiners should assess the institution's risk management program for third-party payday lending relationships. An assessment of third-party relationships should include an evaluation of the bank's risk assessment and strategic planning, as well as the bank's due diligence process for selecting a competent and qualified third party provider. (Refer to the *Subprime Lending Examination Procedures* for additional detail on strategic planning and due diligence.)

Examiners also should ensure that arrangements with third parties are guided by written contract and approved by the institution's board. At a minimum, the arrangement should:

- Describe the duties and responsibilities of each party, including the scope of the arrangement, performance measures or benchmarks, and responsibilities for providing and receiving information;
- Specify that the third party will comply with all applicable laws and regulations;
- Specify which party will provide consumer compliance related disclosures;
- Authorize the institution to monitor the third party and periodically review and verify

that the third party and its representatives are complying with its agreement with the institution;

- Authorize the institution and the appropriate banking agency to have access to such records of the third party and conduct onsite transaction testing and operational reviews at third party loca ions as necessary or appropriate to evaluate such compliance;
- Require the third party to indemnify the institu ion for potential liability resulting from action of the third party with regard to the payday lending program; and
- Address customer complaints, including any responsibility for third-party forwarding and responding to such complaints.

Examiners also should ensure that management sufficiently monitors the third party with respect to its activities and performance. Management should dedicate sufficient staff with the necessary expertise to oversee the third party. The bank's oversight program should monitor the third party's financial condition, its controls, and the quality of its service and support, including its resolution of consumer complaints if handled by the third party. Oversight programs should be documented sufficiently to facilitate he monitoring and management of the risks associated with third-party relationships.

Safety and Soundness Issues

Concentrations

Given the risks inherent in payday lending, concentrations of credit in this line of business pose a significant safety and soundness concern. In the context of these guidelines, a concentration would be defined as a volume of payday loans totaling 25 percent or more of a bank's Tier 1 capital. Where concentrations of payday lending are noted, bank management should be criticized for a failure to diversify risks. Examiners will work with institutions on a case-by-case basis to determine appropriate supervisory actions necessary to address concentrations. Such action may include directing the institution to reduce its loans to an appropriate level, raise additional capital, or submit a plan to achieve compliance.

Capital Adequacy

The FDIC's minimum capital requirements generally apply to portfolios that exhibit substantially lower risk profiles and that are subject to more stringent underwriting procedures than exist in payday lending programs. Therefore, minimum capital requirements are not sufficient to offset the risks associated with payday lending.

As noted in the *2001 Subprime Guidance*, examiners should reasonably expect, as a starting point, that an institution would hold capital against subprime portfolios in an amount that is one and a half to three times greater than what is appropriate for non-subprime assets of a similar type. However, payday lending is among the highest risk subsets of subprime lending, and significantly higher levels of capital than the starting point should be required.

The *2001 Subprime Guidance* indicates that institutions that underwrite higher risk subprime pools, such as payday loans, need significantly higher levels of capital, perhaps as high as 100% of the loans outstanding (dollar-for-dollar capital), depending on the level and volatility of risk. Risks to consider when determining capital requirements include the unsecured nature of the credit, the relative levels of risk of default, loss in the event of default, and the level of classified assets. Examiners should also consider the degree of legal or reputa ional risk associated with the payday business line, especially as it relates to third-party agreements.

Because of the higher inherent risk levels and the increased impact hat payday lending portfolios may have on an institution's overall capital, examiners should document and reference each institution's capital evaluation in their comments and conclusions regarding capital adequacy. (Refer to the *2001 Subprime Guidance* for further information on capital expectations.)

Allowance for Loan and Lease Losses (ALLL) Adequacy

As with other segments of an institution's loan portfolio, examiners should ensure that institutions maintain an ALLL that is adequate to absorb estimated credit losses within the payday loan portfolio. Consistent with the *Interagency Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Associations (Interagency Policy Statement on ALLL)*,[6] the term "estimated credit losses" means an estimate of the current amount of loans that is not likely to be collected; that is, net charge-offs that are likely to be realized in a segment of the loan portfolio given the facts and circumstances as of the evaluation date. Although the contractual term of each payday loan may be short, institutions' methodologies for estimating credit losses on these loans should take into account the fact that many payday loans remain continuously outstanding for longer periods because of renewals and rollovers. In addition, institutions should evaluate the collectibility of accrued fees and finance charges on payday loans and employ appropriate methods to ensure that income is accurately measured.

Examiners should ensure hat institutions engaged in payday lending have methodologies and analyses in place that demonstrate and document that the level of the ALLL for payday loans is appropriate. The application of historical loss rates to the payday loan portfolio, adjusted for the current environmental factors, is one way to determine the ALLL needed for these loans. Environmental factors include levels of and trends in delinquencies and charge-offs, trends in loan volume, effects of changes in risk selection and underwriting standards and in account management prac ices, and current economic conditions. For institutions that do not have loss experience of heir own, it may be appropriate to reference the payday loan loss experience of other institutions with payday loan portfolios with similar attributes. Other methods, such as loss estimation models, are acceptable if they estimate losses in accordance with generally accepted accounting principles. Examiners should review documentation to ensure that institutions loss estimates and allowance methodologies are consistent with the *Interagency Policy Statement on ALLL*.

Classification Guidelines

The *Uniform Retail Credit Classification and Account Management Policy (Retail Classification Policy)*[7] establishes general classification thresholds for consumer loans based on delinquency, but also grants examiners the discretion to classify individual retail loans that exhibit signs of credit weakness regardless of delinquency status. An examiner also may classify retail portfolios, or segments thereof, *where underwriting standards are weak and present unreasonable credit risk*, and may criticize account management practices that are deficient.

Most payday loans have well-defined weaknesses that jeopardize the liquidation of the debt. Weaknesses include limited or no analysis of repayment capacity and the unsecured nature of the credit. In addition, payday loan portfolios are characterized by a marked proportion of obligors whose paying capacity is questionable. As a result of hese weaknesses, payday loan portfolios should be classified Substandard.

Furthermore, payday loans that have been outstanding for extended periods of time evidence a high risk of loss. While such loans may have some recovery value, it is not practical or desirable to defer writing off these essentially worthless assets. Payday loans that are outstanding for greater than 60 days from origination generally meet the definition of Loss. In certain circumstances, earlier charge off may be appropriate (i.e., the bank does not renew beyond the first payday and the borrower is unable to pay, the bank closes an account, etc.). The institution's policies regarding consecutive advances also should be considered when determining Loss classifications. Where the economic substance of consecutive advances is substantially similar to "rollovers" - without appropriate intervening "cooling off" or waiting periods - examiners should treat these loans as continuous advances and classify accordingly.

When classifying payday loans, examiners should reference the *Retail Classification Policy* as the source document. Examiners would normally not classify loans for which the institu ion has documented adequate paying capacity of the obligors and/or sufficient collateral protection or credit enhancement.

Renewals/Rewrites

The *Retail Classification Policy* establishes guidelines for extensions, deferrals, renewals, or rewrites of closed-end accounts. Despite the short-term nature of payday loans, borrowers that request an extension, deferral, renewal, or rewrite should exhibit a renewed willingness and ability to repay the loan. Examiners should ensure that institutions adopt and adhere to the *Retail Classification Policy* standards that control the use of extensions, deferrals, renewals, or rewrites of payday loans. Under the *Retail Classification Policy*, institutions' standards should:

- Limit he number and frequency of extensions, deferrals, renewals, and rewrites;
- Prohibit additional advances to finance unpaid interest and fees and simultaneous loans to the same customer; and
- Ensure that comprehensive and effective risk management, repor ing, and internal controls are established and maintained.

In addition to the above items, institutions should also:

- Establish appropriate "cooling off" or waiting periods between the time a payday loan is repaid and another application is made;
- Establish the maximum number of loans per customer that are allowed within one calendar year or other designated time period; and
- Provide that no more than one payday loan is outstanding with the bank at a time to any one borrower.
- Ensure that payday loans are not provided to customers who had payday loans outstanding **at any lender** for a total of three months during the previous 12 months. When calculating the three-month period, institutions should consider the customers' total use of payday loans at all lenders.

When a customer has used payday loans more than three months in he past 12 months, institutions should offer the customer, or refer the customer to, an alternative longer-term credit product that more appropriately suits the customer's needs. Whether or not an institution is able to provide a customer alternative credit products, an extension of a payday loan is not appropriate under such circumstances.

Accrued Fees and Finance Charges[8]

Examiners should ensure hat institutions evaluate the collectibility of accrued fees and finance charges on payday loans because a portion of accrued interest and fees is generally not collectible. Although regulatory reporting instructions do not require payday loans to be placed on nonaccrual based on delinquency status, institutions should employ appropriate methods to ensure that income is accurately measured. Such methods may include providing loss allowances for uncollectible fees and finance charges or placing delinquent and impaired receivables on nonaccrual status. After a loan is placed on nonaccrual status, subsequent fees and finance charges imposed on he borrower would not be recognized in income and accrued, but unpaid fees and finance charges normally would be reversed from income.

Recovery Practices

After a loan is charged off, institu ions must properly report any subsequent collections on the loan.[9] Typically, some or all of such collections are reported as recoveries to the ALLL. In some instances, the total amount credited to the ALLL as recoveries on an individual loan (which may have included principal, finance charges, and fees) may exceed the amount previously charged off against the ALLL on that loan (which may have been limited to principal). Such a practice understates an institution's net charge-off experience, which is an important indicator of the credit quality and performance of an institution's portfolio.

Consistent with regulatory reporting instructions and prevalent industry practice, recoveries represent collections on amounts that were previously charged off against the ALLL. Accordingly, institutions must ensure that the total amount credited to the ALLL as recoveries on a loan (which may include amounts representing principal, finance charges, and fees) is limited to the amount previously charged off against the ALLL on that loan. Any amounts collected in excess of this limit should be recognized as income.

Compliance Issues

Payday lending raises many consumer protection issues and attracts a great deal of attention from consumer advocates and other regulatory organizations, increasing the potential for litigation. Regardless of whether state law characterizes these transactions as loans, they are considered extensions of credit for purposes of federal consumer protection law. Laws and regulations to be closely scrutinized when reviewing payday lending during consumer compliance examinations include:

Community Reinvestment Act (CRA)/ Part 345

Under interagency CRA regulations and interpretive guidance, a payday lending program may adversely affect CRA performance. For example, evidence of discriminatory or other illegal credit practices are inconsistent with helping to meet community credit needs and adversely affect an evaluation of a financial institution's performance. Examples of illegal credit practices include, but are not limited to violations of: he Equal Credit Opportunity Act, concerning discouraging or discriminating against consumers on a prohibited basis; the Truth in Lending Act, regarding disclosures and certain loan restrictions; and the Federal Trade Commission Act, concerning unfair and deceptive acts or practices. Under longstanding interagency regulatory guidance, only illegal credit practices adversely affect CRA performance and may result in a lower CRA rating. As in all other aspects of the CRA evaluation, FDIC examiners will continue to follow the CRA regulations and guidance issued jointly by the federal banking agencies (FDIC, Federal Reserve, OTS and OCC) and in effect at the time of an examination.

However, other questionable payday lending practices, while not specifically prohibited by law, may be inconsistent with helping to meet the convenience and needs of the community. For example, payday loans to individuals who do not have the ability to repay, or that may result in repeated renewals or extensions and fee payments over a relatively short span of weeks, do not help to meet credit needs in a responsive manner. A full description of the payday lending program and such practices should be included in the section of the CRA Public Performance Evaluation that describes the institution. This section provides a description of the institution's profile, business strategy, and product offerings inside and outside the assessment area(s). As with any public comment, public comments regarding payday lending practices should be discussed appropriately in a financial institution's CRA Public Performance Evaluation, and included in the institution's CRA Public File.

Truth in Lending Act/ Regulation Z

TILA and Regulation Z[10] require banks engaged in consumer lending to ensure that accurate disclosures are provided to customers. A bank hat fails to disclose finance charges and APRs accurately for payday loans - considering the small dollar tolerance for inaccuracies - risks having to pay restitu ion to consumers, which in some instances could be substantial. This risk remains even if the bank provides loans through a third-party agreement.

TILA and Regulation Z also require banks to advertise their loan products in accordance with their provisions. For example, advertisements that state specific credit terms may state only those terms that actually are or will be arranged or offered by the creditor. If an advertisement states a rate of finance charge, it must state the rate as an APR, using that term. If the APR may be increased after the initial origination date, the advertisement must so state. Additional disclosures also may be required in the advertisements.

Equal Credit Opportunity Act/ Regulation B

Illegal discrimination may occur when a bank has both payday and other short-term lending programs that feature substantially different interest rate or pricing structures. Examiners should determine to whom the products are marketed, and how the rates or fees for each program are set, and whether there is evidence of potential discrimination. Payday lending, like o her forms of lending, is also susceptible to discriminatory practices such as discouraging applications, requesting information or evaluating applications on a prohibited basis. If the lender requires that a borrower have income from a job, and does not consider income from other sources such as social security or veterans benefits, then it is illegally discriminating against applicants whose income derives from public assistance.

ECOA and Regulation B limit the type of information that may be requested of applicants during an application for credit. A creditor may not refuse to grant an individual account to a creditworthy applicant on the basis of sex, marital status or any other prohibited basis. A state nonmember bank must ensure that its payday lending program complies with these limita ions.

ECOA and Regulation B require creditors to no ify applicants of adverse actions taken in connection with an application for credit. Notices of adverse action taken must be provided within specified time frames and in specified forms. State nonmember banks involved in payday lending must ensure that such notices are given in an accurate and timely manner.

Fair Credit Reporting Act

A bank engaged directly or indirec ly in payday lending is responsible for complying with requirements to provide notice to a consumer when it declines an application for credit or takes other adverse action based on certain information. If adverse action is taken based on informa ion received from a consumer reporting agency, the consumer must be notified and provided the name and address of the consumer reporting agency. It is important to note that informa ion in "bad check lists" or databases that track outstanding payday loans are considered to be consumer reports, and therefore the companies that provide such a tracking service (such as Teletrack) are consumer repor ing agencies. If adverse action is taken based on information received from a hird party that is not a consumer reporting agency, the adverse action notice must direct the consumer to the bank, and not any third party, for details regarding the character of the informa ion (even where the payday loan applications are received by the bank through a third party such as a payday lender).

Electronic Fund Transfer Act (EFTA)/ Regulation E and Truth in Savings Act (TISA)

Payday lending arrangements that involve the opening of a deposit account or the establishment of "electronic fund transfers" must meet the disclosure and other requirements of both he EFTA and TISA. Examples include providing a device to access funds from a deposit account, or depositing a payday loan directly in a borrower's account and debiting the subsequent payment.

Fair Debt Collection Practices Act (FDCPA)

If a bank engages in payday lending through an arrangement with a third party, and the third party collects defaulted debts on behalf of the bank, the third party may become subject to the provisions of the FDCPA. Although the bank itself may not be subject to the FDCPA, it may face reputa ional risk if the third party violates the FDCPA in collecting the bank's loans. A compliance program should provide for monitoring of collection activi ies, including collection calls, of any third party on behalf of the bank.

Federal Trade Commission Act (FTC Act)

The Federal Trade Commission Act (FTC Act) declares that unfair or deceptive trade practices are illegal. (See 15 USC § 45(a)). State nonmember banks and their institution-affiliated parties will be cited for violations of section 5 of the FTC Act and the FDIC will take appropriate action pursuant to its au hority under section 8 of the Federal Deposit Insurance Act when unfair or deceptive trade practices are discovered. Examiners should focus attention on marketing programs for payday loans, and also be alert for potentially abusive collection practices. Of particular concern is the practice of threatening, and in some cases pursuing, criminal bad check charges, despite the payment of offsetting fees by the consumer and the lender's knowledge at the time the check was accepted that there were insufficient funds to pay it. If evidence of unfair or deceptive trade practices is found, examiners should consult with the regional office and the region should consult with Washington.

Where entities other than banks engage in unfair or deceptive trade practices, the FDIC will coordinate its response with the Federal Trade Commission. (Refer to FIL-57-2002, dated May 30, 2002, for further information.)

Privacy of Consumer Financial Information/Part 332

Payday lending arrangements are subject to the same information sharing restrictions and requirements as any other type of financial service or product provided by FDIC-supervised institutions to consumers. The bank should ensure consumers are appropriately provided with a copy of the bank's initial, revised, and annual notices, as applicable. In addition, the bank should ensure hat a consumer's nonpublic personal information is used and disclosed only as permitted and described in the privacy notice.

Safeguarding Customer Information

The *Interagency Guidelines Establishing Standards for Safeguarding Customer Information*, Appendix B to Part 364, require banks to implement a written information security program to protect the security, confidentiality, and integrity of customer information. The guidelines require banks to assess reasonably foreseeable internal and external threats that could result in unauthorized uses or destruction of customer information systems, and to design a security program to control those risks. A bank's board of directors should approve the written program and oversee its implementation.

Examiners should ensure he bank has appropriately addressed the security risks in payday lending arrangements to safeguard customer information, whether in paper, electronic, or other form, maintained by or on behalf of the bank.

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[1] See January 31, 2001, interagency Expanded Guidance for Subprime Lending Programs (FIL 9-2001) (2001 Subprime Guidance); January 24, 2000, Subprime Lending Examination Procedures (RD Memo No. 00-004); March 4, 1999, Interagency Guidelines on Subprime Lending (FIL-20-99); and May 2, 1997, Risks Associated wi h Subprime Lending (FIL-44-97).

[2] The typical charge is $15 to $20 per $100 advanced for a two-week period, resulting in an APR of nearly 400%.

[3] Payday lenders generally use the term "rollover." Other terms used may include extension, deferral, renewal or rewrite.

[4] Insured depository institutions also may fund payday lenders through a lending relationship. This guidance does not address such situations.

[5] See section 27 of the Federal Deposit Insurance Act, 12 U.S.C. § 1831d (enacted as section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 [the "DIDMCA"]). The authority of national banks to export favorable interest rates on loans to borrowers residing in other states was recognized by the U.S. Supreme Court in Marquette National Bank of Minneapolis v. First Omaha Service Corp., 439 U.S. 299 (1978), in the context of section 85 of he National Bank Act. That authority was subsequently extended to credit unions, savings associations, state nonmember banks and insured foreign branches in the DIDMCA to provide competitive lending equality with national banks.

[6] See July 25, 2001, Interagency Policy Statement on Allowance for Loan and Lease Losses (ALLL) Methodologies and Documentation for Banks and Savings Associations (FIL 63-2001).

[7] See June 29, 2000, Uniform Retail Credit Classification and Account Management Policy (FIL -40-2000).

[8] AICPA Statement of Position 01-6 Accounting by Certain Entities (Including Entities with Trade Receivables) That Lend to or Finance the Activities of Others, provides guidance for accounting for delinquency fees.

[9] AICPA Statement of Position 01-6 provides recogni ion guidance for recoveries of previously charged-off loans.

[10] Federal Reserve Board staff considered payday loans in the context of Regulation Z, and found that they are a form of credit under the Truth in Lending Act. 12 CFR Part 226, Supplement I, Subpart A, Sec ion 226.2(a)(14), note 2. If the fees are finance charges, as they usually will be, see 12 CFR Part 226.4, they must be disclosed as an APR, regardless of how the fee is characterized under state law.

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EXHIBIT 15

No. 14-953-TNM

Office of Inspector General

Office of Audits and Evaluations
Report No. AUD-15-008

The FDIC's Role in Operation Choke Point and Supervisory Approach to Institutions that Conducted Business with Merchants Associated with High-Risk Activities

September 2015

Office of Inspector General

Executive Summary

The FDIC's Role in Operation Choke Point and Supervisory Approach to Institutions that Conducted Business with Merchants Associated with High-Risk Activities

Report No. AUD-15-008
September 2015

Why We Did The Audit

In a letter dated October 23, 2014, thirty-five Members of Congress (referred to hereinafter as Members) requested that the FDIC Office of Inspector General (OIG) investigate the involvement of the FDIC and its staff in the creation and/or execution of the United States Department of Justice (DOJ or Department) initiative known as Operation Choke Point. In the letter, Members expressed concern that the FDIC was working with DOJ in connection with Operation Choke Point to pressure financial institutions to decline banking services to certain categories of lawfully operating merchants that had been associated with high-risk activities. The letter also indicated that it was the Members' belief that FDIC officials had abused their authority by advancing a political or moral agenda to force certain lawful businesses out of the financial services space.

On December 17, 2014, the FDIC Chairman requested that, as part of our planned and ongoing work in this area, we conduct a fact-finding review of the actions of one former and four current senior FDIC officials. The Chairman's request was prompted by concerns raised by a Congressman in a letter dated December 10, 2014 that stated the five officials had allowed their personal and political views to interfere with the important work of the FDIC and that the officials had misled the American people through their emails and in meetings with, and testimony before, the Congress.

The objectives of the audit were to (1) describe the FDIC's role in the DOJ initiative known as Operation Choke Point and (2) assess the FDIC's supervisory approach to financial institutions that conducted business with merchants associated with high-risk activities for consistency with relevant statutes and regulations. As part of the audit, we reviewed a non-statistical sample of 23 FDIC-supervised financial institutions to assess the FDIC's supervisory approach for addressing identified concerns. We also determined the extent to which the five referenced officials were involved with Operation Choke Point and whether their actions involving the institutions we reviewed were based on personal, political, or moral agendas aimed at forcing lawfully operating businesses out of the banking sector. Work on a separate inquiry by the OIG's Office of Investigations into whether one of these five individuals had misled the American people in testimony before the Congress was completed at the close of this audit.

Background

In November 2012, attorneys within DOJ's Civil Division proposed an internal initiative intended to protect consumers from fraud perpetrated by fraudulent merchants, financial institutions, and financial intermediaries known as third-party payment processors (TPPP). The initiative, which DOJ named Operation Choke Point, focused on the relationship between TPPPs and financial institutions because these relationships were the means by which fraudulent merchants were able to access the banking system to commit consumer fraud. In carrying out its work in connection with Operation Choke Point, DOJ issued 60 administrative subpoenas from February 2013 through August 2013 to entities for which the Department determined it had evidence of potential consumer fraud. According to DOJ employees that we spoke with during the audit, 20 of the subpoenas were issued to FDIC-supervised financial institutions.

In August 2013, Members became concerned that the FDIC and DOJ were pressuring financial institutions and TPPPs to terminate business relationships with lawful lenders that provided short-term credit options to underserved consumers. Since that time, Members have also expressed concern that financial institutions were declining basic banking services, such as deposit accounts and loans, to entire categories of merchants that had been associated with high-risk activities. Members asserted that the FDIC and DOJ were using a "high-risk list" of merchant categories that was published in an informational article contained in the FDIC's summer 2011 edition of the *Supervisory Insights* Journal, together with certain FDIC supervisory guidance, to target institutions for increased scrutiny.

The FDIC has defined higher-risk activities as those that have been understood by industry and financial regulators as being subject to complex or varying legal and regulatory environments (such as activities that may be legal only in certain states); being prohibited for certain consumers (such as minors); being subject to varying state and federal licensing and reporting regimes; or tending to display a higher incidence of consumer complaints, returns, or chargebacks. In the context of this audit, merchants associated with high-risk or higher-risk activities include (among others) payday lenders, pawnbrokers, firearms and ammunition manufacturers and retailers, and tobacco retailers.

The FDIC has broad authority under the Federal Deposit Insurance Act (FDI Act), as amended, and other statutes and regulations to supervise the activities of state-chartered financial institutions that are not members of the Federal Reserve System. The FDIC's *Risk Management Manual of Examination Policies*, *Compliance Examination Manual*, and *Formal and Informal Actions Procedures Manual* describe the FDIC's approach for determining an appropriate supervisory corrective action to address an identified concern. In general, these manuals outline a risk-based, graduated approach for addressing concerns identified through the supervisory process. According to two of the manuals, it is sufficient in many cases for examiners to use moral suasion or make written recommendations in reports of examination to address identified problems or concerns. If such actions would not be sufficient, or if serious concerns exist, stronger actions may be taken in the form of informal or formal corrective actions against an institution or responsible individuals.

Audit Results

The FDIC's involvement in Operation Choke Point has been limited to a few FDIC staff communicating with DOJ employees regarding aspects of the initiative's implementation. These communications with DOJ generally related to the Corporation's responsibility to understand and consider the implications of potential illegal activity involving FDIC-supervised financial institutions. Overall, we consider the FDIC's involvement in Operation Choke Point to have been inconsequential to the overall direction and outcome of the initiative.

We determined that the FDIC's supervisory approach to financial institutions that conducted business with merchants on the high-risk list was within the Corporation's broad authorities granted under the FDI Act and other relevant statutes and regulations. However, the manner in which the supervisory approach was carried-out was not always consistent with the FDIC's written policy and guidance.

We found no evidence that the FDIC used the high-risk list to target financial institutions. However, references to specific merchant types in the summer 2011 edition of the FDIC's *Supervisory Insights* Journal and in supervisory guidance created a perception among some bank executives that we spoke with that the FDIC discouraged institutions from conducting business with those merchants. This perception was most prevalent with respect to payday lenders.

With the exception of payday lenders, we found no instances among the financial institutions we reviewed where the FDIC pressured an institution to decline banking services to a merchant on the high-risk list. Further, bank executives that we spoke with indicated that, except for payday lenders, they had not experienced regulatory pressure to terminate an existing customer relationship with a merchant on the high-risk list, including a firearms, ammunition, or tobacco retailer. As described below, the FDIC has had concerns regarding payday lending by financial institutions that precede Operation Choke Point by many years. These concerns led to supervisory guidance and actions that caused FDIC-supervised institutions to stop offering payday loans. More recently, FDIC officials became concerned about other types of banking activities that facilitate payday lending.

Payday Lending and Related Activities

The FDIC's payday lending guidance, which was established in 2003 and updated in 2005, increased expectations and placed heightened scrutiny on institutions that were engaged in payday lending. As a result of the guidance and related supervisory actions, the relatively few FDIC-supervised institutions that were making payday loans stopped doing so in 2006. In the years that followed, the FDIC took steps to encourage institutions to offer affordable, small-dollar loans and researched and communicated concerns about emerging credit products that can have characteristics similar to payday loans, such as deposit advance products.

We found that a number of FDIC officials also had concerns about Automated Clearing House (ACH) payment processing by financial institutions for payday lenders. These concerns were based on the premise that such services facilitate payday lending. The heightened level of concern for payday lending by financial institutions and related ACH processing was reflected in the negative tenor of internal email communications among senior FDIC staff and others that we reviewed. In some cases, these communications involved instances in which FDIC personnel contacted institutions and used moral suasion to discourage them from adopting payday lending products or providing ACH processing for payday lenders. The FDIC does not have a formal definition of moral suasion in its policies. However, examiners commonly use moral suasion in an attempt to influence risk management practices at financial institutions before perceived problems rise to a level that necessitates an informal or formal enforcement action.

We noted two instances in which the FDIC discouraged institutions from providing ACH processing to payday lenders in written communications to the institutions. In both instances, the FDIC's principal stated concern was the reputation risk to the institutions due to their potential or existing relationship with a payday lender. The FDIC does not centrally track its written communications to financial institutions that involve ACH processing concerns. Accordingly, we were unable to determine how often such communications occur. However, our discussions with FDIC executives and our review of regional office status reports identified only three institutions where FDIC officials raised concerns regarding ACH processing practices for payday lenders.

The FDIC's Actions to Address Concerns Regarding its Supervisory Approach

FDIC officials determined that there were misperceptions regarding the Corporation's supervisory approach to institutions that conduct business with merchants on the high-risk list and, therefore, the FDIC took several actions beginning in September 2013. Specifically, the FDIC withdrew references to high-risk merchants from the *Supervisory Insights* article and its guidance, clarified its supervisory policy and guidance, and established an internal policy for documenting and reporting instances in which staff recommend or require institutions to terminate deposit account relationships. Among other things, the internal policy does not allow for the termination of deposit account relationships based solely on reputation risk to an institution. These actions were intended to make clear the FDIC's policy that financial institutions that properly manage customer relationships and effectively mitigate risks are neither prohibited nor discouraged from providing financial services to customers, regardless of the customers' business category, provided that the institutions operate in compliance with applicable laws.

We noted that the policy and guidance described above focuses on deposit accounts and does not explicitly address various other types of banking products, such as credit products. In addition, it is too soon, in our view, to determine whether the actions taken by the FDIC will ensure a common understanding and sustained application of the FDIC's supervisory approach to the issues and risks discussed in this report, both within the FDIC and at FDIC-supervised institutions.

Role of Certain FDIC Officials

We concluded that the five officials referenced above did not play a role in the development or implementation of Operation Choke Point. We also concluded that the individuals did not pursue their own personal, political, or moral agendas aimed at forcing lawfully operating businesses on the high-risk list out of the banking sector. As it pertains to payday lending and related activities, we concluded that the officials acted consistent with a widely-held understanding that the highest levels of the FDIC disfavored these types of banking services. We did, however, identify certain internal email communications and one written communication to an institution involving three of the five individuals that were not consistent with the FDIC's written policy and guidance pertaining to payday lending and related activities.

Refund Anticipation Loans

Our report includes an observation on the FDIC's supervisory approach to financial institutions that offered a credit product known as a refund anticipation loan (RAL). The FDIC considers RALs to carry a significant degree of risk to financial institutions, including third-party, reputation, compliance, and legal risks. Of particular concern to the FDIC is whether an institution can ensure proper underwriting and compliance with consumer protection requirements, particularly when RALs are brokered by large numbers of third-party tax return preparers (sometimes called electronic refund originators—EROs) in conjunction with the filing of a taxpayer's income tax return. Although RALs were not on the high-risk list, we observed that the FDIC's supervisory approach to institutions that offered this type of credit product involved circumstances that were similar to those that prompted the Congressional request to our office.

We identified three FDIC-supervised institutions that offered RALs. These institutions began offering RALs in 1987, 1988, and 2007, respectively. At various times from 2004 through 2009, FDIC examiners criticized the risk management practices pertaining to RALs at two of these institutions during compliance and risk management examinations. In late 2009 and early 2010, the FDIC sent letters to all three institutions expressing concerns about RALs and requesting that the institutions submit plans for discontinuing this type of lending. In early 2011, after efforts to convince these institutions to discontinue offering RALs were unsuccessful and supervisory concerns remained, the tenor of the FDIC's supervisory approach became aggressive. In one case, the FDIC took the highly unusual step of conducting a simultaneous, unannounced review of 250 EROs in 36 states involving hundreds of FDIC examiners in order to develop the evidence needed to compel the institution to stop offering RALs. In another case, a former FDIC supervisory attorney used a confrontational approach to pressure an institution's Board to terminate its RAL offerings. By April 2012, all three institutions had stopped offering RALs.

The FDIC drafted a policy statement in 2010 that defined the FDIC's supervisory concerns and expectations for institutions offering RALs. However, the policy statement was never finalized. In our view, establishing such a policy would have been prudent to ensure institutions understood the risks associated with RALs and provide transparent supervisory guidance and expectations for institutions already (or contemplating) offering RALs.

We concluded that the supervisory actions taken with respect to the three institutions that offered RALs fell within the Corporation's broad statutory authorities because the Corporation is permitted to require a financial institution to discontinue a practice if safety and soundness or consumer protection concerns warrant doing so. However, we believe that the execution of these actions by FDIC management and staff warrants further review and the OIG is conducting additional work in this area. Further, in light of the concerns described in this report regarding the use of moral suasion with financial institutions, the FDIC should determine whether moral suasion is adequately defined in FDIC policy and guidance in terms of the types and circumstances under which it is used to address supervisory concerns, whether it is subject to sufficient scrutiny and oversight, and whether meaningful remedies exist should moral suasion be misused.

Recommendations and Corporation Comments

The report contains three recommendations addressed to the Directors, RMS and DCP, to (1) review and clarify, as appropriate, existing policy and guidance pertaining to the provision and termination of banking services; (2) assess the effectiveness of the FDIC's supervisory policy and approach after a reasonable period of time is allowed for implementation; and (3) coordinate the FDIC's Legal Division to review and clarify, as appropriate, supervisory policy and guidance to ensure that moral suasion is adequately addressed. The Director, RMS, provided a written response on behalf of the FDIC, dated September 10, 2015, to a draft of the report. In the response, the Director concurred with all three of the report's recommendations and described planned and completed corrective actions that were responsive. The FDIC expects to complete all actions to address the recommendations by September 30, 2016.

As noted above, the FDIC has taken and planned corrective actions that are responsive to our recommendations. However, in reiterating our findings and providing perspective surrounding them, management did not discuss the potential impact that statements and actions by FDIC executives can have on those responsible for carrying out the FDIC's supervisory policies and approach. As described in our report, our interviews and review of documents showed that perceptions regarding the views of senior FDIC executives about institutions involved in payday lending and RALs influenced the supervisory approach to handling risks at those institutions. In several instances, the approach was not consistent with written FDIC policy and guidance. Consequently, as it has committed to do, we believe it is prudent for FDIC senior leadership to reiterate its revised policies on a sustained basis to ensure they become engrained in the organization's supervisory culture. Given the significance of these issues, we will, at an appropriate time, follow up on the FDIC's actions to ensure they address the underlying concerns that support our recommendations.

Table of Contents

FDIC

Federal Deposit Insurance Corporation
3501 Fairfax Drive, Arlington, VA 22226

Office of Audits and Evaluations
Office of Inspector General

DATE: September 16, 2015

MEMORANDUM TO: Doreen R. Eberley, Director
Division of Risk Management Supervision

Mark E. Pearce, Director
Division of Depositor and Consumer Protection

Charles Yi
General Counsel

/Signed/

FROM: Mark F. Mulholland
Assistant Inspector General for Audits

SUBJECT: *The FDIC's Role in Operation Choke Point and Supervisory Approach to Institutions that Conducted Business with Merchants Associated with High-Risk Activities* (Report No. AUD-15-008)

This report presents the results of our audit of the FDIC's role in the United States Department of Justice (DOJ or Department) initiative known as Operation Choke Point and the FDIC's supervisory approach to institutions that conducted business with merchants associated with high-risk activities.[1] DOJ has described Operation Choke Point as an effort intended to protect consumers from fraud perpetrated by fraudulent merchants, financial institutions, and financial intermediaries known as third-party payment processors (TPPP).[2] Some Members of Congress, however, have asserted that Operation Choke Point targets certain types of businesses, many of which are licensed and legally-operating, and forces them out of the financial services space and, therefore, out of business.

In a letter dated October 23, 2014, thirty-five Members of Congress (referred to hereinafter as Members) requested that we investigate the involvement of the FDIC and its staff in the creation and/or execution of Operation Choke Point. In the letter, Members expressed concern that the FDIC was working with DOJ in connection with Operation Choke Point to pressure financial

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[1] The FDIC has defined higher-risk activities as those that have been understood by industry and financial regulators as being subject to complex or varying legal and regulatory environments (such as activities that may be legal only in certain states); being prohibited for certain consumers (such as minors); being subject to varying state and federal licensing and reporting regimes; or tending to display a higher incidence of consumer complaints, returns, or chargebacks. In the context of this audit, merchants associated with high-risk or higher-risk activities include (among others) payday lenders, pawnbrokers, firearms and ammunition manufacturers and retailers, and tobacco retailers. A more detailed discussion of such merchants appears later in this report.
[2] Certain terms that are underlined when first used in this report are defined in Appendix 2, *Glossary of Terms*.

institutions to decline banking services to certain categories of lawfully operating merchants that had been associated with high-risk activities. The letter also suggested that a senior FDIC official had provided false testimony regarding this concern during a July 2014 Congressional hearing. Further, the letter indicated that it was the Members' belief that FDIC officials had abused their authority by advancing a political or moral agenda to force certain lawful businesses out of the financial services space.

Consistent with our established protocols for working within the Congressional committee structure, we sent letters, dated November 7, 2014, to the Chairmen of the Committee on Financial Services and the Committee on Oversight and Government Reform of the United States House of Representatives, stating that we would perform work responsive to the Members' concerns. The letters stated that we would conduct our work in two parts. First, we would investigate the serious allegation that a senior FDIC official had provided false testimony to the Congress. At the close of our audit, the Office of Inspector General's (OIG) Office of Investigations had completed work on a separate inquiry on this matter. Secondly, we would review the FDIC's supervisory activities related to Operation Choke Point and determine if the actions and policies of the FDIC were consistent with applicable law, regulations, and policy, and within the mission of the FDIC.

On December 17, 2014, the FDIC Chairman requested that as part of our planned and ongoing work in this area, we conduct a fact-finding review of the actions of one former and four current senior FDIC officials. The Chairman's request was prompted by concerns raised by a Congressman in a letter dated December 10, 2014 stating the five individuals had allowed their personal and political views to interfere with the important work of the FDIC and that the individuals had misled the American people through their emails and in meetings with, and testimony before, the Congress. The Congressman's concerns were based on information contained in a December 8, 2014 staff report of the House Oversight and Government Reform Committee, entitled *Federal Deposit Insurance Corporation's Involvement in "Operation Choke Point."* On January 20, 2015, we notified the FDIC Chairman that we would address the concerns raised in the Congressman's letter as part of this audit.

The objectives of the audit were to (1) describe the FDIC's role in the DOJ initiative known as Operation Choke Point and (2) assess the FDIC's supervisory approach to financial institutions that conducted business with merchants associated with high-risk activities for consistency with relevant statutes and regulations. To address the objectives, we:

- determined the extent to which the FDIC participated in developing and implementing Operation Choke Point;
- evaluated the FDIC's rationale for identifying certain types of merchants as being associated with high-risk activities;
- analyzed relevant statutes, regulations, policies, procedures, guidance, and training;

- reviewed a non-statistical sample[3] of 23 FDIC-supervised financial institutions to assess the FDIC's supervisory approach for addressing identified concerns; and

- conducted interviews of 106 current and former FDIC staff, executives at 19 FDIC-supervised financial institutions, officials in DOJ's Consumer Protection Branch, and officials with selected state banking agencies.

With respect to the five individuals, we determined the extent to which they were involved with Operation Choke Point and whether their actions involving the institutions we reviewed were based on personal, political, or moral agendas aimed at forcing lawful businesses associated with high-risk activities out of the banking sector.

We conducted this performance audit in accordance with generally accepted government auditing standards. Appendix 1 of this report includes additional details on our objectives, scope, and methodology; Appendix 2 contains a glossary of key terms; Appendix 3 contains a list of acronyms and abbreviations; Appendix 4 contains the Corporation's comments on this report; and Appendix 5 contains a summary of the Corporation's corrective actions.

Background

In November 2012, attorneys within the Consumer Protection Branch of DOJ's Civil Division proposed an internal initiative to investigate financial institutions and TPPPs that were suspected of processing payment transactions on behalf of merchants that engaged in fraudulent activities. At that time, DOJ had reason to believe that some TPPPs were processing payment transactions for their client merchants knowing that the merchants were engaged in fraudulent activities. In addition, DOJ believed that some financial institutions involved with those transactions were either aware of the fraud they were facilitating or ignored warning signs of the fraud. This initiative, which DOJ named Operation Choke Point, focused on the relationship between TPPPs and financial institutions because these relationships were the means by which fraudulent merchants were able to access the banking system to commit consumer fraud.

Using various public and nonpublic sources, DOJ compiled evidence of suspected fraudulent activity involving certain merchants, TPPPs, and financial institutions. Based on this information, DOJ issued 60 administrative subpoenas from February 2013 through August 2013 to entities for which the Department determined it had evidence of potential consumer fraud. According to DOJ employees that we spoke with during the audit, 20 of the subpoenas were issued to FDIC-supervised financial institutions.

According to the results of an inquiry performed by DOJ's Office of Professional Responsibility (OPR), DOJ had filed civil actions against three financial institutions in connection with

[3] A non-statistical sample is judgmental and cannot be projected to the population. See Appendix 1 for details regarding our sampling methodology.

Operation Choke Point as of July 7, 2015.[4] The OPR inquiry also found that DOJ had notified the majority of the institutions that received subpoenas that the Department's reviews of their matters had been concluded. However, at the conclusion of OPR's inquiry, some civil and criminal investigations were still viable and open based on information received in response to some of the subpoenas. Further, some United States Attorneys' Offices had open investigations based, at least in part, on evidence obtained from the subpoenas. OPR's inquiry found that although DOJ was focused on completing its investigations, the Department would open and pursue new investigations if it obtained information that institutions, TPPPs, and fraudulent merchants might be continuing to break the law.

In carrying out its work in connection with Operation Choke Point, DOJ employees communicated with regulatory agencies, including the FDIC, the Board of Governors of the Federal Reserve System (FRB), the Office of the Comptroller of the Currency (OCC), and the Consumer Financial Protection Bureau (CFPB). According to DOJ, such communications were intended to ensure that DOJ understood the industry at issue; that DOJ's investigative activities would not unnecessarily or improperly frustrate regulatory efforts; and that DOJ had all relevant information needed to evaluate its available enforcement options to address violations that the Department's investigations might uncover.

Congressional Concerns Pertaining to Operation Choke Point

Congressional review of any role that the FDIC may have played in Operation Choke Point began in August 2013. After an article was published in *The Wall Street Journal* on this subject,[5] 31 Members sent a letter, dated August 22, 2013, to the FDIC Chairman and the United States Attorney General expressing concern that the FDIC and DOJ were pressuring financial institutions and TPPPs to terminate business relationships with lawful lenders that provided short-term credit options to underserved consumers. Since that time, Members have also expressed concern that financial institutions were declining basic banking services, such as deposit accounts and loans, to entire categories of merchants as a result of regulatory pressure stemming from Operation Choke Point. Such merchants included (among others) payday lenders, firearms manufacturers and retailers, pawnbrokers, coin dealers, and tobacco retailers. Further, Members have expressed concern that certain senior FDIC staff had allowed their personal views of these merchants to influence their supervisory decision-making.

The concerns described above were based on the results of investigative efforts by the Committee on Financial Services and the Committee on Oversight and Government Reform of the United States House of Representatives. As part of these efforts, Members have made numerous requests for information to the FDIC and other agencies; exchanged letters and met with agency officials; and held several hearings. In addition, the Committee on Oversight and

[4] On July 7, 2015, OPR issued the results of an inquiry into whether DOJ's Civil Division, acting in concert with federal banking regulators under Operation Choke Point, had abused its authority to conduct civil investigations under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. The inquiry was conducted in response to a request, dated October 16, 2014, from 32 Members of Congress.

[5] August 8, 2013 article, entitled *Probe Turns Up Heat on Banks---Prosecutors Target Firms That Process Payments for Online Payday Lenders, Others*.

Government Reform has issued two written reports.[6] At the close of our audit fieldwork, various Members were continuing to investigate Operation Choke Point.

The FDIC's Supervisory Authorities

The FDIC has broad statutory and regulatory authority to supervise the activities of state-chartered financial institutions that are not members of the Federal Reserve System.[7] Specifically, Sections 9 and 10(b) of the Federal Deposit Insurance Act (FDI Act), as amended, authorize the FDIC to examine the financial institutions it supervises. The FDIC conducts examinations pertaining to safety and soundness, consumer compliance, Community Reinvestment Act (CRA), and specialty areas to assess each institution's operating condition, management practices and policies, and compliance with applicable laws and regulations.[8] Section 8 of the FDI Act authorizes the FDIC to bring enforcement proceedings against any FDIC-supervised institution that, in the opinion of the FDIC, has engaged, is engaging, or is about to engage in an unsafe or unsound practice or has violated, is violating, or is about to violate, a law, rule, or regulation, including consumer protection laws. The FDIC Chairman, in coordination with the Corporation's Board of Directors (Board), is responsible for setting agency priorities and strategies aimed at addressing risks and concerns at FDIC-supervised financial institutions.

Within the FDIC, the Division of Risk Management Supervision (RMS) has primary responsibility for promoting safe and sound banking practices at FDIC-supervised institutions. In fulfilling its responsibilities, RMS plans and conducts regular onsite risk management (i.e., safety and soundness) examinations of financial institutions; issues policy and guidance; communicates with industry officials; reviews applications submitted by financial institutions to expand their activities or locations; and monitors institutions to identify emerging safety-and-soundness issues. RMS also conducts specialty examinations that cover such areas as trust department operations, information technology (IT) controls, and compliance with the Currency and Foreign Transactions Reporting Act—commonly referred to as the Bank Secrecy Act (BSA).

The FDIC's Division of Depositor and Consumer Protection (DCP) has primary responsibility for promoting compliance by FDIC-supervised financial institutions with consumer protection, fair lending, and community reinvestment laws. DCP fulfills its responsibilities through a variety of activities, including regular onsite compliance and CRA examinations of financial institutions; communications with industry officials; dissemination of information to consumers about their rights and required disclosures; and investigations and resolution of consumer complaints regarding FDIC-supervised institutions.

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[6] Reports entitled, *The Department of Justice's "Operation Choke Point": Illegally Choking Off Legitimate Businesses?*, dated May 29, 2014, and *Federal Deposit Insurance Corporation's Involvement in "Operation Choke Point*," dated December 8, 2014.
[7] As of December 31, 2014, the FDIC was the primary federal regulator for 4,138 financial institutions. The majority of these institutions were small community banks with assets totaling $1 billion or less.
[8] Such laws and regulations include the Fair Debt Collection Practices Act (FDCPA) and its implementing Regulation F, the Equal Credit Opportunity Act (ECOA) and its implementing Regulation B, the Truth in Lending Act (TILA) and its implementing Regulation Z, and the Federal Trade Commission Act (FTC Act). The FDIC coordinates with other regulatory agencies, such as the CFPB, on relevant consumer protection matters.

The FDIC's Legal Division is responsible for (among other things) providing legal counsel to RMS and DCP on the full range of laws and regulations governing bank supervision and consumer protection. This includes reviewing the legal sufficiency of proposed enforcement proceedings, such as Cease and Desist Orders, Consent Orders, and Civil Money Penalties (CMP), against institutions or responsible individuals, when appropriate.

The FDIC coordinates its supervisory activities with other federal and state banking agencies that have supervisory responsibility for the institutions within their jurisdictions. In addition, the FDIC coordinates with other federal and state organizations, such as the Federal Financial Institutions Examination Council (FFIEC) and Conference of State Bank Supervisors, when developing supervisory policy and guidance to promote a consistent approach to bank supervision.

Supervisory Corrective Actions

The FDIC's *Risk Management Manual of Examination Policies*, *Compliance Examination Manual*, and *Formal and Informal Actions Procedures Manual* describe the FDIC's approach for determining an appropriate supervisory corrective action to address an identified safety and soundness or consumer protection concern. In general, these manuals outline a risk-based, graduated approach for addressing concerns identified through the supervisory process. According to two of the manuals, it is sufficient in many cases for examiners to use moral suasion or make written recommendations in reports of examination to address identified problems or concerns.[9] The FDIC does not have a formal definition of moral suasion in its policies. However, examiners commonly use moral suasion in an attempt to influence risk management practices at financial institutions before perceived problems rise to a level that necessitates informal or formal action. If moral suasion or recommendations would not be sufficient, or if serious concerns exist, stronger actions may be taken in the form of informal or formal corrective actions against an institution or responsible individuals.

The FDIC generally initiates an informal or formal corrective action when an institution has a safety and soundness or compliance rating of "3," "4," or "5," unless specific circumstances warrant otherwise. Informal actions typically involve the FDIC either recommending that the institution's Board of Directors (Board) adopt a Bank Board Resolution or entering into a Memorandum of Understanding (MOU) with the institution's Board to address specific concerns. Formal actions may involve, for example, a Cease-and-Desist Order or Consent Order; removal, prohibition, or suspension action; or CMP.

TPPPs and Merchants Associated with High-Risk Activities

In the summer of 2011, prior to DOJ's initiation of Operation Choke Point, the FDIC published an informational article entitled, *Managing Risks in Third Party Payment Processor Relationships*, in its *Supervisory Insights* Journal. The Journal, which is intended to promote sound principles and practices in bank supervision, does not represent supervisory policy or

[9] Moral suasion is not discussed in the Compliance Examination Manual.

official guidance. According to its terms, the views expressed in the Journal are those of its authors and do not necessarily reflect official positions of the FDIC.

The article discussed the role of TPPPs and the risks presented to financial institutions that have deposit account relationships with TPPPs. According to the article, deposit relationships with payment processors can expose financial institutions to risks not present in typical commercial customer relationships, including greater strategic, credit, compliance, transaction, legal, and reputation risk. The article also discussed the warning signs that may indicate heightened risk in a TPPP banking relationship, the mitigation controls that institutions should have in place when providing deposit account services to TPPPs, and the supervisory actions that may be taken when risks are not adequately managed.

The article explained that although many TPPPs process legitimate payment transactions for a variety of reputable merchants, an increasing number of TPPPs were initiating payments for abusive telemarketers, deceptive on-line merchants, and organizations engaged in high-risk or illegal activities. Without adequate monitoring systems and controls, a financial institution in a TPPP relationship could facilitate unauthorized transactions or unfair or deceptive practices, resulting in financial harm to consumers. The article identified 30 types of TPPP client merchants that were associated with high-risk activities. The Table below identifies these merchants. We sometimes refer to these merchants collectively as the "high-risk list."

Table: Merchants Associated with High-Risk Activities

Merchant Category	
Ammunition Sales	Life-Time Memberships
Cable Box De-scramblers	Lottery Sales
Coin Dealers	Mailing Lists/Personal Information
Credit Card Schemes	Money Transfer Networks
Credit Repair Services	On-line Gambling
Dating Services	PayDay Loans
Debt Consolidation Scams	Pharmaceutical Sales
Drug Paraphernalia	Ponzi Schemes
Escort Services	Pornography
Firearms Sales	Pyramid-Type Sales
Fireworks Sales	Racist Materials
Get Rich Products	Surveillance Equipment
Government Grants	Telemarketing
Home-Based Charities	Tobacco Sales
Life-Time Guarantees	Travel Clubs

Source: The FDIC's *Supervisory Insights* Journal, Summer 2011 [original] publication.

Financial institutions that process transactions through a TPPP can be exposed to risks not present in other commercial customer relationships because the institutions typically do not have a direct relationship with the TPPP's client merchants. Section 326 of the USA PATRIOT Act, which amended the BSA, requires financial institutions to establish and maintain a Customer Identification Program that enables the institution to form a reasonable belief that it knows the true identity of its customers. Knowing one's customer serves to protect institutions from the potential liability and risk of providing financial services to a customer engaged in fraudulent and unlawful activity. In addition, the FFIEC's *Bank Secrecy Act Anti-Money Laundering Examination Manual* states that financial institutions should have a Customer Due Diligence (CDD) program that enables the institution to predict with relative certainty the types of transactions in which a customer is likely to engage. The CDD program assists the institution in determining when transactions are potentially suspicious so that the institution may meet its statutory obligations of filing Suspicious Activity Reports (SARs), when appropriate.

Proper monitoring of transactions processed through TPPP bank accounts can be particularly challenging because TPPPs can have hundreds or even thousands of client merchants. In addition, TPPPs are generally not subject to BSA or anti-money laundering (AML) requirements. As a result, some TPPPs may be vulnerable to money laundering, identity theft, fraud schemes, and other illegal transactions.

TPPP Guidance

The FDIC's supervisory approach and expectations for financial institutions that establish relationships with TPPPs are defined in various FDIC and interagency guidance.[10] In general, this guidance states that institutions should establish risk management controls that are appropriate for the risks posed by TPPPs and their client merchants. Such controls include careful due diligence for TPPPs and their client merchants and monitoring of account transactions for indications of suspicious activity, such as elevated levels of unauthorized returns, chargebacks, and/or consumer complaints. These risk management controls are intended to mitigate the increased operational, strategic, credit, compliance, transaction, and other risks associated with TPPP relationships.

According to the guidance, when an institution identifies potentially fraudulent or improper activities involving a TPPP or its client merchants, the institution should take prompt action to minimize possible consumer harm. Such action may include filing a SAR, requiring the payment processor to cease processing for a specific merchant, and/or terminating the institution's relationship with the TPPP. Institutions are also expected to develop processor approval programs that include a background check of payment processors and their merchant clients.

When assessing TPPP-related risks, FDIC examiners focus on whether the institution is adequately overseeing the activities and transactions it is processing and appropriately managing and mitigating the associated risks. According to the FDIC's TPPP guidance, institutions that fail to adequately manage TPPP relationships may be viewed as facilitating the processor's or its client merchant's fraudulent or unlawful activity and, thus, may be liable for such acts or practices. In such cases, financial institutions and responsible individuals have been subject to enforcement, supervisory, and other actions.

Direct Banking Relationships

While the high-risk list was introduced in the context of a financial institution having a deposit account relationship with a TPPP, institutions may also provide banking services directly to a

[10] Appendix 1 contains a summary of FDIC and interagency TPPP guidance.

merchant on the high-risk list. Such services include, for example, checking accounts, loans, and the processing of Automated Clearing House (ACH) payment transactions. The FDIC's supervisory approach for assessing banking services offered directly to these (and any other) merchants is reflected in the *Risk Management Manual of Examination Policies*, *Compliance Examination Manual*, *Formal and Informal Actions Procedures Manual*, and *Retail Payment Systems IT Examination Handbook*. In addition, the FDIC has issued specific guidance to institutions that offer payday loans—either to their customers using the institution's own employees or through third-party arrangements with a payday lender. A description of the FDIC's payday lending guidance follows.

Payday Lending

The FDIC initially issued supervisory guidance to address safety and soundness and consumer protection concerns associated with payday lending by FDIC-supervised financial institutions in July 2003.[11] The guidance applied to institutions that were making payday loans both directly to their customers and through third-party payday lenders.[12]

Figure: What Are Payday Loans?

Payday loans are small-dollar, short-term, unsecured loans that borrowers promise to repay out of their next paycheck or regular income payment (such as a social security check).

Payday loans are usually priced at a fixed-dollar fee, which represents the finance charge to the borrower. Because the loans have short terms to maturity, the cost of borrowing, expressed as an annual percentage rate, can be very high relative to traditional loans.

When the guidance was issued, a number of institutions had entered into arrangements whereby third-party payday lenders were making loans on behalf of the institutions. The institutions funded the loans and, therefore, remained responsible for ensuring that the loans were made in a safe and sound manner and in compliance with applicable laws. A key benefit to the payday lenders in these arrangements was that they were permitted to export favorable interest rates in the state where the institution was chartered to borrowers in other states that had more restrictive usury laws. This in effect allowed the payday lenders to avoid state usury laws, prompting many consumer groups, federal and state regulators (including bank regulatory agencies), and Members, to criticize these arrangements as "rent-a-charters" (implying that the institutions were essentially renting their bank charters out to payday lenders).

The July 2003 guidance stated that payday loans are a high-risk, specialized type of subprime lending not typically found in state nonmember institutions. According to the guidance, such loans are most frequently originated by specialized nonbank firms subject to state regulation. The guidance stated that payday loans have well-defined weaknesses that jeopardize the

[11] PR-70-2003: *FDIC Issues Examination Guidance for Payday Lending,* dated July 2, 2003. This guidance supplemented previously issued FDIC and interagency guidance on subprime lending.

[12] The guidance did not apply to financial institutions that (1) made loans to payday lenders; (2) made occasional low-denomination, short-term loans to customers; (3) entered into relationships with TPPPs that processed ACH transactions for payday lenders; or (4) processed ACH transactions directly for payday lenders that had deposit accounts with the institution.

liquidation of the debt, such as limited or no analysis of borrower repayment capacity, the unsecured nature of the credit, and a marked proportion of obligors whose repayment capacity is questionable. Payday lending also raises many consumer protection issues and attracts a great deal of attention from consumer advocates and other regulatory organizations, increasing the potential for litigation.

The July 2003 guidance stated that when institutions facilitate payday lending through third parties, the transaction, legal, and reputation risks to the institutions increase significantly if the third parties are not properly managed. Based on these risks, the FDIC's payday lending guidance imposed significant expectations on institutions engaged in that type of lending. For example, the guidance stated that institutions should hold greater levels of capital against payday loans than for non-subprime assets of a similar nature. In addition, the guidance stated that an institution's CRA rating could be adversely affected if an institution engaged in illegal credit practices.

Due to the heightened safety and soundness and consumer compliance risks posed by payday lending by institutions, the guidance stated that the FDIC would generally perform concurrent risk management and compliance examinations of institutions that engage in payday lending to verify and monitor the institutions' performance relative to the guidance. The guidance also stated that examiners could conduct targeted examinations of the third parties that originated payday loans on behalf of financial institutions under certain circumstances.[13] Further, supervisory corrective actions, including enforcement actions and requirements for institutions to discontinue payday lending, may be pursued when institutions fail to comply with the guidance.

In March 2005, the FDIC revised its July 2003 payday lending guidance due to concerns that FDIC-supervised institutions were offering payday loans in a manner that was inconsistent with the prior guidance, the payday lenders' marketing materials, and industry best practices.[14] The revised guidance reiterated many of the same standards that were contained in the 2003 guidance, but established a new expectation for institutions to ensure that payday loans are not provided to customers who have had such loans outstanding from any lender for a total of 3 months in the previous 12-month period. Additionally, the March 2005 guidance states that providing high-cost, short-term credit on a recurring basis to consumers with long-term credit needs is not responsible lending; increases institutions' credit, legal, reputation, and compliance risks; and can create a serious financial hardship for customers.

Concerns Regarding Payday Lending

As described below, the FDIC, OCC, Congress, and CFPB have raised concerns regarding the risks associated with payday lending by financial institutions. In June 2000, a former FDIC Chairman expressed concern in public remarks that institutions were partnering with payday

[13] Authority to conduct examinations of third parties may be established under several circumstances, including through a bank's written agreement with a third party, section 7 of the Bank Service Company Act, or through powers granted under section 10 of the FDI Act.

[14] Financial Institution Letter (FIL)—FIL-14-2005, *Payday Lending Programs, Revised Examination Guidance*, dated March 1, 2005.

lenders through so called rent-a-charter arrangements.[15] Subsequent FDIC Chairmen and certain FDIC Board members also raised concerns about payday lending by FDIC-supervised financial institutions. In addition, on November 27, 2000, the OCC issued *Advisory Letter on Payday Lending*, (AL 2000-10), which applies to national banks and federal savings associations the agency regulates. The guidance states that the OCC will closely review the activities of banks engaged or proposing to engage in payday lending by examining the banks and any relevant third parties. According to the guidance, examinations will focus on safety and soundness risks and compliance with consumer protection and fair lending laws.

In 2007, the Congress enacted legislation aimed at curbing predatory lending practices. Specifically, the Military Lending Act (MLA)—a component of the 2007 National Defense Authorization Act—placed restrictions on credit products offered to active-duty service members and their families by limiting the annual interest rate on such products to 36 percent, including all fees, charges, and premiums. The associated regulations issued by the Department of Defense that became effective for loans written on or after October 1, 2007, state that payday loans, refund anticipation loans (RAL), and vehicle title loans are subject to the protections of the MLA. Further, in March 2015, the CFPB announced that it was considering proposed rules pertaining to payday lending. Such rules would apply to all insured depository institutions and non-depository entities involved in payday lending. The CFPB raised concerns about practices associated with payday lending and similar products, which can trap consumers in debt and force them to choose between re-borrowing, defaulting, or falling behind on other obligations. At the time of our audit, the CFPB was contemplating requirements on lenders aimed at ensuring borrowers are not trapped in cycles of debt.

Audit Results

The FDIC's involvement in Operation Choke Point has been limited to a few FDIC staff communicating with DOJ employees regarding aspects of the initiative's implementation. These communications with DOJ generally related to the Corporation's responsibility to understand and consider the implications of potential illegal activity involving FDIC-supervised financial institutions. Overall, we consider the FDIC's involvement in Operation Choke Point to have been inconsequential to the overall direction and outcome of the initiative.

We determined that the FDIC's supervisory approach to financial institutions that conducted business with merchants on the high-risk list was within the Corporation's broad authorities granted under the FDI Act and other relevant statutes and regulations. However, the manner in which the supervisory approach was carried out was not always consistent with the FDIC's written policy and guidance.

We found no evidence that the FDIC used the high-risk list to target financial institutions. However, references to specific merchant types in the summer 2011 *Supervisory Insights* Journal article and in supervisory guidance created a perception among some bank executives that we

[15] Remarks made by the former FDIC Chairman at the *Seventh Annual Greenlining Economic Development Summit*, June 13, 2000.

spoke with that the FDIC discouraged institutions from conducting business with those merchants. This perception was most prevalent with respect to payday lenders.

The FDIC's payday lending guidance, which was established in 2003 and updated in 2005, increased expectations and placed heightened scrutiny on institutions that were engaged in payday lending. As a result of the guidance and related supervisory actions, the relatively few FDIC-supervised institutions that were making payday loans stopped doing so in 2006. In the years that followed, the FDIC took steps to encourage institutions to offer affordable, small-dollar loans and researched and communicated concerns about emerging credit products that can have characteristics similar to payday loans, such as deposit advance products.

We found that a number of FDIC officials also had concerns about ACH payment processing for payday lenders. These concerns were based on the premise that such services facilitate payday lending. A heightened level of concern for payday lending by financial institutions and related ACH processing was reflected in the negative tenor of internal email communications among senior FDIC staff and others that we reviewed. In some cases, these communications involved instances in which FDIC personnel contacted institutions and used moral suasion to discourage them from adopting payday lending products or providing ACH processing for payday lenders. The FDIC does not have a formal definition of moral suasion in its policies. However, examiners commonly use moral suasion in an attempt to influence risk management practices at financial institutions before perceived problems rise to a level that necessitates an informal or formal enforcement action.

We noted two instances in which the FDIC discouraged institutions from providing ACH processing to payday lenders in written communications to the institutions. In both instances, the FDIC's principal stated concern was the reputation risk to the institutions due to their potential or existing relationship with a payday lender. The FDIC does not centrally track its written communications to financial institutions that involve ACH processing concerns. Accordingly, we were unable to determine how often such communications occur. However, our discussions with FDIC executives and review of regional office status reports identified only three institutions where FDIC officials raised concerns regarding ACH processing practices for payday lenders.

FDIC officials determined that there were misperceptions regarding the Corporation's supervisory approach to institutions that conduct business with merchants on the high-risk list and, therefore, the FDIC took several actions beginning in September 2013. Specifically, the FDIC withdrew references to high-risk merchants from the *Supervisory Insights* article and its guidance, clarified its supervisory policy and guidance, and established an internal policy for documenting and reporting instances in which staff recommend or require institutions to terminate deposit account relationships. Among other things, the internal policy does not allow for the termination of deposit account relationships based solely on reputation risk to an institution. These actions were intended to make clear the FDIC's policy that financial institutions that properly manage customer relationships and effectively mitigate risks are neither prohibited nor discouraged from providing financial services to customers, regardless of the customers' business category, provided that the institutions operate in compliance with applicable laws. However, the policy and guidance focus on deposit accounts and may warrant clarification to address other types of banking products, such as credit products.

With respect to our review of the actions of the five FDIC officials, we concluded that they did not play a role in the development or implementation of Operation Choke Point. We also concluded that the individuals did not pursue their own personal, political, or moral agendas aimed at forcing lawfully operating businesses on the high-risk list out of the banking sector. As it pertains to payday lending and related activities, we concluded that the officials acted consistent with a widely-held understanding that the highest levels of the FDIC disfavored these types of banking services. We did, however, identify certain internal email communications and one written communication to an institution involving three of the five individuals that were not consistent with the FDIC's written guidance pertaining to payday lending and related activities.

Finally, our report includes an observation on the FDIC's supervisory approach to financial institutions that offered a credit product known as a RAL. The FDIC considers RALs to carry a significant degree of risk to financial institutions, including third-party, reputation, compliance, and legal risks. Of particular concern to the FDIC is whether an institution can ensure proper underwriting and compliance with consumer protection requirements, particularly when RALs are brokered by large numbers of third-party tax return preparers (sometimes called electronic refund originators—EROs) in conjunction with the filing of a taxpayer's income tax return. Although RALs were not on the high-risk list, we observed that the FDIC's supervisory approach to institutions that offered this type of credit product involved circumstances that were similar to those that prompted the Congressional request to our office.

We identified three FDIC-supervised institutions that offered RALs. These institutions began offering RALs in 1987, 1988, and 2007, respectively. At various times from 2004 through 2009, FDIC examiners criticized the risk management practices pertaining to RALs at two of these institutions during compliance and risk management examinations. In late 2009 and early 2010, the FDIC sent letters to all three institutions expressing concerns about RALs and requesting that the institutions submit plans for discontinuing this type of lending. In early 2011, after efforts to convince these institutions to discontinue offering RALs were unsuccessful and supervisory concerns remained, the tenor of the FDIC's supervisory approach became aggressive. In one case, the FDIC took the highly unusual step of conducting a simultaneous, unannounced review of 250 EROs in 36 states involving hundreds of FDIC examiners in order to develop the evidence needed to compel the institution to stop offering RALs. In another case, a former FDIC supervisory attorney used a confrontational approach to pressure an institution's Board to terminate its RAL offerings. By April 2012, all three institutions had stopped offering RALs.

The FDIC drafted a policy statement in 2010 that defined the FDIC's supervisory concerns and expectations for institutions offering RALs. However, the policy statement was never finalized. In our view, establishing such a policy would have been prudent to ensure institutions understood the risks associated with RALs and provide transparent supervisory guidance and expectations for institutions already (or contemplating) offering RALs.

We concluded that the supervisory actions taken with respect to the three institutions that offered RALs fell within the Corporation's broad statutory authorities because the Corporation is permitted to require a financial institution to discontinue a practice if safety and soundness or consumer protection concerns warrant doing so. However, we found that the FDIC took an aggressive, and at times, confrontational approach to convince the institutions to discontinue their RAL programs. We believe that the execution of these actions by FDIC management and staff warrants further review, and the OIG is conducting additional work in this area.

The FDIC's Role in Operation Choke Point

The FDIC did not participate in the development of DOJ's internal proposal in November 2012 to investigate financial institutions and TPPPs that were suspected of processing payment transactions on behalf of merchants engaged in fraudulent activities. In addition, the FDIC did not coordinate with DOJ in its efforts to assemble evidence of potential fraudulent activity involving these entities or to identify the financial institutions and other entities that subsequently received subpoenas in connection with Operation Choke Point. Further, DOJ did not notify the FDIC of the financial institutions that received subpoenas. DOJ employees informed us that the Department typically does not notify the primary federal bank regulator when a subpoena is issued to an insured institution. Except as discussed below, RMS and DCP officials that we spoke with were not aware of the specific FDIC-supervised institutions that received a DOJ subpoena. These officials indicated that they may learn of a DOJ subpoena if the institution informs the FDIC, or through standard information requests to an institution prior to a compliance examination.[16]

DOJ employees informed us that many of the subpoenas issued pursuant to Operation Choke Point contained copies of publicly available guidance on payment processors that was issued by the FDIC, the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN), and the OCC.[17] The FDIC guidance contained a footnote listing examples of telemarketing, on-line businesses, and other merchants that may have a higher incidence of consumer fraud or potentially illegal activities or that may otherwise pose elevated risk.[18] Members have raised concern that including the FDIC guidance in the DOJ subpoenas was an attempt by the Corporation and the Department to pressure financial institutions to terminate business relationships with those merchants, regardless of the risks the merchants posed to the institutions.

DOJ employees informed us that the intent of including the regulatory guidance in the subpoenas was to provide the subpoena recipients with information about the risks posed by TPPPs and the responsibilities of financial institutions in managing those risks. Further, DOJ believed that the guidance could help institutions to better identify and provide documents that were responsive to DOJ's subpoenas. DOJ employees stated that they did not have discussions with anyone at the

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[16] Prior to the start of a compliance examination, DCP submits a document request to the institution that, among other things, requests information about any investigations by other federal agencies.
[17] The guidance consisted of FDIC FIL 3-2012, *Payment Processor Relationships* (Revised Guidance), dated January 31, 2012; FinCEN's Advisory, *Risk Associated with Third Party Payment Processors*, dated October 22, 2012; and OCC Bulletin 2008-12, *Payment Processors*, dated April 24, 2008.
[18] Such entities consisted of credit repair services, debt consolidation and forgiveness programs, on-line gambling-related operations, government grant or will-writing kits, payday or subprime loans, pornography, on-line tobacco or firearms sales, pharmaceutical sales, sweepstakes, and magazine subscriptions. According to the footnote in the guidance, these entities were not all-inclusive.

FDIC about whether to include the guidance in the subpoenas, and FDIC officials informed us that they had no knowledge that the guidance would be included in the subpoenas. Further, OPR's review of contemporaneous documents and discussions with DOJ attorneys during its inquiry into Operation Choke Point found that DOJ attorneys did not intend to discourage institutions from conducting business with specific categories of lawful merchants when they included the regulatory guidance in the subpoenas.

We identified a limited number of FDIC staff in the Washington, D.C. office who began communicating with DOJ employees in early 2013 regarding the Department's efforts to investigate certain financial institutions, TPPPs, and merchants. The majority of these communications involved two staff attorneys in the FDIC's Legal Division.[19] In addition, during the period covering March 2013 through April 2015, DOJ formally requested from the FDIC information pertaining to 3 of the 20 FDIC-supervised institutions that DOJ subpoenaed pursuant to Operation Choke Point.[20] The information requested by DOJ included such things as reports of examination, correspondence, memoranda, and examiner working papers related to the institutions' ACH processing activities, remotely-created check businesses, TPPP relationships, and BSA/AML compliance. As of July 15, 2015, the FDIC had provided or was working to provide information responsive to these requests.

FDIC staff informed us that they learned of DOJ's investigative work involving TPPPs, financial institutions, and merchants through informal discussions with a DOJ employee following an inter-agency training conference held in February 2013. In addition, a DOJ employee discussed aspects of the Department's work in this area during a meeting of the *Interagency Bank Fraud Enforcement Working Group* in early 2013.[21] At that time, DCP, RMS, and the Legal Division were—separate from DOJ— researching illegal payday lending activity based on concerns raised by a state regulator to the FDIC in December 2012. That research, which was internal to the FDIC, continued through August 2013.

The FDIC's communications with DOJ consisted of responding to requests from DOJ employees for information about FDIC-supervised institutions that the Department was investigating; responding to DOJ inquiries about remedies that federal regulators could potentially pursue in the event that illegal payday lending was associated with insured-depository institutions; and

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[19] We identified three other FDIC employees who communicated with DOJ employees regarding their investigative activities pertaining to Operation Choke Point. These individuals consisted of (1) a supervisory attorney in the Legal Division who oversaw the activities of the two staff attorneys referenced above; (2) an RMS employee in the Washington, D.C. office who had informal conversations with DOJ staff during inter-agency meetings and training conferences; and (3) an FDIC OIG criminal investigator assigned to investigate activities at one of the FDIC-supervised institutions that received a subpoena from DOJ. The FDIC OIG notified Members about the communications between the OIG investigator and DOJ and provided relevant documentation to the Members in June and July 2014.

[20] Such requests were processed based on procedures defined in 12 C.F.R. Part 309—*Disclosure of Information*. On June 30, 2015, we provided FDIC officials with the names of the 20 FDIC-supervised institutions that received DOJ subpoenas so that the officials could determine whether the Corporation had received any formal requests for information from the Department. Prior to our providing this information, FDIC officials were not aware of all of the FDIC-supervised institutions that DOJ had subpoenaed in connection with Operation Choke Point.

[21] The working group, which has been in existence for about 30 years, is comprised of individuals from banking, law enforcement, and other federal agencies, including the FDIC.

reviewing documents obtained by DOJ in the course of its investigative activities. We concluded that the FDIC's communications with DOJ employees were based on the FDIC's responsibility to understand and consider potentially illegal activity involving FDIC-supervised institutions, as well as the risks such activities could pose for the institutions.

In April 2013, one of the two FDIC staff attorneys referenced above informed a DOJ employee that both FDIC attorneys were interested in working at the Department on a temporary detail to focus on DOJ's efforts to investigate TPPPs, financial institutions, and merchants. Although the FDIC attorneys had subsequent discussions about a potential detail with DOJ employees, neither FDIC attorney discussed a detail assignment with their supervisor and the FDIC never detailed any of its employees to DOJ to work on matters related to Operation Choke Point.

In June 2013, a DOJ employee assigned to work on Operation Choke Point provided the two FDIC staff attorneys with a hardcopy listing of 15 institutions that had received subpoenas from the Department and that DOJ believed were supervised by the FDIC.[22] At that time, one of the FDIC staff attorneys provided the listing to a DCP employee in the Washington, D.C., office who was working on matters pertaining to fraudulent activities perpetuated by TPPPs. We found no evidence that the listing was provided to RMS or DCP Regional Offices or to field examiners who had direct supervisory responsibility for these institutions.

According to the FDIC's time and attendance records, the two FDIC staff attorneys charged approximately 50 hours (combined) to matters pertaining to Operation Choke Point from February through August 2013. According to these attorneys, a significant portion of the time charges involved gaining remote access to a DOJ system that contained information obtained from the subpoenas that DOJ had issued to FDIC-supervised institutions. Although the attorneys obtained remote access to the system in late August 2013, they informed us that they did not access the information in the system because they were instructed not to do so by an executive in the Legal Division following public reports alleging that the FDIC was working with DOJ to pressure institutions to decline banking services to certain types of merchants.

Senior FDIC executives, including the Chairman, RMS Director, DCP Director, former Acting General Counsel, and all six Regional Directors, informed us that they had never had any discussions with DOJ regarding Operation Choke Point. These statements were consistent with the results of our interviews of officials in the DOJ's Consumer Protection Branch, which had responsibility for planning and executing Operation Choke Point.

The FDIC Chairman informed us that he became aware of Operation Choke Point after receiving the August 22, 2013, letter from Members expressing concern that the FDIC and DOJ were pressuring financial institutions and TPPPs to terminate business relationships with lawful lenders. At that time, the FDIC Chairman requested a briefing from his staff on the matter and asked that he be kept fully informed of any communications between the FDIC and DOJ. The Chairman also requested that any communications between FDIC staff and DOJ be limited to official requests for information from the Department.

[22] Fourteen of the 15 institutions were supervised by the FDIC at the time of our audit.

The FDIC's Supervisory Approach to Institutions that Conducted Business with Merchants on the High-Risk List

We determined that the FDIC's supervisory approach to financial institutions that conducted business with merchants on the high-risk list was within the Corporation's broad authorities granted under the FDI Act and other relevant statutes and regulations. In addition, we found no evidence that the FDIC used the high-risk list to target financial institutions. Further, both the high-risk list and supervisory guidance containing references to specific merchant categories were developed before the inception of Operation Choke Point and were not a driving factor in the initiative's implementation. However, as described later, references to specific merchant types in the summer 2011 *Supervisory Insights* Journal article and in supervisory guidance created a perception among some bank executives that we spoke with that the FDIC discouraged institutions from conducting business with those merchants. This perception was most prevalent with respect to payday lenders.

With the exception of payday lenders, we found no instances among the 23 financial institutions we reviewed where the FDIC pressured an institution to decline banking services to a merchant on the high-risk list. In addition, bank executives that we spoke with indicated that, except for payday lenders, they had not experienced regulatory pressure to terminate an existing customer relationship with a merchant on the high-risk list, including a firearms, ammunition, or tobacco retailer. Although pawnbrokers were not on the high-risk list, executives from five institutions informed us that they provided banking services to these merchants and had never experienced regulatory pressure to terminate the business relationships.

The FDIC's concerns regarding payday lending by financial institutions precede Operation Choke Point by many years. The FDIC's payday lending guidance, which was established in 2003 and updated in 2005, increased expectations and placed heightened scrutiny on institutions that engage in that type of lending. As a result of this supervisory posture, FDIC-supervised institutions stopped making payday loans in 2006. In the years that followed, the FDIC took steps to encourage financial institutions to offer affordable, small-dollar loans and proactively researched and communicated concerns about emerging credit products that can have characteristics similar to payday loans, such as deposit advance products.

Based on our review of internal FDIC email communications and discussions with FDIC staff, we found that a number of FDIC officials also had concerns regarding financial institutions that provided ACH payment processing for payday lenders. These concerns were based on the premise that the institution was, in effect, facilitating payday lending by processing ACH payments, even though the institution was not engaging in direct payday lending. ACH payment processing activities are covered in the FFIEC's *Bank Secrecy Act Anti-Money Laundering Examination Manual* and *Retail Payment Systems IT Examination Handbook.* We were unable to determine the approximate number of financial institutions that facilitate ACH payment processing activities because that information is not tracked by the FDIC. Based on our review of regional office monthly status reports for the 4-year period ended December 31, 2014, we identified concerns specifically focused on ACH processing for payday lenders at three FDIC-supervised financial institutions.

The heightened level of concern for payday lending by financial institutions and related activities was reflected in the negative tenor of internal email communications among senior FDIC staff and others that we reviewed. We also noted two instances in which the FDIC used moral suasion in its written communications to institutions to discourage them from providing ACH processing to payday lenders. In both instances, the FDIC's principal stated concerns were based primarily on reputation risk to the institutions due to their potential or existing relationship with a payday lender.

The FDIC has taken a number of actions to address concerns raised by Members that the Corporation was pressuring financial institutions to decline banking services to merchants on the high-risk list. These actions were intended to make clear the FDIC's policy that financial institutions that properly manage customer relationships and effectively mitigate risks are neither prohibited nor discouraged from providing financial services to customers, regardless of the customers' business category, provided that the institutions operate in compliance with applicable laws.

<u>The High-Risk List</u>

The FDIC's summer 2011 *Supervisory Insights* Journal and original supervisory guidance on financial institution relationships with TPPPs included examples of merchants associated with high-risk activities.[23] Both the article and guidance were developed prior to the inception of Operation Choke Point and were not a principal factor in the initiative's implementation. RMS, DCP, and Legal Division staff informed us that the references to these merchants were not the primary purpose of the article or guidance. Rather, the references were intended to illustrate the types of merchants that the payments industry had identified as being associated with higher-levels of fraudulent activity. The focus of the article and guidance, according to these FDIC officials, was to describe the risks associated with financial institution relationships with TPPPs and to provide guidance on appropriate risk management controls and practices for these relationships.

We reviewed the policies of six non-statistically sampled companies in the payments industry and confirmed that the policies of one or more of those companies (1) categorized all but two of the merchants on the high-risk list as high-risk and/or (2) prohibited the processing of transactions by those merchants.[24] We also noted that from June 2005 until November 2014, the FFIEC *Bank Secrecy Act Anti-Money Laundering Examination Manual* identified the following types of merchants as being associated with high-risk activities in the context of third-party payment transactions: on-line payday lenders, on-line gambling-related operations, offshore

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[23] The supervisory guidance consisted of: FIL-127-2008, *Guidance on Payment Processor Relationships*; FIL-3-2012: *Payment Processor Relationships, Revised Guidance; and* FIL-43-2013: *FDIC Supervisory Approach to Payment Processing Relationships With Merchant Customers That Engage in Higher-Risk Activities*.

[24] The exceptions were government grants and coin dealers. The FDIC included government grants on the high-risk list because the Federal Trade Commission had received complaints in connection with disreputable merchants that sold government grant writing kits with public information that consumers could have readily obtained through the Internet. Coin dealers were included because related transactions can be cash-intensive and pose risks associated with money laundering. The policies we reviewed were issued by the following companies: Visa, Inc.; MasterCard, Inc.; PayPal; Amazon, Inc; Ebay, Inc.; and Google, Inc.

companies, mail order and telephone order companies, telemarketing companies, and adult entertainment businesses.[25] Several of these merchant categories appear on the high-risk list. In November 2014, the FFIEC updated the *Bank Secrecy Act Anti-Money Laundering Examination Manual* to (among other things) remove references to specific types of merchants associated with high-risk activities in the context of TPPP transactions.

We reviewed examiner training materials pertaining to TPPPs that were prepared by the FDIC and FFIEC and found that although the materials included references to specific types of merchants associated with high-risk activities, the focus of the materials was on TPPP risks and how institutions should manage those risks.[26] We found no indication in the training materials that examiners were encouraged to pressure financial institutions to decline banking services to merchants based on the category of their business. Nevertheless, references to specific merchants in the *Supervisory Insights* Journal article and in supervisory guidance, together with a heightened level of scrutiny of TPPPs, led to a perception among executives at some institutions in our sample that providing banking services to merchants on the high-risk list was discouraged by the FDIC.

To clarify its supervisory approach, the FDIC revised its summer 2011 *Supervisory Insights* Journal article and supervisory guidance on financial institution relationships with TPPPs by removing the high-risk list and references to specific types of merchants. The FDIC also issued FIL-41-2014, *FDIC Clarifying Supervisory Approach to Institutions Establishing Account Relationships with Third-Party Payment Processors*, and revised FIL-43-2013, *FDIC Supervisory Approach to Payment Processing Relationships With Merchant Customers That Engage in Higher-Risk Activities*, in July 2014 to state that financial institutions that properly manage relationships and effectively mitigate risks are neither prohibited nor discouraged from providing payment processing services to customers, regardless of the customers' business, provided that the customers are operating in compliance with applicable federal and state law.

Payday Lending by Financial Institutions

As discussed in the Background section of the report, FIL-14-2005, *Payday Lending Programs, Revised Examination Guidance*, dated March 1, 2005, states that financial institutions that provide high-cost, short-term loans on a recurring basis to customers with long-term credit needs is not responsible lending. According to the guidance, such loans present increased credit, legal, reputation, and compliance risk to financial institutions and can create a serious financial hardship for consumers. For these reasons, FIL-14-2005 imposes additional expectations on institutions that engage in payday lending; subjects these institutions to heightened scrutiny; and states that institutions should develop procedures to ensure that payday loans are not provided to customers who had payday loans outstanding from any lender for a total of 3 months during the

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[25] The November 2014 version continues to include references to certain types of merchants, such as on-line payment processors, credit repair services, on-line gambling, and adult entertainment, in the context of electronic banking products offered by financial institutions to customers.
[26] We reviewed training materials for the FDIC's June 21, 2011 Risk Analysis Center presentation, entitled *Risks Associated with Third Party Payment Processor Relationships*, and the FFIEC's September 17, 2013 IT Conference presentation, entitled *Third Party Payment Processors: Relationships, Guidance, and Case Examples*.

previous 12 months. Failure to meet the standards in the FIL can result in supervisory enforcement actions, which may include requiring institutions to discontinue payday lending.

Of the more than 5,200 financial institutions that the FDIC was supervising when FIL-14-2005 was issued, only 12 institutions had payday lending programs. At that time, all 12 institutions were instructed to submit plans detailing how the institutions would address the expectation to limit payday loans to customers. In addition, an institution's payday lending programs were subject to heightened supervision, which included more frequent examination activities and regular contact with the institution's management. This supervisory strategy was coordinated on a national basis within the FDIC through a payday lending review group, which was led by the former Atlanta Regional Director.

On February 17, 2006, three FDIC Regional Directors sent letters to the Boards of 11 FDIC-supervised institutions that were known to still have payday lending programs at that time. The letters, which were reviewed and sent with the concurrence of the FDIC Chairman and the Legal Division, stated that the FDIC had conducted (or was conducting) onsite examinations or visitations of the institutions and third-party entities and/or had conducted offsite analyses related to the institutions' payday lending activities. The letters referenced ongoing correspondence and discussions with the institutions regarding their payday lending programs and explained that the focus of the FDIC's supervisory efforts in this area was on the credit quality of the institutions' payday lending products, compliance with laws and regulations, and the effectiveness of management and the Board in the oversight of third-party performance.

The letters sent in February 2006 stated that the FDIC had observed a pattern of unsuccessful supervision and management of third-party providers by the institutions and described significant concerns regarding the institutions' ability to administer their payday lending programs. Ten of the 11 letters noted deficiencies in the institutions' payday lending programs, such as:[27]

- not properly managing the performance of third-party payday service providers that facilitate payday lending;

- apparent violations of the Fair and Accurate Credit Transactions Act and Regulation B of the ECOA arising from lending activities pertaining to alternative credit products (ACP) and violations of Regulation Z of the TILA due to inadequate customer disclosures;

- sensitive customer information not being adequately protected; and

- inadequate internal audit procedures pertaining to payday and ACP lending activities.

All 11 letters stated that the safety and soundness risks and compliance concerns associated with the institutions' payday lending activities were unacceptable and that the institutions could not develop the necessary environment to properly administer such a high-risk activity. Eight of the letters stated that the institutions should exit the payday lending business, or notify the FDIC

[27] One letter did not identify any deficiencies with the subject institution's payday lending program.

within 15 days of how the institutions expected to correct all identified problems and change their Board and management's oversight to ensure that there would be no problems or issues going forward. The remaining three letters stated that the institutions should consider terminating their payday lending programs and contact the FDIC to schedule a meeting to discuss the matter further. In addition, two of the 11 letters questioned the suitability of any bank to engage in payday lending, particularly through the Internet or third-party marketers. Such statements were inconsistent with the FDIC's written payday lending guidance, which allows institutions to engage in payday lending provided that they have adequate controls. By the end of February 2006, 10 of the 11 institutions indicated that they were planning to stop making payday loans. As of August 2006, all 11 institutions had stopped making payday loans.

Concerns regarding the lack of alternatives in the banking sector to non-bank payday loans prompted the FDIC to issue FIL-50-2007, *Affordable Small-Dollar Loan Products, Final Guidelines*, on June 19, 2007. The FIL encouraged financial institutions to offer and promote affordable, small-dollar credit products to their customers. According to the FIL, these products should have reasonable interest rates with no or low fees and be structured with payments that reduce the principal balance. On the same day the FIL was issued, the FDIC's Board approved the *Affordable and Responsible Consumer Credit* initiative—a 2-year pilot to review affordable and responsible small-dollar loan programs in FDIC-supervised institutions. When announcing the institutions that would participate in the pilot on February 5, 2008, a former FDIC Chairman stated: "Our goal is to identify small-dollar loan programs that are profitable for lenders and affordable alternatives to payday loans and other high-cost loans that are harming consumers and communities across America."

The pilot, which concluded in the fourth quarter of 2009, involved 28 financial institutions with assets ranging from $28 million to nearly $10 billion. The FDIC reported that as a result of the pilot, these institutions made 34,400 small dollar loans totaling approximately $40 million. According to the FDIC, the performance of the loans was in line with the performance of other unsecured consumer credit products and it was determined that it was feasible for institutions to offer such loans in a safe and sound manner. The pilot also resulted in the development of a business template intended for institutions to model safe, affordable, and feasible small-dollar loans.

The FDIC's concerns regarding payday lending by financial institutions continued in the years that followed. For example, in a letter dated May 29, 2012, to the Executive Director of the Americans for Financial Reform, the FDIC Chairman stated that the Corporation was deeply concerned about continued reports of institutions engaging in payday lending and the expansion of payday lending activities under third-party arrangements. The letter added that the Chairman had asked DCP to make it a priority to investigate reports of institutions engaging in payday lending and recommend further steps by the FDIC. The Chairman's letter was in response to concerns raised by the Executive Director in a letter, dated February 22, 2012, that institutions were offering a credit product known as a deposit advance that was structured like a payday loan and that a major software system provider was marketing a bank payday software product.

During 2012 and 2013, DCP's Washington, D.C., office researched deposit advance products, including the product being marketed by the software system provider referenced above.

Because the provider serviced a significant number of financial institutions, there was concern that the provider's product could quickly become widespread. In June 2012, DCP officials in the Washington, D.C., office contacted the Regional Offices to determine if any FDIC-supervised institutions were offering the product. The Regional Offices identified two institutions that were considering the product and discouraged both institutions from offering the product. Both institutions subsequently decided not to offer the product.

Based on the results of its research, DCP identified some deposit advance products and practices with characteristics similar to payday loans that appeared to be concentrated in a limited number of FDIC-supervised financial institutions. DCP determined that the FDIC's payday lending guidance did not fully address the risks associated with these emerging products and practices and issued guidance, entitled *Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products*, dated November 21, 2013. The OCC issued nearly identical guidance, entitled *Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products*, on November 26, 2013.

Internal FDIC Efforts Related to Payday Lending

In March 2013, the Director, DCP, established an internal FDIC working group comprised of RMS, DCP, and Legal Division staff to research and assess risks associated with TPPPs, particularly those that may be involved in illegal on-line payday lending activities. As part of this effort, the working group contacted other federal agencies, including the FRB, CFPB, and DOJ, to learn about any work those agencies might have ongoing to protect consumers from illegal activities facilitated by TPPPs. DCP and Legal Division officials informed us that these internal efforts ended in August 2013, at which point the FDIC's focus shifted to addressing concerns raised by Members. Prior to that time, the FDIC had drafted, but not finalized, the following documents:

- Four memoranda and a whitepaper describing (among other things) consumer protection laws pertaining to payday lending and legal remedies available to the FDIC in the event that illegal payday lending was facilitated through FDIC-supervised institutions.

- A FIL intended to raise awareness of the significant risks associated with institutions that processed and received ACH transactions originated by certain higher-risk merchants (including payday lenders) and TPPPs. The guidance discussed the responsibilities of institutions to identify and mitigate such risks. In lieu of finalizing the guidance, the FDIC issued FIL-43-2013, which is described later in the report.

Concerns Regarding Payday Lending and Related Banking Services

As discussed above, the FDIC's concerns regarding payday lending by financial institutions are longstanding. According to three of the FDIC's six Regional Directors that we spoke with, these concerns extended to ACH payment processing (either through a TPPP or through a deposit account relationship with a payday lender) because such services effectively facilitate payday lending. The heightened level of concern for payday lending by financial institutions and ACH processing for payday lenders was reflected in the negative tenor of certain internal email communications among senior FDIC staff and others that we reviewed.[28] Some of these communications also reflected instances in which moral suasion was used to discourage institutions from providing these types of banking services to, or on behalf of, payday lenders. Examples of such communications follow.

- *Apparently, because of legal considerations, the FDIC has never expressly stated publicly that our supervised institutions are not permitted to do business with payday lenders but the payday lending guidance and our public posture makes clear that we view payday loans as extremely risky.* (Associate Director, DCP, to the Director, DCP, and other Senior DCP Staff, June 10, 2011).[29]

- *Our* [Field Office Supervisors—FOS] *canvassed their examination staff and none reported any financial institutions offering "deposit advance products." However, there is one financial institution in* [location redacted] *that is contemplating offering such a product. The name of that bank is* [name redacted]. *Of course, we are strongly encouraging them to reconsider the decision.* (Current Atlanta Regional Director to DCP executives and staff in Atlanta and Washington, D.C., February 29, 2012).

- *By the way…I think you will be pleased….bank with ach is getting out of payday ach and all ach activities…now that is something to celebrate on Thanksgiving!* (Former Atlanta Regional Director to the Director, DCP, November 21, 2012).

- *I have never said this to you (but I am sincerely passionate about this)…but I literally cannot stand pay day lending. They are abusive, fundamentally wrong, hurt people, and do not deserve to be in any way associated with banking.* (Former Atlanta Regional Director to the Director, DCP, November 26, 2012).

- *Any banks even remotely involved in payday* [sic] *should be promptly brought to my attention.* (Former Atlanta Regional Director to members of his staff, December 5, 2012).

- *Pay day lenders bring reputational risk, compliance risks, legal risk, and risk management concerns…..nothing good for our banks.* (Former Atlanta Regional Director to his staff, March 22, 2013).

We also noted two instances in which the FDIC used moral suasion in written communications to institutions to discourage them from providing ACH processing services for payday lenders. In one instance, a FOS in the Atlanta Region sent an email to a bank executive on March 6, 2014, in response to a question about payday lending raised by the bank executive. The email

[28] See Appendix 1 for a description of our methodology for selecting email communications for review.
[29] This email communication was sent in response to an inquiry by an FDIC executive regarding whether the FDIC had a policy in place that prohibited financial institutions from allowing payday lenders to hold deposit accounts with financial institutions. In addition, we confirmed that the author of the email did not consult with an attorney in forming the opinion expressed in the email.

discussed supervisory guidance and expectations pertaining to a prospective relationship with a payday lender that the institution was considering. The relationship involved providing ACH processing services for a Native-American group that was proposing to offer payday loan products on-line. The entire text of the email from the FOS read as follows:

> *To follow-up on our phone call conversation, the following Financial Institution Letters (FILs) should be considered:*
>
> - *FIL-14-2005: Guidelines for Payday Lending*
> - *FIL-44-2008: Guidance for Managing Third-Party Risk*
>
> *The FILs can be accessed from our external website www.fdic.gov by selecting the laws and regulations tabs and picking the FILs option. If I understand what is being proposed, a Native-American group is proposing to offer payday loan products online and funds will flow from the bank though* [sic] *ACH transactions. As I mentioned earlier, while the bank is not expected to directly offer payday loans, it will facilitate such lending and the risks discussed in FIL-14-2005 should be closely considered. I am not sure how the arrangement is expected to work, but if a third-party vendor will be involved ,or any relationship connecting the bank with the depositor group that must be supervised, the concerns raised in FIL-44-2008 must be addressed.*
>
> *As I stated earlier, the arrangement will receive close regulatory scrutiny from the FDIC and State Banking Department. In-depth BSA and IT reviews of this relationship will also take place. Even under the best circumstances, if this venture is undertaken with the proper controls and strategies to try to mitigate risks, since your institution will be linked to an organization providing payday services, your reputation could suffer.*
>
> *If the Board plans to go forward with this venture, please reduce your plans to writing by submitting a letter to the FDIC's Regional Director* [name redacted] *and* [State regulator and name redacted] *outlining your proposal.*

The current Atlanta Regional Director became aware of the email in September 2014 after it was identified during a search of email communications in connection with a request for information from the Congress. FDIC officials informed us that the email referenced FDIC guidance that was not relevant to the proposed banking relationship and that communications of that nature should only come from the Regional Office. As a result, the Atlanta Regional Director contacted the bank executive on September 10, 2014, to clarify the FDIC's supervisory approach and expectations for such relationships and to emphasize that the FDIC does not, in any way, prohibit payday lending.

A detailed description of the second instance follows.

Use of Moral Suasion to Discourage ACH Processing for a Payday Lender

In October 2012, an IT examiner in the Chicago Regional Office conducting an offsite review of ACH transaction data provided by the Federal Reserve identified an institution with a significant volume of ACH returns relative to other institutions in the state. The IT examiner provided the information to RMS and DCP examiners who contacted the institution to discuss the return rates. The RMS and DCP examiners learned that substantially all of the ACH returns related to a payment processing relationship the institution had with a payday lender. Although the institution provided an explanation for the large volume of ACH returns, examiners determined that an on-site visitation of the institution to assess the associated risk was appropriate. On November 13, 2012, the Chicago Regional Director sent an email to the FDIC's Chief of Staff; the current and former Director, RMS; the Director and Deputy Director, DCP; and a Legal Division official in the Washington, D.C. Office. The email read, in part:

> *We have recently identified an institution in* [location and institution name redacted] *that is providing ACH processing for a payday lender. As indicated in the commentary immediately below, we are planning a visitation to the bank next month to review the bank's third party activities, including its association with the payday lender. In consideration of this development, the Chicago Region withdraws its recommendation of* [name of individual and institution redacted] *for membership on the* [FDIC Community Bank] *Advisory Committee.*

RMS and DCP, together with the state banking department, conducted a visitation of the institution on December 17-18, 2012.[30] The examiners found that the institution had reasonable controls in place to protect against fraud in the ACH origination service and to prevent undue credit and operational risk. However, the examiners recommended that the institution review and strengthen the terms of its agreement with the payday lender; analyze the level of funds held in the payday lender's deposit account to minimize credit risk to the institution; and develop a strategy to reduce the level of ACH returns. The visitation also identified consumer compliance concerns and recommended that the institution conduct a compliance risk assessment; establish formal monitoring procedures to ensure risks are effectively controlled; and implement a formal process for reporting to the Board.

After FDIC examiners provided preliminary results of the visitation to the Chicago Regional Office, the Chicago Regional Director notified the Director, DCP, that the Office would pursue a strategy to facilitate the institution's exit from the payment processing relationship with the payday lender. The Regional Director notified the Director, DCP, of the strategy via email and during a conference call on January 16, 2013. Additionally, beginning in February 2013 and continuing through August 2013, the Chicago Regional Office's monthly status reports to the Directors, RMS and DCP, referenced concerns related to the institution's involvement with a third party that facilitated payday lending and the FDIC's supervisory expectation for the institution to exit the relationship.

[30] Although the visitation focused on the payment processing relationship with the payday lender, a review of the institution's controls over the issuance of multi-purpose gift cards by another company was also performed.

On February 8, 2013, FDIC and state examiners held a conference call with the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO) of the institution to reinforce the findings of the visitation and obtain management's commitment to address the recommendations. During the call, an FDIC FOS informed the institution's CEO and the CFO that the payment processing relationship with the payday lender carried a high degree of third-party, reputation, compliance, and legal risks that may not be acceptable. The FOS indicated that the FDIC's primary concern with the relationship was reputation risk. Specifically, the payday lender had an "F" rating with the Better Business Bureau (BBB) that was not consistent with the bank's positive image or the services the institution provided to the community.[31] The FOS informed the institution's CEO that the Board would receive formal correspondence from the Regional Office in the coming weeks urging the Board to terminate the payment processing relationship with the payday lender.

Immediately following the conference call, the FOS sent an email to an Assistant Regional Director in the Chicago Regional Office stating that the BBB rating was the most compelling information the FDIC had to pursue a termination of the relationship because legally the institution was entitled to maintain the relationship and the institution was administering the relationship in a reasonable fashion.[32] On February 15, 2013, the Chicago Regional Office sent a letter to the institution notifying its Board that the FDIC had recently become aware of the bank's involvement in activities related to payday lending—specifically the processing of transactions on behalf of a payday lender. The letter stated, in part:

> *It is our view that payday loans are costly, and offer limited utility for consumers, as compared to traditional loan products. Furthermore, the* [redacted] *relationship carries a high degree of risk to the institution, including third-party, reputational, compliance, and legal risk, which may expose the bank to individual and class actions by borrowers and local regulatory authorities. Consequently, we have generally found that activities related to payday lending are unacceptable for an insured depository institution.*

The letter added that members of the Chicago Regional Office's management team would contact the institution's Board to schedule a meeting to further discuss the FDIC's concerns with the relationship. On April 30, 2013, the FOS and a state examiner met with the institution's CEO and CFO to discuss the status of the payment processing relationship with the payday lender. The meeting took place during a state-led safety and soundness examination. The CEO and CFO informed the examiners that a decision had not yet been made regarding the future of the institution's relationship with the payday lender. The FOS discussed ongoing concerns that the regulators had regarding payday lending programs and encouraged the CEO and CFO to formally notify the Regional Office regarding the institution's planned actions. The CEO and CFO agreed to do so. On May 29, 2013, the state banking agency submitted its report of examination to the institution's Board. The report did not mention the institution's payment processing relationship with the payday lender. We spoke with representatives of the state

[31] The BBB rates organizations on a scale of A+ (highest) to F (lowest). The rating represents the BBB's opinion of how the business is likely to interact with its customers.
[32] The FOS and the Chicago Regional Director informed us that they did not request or receive advice from the Legal Division regarding the legal sufficiency of persuading the institution to exit the payment processing relationship with the payday lender.

banking department who informed us that they did not have an objection to the institution's relationship with the payday lender.

In a letter dated June 18, 2013, the institution's CEO notified the Chicago Regional Office that the relationship with the payday lender would be terminated. The letter noted that the institution had not been cited for noncompliance with any laws or regulations in connection with the relationship. In addition, the letter stated that the institution had engaged a consultant to conduct a risk assessment of the relationship and although the assessment identified areas warranting control improvements, it also concluded that the relationship posed no significant risk to the institution, including financial, reputation, or legal risk. The letter also expressed disappointment with the FDIC's supervisory approach, particularly its ability to pressure an institution to terminate a business relationship when there were no safety and soundness considerations other than potential reputation risk. An email dated June 19, 2013, from the FOS to a Chicago Assistant Regional Director, stated: "In the end, we are getting them out of [ACH processing for a payday lender] through moral persuasion and as you know from a legal perspective we don't have much of a position, if any."

The Chicago Regional Director informed us that he pursued a strategy of persuading the institution to terminate its payment processing relationship with the payday lender because it was his perception that senior FDIC management in the Washington, D.C. office, including the current and former Chairmen, did not favor banking services that facilitated payday lending. The Regional Director recalled a meeting held in late 2010 or early 2011 during which the former Senior Deputy Director, Division of Supervision and Consumer Protection (DSC),[33] informed the Regional Directors that if an institution in their region was facilitating payday lending, the Regional Director should require the institution to submit a plan for exiting the business. We contacted the former Senior Deputy Director, DSC, about this matter and he stated that he did not communicate such an expectation to the Regional Directors.

The Director, DCP, was both aware of the Chicago Regional Office's strategy to persuade the institution to exit the relationship with the payday lender through monthly status reports from the Chicago Regional Office as well as conference calls and email communications from the Regional Director. Although the Director, DCP, was aware that the Regional Director had planned to send, and subsequently did send, a letter to the institution requesting a plan to exit the relationship, the Director informed us that he did not receive a copy of the letter or the institution's June 2013 response until early July 2013. The Director, DCP, indicated that his initial reaction/priority at that time was to gain an understanding of the region's perception of the risks in the relationship and the region's plan for following up with the institution to address the issues raised in its June 2013 response letter. No one at the FDIC informed the Chicago Regional Director that the February 2013 letter sent to the institution was inconsistent with FDIC policy or guidance until after Operation Choke Point was publicized in the media.

[33] In conjunction with other organizational changes made in response to the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010, DSC was split into RMS and DCP, effective February 13, 2011.

In the fall of 2013, the Chicago Regional Director and the Director, DCP, separately contacted the institution to clarify the FDIC's supervisory policy and guidance for institutions that provide ACH processing for third parties, including payday lenders. FDIC officials informed us that the institution ultimately terminated its payment processing relationship with the payday lender but continued to provide other types of banking services to the merchant.

Regional Director Perspectives

We interviewed all six of the FDIC's Regional Directors to obtain their perspectives on the FDIC's stance towards payday lending by financial institutions and ACH processing for payday lenders. Three of the six Regional Directors informed us that it was their perception that senior FDIC executives in Washington, D.C., up to and including the former and current FDIC Chairmen, had serious concerns regarding the facilitation of payday lending by FDIC-supervised institutions. The three Regional Directors stated that senior FDIC management never made a distinction between payday lending by financial institutions and ACH processing for payday lenders when communicating their concerns. In addition, these three Regional Directors believed that there was a general expectation from executives in Washington, D.C., to discourage institutions from facilitating payday lending. Further, two of these three Regional Directors believed that if an institution was found to be facilitating payday lending, an expectation existed to pursue an exit strategy. The remaining Regional Director believed there was an expectation that examiners should place a heightened level of scrutiny on the associated controls. All three Regional Directors added that they had observed a shift in the supervisory tenor among Washington, D.C., executives towards institutions that facilitate payday lending since the fall of 2013. The current tenor, according to these Regional Directors, is that such activity is acceptable, provided that the institution complies with applicable policy, guidance, and laws.

The remaining three Regional Directors that we spoke with indicated that it was their perception that executives in Washington, D.C., viewed payday lending by financial institutions and ACH processing for payday lenders as acceptable, provided that the institution complies with applicable policy, guidance, and laws.

All six of the Regional Directors informed us that concerns regarding individual FDIC-supervised institutions facilitating payday lending have been relatively infrequent in recent years. These views were consistent with our review of monthly status reports submitted by the Regional Directors to the Directors of RMS and DCP for the 4-year period ended December 31, 2014. These monthly status reports identified concerns specifically pertaining to payday lending activities facilitated through ACH processing at just three financial institutions. All three of the institutions were under the supervision of the Chicago Regional Office.

Role of Certain Former and Current FDIC Officials

As mentioned earlier in this report, the FDIC Chairman requested that as part of our planned and ongoing work related to Operation Choke Point, we conduct a fact-finding review of the actions of senior FDIC staff, including but not limited to, one former and four current officials. The Chairman's request was prompted by concerns raised by a Congressman in a letter dated December 10, 2014, that identified five individuals that had allegedly allowed their personal and political views to interfere with the important work of the FDIC and that they had misled the

American people through their emails and in meetings with, and testimony before, the Congress. These five individuals served as the former Acting General Counsel; a Deputy Director, DCP; the former Atlanta Regional Director; the Chicago Regional Director; and the Director, DCP.[34] The Member's concerns were based on information contained in a December 8, 2014 staff report of the House Oversight and Government Reform Committee, entitled *Federal Deposit Insurance Corporation's Involvement in "Operation Choke Point."*

We performed audit procedures to determine the extent to which the individuals serving in the five referenced positions were involved in the development or implementation of Operation Choke Point and whether their actions involving the institutions we reviewed were based on personal, political, or moral agendas aimed at forcing lawful businesses on the high-risk list out of the banking sector. As part of these audit procedures, we interviewed relevant FDIC and DOJ employees, reviewed selected email communications that the five individuals sent and received on the topic of payday lenders, and reviewed supervisory records pertaining to our 23 sampled institutions.[35]

Based on our analysis, we determined that none of the five individuals played a role in the development or implementation of Operation Choke Point. In addition, we concluded that the individuals did not pursue their own personal, political, or moral agendas aimed at forcing lawfully-operating businesses on the high-risk list out of the banking sector. As it pertains to payday lending and related activities, we concluded that the officials acted consistent with a widely-held understanding that the highest levels of the FDIC disfavored these types of banking services. Concerns regarding these types of banking services were rooted in safety and soundness and consumer protection risks. We also noted instances in which internal FDIC email communications and/or a communication to a financial institution involving the former Atlanta Regional Director; the Chicago Regional Director; and the Director, DCP; were not consistent with written FDIC policy or guidance. The exceptions pertained to ACH processing for payday lenders by financial institutions. A brief description of our results by individual follows.

Former Acting General Counsel. We did not identify any actions taken by this individual that influenced the FDIC's supervisory approach pertaining to payday lending for the institutions we reviewed. As mentioned earlier, work on a separate inquiry into the allegation that this individual provided false testimony to the Congress was completed by the OIG's Office of Investigations at the close of our audit.

Deputy Director, DCP. We did not identify any actions taken by this individual that influenced the FDIC's supervisory approach pertaining to payday lending for the institutions we reviewed. We did, however, note a limited number of internal email communications in which this individual attempted to cast payday lending by financial institutions in a negative light in public communications by the FDIC Chairman. However, we found no evidence that these negative connotations were incorporated into the Chairman's communications.

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[34] The former Atlanta Regional Director retired from the FDIC on May 3, 2014.
[35] See Appendix 1 for a detailed description of our scope and methodology, including our approach for reviewing email communications for the five individuals.

Former Atlanta Regional Director. This individual played a key role in developing the FDIC's payday lending guidance and led an internal FDIC working group in 2005 that helped to establish and implement the Corporation's supervisory strategies pertaining to payday lending. We identified certain email communications authored by this individual, some of which were sent to his supervisor—the Director, DCP—and others of which were sent to his staff that reflected strongly-held, negative views about payday lenders and ACH processing by banks for payday lenders. Some of these communications related to one of the 23 institutions in our sample. The views expressed in these email communications were not consistent with written FDIC policy or guidance, which permits institutions to provide banking services to payday lenders provided that the institutions have adequate risk management controls and comply with applicable laws. In our view, such communications also reflected poor judgment as they had the propensity to influence staff behavior and lead to communications with financial institutions that are inconsistent with written FDIC policy and guidance.

The Chicago Regional Director. As discussed earlier, this individual sent a written communication to one of the 23 institutions in our sample discouraging the institution from providing ACH processing services to a payday lender even though material safety and soundness or consumer protection concerns to warrant doing so did not exist. This approach was not consistent with the written FDIC policy or guidance. The individual believed that his communication was consistent with senior FDIC management's expectations to discourage financial institutions from facilitating payday lending. In addition, the individual's supervisor—the Director, DCP—was aware of the Chicago Regional Director's communication and the institution's response, but did not inform the Chicago Regional Director that his communication was inconsistent with FDIC policy or guidance until concerns were raised publicly about the FDIC's approach to financial institutions that facilitate payday lending.

Director, DCP. This individual took a lead role in responding to the FDIC Chairman's request to investigate reports of financial institutions engaging in payday lending and recommending further steps that could be taken by the FDIC to address the associated risks. This individual established an interdivisional working group to research the risks to institutions associated with the facilitation of illegal payday lending activities through TPPPs and developed FDIC guidance on deposit advance products.

The Director, DCP, informed us that he did not advise the former Atlanta Regional Director that some of his internal email communications were inconsistent with FDIC policy and guidance because it was the Director's belief that these communications would not be shared with anyone else. However, as described earlier, similar communications were shared with the former Atlanta Regional Director's staff. In addition, it was the Director's belief that the former Atlanta Regional Director's emails were more emotional than substantive and that this individual would not take action to pressure an institution to decline banking services in violation of FDIC policy or guidance.

With respect to the Chicago Regional Director's written communication referenced above, the Director, DCP, informed us that it was his understanding that the institution was being persuaded to terminate its relationship with the payday lender for safety and soundness reasons and not primarily because of reputation risk. Further, the Director did not advise the Chicago Regional

Director that his communication with the institution was inconsistent with FDIC policy and guidance until September 2013. The Director stated that after seeing the communication in early July 2013, he attempted to understand the risks associated with the relationship and the region's approach to addressing those risks.

Because the FDIC Chairman has already committed to reviewing the facts and circumstances pertaining to the five individuals, and taking action, as appropriate, we are not making recommendations in this area.

The FDIC's Actions to Address Concerns Regarding Its Supervisory Approach

FDIC officials determined that there were misperceptions about the FDIC's supervisory approach to institutions that conduct business with merchants associated with high-risk activities. As a result, beginning in September 2013, the FDIC took a number of actions to address these misperceptions. These actions are intended to promote a common understanding and consistent implementation of the FDIC's supervisory approach in this area. These actions are described below:

- On September 27, 2013, the FDIC issued FIL-43-2013, *FDIC Supervisory Approach to Payment Processing Relationships With Merchant Customers That Engage in Higher-Risk Activities*. The FIL clarified the FDIC's policy and supervisory approach related to facilitating payment processing services directly, or indirectly through a third party, for merchant customers engaged in higher-risk activities. According to the FIL, facilitating payment processing for these types of merchant customers can pose risks to financial institutions. However, institutions that properly manage these relationships and risks are neither prohibited nor discouraged from providing payment processing services to customers operating in compliance with applicable law.

  FIL-43-2013 also states that the focus of the FDIC's examination process is on assessing whether institutions are adequately overseeing the activities and transactions they process and appropriately managing and mitigating risks. The FIL adds that institutions with appropriate systems and controls will not be criticized for providing payment processing services to businesses operating in compliance with applicable law.

- On July 28, 2014, the FDIC issued FIL-41-2014, *FDIC Clarifying Supervisory Approach to Institutions Establishing Account Relationships with Third-Party Payment Processors*. The FIL reiterated the FDIC's policy that institutions that properly manage customer relationships are neither prohibited nor discouraged from providing services to any customer operating in compliance with applicable law. The FIL also states that the focus of the FDIC's supervisory approach to institutions with TPPP relationships is to ensure adequate procedures for conducting due diligence, underwriting, and ongoing monitoring of the relationships. According to the FIL, institutions that follow the FDIC's outstanding guidance will not be criticized for establishing and maintaining TPPP relationships.

Additionally, FIL-41-2014 states that the examples of merchant categories associated with higher-risk activities included in previously-issued FDIC guidance[36] and the informational article in the Summer 2011 *Supervisory Insights* Journal led to misunderstandings regarding the FDIC's supervisory approach to TPPPs and created a misperception that the merchant categories were prohibited or discouraged. As a result, the FDIC removed the lists of examples of merchant categories from previously issued guidance and the informational article.

- On January 28, 2015, the FDIC issued FIL-5-2015, *Statement on Providing Banking Services*. The FIL states that individual customers within broader customer categories present varying degrees of risk. Consequently, institutions should take a risk-based approach in assessing individual customer relationships rather than declining to provide banking services to entire categories of customers. Financial institutions that can properly manage customer relationships and effectively mitigate risks are neither prohibited nor discouraged from providing services to any category of customer accounts or individual customers operating in compliance with applicable state and federal law.

  FIL-5-2015 recognizes that some institutions may hesitate to provide certain types of banking services due to concerns that they will be unable to comply with the associated requirements of the BSA. According to the FIL, the FDIC and the other federal banking agencies recognize that as a practical matter, it is not possible to detect and report all potentially illicit transactions that flow through an institution. Isolated or technical violations, which are limited instances of noncompliance with the BSA that occur within an otherwise adequate system of policies, procedures, and processes, generally do not prompt serious regulatory concern or reflect negatively on management's supervision or commitment to BSA compliance. The FIL adds that when an institution follows existing guidance and maintains an appropriate risk-based program, the institution will be well-positioned to appropriately manage customer accounts, while generally detecting and deterring illicit financial transactions.

  FIL 5-2015 also states that any FDIC-supervised institution concerned that FDIC personnel are not following the policies on providing banking services may contact the FDIC's Office of the Ombudsman (OO) using a dedicated, confidential toll-free number or email address. Individuals or institutions may also contact the FDIC OIG through its Web site, by phone, or by email.

- On January 28, 2015, the FDIC established an internal policy for documenting and reporting instances in which FDIC staff recommend or require institutions to terminate deposit account relationships. According to the policy, recommendations or requirements to terminate a customer deposit account should not be made through informal

[36] This guidance consists of FIL-127-2008, *Guidance on Payment Processor Relationships*, originally issued on November 7, 2008, and revised in July 2014; FIL-3-2012, *Payment Processor Relationships, Revised Guidance*, originally issued on January 31, 2012, and revised in July 2014; and FIL-43-2013, *FDIC Supervisory Approach to Payment Processing Relationships With Merchant Customers That Engage in Higher-Risk Activities*, originally issued on September 27, 2013, and revised in July 2014.

suggestions. In addition, criticisms of an institution's management or mitigation of risk associated with deposit accounts that do not rise to the level of a recommendation or a requirement to terminate an account should not be made through informal suggestions. Rather, criticisms of an institution's management or mitigation of risk associated with deposit accounts must be made in writing in a report of examination. Further, recommendations or requirements to terminate deposit accounts must be made in writing and must be approved in writing by the Regional Director before being provided to and discussed with the institution's management and Board.

The policy provides that before findings involving customer account terminations are included in a report of examination or supervisory actions are pursued, the findings and supervisory actions must be thoroughly vetted with Regional Office and legal staff. As part of this effort, examiners should include the supervisory basis for recommending or requiring account terminations and address any specific laws or regulations examiners believe are being violated, if applicable. Further, recommendations to terminate deposit account relationships cannot be based solely on reputation risk to the institution. The policy adds that the Regional Directors must report quarterly to the Directors, RMS and DCP, as well as to the FDIC Board regarding requests or requirements for institutions to terminate deposit accounts, along with the basis for such action. The first two of these reports covered the first two quarters of 2015 and identified no requests or requirements for an institution to terminate a deposit account.

Following the issuance of the policy, the FDIC Chairman participated in a national conference call with FDIC supervisory staff to discuss the documentation and reporting requirements described above. The Chairman also met with all six of the FDIC's Regional Directors to emphasize the importance of complying with the policy. In addition, the FDIC plans to emphasize the policy's requirements during upcoming meetings and training sessions with supervisory staff.

We noted that the policy and guidance described above focuses on deposit accounts and does not explicitly address various other types of banking products, such as credit products. The FDIC should consider whether the policy and guidance warrants clarification to address such products.

Banker Perspectives

We interviewed senior executives at 19 of the 23 financial institutions in our sample to obtain the executives' views on the FDIC's supervisory approach to institutions that provided banking services (either directly or through TPPPs) to merchants on the high-risk list.[37] As part of these interviews, we asked the executives for their thoughts on the FDIC's payday lending and TPPP guidance. We also asked executives at certain institutions about their views on RALs. Although the perspectives provided by the executives varied, several salient views emerged and are described below. We are including these perspectives in our report for the FDIC's consideration in its ongoing outreach to community banks.

[37] Executives at 4 of the 23 institutions declined our offer for an interview.

The High-Risk List. Executives at all but one of the 19 institutions were familiar with the Summer 2011 *Supervisory Insights* Journal article that contained the high-risk list. Executives at 14 of the other 18 institutions stated that after reading the article, it was not their impression that the FDIC discouraged institutions from conducting business with merchants on the high-risk list. However, executives at 4 of the 18 institutions believed that the article suggested that the FDIC discouraged institutions from conducting business with merchants on the high-risk list.

The FDIC's Payday Lending Guidance. Executives at 11 of the 19 institutions stated that they were not familiar with, or had no perspectives on, the FDIC's payday lending guidance. In several cases, this was because the executives simply had no business interest in offering that type of credit product. Executives at five institutions indicated that the payday lending guidance was generally appropriate, while executives at the remaining three institutions thought the guidance was not appropriate. Executives at one of these three institutions stated that the payday lending model as defined in guidance makes payday lending cost prohibitive for institutions.

Termination of Business Relationships. With the exception of payday lenders, none of the executives indicated that they had experienced pressure from the FDIC to terminate a business relationship with a merchant on the high-risk list, including a firearms and ammunition retailer, or tobacco retailer. Although pawnbrokers were not on the high-risk list, executives from five institutions informed us that they provided banking services to these merchants and had never experienced regulatory pressure to terminate the business relationships.

Executives at two institutions stated that they had stopped making payday loans through third-party arrangements with payday lenders in the mid-2000s because the cost of complying with the FDIC's payday lending guidance was too great and the FDIC had exerted pressure on the institutions to stop making payday loans. These executives also expressed concern about the FDIC's heightened scrutiny of payday lending and the risk of potential supervisory actions against institutions that engage in that type of activity. In addition, the executives stated that they have declined to provide banking services to payday lenders because of the associated risks.

Executives at a third institution stated that they terminated a payment processing relationship with a payday lender in 2013 in response to pressure from the FDIC. The executives at this institution stated that the pressure was based primarily on reputation risk to the institution because of its association with a payday lender. The executives added that, in their view, the relationship posed no significant safety and soundness or consumer compliance risk to the institution.

The FDIC's TPPP Guidance. Executives at 12 institutions indicated that the risk management concepts and principles defined in the FDIC's TPPP guidance were appropriate. Executives at one of these institutions indicated that they understood the importance of properly managing TPPPs because they can be a source of illegal transactions, while executives at a second institution stated that they would adopt the controls described in the guidance even if the guidance did not exist because doing so was a good business practice. Executives at a third institution indicated that the guidance was clear, contained an appropriate amount of detail, and that the institution was using the guidance to implement related internal controls.

Executives at seven institutions indicated that the resources required to implement risk management controls as described in the guidance are not practical, particularly for small community banks. Executives at all seven institutions expressed concern about the FDIC's high level of scrutiny of TPPP relationships, and/or the extent to which institutions must go to ensure that the business activities and transactions of TPPP merchant clients comply with applicable federal and state laws. Executives at one of these institutions stated that such monitoring is tantamount to detective work rather than providing banking services. Executives at another institution indicated that they would never conduct business with TPPPs due to regulatory burden and pressure.

TPPPs. Executives at three institutions stated that the FDIC pressured their institutions to exit business relationships involving TPPPs. Executives from two of the institutions believed the ultimate direction came from the FDIC's Washington, D.C., office.

RALs. Executives from two institutions stated that FDIC officials forced them to stop facilitating RALs and applied increased scrutiny of their institutions' RAL programs. These executives also said that FDIC officials noted the lack of the Internal Revenue Service (IRS) debt indicator[38] as a reason for pressuring the institutions to discontinue facilitating RALs.

State Banking Agencies. Executives at six institutions described instances in which the FDIC raised concern about their institutions' payday lending activities, management of TPPP relationships, and/or practices for offering RALs. However, the state regulators for these institutions exhibited a lesser level of concern for these risks. In one instance, a state banking agency and the FDIC issued separate reports of examination for an institution covering the same period. The state banking agency assigned three CAMELS component ratings and a composite rating that were higher than the FDIC's ratings.

Positive Feedback. While not specifically asked, executives at six institutions made complimentary remarks about certain FDIC personnel and/or indicated that FDIC officials treated their institutions in a fair, open, and transparent manner. One executive complimented FDIC staff for helping the institution address a consent order, and an executive from another institution stated that the FDIC helped to improve the institution's monitoring and management of BSA risks.

Observation: Refund Anticipation Loans

During the course of our audit, we became aware of a credit product known as a RAL. Although RALs were not included on the high-risk list, we observed that the FDIC's supervisory approach to institutions that offered this credit product raised questions similar to those that prompted the Congressional request to our office. Specifically, the FDIC took unusual and aggressive actions to prohibit institutions from offering this credit product. Below is an explanation of RALs and

[38] Prior to 2011, tax preparers who electronically submitted a client's tax return received an acknowledgement from the IRS that included (among other things) information about whether the taxpayer would have any portion of their refund offset for delinquent tax or other debts, such as unpaid child support or delinquent federally funded student loans. This information was often referred to as the debt indicator.

related risks, a description of certain aspects of the FDIC's supervisory approach at the institutions that offered this product, and our preliminary concerns.

What is a RAL?

A RAL is a particular type of loan product typically brokered by a national or local tax preparation company in conjunction with the filing of a taxpayer's income tax return. As part of the RAL process, the tax preparer works in cooperation with a financial institution to advance the refund as a loan, minus tax preparation costs, other fees, and a finance charge. The taxpayer in turn provides authorization to the IRS to send the refund directly to the institution to repay the loan. One benefit of RALs is that they allow taxpayers to receive cash quickly, often on the same day they file their returns. However, as discussed below, RALs also present safety and soundness and consumer protection concerns.

Concerns with RALs

The Congress, IRS, OCC, and consumer advocacy groups have all raised concerns about RALs. Specifically, the MLA (discussed earlier) limits annual percentage rates on certain loans offered to military service personnel, including RALs, to 36 percent. The IRS has expressed concern that RALs may provide tax preparers with financial incentives to take improper tax return positions to inappropriately inflate refund claims. The OCC's February 2010 *Policy Statement on Tax Refund-Related Products* describes supervisory expectations for national banks that offer RALs and related products, as well as the associated legal, compliance, consumer protection, reputation, and safety and soundness risks. Because of these risks, the OCC has largely extinguished RALs from the national banking system and indicated that the agency would not accept, license, or charter an institution concentrating in these services today. Consumer advocacy groups have also criticized RALs as predatory in nature because they are costly and frequently targeted to low-income taxpayers.

The FDIC considers RALs to carry a significant degree of risk to financial institutions, including third-party, reputation, compliance, and legal risks. Of particular concern to the FDIC is the ability of a financial institution to ensure proper underwriting and compliance with consumer protection requirements when this credit product is offered through hundreds or thousands of EROs. Contributing to these concerns was the IRS' decision, which became effective with the 2011 tax season, to discontinue providing tax preparers and financial institutions with the "debt indicator" underwriting tool. In the absence of a debt indicator, and for other reasons, the FDIC concluded that institutions could not facilitate RALs in a safe and sound manner and determined that RALs were unacceptable for FDIC-supervised institutions.

The FDIC's Supervisory Approach to Institutions that Offered RALs

We identified three FDIC-supervised institutions that offered RALs (referred to herein as Institutions A, B, and C). Institutions A, B, and C began offering RALs in 1987, 1988, and 2007, respectively. At various times from 2004 through 2009, FDIC examiners criticized the risk management practices pertaining to the RAL programs at Institutions A and B during compliance and risk management examinations. Among other things, examiners criticized these institutions for apparent violations of consumer protection laws and regulations and insufficient oversight of their EROs. In addition, Institution A stipulated and consented to a Cease and Desist Order in February 2009 arising from deficiencies in the institution's compliance management system with regard to RALs and the institution's inability to adequately assess, measure, monitor, and control third-party risk.

In late 2009, the FDIC contended that Institution A had expanded its RAL program while operating under the Cease and Desist Order. This expansion prompted the FDIC to send letters to the institution's Board, dated December 30 and 31, 2009, expressing continued concerns about the institution's RAL products and requesting a plan for discontinuing this type of lending. In separate letters dated February 3, 2010, the FDIC notified the Boards of the two remaining institutions that RALs were unacceptable for the institutions and that plans should be developed for the expeditious exit of those lines of business. Notably, the FDIC had not identified any control weaknesses in Institution C's RAL program prior to sending these letters.[39] The FDIC's letters to all three institutions were coordinated through the Washington, D.C., office.

In early 2011, after prior efforts to convince the three institutions to discontinue offering RALs were unsuccessful, RMS, DCP, and Legal Division executives in the Washington, D.C., office undertook an aggressive, and at times confrontational, approach to compel the institutions to stop offering RALs. As part of this approach, in January 2011, the Director, DCP, and the former Senior Deputy Director, RMS, proposed, and the former FDIC Chairman approved, plans to commit significant examiner resources to conduct horizontal reviews of the institutions' EROs throughout the United States if the institutions would not voluntarily discontinue their RAL programs. A brief description of key FDIC supervisory actions to compel the institutions to stop offering RALs beginning in early 2011 follows.

<u>Institution A</u>

In a memorandum dated January 7, 2011, to the Director, DCP, attorneys within the FDIC's Legal Division assessed the litigation risk to the Corporation pertaining to a proposed enforcement action that would require Institution A to terminate its RAL program. At that time, DCP and RMS were contemplating the issuance of a Notice of Charges and Hearing against the institution because prior efforts to persuade the institution to stipulate to such an order had been unsuccessful. The Legal Division memorandum noted that although the institution was already operating under a Cease and Desist Order for deficiencies in its RAL program, the most recent compliance examination of the institution found that the deficiencies had been largely corrected.[40] Without direct criticism of the institution's RALs, or examination staff that could opine as an expert witness that a deficiency in the institution's RAL program rose to an unsafe or

[39] After sending the letters, a February 2010 examination issued by the institution's state regulator noted that the FDIC was viewing RALs as "an unacceptable business line." A September 2010 compliance examination report noted an inadequate bank policy and monitoring practices related to the institution's RAL program. The report contained numerous recommendations to enhance the institution's internal controls over its RAL program.

[40] The FDIC's January 2011 litigation risk assessment indicated that the FDIC's determination that the institution's RAL deficiencies had apparently been corrected was based, in part, upon the results of preannounced visitations to the institution and the institution's EROs, during which FDIC staff were accompanied by bank personnel. The FDIC did not select the EROs using statistical techniques. As a result, FDIC staff believed that deficiencies could be more pronounced if the visitations were conducted on an unannounced basis.

unsound practice or that the institution was faced with an abnormal risk of loss from the program, the memorandum concluded that the litigation risk to the FDIC of pursuing an enforcement action based primarily on safety and soundness arguments was extremely high.

The memorandum noted that DCP and RMS were developing plans to conduct horizontal, unannounced site-visits of the institution's EROs that may identify potential violations of law, rule or regulation, as well as potential unsafe and unsound practices. The memorandum indicated that such a determination could be used to support a proposed enforcement action. Accordingly, the memorandum recommended that the FDIC postpone any enforcement action pending the results of the horizontal reviews.

In an e-mail, dated January 28, 2011, and subsequent discussion held on January 31, 2011, an RMS official informed Institution A's CEO that executing a written agreement requiring the institution to discontinue its RAL program was a prerequisite for allowing the institution to bid on failing banks. At that time, Institution A had an interest in acquiring failing banks. However, Institution A's CEO did not sign such an agreement.

Notwithstanding the litigation risk, the FDIC issued a Notice of Charges and Hearing on February 9, 2011, charging Institution A with engaging in unsafe or unsound banking practices and violations of laws with respect to the underwriting of RALs. Specifically, the Notice stated that the institution's underwriting procedures did not mitigate the absence of the IRS debt indicator and did not consider data needed to assess risk in an unsecured consumer loan portfolio. The institution denied the charges. On February 15, 2011, DCP and RMS commenced an unannounced visitation of the institution to review and analyze its RAL program and compliance with an outstanding February 2009 Cease and Desist Order. On the same day, DCP and RMS deployed approximately 400 examiners to conduct a 2-day horizontal review of 250 EROs in 36 states. The purpose of the review was to determine whether the EROs were complying with federal and state laws and regulations pertaining to the origination of RALs. RMS and DCP officials informed us that the number of EROs reviewed was large because a statistically valid sample was needed to support any supervisory actions that may have been warranted based on the outcome of the review.

The visitation and horizontal review identified unsafe and unsound practices and violations of laws and regulations at the institution and EROs. As a result, the FDIC issued an Amended Notice of Charges for an Order to Cease and Desist; Notice of Assessment of Civil Money Penalties, Findings of Fact and Conclusions of Law; Order to Pay; and Notice of Hearing on May 3, 2011, against Institution A. Following a series of legal actions and discussions, the FDIC and Institution A reached a settlement on December 8, 2011, regarding the Amended Notice of Charges and a lawsuit filed by the institution against the FDIC in March 2011.[41] As part of the settlement, the institution agreed to discontinue making RALs after the 2012 tax season and

[41] On March 1, 2011, Institution A filed a lawsuit against the FDIC stating that the FDIC's action seeking to prohibit the institution from offering RALs constituted a generally applicable change in law that was required to be administered through traditional notice and comment rulemaking required by the Administrative Procedures Act or in another fashion permitted by law. The Court dismissed the lawsuit in December 2011, based on the institution's filing for a voluntary dismissal.

never re-enter that line of business. Such provisions are unusual in FDIC Consent Orders as they typically allow an institution to re-enter lending activity after consulting with, or obtaining a non-objection from the FDIC. Institution A also agreed as part of the settlement to pay a CMP totaling $900,000 and voluntarily dismissed a lawsuit that had been filed against the FDIC on March 11, 2011.

Institution B

On February 3, 2011, the FDIC delivered a proposed consent order to Institution B's Board that would have (among other things) required the institution to stop offering RALs. The proposed order was based on significant weaknesses in the institution's oversight, control, and monitoring of third-party risk, particularly with respect to nontraditional products, and apparent violations of laws and/or regulations detailed in a May 2009 compliance examination report. On February 14, 2011, representatives from RMS, DCP, and the Legal Division participated in a meeting with the institution's Board during which the results of the compliance examination were presented. During the meeting, FDIC officials attempted to persuade the institution's Board to stipulate to a Cease and Desist Order requiring the institution to discontinue offering RALs. The FDIC's approach to doing so was confrontational. An excerpt from a summary of the Board meeting prepared by an RMS employee states, in part:

> [A former FDIC supervisory attorney] *then began by stating that management at the FDIC in Washington would bring the full force of the Corporation to bear against the bank if the Board of Directors did not immediately agree to cease offering RALs at the end of the 2011 tax season.* [The FDIC attorney] *said there would be immediate consequences, beginning the next day, unless the Board agreed to stop offering RALs. When asked,* [the FDIC attorney] *did not answer why the immediate decision was necessary although the FDIC was aware that the bank had been offering RALs since 1988 with no detrimental effect on the bank or any customer.* [The FDIC attorney] *said that "nothing is off the table" pertaining to actions the management of the FDIC would take. When asked by* [the institution's counsel], [the FDIC attorney] *declined to state the actions FDIC management would take if the Board did not get out of the RAL business.*

The institution's Board committed to terminating its RAL program during the meeting. Immediately following the meeting, DCP and RMS executives in Washington, D.C., were notified of the Board's decision and a decision was made to cancel the horizontal review of the institution's EROs that was scheduled to commence the next day. On February 16, 2011, the institution issued a public press release stating that it had decided to exit the RAL business at the conclusion of the 2011 tax season following extensive conversations with its primary regulator, the FDIC, regarding its concerns about RALs.

In October 2011, Institution B stipulated to a consent order, order for restitution, and order to pay CMPs. Among other things, the Consent Order stated that the institution had exited the RAL business and would not resume that type of lending.

Institution C

In a letter dated February 3, 2011, the FDIC notified the institution's Board that supervisory and enforcement actions may be pursued against the institution if the Board failed to submit a plan for promptly discontinuing its RAL program. In a letter dated February 9, 2011, the institution's Board notified the FDIC that a special Board meeting had been held the previous day to discuss the FDIC's February 2011 letter. During that meeting, it was decided that the institution would stop offering RALs after the 2011 tax season, which ended April 21, 2011.

Conclusions

Senior FDIC officials in Washington, D.C., including the former Chairman, considered the safety and soundness and consumer protection risks associated with RALs to be unacceptable and took actions to prohibit this practice at FDIC-supervised institutions.[42] The FDIC drafted a policy statement in 2010 that defined the FDIC's supervisory concerns and expectations for institutions offering RALs. However, the policy statement was never finalized. In our view, establishing such a policy would have been prudent to ensure that institutions understood the risks associated with RALs and provide transparent supervisory guidance and expectations for institutions already (or contemplating) offering RALs.

We concluded that the actions taken with respect to the three institutions that offered RALs fell within the Corporation's broad statutory authorities because the Corporation is permitted to require a financial institution to discontinue a practice if safety and soundness or consumer protection concerns warrant doing so. However, we believe that the execution of these actions and the role of the individuals involved warrants further review, and the OIG is conducting additional work in this area.

Recommendations

As discussed earlier, the FDIC clarified its supervisory policy and guidance to address misperceptions regarding the Corporation's supervisory approach to institutions that conduct business with merchants on the high-risk list. The policy and guidance, however, focuses on deposit accounts and does not explicitly address various other types of banking products, such as credit products. In addition, it is too soon, in our view, to determine whether the actions taken by the FDIC will ensure a common understanding and sustained application of the FDIC's supervisory approach to the issues and risks discussed in this report, both within the FDIC and at FDIC-supervised institutions. In this regard, an assessment of the implementation of that approach to ensure it is having the intended effect would be prudent. Such an assessment would also be consistent with the internal control and monitoring principles defined in FDIC Circular 4010.3, *FDIC Enterprise Risk Management Program*. This circular provides for continuous monitoring to enhance program performance and operations and a process to identify, analyze, and reduce exposure to risks.

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[42] Although Institutions A, B, and C stopped offering RALs, FDIC officials informed us that they continued to facilitate other products with EROs, such as tax refund anticipation checks.

We recommend that the Directors, RMS and DCP, coordinate to:

1. Review and clarify, as appropriate, existing policy and guidance pertaining to the provision and termination of banking services to ensure it adequately addresses banking products other than deposit accounts, such as credit products.

2. Assess the effectiveness of the FDIC's supervisory policy and approach with respect to the issues and risks discussed in this report after a reasonable period of time is allowed for implementation.

With respect to the use of moral suasion to address supervisory concerns with financial institutions, it would be prudent for the FDIC to review its supervisory policy and guidance to determine whether moral suasion is adequately addressed.

We recommend that the Directors, RMS and DCP, coordinate with the Legal Division to:

3. Review and clarify, as appropriate, existing supervisory policy and guidance to ensure it adequately defines moral suasion in terms of the types and circumstances under which it is used to address supervisory concerns, whether it is subject to sufficient scrutiny and oversight, and whether meaningful remedies exist should moral suasion be misused.

Corporation Comments and OIG Evaluation

The Director, RMS, provided a written response on behalf of the FDIC, dated September 10, 2015, to a draft of this report. The response is presented in its entirety in Appendix 4. In the response, the Director concurred with all three of the report's recommendations and described planned and completed corrective actions that were responsive. The FDIC expects to complete all actions to address the recommendations by September 30, 2016. A summary of the Corporation's corrective actions is presented in Appendix 5.

In addition to actions already taken, the FDIC's response noted that a sustained effort to communicate with its staff and the industry is important to address what it perceives as potential confusion about appropriate supervisory standards and to ensure a common understanding and sustained application of the FDIC's approach. The FDIC committed to continuing to communicate to its staff and the industry regarding the distinctions between the standards applicable to credit products, including payday loans, offered by banks and those applicable to other banking services. To that end, the FDIC plans to update its guidance on payday lending by banks to clarify that the guidance does not apply to banks offering deposit accounts or extending credit to payday lenders.

The FDIC plans to conduct internal reviews to assess compliance with its actions to address the issues discussed in the report. The FDIC also plans to continue its reporting to the Board on deposit account terminations; highlight supervisory guidance in outreach events; and monitor inquiries and comments from the OO. In addition, the FDIC also plans to revise its written examination guidance by replacing the term moral suasion with a description of the informal communication that FDIC personnel can use to help mitigate practices that could cause a bank to experience financial or other difficulties. Further, with respect to our observation on RALs, the response stated that the FDIC would address the OIG's results after the OIG completes additional work in this area.

As noted above, the FDIC has taken and planned corrective actions that are responsive to our recommendations. However, in reiterating our findings and providing perspective surrounding them, management did not discuss the potential impact that statements and actions by FDIC executives can have on those responsible for carrying out the FDIC's supervisory policies and approach. As described in our report, our interviews and review of documents showed that perceptions regarding the views of senior FDIC executives about institutions involved in payday lending and RALs influenced the supervisory approach to handling risks at those institutions. In several instances, the approach was not consistent with written FDIC policy and guidance. Consequently, as it has committed to do, we believe it is prudent for FDIC senior leadership to reiterate its revised policies on a sustained basis to ensure they become engrained in the organization's supervisory culture. Given the significance of these issues, we will, at an appropriate time, follow up on the FDIC's actions to ensure they address the underlying concerns that support our recommendations.

EXHIBIT 16

No. 14-953-TNM

Appointment

From: Lipari, Elizabeth V. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=ELIPARI]
Sent: 3/14/2013 8:19:46 AM
To: [redacted]Sen, Surge [ssen@FDIC.gov]; Hollifield, Ardie [ahollifield@FDIC.gov]; Keest, Kathleen [kkeest@FDIC.gov]; Brown, Luke H. [LuBrown@FDIC.gov]

Subject: ACH
Location: [redacted]

Start: 3/18/2013 3:00:00 PM
End: 3/18/2013 4:00:00 PM
Show Time As: Tentative

Required Attendees: [redacted]Sen, Surge; Hollifield, Ardie; Keest, Kathleen; Brown, Luke H.

Update: Comments added to invite.

Conference No. Redacted
Code Redacted

Participants from [redacted] will be:
[redacted] Treasury Services (NACHA expert)
[redacted] GC for our consumer bank
[redacted] head of product and marketing for Segment 2

From: Pearce, Mark (DCP) [mailto:MaPearce@FDIC.gov]
Sent: Tuesday, March 12, 2013 03:48 PM Eastern Standard Time
To: [redacted]
Subject: RE: Following up

[redacted]

A call would be fine.

We are interested in the operational issues in monitoring the ACH transactions from payday lenders (or other higher-risk sources) to effectively identify multiple presentments when they occur, and also how easy it is for bank to implement stop payment requests (or revocation of authorizations) from consumers. We know that some online payday lenders resubmit under different names and in different amounts, in any effort to thwart monitoring. Curious how you plan to manage this challenge.

[redacted]

[redacted]

From: [redacted]
Sent: Tuesday, March 12, 2013 2:35 PM
To: Pearce, Mark (DCP)
Subject: Following up

Hi Mark – nice seeing you today! I wanted to follow up on the payday/ACH conversation. Our internal team would be happy to discuss what we're seeing in our research. [redacted]

[redacted]

EXHIBIT 17

No. 14-953-TNM

[redacted]

From: Dujenski, Thomas J. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=TDUJENSKI]
Sent: 5/8/2013 2:32:23 PM
To: Dean, Michael J. [MiDean@FDIC.gov]
Subject: RE: (No Subject)

never do...to easy

[redacted]

[redacted]
From: Dean, Michael J.
Sent: Wednesday, May 08, 2013 10:36 AM Eastern Standard Time
To: Dujenski, Thomas J.
Subject: RE:

If we don't want banks facilitating pay day lending via ACH, why don't we just come out with a statement or FIL letter warning banks.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

EXHIBIT 18

No. 14-953-TNM

Message

From:	Eberley, Doreen R. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=DEBERLEY]
Sent:	4/20/2015 7:31:53 PM
To:	Lennox, Jill A. [jlennox@fdic.gov]
CC:	Mulholland, Mark F. [mmulholland@fdic.gov]
Subject:	RE: OIG audit on Choke Point - RD meeting

Ok – thanks. I'll see if we have any agendas.

From: Lennox, Jill A.
Sent: Monday, April 20, 2015 7:07 PM
To: Eberley, Doreen R.
Cc: Mulholland, Mark F.
Subject: OIG audit on Choke Point - RD meeting

Doreen,

Thanks for your time today. In our meeting you asked about the timeframe regarding a meeting of Regional Directors (RD) where payday lending was discussed. I checked my notes - Mr. Lowe could not recall the exact timeframe but estimated it was in 2010 or early 2011. It was an in-person RD meeting that Chris Spoth and others attended.

Regards, Jill

Jill Lennox, CPA, CFE
Evaluations Manager, Office of Inspector General
Federal Deposit Insurance Corporation
[redacted]
E-mail: jlennox@fdic.gov

EXHIBIT 19

No. 14-953-TNM

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COURT REPORTING

Transcript of **Marvin Anthony Lowe**

Friday, April 27, 2018

Advance America, et al. v. Federal Deposit Insurance Corporation, et al.

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Alderson Reference Number: 78001

[redacted]

Was it your understanding that, in fact, the FDIC's leadership was deeply concerned about the facilitation of payday lending activities?

A. Yes.

[redacted]

paragraph in the -- it's the second full paragraph that starts "The Chicago Regional Director".

Do you see that, sir?

A. Yes.

Q. So it says: "The Chicago Regional Director -- and that's you. Right?

A. That's correct.

Q. "Informed us that he pursed a strategy of persuading the institution to terminate its payment processing relationship with the payday lender because it was his perception that senior FDIC management in the Washington, D.C. office, including the current and former chairman, did not favor banking services that facilitated payday lending."

And that's a true statement. Right?

A. To my knowledge, yes.

Q. Okay. "And the regional director recalled a meeting held in late 2010 or early 2011 during which the former Senior Deputy Director, Division of Supervision and Consumer Protection, DSC, informed the regional directors that if an institution in their region was facilitating payday lending, the regional director should require the institution to submit a plan for exiting the business."

Was that Mr. Spoth?

A. Yes.

Q. And that's S-P-O-T-H?

A. Correct.

Q. Okay. And what do you recall about, you know, what Mr. Spoth said at that meeting?

A. My recollection and, again, it's been a number of years, but it was during a regional director meeting, one of our quarterly meetings, and the comment -- the part that I do remember is that he indicated that he had had discussions with what he referred to as the sixth floor, and the comment was if any regional director, if a bank was found to be involved in payday lending, someone was going to be fired.

Q. Okay. And what is the sixth floor?

A. It's where the chairman and the leadership of FDIC have their offices.

Q. Okay. And was any reason given for this

[redacted]

Now, with the bank being a third-party payment processor payday lender, that was something that Mr. Pearce discouraged. Correct?

A. Yes.

[redacted]

of ACH returns are reasonable as ACH transactions are initiated only for the [redacted] customers who have effectively defaulted. After completion of the visitation, we will determine a supervisory strategy for the bank, including considerations for encouraging a termination of the relationship with the payday lender."

Why, if the ACH returns were reasonable, would the bank be encouraged to terminate with the payday lender? Was it because of Mr. Pearce's general preference that there not be a facilitation of payday lending?

MR. DOBER: Objection as to form.

THE WITNESS: I think it would be because of the FDIC's viewpoint with regard to payday lenders.

[redacted]

[redacted]

[redacted]

Q. Okay. "It is our view that payday loans are costly and offer limited utility for consumers as compared to traditional loan products."

Now, when you say "it's our view", is that the FDIC's view?

A. Yes.

Q. Okay. "Furthermore, the [redacted] relationship carries a degree of risk to the institution, including third-party reputational, compliance, and legal risk which may expose the bank to individual and class actions by borrowers and local regulatory authorities."

During your time at the FDIC, did you ever see a bank get sued because of the activities of a payday lender whose services they were facilitating?

A. No.

Q. And you go on to say: "Consequently, we have generally found that activities related to payday lending are unacceptable for an insured depository institution."

Was that true throughout your tenure in the Chicago Region?

A. It was true for the FDIC.

[redacted]

[redacted]

Let me ask you did anyone ever criticize you for the way in which you interacted with banks that were facilitating lending before Congress started doing hearings?

A. No.

[redacted]

[redacted]

Q. Did you feel like you were being scapegoated, that, Hey, there are all these congressional hearings and, you know, they're now saying I committed an error of judgment when I was just following their policy?

A. Yes.

[redacted]

[redacted]

Q. Okay. Now, after you were the recipient of [redacted] the OIG report, did you get any calls from anyone at the FDIC essentially expressing sympathy, you know, sorry, you know, you were put through that?

A. Yes.

Q. Who called you?

A. Just some close friends, some of my associates.

Q. Okay. And any like people from other

regions?

A. Yes.

Q. Okay. Which other regions?

A. San Francisco, Kansas City, Dallas.

Q. And was there a point, basically, there but for the grace of God go I?

MR. DOBER: Objection as to form.

THE WITNESS: No. I wouldn't characterize it in that manner.

BY MR. THOMPSON:

Q. Okay. But they were just saying, Hey, you were just doing your job and it's too bad this happened?

MR. DOBER: Objection as to form.

THE WITNESS: That's a good synopsis, yes.

[redacted]

EXHIBIT 20

No. 14-953-TNM

Office of the
Comptroller of the Currency
U.S. Department of the Treasury

OCC BULLETIN 1996-43

Subject: Credit Derivatives
Date: August 12, 1996

To: Chief Executive Officers of all National Banks, Department and Division Heads, and all Examining Personnel

Description: Guidelines for National Banks

Purpose

This bulletin informs bankers of a new set of derivative products and provides initial guidance on supervisory issues related to bank participation in the developing market for credit derivatives. The guidance is principally intended for end-user banks, rather than dealers, unless otherwise indicated.

Background

Credit derivatives are new financial instruments marketed as an efficient way to manage credit exposure. Credit derivatives permit the transfer of credit exposure between parties -- i.e., the buyer and seller of the credit protection -- in isolation from other forms of risk. These derivatives represent a natural extension of the market for similar products that "unbundle" risks, such as certain interest rate and foreign exchange products.

When used properly, credit derivatives can help to diversify credit risk, improve earnings, and lower the risk profile of an institution. Conversely, the improper use of credit derivatives, similar to poor lending practices, can result in an imprudent credit risk profile. Although the current volume of credit derivative activity in U.S. banks is quite small and mainly limited to dealers, many banks have begun to evaluate these products as tools for credit risk management.

With a credit derivative, a bank can both acquire and hedge risk. When a bank acquires risk, it takes on a credit exposure. Unlike traditional loan assets, most credit derivatives, except for credit-linked notes (discussed below), are off-balance-sheet contracts. The risk acquiror (i.e., seller of credit protection) may have several reasons for assuming the risk of a specific reference credit. For example, the protection seller may be underloaned, and would like to take carefully targeted credit risk in order to improve earnings, while also diversifying credit risk by assuming a risk position that has a low correlation with existing portfolio risks.

When a bank hedges risk, it transfers a credit exposure, but not the asset itself, to a counterparty who agrees to make a payment under certain conditions. Thus, the buyer of credit protection can hedge an existing exposure, much as the bank can with a loan participation. With a credit derivative, however, the asset remains on the bank's books. Because the exposure, but not the asset itself, is sold, credit derivatives can assist banks in managing internal limits, while avoiding customer relationship problems that can arise if the bank sells the asset.

There are three principal types of credit derivatives: **credit default swaps**, **total rate of return (TROR) swaps**, and **credit-linked notes**. Credit default swaps and TROR swaps are off-balance-sheet transactions. Credit-linked notes are credit-sensitive, cash-market structured notes that appear on the balance sheet like any other security. While these three vehicles are currently the predominant types of credit derivative transactions, the OCC expects that many variations, as well as new product types, will develop.

Credit default swaps are similar to standby letters of credit. The risk hedger (i.e., buyer of credit protection) pays a fee, which effectively represents an option premium, in return for the right to receive a conditional payment if a specified "reference credit" defaults. A reference credit is simply the party whose credit performance will determine credit derivative cash flows. Typically, the reference credit has a borrowing relationship with the bank that is buying credit protection. The bank may diversify its portfolio by reducing its exposure to the borrower, and the swap enables it to do so without disturbing its relationship with the customer. The methods used to determine the amount of the payment that would be triggered by the default vary by instrument. In some contracts, the amount of the payment is agreed upon at the inception of the contract. In others, the amount paid is determined after the default event and is based upon the observed prices of similar debt obligations of the borrower in the corporate bond market. A default event typically must exceed a materiality threshold in order to trigger a payment under the swap contract.

A TROR swap transfers the total economic performance of a reference asset (or index), which includes all associated cash flows, as well as capital appreciation or depreciation. The total return payer pays the total rate of return on a reference asset, which includes contractual payments plus any price appreciation, in return for a floating rate plus any depreciation on the reference asset. The total return payer has hedged its credit risk, while the total return receiver has accepted credit risk. If the reference asset depreciates, the total return payer will receive the depreciation amount from its counterparty. Although the hedger has transferred the risk of the asset, it does not transfer the asset itself. It retains the customer relationship and must continue to fund the earning asset. TROR swaps may, but need not, terminate upon a default event.

A **credit-linked note** is an on-balance-sheet, cash-market structured note often issued by a special purpose trust vehicle. The note represents a synthetic corporate bond or loan, because a credit derivative (credit default or TROR swap) is embedded in the structure. Depending upon the performance of a specified reference credit, and the type of derivative embedded in the note, the note may not be redeemable at par value. These notes are similar to variable principal redemption (VPR) bonds referenced in Advisory Letter 94-2, "Purchases of Structured Notes." The primary difference is that credit-linked notes have principal (par value) at risk depending upon the credit performance of a reference credit, whereas VPR bonds have principal at risk based upon changes in financial market rates. For example, the purchaser of a credit-linked note with an embedded default swap may receive only 60 percent of the original par value if a reference credit defaults. Investors in credit-linked notes assume credit risk of both the reference credit and the underlying collateral. The trust is generally collateralized with high-quality assets to assure payment of contractual amounts due. Like other structured notes, credit-linked notes allow an investor to take a customized investment view. Credit-linked notes may contain leverage that can magnify the risk and return of the asset.

When properly used, credit derivatives, like other financial derivatives, can provide national banks with substantial benefits. Most significantly, credit derivatives can allow banks to reduce concentration risks. For example, using a credit default swap, a bank may hedge a concentration risk by purchasing credit protection against a specific borrower's default. A bank can hedge against credit deterioration of a specific asset, short of an actual default, by paying the total return on a TROR swap. Alternatively, banks can adjust their credit profile by purchasing credit protection (i.e., hedging risk) against borrowers in an industry where an undesired exposure exists and selling protection (i.e., acquiring risk) in another industry. Portfolio management techniques can allow banks to increase the return on a portfolio, for a given level of risk, by structuring the portfolio to diversify credit exposures. To effectively diversify credit exposures, however, banks should understand how their asset risks are correlated. For example, if a fall in commodity prices will affect land prices, credit portfolios exposed to both commodity and land prices will typically have greater risks than portfolios without such correlated credit exposures. Using credit derivatives to manage the risk/return trade-off in a portfolio is an appropriate use of these products.

Banking Circular 277 (Risk Management of Financial Derivatives) used the term "interconnection risk" to describe "cross-risk" effects within a portfolio, such as when interest rate and credit risks of assets in a portfolio are inter-related. For example, an increase in interest rates, which lowers the value of a bank's fixed income assets, can also increase the default likelihood of borrowers in rate-sensitive industries. A change in a foreign currency exchange rate, which might increase a bank's foreign exchange risk, will likely affect the creditworthiness of a bank's domestic loan customer that has significant operations in that foreign country. Given that a bank has properly identified the risk dimensions within its portfolio, credit derivatives represent products that banks can use to manage such risks more precisely.

Supervisory Policy

Banking Circular 277 provides guidance for financial derivatives activities, and is equally appropriate for users of credit derivatives. Proper control over derivatives activities begins with effective senior management and board oversight. The oversight process includes sound policies and procedures to govern the use of derivatives, systems to identify, measure, monitor, and control risks, and independent oversight systems, such as audit coverage, to identify deficiencies in internal controls or systems.

While credit derivatives offer banks the potential to improve the risk/return profile of their credit portfolios through asset diversification, these products are new and largely untested. Valuation methods for transactions are not as analytically developed as they are for other financial derivatives. Capital requirements and accounting standards are not yet definitive, and clarity on these issues will almost certainly lag advances in product development. In light of these uncertainties, before participating, banks interested in using credit derivatives should use proper care and due diligence.

Much of the benefit credit derivatives can provide in diversifying portfolio risks depends upon a thorough understanding of the portfolio's existing risk profile, particularly credit concentrations. Prior to substantial participation in the market for credit derivatives, protection selling banks should thoroughly evaluate their credit portfolios, identifying credit concentrations and risk inter-connections, in order to assess how these products can best help to achieve strategic portfolio objectives.

National banks should subject credit derivatives, as they would any new product, to a uniform product assessment process to ensure that all significant risks have been addressed in the face of changing markets, organizational structure, systems, policies, and procedures. This process should generally include, as appropriate, a description of the risk management processes, limits and exception approval processes, legal documentation approvals, capital allocations, and accounting procedures. Also, systems support and operational capacity should be able to adequately accommodate the types of credit derivatives activities in which the bank engages. Further guidance on the uniform assessment process is contained in the "Risk Management of Financial Derivatives" booklet of the *Comptroller's Handbook*.

Risks Associated With Credit Derivatives

In discussing risk with bankers, the OCC's examiners assess banking risk relative to its impact on capital and earnings. From a supervisory perspective, risk is the potential that events, expected or unanticipated, may have an adverse impact on the bank's capital or earnings. The OCC has defined nine categories of risk for bank supervision purposes. These risks are: *credit, interest rate, liquidity, price, foreign exchange, transaction, compliance, strategic*, and *reputation*. These categories are not mutually exclusive; any product or service may expose the bank to multiple risks. For analysis and discussion purposes, however, the OCC identifies and assesses the risks separately.

For end-users, the risks associated with credit derivatives are *credit, transaction, liquidity, compliance* and *strategic*. For dealers in credit derivatives, the risk spectrum also includes price and reputation risks. The definitions of these risks are summarized below. For complete definitions, see the "Bank Supervision Process" booklet of the *Comptroller's Handbook*. The following paragraphs contain a discussion of how credit derivatives entail these risks.

Credit Risk

Credit risk is the risk to earnings or capital arising from an obligor's, or counterparty's, failure to meet the terms of any contract with the bank or to perform otherwise as agreed. All credit derivative transactions expose a bank to credit risk. The credit quality of both the reference asset and the derivative contract counterparty (if a bank is buying protection) are the principal determinants of credit risk. Even though these instruments are referred to as credit derivatives, some forms are the functional equivalents of letters of credit or options.

Counterparty credit risk should be strictly controlled through a formal and independent credit process. The credit department should periodically review the creditworthiness of both derivatives counterparties and reference credits, assign risk ratings to them and adjust credit reserves. Nonperforming contracts should be treated consistently with the bank's internal policy for nonperforming loans, and credit policies should address collateral requirements.

For the seller of credit protection (risk acquiror), the primary credit risk is to a reference credit, because the contract typically requires a payment from one party to the second when the credit quality of a reference credit has deteriorated. Thus, a bank that provides credit protection to a counterparty through a credit derivative is principally exposed to the credit risk of the reference asset, as though that reference asset itself were on the bank's balance sheet. The credit risk borne by the provider of credit protection should generally be measured as an exposure to the reference asset, rather than as an exposure to the contract counterparty. For TROR swaps, however, the protection seller (TROR receiver) receives appreciation from its counterparty. Therefore, in these transactions, the protection seller incurs credit risk for both the reference credit, and to a lesser extent, the counterparty.

For the purchaser of credit protection, the credit risk is exposure to the contract's counterparty. The protection purchaser is exposed to the credit risk associated with the failure of its counterparty (i.e., the "guarantor") to fulfill its obligation. This counterparty credit risk is similar to that of other derivative contracts, such as swaps, forwards, and options. To suffer a loss when purchasing credit protection, the reference credit and the counterparty provider **both** would have to default on their obligations. For this reason, banks that buy credit protection on a specified reference credit should generally solicit counterparties whose creditworthiness has a low default correlation (i.e., not closely related) with that of the reference credit.

Before entering into a credit derivative transaction as the **buyer** of protection, a bank should evaluate the financial condition of the provider of the credit protection. While the contract is in place, the buyer should continually monitor the condition of this counterparty. As with lending, the depth and frequency of the analysis of the counterparty should be a function of the potential size of the credit exposure.

L kewise, before entering into a credit derivative transaction as a **seller** of protection, a bank should conduct a complete credit review of the reference asset and, as necessary, the counterparty. That review should be similar to the process of granting a loan or providing a letter of credit.

Default swaps pose many of the same credit risk management issues as loans. Depending upon contract terms, protection sellers often have the choice of making a payment (given a default of the reference credit) equal to the decline in value of the reference asset, or acquiring the asset at the notional contract amount and working it out. When developing credit policies and procedures for these derivative structures, management should specifically address information disclosures and post-default strategies, considering the impact on relationships, liquidity, and legal standing.

Transaction Risk

Transaction risk is the risk to earnings or capital arising from problems with service or product delivery. Such problems with credit derivatives often arise when a bank does not fully understand or implement the transaction. Bank management should fully understand how the product works and the variables that determine its performance.

Unlike most other credit enhancements, such as letters of credit, the degree of credit risk transference in a credit derivative depends on the design of the product. One credit derivative can, by design, transfer a much higher proportion of the credit risk than another. For example, some credit derivatives pay a protection-buyer only when a previously defined default or downgrade occurs. Other derivatives might make a payment only for the loss in value beyond a threshold. Some derivatives might specify a reference asset that is similar, but not identical, to an asset the bank owns. Thus, a protection-buying bank should carefully consider the degree of correlation between the owned asset and the reference asset specified in the credit derivative. Finally, a credit derivative may provide protection against loss on loans to the reference credit for a period of time that is less than the remaining maturity of the loan or security.

When evaluating credit derivative transactions, banks should carefully assess the costs and benefits of each transaction. Protection-buying banks need to consider the effect of any feature that would alter the amount of credit protection provided by the contract. Likewise, as a provider of credit protection, banks should consider how various contract features affect the credit risk it is taking on and the compensation it receives for doing so.

Liquidity Risk

Liquidity risk is the risk to earnings or capital arising from a bank's inability to meet its obligations when they come due. End-users typically measure liquidity risks by evaluating cash flow/funding risks. Dealers measure liquidity risks by considering both funding risks and individual product liquidity risks.

Cash flow risks depend upon the bank's role in a transaction. Much like other financial derivatives, most credit derivatives allow a bank to accept an exposure without incurring an on-balance-sheet funding requirement. As a protection seller, a bank can create an off-balance-sheet exposure similar to, though generally with considerably less cash flow requirements than, a standby letter of credit. Upon default of a reference credit, the protection seller must make a payment. The protection buyer hedges the on-balance-sheet credit exposure but retains the obligation to fund the asset.

Dealers measure product liquidity risks by the size of the bid/ask spread. As with most new product types where transaction liquidity is limited, credit derivatives can have higher bid/ask spreads, which increase transaction costs. Dealers need to assess product liquidity risks and evaluate the need for close-out reserves. End-users should recognize that limited market depth can make it difficult to offset their positions prior to contract maturity.

National banks participating in credit derivatives markets should incorporate the impact of these activities on their cash flows into regular liquidity planning and monitoring systems. For both dealers and end-users, cash flow projections should incorporate all significant sources and uses of cash and collateral. The bank's contingency funding plan should address the impact of any early termination agreements or collateral/margin arrangements, as well as any unique issues associated with credit derivatives.

Compliance Risk

Compliance risk is the risk to earnings or capital arising from violations of, or non-conformance with, laws, rules, regulations, prescr bed practices, or ethical standards. Such failures could adversely affect a bank's success in the market for credit derivatives and could lessen its overall financial condition. Because credit derivative instruments are new and evolving, there are uncertainties about certain legal issues, the appropriate regulatory capital and reporting treatment, as well as other regulatory issues.

The OCC expects that U.S. bank and thrift supervisory agencies, as well as banking supervisors internationally, will continue to evaluate the market and discuss the supervisory treatment of these products. Therefore, over time, national banks should expect revised or more detailed guidance regarding credit derivatives.

Before engaging in credit derivatives transactions a national bank should reasonably satisfy itself that it and its counterparties have the legal and necessary regulatory authority to engage in the transactions. In addition, national banks engaging in credit derivative transactions should closely evaluate the legal documentation underlying the transactions. They should ensure that the transactions comply with applicable laws.

Participants are encouraged to use standardized documents as they become available. Currently, however, because the market is new, the standardized documentation that generally exists for other financial derivatives may not be present for credit derivatives. Two dealers offering identical transactions may document them in different ways, and the methods used to determine cash flows may also differ. For default swaps and credit-linked notes with embedded default swaps, the definition of a default and the determination of the payout following default are major issues to evaluate. End-user national banks should have legal counsel review credit derivative contracts, including credit-linked notes for an investment portfolio, before execution. These steps should ensure that the terms of the contracts are well understood and that the contracts are legally sound. Moreover, bank management should establish procedures to ensure that the contract's terms are consistent with the desired risk profile. Dealers should have legal counsel review documentation, prior to transaction execution, for non-standard or complex transactions.

Price Risk

Price risk is the risk to earnings or capital arising from changes in the value of portfolios of financial instruments. In the market for credit derivatives, some banks will participate as end-users, while others will act as dealers who will both buy and sell credit protection on the same (or similar) underlying reference assets. The OCC expects dealer banks to have sound policies, procedures, and systems to ensure that exposures are measured in a timely fashion and are within board-approved risk limits. As with other financial derivatives, the dealer's risk measurement system should include stress testing to evaluate the bank's exposure in a highly stressed market scenario.

The absence of historical data on defaults, and on correlations between default events, complicates the precise measurement of risk and makes the contingent exposures of credit derivatives difficult to forecast and fully hedge. In default swaps, the sellers of credit protection will likely make infrequent payments. However, when they are required to do so, those payments can be large. Also, because of the limited liquidity due to the absence of a deep dealer market, bank dealers may find it difficult to price transactions and to hedge cash flow exposures on a timely basis. As a result, dealer banks may find themselves more vulnerable to high volatilities of anticipated cash flows than with other financial derivative products. When evaluating credit derivatives as a line of business, and particularly when establishing risk limits, national bank dealers should carefully consider the differences in the potential liquidity characteristics of credit derivatives compared to other more familiar derivatives, such as interest rate and foreign exchange swaps and forwards.

Strategic Risk

Strategic risk is the risk to earnings or capital arising from adverse business decisions or improper implementation of those decisions. National banks that plan to enter the market for credit derivatives should ensure that the activity is consistent with the overall business strategies and credit risk appetite that have been approved by the board. The decision to use credit derivatives to manage risk in credit portfolios, much as the decision to use financial derivatives to manage interest rate and price risks, represents a strategic management decision. To achieve the significant benefits that credit derivatives can provide, many end-users will find it necessary to merge the talents of both credit and treasury (as well as trading) risk management personnel. Historically, these areas have been separated within most banks.

Reputation Risk

Reputation risk is the risk to earnings or capital arising from negative public opinion. This affects the bank's ability to establish new relationships or services, or to maintain existing ones. Because credit derivatives are new and take many different forms, the OCC is concerned that dealer banks may enter into transactions with counterparties that do not fully understand the terms and risks of the transactions. These risks could expose the bank to litigation, financial loss, or damage to its reputation.

Credit derivatives with leveraged payoff profiles pose particular reputation risks. Examples include binary default swaps, which require the protection seller to make a fixed payment upon default, without regard to any recovery on the reference asset, and certain credit-linked notes. Before recommending leveraged credit derivative products, national bank dealers should have rigorous policies and procedures in place to ensure that transactions are appropriate, that the counterparty will be able to fulfill its obligations under the terms of the contract, and that the transaction will not undermine longstanding customer relationships.

Accounting Considerations

Consistent with the FFIEC's decision to follow generally accepted accounting principles (GAAP) beginning with the March 1997 call reports, national banks should follow GAAP for regulatory reporting purposes. Currently, however, there is no authoritative guidance under GAAP that covers credit derivatives. Accordingly, as part of the new product approval process, national banks should consult with qualified independent accountants to determine the accounting effects of credit derivative transactions and to develop appropriate accounting policies.

Risk-Based Capital And Regulatory Reporting

Bank management must ensure that credit derivatives are incorporated into their risk-based capital (RBC) computation. Over the near-term, the RBC treatment of a credit derivative will be determined on a case-by-case basis through a review of the specific characteristics of the transaction. For example, banks should note that some forms of credit derivatives are functionally equivalent to standby letters of credit or similar types of financial enhancements. However, other forms might be treated like interest rate, equity, or other commodity derivatives, which have a different RBC requirement. As the market for credit derivatives expands, the OCC will provide additional guidance on the appropriate regulatory capital treatment.

Originating Office

For further information about this bulletin, contact the Office of the Chief National Bank Examiner (202) 649-6370.

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EXHIBIT 21

No. 14-953-TNM

FDIC

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Financial Institution Letter
FIL-52-2006
June 21, 2006

FOREIGN-BASED THIRD-PARTY SERVICE PROVIDERS
Guidance on Managing Risks in These Outsourcing Relationships

Summary: The FDIC has prepared the attached guidance to address the risks inherent in outsourcing relationships between U.S. financial institutions and foreign-based third-party service providers. The guidance provides steps that institutions should take to successfully manage such risks.

Distribution:
FDIC-Supervised Banks (Commercial and Savings)

Suggested Routing:
Board of Directors
Chief Executive Officer
Executive Officers

Related Topics:
Technology Outsourcing (see FIL-81-2000)

Attachment:
Guidance for Financial Institutions on the Use of Foreign-Based Third-Party Service Providers

Contact:
Examination Specialist William H. Henley, Jr. at (202) 898-6513

Note:
FDIC financial institution letters (FILs) may be accessed from the FDIC's Web site at www.fdic.gov/news/news/financial/2006/index.html.

To receive FILs electronically, please visit http://www.fdic.gov/about/subscriptions/fil.html.

Paper copies of FDIC financial institution letters may be obtained through the FDIC's Public Information Center (1-877-275-3342 or 703-562-2200).

Highlights:

- Financial institutions that have outsourcing relationships with third-party service providers face reputational, operational/transactional, compliance and strategic risks.
- When the third-party service provider resides or performs contractual work outside of the United States, an additional element of risk – "country risk" – is introduced.
- Financial institutions have the opportunity to enter into contractual arrangements with foreign-based third-party service providers with increasing frequency to handle such services as technology and data processing.
- U.S.-based third-party service providers are subcontracting substantial portions of their work to entities located outside of the United States. Many financial institutions may be unaware of these subcontracting arrangements or not adequately monitoring these relationships.
- Prior to selecting a third-party service provider, financial institutions should complete thorough due diligence.
- The financial institution's management should identify any undisclosed foreign-based subcontracting arrangements prior to entering into a contract with a foreign-based third-party service provider.
- Contracts with a third-party service provider should be written to protect the financial institution's interests.
- After the contract is signed, management should continually monitor the condition of the foreign-based third-party service provider and the country in which it is located.

Case 1:14-cv-00953-HHK Document 19-4 Filed 08/18/14 Page 22 of 86

Guidance for Financial Institutions on the Use of Foreign-Based Third-Party Service Providers

Financial institutions have traditionally used domestic third-party service providers to handle their technology, data processing and other needs, such as call center services. However, with increasing frequency, institutions have been presented with opportunities to enter into contractual arrangements with foreign-based third-party service providers (FBTSPs) to fulfill those needs. Moreover, U.S.-based third-party service providers are subcontracting substantial portions of their operations to entities located outside of the United States. In its 2004 study of offshore outsourcing of data services to identify both consumer and safety and soundness risks associated with offshore data processing,[1] the FDIC learned that financial institutions may be unaware of such subcontracting arrangements or, if they are aware, are not adequately monitoring the relationship.

The increased use of FBTSPs by U.S. financial institutions and U.S. third-party service providers is due, in large part, to the potential cost savings that are achievable as low-wage, yet highly qualified, labor pools are tapped in foreign countries. However, as with any sound business decision, financial institutions cannot accept the benefits while ignoring the potential risks.

The use of FBTSPs raises country, reputational, operational/transactional, compliance and strategic risks. To address those risks, the appropriate managers of the financial institution need to conduct a risk assessment, exercise due diligence in the selection process, consider protective contract provisions, and establish monitoring and oversight procedures in connection with the arrangements, as explained in this guidance.

Risk Management in the Use of Foreign-Based Third-Party Service Providers

Responsibilities of Directors and Officers

Institutions that transfer internal processes or data to third-party service providers have the same risk management, security, privacy, and other consumer protection responsibilities that they would have if they were conducting the activities themselves. The board of directors and senior management have a responsibility to ensure that third-party service provider activity is conducted in a safe and sound manner in compliance with policies and applicable laws. Their responsibilities include ensuring that systems and controls are established and maintained for the security and integrity of outsourced data, whether the third-party service provider is domestic or foreign.

An institution's board of directors and senior management are responsible for recognizing the risks associated with the institution's outsourcing relationships with FBTSPs and adopting and implementing an effective risk management strategy. Of primary importance at the outset is assessing whether a relationship with a FBTSP is consistent with the financial institution's overall business strategy.

Case 1:14-cv-00953-HG K Document 197-24 Filed 08/18/14 Page 4 of 8

Before a financial institution executes a contract with a FBTSP, it should assess the associated risks, exercise appropriate due diligence and consider various contract issues, including choice of law and jurisdictional matters. In order to properly oversee the risks of the outsourcing relationship, including country and compliance risks, the financial institution should have in place sufficient risk management policies, performance monitoring and oversight processes, legal and technical expertise, and access to critical information. Risk management includes the following: the ability to address the exposure introduced by the relationship with a FBTSP; and appropriate contingency plans and exit strategies to ensure continued access to critical information, as well as service continuity and resumption in the event of unexpected disruptions or restrictions in service resulting from transaction or country risk developments.[2]

Risk Categories

Country Risk

Country risk is the exposure to the economic, social and political conditions and events in a foreign country that may adversely affect the ability of the FBTSP to meet the level of service required by the arrangement, resulting in harm to the financial institution. In extreme cases, this exposure could result in the loss of data, research and development efforts, or other assets. Contracting with a FBTSP exposes a financial institution to country risk, a unique characteristic of these arrangements. Managing country risk requires the ability to gather and assess information regarding a foreign government's policies, including those addressing information access, as well as local political, social, economic, and legal conditions.

Reputational Risk

Reputational risk is the risk that potential negative publicity about a financial institution's business practices will cause a decline in the customer base, costly litigation, or the loss of revenue. A financial institution's reputation, particularly the level of trust afforded to it by customers, consumers, and counterparties, can be seriously tarnished due to perceived or real breaches in its ability to conduct business securely and responsibly. Financial institutions are also responsible for risks associated with the activities of FBTSPs with which they contract. For example, deficiencies in security and privacy policies that result in the release of customer information by a FBTSP may cause damage to the financial institution's reputation.

Operational/Transactional Risk

Operational/transactional risk is the risk of incurring a financial loss because of various types of human or technical error and fraud. Operational/transactional risk arises from fraud, processing errors, systems disruptions or other unanticipated events that impact the financial institution's ability to deliver timely products or services. This risk is evident in each product and service offered. Operational/transactional risk includes the risks associated with the failure of communications, transportation or data processing, such as the breakdown of some components of the hardware, software or communication systems; internal control system deficiencies;

human errors; or management failure. As a result, the financial institution could experience delays or disruptions in processing, clearing, and settling retail payment transactions. The level of operational/transactional risk is affected by the structure of the financial institution's processing environment, including the types of services offered and the complexity of the processes and supporting technology.

The key to controlling operational/transactional risk is by adopting effective polices, procedures, and controls to meet the new risk exposures introduced by the relationship with a FBTSP. Basic internal controls, including background checks, segregation of duties, dual controls, and reconcilements, remain important. Information security often represents the most significant control area requiring additional procedures, tools, expertise, and testing. Institutions should determine the appropriate level of security controls, including the use of encryption, based on their assessment of the sensitivity of the information to the customer and the financial institution and the financial institution's risk tolerance level.

As part of its assessment of operational/transactional risk, the financial institution needs to determine the frequency with which it should obtain backup files and updated escrow agreements to the application source code from the FBTSP.

Compliance Risk

Compliance risk assessment is intended to ensure that the financial institution's arrangement with a FBTSP does not interfere with the institution's compliance with applicable U.S. laws and regulations. This assessment includes the financial institution's compliance with applicable consumer protection, privacy, and information security laws and regulations, as well as requirements concerning accessibility and retention of records, such as in the Bank Secrecy Act.[3] Institutions engaging FBTSPs should also familiarize themselves with the national sanctions and embargo programs of U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC),[4] and restrictions on the commercial exportation of encryption.[5] In addition, the financial institution should consider the potential impact of foreign data privacy laws or regulatory requirements, how they differ from U.S. privacy laws and regulations, and any operational procedures necessary to address those conflicts.[6]

Strategic Risk

Strategic risk is the risk associated with the financial institution's future business plans and strategies. This risk category includes plans for entering new business lines, expanding existing services through mergers and acquisitions, and enhancing infrastructure (e.g., physical plant and equipment, information technology and networking). Managing strategic risk requires financial institutions to develop strategic plans to grow market share through new products and services, while managing additional research and development, marketing, and operational costs. Strategic risk assessment involves a planning process that demonstrates an understanding of the risks, appropriate procedures to mitigate those risks, and the financial institution's capability to provide the service.

Risk Management

Due Diligence

Selecting a FBTSP begins with management applying the same level of due diligence it applies when initiating a domestic outsourcing arrangement. An appropriate level of due diligence includes an evaluation of the FBTSP's financial condition, references, and recent audit reports. However, in this context, due diligence also should include an evaluation of the potential impact of the foreign jurisdiction's laws and legal environment, regulatory requirements, local business practices, and accounting standards, as well as the degree to which any rapid decline in the local economy, or political stability, would affect the FBTSP's ability to meet the financial institution's servicing needs. The due diligence should consider the parties' respective responsibilities in the event changes in the law or regulations of the United States or the foreign country make it difficult or impossible for the FBTSP to fulfill the contract.

Contracts

Any contract between the financial institution and a FBTSP should address the risk factors identified during the financial institution's risk assessment and due diligence processes. In addition, the Bank Service Company Act[7] requires the financial institution to advise the FDIC that it has entered into a contract with a third-party service provider, including one located outside the United States, within 30 days of doing so.[8]

Privacy. Management must seriously consider the inclusion of provisions that will protect the privacy of customers and the confidentiality of records given U.S. law and regulations. For example, FDIC regulations call for third-party service provider contracts to include provisions requiring the third-party service provider to implement procedures that meet the objectives of the customer information security guidelines.[9] In this connection, the financial institution should consider the inclusion of requirements that the FBTSP notify the financial institution in the event of an unauthorized access to data or other information security-related events. In addition, the financial institution may wish to include provisions about the FBTSP's obligation to preclude disclosure of any customer information to nonaffiliated third parties other than as permitted under U.S. privacy laws, and to use the information only to provide those services described in the contract. [10]

Examination of a FBTSP. Arrangements with FBTSPs should always be established in a way that permits the FDIC to access facilities and examine the services performed by the FBTSP pursuant to the Bank Service Company Act. Moreover, the financial institution should not share FDIC examination reports with either a foreign regulatory authority or a FBTSP without the FDIC's express written approval. Contracts establishing relationships with FBTSPs should permit the enforcement of such arrangements in all jurisdictions in which they are intended to apply.

Choice of Law. As part of its risk assessment, a financial institution should carefully consider whether it wants U.S. law or the law where the FBTSP is located to apply in the resolution of contract disputes or other legal issues between the parties. Any contract with the FBTSP might include choice of law and other provisions that specify which law is to apply and the court system in which disputes will be heard. Those provisions will assist the financial institution in maintaining continuity of service, access to data, and protection of customer information. In this regard, institutions should consider carefully the impact of any provision in an agreement presented by the FBTSP that states that the FBTSP has no presence or conducts no business within the United States.

In addition, those contract provisions may be subject to interpretation by foreign courts applying local laws. Those laws may not recognize choice of law provisions, or differ from U.S. law with respect to what they require of financial institutions or the degree to which they protect customers. Any analysis of local law obtained as part of a financial institution's due diligence from counsel experienced in that country's laws might include a discussion about the enforceability of all aspects of any contract, including choice of law and jurisdictional provisions.

Ownership of Information and Intellectual Property. It is appropriate that any agreement with a FBTSP require that all data transferred to the FBTSP remain the property of the financial institution, regardless of how the data are processed, stored, copied, or reproduced, and that the data be returned to the financial institution upon termination of the contract. In addition, service agreements should contain provisions that protect the financial institution's rights in any intellectual property such as design, graphics or code created by the FBTSP in order to meet the requirements of the agreement.

Monitoring and Oversight

When an arrangement with a FBTSP has been established, a financial institution should monitor both the FBTSP and the conditions within the country in which it is located. Among the areas to be considered in developing an oversight program are the FBTSP's:

- level of performance,
- financial condition,
- data security procedures,
- business recovery plans and testing,
- adequacy of insurance coverage, and
- compliance with applicable laws and regulations.

The financial institution should arrange to receive and evaluate any reports prepared by independent outside auditors and the FBTSP's staff as well as any reports prepared by its own auditors.[11] In addition, the financial institution should monitor economic and governmental conditions within the country in which the FBTSP is based in order to determine whether changes in those conditions are likely to adversely affect the ability of the FBTSP to perform under the arrangement.

Undisclosed Foreign-Based Subcontracting Arrangements

Undisclosed foreign-based subcontracting arrangements occur when a domestic third-party service provider subcontracts all or part of the work for a financial institution to an offshore company without prior notice to or consent from the financial institution. Third-party service provider contracts often permit subcontracting. However, the transfer of data overseas without any notification to the financial institution may increase risk in an outsourcing relationship.

Standard Federal Financial Institutions Examination Council (FFIEC) examination procedures include a review of outsourcing arrangements to determine whether:

- subcontracting is employed either under or outside the terms of the contract;
- the financial institution is aware of the subcontracting and the vendor's location; and
- the financial institution has procedures for monitoring all outsourcing arrangements to ensure adequate controls are in place or the third-party service provider has proper procedures and controls to monitor its subcontracting arrangements.

The financial institution should consider including contract provisions that require a third-party service provider to notify the financial institution of and obtain approval for changes to significant subcontracting relationships, whether the subcontracted entity is domestic or foreign-based. Further, contract provisions allowing the financial institution to monitor the primary contractor's risk management activities related to foreign-based subcontractors should be considered.

Access to Information

A financial institution should not establish an arrangement with a FBTSP located in any jurisdiction in which local laws or regulations or administrative procedures would interfere with the FDIC's full and complete access to data or other relevant information as required by the Bank Service Company Act. Any analysis of local law obtained from counsel experienced in the law and practices of that jurisdiction might include a discussion as to whether there are any provisions or practices, including data transfer restrictions that would impair the FDIC's access to information or ability to examine the financial institution's operations.

Critical data or other information related to services provided by a FBTSP to a financial institution must be readily available at the financial institution's U.S. office(s). A financial institution must maintain, in the files of a U.S. office, appropriate documentation to support all arrangements with FBTSPs. Appropriate documentation typically includes a copy of the contract establishing the arrangement, supporting legal opinions, due diligence reports, audits, financial statements, performance reports, and other critical data or information, including any related transactions.

FDIC Supervision

The FDIC may examine a financial institution's outsourcing arrangement with a FBTSP or – in the case of a regulated entity – obtain information through the appropriate supervisory agency in the FBTSP's home country. The FDIC's examination procedures will cover the adequacy of the financial institution's due diligence efforts in the selection of a FBTSP, its risk assessment and the steps taken to manage those risks. This will include an assessment of relevant contract provisions and the financial institution's periodic review of internal/external audits or testing to assure compliance with applicable laws and to ensure access to critical information.

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[1] See, Offshore Outsourcing of Data Services by Insured Institutions and Associated Consumer Risks, FDIC, June 2004.

[2] See, Country Risk Management FIL 23-2002, March 11, 2002; Bank Technology Bulletin on Outsourcing, FIL 50-2201, June 4, 2001; Security Standards for Customer Information, FIL 22-2001, March 14, 2001; Risk Management of Technology Outsourcing, FIL 81-2000, Nov. 29, 2000.

[3] In this regard, institutions using FBTSPs should be aware of Section 319 of the USA Patriot Act, Pub. L. No. 107-56 (Oct. 26, 2001) that requires an institution to make information on anti-money laundering compliance by the institution or its customers available within 120 hours of a government request.

[4] The Office of Foreign Assets Control of the U.S. Department of the Treasury administers and enforces economic and trade sanctions against targeted foreign countries, organizations sponsoring terrorism, and international narcotics traffickers based on U.S. foreign policy and national security goals. For more information, refer to the OFAC Web site at www.treas.gov/offices/eotffc/ofac/.

[5] Export controls on commercial encryption products are administered by the Bureau of Industry and Security, part of the Department of Commerce. You may be an exporter if you provide encryption software to a FBTSP. Export administration regulations regarding encryption are contained in 15 CFR §§ 740.13, 740.17, & 742.15. See, www.bis.doc.gov.

[6] An institution should identify and understand the application of any laws within a foreign jurisdiction that apply to information transferred from the United States to that foreign jurisdiction over the Internet or to information "collected" within the foreign jurisdiction using automated or other equipment in that jurisdiction.

[7] 12 USC § 1867(c)(1).

[8] 12 USC § 1867(c)(2).

[9] 12 CFR 364, Appendix B, ¶ III.D.2.

[10] See, e.g. 12 CFR 332.11 & 13.

[11] Based upon the bank's own risk assessment, the bank should monitor its third-party service providers to confirm that they adequately safeguard bank customer information. As part of this monitoring, a bank should review audits, summaries of test results, or other equivalent evaluations of its third-party service providers. See 12 CFR 364, Appendix B,¶ III.D.3.

EXHIBIT 22

No. 14-953-TNM

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Financial Institution Letter
FIL-44-2008
June 6, 2008

THIRD-PARTY RISK

Guidance for Managing Third-Party Risk

Summary: The attached FDIC guidance describes potential risks arising from third-party relationships and outlines risk management principles that may be tailored to suit the complexity and risk potential of a financial institution's significant third-party relationships.

Distribution:
FDIC-Supervised Banks (Commercial and Savings)

Suggested Routing:
Chief Executive Officer
Chief Financial Officer
Chief Compliance Officer
Chief Risk Officer

Related Topics:
Risk Management
Third-Party Contracts
Outsourcing Arrangements
FFIEC IT Handbook on Outsourcing Technology Services (June 2004)
Required Notification for Compliance with the Bank Service Company Act

Attachment:
Guidance for Managing Third-Party Risk

Contact: Senior Examination Specialist Kenyon T. Kilber (Risk Management) at kkilber@fdic.gov or (202) 898-8935, or Policy Analyst Victoria Pawelski (Compliance) at vpawelski@fdic.gov or (202) 898-3571

Note:
FDIC financial institution letters (FILs) may be accessed from the FDIC's Web site at http://www.fdic.gov/news/news/financial/2008/index.html.

To receive FILs electronically, please visit http://www.fdic.gov/about/subscriptions/fil.html.

Paper copies of FDIC financial institution letters may be obtained through the FDIC's Public Information Center, 3501 Fairfax Drive, E-1002, Arlington, VA 22226 (1-877-275-3342 or 703-562-2200).

Highlights:

Financial institutions often rely upon third parties to perform a wide variety of services and other activities. An institution's board of directors and senior management are ultimately responsible for managing activities conducted through third-party relationships, and identifying and controlling the risks arising from such relationships, to the same extent as if the activity were handled within the institution.

Management should tailor the principles contained in this guidance to each significant third-party arrangement, taking into consideration such factors as the complexity, magnitude, and nature of the arrangement and associated risks. This guidance outlines the potential risks that may arise from the use of third parties and addresses the following four basic elements of an effective third-party risk management program:

- Risk assessment
- Due diligence in selecting a third party
- Contract structuring and review
- Oversight

This guidance is based on and supplements the principles contained in policy guidance that has previously addressed third-party risk in the context of specific functions, such as information technology. This guidance is intended to assist in the effective management of third-party relationships, and should not be considered as a set of required procedures.

GUIDANCE FOR MANAGING THIRD-PARTY RISK

<u>Introduction</u>

An institution's board of directors and senior management are ultimately responsible for managing activities conducted through third-party relationships, and identifying and controlling the risks arising from such relationships, to the same extent as if the activity were handled within the institution. This guidance includes a description of potential risks arising from third-party relationships, and provides information on identifying and managing risks associated with financial institutions' business relationships with third parties.[1] This guidance applies to any of an institution's third-party arrangements, and is intended to be used as a resource for implementing a third-party risk management program.

This guidance provides a general framework that boards of directors and senior management may use to provide appropriate oversight and risk management of significant third-party relationships. A third-party relationship should be considered significant if the institution's relationship with the third party is a new relationship or involves implementing new bank activities; the relationship has a material effect on the institution's revenues or expenses; the third party performs critical functions; the third party stores, accesses, transmits, or performs transactions on sensitive customer information; the third party markets bank products or services; the third party provides a product or performs a service involving subprime lending or card payment transactions; or the third party poses risks that could significantly affect earnings or capital.

The FDIC reviews a financial institution's risk management program and the overall effect of its third-party relationships as a component of its normal examination process. As noted, the FDIC evaluates activities conducted through third-party relationships as though the activities were performed by the institution itself. In that regard, it must be noted that while an institution may properly seek to mitigate the risks of third-party relationships through the use of indemnity agreements with third parties, such agreements do not insulate the institution from its ultimate responsibility to conduct banking and related activities in a safe and sound manner and in compliance with law.

Management should consider the principles addressed in this guidance and ensure that appropriate procedures are in place, taking into account the complexity and risk potential for each of its third-party relationships. The precise use of a risk management process is dependent upon the nature of the third-party relationship, the scope and magnitude of the activity, and the risk identified.

<u>Background</u>

Financial institutions generally enter into third-party relationships by outsourcing certain operational functions to a third party or by using a third party to make products and services available that the institution does not originate. Also, financial institutions may enter into arrangements with third parties in which the institution funds certain products originated by a third party. As the financial services industry continues to evolve, some financial institutions are also using third parties for functions that are either new or have traditionally been performed in-

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[1] This guidance supplements, but does not replace, previously issued information on third-party risk and is intended to assist in the management of third-party relationships.

house. For purposes of this guidance, the term “third party” is broadly defined to include all entities that have entered into a business relationship with the financial institution, whether the third party is a bank or a nonbank, affiliated or not affiliated, regulated or nonregulated, or domestic or foreign.

The FDIC recognizes that the use of third parties can assist management in attaining strategic objectives by increasing revenues or reducing costs. The use of a third party also commonly serves as a vehicle for management to access greater expertise or efficiency for a particular activity. The decision about whether to use a third party should be considered by an institution’s board of directors and management taking into account the circumstances unique to the potential relationship. The use of third parties in no way diminishes the responsibility of the board of directors and management to ensure that the third-party activity is conducted in a safe and sound manner and in compliance with applicable laws, regulations, and internal policies.

This guidance provides a general framework for the implementation of an effective third-party risk management process. This guidance does not supersede previously issued FDIC and interagency guidance on managing third-party risk in the context of specific functions or activities. Also, transactions with affiliated entities remain subject to sections 23A and 23B of the Federal Reserve Act—the specific requirements of which are not addressed here.

This guidance applies to any of an institution’s third-party arrangements, and is intended to be used as a resource for implementing a third-party risk management program, including functions and activities not specifically addressed in other guidance. The guidelines should not be considered a set of mandatory procedures, but management should ensure that sufficient procedures and policies are in place to control the risks associated with a particular third-party relationship.

Potential Risks Arising from Third-Party Relationships

There are numerous risks that may arise from a financial institution’s use of third parties. Some of the risks are associated with the underlying activity itself, similar to the risks faced by an institution directly conducting the activity. Other potential risks arise from or are heightened by the involvement of a third party. Failure to manage these risks can expose an institution to regulatory action, financial loss, litigation and reputation damage, and may even impair the institution’s ability to establish new or service existing customer relationships.

Not all of the following risks will be applicable to every third-party relationship; however, complex or significant arrangements may have definable risks in most areas. The financial institution’s board of directors and senior management should understand the nature of these risks in the context of the institution’s current or planned use of third parties. The following summary of risks is not considered all-inclusive.

Strategic risk. Strategic risk is the risk arising from adverse business decisions, or the failure to implement appropriate business decisions in a manner that is consistent with the institution’s strategic goals. The use of a third party to perform banking functions or to offer products or services that do not help the financial institution achieve corporate strategic goals and provide an adequate return on investment exposes the financial institution to strategic risk.

Case 1:14-cv-00953-GK Document 199-16 Filed 10/12/14 Page 4 of 12

Reputation risk. Reputation risk is the risk arising from negative public opinion. Third-party relationships that result in dissatisfied customers, interactions not consistent with institution policies, inappropriate recommendations, security breaches resulting in the disclosure of customer information, and violations of law and regulation are all examples that could harm the reputation and standing of the financial institution in the community it serves. Also, any negative publicity involving the third party, whether or not the publicity is related to the institution's use of the third party, could result in reputation risk.

Operational risk. Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events. Third-party relationships often integrate the internal processes of other organizations with the bank's processes and can increase the overall operational complexity.

Transaction risk. Transaction risk is the risk arising from problems with service or product delivery. A third party's failure to perform as expected by customers or the financial institution due to reasons such as inadequate capacity, technological failure, human error, or fraud, exposes the institution to transaction risk. The lack of an effective business resumption plan and appropriate contingency plans increase transaction risk. Weak control over technology used in the third-party arrangement may result in threats to security and the integrity of systems and resources. These issues could result in unauthorized transactions or the inability to transact business as expected.

Credit risk. Credit risk is the risk that a third party, or any other creditor necessary to the third-party relationship, is unable to meet the terms of the contractual arrangements with the financial institution or to otherwise financially perform as agreed. The basic form of credit risk involves the financial condition of the third party itself. Some contracts provide that the third party ensures some measure of performance related to obligations arising from the relationship, such as loan origination programs. In these circumstances, the financial condition of the third party is a factor in assessing credit risk. Credit risk also arises from the use of third parties that market or originate certain types of loans, solicit and refer customers, conduct underwriting analysis, or set up product programs for the financial institution. Appropriate monitoring of the activity of the third party is necessary to ensure that credit risk is understood and remains within board-approved limits.

Compliance risk. Compliance risk is the risk arising from violations of laws, rules, or regulations, or from noncompliance with internal policies or procedures or with the institution's business standards. This risk exists when the products or activities of a third party are not consistent with governing laws, rules, regulations, policies, or ethical standards. For example, some third parties may engage in product marketing practices that are deceptive in violation of Section 5 of the Federal Trade Commission Act, or lending practices that are discriminatory in violation of the Equal Credit Opportunity Act and the Federal Reserve Board's Regulation B. Additionally, the ability of the third party to maintain the privacy of customer records and to implement an appropriate information security and disclosure program is another compliance concern. Liability could potentially extend to the financial institution when third parties experience security breaches involving customer information in violation of the safeguarding of customer information standards under FDIC and Federal Trade Commission regulations. Compliance risk is exacerbated when an institution has inadequate oversight, monitoring or audit functions.

Case 1:14-cv-00953-GK Document 19-36 Filed 10/12/14 Page 5 of 13

Other risks. The types of risk introduced by an institution's decision to use a third party cannot be fully assessed without a complete understanding of the resulting arrangement. Therefore, a comprehensive list of potential risks that could be associated with a third-party relationship is not possible. In addition to the risks described above, third-party relationships may also subject the financial institution to liquidity, interest rate, price, foreign currency translation, and country risks.

Risk Management Process

The key to the effective use of a third party in any capacity is for the financial institution's management to appropriately assess, measure, monitor, and control the risks associated with the relationship. While engaging another entity may assist management and the board in achieving strategic goals, such an arrangement reduces management's direct control. Therefore, the use of a third party increases the need for oversight of the process from start to finish. This guidance provides four main elements of an effective third-party risk management process: (1) risk assessment, (2) due diligence in selecting a third party, (3) contract structuring and review, and (4) oversight.

While these four elements apply to any third-party activities, the precise use of this process is dependent upon the nature of the third-party relationship, the scope and magnitude of the activity, and the risks identified. These guidelines are not intended to result in an expansion or a decrease in the use of third parties by financial institutions, but to provide a framework for assessing, measuring, monitoring, and controlling risks associated with third parties. A comprehensive risk management process, which includes management of any third-party relationships, will enable management to ensure that capital is sufficient to support the institution's underlying risk exposures and that the third party is operating in a manner consistent with federal and state laws, rules, and regulations, including those intended to protect consumers.

1. Risk Assessment

Risk assessment is fundamental to the initial decision of whether or not to enter into a third-party relationship. The first step in the risk assessment process should be to ensure that the proposed relationship is consistent with the institution's strategic planning and overall business strategy. Next, management should analyze the benefits, costs, legal aspects, and the potential risks associated with the third party under consideration. Expanded analysis would be warranted if the product or service is a new activity or product for the institution. It is key for management to develop a thorough understanding of what the proposed relationship will accomplish for the institution, and why the use of a third party is in its best interests. A risk/reward analysis should be performed for significant matters, comparing the proposed third-party relationship to other methods of performing the activity or product offering, including the use of other vendors or performing the function in-house. For such matters, the analysis should be considered integral to the bank's overall strategic planning, and should thus be performed by senior management and reviewed by the board or an appropriate committee.

Responsible bank personnel should have the requisite knowledge and skills to adequately perform the analysis. Certain aspects of the risk assessment phase may include the use of internal auditors, compliance officers, technology officers, and legal counsel. This phase should also identify performance criteria, internal controls, reporting needs, and contractual requirements that would be critical to the ongoing assessment and control of specific identified

Case 1:14-cv-00953-GK Document 17-16 Filed 08/18/14 Page 5 of 13

risks. For example, if the activity involves consumer products and services, the board and management should establish a clear solicitation and origination strategy that allows for an assessment of performance, as well as mid-course corrections. In addition, assessing the best method of providing information security and meeting customer privacy requirements should not be overlooked during this phase.

After completing the general assessment of risks, particularly relative to the institution's overall strategic plan, management should review its ability to provide adequate oversight and management of the proposed third-party relationship on an ongoing basis. While identifying and understanding the risks associated with the third party is critical at the outset, the long-term management of the relationship is vital to success. For significant third-party relationships, the board may consider appointing a senior manager to be responsible for the relationship, including due diligence, implementation, ongoing oversight, and periodic reporting to the board. This management official should have the requisite knowledge and skills to critically review all aspects of the relationship. The board and management should also ensure that the institution's compliance management system is adapted to effectively address the third-party relationship and appropriately respond to emerging issues and compliance deficiencies.

A final part of the initial risk assessment phase for significant relationships involves carefully estimating the long-term financial effect of the proposed third-party relationship. The board should take into account all aspects of the long-term potential of the relationship, as well as the managerial expertise and other associated costs that would result from the decision to use a third party, and not be unduly influenced by short-term cost savings. The long-term financial risk resulting from an initial incomplete accounting of costs and/or an overestimation of benefits can undermine appropriate decisions in other phases of the risk management process.

2. Due Diligence in Selecting a Third Party

Following an assessment of risks and a decision to proceed with a plan to establish a third-party relationship, management must select a qualified entity to implement the activity or program. The due diligence process provides management with the information needed to address qualitative and quantitative aspects of potential third parties to determine if a relationship would help achieve the financial institution's strategic and financial goals and mitigate identified risks. Not only should due diligence be performed prior to selecting a third party, but it should also be performed periodically during the course of the relationship, particularly when considering a renewal of a contract.

The scope and depth of due diligence is directly related to the importance and magnitude of the institution's relationship with the third party. For example, large-scale, highly visible programs or programs dealing with sensitive data integral to the institution's success warrant an in-depth due diligence of the potential third party, while the due diligence process for isolated low-risk third-party activities would be much less comprehensive.

Comprehensive due diligence involves a review of all available information about a potential third party, focusing on the entity's financial condition, its specific relevant experience, its knowledge of applicable laws and regulations, its reputation, and the scope and effectiveness of its operations and controls. The evaluation of a third party may include the following items:

Case 1:14-cv-00953-GK Document 17-16 Filed 10/28/18 Page 7 of 13

- Audited financial statements, annual reports, SEC filings, and other available financial indicators.
- Significance of the proposed contract on the third party's financial condition.
- Experience and ability in implementing and monitoring the proposed activity.
- Business reputation.
- Qualifications and experience of the company's principals.
- Strategies and goals, including service philosophies, quality initiatives, efficiency improvements, and employment policies.
- Existence of any significant complaints or litigation, or regulatory actions against the company.
- Ability to perform the proposed functions using current systems or the need to make additional investment.
- Use of other parties or subcontractors by the third party.
- Scope of internal controls, systems and data security, privacy protections, and audit coverage.
- Business resumption strategy and contingency plans.
- Knowledge of relevant consumer protection and civil rights laws and regulations.
- Adequacy of management information systems.
- Insurance coverage.

3. Contract Structuring and Review

After selecting a third party, management should ensure that the specific expectations and obligations of both the financial institution and the third party are outlined in a written contract prior to entering into the arrangement. Board approval should be obtained prior to entering into any material third-party arrangements. Appropriate legal counsel should also review significant contracts prior to finalization. Any material or significant contract with a third party should prohibit assignment, transfer or subcontracting by the third party of its obligations to another entity, unless and until the financial institution determines that such assignment, transfer, or subcontract would be consistent with the due diligence standards for selection of third parties.

The level of detail in contract provisions will vary with the scope and risks associated with the third-party relationship. The following topics should be considered as a contract is structured, with the applicability of each dependent upon the nature and significance of the third-party relationship.

Scope. The contract should clearly set forth the rights and responsibilities of each party to the contract, including the following:

- Timeframe covered by the contract.
- Frequency, format, and specifications of the service or product to be provided.
- Other services to be provided by the third party, such as software support and maintenance, training of employees, and customer service.
- Requirement that the third party comply with all applicable laws, regulations, and regulatory guidance.
- Authorization for the institution and the appropriate federal and state regulatory agency to have access to records of the third party as are necessary or appropriate to evaluate compliance with laws, rules, and regulations.

- Identification of which party will be responsible for delivering any required customer disclosures.
- Insurance coverage to be maintained by the third party.
- Terms relating to any use of bank premises, equipment, or employees.
- Permissibility/prohibition of the third party to subcontract or use another party to meet its obligations with respect to the contract, and any notice/approval requirements.
- Authorization for the institution to monitor and periodically review the third party for compliance with its agreement.
- Indemnification.

Cost/compensation. For both the financial institution and the third party, the contract should outline the fees to be paid, including any fixed compensation, variable charges, and any fees to be paid for nonrecurring items or special requests. Other items that should be addressed, if applicable, are the cost and responsibility for purchasing and maintaining any equipment, hardware, software, or other item related to the activity. Also, the party responsible for payment of any legal or audit expenses should be identified.

Financial institutions should employ compensation programs that are consistent with sound banking practices and consumer protection laws. Compensation schemes should be structured to promote favorable long-term performance in a safe and sound manner. Volume and short-term incentives should be subject to strict quality control, and in the area of loan originations, are of particular concern. The FDIC expressly discourages the use of compensation arrangements which may encourage third-party originators to inappropriately steer borrowers into higher cost products.

Performance standards. For certain relationships, clearly defined performance standards should be included to serve as a basis for measuring the performance of the third party, and may also be used as a factor in compensation arrangements. Industry standards may be used as a reference for certain functions, or standards may be set to reflect the particular relationship between the third party and the financial institution. Management should periodically review the performance measures to ensure consistency with its overall objectives.

Reports. The contract should specify the type and frequency of management information reports to be received from the third party. Routine reports may include performance reports, audits, financial reports, security reports, and business resumption testing reports. Management should also consider mandating exception-based reports that would serve as notification of any changes or problems that could affect the nature of the relationship or pose a risk to the financial institution.

Audit. In addition to the types and frequency of audit reports that the financial institution is entitled to receive from the third party, the contract should also specify the institution's right to audit the third party (or engage an independent auditor) as needed to monitor performance under the contract. Management should ensure that the third party's internal control environment as it relates to the service or product being provided to the financial institution is sufficiently audited. If material to the arrangement, specific internal controls to be maintained by the third party should be defined in the contract.

Confidentiality and security. The contract should prohibit the third party and its agents from using or disclosing the institution's information, except as necessary to perform the functions designated by the contract. Any nonpublic personal information on the institution's customers must be handled in a manner consistent with the institution's own privacy policy and in accordance with applicable privacy laws and regulations. Any breaches in the security and confidentiality of information, including a potential breach resulting from an unauthorized intrusion, should be required to be fully and promptly disclosed to the financial institution.

Customer complaints. The contract should specify whether the financial institution or the third party has the duty to respond to any complaints received by the third party from customers of the financial institution. If the third party is responsible for such responses, a copy of any complaint and the response should be forwarded to the financial institution. The contract should also provide for periodic summary reports detailing the status and resolution of complaints.

Business resumption and contingency plans. The contract should address the third party's responsibility for continuation of services provided for in the contractual arrangement in the event of an operational failure, including both man-made and natural disasters. The third party should have appropriate protections for backing up information and also maintain disaster recovery and contingency plans with sufficiently detailed operating procedures. Results of testing of these plans should be provided to the financial institution.

Default and termination. To mitigate risks associated with contract default and/or termination, the contract should address both issues. The contract should specify what circumstances constitute default, identify remedies, and allow for a reasonable opportunity to cure a default. Similarly, termination rights should be identified in the contract, especially for material third-party arrangements and relationships involving rapidly changing technology or circumstances. Termination rights may be sought for various conditions, such as a change in control, substantial increase in cost, failure to meet performance standards, failure to fulfill contractual obligations, inability to prevent violations of law, bankruptcy, company closure, and insolvency. The contract should state termination and notification requirements, with operating requirements and time frames to allow for the orderly conversion to another entity without excessive expense. Return of the financial institution's data, records, and/or other resources should also be addressed.

Dispute resolution. The institution should consider whether the contract should include a dispute resolution process for the purpose of resolving problems expeditiously. Continuation of the arrangement between the parties during the dispute should also be addressed.

Ownership and license. The contract should address ownership issues and the third party's right to use the financial institution's property, including data, equipment, software, and intellectual property such as the institution's name and logo, trademark, and other copyrighted material. It should also address ownership and control of any records generated by the third party.

Indemnification. Indemnification provisions require a third party to hold the financial institution harmless from liability as a result of negligence by the third party, and vice versa. Incorporating these provisions into a contract may reduce the potential for the institution to be held liable for claims arising from the third party's negligence. It bears repeating, however, that such provisions cannot shift to third parties the institution's ultimate responsibility to conduct banking and related activities in a safe and sound manner and in compliance with laws, regulations and sound banking principles. Also, the existence of indemnification provisions will not be a mitigating factor where deficiencies indicate the need to seek corrective actions. Where violations of consumer protection or other laws, regulations, and sound banking principles are present, or when banking and related activities are not conducted in a safe and sound manner, the FDIC's consideration of remedial measures, including restitution orders, will be made irrespective of the existence of indemnification clauses in third-party contracts.

<u>Limits on liability.</u> A third party may wish to contractually limit the amount of liability that it could incur as a result of the relationship with the financial institution. Before entering into such a contract, management of the financial institution should carefully consider whether the proposed damage limitation is reasonable compared to the amount of loss the institution could experience should the third party fail to adequately perform.

4. Oversight

Institutions should maintain adequate oversight of third-party activities and adequate quality control over those products and services provided through third-party arrangements in order to minimize exposure to potential significant financial loss, reputation damage, and supervisory action. The board should initially approve, oversee, and review at least annually significant third-party arrangements, and review these arrangements and written agreements whenever there is a material change to the program. Management should periodically review the third party's operations in order to verify that they are consistent with the terms of the written agreement and that risks are being controlled. The institution's compliance management system should ensure continuing compliance with applicable federal and state laws, rules, and regulations, as well as internal policies and procedures.

Management should allocate sufficient qualified staff to monitor significant third-party relationships and provide the necessary oversight. Management should consider designating a specific officer to coordinate the oversight activities with respect to significant relationships, and involve their compliance management function and, as necessary, involve other operational areas such as audit and information technology, in the monitoring process. The extent of oversight of a particular third-party relationship will depend upon the potential risks and the scope and magnitude of the arrangement.

An oversight program will generally include monitoring of the third party's quality of service, risk management practices, financial condition, and applicable controls and reports. Results of oversight activities for material third-party arrangements should be periodically reported to the financial institution's board of directors or designated committee. Identified weaknesses should be documented and promptly addressed.

Performance monitoring should include, as appropriate, the following:

- Evaluate the overall effectiveness of the third-party relationship and the consistency of the relationship with the financial institution's strategic goals.
- Review any licensing or registrations to ensure the third party can legally perform its services.
- Evaluate the third party's financial condition at least annually. Financial review should be as comprehensive as the credit risk analysis performed on the institution's borrowing

relationships. Audited financial statements should be required for significant third-party relationships.

- Review the adequacy of the third party's insurance coverage.
- Ensure that the third party's financial obligations to others are being met.
- Review audit reports or other reports of the third party, and follow up on any needed corrective actions.
- Review the adequacy and adherence to the third party's policies relating to internal controls and security issues.
- Monitor for compliance with applicable laws, rules, and regulations.
- Review the third party's business resumption contingency planning and testing.
- Assess the effect of any changes in key third party personnel involved in the relationship with the financial institution.
- Review reports relating to the third party's performance in the context of contractual requirements and performance standards, with appropriate follow-up as needed.
- Determine the adequacy of any training provided to employees of the financial institution and the third party.
- Administer any testing programs for third parties with direct interaction with customers.
- Review customer complaints about the products and services provided by the third party and the resolution of the complaints.
- Meet as needed with representatives of the third party to discuss performance and operational issues.

Proper documentation will facilitate the monitoring and management of the risks associated with third-party relationships. Therefore, institutions should maintain documents and records on all aspects of the third-party relationship, including valid contracts, business plans, risk analyses, due diligence, and oversight activities (including reports to the board or delegated committees). Also, retain documents regarding any dispute resolution.

FDIC Supervision of Third-Party Relationships

A financial institution's board of directors and senior management are responsible for identifying and controlling risks arising from third-party relationships to the same extent as if the third-party activity were handled within the institution. The FDIC reviews a financial institution's management of significant third-party relationships in the context of the normal supervisory process. In addition to safety and soundness examinations, the FDIC compliance examinations evaluate the quality and effectiveness of an institution's compliance risk management program as it pertains to third-party arrangements, and reviews these operations to ensure that the products, services, and activities of a third party comply with consumer protection and civil rights laws and regulations. Further, reviews of third-party arrangements are often a critical area included in examinations of the trust and information technology functions.

The principal focus of supervisory efforts is the review of management's record and process of assessing, measuring, monitoring, and controlling risks associated with an institution's significant third-party relationships. The depth of the examination review will depend upon the scope of activity conducted through or by the third party and the degree of risk associated with the activity and relationship.

Review of third-party relationships contributes to the FDIC's overall evaluation of management and its ability to effectively control risk. Additionally, the use of third parties could have a significant effect on other key aspects of performance, such as earnings, asset quality, liquidity, rate sensitivity, and the institution's ability to comply with laws and regulations. Findings resulting from the review of an institution's third-party relationships will be addressed as needed in the Report of Examination. Appropriate corrective actions, including enforcement actions, may be pursued for deficiencies related to a third-party relationship that pose a safety and soundness or compliance management concern or result in violations of applicable Federal or State laws or regulations. Financial institutions are reminded that indemnity or other contractual provisions with third parties cannot insulate the financial institution from such corrective actions.

Finally, financial institutions should in all cases take care to comply with Section 7 of The Bank Service Company Act (12 U.S.C. 1867) which requires insured financial institutions to notify their appropriate federal banking agency in writing of contracts or relationships with third parties that provide certain services to the institution. These services include check and deposit sorting and posting, computation and posting of interest and other credits and charges, preparation and mailing of checks, statements, notices, and similar items, or any other clerical, bookkeeping, accounting, statistical, or similar functions performed for a depository institution. Refer to Financial Institution Letter 49-99, dated June 3, 1999.

EXHIBIT 23

No. 14-953-TNM

FDIC

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Financial Institution Letter
FIL-127-2008
November 7, 2008

GUIDANCE ON PAYMENT PROCESSOR RELATIONSHIPS

Summary: The FDIC is issuing the attached guidance that describes potential risks associated with relationships with entities that process payments for telemarketers and other merchant clients. These types of relationships pose a higher risk and require additional due diligence and close monitoring. This guidance outlines risk management principles for this type of higher-risk activity.

Distribution:
FDIC-supervised Institutions

Suggested Routing:
Chief Executive Officer
Executive Officers
BSA Compliance Officer

Related Topics:
Risk Management
FDIC Guidance for Managing Third-Party Risk (FIL 44-2008, June 2008)
FFIEC Handbook on Retail Payment Systems (March 2004)
FFIEC Handbook on Outsourcing Technology Services (June 2004)
FFIEC Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination Manual

Attachment:
Guidance on Payment Processor Relationships

Contact:
Michael Benardo, Chief, Cyber Fraud and Financial Crimes Section, at mbenardo@fdic.gov or (202) 898-7319

Note:
FDIC financial institution letters (FILs) may be accessed from the FDIC's Web site at www.fdic.gov/news/news/financial/2008/index.html.

To receive FILs electronically, please visit http://www.fdic.gov/about/subscriptions/fil.html.

Paper copies of FDIC financial institution letters may be obtained through the FDIC's Public Information Center, 3501 Fairfax Drive, E-1002, Arlington, VA 22226 (1-877-275-3342 or 703-562-2200).

Highlights:

- Account relationships with entities that process payments for telemarketers and other merchant clients could expose financial institutions to increased strategic, credit, compliance, transaction, and reputation risks.
- Account relationships with these higher-risk entities require careful due diligence and monitoring as well as prudent and effective underwriting.
- Payment processors pose greater money laundering and fraud risk if they do not have an effective means of verifying their merchant clients' identities and business practices.
- A financial institution should assess its risk tolerance for this type of activity as part of its risk management program and develop policies and procedures that address due diligence, underwriting, and ongoing monitoring of high-risk payment processor relationships for suspicious activity.
- Financial institutions should be alert to consumer complaints that suggest a payment processor's merchant clients are inappropriately obtaining personal account information.
- Financial institutions should act promptly when they believe fraudulent or improper activities have occurred related to a payment processor.

GUIDANCE ON PAYMENT PROCESSOR RELATIONSHIPS

The FDIC has seen an increase in the number of relationships between financial institutions and payment processors in which the payment processor is a deposit customer of the financial institution and uses its customer relationship to process payments for merchant clients. Most payment processors effect transactions that are legitimate payments for a variety of reputable merchants. However, telemarketing and online merchants, in the aggregate, have displayed a higher incidence of unauthorized charges and associated returns or charge backs, which is often indicative of fraudulent activity. Payment processors pose greater money laundering and fraud risk if they do not have an effective means of verifying their merchant clients' identities and business practices. In these cases, financial institutions should perform enhanced due diligence and heightened account monitoring.

Payment processors typically process payments by creating and depositing remotely created checks (RCCs)—often referred to as "Demand Drafts"—or by originating Automated Clearing House (ACH) debits on behalf of their merchant customers. The payment processor may use its own deposit account to process such transactions, or it may establish deposit accounts for its merchant clients to process transactions. Although all the core elements of managing third-party risk are present in payment processor relationships (e.g., risk assessment, due diligence, and oversight), managing this risk where there may not be a direct customer relationship with the merchant can present challenges for financial institutions. Risks associated with this type of activity are heightened when neither the payment processor nor the financial institution performs adequate due diligence on the merchants for which payments are originated.

Potential Risks Arising from Payment Processor Relationships

Deposit relationships with payment processors expose financial institutions to risks that may not be present in relationships with other commercial customers, including increased strategic, credit, compliance, and transaction risks. In addition, financial institutions also should consider the potential for legal, reputation, and other risks presented by relationships with payment processors, including those associated with customer complaints, returned items, and potential unfair or deceptive practices. Financial institutions that do not adequately manage these relationships may be viewed as facilitating fraudulent or unlawful activity by a payment processor or merchant client. Therefore, it is imperative that financial institutions recognize and understand the businesses with which they are involved.

Financial institutions should be alert for payment processors that use more than one financial institution to process merchant client payments. Processors may use multiple financial institutions because they recognize that one or more of the relationships may be terminated as a result of suspicious activity.

Financial institutions also should be alert to consumer complaints that suggest a payment processor's merchant clients are inappropriately obtaining personal account information and using it to create unauthorized RCCs or ACH debits.

Financial institutions should act promptly when they believe fraudulent or improper activities have occurred related to activities of a payment processor. Appropriate actions may include, but are not limited to, filing a Suspicious Activity Report, requiring the payment processor to cease processing for that specific merchant, or terminating the financial institution's relationship with the payment processor.

Risk Management Controls

Financial institutions should establish clear lines of responsibility for controlling risks associated with payment processor relationships. These include effective due diligence and underwriting, as well as ongoing monitoring of high-risk accounts for an increase in unauthorized returns and suspicious activity. Implementing appropriate controls over payment processors and their merchant clients will help identify those payment processors that process items for fraudulent telemarketers or other unscrupulous merchants and help ensure that the financial institution does not facilitate these transactions. Due diligence, underwriting, and account monitoring are especially important for financial institutions in which processors deposit RCCs and through which processors initiate ACH transactions for their merchant clients.

<u>Due Diligence and Underwriting</u>

Due diligence and effective underwriting are critical for an effective risk management program. Financial institutions should implement policies and procedures to reduce the likelihood of establishing or maintaining an inappropriate relationship with a payment processor through which unscrupulous merchants can access customers' deposit accounts.

Financial institutions that initiate transactions for payment processors should develop a processor approval program that extends beyond credit risk management. This program should include a due diligence and underwriting policy that, among other things, requires a background check of the payment processor and its merchant clients. This will help validate the activities, creditworthiness, and business practices of the payment processor. At a minimum, the policy should authenticate the processor's business operations and assess the entity's risk level. An assessment of the processor should include:

- Reviewing the processor's promotional materials, including its Web site, to determine the target clientele.[1]

[1] Businesses with elevated risk may include offshore companies, on-line gambling-related operations, and on-line payday lenders. For example, a processor whose customers are primarily offshore would be inherently riskier than a processor whose customers are primarily restaurants.

Case 1:14-cv-00953-GK Document 19-3 Filed 08/18/14 Page 26 of 586

- Determining if the processor re-sells its services to a third party who may be referred to as an "agent or provider of Independent Sales Organization opportunities" or "gateway" arrangements".[2]

- Reviewing the processor's policies, procedures, and processes to determine the adequacy of due diligence standards for new merchants.

- Identifying the major lines of business and volume for the processor's customers.

- Reviewing corporate documentation, including independent reporting services and, if applicable, documentation on principal owners.

- Visiting the processor's business operations center.

Financial institutions should require the payment processor to provide information on its merchant clients, such as the merchant's name, principal business activity, geographic location, and sales techniques. Financial institutions should verify directly, or through the payment processor, that the originator of the payment (i.e., the merchant) is operating a legitimate business. Such verification could include comparing the identifying information with public record and fraud databases and a trusted third party, such as a credit report from a consumer reporting agency or the state Better Business Bureau, or checking references from other financial institutions.

<u>Ongoing Monitoring</u>
Financial institutions that initiate transactions for payment processors should implement systems to monitor for higher rates of returns or charge backs, which often are evidence of fraudulent activity. High levels of RCCs or ACH debits returned as unauthorized or due to insufficient funds can be an indication of fraud.

Financial institutions are required to have a Bank Secrecy Act/Anti-Money Laundering (BSA/AML) compliance program and appropriate policies, procedures, and processes in place for monitoring, detecting, and reporting suspicious activity. Non-bank payment processors generally are not subject to BSA/AML regulatory requirements, and therefore some payment processors may be vulnerable to money laundering, identity theft, fraud schemes, and illicit transactions. The FFIEC BSA/AML Examination Manual urges financial institutions to effectively assess and manage risk with respect to third-party payment processors and, as a result, a financial institution's risk management program should include procedures for monitoring payment processor information, such as merchant data, transaction volume, and charge-back history.

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[2] An Independent Sales Organization is an outside company contracted to procure new merchant relationships. Gateway arrangements are similar to Internet service providers that sell excess computer storage capacity to third parties, who in turn distribute computer services to other individuals unknown to the provider. The third party would make decisions about who would be receiving the service, although the provider would be responsible for the ultimate storage capacity.

Evolving Legal Framework for Remotely Created Checks

The laws and regulations governing the acceptance of RCCs are continually evolving in response to new fraud techniques, technological advancements, increased use of image-based processing, and other factors. As such, financial institutions should ensure that payment processors and their merchants are aware of and comply with the legal/regulatory framework governing these payments and have in place a process to remain informed of changes to applicable laws and regulations, such as:

- Changes to Federal Reserve Bank Operating Circular 3 that clarify electronically created images (including RCC items) that were not originally captured from paper are not eligible to be processed as Check 21 items (effective July 15, 2008).[3]

- Changes to Regulation CC that establish transfer and presentment warranties for RCC items that effectively return the responsibility for ensuring a check is authorized by the account holder to the bank of first deposit (effective July 1, 2006).[4]

- Rules and regulations governing the applicable ACH payment transactions.[5]

- Rules governing the use of telemarketing that require verifiable authorization of payment for services.[6]

Conclusion

The FDIC supports financial institutions' participation in payment systems to serve the needs of legitimate payment processors and their merchant clients. However, to limit potential risks, financial institutions should implement risk management policies and procedures that include appropriate oversight and controls commensurate with the risk and complexity of the activities. At a minimum, risk management programs should assess the financial institution's risk tolerance for this type of activity, verify the legitimacy of the payment processor's business operations, and monitor payment processor relationships for suspicious activity. Financial institutions should act promptly if they believe fraudulent or improper activities have occurred related to activities of a payment processor.

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[3] Federal Reserve Banks Operating Circular No. 3 - Collection of Cash Items and Returned Checks, www.frbservices.org/files/regulations/pdf/operating_circular_3.pdf.
[4] Effective July 1, 2006 [70 Fed. Reg. 71218-71226 (November 28, 2005)].
[5] NACHA [www.nacha.org/ACH_Rules/ach_rules.htm].
[6] Federal Trade Commission Telemarketing Sales Rule [16 CFR 310].

EXHIBIT 24

No. 14-953-TNM

Supervisory Insights

Devoted to Advancing the Practice of Bank Supervision

Vol. 8, Issue 1 Summer 2011

Inside

Third-Party Payment Processor Relationships

Small Business Administration Lending

FDIC

Supervisory Insights

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Managing Risks in Third-Party Payment Processor Relationships

During the past few years, the Federal Deposit Insurance Corporation (FDIC) has observed an increase in the number of deposit relationships between financial institutions and third-party payment processors and a corresponding increase in the risks associated with these relationships. Deposit relationships with payment processors can expose financial institutions to risks not present in typical commercial customer relationships, including greater strategic, credit, compliance, transaction, legal, and reputation risk. It was for this reason in 2008 that the FDIC issued *Guidance on Payment Processor Relationships* which outlines risk mitigation principles for this type of higher-risk activity.[1]

Although many payment processors effect legitimate payment transactions for a variety of reputable merchants, an increasing number of processors have been initiating payments for abusive telemarketers, deceptive online merchants, and organizations that engage in high risk or illegal activities. In the absence of adequate monitoring systems and controls, a financial institution could be facilitating unauthorized transactions or unfair or deceptive practices resulting in financial harm to the consumer. Therefore, it is essential that financial institutions and examiners recognize and understand the risks associated with these relationships.

This article explains the role of third-party payment processors and the risks they can present to financial institutions, identifies warning signs that may indicate heightened risk in a payment processor relationship, and discusses the risk mitigation controls that should be in place to manage this risk. The article concludes with an overview of supervisory remedies that may be used when it is determined that a financial institution does not have an adequate program in place for monitoring and addressing the risks associated with third-party payment processor relationships.

Background

The core elements of managing third-party risk are present in payment processor relationships (e.g., risk assessment, policies and procedures, due diligence, and oversight). Managing these risks can be particularly challenging as the financial institution does not have a direct customer relationship with the payment processor's merchant clients. Furthermore, the risks associated with this type of activity are heightened when neither the payment processor nor the financial institution performs adequate due diligence, such as verifying the identities and business practices of the merchants for which payments are originated and implementing a program of ongoing monitoring for suspicious activity.

For example, in a typical third-party payment processor relationship, the payment processor is a deposit customer of the financial institution which uses its deposit account to process payments for its merchant clients. The payment processor receives lists of payments to be generated by the merchant clients for the payment of goods or services and initiates the payments by creating and depositing them into a transaction account at a financial institution. In some cases, the payment processor may establish individual accounts at the financial institution in the name

[1] Financial Institution Letter (FIL) 127-2008, *Guidance on Payment Processor Relationships,* dated November 7, 2008. See: http://www.fdic.gov/news/news/financial/2008/fil08127.html.

Third-Party Payment Processors

continued from pg. 3

of each merchant client and deposit the appropriate payments into these accounts. The merchant may then be a co-owner of the deposit account and make withdrawals from the account to receive its sales proceeds, or the payment processor may periodically forward the sales proceeds from the account to the merchant. Alternatively, the payment processor may commingle payments originated by the merchant clients into a single deposit account in the name of the payment processor. In this case, the payment processor should maintain records to allocate the deposit account balance among the merchant clients.

Payment Types Used by Third-Party Payment Processors

Payment processors may offer merchants a variety of alternatives for accepting payments including credit and debit card transactions, traditional check acceptance, Automated Clearing House (ACH) debits and other alternative payment channels. The potential for misuse or fraud exists in all payment channels. However, the FDIC has observed that some of the most problematic activity occurs in the origination of ACH debits or the creation and deposit of remotely created checks.

Automated Clearing House Debits

The ACH network is a nationwide electronic payment network which enables participating financial institutions to distribute electronic credit and debit entries to bank accounts and settle these entries.

Common ACH credit transfers include the direct deposit of payroll and certain benefits payments. Direct debit transfers also may be made through the ACH network and include consumer payments for insurance premiums, mortgage loans, and other types of bills. Rules and regulations governing the ACH networks are established by NACHA - The Electronic Payments Association (formerly National Automated Clearing House Association)[2] and the Board of Governors of the Federal Reserve System.

Third-party payment processors initiate ACH debit transfers as payments for merchant clients by submitting these transfers, which contain the consumer's financial institution routing number and account number (found at the bottom of a check) to their financial institution to enter into the ACH networks. Telemarketers and online merchants obtain this information from the consumer and transmit it to the payment processor to initiate the ACH debit transfers. The risk of fraud arises when an illicit telemarketer or online merchant obtains the consumer's account information through coercion or deception and initiates an ACH debit transfer that may not be fully understood or authorized by the consumer.

As with all payment systems and mechanisms, the financial institution bears the responsibility of implementing an effective system of internal controls and ongoing account monitoring for the detection and resolution of fraudulent ACH transfers. If an unauthorized ACH debit is posted to a consumer's account, the procedures for resolving errors contained in the Federal Reserve Board's Regulation E,

[2] NACHA establishes the rules and procedures governing the exchange of automated clearinghouse payments. See http://www.nacha.org/c/achrules.cfm.

which governs electronic funds transfers,[3] provide the consumer 60 days after the financial institution sends an account statement to report the unauthorized ACH debit.[4] Regulation E requires the consumer's financial institution to investigate the matter and report to the consumer the results of the investigation within a prescribed time frame. In the case of an ACH debit, when a consumer receives a refund for an unauthorized debit, ACH rules permit the consumer's financial institution to recover the amount of the unauthorized payment by returning the debit item to the originating financial institution.

Remotely Created Checks

Remotely Created Checks (RCCs), often referred to as "demand drafts," are payment instruments that do not bear the signature of a person on whose account the payments are drawn. In place of the signature, the RCC bears the account holder's printed or typed name, or a statement that the accountholder's signature is not required or the account holder has authorized the issuance of the check. Similar to the initiation of an ACH debit transfer, an account holder authorizes the creation of an RCC by providing his financial institution's routing number and his account number. Examples of RCCs are those created by a credit card or utility company to make a payment on an account, or those initiated by telemarketers or online merchants to purchase goods or services.

The risk of fraud associated with RCCs is often greater than the risk associated with other kinds of debits that post to transaction accounts. For example, an illicit payment originator might obtain a consumer's account information by copying it from an authorized check or misleading the consumer into providing the information over the telephone or the Internet. Once the necessary information is obtained, the payment originator can generate unauthorized RCCs and forward them for processing. Similar to the responsibilities associated with the ACH network, the financial institution should implement an effective system of internal controls and account monitoring to identify and resolve the unauthorized RCC.

RCCs may be processed as a paper item through the customary clearing networks or converted to and processed as an ACH debit. However, check clearing and ACH rules differ as to the re-crediting of an accountholder for an unauthorized RCC and how losses are allocated by and between the participating financial institutions. RCCs processed as checks are governed by provisions of the Uniform Commercial Code (UCC) and the Expedited Funds Availability Act,[5] as implemented by Regulation CC. RCCs converted to ACH debits are governed by applicable ACH rules, the Electronic Fund Transfer Act, and Regulation E.

In response to heightened concern about the risk of fraud, in 2005 the Federal Reserve amended Regulation CC to transfer the liability for losses

[3] Provisions of the Federal Reserve Board's Regulation E establish the rights, liabilities, and responsibilities of participants in electronic fund transfer systems, such as automated teller machine transfers, telephone bill-payment services, point-of-sale terminal transfers, and preauthorized transfers from or to a consumer's account.

[4] 12 CFR Section 205.11.

[5] The Expedited Funds Availability Act (EFAA), enacted in 1987, addresses the issue of delayed availability of funds by banks. The EFAA requires banks to (1) make funds deposited in transaction accounts available to customers within specified time frames, (2) pay interest on interest-bearing transaction accounts not later than the day the bank receives credit, and (3) disclose funds-availability policies to customers.

Third-Party Payment Processors

continued from pg. 5

resulting from unauthorized RCCs.[6] At the same time, the Board also amended Regulation J (the Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire) to clarify that certain warranties, similar to those provided under the UCC, apply to RCCs collected through the Reserve Banks. In conjunction with Regulation CC, the amendments to Regulation J shifted the liability for losses attributed to unauthorized RCCs to the financial institution where the check is first deposited as this institution is in the best position to know its customer (the creator of the RCC) and determine the legitimacy of the deposits. The liability also creates an economic incentive for depository institutions to perform enhanced due diligence on those customers depositing RCCs. Furthermore, by providing the paying financial institution with the ability to recover against the financial institution presenting the unauthorized RCC, these regulatory changes should make it easier for customers to obtain re-credits.[7]

Types of High Risk Payments

Although many clients of payment processors are reputable merchants, an increasing number are not and should be considered "high risk." These disreputable merchants use payment processors to charge consumers for questionable or fraudulent goods and services. Often a disreputable merchant will engage in high pressure and deceptive sales tactics, such as aggressive telemarketing or enticing and misleading pop-up advertisements on Web sites. For example, consumers should be cautious when Web sites offer "free" information and ask consumers to provide payment information to cover a small shipping and handling fee. In some instances and without proper disclosure, consumers who agreed to pay these fees, often found their bank accounts debited for more than the fee and enrolled in costly plans without their full understanding and consent.[8] Still other disreputable merchants will use processors to initiate payments for the sale of products and services, including, but not limited to, unlawful Internet gambling and the illegal sale of tobacco products on the Internet.

Generally, high-risk transactions occur when the consumer does not have a familiarity with the merchant, or when the quality of the goods and services being sold is uncertain. Activities involving purchases made over the telephone or on the Internet tend to be riskier in that the consumer cannot fully examine or evaluate the product or service purchased. Similarly, the consumer may not be able to verify the identity or legitimacy of the person or organization making the sale.

[6] Effective July 1, 2006 [70 Fed. Reg. 71218-71226 (November 28, 2005)].

[7] Changes to Federal Reserve Bank Operating Circular No. 3 on the Collection of Cash Items and Returned Checks clarifies that electronically created images (including RCC items) that were not originally captured from paper are not eligible to be processed as Check 21 items (effective July 15, 2008), www.frbservices.org/files/regulations/pdf/operating_circular_3.pdf.

[8] Rules governing the use of telemarketing require verifiable authorization of payment for services. See the Federal Trade Commission Telemarketing Sales Rule [16 CFR 310]. See: http://www.ftc.gov/os/2002/12/tsrfinalrule.pdf.

Some merchant categories that have been associated with high-risk activity include, but are not limited to:

- Ammunition Sales
- Cable Box De-scramblers
- Coin Dealers
- Credit Card Schemes
- Credit Repair Services
- Dating Services
- Debt Consolidation Scams
- Drug Paraphernalia
- Escort Services
- Firearms Sales
- Fireworks Sales
- Get Rich Products
- Government Grants
- Home-Based Charities
- Life-Time Guarantees
- Life-Time Memberships
- Lottery Sales
- Mailing Lists/Personal Info
- Money Transfer Networks
- On-line Gambling
- PayDay Loans
- Pharmaceutical Sales
- Ponzi Schemes
- Pornography
- Pyramid-Type Sales
- Racist Materials
- Surveillance Equipment
- Telemarketing
- Tobacco Sales
- Travel Clubs

Of particular concern, the FDIC and other federal regulators have seen an increase in payment processors initiating payment for online gaming activities that may be illegal. The Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA) prohibits financial institutions from accepting payments from any person engaged in the business of betting or wagering with a business in unlawful Internet gambling (see the FDIC's Financial Institution Letter on the *Unlawful Internet Gambling Enforcement Act,* FIL-35-2010, dated June 30, 2010).[9]

High-Risk Payment Processor Relationship Warning Signs

Financial institutions and examiners should be aware of the warning signs that may indicate heightened risk in a payment processor relationship. One of the more telling signs is a high volume of consumer complaints that suggest a merchant client is inappropriately obtaining personal account information; misleading customers as to the quality, effectiveness, and usefulness of the goods or services being offered; or misstating the sales price or charging additional and sometimes recurring fees that are not accurately disclosed or properly authorized during the sales transaction. However, this may be somewhat difficult to determine in that it may be almost

[9] 12 CFR Part 233 – Regulation GG, Financial Institution Letter (FIL) 35-2010, *Unlawful Internet Gambling Enforcement Act,* dated June 30, 2010. See http://www.fdic.gov/news/news/financial/2010/fil10035.html.

Third-Party Payment Processors

continued from pg. 7

impossible for financial institutions and examiners to know if consumers are submitting complaints directly to the payment processor or the merchants. One way financial institutions and examiners can determine if consumers are making complaints or voicing their dissatisfaction is to review certain Web sites, such as those for regional Better Business Bureaus, or blogs intended to collect and share such information to alert other consumers.

Financial institutions with third-party payment processor relationships should consider monitoring the Internet for complaints that mention them by name. The financial institution's name typically appears on the face of a RCC or in the record of an ACH debit. As a result, consumers often associate the financial institution with the transaction and may complain about the institution facilitating the payment. Complaints also may be lodged with the depository financial institution by the financial institution of the consumer whose account was charged. As required by statute and federal regulation, the depository financial institution must acknowledge, research, and respond to each complaint made directly to them.

Another indication of the potential for heightened risk in a payment processor relationship is a large number of returns or charge backs. Consumers who are dissatisfied with goods or services delivered or provided, or consumers who feel they were deceived or coerced into providing their account information, can request their financial institution return the RCC or ACH debit to the depository financial institution as an unauthorized transaction. In addition, items may be returned if insufficient funds are available to cover the unauthorized items, resulting in the consumer's account being overdrawn. In these circumstances, the items often are returned as "NSF" rather than as "unauthorized." Accordingly, financial institutions with payment processor relationships should implement systems to monitor for higher rates of returns or charge backs, which can be evidence of fraudulent activity.

Another warning sign is a significant amount of activity which generates a higher than normal level of fee income. In an increasingly competitive market place, financial institutions are looking for ways to grow non-interest fee income, and this is especially true for troubled institutions. Although fee income from third-party payment processor relationships may benefit an institution's bottom line, it can indicate an increased level of risk. Side agreements may be established between payment processors and financial institutions, whereby the payment processor pays the institution a fee for each item deposited, generating a higher level of fee income. However, the greatest source of income from these relationships tends to be returned item fees. Financial institutions routinely charge deposit customers a fee for each returned item. Because payment processors may generate a high volume of returned items, the fee income associated with this activity is typically much higher.

As a caveat, financial institutions and examiners should be alert for payment processors that use more than one financial institution to process merchant client payments, or nested arrangements where a payment processor's merchant client is also doing third-party payment processing. Spreading the activity among several institutions may allow processors that engage in inappropriate activity to avoid detection. For example, a single institution may not detect high levels of returned items if they are spread among several financial institutions.

Payment processors also may use multiple financial institutions in case one or more of the relationships is terminated as a result of suspicious activity.

Finally, another troubling development is payment processors that purposefully solicit business relationships with troubled institutions in need of capital. Payment processors identify and establish relationships with troubled institutions as these institutions may be more willing to engage in higher-risk transactions in return for increased fee income. In some cases, payment processors have made a commitment to purchase stock in certain troubled financial institutions or guarantee to retain a large deposit with the institution, thereby providing additional, needed capital. Often, the targeted financial institutions are smaller, community banks that lack the infrastructure to properly manage or control a third-party payment processor relationship.

Risk Controls

A framework for prudently managing relationships with third-party payment processors was communicated in the FDIC's 2008 *Guidance on Payment Processor Relationships.*[10] Financial institutions in relationships with payment processors should establish clear lines of responsibility for controlling the associated risks. Such responsibilities include effective due diligence and underwriting, as well as ongoing monitoring of high-risk accounts for an increase in unauthorized returns and suspicious activity and maintenance of adequate balances or reserves to cover expected high levels of returned items. The relationship should be governed by a written contract between the financial institution and the third-party payment processor which outlines each party's duties and responsibilities. Implementing appropriate and effective controls over payment processors and their merchant clients will help identify those processors working with fraudulent telemarketers or other unscrupulous merchants and help ensure the financial institution does not facilitate such transactions.

Due Diligence and Underwriting

Due diligence and prudent underwriting standards are critical components of a risk mitigation program. Financial institutions should implement policies and procedures that reduce the likelihood of establishing or maintaining a relationship with payment processors through which unscrupulous merchants can access customers' deposit accounts.

Financial institutions that initiate transactions for payment processors should develop a processor approval program that extends beyond credit risk management. This program should incorporate an effective due diligence and underwriting policy that, among other things, requires background checks of payment processors and merchant clients. A processor approval program will help validate the activities, creditworthiness, and business practices of the payment processor and should, at a minimum,

[10] Financial Institution Letter (FIL) 127-2008, *Guidance on Payment Processor Relationships,* November 7, 2008, http://www.fdic.gov/news/news/financial/2008/fil08127.html.

Third-Party Payment Processors

continued from pg. 9

authenticate the processor's business operations and assess the entity's risk level. Any processor assessment should include:

- Reviewing the processor's promotional materials, including its Web site, to determine the target clientele.
- Determining if the processor re-sells its services to "Independent Sales Organizations" (companies contracted to procure new merchant relationships) or through "gateway arrangements" (selling excess capacity to third parties, which in turn sell services to other individuals unknown to the payment processor).
- Reviewing the processor's policies, procedures, and processes to determine the adequacy of due diligence standards for new merchants.
- Identifying the major lines of business and volume for the processor's customers.
- Determining whether the institution maintains appropriate balances or reserves for each individual merchant based on the type of client and the risk involved in the transactions processed and the expected volume of returned items.
- Reviewing corporate documentation, obtaining information on the processor from independent reporting services and, if applicable, documentation on principal owners.
- Visiting the processor's business operations center.
- Requesting copies of consumer complaints and the procedures for handling consumer complaints and redress.
- Obtaining information pertaining to any litigation and actions brought by federal, state, or local regulatory or enforcement agencies.
- Obtaining information about the history of returned items and customer refunds.

Financial institutions should require the payment processor to provide information on its merchant clients, such as the merchant's name, principal business activity, geographic location, and sales techniques. Additionally, financial institutions should verify directly, or through the payment processor, that the originator of the payment (i.e., the merchant) is operating a legitimate business. Such verification could include comparing the identifying information with public record, fraud databases and a trusted third party, such as a credit report from a consumer reporting agency or the state Better Business Bureau, or checking references from other financial institutions.

Ongoing Monitoring

Financial institutions are required to have a Bank Secrecy Act/Anti-Money Laundering (BSA/AML) compliance program and appropriate policies, procedures, and processes in place for monitoring, detecting, and reporting suspicious activity.[11] However, non-bank payment processors generally are not subject to BSA/AML regulatory requirements and, therefore, some payment processors may be vulnerable to money laundering, identity theft, fraud schemes, and illicit transactions. The Federal Financial Institutions Examination Council BSA/AML Examination Manual urges financial institutions to effectively assess and manage risk with respect to third-party payment processors. As a result, a financial institution's risk mitigation program should include procedures for monitoring payment processor information, such as merchant data, transaction volume, and charge-back history.[12]

Appropriate Supervisory Responses

In those instances where examiners determine that a financial institution fails to have an adequate program in place to monitor and address risks associated with third-party payment processor relationships, formal or informal enforcement actions may be appropriate. Formal actions have included Cease and Desist Orders under Section 8(b) or 8(c) of the *Federal Deposit Insurance (FDI) Act*, as well as assessment of Civil Money Penalties under Section 8(i) of the FDI Act. These orders have required the financial institution to immediately terminate the high-risk relationship and establish reserves or funds on deposit to cover anticipated charge backs.

As appropriate, the examiner will determine if financial institution management has knowledge that the payment processor or the merchant clients are engaging in unfair or deceptive practices in violation of Section 5 of the Federal Trade Commission Act. In those cases where a financial institution does not conduct due diligence, accepts a heightened level of risk, and allows transactions for high-risk merchants to pass though it, it may be determined that the financial institution is aiding and abetting the merchants. This also could indicate a disregard for the potential for financial harm to consumers and, as a result, the financial institution may be subject to civil money penalties or required to provide restitution.

[11] Banks, bank holding companies, and their subsidiaries are required by federal regulations to file a Suspicious Activity Report if they know, suspect, or have reason to suspect the transaction may involve potential money laundering or other illegal activity, is designed to evade the Bank Secrecy Act or its implementing regulations, has no business or apparent lawful purpose, or is not the type of transaction in which particular customer would normally be expected to engage. See 12 CFR 353 (http://www.ffiec.gov/bsa_aml_infobase/pages_manual/regulations/12CFR353.htm) and 31 CFR 103.18 (http://www.ffiec.gov/bsa_aml_infobase/pages_manual/regulations/31CFR103.pdf.)

[12] See "Third-Party Payment Processors—Overview," from the Bank Secrecy Act/Anti-Money Laundering Examination Manual, http://www.ffiec.gov/bsa_aml_infobase/pages_manual/OLM_063.htm.

Third-Party Payment Processors

continued from pg. 11

Conclusion

Deposit relationships with payment processors expose financial institutions to risks that may not be present in relationships with other commercial customers. To limit potential risks, financial institutions should implement risk mitigation policies and procedures that include appropriate oversight and controls commensurate with the risk and complexity of the activities. At a minimum, risk mitigation programs should result in the financial institution assessing its risk tolerance for this type of activity, verifying the legitimacy of the payment processor's business operations, and monitoring payment processor relationships for suspicious activity.

Financial institutions should act promptly if they believe fraudulent or improper activities have occurred related to a payment processor's activities. Appropriate actions may include filing a Suspicious Activity Report, requiring the payment processor to cease processing for that specific merchant, or terminating the financial institution's relationship with the payment processor. Should it be determined that a financial institution does not have an adequate program in place to monitor and address the risks associated with third-party payment processor relationships, an appropriate supervisory response will be used to require the financial institution to correct the deficiencies.

Michael B. Benardo
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Division of Risk Management Supervision
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Robert J. Wirtz
Assistant Regional Director (Compliance)
Division of Depositor and Consumer Protection
rwirtz@fdic.gov

EXHIBIT 25

No. 14-953-TNM

Message

From:	Lowe, M. Anthony [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=MLOWE]
Sent:	5/27/2014 4:53:19 PM
To:	Bartelt, John J. [JBartelt@FDIC.gov]
CC:	Sabanty, Teresa M. [TSabanty@FDIC.gov]
Subject:	RE: TPPP

From the SIJ article in 2011…

Some merchant categories that have been associated with high-risk activity include, but are not limited to:

- Ammunition Sales
- Cable Box De-scramblers
- Coin Dealers
- Credit Card Schemes
- Credit Repair Services
- Dating Services
- Debt Consolidation Scams
- Drug Paraphernalia
- Escort Services
- Firearms Sales
- Fireworks Sales
- Get Rich Products
- Government Grants
- Home-Based Charities
- Life-Time Guarantees
- Life-Time Memberships
- Lottery Sales
- Mailing Lists/Personal Info
- Money Transfer Networks
- On-line Gambling
- PayDay Loans
- Pharmaceutical Sales
- Ponzi Schemes
- Pornography
- Pyramid-Type Sales
- Racist Materials
- Surveillance Equipment
- Telemarketing
- Tobacco Sales
- Travel Clubs

M. Anthony Lowe
Regional Director
Chicago

From: Lowe, M. Anthony
Sent: Tuesday, May 27, 2014 3:48 PM
To: Bartelt, John J.
Cc: Sabanty, Teresa M.
Subject: RE: TPPP

It doesn't appear that we include the chart in our presentation. I'll stop down with our presenter (Christine Tullio?) today or tomorrow, to make sure she doesn't stray in commentary too deep into mentioning any specific merchant.

M. Anthony Lowe
Regional Director
Chicago

From: Lowe, M. Anthony
Sent: Tuesday, May 27, 2014 3:34 PM
To: Bartelt, John J.

Cc: Sabanty, Teresa M.
Subject: FW: TPPP
Importance: High

John – fyi.

M. Anthony Lowe
Regional Director
Chicago

From: Eberley, Doreen R.
Sent: Tuesday, May 27, 2014 3:32 PM
To: RDs
Cc: Pearce, Mark (DCP)
Subject: TPPP

Team, Please do not distribute or use in outreach the chart of potentially higher risk merchants (the one that was in the FFIEC slides and was also part of a 2011 SIJ article). Will discuss further next week. Thanks, Doreen

EXHIBIT 26

No. 14-953-TNM

FDIC

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Financial Institution Letter
FIL-3-2012
January 31, 2012

Payment Processor Relationships
Revised Guidance

Summary: Attached is revised guidance describing potential risks associated with relationships with third-party entities that process payments for telemarketers, online businesses, and other merchants (collectively "merchants"). These relationships can pose increased risk to institutions and require careful due diligence and monitoring. This guidance outlines certain risk mitigation principles for this type of activity.

Statement of Applicability to Institutions with Total Assets under $1 Billion: This guidance applies to all FDIC-supervised financial institutions that have relationships with third-party payment processors.

Distribution:
FDIC-Supervised Institutions

Suggested Routing:
Chief Executive Officer
Executive Officers
Compliance Officer
Chief Information Officer
BSA Officer

Related Topics:
Guidance on Payment Processor Relationships (FIL 127-2008, November 2008)
Consumer Protection, Compliance Risk, and Risk Management
FDIC Guidance for Managing Third-Party Risk (FIL 44-2008, June 2008)
FFIEC Handbook on Retail Payment Systems (February 2010)
FFIEC Handbook on Outsourcing Technology Services (June 2004)
FFIEC Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination Manual (April 2010)
Managing Risks in Third-Party Payment Processor Relationships (Summer 2011 Supervisory Insights Journal)

Attachment:
Revised Guidance on Payment Processor Relationships

Contacts:
Kathryn Weatherby, Examination Specialist (Fraud), Division of Risk Management Supervision, at kweatherby@fdic.gov or (703) 254-0469

John Bowman, Review Examiner, Division of Depositor and Consumer Protection, at jbowman@fdic.gov or (202) 898-6574

Note:
FDIC Financial Institution Letters may be accessed from the FDIC's Web site at www.fdic.gov/news/news/financial/2012/index.html.

To receive Financial Institution Letters electronically, please visit http://www.fdic.gov/about/subscriptions/fil.html. Paper copies may be obtained through the FDIC's Public Information Center, 3501 Fairfax Drive, E-1002, Arlington, VA 22226 (877-275-3342 or 703-562-2200).

Highlights:

- Account relationships with third-party entities that process payments for merchants require careful due diligence, close monitoring, and prudent underwriting.
- Account relationships with high-risk entities pose increased risks, including potentially unfair or deceptive acts or practices under Section 5 of the Federal Trade Commission Act.
- Certain types of payment processors may pose heightened money laundering and fraud risks if merchant client identities are not verified and business practices are not reviewed.
- Financial institutions should assess risk tolerance in their overall risk assessment program and develop policies and procedures addressing due diligence, underwriting, and ongoing monitoring of high-risk payment processor relationships.
- Financial institutions should be alert to consumer complaints or unusual return rates that suggest the inappropriate use of personal account information and possible deception or unfair treatment of consumers.
- Financial institutions should act promptly when fraudulent or improper activities occur relating to a payment processor, including possibly terminating the relationship.
- Improperly managing these risks may result in the imposition of enforcement actions, such as civil money penalties or restitution orders.

Financial Institution Letter
FIL-3-2012
January 31, 2012

Revised Guidance on Payment Processor Relationships

The FDIC has recently seen an increase in the number of relationships between financial institutions and payment processors in which the payment processor, who is a deposit customer of the financial institution, uses its relationship to process payments for third-party merchant clients. Payment processors typically process payments either by creating and depositing remotely created checks (RCCs)—often referred to as “Demand Drafts”—or by originating Automated Clearing House (ACH) debits on behalf of their merchant customers. The payment processor may use its own deposit account to process such transactions, or it may establish deposit accounts for its merchant clients.

While payment processors generally effect legitimate payment transactions for reputable merchants, the risk profile of such entities can vary significantly depending on the make-up of their customer base. For example, payment processors that deal with telemarketing and online merchants[1] may have a higher risk profile because such entities have tended to display a higher incidence of consumer fraud or potentially illegal activities than some other businesses. Given this variability of risk, payment processors must have effective processes for verifying their merchant clients’ identities and reviewing their business practices. Payment processors that do not have such processes can pose elevated money laundering and fraud risk for financial institutions, as well as legal, reputational, and compliance risks if consumers are harmed.

Financial institutions should understand, verify, and monitor the activities and the entities related to the account relationship. Although all of the core elements of managing third-party risk should be considered in payment processor relationships (e.g., risk assessment, due diligence, and oversight), managing this risk poses an increased challenge for the financial institution when there may not be a direct customer relationship with the merchant. For example, it may be difficult to obtain necessary information from the payment processor, particularly if a merchant is also a payment processor, resulting in a “nested” payment processor or “aggregator” relationship.

Financial institutions should ensure that their contractual agreements with payment processors provide them with access to necessary information in a timely manner. These agreements should also protect financial institutions by providing for immediate account closure, contract termination, or similar action, as well as establishing adequate reserve requirements to cover anticipated charge backs. Accordingly, financial institutions should perform due diligence and account monitoring appropriate to the risk posed by the payment processor and its merchant

[1] Examples of telemarketing, online businesses, and other merchants that may have a higher incidence of consumer fraud or potentially illegal activities or may otherwise pose elevated risk include credit repair services, debt consolidation and forgiveness programs, online gambling-related operations, government grant or will-writing kits, payday or subprime loans, pornography, online tobacco or firearms sales, pharmaceutical sales, sweepstakes, and magazine subscriptions. This list is not all-inclusive.

Case 1:14-cv-00953-TNM Document 197-19 Filed 08/18/14 Page 237 of 76

base. Risks associated with this type of activity are further increased if neither the payment processor nor the financial institution performs adequate due diligence on the merchants for which payments are originated. Financial institutions are reminded that they cannot rely solely on due diligence performed by the payment processor. The FDIC expects a financial institution to adequately oversee all transactions and activities that it processes and to appropriately manage and mitigate operational risks, Bank Secrecy Act (BSA) compliance, fraud risks, and consumer protection risks, among others.

Potential Risks Arising from Payment Processor Relationships

Deposit relationships with payment processors expose financial institutions to risks not customarily present in relationships with other commercial customers. These include increased operational, strategic, credit, compliance, and transaction risks. In addition, financial institutions should consider the potential for legal, reputational, and other risks, including risks associated with a high or increasing number of customer complaints and returned items, and the potential for claims of unfair or deceptive practices. *Financial institutions that fail to adequately manage these relationships may be viewed as facilitating a payment processor's or merchant client's fraudulent or unlawful activity and, thus, may be liable for such acts or practices.* In such cases, the financial institution and responsible individuals have been subject to a variety of enforcement and other actions. Financial institutions must recognize and understand the businesses and customers with which they have relationships and the liability risk for facilitating or aiding and abetting consumer unfairness or deception under Section 5 of the Federal Trade Commission Act.[2]

Financial institutions should be alert for payment processors that use more than one financial institution to process merchant client payments or that have a history of moving from one financial institution to another within a short period. Processors may use multiple financial institutions because they recognize that one or more of the relationships may be terminated as a result of suspicious activity.

Financial institutions should also be on alert for payment processors that solicit business relationships with troubled financial institutions in need of capital. In such cases, payment processors will identify and establish relationships with troubled financial institutions because these financial institutions may be more willing to engage in higher-risk transactions in exchange for increased fee income. In some cases, payment processors have also committed to purchasing stock in certain troubled financial institutions or have guaranteed to place a large deposit with the financial institution, thereby providing additional, much-needed capital. Often, the targeted financial institutions are smaller, community banks that lack the infrastructure to properly manage or control a third-party payment processor relationship.

[2] Under Section 8 of the Federal Deposit Insurance Act, the FDIC has authority to enforce the prohibitions against Unfair or Deceptive Acts or Practices (UDAP) in the Federal Trade Commission Act. UDAP violations can result in unsatisfactory Community Reinvestment Act ratings, compliance rating downgrades, restitution to consumers, and the pursuit of civil money penalties.

Financial institutions also should be alert to an increase in consumer complaints about payment processors and/or merchant clients or an increase in the amount of returns or charge backs, all of which may suggest that the originating merchant may be engaged in unfair or deceptive practices or may be inappropriately obtaining or using consumers' personal account information to create unauthorized RCCs or ACH debits. Consumer complaints may be made to a variety of sources and not just directly to the financial institution. They may be sent to the payment processor or the underlying merchant, or directed to consumer advocacy groups or online complaint Web sites or blogs. Financial institutions should take reasonable steps to ensure they understand the type and level of complaints related to transactions that it processes. Financial institutions should also determine, to the extent possible, if there are any external investigations of or legal actions against a processor or its owners and operators during initial and ongoing due diligence of payment processors.

Financial institutions should act promptly to minimize possible consumer harm, particularly in cases involving potentially fraudulent or improper activities relating to activities of a payment processor or its merchant clients. Appropriate actions include filing a Suspicious Activity Report,[3] requiring the payment processor to cease processing for a specific merchant, freezing certain deposit account balances to cover anticipated charge backs, and/or terminating the financial institution's relationship with the payment processor.

Risk Mitigation

Financial institutions should delineate clear lines of responsibility for controlling risks associated with payment processor relationships. Controls may include enhanced due diligence; effective underwriting; and increased scrutiny and monitoring of high-risk accounts for an increase in unauthorized returns, charge backs, suspicious activity, and/or consumer complaints. Implementing appropriate controls for payment processors and their merchant clients can help identify payment processors that process items for fraudulent telemarketers, online scammers, or other unscrupulous merchants and help ensure that the financial institution is not facilitating these transactions. Appropriate oversight and monitoring of these accounts may require the involvement of multiple departments, including information technology, operations, BSA/anti-money laundering (AML), and compliance.

Due Diligence and Underwriting

Financial institutions should implement policies and procedures designed to reduce the likelihood of establishing or maintaining inappropriate relationships with payment processors used by unscrupulous merchants. Such policies and procedures should outline the bank's thresholds for unauthorized returns, the possible actions that can be taken against payment processors that exceed these standards, and methods for periodically reporting such activities to the bank's board of directors and senior management.

[3] The U.S. Department of Treasury's Regulation 31 (CFR 103.18) requires that every federally supervised banking organization file a SAR when the institution detects a known or suspected violation of federal law. Part 353 of the FDIC's Rules and Regulations addresses SAR filing requirements and makes them applicable to all state-chartered financial institutions that are not members of the Federal Reserve System.

As part of such policies and procedures, financial institutions should develop a processor approval program that extends beyond credit risk management. This program should include a due diligence and underwriting policy that, among other things, requires a background check of the payment processor, its principal owners, and its merchant clients. This will help validate the activities, creditworthiness, and business practices of the payment processor, as well as identify potential problem merchants. Payment processors may also process transactions for other payment processors, resulting in nested payment processors or aggregator relationships. The financial institution should be aware of these activities and obtain data on the nested processor and its merchant clients. Nested processors and aggregator relationships pose additional challenges as they may be extremely difficult to monitor and control; therefore, risk to the institution is significantly elevated in these cases.

Controls and due diligence requirements should be robust for payment processors and their merchant clients. At a minimum, the policies and procedures should authenticate the processor's business operations and assess the entity's risk level. An assessment should include:

- Identifying the major lines of business and volume for the processor's customers;
- Reviewing the processor's policies, procedures, and processes to determine the adequacy of due diligence standards for new merchants;
- Reviewing corporate documentation, including independent reporting services and, if applicable, documentation on principal owners;
- Reviewing the processor's promotional materials, including its Web site, to determine the target clientele;[4]
- Determining if the processor re-sells its services to a third party that may be referred to as an agent or provider of "Independent Sales Organization opportunities" or a "gateway arrangement"[5] and whether due diligence procedures applied to those entities are sufficient;
- Visiting the processor's business operations center;
- Reviewing appropriate databases to ensure that the processor and its principal owners and operators have not been subject to law enforcement actions; and,
- Determining whether any conflicts of interest exist between management and insiders of the financial institution.

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[4] See footnote 1 for examples of potentially high-risk areas.

[5] An Independent Sales Organization is an outside company contracted to procure new merchant relationships. Gateway arrangements are similar to Internet service providers that sell excess computer storage capacity to third parties, who in turn distribute computer services to other individuals unknown to the provider. The third party would make decisions about who would be receiving the service, although the provider would be responsible for the ultimate storage capacity.

Financial institutions should require that payment processors provide information on their merchant clients, such as the merchant's name, principal business activity, location, and sales techniques. The same information should be obtained if the merchant uses sub-merchants (often called "affiliates"). Additionally, financial institutions should verify directly, or through the payment processor, that the originator of the payment (i.e., the merchant) is operating a legitimate business. Such verification could include comparing the identifying information with public record, fraud databases, and a trusted third party, such as a consumer reporting agency or consumer advocacy group, and/or checking references from other financial institutions. The financial institution should also obtain independent operational audits of the payment processor to assess the accuracy and reliability of the processor's systems. The more the financial institution relies on the payment processor for due diligence and monitoring of its merchant client without direct financial institution involvement and verification, the more important it is to have an independent review to ensure that the processor's controls are sufficient and that contractual agreements between the financial institution and the third-party payment processor are honored.

Ongoing Monitoring

Financial institutions that initiate transactions for payment processors should implement systems to monitor for higher rates of returns or charge backs and/or high levels of RCCs or ACH debits returned as unauthorized or due to insufficient funds, all of which often indicate fraudulent activity. This would include analyzing and monitoring the adequacy of any reserve balances or accounts established to continually cover charge-back activity.

Financial institutions are required to have a BSA/AML compliance program and appropriate policies, procedures, and processes for monitoring, detecting, and reporting suspicious activity. However, nonbank payment processors generally are not subject to BSA/AML regulatory requirements, and therefore some payment processors are more vulnerable to money laundering, identity theft, fraud schemes, and illicit transactions. The FFIEC BSA/AML Examination Manual urges financial institutions to effectively assess and manage risk associated with third-party payment processors. As a result, a financial institution's risk mitigation program should include procedures for monitoring payment processor information, such as merchant data, transaction volume, and charge-back history.

Consumer complaints and/or high rates of return may be an indicator of unauthorized or illegal activity. As such, financial institutions should establish procedures for regularly surveying the sources of consumer complaints that may be lodged with the payment processor, its merchant clients or their affiliates, or on publicly available complaint Web sites and/or blogs. This will help the institutions identify processors and merchants that may pose greater risk.

Similarly, financial institutions should have a formalized process for periodically auditing their third-party payment processing relationships; including reviewing merchant client lists and confirming that the processor is fulfilling contractual obligations to verify the legitimacy of its merchant clients and their business practices.

Conclusion

The FDIC recognizes that financial institutions provide legitimate services for payment processors and their merchant clients. However, to limit potential risks, financial institutions should implement risk mitigation policies and procedures that include oversight and controls appropriate for the risk and transaction types of the payment processing activities. At a minimum, Board-approved policies and programs should assess the financial institution's risk tolerance for this type of activity, verify the legitimacy of the payment processor's business operations, determine the character of the payment processor's ownership, and ensure ongoing monitoring of payment processor relationships for suspicious activity, among other things. Adequate routines and controls will include sufficient staffing with the appropriate background and experience for managing third-party payment processing relationships of the size and scope present at the institution, as well as strong oversight and monitoring by the board and senior management. Financial institutions should act promptly if they believe fraudulent or improper activities potentially resulting in consumer harm have occurred related to activities of a payment processor or its merchant clients, in accordance with their duties under BSA/AML policies and procedures, as well as under Section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive acts and practices.

Sandra L. Thompson
Director
Division of Risk Management Supervision

Mark Pearce
Director
Division of Depositor and Consumer Protection

EXHIBIT 27

No. 14-953-TNM

From: Benardo, Michael B.
Sent: Tuesday, November 15, 2011 2:02 PM
To: Bowman, John B.
Subject: RE: TPPP FIL

John—

Sorry for the delay in getting back to you.

I agree that, from a formatting perspective, the footnote doesn't really work on the cover page. I like where you put it, except that I would suggest a few edits to the footnote, so that it reads like this:

> "Examples of telemarketing and online merchants that have displayed a higher incidence of consumer fraud or potentially illegal activities noted by the FDIC include: credit repair services, gambling, government grant or will writing kits, pay day or sub-prime loans, pornography, tobacco or firearms sales, sweepstakes, and magazine subscriptions. This list is not all-inclusive. While some of these activities might be legitimate, financial institutions should be aware of the increased risks associated with payments to such merchants."

I red lined the attached copy. I would also suggest updating the month from September to November before sending it forward.

Final Revised TPPP FIL (2011) ...

Let me know if you have any questions.

Mike

From: Bowman, John B.
Sent: Tuesday, November 15, 2011 9:46 AM
To: Benardo, Michael B.
Subject: TPPP FIL

Hi Mike:

I edited the FIL based on the recommendations from yesterday's briefing. I toyed with the idea of including a footnote on the first page but as you can see it moves things to the second page. So, I'm not so sure this is a workable solution. I also included a footnote on the second page, which is still upfront and should grab some attention. I'm just concerned with putting anything later in the document as the reader may not get the message. In any event, this is a starting point. Let me know what you think. Thanks.

<< File: Final Revised TPPP FIL (11-15-2011).doc >>

Regards,

John B. Bowman
Review Examiner Washington Office
[redacted]

From: Benardo, Michael B.
Sent: Thursday, December 22, 2011 11:20 AM
To: Valdez, Victor J.
Cc: Jackson, Michael L.; Butler, Janice; Weatherby, Kathryn M.; Sawin, April D.
Subject: RE: TPPP FIL Meeting with Chairman

Better late than never...

Final Revised TPPP FIL (2011) ...

Here is the FIL with the language added to address the comments made by the Acting Chairman at his briefing. A footnote has been added to the first page of the guidance. It includes a list of the types of high risk merchants we are talking about.

DCP has approved this version to go forward to the 6th floor to see if this addresses the comments made

Please let me know if you have any questions.

Thank you,

Mike

From: Valdez, Victor J.
Sent: Wednesday, November 09, 2011 4:41 PM
To: Benardo, Michael B.
Cc: Jackson, Michael L.; Plunkett, Sylvia H.; Miller, Jonathan N.; Butler, Janice
Subject: TPPP FIL Meeting with Chairman

Mike,
I just spoke to Lorraine and, as of now, we are still on the calendar for briefing the Chairman on Mon. Lorraine does not have a copy of the proposed FIL. I believe the attached e-mail has the latest version of the FIL. Please let me know if this is correct? If so, I will send it to Lorraine as a read-ahead for Mon's meeting. If not, please send me that copy. Also, are there any other read-ahead material you want me to send?
Vic

<< Message: FW: Proposed Third Party Payments Guidance >>

FDIC
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Financial Institution Letter
FIL-XX-2011
December XX, 2011

Payment Processor Relationships
Revised Guidance

Summary: Attached is revised guidance describing potential risks associated with relationships with third-party entities that process payments for telemarketers, online businesses, and other merchants. These relationships pose increased risk to institutions and require careful due diligence and monitoring. This guidance outlines certain risk mitigation principles for this type of activity.

Statement of Applicability to Institutions with Total Assets under $1 Billion: This guidance applies to all FDIC-supervised financial institutions that have relationships with third-party payment processors.

Distribution:
FDIC Supervised Institutions

Suggested Routing:
Chief Executive Officer
Executive Officers
Compliance Officer
Chief Information Officer
BSA Officer

Related Topics:
Guidance on Payment Processor Relationships (FIL 127 2008, November 2008)
Consumer Protection, Compliance Risk, and Risk Management
FDIC Guidance for Managing Third Party Risk (FIL 44 2008, June 2008)
FFIEC Handbook on Retail Payment Systems (February 2010)
FFIEC Handbook on Outsourcing Technology Services (June 2004)
FFIEC Bank Secrecy Act/Anti Money Laundering (BSA/AML) Examination Manual (April 2010)
Managing Risks in Third Party Payment Processor Relationships (Summer 2011 Supervisory Insights Journal)

Attachment:
Revised Guidance on Payment Processor Relationships

Contacts:
Kathryn Weatherby, Examination Specialist (Fraud), Division of Risk Management Supervision, at kweatherby@fdic.gov or (703) 254 0469

John Bowman, Review Examiner, Division of Depositor and Consumer Protection, at jbowman@fdic.gov or (202) 898 6574

Note:
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To receive FILs electronically, please visit http://www.fdic.gov/about/subscriptions/fil.html
Paper copies may be obtained through the FDIC's Public Information Center, 3501 Fairfax Drive, E 1002, Arlington, VA 22226 (877 275 3342 or 703 562 2200).

Highlights:

- Account relationships with entities processing payments for telemarketers or other potentially high-risk merchants require careful due diligence, close monitoring, and prudent underwriting.
- Account relationships with high-risk entities pose increased risks, including potentially unfair or deceptive acts or practices under Section 5 of the Federal Trade Commission Act.
- Certain types of payment processors pose money laundering and fraud risks if merchant client identities are not verified and business practices are not reviewed.
- Financial institutions should assess risk tolerance in their overall risk assessment program and develop policies and procedures addressing due diligence, underwriting, and ongoing monitoring of high-risk payment processor relationships.
- Financial institutions should be alert to consumer complaints or unusual return rates that suggest the inappropriate use of personal account information and possible deception or unfair treatment of consumers.
- Financial institutions should act promptly when fraudulent or improper activities occur relating to a payment processor, including possibly terminating the relationship.
- Improperly managing these risks may result in the imposition of enforcement actions, such as civil money penalties or restitution orders.

Revised Guidance on Payment Processor Relationships

The FDIC has recently seen an increase in the number of relationships between financial institutions and payment processors in which the payment processor, who is a deposit customer of the financial institution, uses its relationship to process payments for third-party merchant clients. Payment processors typically process payments either by creating and depositing remotely created checks (RCCs) often referred to as "Demand Drafts" or by originating Automated Clearing House (ACH) debits on behalf of their merchant customers. The payment processor may use its own deposit account to process such transactions, or it may establish deposit accounts for its merchant clients.

While many payment processors effect legitimate payment transactions for reputable merchants, telemarketing and online merchants[1] have displayed a higher incidence of consumer fraud or potentially illegal activities. In the absence of an effective means for verifying their merchant clients' identities and reviewing their business practices, payment processors pose elevated money laundering and fraud risk for financial institutions, as well as legal, reputational, and compliance risks if consumers are harmed.

Financial institutions should understand, verify, and monitor the activities and the entities related to the account relationship. Although all of the core elements of managing third-party risk should be considered in payment processor relationships (e.g., risk assessment, due diligence, and oversight), managing this risk poses an increased challenge for the financial institution when there may not be a direct customer relationship with the merchant. For example, it may be difficult to obtain necessary information from the payment processor, particularly if a merchant is also a payment processor, resulting in a "nested" payment processor or "aggregator" relationship.

Financial institutions should ensure that their contractual agreements with payment processors provide them with access to necessary information in a timely manner. These agreements should also protect financial institutions by providing for immediate account closure, contract termination, or similar action, as well as establishing adequate reserve requirements to cover anticipated charge backs. Accordingly, financial institutions should perform due diligence and account monitoring appropriate to the risk posed by the payment processor and its merchant base. Risks associated with this type of activity are further increased if neither the payment processor nor the financial institution performs adequate due diligence on the merchants for which payments are originated. Financial institutions are reminded that they cannot rely solely on due diligence performed by the payment processor. The FDIC expects a financial institution to adequately oversee all transactions and activities that it processes and to appropriately manage and mitigate operational risks, Bank Secrecy Act (BSA) compliance, fraud risks, and consumer protection risks, among others.

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[1] Examples of telemarketing and online merchants that have displayed a higher incidence of consumer fraud or potentially illegal activities noted by the FDIC include: credit repair services, gambling, government grant or will writing kits, pay day or sub-prime loans, pornography, tobacco or firearms sales, sweepstakes, and magazine subscriptions. This list is not all-inclusive. The risks presented by each relationship must be measured according to its own facts and circumstances. While some of these activities might be legitimate, financial institutions should be aware of the increased risks associated with payments to such merchants.

Potential Risks Arising from Payment Processor Relationships

Deposit relationships with payment processors expose financial institutions to risks not customarily present in relationships with other commercial customers. These include increased operational, strategic, credit, compliance, and transaction risks. In addition, financial institutions should consider the potential for legal, reputational, and other risks, including risks associated with a high or increasing number of customer complaints and returned items, and the potential for claims of unfair or deceptive practices. *Financial institutions that fail to adequately manage these relationships may be viewed as facilitating a payment processor's or merchant client's fraudulent or unlawful activity and, thus, may be liable for such acts or practices.* In such cases, the financial institution and responsible individuals have been subject to a variety of enforcement and other actions. Financial institutions must recognize and understand the businesses and customers with which they have relationships and the liability risk for facilitating or aiding and abetting consumer unfairness or deception under Section 5 of the Federal Trade Commission Act.[2]

Financial institutions should be alert for payment processors that use more than one financial institution to process merchant client payments or that have a history of moving from one financial institution to another within a short period. Processors may use multiple financial institutions because they recognize that one or more of the relationships may be terminated as a result of suspicious activity.

Financial institutions should also be on alert for payment processors that solicit business relationships with troubled financial institutions in need of capital. In such cases, payment processors will identify and establish relationships with troubled financial institutions because these financial institutions may be more willing to engage in higher-risk transactions in exchange for increased fee income. In some cases, payment processors have also committed to purchasing stock in certain troubled financial institutions or have guaranteed to place a large deposit with the financial institution, thereby providing additional, much-needed capital. Often, the targeted financial institutions are smaller, community banks that lack the infrastructure to properly manage or control a third-party payment processor relationship.

Financial institutions also should be alert to an increase in consumer complaints about payment processors and/or merchant clients or an increase in the amount of returns or chargebacks, all of which may suggest that the originating merchant may be engaged in unfair or deceptive practices or may be inappropriately obtaining or using consumers' personal account information to create unauthorized RCCs or ACH debits. Consumer complaints may be made to a variety of sources and not just directly to the financial institution. They may be sent to the payment processor or the underlying merchant, or directed to consumer advocacy groups or online complaint Web sites or blogs. Financial institutions should take reasonable steps to ensure they understand the type and level of complaints related to transactions that it processes. Financial institutions should also

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[2] Under Section 8 of the Federal Deposit Insurance Act, the FDIC has authority to enforce the prohibitions against Unfair or Deceptive Acts or Practices (UDAP) in the Federal Trade Commission Act. UDAP violations can result in unsatisfactory Community Reinvestment Act ratings, compliance rating downgrades, restitution to consumers, and the pursuit of civil money penalties.

determine, to the extent possible, if there are any external investigations of or legal actions against a processor or its owners and operators during initial and ongoing due diligence of payment processors.

Financial institutions should act promptly to minimize possible consumer harm, particularly in cases involving potentially fraudulent or improper activities relating to activities of a payment processor or its merchant clients. Appropriate actions include filing a Suspicious Activity Report,[3] requiring the payment processor to cease processing for a specific merchant, freezing certain deposit account balances to cover anticipated charge backs, and/or terminating the financial institution's relationship with the payment processor.

Risk Mitigation

Financial institutions should delineate clear lines of responsibility for controlling risks associated with payment processor relationships. Controls may include enhanced due diligence; effective underwriting; and increased scrutiny and monitoring of high-risk accounts for an increase in unauthorized returns, charge backs, suspicious activity, and/or consumer complaints. Implementing appropriate controls for payment processors and their merchant clients can help identify payment processors that process items for fraudulent telemarketers, online scammers, or other unscrupulous merchants and help ensure that the financial institution is not facilitating these transactions. Appropriate oversight and monitoring of these accounts may require the involvement of multiple departments, including information technology, operations, BSA/anti-money laundering (AML), and compliance.

Due Diligence and Underwriting

Financial institutions should implement policies and procedures designed to reduce the likelihood of establishing or maintaining inappropriate relationships with payment processors through which unscrupulous merchants can charge consumers. Such policies and procedures should outline the bank's thresholds for unauthorized returns, the possible actions that can be taken against payment processors that exceed these standards, and methods for periodically reporting such activities to the bank's board of directors and senior management.

As part of such policies and procedures, financial institutions should develop a processor approval program that extends beyond credit risk management. This program should include a due diligence and underwriting policy that, among other things, requires a background check of the payment processor, its principal owners, and its merchant clients. This will help validate the activities, creditworthiness, and business practices of the payment processor, as well as identify potential problem merchants. Payment processors may also process transactions for other payment processors, resulting in nested payment processors or aggregator relationships. The financial institution should be aware of these activities and obtain data on the nested processor and its merchant clients. Nested processors and aggregator relationships pose additional

[3] The U.S. Department of Treasury's Regulation 31 (CFR 103.18) requires that every federally supervised banking organization file a SAR when the institution detects a known or suspected violation of federal law. Part 353 of the FDIC's Rules and Regulations addresses SAR filing requirements and makes them applicable to all state-chartered financial institutions that are not members of the Federal Reserve System.

challenges as they may be extremely difficult to monitor and control; therefore, risk to the institution is significantly elevated in these cases.

Controls and due diligence requirements should be robust for payment processors and their merchant clients. At a minimum, the policies and procedures should authenticate the processor's business operations and assess the entity's risk level. An assessment should include:

- Identifying the major lines of business and volume for the processor's customers;
- Reviewing the processor's policies, procedures, and processes to determine the adequacy of due diligence standards for new merchants;
- Reviewing corporate documentation, including independent reporting services and, if applicable, documentation on principal owners;
- Reviewing the processor's promotional materials, including its Web site, to determine the target clientele;[4]
- Determining if the processor re-sells its services to a third party that may be referred to as an agent or provider of "Independent Sales Organization opportunities" or a "gateway arrangement"[5] and whether due diligence procedures applied to those entities are sufficient;
- Visiting the processor's business operations center;
- Reviewing appropriate databases to ensure that the processor and its principal owners and operators have not been subject to law enforcement actions; and,
- Determining whether any conflicts of interest exist between management and insiders of the financial institution.

Financial institutions should require that payment processors provide information on their merchant clients, such as the merchant's name, principal business activity, location, and sales techniques. The same information should be obtained if the merchant uses sub-merchants (often called "affiliates"). Additionally, financial institutions should verify directly, or through the payment processor, that the originator of the payment (i.e., the merchant) is operating a legitimate business. Such verification could include comparing the identifying information with

[4] Businesses with elevated risk may include offshore companies, online gambling-related operations, and online payday lenders. Other businesses with elevated risks include credit repair schemes. debt consolidation and forgiveness. pharmaceutical sales, telemarketing entities, and online sale of tobacco products.

[5] An Independent Sales Organization is an outside company contracted to procure new merchant relationships. Gateway arrangements are similar to Internet service providers that sell excess computer storage capacity to third parties. who in turn distribute computer services to other individuals unknown to the provider. The third party would make decisions about who would be receiving the service. although the provider would be responsible for the ultimate storage capacity.

public record, fraud databases, and a trusted third party, such as a consumer reporting agency or consumer advocacy group, and/or checking references from other financial institutions. The financial institution should also obtain independent operational audits of the payment processor to assess the accuracy and reliability of the processor's systems. The more the financial institution relies on the payment processor for due diligence and monitoring of its merchant client without direct financial institution involvement and verification, the more important it is to have an independent review to ensure that the processor's controls are sufficient and that contractual agreements between the financial institution and the third-party payment processor are honored.

Ongoing Monitoring

Financial institutions that initiate transactions for payment processors should implement systems to monitor for higher rates of returns or charge backs and/or high levels of RCCs or ACH debits returned as unauthorized or due to insufficient funds, all of which often indicate fraudulent activity. This would include analyzing and monitoring the adequacy of any reserve balances or accounts established to continually cover charge-back activity.

Financial institutions are required to have a BSA/AML compliance program and appropriate policies, procedures, and processes for monitoring, detecting, and reporting suspicious activity. However, nonbank payment processors generally are not subject to BSA/AML regulatory requirements, and therefore some payment processors are more vulnerable to money laundering, identity theft, fraud schemes, and illicit transactions. The FFIEC BSA/AML Examination Manual urges financial institutions to effectively assess and manage risk associated with third-party payment processors. As a result, a financial institution's risk mitigation program should include procedures for monitoring payment processor information, such as merchant data, transaction volume, and charge-back history.

Even more so than high rates of returns, consumer complaints may indicate unauthorized or illegal activity. As such, financial institutions should establish procedures for regularly surveying the sources of consumer complaints that may be lodged with the payment processor, its merchant clients or their affiliates, or on publicly available complaint Web sites and/or blogs. This will help the institutions identify processors and merchants that may pose greater risk.

Similarly, financial institutions should have a formalized process for periodic audit of their third-party payment processing relationships, including reviewing merchant client lists and confirming that the processor is fulfilling contractual obligations to verify the legitimacy of its merchant clients and their business practices.

Conclusion

The FDIC recognizes that financial institutions provide legitimate services for payment processors and their merchant clients. However, to limit potential risks, financial institutions should implement risk mitigation policies and procedures that include oversight and controls appropriate for the risk and transaction types of the payment processing activities. At a minimum, Board-approved policies and programs should assess the financial institution's risk tolerance for this type of activity, verify the legitimacy of the payment processor's business operations, determine the character of the payment processor's ownership, and ensure ongoing monitoring of payment processor relationships for suspicious activity, among other things. Adequate routines and controls will include sufficient staffing with appropriate background and experience for managing third-party payment processing relationships of the size and scope present at the institution, as well as strong oversight and monitoring by the Board and senior management. Financial institutions should act promptly if they believe fraudulent or improper activities potentially resulting in consumer harm have occurred related to activities of a payment processor or its merchant clients, in accordance with their duties under BSA/AML policies and procedures, as well as under Section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive acts and practices.

Sandra L. Thompson
Director
Division of Risk Management Supervision

Mark Pearce
Director
Division of Depositor and Consumer Protection

Elston, Dennis R.

This material has been redacted as non-responsive.

From: Elston, Dennis R.
Sent: Thursday, March 06, 2014 9:43 AM
To: Redacted
Cc: Elston, Dennis R.
Subject: Payday Lending and Related Guidance

Redacted

To follow-up on our phone call conversation, the following Financial Institution Letters (FILs) should be considered:

- FIL-14-2005: Guidelines for Payday Lending
- FIL-44-2008: Guidance for Managing Third-Party Risk

The FILs can be accessed from our external website www.fdic.gov by selecting the laws and regulations tabs and picking the FILs option. If I understand what is being proposed, a Native-American group is proposing to offer payday loan products online and funds will flow from the bank though ACH transactions. As I mentioned earlier, while the bank is not expected to directly offer payday loans, it will facilitate such lending and the risks discussed in FIL-14-2005 should be closely considered. I am not sure how the arrangement is expected to work, but if a third-party vendor will be involved, or any relationship connecting the bank with the depositor group that must be supervised, the concerns raised in FIL-44-2008 must be addressed.

As I stated earlier, the arrangement will receive close regulatory scrutiny from the FDIC and State Banking Department. In-depth BSA and IT reviews of this relationship will also take place. Even under the best circumstances, if this venture is undertaken with the proper controls and strategies to try to mitigate risks, since your institution will be linked to an organization providing payday services, your reputation could suffer.

If the Board plans to go forward with this venture, please reduce your plans to writing by submitting a letter to the FDIC's Regional Director (Thomas J. Dujenski) and the Superintendent of Banks for the State of Alabama (John Harrison) outlining your proposal.

Thanks,
Dennis

From: [redacted]
Sent: Friday, March 08, 2013 2:53 PM
To: Sagatelian, Marguerite; [redacted]
Subject: RE: Payday Lending

Will do.

A note that both Joel Sweet (of DOJ) and Mike Benardo emphasized: although payday lending is a particularly ugly practice, it is only one of the TPPP problems out there. And as we have noted, Redacted *may* be one of them, where the non-bank part of the equation was misusing payroll taxes and apparently was quite well known in the lower echelons.

From: Sagatelian, Marguerite
Sent: Friday, March 08, 2013 10:49 AM
To [redacted]; [redacted]
Subject: RE: Payday Lending

Thank you, both. What has prompted today's inquiry is that the Chairman is meeting with some bankers next week, and DCP wants to give the Chairman some "talking points" as to how banks facilitate payday lending and why the FDIC is concerned. I think your supplemental memo addresses that point. We have a few TPPP cases right now, two of which are with [redacted] and [redacted] Please make sure that you coordinate your efforts with [redacted] and [redacted] so that we develop a consistent approach regarding TPPPs. Thanks.

From: [redacted]
Sent: Friday, March 08, 2013 10:41 AM
To: [redacted] Sagatelian, Marguerite
Subject: RE: Payday Lending

I echo what [redacted] aid below. Let me add the following:

Just so we are all on the same page, we did two memos, the second a supplemental memo in which we outlined four situations in which a bank might be involved with payday lending, including TPPPs. That second memo seems to go to what DCP was asking you. I am attaching a copy of that second memo again for your convenience; if DCP hasn't seen that memo, that may be the one they want. The memo concludes that a bank's relationship to payday lending (some engage in it directly) or to the payday lender or TPPP might by itself give rise to a possible enforcement action, depending on the nature of the relationship. Also, the KYC regulations for banks and regulatory guidance on TPPPs imposing due diligence requirements obligate banks to make sufficient inquiries that should allow banks to uncover most really bad behavior Those due diligence requirements definitely give us (the FDIC) grounds for asking banks to keep track of what their payday lender/TPPP account holders are doing and a failure of banks to perform that due diligence may be grounds for an enforcement action, again in the right situations.

If DCP is looking for more than that, we are happy to look into whatever they want. What I just said is a little abstract but the nature of the relationships and underlying conduct will really be key to any consideration of an enforcement action so any more specific delineation of a possible enforcement action would be easier in the context of a specific bank and payday lending situation.

In that regard, I have also been doing some general research into how payday lending operates in practice particularly as it relates to insured depository financial institutions. While not directly involving payday lending, I also agree with [redacted] that the Redacted case looks to be a good case regarding TPPPs that warrants further inquiry.

From: [redacted]
Sent: Friday, March 08, 2013 10:06 AM
To: Sagatelian, Marguerite; [redacted]
Subject: RE: Payday Lending

Marguerite,

We have not updated the memo as yet because we have taken many steps in the right direction, I think but are still working on putting together a solid approach on this issue. Director Pearce asked us to follow up with Mike Benardo, which I did. Mike had a wealth of information as to how payday lenders use weak or failing banks – sometimes with the banks' awareness and sometimes not -- as essentially shells out of which they operate. (Note: That scenario may also be present in the Redacted Bank Case.)

As I think I mentioned in a couple of emails and in my status updates, my meeting with Mike Benardo led me to an invitation to his presentation on third party processors last week. There he introduced me to Joel Sweet, an AUSA who specializes in consumer cases involving 3d party processors. Joel has a wealth of knowledge about how to get both the payday lender and the bank that facilitates the lending. Luckily for us, Joel is just starting (last week) a 6 month detail at Main Justice. Joel, Lance and I are working to schedule a meeting next week. Our goal is to come out of that meeting with at least a broad outline of how to approach this problem.

I hope this is helpful. Please let me know if you have any questions.

Thanks.

[redacted]

From: Sagatelian, Marguerite
Sent: Friday, March 08, 2013 9:32 AM
To: [redacted]
Subject: Payday Lending

[redacted] and [redacted]

I've received an inquiry from DCP about where we stand regarding our research into what avenues are available to the FDIC to take action against banks that facilitate payday lending. I have the memo you did a while back. Has that memo been updated? I know that after we met with Mark, you were going to explore the BSA/Know Your Customer requirements to see if that would provide the FDIC with the means to get at payday lending (either by the bank's direct customer or through a third party payment processor).

Please let me know where things stand and send me any updated memo you have completed.

Thanks,
Marguerite

Marguerite Sagatelian
FDIC
Senior Counsel - Consumer Enforcement Unit
550 17th Street, N.W., [redacted]
Washington, DC 20429
([redacted]

From: Sagatelian, Marguerite
Sent: Friday, March 08, 2013 9:32 AM
To: [redacted].; [redacted]
Subject: Payday Lending

[redacted] and [redacted]

I've received an inquiry from DCP about where we stand regarding our research into what avenues are available to the FDIC to take action against banks that facilitate payday lending. I have the memo you did a while back. Has that memo been updated? I know that after we met with Mark, you were going to explore the BSA/Know Your Customer requirements to see if that would provide the FDIC with the means to get at payday lending (either by the bank's direct customer or through a third party payment processor).

Please let me know where things stand and send me any updated memo you have completed.

Thanks,
Marguerite

Marguerite Sagatelian
FDIC
Senior Counsel Consumer Enforcement Unit
550 17th Street, N.W., [redacted]
Washington, DC 20429
([redacted]

From: [redacted]
Sent: Wednesday, August 28, 2013 9:56 AM
To: [redacted]
Subject: RE: Pornography

And porn ain't illegal; obscenity is, which is subject to community standards.

From: [redacted]
Sent: Wednesday, August 28, 2013 9:53 AM
To: [redacted]
Subject: RE: Pornography

I don't have a legal argument to make (I don't think) but I agree that tying payday lending to pornography is a bit moralistic to me. I still think the better analogy is to telemarketing. Payday lending may be illegal some places, but it is legal IN ABOUT 35 STATES!!! In other words, in about 2/3 of the states (depending on which assessment of the various state laws you accept). And, whether we agree with them or not, there is still an argument made by some advocates of payday lending beyond the usual industry shills that payday lending done right serves a legitimate purpose for the unbanked that regular banks won't/can't meet. (In 2009 FDIC urged its banks to offer a new pdl-like product with an interest rate cap around 36% and it got no takers.) Failing to make that distinction between illegal and legal payday lending and instead lumping it in with purely objectionable products seems to me to feed the impression that we are trying to combat: that this is not a full-blown assault on payday lending but is instead targeted to on-line payday lending in states where it is illegal. If we really think it is that pernicious a practice, we should expand our enforcement approach beyond that limited target.

From: [redacted]
Sent: Wednesday, August 28, 2013 9:34 AM
To: [redacted]
Subject: RE: Pornography

PAY DDAY LENDING MAKES PORN LOOK BAD?

From: Rosebrock, Seth P.
Sent: Wednesday, August 28, 2013 9:33 AM
To: Lesemann, Dana J.
Subject: RE: Pornography

That was the idea ;)

[redacted]
Direct: [redacted]
Cellular [redacted]

From: [redacted]
Sent: Wednesday, August 28, 2013 9:33 AM
To: [redacted]
Subject: RE: Pornography

Well, that got my attention. Now I will read the email.

From: [redacted]
Sent: Wednesday, August 28, 2013 9:32 AM
To: Sagatelian, Marguerite
Cc: [redacted]
Subject: Pornography

FYI:

I just got a call from Jonathan Miller regarding why we kept taking pornography out of their write up.

I explained that we felt there was a difference between on-line gambling and payday lending (which are illegal in some states) and pornography (which may be immoral, but which is not per se illegal). I noted that we didn't want to seem like we as a regulator were making moral judgments regarding the types of businesses with which our institutions deal. Rather, we wanted to make it clear that were making rational safety and soundness decisions by discouraging our institutions from engaging in or facilitating illegal transactions.

Jonathan heard where we were coming from, but nonetheless wants to retain a reference to pornography in our letters / talking points. He thinks it's important for Congress to get a good picture regarding the unsavory nature of the businesses at issue. He repeated that "one is judged by the friends one keeps," and he seems to feel strongly that including payday lenders in the same circle as pornographers and on-line gambling businesses will ultimately help with the messaging on this issue.

If you feel that there is legal argument beyond the one I made, and would like us to push back on this issue, please let me know.

[redacted]

[redacted] Counsel
Federal Deposit Insurance Corporation
Legal Division, Consumer Enforcement Unit
1776 F. Street NW, [redacted]
Washington, DC 20429
Direct: [redacted] Cellular: [redacted]

EXHIBIT 28

No. 14-953-TNM

FDIC

Federal Deposit Insurance Corporation
550 17th Street, NW, Washington, D.C. 20429-9990

Financial Institution Letter
FIL-43-2013
September 27, 2013

FDIC Supervisory Approach to Payment Processing Relationships With Merchant Customers That Engage in Higher-Risk Activities

Summary: The FDIC is clarifying its policy and supervisory approach related to facilitating payment processing services directly, or indirectly through a third party, for merchant customers engaged in higher-risk activities. Facilitating payment processing for merchant customers engaged in higher-risk activities can pose risks to financial institutions; however, those that properly manage these relationships and risks are neither prohibited nor discouraged from providing payment processing services to customers operating in compliance with applicable law.

Statement of Applicability to Institutions With Total Assets Under $1 Billion: This Financial Institution Letter applies to all FDIC-supervised banks and savings associations, including community institutions.

Distribution:
FDIC-Supervised Banks (Commercial and Savings)

Suggested Routing:
Board of Directors, Senior Executive Officers, Chief Credit Officer, Chief Information Technology Officer, Bank Secrecy Act Officer

Related Topics:
Guidance for Managing Third-Party Risk, FIL-44-2008;
Guidance on Payment Processor Relationships, FIL-127-2009;
Managing Risks in Third-Party Payment Processor Relationships, Supervisory Insights Journal, Summer 2011;
Payment Processor Relationships, Revised Guidance, FIL-3-2012;
FFIEC Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination Manual; and
FFIEC Information Technology Hand book, Retail Payments Systems Booklet.

Attachment:
FDIC Supervisory Approach to Payment Processing Relationships With Merchant Customers That Engage in Higher-Risk Activities

Contacts:
Michael Benardo, Section Chief, Division of Risk Management Supervision at MBenardo@FDIC.gov or 703-254-0450; Surge Sen, Section Chief, Division of Depositor and Consumer Protection at SSen@FDIC.gov or 202-898-6699

Note:
FDIC Financial Institution Letters (FILs) may be accessed from the FDIC's Web site at http://www.fdic.gov/news/news/financial/2013/index.html.

To receive FILs electronically, please visit http://www.fdic.gov/about/subscriptions/fil.html.

Paper copies may be obtained via the FDIC's Public Information Center, 3501 Fairfax Drive, E-1002, Arlington, VA 22226 (877-275-3342 or 703-562-2200).

Highlights:

- Financial institutions that provide payment processing services directly or indirectly for merchant customers engaged in higher-risk activities are expected to perform proper risk assessments, conduct due diligence to determine merchant customers are operating in accordance with applicable law, and maintain systems to monitor relationships over time.

- Proper management of relationships with merchant customers engaged in higher-risk activities is essential. Financial institutions need to assure themselves that they are not facilitating fraudulent or other illegal activity. Institutions could be exposed to financial or legal risk should the legality of activities be challenged.

- FDIC's examination focus is on assessing whether financial institutions are adequately overseeing activities and transactions they process and appropriately managing and mitigating risks. Financial institutions that have appropriate systems and controls will not be criticized for providing payment processing services to businesses operating in compliance with applicable law.

FDIC Supervisory Approach to Payment Processing Relationships With Merchant Customers That Engage in Higher-Risk Activities

The FDIC is issuing this letter to clarify its policy and supervisory approach related to facilitating payment processing[1] services directly, or indirectly through a third party, for merchant customers engaged in higher-risk activities.[2] Facilitating payment processing for merchant customers engaged in higher-risk activities can pose risks to financial institutions and requires due diligence and monitoring, as detailed in prior FDIC and interagency guidance and other information.[3] Financial institutions that properly manage these relationships and risks are neither prohibited nor discouraged from providing payment processing services to customers operating in compliance with applicable federal and state law.

The FDIC and other agency guidance indicate that financial institutions that provide payment processing services directly or indirectly for merchants engaged in higher-risk activities are expected to perform proper risk assessments, conduct due diligence sufficient to ascertain that the merchants are operating in accordance with applicable law, and maintain appropriate systems to monitor these relationships over time. The proper management of relationships with merchant customers engaged in higher-risk activities is essential. Financial institutions need to assure themselves that they are not facilitating fraudulent or other illegal activity. Institutions could be exposed to financial or legal risk should the legality of activities be challenged.

The FDIC is aware that some payment processors or merchants may target institutions that are unfamiliar with the related risks or that lack proper due diligence or controls to manage these risks. Thus financial institutions that engage or plan to engage in these activities should review this guidance. The focus of FDIC examinations is to assess whether financial institutions are adequately overseeing activities and transactions they process and appropriately managing and mitigating related risks. Those that are operating with the appropriate systems and controls will not be criticized for providing payment processing services to businesses operating in compliance with applicable law.

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[1] Payments may be in the form of remotely created checks (also known as "Demand Drafts"), Automated Clearing House transactions, or similar methods.

[2] Higher-risk activities are those that tend to display a higher incidence of consumer fraud or potentially illegal activities than some other businesses. Higher-risk activities are typically characterized by high rates of return, high rates of unauthorized transactions, consumer complaints, or evidence of state or federal regulatory or criminal actions against the business customer, which indicate that the activity needs to be reviewed to determine whether fraudulent or illegal activity is occurring. See FDIC, Financial Institution Letter, FIL-3-2012, *Payment Processor Relationships, Revised Guidance* issued January 2012.

[3] FDIC guidance and other information on this topic includes:

- Financial Institution Letter, FIL-44-2008, *Guidance for Managing Third-Party Risk* issued June 2008.
- Financial Institution Letter, FIL-127-2008, *Guidance on Payment Processor Relationships* issued November 2008.
- *Managing Risks in Third-Party Payment Processor Relationships* Summer 2011 Supervisory Insights Journal.
- Financial Institution Letter, FIL-3-2012, *Payment Processor Relationships, Revised Guidance* issued January 2012.

FFIEC guidance on this topic includes:

- The *FFIEC Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination Manual*.
- *The FFIEC Information Technology Handbook*, "Retail Payments Systems Booklet."

EXHIBIT 29

No. 14-953-TNM

Office of the Comptroller of the Currency
U.S. Department of the Treasury

OCC BULLETIN 2013-29

Subject: Third-Party Relationships
Date: October 30, 2013

To: Chief Executive Officers and Chief Risk Officers of All National Banks and Federal Savings Associations, Technology Service Providers, Department and Division Heads, All Examining Personnel, and Other Interested Parties

Description: Risk Management Guidance

Summary

This bulletin provides guidance to national banks and federal savings associations (collectively, banks) for assessing and managing risks associated with third-party relationships. A third-party relationship is any business arrangement between a bank and another entity, by contract or otherwise.[1]

The Office of the Comptroller of the Currency (OCC) expects a bank to practice effective risk management regardless of whether the bank performs the activity internally or through a third party. A bank's use of third parties does not diminish the responsibility of its board of directors and senior management to ensure that the activity is performed in a safe and sound manner and in compliance with applicable laws.[2]

This bulletin rescinds OCC Bulletin 2001-47, "Third-Party Relationships: Risk Management Principles," and OCC Advisory Letter 2000-9, "Third-Party Risk." This bulletin supplements and should be used in conjunction with other OCC and interagency issuances on third-party relationships and risk management listed in appendix B. In connection with the issuance of this bulletin, the OCC is applying to federal savings associations (FSA) certain guidance applicable to national banks, as indicated in appendix B.

Highlights

- A bank should adopt risk management processes commensurate with the level of risk and complexity of its third-party relationships.
- A bank should ensure comprehensive risk management and oversight of third-party relationships involving critical activities.
- An effective risk management process throughout the life cycle of the relationship includes
    - plans that outline the bank's strategy, identify the inherent risks of the activity, and detail how the bank selects, assesses, and oversees the third party.
    - proper due diligence in selecting a third party.
    - written contracts that outline the rights and responsibilities of all parties.
    - ongoing monitoring of the third party's activities and performance.
    - contingency plans for terminating the relationship in an effective manner.
    - clear roles and responsibilities for overseeing and managing the relationship and risk management process.
    - Documentation and reporting that facilitates oversight, accountability, monitoring, and risk management.
    - Independent reviews that allow bank management to determine that the bank's process aligns with its strategy and effectively manages risks.

Note for Community Banks

This guidance applies to all banks with third-party relationships. A community bank should adopt risk management practices commensurate with the level of risk and complexity of its third-party relationships. A community bank's board and management should identify those third-party relationships that involve critical activities and ensure the bank has risk management practices in place to assess, monitor, and manage the risks.

Background

Banks continue to increase the number and complexity of relationships with both foreign and domestic third parties, such as

- outsourcing entire bank functions to third parties, such as tax, legal, audit, or information technology operations.
- outsourcing lines of business or products.
- relying on a single third party to perform multiple activities, often to such an extent that the third party becomes an integral component of the bank's operations.
- working with third parties that engage directly with customers.[3]
- contracting with third parties that subcontract activities to other foreign and domestic providers.
- contracting with third parties whose employees, facilities, and subcontractors may be geographically concentrated.

- working with a third party to address deficiencies in bank operations or compliance with laws or regulations.

The OCC is concerned that the quality of risk management over third-party relationships may not be keeping pace with the level of risk and complexity of these relationships. The OCC has identified instances in which bank management has

- failed to properly assess and understand the risks and direct and indirect costs involved in third-party relationships.
- failed to perform adequate due diligence and ongoing monitoring of third-party relationships.
- entered into contracts without assessing the adequacy of a third party's risk management practices.
- entered into contracts that incentivize a third party to take risks that are detrimental to the bank or its customers, in order to maximize the third party's revenues.
- engaged in informal third-party relationships without contracts in place.

These examples represent trends whose associated risks reinforce the need for banks to maintain effective risk management practices over third-party relationships.

Risk Management Life Cycle

The OCC expects a bank to have risk management processes that are commensurate with the level of risk and complexity of its third-party relationships and the bank's organizational structures. Therefore, the OCC expects more comprehensive and rigorous oversight and management of third-party relationships that involve ***critical activities***—significant bank functions (e.g., payments, clearing, settlements, custody) or significant shared services (e.g., information technology), or other activities that

- could cause a bank to face significant risk[4] if the third party fails to meet expectations.
- could have significant customer impacts.
- require significant investment in resources to implement the third-party relationship and manage the risk.
- could have a major impact on bank operations if the bank has to find an alternate third party or if the outsourced activity has to be brought in-house.

An effective third-party risk management process follows a continuous life cycle for all relationships and incorporates the following phases:

Planning: Developing a plan to manage the relationship is often the first step in the third-party risk management process. This step is helpful for many situations but is necessary when a bank is considering contracts with third parties that involve critical activities.

Due diligence and third-party selection: Conducting a review of a potential third party before signing a contract[5] helps ensure that the bank selects an appropriate third party and understands and controls the risks posed by the relationship, consistent with the bank's risk appetite.

Contract negotiation: Developing a contract that clearly defines expectations and responsibilities of the third party helps to ensure the contract's enforceability, limit the bank's liability, and mitigate disputes about performance.

Ongoing monitoring: Performing ongoing monitoring of the third-party relationship once the contract is in place is essential to the bank's ability to manage risk of the third-party relationship.

Termination: Developing a contingency plan to ensure that the bank can transition the activities to another third party, bring the activities in-house, or discontinue the activities when a contract expires, the terms of the contract have been satisfied, in response to contract default, or in response to changes to the bank's or third party's business strategy.

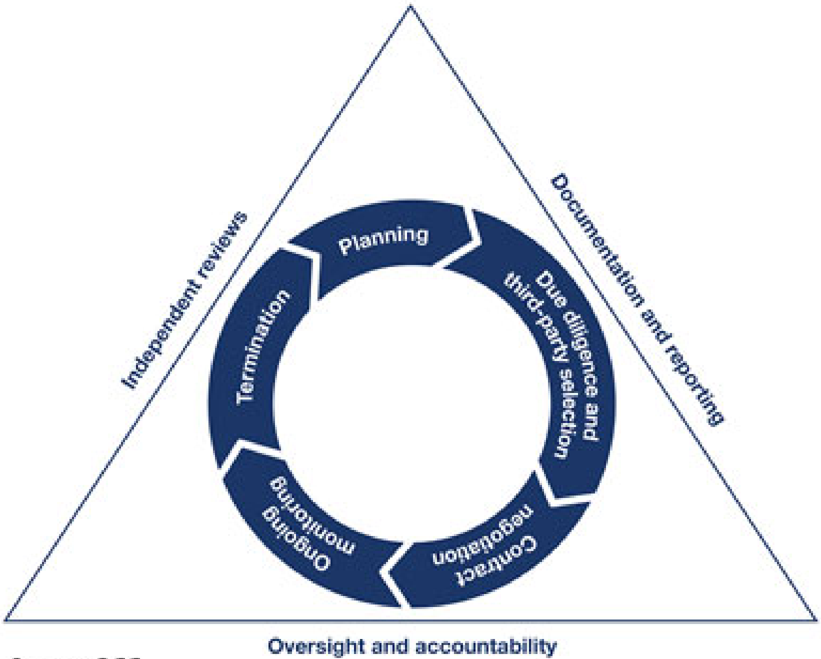
In addition, a bank should perform the following throughout the life cycle of the relationship as part of its risk management process:

Oversight and accountability: Assigning clear roles and responsibilities for managing third-party relationships and integrating the bank's third-party risk management process with its enterprise risk management framework enables continuous oversight and accountability.

Documentation and reporting: Proper documentation and reporting facilitates oversight, accountability, monitoring, and risk management associated with third-party relationships.

Independent reviews: Conducting periodic independent reviews of the risk management process enables management to assess whether the process aligns with the bank's strategy and effectively manages risk posed by third-party relationships.

Figure 1: Risk Management Life Cycle



Source: OCC

Planning

Before entering into a third-party relationship, senior management should develop a plan to manage the relationship. The management plan should be commensurate with the level of risk and complexity of the third-party relationship and should

- discuss the risks inherent in the activity.
- outline the strategic purposes (e.g., reduce costs, leverage specialized expertise or technology, augment resources, expand or enhance operations), legal and compliance aspects, and inherent risks associated with using third parties, and discuss how the arrangement aligns with the bank's overall strategic goals, objectives, and risk appetite.
- assess the complexity of the arrangement, such as the volume of activity, potential for subcontractors, the technology needed, and the likely degree of foreign-based third-party support.
- determine whether the potential financial benefits outweigh the estimated costs to control the risks (including estimated direct contractual costs and indirect costs to augment or alter bank processes, systems, or staffing to properly manage the third-party relationship or adjust or terminate existing contracts).
- consider how the third-party relationship could affect other strategic bank initiatives, such as large technology projects, organizational changes, mergers, acquisitions, or divestitures.
- consider how the third-party relationship could affect bank and dual employees[6] and what transition steps are needed to manage the impacts when the activities currently conducted internally are outsourced.
- assess the nature of customer interaction with the third party and potential impact the relationship will have on the bank's customers—including access to or use of those customers' confidential information, joint marketing or franchising arrangements, and handling of customer complaints—and outline plans to manage these impacts.
- assess potential information security implications including access to the bank's systems and to its confidential information.
- consider the bank's contingency plans in the event the bank needs to transition the activity to another third party or bring it in-house.
- assess the extent to which the activities are subject to specific laws and regulations (e.g., privacy, information security, Bank Secrecy Act/Anti-Money Laundering (BSA/AML), fiduciary requirements).
- consider whether the selection of the third party is consistent with the bank's broader corporate policies and practices including its diversity policies and practices.
- detail how the bank will select, assess, and oversee the third party, including monitoring the third party's compliance with the contract.
- be presented to and approved by the bank's board of directors when critical activities are involved.

Due Diligence and Third-Party Selection

A bank should conduct due diligence on all potential third parties before selecting and entering into contracts or relationships. A bank should not rely solely on experience with or prior knowledge of the third party as a proxy for an objective, in-depth assessment of the third party's ability to perform the activity in compliance with all applicable laws and regulations and in a safe and sound manner.

The degree of due diligence should be commensurate with the level of risk and complexity of the third-party relationship. More extensive due diligence is necessary when a third-party relationship involves critical activities. On-site visits may be useful to understand fully the third party's operations and capacity. If the bank uncovers information that warrants additional scrutiny, it should broaden the scope or assessment methods of the due diligence as needed.

The bank should consider the following during due diligence:

Strategies and Goals

Review the third party's overall business strategy and goals to ensure they do not conflict with those of the bank. Consider how the third party's current and proposed strategic business arrangements (such as mergers, acquisitions, divestitures, joint ventures, or joint marketing initiatives) may affect the activity. Also consider reviewing the third party's service philosophies, quality initiatives, efficiency improvements, and employment policies and practices.

Legal and Regulatory Compliance

Evaluate the third party's legal and regulatory compliance program to determine whether the third party has the necessary licenses to operate and the expertise, processes, and controls to enable the bank to remain compliant with domestic and international laws and regulations. Check compliance status with regulators and self-regulatory organizations as appropriate.

Financial Condition

Assess the third party's financial condition, including reviews of the third party's audited financial statements. Evaluate growth, earnings, pending litigation, unfunded liabilities, and other factors that may affect the third party's overall financial stability. Depending on the significance of the third-party relationship, the bank's analysis may be as comprehensive as if extending credit to the third party.

Business Experience and Reputation

Evaluate the third party's depth of resources and previous experience providing the specific activity. Assess the third party's reputation, including history of customer complaints or litigation. Determine how long the third party has been in business, its market share for the activities, and whether there have been significant changes in the activities offered or in its business model. Conduct reference checks with external organizations and agencies such as the industry associations, Better Business Bureau, Federal Trade Commission, state attorneys general offices, state consumer affairs offices, and similar foreign authorities. Check U.S. Securities and Exchange Commission or other regulatory filings. Review the third party's Web sites and other marketing materials to ensure that statements and assertions are in-line with the bank's expectations and do not overstate or misrepresent activities and capabilities. Determine whether and how the third party plans to use the bank's name and reputation in marketing efforts.

Fee Structure and Incentives

Evaluate the third party's normal fee structure and incentives for similar business arrangements to determine if the fee structure and incentives would create burdensome upfront fees or result in inappropriate risk taking by the third party or the bank.

Qualifications, Backgrounds, and Reputations of Company Principals

Ensure the third party periodically conducts thorough background checks on its senior management and employees as well as on subcontractors who may have access to critical systems or confidential information. Ensure that third parties have policies and procedures in place for removing employees who do not meet minimum background check requirements.

Risk Management

Evaluate the effectiveness of the third party's risk management program, including policies, processes, and internal controls. Where applicable, determine whether the third party's internal audit function independently and effectively tests and reports on the third party's internal controls. Evaluate processes for escalating, remediating, and holding management accountable for concerns identified during audits or other independent tests. If available, review Service Organization Control (SOC) reports, prepared in accordance with the American Institute of Certified Public Accountants Statement on Standards for Attestation Engagements No. 16 (SSAE 16). Consider whether these reports contain sufficient information to assess the third party's risk or whether additional scrutiny is required through an audit by the bank or other third party at the bank's request. Consider any certification by independent third parties for compliance with domestic or international internal control standards (e.g., the National Institute of Standards and Technology and the International Standards Organization).

Information Security

Assess the third party's information security program. Determine whether the third party has sufficient experience in identifying, assessing, and mitigating known and emerging threats and vulnerabilities. When technology is necessary to support service delivery, assess the third party's infrastructure and application security programs, including the software development life cycle and results of vulnerability and penetration tests. Evaluate the third party's ability to implement effective and sustainable corrective actions to address deficiencies discovered during testing.

Management of Information Systems

Gain a clear understanding of the third party's business processes and technology that will be used to support the activity. When technology is a major component of the third-party relationship, review both the bank's and the third party's information systems to identify gaps in service-level expectations, technology, business process and management, or interoperability issues. Review the third party's processes for maintaining accurate inventories of its technology and its subcontractors. Assess the third party's change management processes to ensure that clear roles, responsibilities, and segregation of duties are in place. Understand the third party's performance metrics for its information systems and ensure they meet the bank's expectations.

Resilience

Assess the third party's ability to respond to service disruptions or degradations resulting from natural disasters, human error, or intentional physical or cyber attacks. Determine whether the third party maintains disaster recovery and business continuity plans that specify the time frame to resume activities and recover data. Review the third party's telecommunications redundancy and resilience plans and preparations for known and emerging threats and vulnerabilities, such as wide-scale natural disasters, distributed denial of service attacks, or other intentional or unintentional events. Review the results of business continuity testing and performance during actual disruptions.

Incident-Reporting and Management Programs

Review the third party's incident reporting and management programs to ensure there are clearly documented processes and accountability for identifying, reporting, investigating, and escalating incidents. Ensure that the third party's escalation and notification processes meet the bank's expectations and regulatory requirements.

Physical Security

Evaluate whether the third party has sufficient physical and environmental controls to ensure the safety and security of its facilities, technology systems, and employees.

Human Resource Management

Review the third party's program to train and hold employees accountable for compliance with policies and procedures. Review the third party's succession and redundancy planning for key management and support personnel. Review training programs to ensure that the third party's staff is knowledgeable about changes in laws, regulations, technology, risk, and other factors that may affect the quality of the activities provided.

Reliance on Subcontractors

Evaluate the volume and types of subcontracted activities and the subcontractors' geographic locations. Evaluate the third party's ability to assess, monitor, and mitigate risks from its use of subcontractors and to ensure that the same level of quality and controls exists no matter where the subcontractors' operations reside. Evaluate whether additional concentration-related risks may arise from the third party's reliance on subcontractors and, if necessary, conduct similar due diligence on the third party's critical subcontractors.

Insurance Coverage

Verify that the third party has fidelity bond coverage to insure against losses attributable to dishonest acts, liability coverage for losses attributable to negligent acts, and hazard insurance covering fire, loss of data, and protection of documents. Determine whether the third party has insurance coverage for its intellectual property rights, as such coverage may not be available under a general commercial policy. The amounts of such coverage should be commensurate with the level of risk involved with the third party's operations and the type of activities to be provided.

Conflicting Contractual Arrangements With Other Parties

Obtain information regarding legally binding arrangements with subcontractors or other parties in cases where the third party has indemnified itself, as such arrangements may transfer risks to the bank. Evaluate the potential legal and financial implications to the bank of these contracts between the third party and its subcontractors or other parties.

Senior management should review the results of the due diligence to determine whether the third party is able to meet the bank's expectations and whether the bank should proceed with the third-party relationship. If the results do not meet expectations, management should recommend that the third party make appropriate changes, find an alternate third party, conduct the activity in-house, or discontinue the activity. As part of any recommended changes, the bank may need to supplement the third party's resources or increase or implement new controls to manage the risks. Management should present results of due diligence to the board when making recommendations for third-party relationships that involve critical activities.

Contract Negotiation

Once the bank selects a third party, management should negotiate a contract that clearly specifies the rights and responsibilities of each party to the contract. Additionally, senior management should obtain board approval of the contract before its execution when a third-party relationship will involve critical activities. A bank should review existing contracts periodically, particularly those involving critical activities, to ensure they continue to address pertinent risk controls and legal protections. Where problems are identified, the bank should seek to renegotiate at the earliest opportunity.

Contracts should generally address the following:

Nature and Scope of Arrangement

Ensure that the contract specifies the nature and scope of the arrangement. For example, a third-party contract should specifically identify the frequency, content, and format of the service, product, or function provided. Include in the contract, as applicable, such ancillary services as software or other technology support and maintenance, employee training, and customer service. Specify which activities the third party is to conduct, whether on or off the bank's premises, and describe the terms governing the use of the bank's information, facilities, personnel, systems, and equipment, as well as access to and use of the bank's or customers' information. When dual employees will be used, clearly articulate their responsibilities and reporting lines.[7]

Performance Measures or Benchmarks

Specify performance measures that define the expectations and responsibilities for both parties including conformance with regulatory standards or rules. Such measures can be used to motivate the third party's performance, penalize poor performance, or reward outstanding performance. Performance measures should not incentivize undesirable performance, such as encouraging processing volume or speed without regard for accuracy, compliance requirements, or adverse effects on customers. Industry standards for service-level agreements may provide a reference point for standardized services, such as payroll processing. For more customized activities, there may be no standard measures. Instead, the bank and third party should agree on appropriate measures.

Responsibilities for Providing, Receiving, and Retaining Information

Ensure that the contract requires the third party to provide and retain timely, accurate, and comprehensive information such as records and reports that allow bank management to monitor performance, service levels, and risks. Stipulate the frequency and type of reports required, for example: performance reports, control audits, financial statements, security reports, BSA/AML and Office of Foreign Asset Control (OFAC) compliance responsibilities and reports for monitoring potential suspicious activity, reports for monitoring customer complaint activity, and business resumption testing reports.

Ensure that the contract sufficiently addresses

- the responsibilities and methods to address failures to adhere to the agreement including the ability of both parties to the agreement to exit the relationship.
- the prompt notification of financial difficulty, catastrophic events, and significant incidents such as information breaches, data loss, service or system interruptions, compliance lapses, enforcement actions, or other regulatory actions.
- the bank's materiality thresholds and procedures for notifying the bank in writing whenever service disruptions, security breaches, or other events pose a significant risk to the bank.
- notification to the bank before making significant changes to the contracted activities, including acquisition, subcontracting, off-shoring, management or key personnel changes, or implementing new or revised policies, processes, and information technology.
- notification to the bank of significant strategic business changes, such as mergers, acquisitions, joint ventures, divestitures, or other business activities that could affect the activities involved.
- the ability of the third party to resell, assign, or permit access to the bank's data and systems to other entities.
- the bank's obligations to notify the third party if the bank implements strategic or operational changes or experiences significant incidents that may affect the third party.

The Right to Audit and Require Remediation

Ensure that the contract establishes the bank's right to audit, monitor performance, and require remediation when issues are identified. Generally, a third-party contract should include provisions for periodic independent internal or external audits of the third party, and relevant subcontractors, at intervals and scopes consistent with the bank's in-house functions to monitor performance with the contract. A bank should include in the contract the types and frequency of audit reports the bank is entitled to receive from the third party (e.g., financial, SSAE 16, SOC 1, SOC 2, and SOC 3 reports, and security reviews). Consider whether to accept audits conducted by the third party's internal or external auditors. Reserve the bank's right to conduct its own audits of the third party's activities or to engage an independent party to perform such audits. Audit reports should include a review of the third party's risk management and internal control environment as it relates to the activities involved and of the third party's information security program and disaster recovery and business continuity plans.

Responsibility for Compliance With Applicable Laws and Regulations

Ensure the contract addresses compliance with the specific laws, regulations, guidance, and self-regulatory standards applicable to the activities involved, including provisions that outline compliance with certain provisions of the Gramm-Leach-Bliley Act (GLBA) (including privacy and safeguarding of customer information); BSA/AML; OFAC; and Fair Lending and other consumer protection laws and regulations. Ensure that the contract requires the third party to maintain policies and procedures which address the bank's right to conduct periodic reviews so as to verify the third party's compliance with the bank's policies and expectations. Ensure that the contract states the bank has the right to monitor on an ongoing basis the third party's compliance with applicable laws, regulations, and policies and requires remediation if issues arise.

Cost and Compensation

Fully describe compensation, fees, and calculations for base services, as well as any fees based on volume of activity and for special requests. Ensure the contracts do not include burdensome upfront fees or incentives that could result in inappropriate risk taking by the bank or third party. Indicate which party is responsible for payment of legal, audit, and examination fees associated with the activities involved. Consider outlining cost and responsibility for purchasing and maintaining hardware and software. Specify the conditions under which the cost structure may be changed, including limits on any cost increases.

Ownership and License

State whether and how the third party has the right to use the bank's information, technology, and intellectual property, such as the bank's name, logo, trademark, and copyrighted material. Indicate whether any records generated by the third party become the bank's property.

Include appropriate warranties on the part of the third party related to its acquisition of licenses for use of any intellectual property developed by other third parties. If the bank purchases software, establish escrow agreements to provide for the bank's access to source code and programs under certain conditions (e.g., insolvency of the third party).

Confidentiality and Integrity

Prohibit the third party and its subcontractors from using or disclosing the bank's information, except as necessary to provide the contracted activities or comply with legal requirements. If the third party receives bank customers' personally identifiable information, the contract should ensure that the third party implements and maintains appropriate security measures to comply with privacy regulations and regulatory guidelines. Specify when and how the third party will disclose, in a timely manner, information security breaches that have resulted in unauthorized intrusions or access that may materially affect the bank or its customers. Stipulate that intrusion notifications include estimates of the effects on the bank and specify corrective action to be taken by the third party. Address the powers of each party to change security and risk management procedures and requirements, and resolve any confidentiality and integrity issues arising out of shared use of facilities owned by the third party. Stipulate whether and how often the bank and the third party will jointly practice incident management plans involving unauthorized intrusions or other breaches in confidentiality and integrity.

Business Resumption and Contingency Plans

Ensure the contract provides for continuation of the business function in the event of problems affecting the third party's operations, including degradations or interruptions resulting from natural disasters, human error, or intentional attacks. Stipulate the third party's responsibility for backing up and otherwise protecting programs, data, and equipment, and for maintaining current and sound business resumption and contingency plans. Include provisions—in the event of the third party's bankruptcy, business failure, or business interruption—for transferring the bank's accounts or activities to another third party without penalty.

Ensure that the contract requires the third party to provide the bank with operating procedures to be carried out in the event business resumption and disaster recovery plans are implemented. Include specific time frames for business resumption and recovery that meet the bank's requirements, and when appropriate, regulatory requirements. Stipulate whether and how often the bank and the third party will jointly practice business resumption and disaster recovery plans.

Indemnification

Consider including indemnification clauses that specify the extent to which the bank will be held liable for claims that cite failure of the third party to perform, including failure of the third party to obtain any necessary intellectual property licenses. Carefully assess indemnification clauses that require the bank to hold the third party harmless from liability.

Insurance

Stipulate that the third party is required to maintain adequate insurance, notify the bank of material changes to coverage, and provide evidence of coverage where appropriate. Types of insurance coverage may include fidelity bond coverage, liability coverage, hazard insurance, and intellectual property insurance.

Dispute Resolution

Consider whether the contract should establish a dispute resolution process (arbitration, mediation, or other means) to resolve problems between the bank and the third party in an expeditious manner, and whether the third party should continue to provide activities to the bank during the dispute resolution period.

Limits on Liability

Determine whether the contract limits the third party's liability and whether the proposed limit is in proportion to the amount of loss the bank might experience because of the third party's failure to perform or to comply with applicable laws. Consider whether a contract would subject the bank to undue risk of litigation, particularly if the third party violates or is accused of violating intellectual property rights.

Default and Termination

Ensure that the contract stipulates what constitutes default, identifies remedies and allows opportunities to cure defaults, and stipulates the circumstances and responsibilities for termination. Determine whether it includes a provision that enables the bank to terminate the contract, upon reasonable notice and without penalty, in the event that the OCC formally directs the bank to terminate the relationship. Ensure the contract permits the bank to terminate the relationship in a timely manner without prohibitive expense. Include termination and notification requirements with time frames to allow for the orderly conversion to another third party. Provide for the timely return or destruction of the bank's data and other resources and ensure the contract provides for ongoing monitoring of the third party after the contract terms are satisfied as necessary. Clearly assign all costs and obligations associated with transition and termination.

Customer Complaints

Specify whether the bank or third party is responsible for responding to customer complaints. If it is the third party's responsibility, specify provisions that ensure that the third party receives and responds timely to customer complaints and forwards a copy of each complaint and response to the bank. The third party should submit sufficient, timely, and usable information to enable the bank to analyze customer complaint activity and trends for risk management purposes.

Subcontracting

Stipulate when and how the third party should notify the bank of its intent to use a subcontractor. Specify the activities that cannot be subcontracted or whether the bank prohibits the third party from subcontracting activities to certain locations or specific subcontractors. Detail the contractual obligations—such as reporting on the subcontractor's conformance with performance measures, periodic audit results, compliance with laws and regulations, and other contractual obligations. State the third party's liability for activities or actions by its subcontractors and which party is responsible for the costs and resources required for any additional monitoring and management of the subcontractors. Reserve the right to terminate the contract without penalty if the third party's subcontracting arrangements do not comply with the terms of the contract.

Foreign-Based Third Parties

Include in contracts with foreign-based third parties choice-of-law covenants and jurisdictional covenants that provide for adjudication of all disputes between the parties under the laws of a single, specific jurisdiction. Understand that such contracts and covenants may be subject, however, to the interpretation of foreign courts relying on local laws. Foreign courts and laws may differ substantially from U.S. courts and laws in the application and enforcement of choice-of-law covenants, requirements on banks, protection of privacy of customer information, and the types of information that the third party or foreign governmental entities will provide upon request. Therefore, seek legal advice to ensure the enforceability of all aspects of a proposed contract with a foreign-based third party and other legal ramifications of each such arrangement.

OCC Supervision

In contracts with service providers, stipulate that the performance of activities by external parties for the bank is subject to OCC examination oversight, including access to all work papers, drafts, and other materials. The OCC treats as subject to 12 USC 1867(c) and 12 USC 1464(d)(7), situations in which a bank arranges, by contract or otherwise, for the performance of any applicable functions of its operations. Therefore, the OCC generally has the authority to examine and to regulate the functions or operations performed or provided by third parties to the same extent as if they were performed by the bank itself on its own premises.[8]

Ongoing Monitoring

Ongoing monitoring for the duration of the third-party relationship is an essential component of the bank's risk management process. More comprehensive monitoring is necessary when the third-party relationship involves critical activities. Senior management should periodically assess existing third-party relationships to determine whether the nature of the activity performed now constitutes a critical activity.

After entering into a contract with a third party, bank management should dedicate sufficient staff with the necessary expertise, authority, and accountability to oversee and monitor the third party commensurate with the level of risk and complexity of the relationship. Regular on site visits may be useful to understand fully the third party's operations and ongoing ability to meet contract requirements. Management should ensure that bank employees that directly manage third-party relationships monitor the third party's activities and performance. A bank should pay particular attention to the quality and sustainability of the third party's controls, and its ability to meet service-level agreements, performance metrics and other contractual terms, and to comply with legal and regulatory requirements.

The OCC expects the bank's ongoing monitoring of third-party relationships to cover the due diligence activities discussed earlier. Because both the level and types of risks may change over the lifetime of third-party relationships, a bank should ensure that its ongoing monitoring adapts accordingly. This monitoring may result in changes to the frequency and types of required reports from the third party, including service-level agreement performance reports, audit reports, and control testing results. In addition to ongoing review of third-party reports, some key areas of consideration for ongoing monitoring may include assessing changes to the third party's

- business strategy (including acquisitions, divestitures, joint ventures) and reputation (including litigation) that may pose conflicting interests and impact its ability to meet contractual obligations and service-level agreements.
- compliance with legal and regulatory requirements.
- financial condition.
- insurance coverage.
- key personnel and ability to retain essential knowledge in support of the activities.
- ability to effectively manage risk by identifying and addressing issues before they are cited in audit reports.
- process for adjusting policies, procedures, and controls in response to changing threats and new vulnerabilities and material breaches or other serious incidents.
- information technology used or the management of information systems.
- ability to respond to and recover from service disruptions or degradations and meet business resilience expectations.
- reliance on, exposure to, or performance of subcontractors; location of subcontractors; and the ongoing monitoring and control testing of subcontractors.
- agreements with other entities that may pose a conflict of interest or introduce reputation, operational, or other risks to the bank.
- ability to maintain the confidentiality and integrity of the bank's information and systems.
- volume, nature, and trends of consumer complaints, in particular those that indicate compliance or risk management problems.
- ability to appropriately remediate customer complaints.

Bank employees who directly manage third-party relationships should escalate to senior management significant issues or concerns arising from ongoing monitoring, such as an increase in risk, material weaknesses and repeat audit findings, deterioration in financial condition, security breaches, data loss, service or system interruptions, or compliance lapses. Additionally, management should ensure that the bank's controls to manage risks from third-party relationships are tested regularly, particularly where critical activities are involved. Based on the results of the ongoing monitoring and internal control testing, management should respond to issues when identified including escalating significant issues to the board.

Termination

A bank may terminate third-party relationships for various reasons, including

- expiration or satisfaction of the contract.
- desire to seek an alternate third party.
- desire to bring the activity in-house or discontinue the activity.
- breach of contract.

Management should ensure that relationships terminate in an efficient manner, whether the activities are transitioned to another third party or in-house, or discontinued. In the event of contract default or termination, the bank should have a plan to bring the service in-house if there are no alternate third parties. This plan should cover

- capabilities, resources, and the time frame required to transition the activity while still managing legal, regulatory, customer, and other impacts that might arise.
- risks associated with data retention and destruction, information system connections and access control issues, or other control concerns that require additional risk management and monitoring during and after the end of the third-party relationship.
- handling of joint intellectual property developed during the course of the arrangement.
- reputation risks to the bank if the termination happens as a result of the third party's inability to meet expectations.

The extent and flexibility of termination rights may vary with the type of activity.

Oversight and Accountability

The bank's board of directors (or a board committee) and senior management are responsible for overseeing the bank's overall risk management processes. The board, senior management, and employees within the lines of businesses who manage the third-party relationships have distinct but interrelated responsibilities to ensure that the relationships and activities are managed effectively and commensurate with their level of risk and complexity, particularly for relationships that involve critical activities:[9]

Board of Directors

- Ensure an effective process is in place to manage risks related to third-party relationships in a manner consistent with the bank's strategic goals, organizational objectives, and risk appetite.
- Approve the bank's risk-based policies that govern the third-party risk management process and identify critical activities.
- Review and approve management plans for using third parties that involve critical activities.
- Review summary of due diligence results and management's recommendations to use third parties that involve critical activities.
- Approve contracts with third parties that involve critical activities.
- Review the results of management's ongoing monitoring of third-party relationships involving critical activities.
- Ensure management takes appropriate actions to remedy significant deterioration in performance or address changing risks or material issues identified through ongoing monitoring.
- Review results of periodic independent reviews of the bank's third-party risk management process.

Senior Bank Management

- Develop and implement the bank's third-party risk management process.
- Establish the bank's risk-based policies to govern the third-party risk management process.
- Develop plans for engaging third parties, identify those that involve critical activities, and present plans to the board when critical activities are involved.
- Ensure appropriate due diligence is conducted on potential third parties and present results to the board when making recommendations to use third parties that involve critical activities.
- Review and approve contracts with third parties. Board approval should be obtained for contracts that involve critical activities.
- Ensure ongoing monitoring of third parties, respond to issues when identified, and escalate significant issues to the board.
- Ensure appropriate documentation and reporting throughout the life cycle for all third-party relationships.
- Ensure periodic independent reviews of third-party relationships that involve critical activities and of the bank's third-party risk management process. Analyze the results, take appropriate actions, and report results to the board.
- Hold accountable the bank employees within business lines or functions who manage direct relationships with third parties.
- Terminate arrangements with third parties that do not meet expectations or no longer align with the bank's strategic goals, objectives, or risk appetite.
- Oversee enterprise-wide risk management and reporting of third-party relationships.

Bank Employees Who Directly Manage Third-Party Relationships

- Conduct due diligence of third parties and report results to senior management.
- Ensure that third parties comply with the bank's policies and reporting requirements.
- Perform ongoing monitoring of third parties and ensure compliance with contract terms and service-level agreements.
- Ensure the bank or the third party addresses any issues identified.
- Escalate significant issues to senior management.
- Notify the third party of significant operational issues at the bank that may affect the third party.
- Ensure that the bank has regularly tested controls in place to manage risks associated with third-party relationships.
- Ensure that third parties regularly test and implement agreed-upon remediation when issues arise.

- Maintain appropriate documentation throughout the life cycle.
- Respond to material weaknesses identified by independent reviews.
- Recommend termination of arrangements with third parties that do not meet expectations or no longer align with the bank's strategic goals, objectives, or risk appetite.

Documentation and Reporting

A bank should properly document and report on its third-party risk management process and specific arrangements throughout their life cycle. Proper documentation and reporting facilitates the accountability, monitoring, and risk management associated with third parties and typically includes

- a current inventory of all third-party relationships, which should clearly identify those relationships that involve critical activities and delineate the risks posed by those relationships across the bank.[10]
- approved plans for the use of third-party relationships.
- due diligence results, findings, and recommendations.
- analysis of costs associated with each activity or third-party relationship, including any indirect costs assumed by the bank.
- executed contracts.
- regular risk management and performance reports required and received from the third party (e.g., audit reports, security reviews, and reports indicating compliance with service-level agreements).
- regular reports to the board and senior management on the results of internal control testing and ongoing monitoring of third parties involved in critical activities.
- regular reports to the board and senior management on the results of independent reviews of the bank's overall risk management process.

Independent Reviews

Senior management should ensure that periodic independent reviews are conducted on the third-party risk management process, particularly when a bank involves third parties in critical activities. The bank's internal auditor or an independent third party may perform the reviews, and senior management should ensure the results are reported to the board. Reviews may include assessing the adequacy of the bank's process for

- ensuring third-party relationships align with the bank's business strategy.
- identifying, assessing, managing, and reporting on risks of third-party relationships.
- responding to material breaches, service disruptions, or other material issues.
- identifying and managing risks associated with complex third-party relationships, including foreign-based third parties and subcontractors.
- involving multiple disciplines across the bank as appropriate during each phase of the third-party risk management life cycle.[11]
- ensuring appropriate staffing and expertise to perform due diligence and ongoing monitoring and management of third parties.
- ensuring oversight and accountability for managing third-party relationships (e.g., whether roles and responsibilities are clearly defined and assigned and whether the individuals possess the requisite expertise, resources, and authority).
- ensuring that conflicts of interest or appearances of conflicts of interest do not exist when selecting or overseeing third parties.
- identifying and managing concentration risks that may arise from relying on a single third party for multiple activities, or from geographic concentration of business due to either direct contracting or subcontracting agreements to the same locations.

Senior management should analyze the results of independent reviews to determine whether and how to adjust the bank's third-party risk management process, including policy, reporting, resources, expertise, and controls. Additionally, the results may assist senior management's understanding of the effectiveness of the bank's third-party risk management process so that they can make informed decisions about commencing new or continuing existing third-party relationships, bringing activities in-house, or discontinuing activities. Management should respond promptly and thoroughly to significant issues or concerns identified and escalate to the board if the risk posed is approaching the bank's risk appetite limits.

Supervisory Reviews of Third-Party Relationships

The OCC expects bank management to engage in a robust analytical process to identify, measure, monitor, and control the risks associated with third-party relationships and to avoid excessive risk taking that may threaten a bank's safety and soundness. A bank's failure to have an effective third-party risk management process that is commensurate with the level of risk, complexity of third-party relationships, and organizational structure of the bank may be *an unsafe and unsound banking practice*.

When reviewing third-party relationships, examiners should

- assess the bank's ability to oversee and manage its relationships.
- highlight and discuss material risks and any deficiencies in the bank's risk management process with the board of directors and senior management.
- carefully review the bank's plans for appropriate and sustainable remediation of such deficiencies, particularly those associated with the oversight of third parties that involve critical activities.
- follow existing guidance for citing deficiencies in supervisory findings and reports of examination, and recommend appropriate supervisory actions. These actions may range from citing the deficiencies in Matters Requiring Attention to recommending formal enforcement action.
- consider the findings when assigning the management component of the Federal Financial Institutions Examination Council's (FFIEC) Uniform Financial Institutions Rating System (CAMELS ratings).[12] Serious deficiencies may result in management being deemed less than satisfactory.
- reflect the associated risks in their overall assessment of the bank's risk profile.

When circumstances warrant, the OCC may use its authority to examine the functions or operations performed by a third party on the bank's behalf.

Such examinations may evaluate safety and soundness risks, the financial and operational viability of the third party to fulfill its contractual obligations, compliance with applicable laws and regulations, including consumer protection, fair lending, BSA/AML and OFAC laws, and whether the third party engages in unfair or deceptive acts or practices in violation of federal or applicable state law. The OCC will pursue appropriate corrective measures, including enforcement actions, to address violations of law and regulations or unsafe or unsound banking practices by the bank or its third party. The OCC has the authority to assess a bank a special examination or investigation fee when the OCC examines or investigates the activities of a third party for the bank.

Further Information

Please contact John Eckert, Director, Operational Risk and Core Policy, at (202) 649-7163.

John C. Lyons Jr.
Senior Deputy Comptroller and Chief National Bank Examiner

Appendix A: Risks Associated With Third-Party Relationships
Appendix B: References

APPENDIX A: Risks Associated With Third-Party Relationships

Use of third parties reduces management's direct control of activities and may introduce new or increase existing risks, specifically, operational, compliance, reputation, strategic, and credit risks and the interrelationship of these risks. Increased risk most often arises from greater complexity, ineffective risk management by the bank, and inferior performance by the third party. Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for an expanded discussion of banking risks and their definitions.

Operational Risk

Operational risk is present in all products, services, functions, delivery channels, and processes. Third-party relationships may increase a bank's exposure to operational risk because the bank may not have direct control of the activity performed by the third party.

Operational risk can increase significantly when third-party relationships result in concentrations. Concentrations may arise when a bank relies on a single third party for multiple activities, particularly when several of the activities are critical to bank operations. Additionally, geographic concentrations can arise when a bank's own operations and that of its third parties and subcontractors are located in the same region or are dependent on the same critical power and telecommunications infrastructures.

Compliance Risk

Compliance risk exists when products, services, or systems associated with third-party relationships are not properly reviewed for compliance or when the third party's operations are not consistent with laws, regulations, ethical standards, or the bank's policies and procedures. Such risks also arise when a third party implements or manages a product or service in a manner that is unfair, deceptive, or abusive to the recipient of the product or service. Compliance risk may arise when a bank licenses or uses technology from a third party that violates a third party's intellectual property rights. Compliance risk may also arise when the third party does not adequately monitor and report transactions for suspicious activities to the bank under the BSA or OFAC. The potential for serious or frequent violations or noncompliance exists when a bank's oversight program does not include appropriate audit and control features, particularly when the third party is implementing new bank activities or expanding existing ones, when activities are further subcontracted, when activities are conducted in foreign countries, or when customer and employee data is transmitted to foreign countries.

Compliance risk increases when conflicts of interest between a bank and a third party are not appropriately managed, when transactions are not adequately monitored for compliance with all necessary laws and regulations, and when a bank or its third parties have not implemented appropriate controls to protect consumer privacy and customer and bank records. Compliance failures by the third party could result in litigation or loss of business to the bank and damage to the bank's reputation.

Reputation Risk

Third-party relationships that do not meet the expectations of the bank's customers expose the bank to reputation risk. Poor service, frequent or prolonged service disruptions, significant or repetitive security lapses, inappropriate sales recommendations, and violations of consumer law and other law can result in litigation, loss of business to the bank, or negative perceptions in the marketplace. Publicity about adverse events surrounding the third parties also may increase the bank's reputation risk. In addition, many of the products and services involved in franchising arrangements expose banks to higher reputation risks. Franchising the bank's attributes often includes direct or subtle reference to the bank's name. Thus, the bank is permitting its attributes to be used in connection with the products and services of a third party. In some cases, however, it is not until something goes wrong with the third party's products, services, or client relationships, that it becomes apparent to the third party's clients that the bank is involved or plays a role in the transactions. When a bank is offering products and services actually originated by third parties as its own, the bank can be exposed to substantial financial loss and damage to its reputation if it fails to maintain adequate quality control over those products and services and adequate oversight over the third party's activities.

Strategic Risk

A bank is exposed to strategic risk if it uses third parties to conduct banking functions or offer products and services that are not compatible with the bank's strategic goals, cannot be effectively monitored and managed by the bank, or do not provide an adequate return on investment. Strategic risk exists in a bank that uses third parties in an effort to remain competitive, increase earnings, or control expense without fully performing due diligence reviews or implementing the appropriate risk management infrastructure to oversee the activity. Strategic risk also arises if management does not possess adequate expertise and experience to oversee properly the third-party relationship.

Conversely, strategic risk can arise if a bank does not use third parties when it is prudent to do so. For example, a bank may introduce strategic risk when it does not leverage third parties that possess greater expertise than the bank does internally, when the third party can more cost effectively supplement internal expertise, or when the third party is more efficient at providing a service with better risk management than the bank can provide internally.

Credit Risk

Credit risk may arise when management has exercised ineffective due diligence and oversight of third parties that market or originate certain types of loans on the bank's behalf, resulting in low-quality receivables and loans. Ineffective oversight of third parties can also result in poor account management, customer service, or collection activities. Likewise, where third parties solicit and refer customers, conduct underwriting analysis, or set up product programs on behalf of the bank, substantial credit risk may be transferred to the bank if the third party is unwilling or unable to fulfill its obligations.

Credit risk also may arise from country or sovereign exposure. To the extent that a bank engages a foreign-based third party, either directly or through subcontractors, the bank may expose itself to country risk.

APPENDIX B: References

Additional guidance about third-party relationships and risk management practices can be found in the following documents.[13]

OCC Guidance

Issuance	Date	Subject	Description/Applicability to FSAs
Comptroller's Handbook	Various	Asset Management series	Each of the booklets in the Comptroller's Handbook Asset Management series provides guidance on oversight of third-party providers. **Applies to FSAs.**
Comptroller's Handbook	September 2013	Other Real Estate Owned	Provides guidance on managing foreclosed properties, including risk management of third-party relationships. **Applies to FSAs.**
Comptroller's Handbook	April 2012	SAFE Act	Provides procedures for examining mortgage loan originator (MLO) activities for compliance with the Secure & Fair Enforcement & Licensing Act of 2008, which mandates a nationwide licensing and registration system for residential MLOs. MLOs may be employees of a bank or third-party vendors. **Applies to FSAs.**
Comptroller's Handbook	May 2011	Servicemembers Civil Relief Act of 2003 (SCRA)	Provides guidance on SCRA requirements applicable to banks and servicers, as a large number of banks outsource loan-servicing functions such as credit administration to third-party servicers.
Comptroller's Handbook	December 2010	Truth in Lending Act	Provides guidance to banks and servicers on the content and timing of disclosures; interest rate calculations; and prohibited activities.
Comptroller's Handbook	September 2010	Real Estate Settlement Procedures	Provides guidance to banks and servicers on the content and timing of pre-settlement and settlement disclosures to borrowers and on prohibited practices.
Comptroller's Handbook	January 2010	Fair Lending	Provides guidance on indicators of potential disparate treatment in loan servicing and loss mitigation; use of vendor-designed credit scorecards; and guidance on evaluating third parties.
Comptroller's Handbook	April 2003	Internal and External Audits	Provides guidelines for banks that outsource internal audit.
Comptroller's Handbook	December 2001	Merchant Processing	Provides guidance on risk management of third-party processors.

Comptroller's Handbook	February 1994	Retail Nondeposit Investment Sales	Provides guidance on risk management and board oversight of third-party vendors selling nondeposit investment products. (See OCC Bulletin 1994-13)
Alert 2012-16	December 21, 2012	Information Security: Distributed Denial of Service Attacks and Customer Account Fraud	Highlights the risks related to these attacks; raises awareness for banks to be prepared to mitigate associated risks. Preparation may include ensuring sufficient resources in conjunction with pre-contracted third-party servicers that can assist in managing the internet-based traffic flow. **Applies to FSAs.**
Alert 2001-4	April 24, 2001	Network Securities Vulnerabilities	Alerts banks to review contracts with service providers to ensure that security maintenance and reporting responsibilities are clearly described.
News Release 2013-116	July 17, 2013	OCC Statement Regarding Oversight of Debt Collection and Debt Sales	Appendix provides guidance on the due diligence and ongoing monitoring of third parties to which banks sell consumer debt. **Applies to FSAs.**
News Release 2012-93	June 21, 2012	Regulators Issue Joint Guidance to Address Mortgage Servicer Practices that Affect Servicemembers	Provides guidance to banks and mortgage servicers, including ensuring that their employees are adequately trained about the options available for homeowners with permanent change of station orders. **Applies to FSAs.**
Bulletin 2013-10	March 29, 2013	Flood Disaster Protection Act: Interagency Statement on Effective Dates of Certain Provisions of the Biggert–Waters Act and Impact on Proposed Interagency Questions and Answers	Provides guidance to lenders or their servicers regarding the contents of notifications to borrowers about flood insurance renewals, force placement to ensure continuity of coverage, use of private flood insurance policies, related insurance fees, and escrow accounts. Provides summaries of new requirements for disclosure contents and timing. **Applies to FSAs.**
Bulletin 2011-39	September 22, 2011	Fair Credit Reporting and Equal Credit Opportunity Acts —Risk-Based Pricing Notices: Final Rules	Provides guidance on notification requirements (timing, content) when adverse credit decision relies on a credit score, including those generated by third-party vendors (i.e., consumer reporting agencies). **Applies to FSAs.**
Bulletin 2011-30	July 6, 2011	Counterparty Credit Risk Management: Interagency Supervisory Guidance	Addresses some of the weaknesses highlighted by the recent financial crisis and reinforces sound governance of counterparty credit risk (CCR) management practices through prudent board and senior management oversight and an effective CCR management framework. **Applies to FSAs with the issuance of this bulletin.**
Bulletin 2011-29	June 30, 2011	Foreclosure Management: Supervisory Guidance	Discusses third-party vendor management and reaffirms expectations that management should properly structure, carefully conduct, and prudently manage relationships with third-party vendors, including outside law firms assisting in the foreclosure process. **Applies to FSAs.**
Bulletin 2011-27	June 28, 2011	Prepaid Access Programs: Risk Management Guidance and Sound Practices	Highlights the risks and provides risk management guidance concerning prepaid access programs. **Applies to FSAs.**
Bulletin 2011-26	June 28, 2011	Authentication in an Internet Banking Environment: Supplement	Reinforces the guidance's risk management framework and updates expectations regarding banks' authentications systems and practices whether they are provided internally or by a technology service provider. **Applies to FSAs.**
Bulletin 2011-12	April 4, 2011	Sound Practices for Model Risk Management: Supervisory Guidance	Includes guidance on the use of third-party models. **Applies to FSAs.**
Bulletin 2011-11	March 29, 2011	Risk Management Elements: Collective Investment Funds and Outsourcing Arrangements	Expands upon long-standing guidance on sound risk management and beneficiary/participant protections for bank-offered collective investment funds (CIF). The focus is on supervisory concerns that arise if a bank delegates responsibility for a bank CIF to a third-party service provider, such as a registered investment adviser. **Applies to FSAs with the issuance of this bulletin.**
Bulletin 2010-42	December 10, 2010	Sound Practices for Appraisals and Evaluations: Interagency	Provides guidance regarding a bank's responsibility for selecting appraisers and people performing evaluations based on their

		Appraisal and Evaluation Guidelines	competence, experience, and knowledge of the market and type of property being valued. **Applies to FSAs.**
Bulletin 2010-30	August 16, 2010	Reverse Mortgages: Interagency Guidance	Provides guidance on managing the compliance and reputation risks when making, purchasing, or servicing reverse mortgages through a third party, such as a mortgage broker or correspondent. **Applies to FSAs.**
Bulletin 2010-7	February 18, 2010	Tax Refund Anticipation Loans: Guidance on Consumer Protection and Safety and Soundness	Provides guidance to enhance, clarify, and increase awareness regarding the measures the OCC expects to see in place for tax refund-related products offered by banks, including issues related to reliance on third-party tax return preparers who interact with consumers.
Bulletin 2010-1	January 8, 2010	Interest Rate Risk: Interagency Advisory on Interest Rate Risk Management	Includes guidance on selection, control frameworks, and validation of third-party asset liability management models. **Applies to FSAs.**
Bulletin 2009-15	May 22, 2009	Investment Securities: Risk Management and Lessons Learned	Provides guidance for banks that use the services of third parties who compile and provide investment analytics for bank management.
Bulletin 2008-12	April 24, 2008	Payment Processors: Risk Management Guidance	Provides guidance to banks regarding relationships with third-party processors and requirements for effective due diligence, underwriting, and monitoring. **Applies to FSAs with the issuance of this bulletin.**
Bulletin 2008-5	March 6, 2008	Conflicts of Interest: Risk Management Guidance—Divestiture of Certain Asset Management Businesses	Provides guidance for banks that contemplate divestiture of affiliated funds and associated advisers, whether directly, or through their broader corporate organizations.
Bulletin 2008-4	February 2, 2008	Flood Disaster Protection Act: Flood Hazard Determination Practices	Provides guidance to banks that outsource flood hazard determinations to third-party servicers to ensure that appropriate information is used when performing flood determinations and that revision dates be included in the determination form. **Applies to FSAs with the issuance of this bulletin.**
Bulletin 2006-47	December 13, 2006	Allowance for Loan and Lease Losses (ALLL): Guidance and Frequently Asked Questions (FAQs) on the ALLL	Includes guidance for when some or the entire loan review function and the validation of the ALLL methodology is outsourced to a qualified external party, and identifies the minimum objectives of a loan review program. **Applies to FSAs.**
Bulletin 2006-39	September 1, 2006	Automated Clearing House Activities: Risk Management Guidance	Provides guidance for banks and examiners on managing the risks of automated clearing house (ACH) activity, which can include new and evolving types of ACH transactions as well as new participants in the ACH network, including certain merchants and third parties known as third-party senders. **Applies to FSAs with the issuance of this bulletin.**
Bulletin 2005-35	October 12, 2005	Authentication in an Internet Banking Environment: Interagency Guidance	Highlights requirements for banks to use this guidance when evaluating and implementing authentication systems and practices whether they are provided internally or by a technology service provider. **Applies to FSAs.**
Bulletin 2005-27	August 4, 2005	Real Estate Settlement Procedures Act (RESPA): Sham Controlled Business Arrangements	Provides guidance on determining if a RESPA settlement service provider (often a third-party servicer or vendor) is a "controlled business arrangement" and therefore entitled to certain exemptions. **Applies to FSAs with the issuance of this bulletin.**
Bulletin 2005-22	May 16, 2005	Home Equity Lending: Credit Risk Management Guidance	Sets forth regulatory expectations for enhanced risk management practices, including management of third-party originations. **Applies to FSAs.**
Bulletin 2005-13	April 14, 2005	Response Programs for Unauthorized Access to Customer Information and Customer Notice: Final Guidance: Interagency Guidance	Provides guidance on banks implementing a response program to address unauthorized access to customer information maintained by the institution or its service providers. **Applies to FSAs.**

Bulletin 2005-1	January 12, 2005	Proper Disposal of Consumer Information: Final Rule	Sets standards for information security. Requires agreements with service providers on disposal. Describes duties of users of consumer reports regarding identity theft. **Applies to FSAs with the issuance of this bulletin.**
Bulletin 2004-47	October 27, 2004	FFIEC Guidance: Risk Management for the Use of Free and Open Source Software (FOSS)	Provides guidance for institutions considering using or deploying FOSS regardless of whether it will be provided internally or by a third-party service provider. **Applies to FSAs.**
Bulletin 2004-20	May 10, 2004	Risk Management of New, Expanded, or Modified Bank Products and Services: Risk Management Process	Reminds banks of the risk management process they should follow to prudently manage the risks associated with new, expanded, or modified bank products and services, including those provided by third parties.
Bulletin 2003-15	April 23, 2003	Weblinking: Interagency Guidance on Weblinking Activity	Provides guidance to institutions that develop and maintain their own Web sites, as well as institutions that use third-party service providers for this function. **Applies to FSAs.**
Bulletin 2003-12	March 17, 2003	Interagency Policy Statement on Internal Audit and Internal Audit Outsourcing: Revised Guidance on Internal Audit and Its Outsourcing	Reflects developments within the financial, audit, and regulatory industries, particularly the Sarbanes–Oxley Act of 2002 that established numerous independence parameters for audit firms that provide external audit, outsourced internal audit, and other non-audit services for financial institutions. **Applies to FSAs.**
Bulletin 2002-16	May 15, 2002	Bank Use of Foreign-Based Third-Party Service Providers: Risk Management Guidance	Provides guidance on managing the risks that may arise from outsourcing relationships with foreign-based third-party service providers, and addresses the need for banks to establish relationships with foreign-based third-party service providers in a way that does not diminish the ability of the OCC to timely access data or information needed for supervisory activities. **Applies to FSAs with the issuance of this bulletin.**
Bulletin 2002-03	January 15, 2002	Real Estate Settlement Procedures Act: Examiner Guidance—Mark-ups of Settlement Service Fees	Provides guidance on determining if a RESPA settlement service provider (often a third-party servicer or vendor) is charging more for a settlement service provided by a third party than is actually paid to the third party and the third party is not involved in the mark-up, which is prohibited by RESPA Section 8(b) (implemented by Regulation X) in most but not all states. **Applies to FSAs with the issuance of this bulletin.**
Bulletin 2001-51	December 12, 2001	Privacy of Consumer Financial Information: Small Bank Compliance Guide	Includes guidance for banks to evaluate agreements with nonaffiliated third parties that involve the disclosure of consumer information. **Applies to FSAs.**
Bulletin 2001-12	February 28, 2001	Bank-Provided Account Aggregation Services: Guidance to Banks	Includes guidance for banks that offer aggregation services through third-party service providers.
Bulletin 2001-8	February 15, 2001	Guidelines Establishing Standards for Safeguarding Customer Information: Final Guidelines	Alerts banks that oversight program of service providers should include confirmation that the providers have implemented appropriate measures designed to meet the objectives of the guidelines. **Applies to FSAs with the issuance of this bulletin.**
Bulletin 2000-25	September 8, 2000	Privacy Laws and Regulations: Summary of Requirements	Includes guidance for banks to evaluate agreements with third parties that involve the disclosure of consumer information. **Applies to FSAs with the issuance of this bulletin.**
Bulletin 2000-14	May 15, 2000	Infrastructure Threats—Intrusion Risks: Message to Bankers and Examiners	Provides guidance on how to prevent, detect, and respond to intrusions into bank computer systems, including outsourced systems.
Bulletin 1999-14	March 29, 1999	Real Estate Settlement Procedures Act: Statement of Policy—Lender Payments to Mortgage Brokers	Provides guidance on services normally performed in loan origination, including those often performed by a third-party servicer or vendor. **Applies to FSAs with the issuance of this bulletin.**
Bulletin 1998-3	March 17, 1998	Technology Risk Management: Guidance for Bankers and Examiners	Includes a short description of a bank's responsibility with regard to outsourcing its technology products and services. **Applies to FSAs with the issuance of this bulletin.**
Bulletin 1996-48	September 3,	Stored Value Card Systems:	Provides basic information to assist banks in identifying and

	1996	Information for Bankers and Examiners	managing risks involved in stored value systems. **Applies to FSAs with the issuance of this bulletin.**
Advisory Letter 2004-6	May 6, 2004	Payroll Card Systems	Advises banks engaged in payroll cards systems involving nonbank third parties to fully comply with OCC guidance on third-party relationships.
Advisory Letter 2002-3	March 22, 2002	Guidance on Unfair or Deceptive Acts or Practices	Describes legal standards and provides guidance on unfair or deceptive acts and practices. Cross references other OCC guidance on: selecting a third-party vendor; monitoring vendor performance; maintaining proper documentation about vendor management; review of contractual arrangements; compensation concerns; monitoring consumer complaints; payment procedures; and loan collection activities.
Advisory Letter 2000-11	November 27, 2000	Title Loan Programs	Alerts banks to OCC concerns over title loan programs, including the involvement of third-party vendors.
Advisory Letter 2000-10	November 27, 2000	Payday Lending	Alerts banks to OCC concerns over payday lending programs, including the involvement of third-party vendors. **Applies to FSAs.**
Banking Circular 181	August 2, 1984	Purchases of Loans in Whole or in Part-Participations	Describes prudent purchases of loans from and loan participations with third parties. **Applies to FSAs with the issuance of this bulletin.**

FFIEC Handbooks

Issuance	Date	Subject	Description
FFIEC Bank Secrecy Act/ Anti-Money Laundering Examination Manual	April 29, 2010	Bank Secrecy Act and Anti-Money Laundering	Provides guidance on identifying and controlling risks associated with money laundering and terrorist financing, including third-party payment processors and professional service providers.
FFIEC Information Technology Examination Handbook	Various	"Outsourcing Technology Services" and "Supervision of Technology Service Providers"	Provides guidance on managing risks associated with the outsourcing of IT services. Several other booklets of the FFIEC IT Examination Handbook also provide guidance addressing third-party relationships.

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[1] Third-party relationships include activities that involve outsourced products and services, use of independent consultants, networking arrangements, merchant payment processing services, services provided by affiliates and subsidiaries, joint ventures, and other business arrangements where the bank has an ongoing relationship or may have responsibility for the associated records. Affiliate relationships are also subject to sections 23A and 23B of the Federal Reserve Act (12 USC 371c and 12 USC 371c-1) as implemented in Regulation W (12 CFR 223). Third-party relationships generally do not include customer relationships.

[2] An OCC-supervised bank that provides services to another OCC-supervised bank is held to the same standards of due diligence, controls, and oversight as is a non-bank entity.

[3] For example, in franchising arrangements, the bank lends its name or regulated entity status to activities originated or predominantly conducted by others. Thus, the bank is permitting its attributes to be used in connection with the products and services of a third party. The risks to the bank from these franchising arrangements vary based on the terms of the agreement between the bank and the third party and the nature of the services offered. When a bank is offering products and services originated by third parties as its own, the bank can be exposed to substantial financial loss and damage to its reputation if it fails to maintain adequate quality control over those products and services and adequate oversight over the third-party activities. Risk may also increase when the third party relies on the bank's regulated entity status and offers services or products through the bank with fees, interest rates, or other terms that cannot be offered by the third party directly.

[4] Refer to appendix A for a discussion of risks associated with third-party relationships.

[5] Except for nondisclosure agreements that may be required in order for the bank to conduct due diligence.

[6] Dual employees are employed by both the bank and the third party.

[7] If the bank enters into a written arrangement under which a broker registered under the securities laws offers brokerage services on or off the premises of the bank, the bank should ensure that the arrangement qualifies for the exception in the Securities and Exchange Act of 1934, 15 USC 78c(a)(4)(B)(i), and Regulation R, 12 CFR 218.700-701 and 17 CFR 247.700-701, for third-party brokerage arrangements. Otherwise, the bank may be required to register as a securities broker under the federal securities laws. The bank also should ensure compliance with regulatory requirements if bank employees receive fees for referrals to the third-party broker.

[8] Before conducting an examination of a third party that is a functionally regulated affiliate (FRA), the OCC is required to give notice to and consult with the FRA's primary regulator and, to the fullest extent possible, avoid duplication of examination activities, reporting requirements, and requests for information. See 12 USC 1831v.

[9] When a third-party relationship involves critical activities, a bank may need to consider appointing a senior officer to provide oversight of that relationship.

[10] Under 12 USC 1867(c)(2), national banks are required to notify the OCC of the existence of a servicing relationship. FSAs are subject to similar requirements set forth in 12 USC 1464(d)(7)(D)(ii) and 12 USC 1867(c)(2). The OCC implements this notification requirement by requiring banks to maintain a current inventory of all third-party relationships and make it available to examiners upon request.

[11] In addition to the functional business units, this may include information technology, identity and access management, physical security, information security, business continuity, compliance, legal, risk management, and human resources.

[12] The CAMELS rating is an overall assessment of a bank based on six individual ratings; the word CAMELS is an acronym for these individual elements of regulatory assessment (capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk).

[13] All guidance applies to national banks. Guidance not currently applicable to FSAs (as noted in this appendix) is undergoing review through the OCC's policy integration efforts.

EXHIBIT 30

No. 14-953-TNM

FDIC
Federal Deposit Insurance Corporation
[redacted] [redacted] Field Office

November 20, 2014

TO: BSA Workpaper File
[redacted]

FROM: [redacted]
Bank Secrecy Act Specialist

SUBJECT: [redacted]/14 BSA Exam Overview

CONTACTS: [redacted]

Redacted

Attorneys Eyes Only -- Outside Counsel

Redacted

Recommendations

The following recommendations were discussed with management throughout the Exam as well as at the BSA Exit meeting held on [redacted]. It should be noted that several of these areas for improvement have already been identified by Management and/or independent testing but are contained below in order to underline their importance:

Redacted

- Continue to scrub legacy [redacted] customer base for previously unidentified high risk relationships including payday lenders, casinos, pawn brokers, and Privately Owned ATM's. Add such relationships to the high risk list and perform EDD in a timely manner.

Redacted

Redacted

Redacted

EXHIBIT 31

No. 14-953-TNM

[redacted]

[redacted]

[redacted]

[redacted]

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Attorneys Eyes Only

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Attorneys Eyes Only

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[redacted]

Emerging Issues

Bank Payday Lending (Deposit Advance Lending)

- On November 21, 2013, the FDIC and the OCC issued separate but similar final guidances' on deposit advance products (bank payday). The guidances' are intended to ensure that FDIC-supervised and national banks that offer or may consider offering the product are aware of the variety of credit, reputation, operational, compliance and other risks posed by deposit advance loans, and they have taken appropriate steps to mitigate the risks. The FDIC's guidance describes supervisory expectations for banks, including appropriate underwriting policies and practices, and supplements the FDIC's existing guidance on payday loans and subprime lending.
- According to media reports in January 2014, each of the banks known to have previously offered deposit advance loans made the business decision not to continue extending this type of credit under the parameters set forth in the Guidance.
- Bank deposit advance loans share many characteristics with traditional storefront payday loans, including: high fees; very short, lump-sum repayment periods; and inadequate attention to the consumer's ability to repay, a fundamental tenet of prudent lending.

- The FDIC recognizes the need for responsible small-dollar credit products. The FDIC's 2007 *Affordable Small-Dollar Loan Guidelines* encourage insured institutions to offer small-dollar loan products that have affordable, reasonable interest rates with no or low fees and payments that reduce the principal balance of the loan. The FDIC encourages banks to develop new or innovative programs to effectively meet the need for small-dollar credit that do not exhibit the risks associated with deposit advance products and payday loans.

- Examinations will focus on potential safety and soundness issues and compliance with applicable consumer protection statutes. The FDIC will take appropriate supervisory action to address any unsafe or unsound banking practices associated with these products, to prevent harm to consumers, and to ensure compliance with all applicable laws.

- The CFPB's research on payday and deposit advance products (April 24, 2013) raises serious concerns with these products. On April 24, 2013, the Federal Reserve Board issued a policy statement to emphasize to state member banks the significant consumer risks associated with deposit advance products.

<u>Third Party Payment Processor and Merchants That Engage in Higher-Risk Activities</u>

- There continue to be concerns regarding the role of banks in facilitating potentially illegal or fraudulent transactions for merchant customers engaged in higher-risk. Facilitating Automated Clearing House (ACH) and other transactions for third-party payment processors (TPPPs) and merchant customers engaged in higher-risk activities may pose risks to financial institutions. Such relationships require a greater degree of due diligence and monitoring, as detailed in prior FDIC and interagency guidance.
- On September 27, 2013, the FDIC issued a FIL clarifying that supervised financial institutions that properly manage these relationships and effectively mitigate the risks are neither prohibited nor discouraged from providing electronic payment processing services to customers operating in compliance with applicable laws. The 2013 guidance reaffirms guidance released last year: *Payment Processor Relationships, Revised Guidance* (FIL-3-2012) Financial institutions that provide payment processing services for merchants directly or indirectly engaged in higher-risk activities are expected to do proper risk assessments, conduct due diligence sufficient to ascertain that the merchants are operating in accordance with applicable law, and maintain appropriate systems to monitor these relationships over time.
- As stated in prior guidance, the proper management of relationships with merchant customers engaged in higher-risk activities is essential because financial institutions may be held responsible for facilitating illegal, fraudulent, or improper activity.
- The FDIC remains concerned that some payment processors or merchants may target institutions that are unaware of these risks or do not have the proper due diligence or controls in place to manage them.

- Higher-risk activities are those that tend to display a higher incidence of consumer fraud or potentially illegal activities than some other businesses. Higher-risk activities are typically characterized by:
  - High rates of return
  - High rates of unauthorized transactions
  - High rates of consumer complaints
  - Evidence of state or federal regulatory or criminal actions against the business customer

The presence of one or more of these factors indicates that the financial institution should review the activity to determine whether fraudulent or illegal activity is occurring.

- *The focus of FDIC examinations is on ensuring that financial institutions are adequately overseeing transactions and activities they process and appropriately managing and mitigating related risks.*

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

EXHIBIT 32

No. 14-953-TNM

Message

From: Hancock, Gary D. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=GHANCOCK]
Sent: 5/21/2014 3:15:46 PM
To: Pearce, Mark (DCP) [MaPearce@FDIC.gov]
Subject: RE: Are Bank's Payday Lenders?

Perfect . Hopefully it won't be long until our payday lenders are required to play fair as well.

From: Pearce, Mark (DCP)
Sent: Wednesday, May 21, 2014 3:07 PM
To: Hancock, Gary D.
Subject: RE: Are Bank's Payday Lenders?

Thanks. The "deposit advance" product mentioned is the one we issued guidance on last November. Banks offering this product have announced they will stop offering that product.

m.

Sent with Good (www.good.com)

-----Original Message-----
From: Hancock, Gary D.
Sent: Wednesday, May 21, 2014 03:03 PM Eastern Standard Time
To: Pearce, Mark (DCP)
Subject: Are Bank's Payday Lenders?

Mark,

Here is the article I told you about. Great local investigative reporting and he even quotes the Center for Responsible Lending at the end. It's a tad dated, but not a lot has materially changed.

Take care,
Gary

EXHIBIT 33

No. 14-953-TNM

FDIC

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Finan[redacted] Institution Letter
FIL-41-2014
July 28, 201[redacted]

FDIC Clarifying Supervisory Approach to Institutions Establishing Account Relationships with Third-Party Payment Processors

Summary: The FDIC is clarifying its supervisory approach to institutions establishing account relationships with third-party payment processors (TPPPs). As part of its regular safety and soundness examination activities, the FDIC reviews and assesses the extent to which institutions having account relationships with TPPPs follow the outstanding guidance. FDIC guidance and an informational article contained lists of examples of merchant categories that had been associated by the payments industry with higher-risk activity when the guidance and article were released. The lists of examples of merchant categories have led to misunderstandings regarding the FDIC's supervisory approach to TPPPs, creating the misperception that the listed examples of merchant categories were prohibited or discouraged. In fact, it is FDIC's policy that insured institutions that properly manage customer relationships are neither prohibited nor discouraged from providing services to any customer operating in compliance with applicable law. Accordingly, the FDIC is clarifying its guidance to reinforce this approach, and as part of this clarification, the FDIC is removing the lists of examples of merchant categories from its official guidance and informational article.

Statement of Applicability to Institutions Under $1 Billion in Total Assets: This Financial Institution Letter applies to all FDIC-supervised institutions, including community banks, although its application is commensurate with size and risk.

Distribution:
FDIC-Supervised Banks (Commercial and Savings)

Suggested Routing:
Board of Directors, Chief Executive Officer, Senior Executive Officers, Chief Loan Officer, Chief Information Technology Officer, Bank Secrecy Act Officer

Related Topics:
- FIL-127-2008, "Guidance on Payment Processor Relationships," http://www.fdic.gov/news/news/financial/2008/fil08127.html
- FIL-3-2012, "Payment Processor Relationships, Revised Guidance," http://www.fdic.gov/news/news/financial/2012/fil12003.html
- FIL-43-2013, "FDIC Supervisory Approach to Payment Processing Relationships with Merchant Customers That Engage in Higher-Risk Activities," http://www.fdic.gov/news/news/financial/2013/fil13043.html.
- "Managing Risks in Third-Party Payment Processor Relationships," *FDIC Supervisory Insights,* Summer 2011, http://www.fdic.gov/regulations/examinations/supervisory/insights/sisum11/managing.html
- *The FFIEC Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination Manual*, http://www.ffiec.gov/bsa_aml_infobase/pages_manual/OLM_063.htm

Attachment:
FDIC Clarifying Official Guidance and Other Information Related to Third-Party Payment Processors

Contact:
Michael B. Benardo, Chief, Cyber-Fraud and Financial Crimes Section, (703) 254-0450 or MBenardo@FDIC.gov

Note:
FDIC Financial Institution Letters (FILs) may be accessed from the FDIC's Web site at www.fdic.gov/news/news/financial/2014/index.html.

To receive FILs electronically, please visit http://www.fdic.gov/about/subscriptions/fil.html.

Paper copies may be obtained through the FDIC's Public Information Center, 3501 Fairfax Drive, E-1002, Arlington, VA 22226 (877-275-3342 or 703-562-2200).

Highlights:

- The focus of the FDIC's supervisory approach to institutions establishing account relationships with TPPPs is to ensure institutions have adequate procedures for conducting due diligence, underwriting, and ongoing monitoring of these relationships. When an institution is following the outstanding guidance, it will not be criticized for establishing and maintaining relationships with TPPPs.
- The FDIC encourages insured depository institutions to serve their communities and recognizes the importance of services they provide. It is the FDIC's policy that insured institutions that properly manage customer relationships are neither prohibited nor discouraged from providing services to any customer operating in compliance with applicable law.
- The FDIC is reissuing guidance (FIL-127-2008, Guidance on Payment Processor Relationships; FIL-3-2012, Payment Processor Relationships, Revised Guidance; and FIL-43-2013, FDIC Supervisory Approach to Payment Processing Relationships With Merchant Customers That Engage in Higher-Risk Activities) and an informational article, "Managing Risks in Third-Party Payment Processor Relationships," Summer 2011, *Supervisory Insights,* to remove lists of examples of merchant categories.

FDIC Clarifying Supervisory Approach to Institutions Establishing Account Relationships with Third-Party Payment Processors

The FDIC is clarifying its supervisory approach to institutions establishing account relationships with third-party payment processors (TPPPs). FDIC guidance indicates that insured institutions that engage in customer relationships with TPPPs should assess their risk tolerance for this type of activity and develop an appropriate risk management framework, which includes policies and procedures that address due diligence, underwriting, and ongoing monitoring.

FDIC guidance[1] and an informational article that appeared in the Summer 2011 issue of the FDIC's *Supervisory Insights*[2] describe potential risks associated with relationships with TPPPs facilitating payment transactions for merchant clients. The original documents contained lists of examples of telemarketing or Internet merchant categories that had been associated by the payments industry with higher-risk activity. These examples of merchant categories included activities that could be subject to complex or varying legal and regulatory environments, such as those that may be legal only in certain states; those that may be prohibited for certain consumers, such as minors; those that may be subject to varying state and federal licensing and reporting regimes; and those that may result in higher levels of complaints, returns, or chargebacks.

The lists of examples of merchant categories in the FDIC's guidance and the article were intended to be illustrative of trends identified by the payments industry at the time the guidance and article were released. Further, the lists of examples of merchant categories were considered to be incidental to the primary purpose of the guidance, which was to describe the risks associated with financial institutions' relationships with TPPPs, and to provide guidance to insured institutions on appropriate risk management for relationships with TPPPs. Nevertheless, the lists of examples of merchant categories have led to misunderstandings regarding the FDIC's supervisory approach to institutions' relationships with TPPPs, resulting in the misperception that the listed examples of merchant categories were prohibited or discouraged. The FDIC encourages insured depository institutions to serve their communities and recognizes the importance of services they provide. In fact, it is the FDIC's policy that insured institutions that properly manage customer relationships are neither prohibited nor discouraged from providing services to customers operating in compliance with applicable federal and state law. Accordingly, as part of clarifying our guidance, the FDIC is removing the lists of examples of merchant categories from outstanding guidance and the article.

As part of its regular safety and soundness examination activities, the FDIC reviews and assesses the extent to which an institution having account relationships with TPPPs follows the outstanding guidance. Where an institution is following the outstanding guidance, the institution will not be criticized for establishing and maintaining account relationships with TPPPs.

---

[1] FIL-127-2008, "Guidance on Payment Processor Relationships," http://www.fdic.gov/news/news/financial/2008/fil08127 html; FIL-3-2012, "Payment Processor Relationships, Revised Guidance," http://www.fdic.gov/news/news/financial/2012/fil12003.html; and FIL-43-2013, "FDIC Supervisory Approach to Payment Processing Relationships with Merchant Customers That Engage in Higher-Risk Activities," http://www fdic.gov/news/news/financial/2013/fil13043.html.

[2] "Managing Risks in Third-Party Payment Processor Relationships," *FDIC Supervisory Insights,* Summer 2011. *Supervisory Insights* contains timely and informative articles about risk management issues for bankers, but it is not official FDIC guidance. *Supervisory Insights* specifically states, "The views expressed in *Supervisory Insights* are those of the authors and do not necessarily reflect official positions of the Federal Deposit Insurance Corporation. In particular, articles should not be construed as definitive regulatory or supervisory guidance."

Any concerns with the FDIC's application of this policy should be shared with the appropriate Regional Director, the Director of the Division of Risk Management Supervision at DirectorRMS@FDIC.gov, or the FDIC's Office of the Ombudsman at Ombudsman@FDIC.gov.

The revised 2008, 2012, and 2013 guidance and 2011 informational article can be found at these links:

FIL 127-2008, "Guidance on Payment Processor Relationships," http://www.fdic.gov/news/news/financial/2008/fil08127.html.

FIL-3-2012, "Payment Processor Relationships, Revised Guidance," http://www.fdic.gov/news/news/financial/2012/fil12003.html

FIL-43-2013, "FDIC Supervisory Approach to Payment Processing Relationships with Merchant Customers That Engage in Higher-Risk Activities," http://www.fdic.gov/news/news/financial/2013/fil13043.html

FDIC Supervisory Insights, Summer 2011, "Managing Risks in Third-Party Payment Processor Relationships," http://www.fdic.gov/regulations/examinations/supervisory/insights/sisum11/managing.html

EXHIBIT 34

No. 14-953-TNM

Alderson®

COURT REPORTING

Transcript of **Doreen R. Eberley 30(b)(6)**

Friday, May 18, 2018

Advance America, et al. v. Federal Deposit Insurance Corporation, et al.

Alderson Court Reporting
1-800-FOR-DEPO (367-9976)
Info@AldersonReporting.com
www.AldersonReporting.com

Alderson Reference Number: 78206

Q Okay.
A So that's what the examiner is going to be doing.
Q Okay. So --
A So if the bank has said that a relationship is low risk or not high risk, and in fact the transaction activity is not consistent with that and the bank is not doing sufficient monitoring because they haven't flagged that account as one that requires a certain level of monitoring or enhanced monitoring, the bank may not be fulfilling its obligations and may be violating the Bank Secrecy Act. It may be not reporting suspicious activity that is occurring.
Q So what are the FDIC's potential responses if it makes that sort of determination in a bank examination?
A If a bank is not carrying out its Bank Secrecy Act obligations, it could be a violation of the Bank Secrecy Act rule. Our Part 326 is the Bank Secrecy Act rule. There could be violations for not filing suspicious activity reports if the examiners

observe suspicious activity in the bank's monitoring logs and records. If the bank doesn't have a good system for monitoring, there could be a general program failure violation.

Q Okay. Now, the revised guidance in Exhibit 5 does not have this footnote 1 that we discussed; is that correct?

A That's correct.

Q From the FDIC's perspective, did the removal of that footnote effect any substantive change to FDIC policy?

A No.

[redacted]

[redacted]

Q So under this guidance, is it accurate to say that the FDIC expects banks facilitating payment processing for merchant customers engaged in payday lending to engage in heightened due diligence and monitoring?

A Yes.

Q What would happen if a bank refused to

EXHIBIT 35

No. 14-953-TNM

[redacted]

From: Miller, Jonathan N. [JonMiller@FDIC.gov]
Sent: 4/8/2011 7:27:32 PM
To: Pearce, Mark (DCP) [MaPearce@FDIC.gov]; Brown, Luke H. [LuBrown@FDIC.gov]
CC: Ernst, Keith S. [KErnst@FDIC.gov]
Subject: RE: Payday lenders

This makes me mad. I don't suppose we can do anything about it?

We should show it to banks to prove the reputat'l risk argmnt.

From: Pearce, Mark (DCP)
Sent: Friday, April 08, 2011 10:05 AM
To: Miller, Jonathan N.; Brown, Luke H.
Subject: Payday lenders

Take a look at this:
http://cfsaa.com/about-cfsa/membership.aspx

[redacted]

[redacted]

EXHIBIT 36

No. 14-953-TNM

[redacted]

[redacted] [redacted]
[redacted] [redacted]
[redacted] [redacted]
[redacted] [redacted]
[redacted] [redacted]

[redacted]

[redacted]

From: Brown, Luke H.
Sent: Friday, June 10, 2011 5:45 PM
To: Miller, Jonathan N.; Pearce, Mark (DCP)
Cc: Plunkett, Sylvia H.; Gimble, Glenn S.
Subject: RE: Notice Received from [redacted]

We're doing more leg work on this. The issue came up a few years ago. We had two or three FDIC institutions that had deposit accounts with payday lenders and they somehow helped facilitate the transfer of funds between the payday lenders and their customers but I believe there was no direct relationship between the bank and the customer. At the time, the Chairman was unhappy about this arrangement but I don't remember what we did about it. We'll follow up with more info.

[redacted]

From: Miller, Jonathan N.
Sent: Friday, June 10, 2011 5:26 PM
To: Brown, Luke H.; Pearce, Mark (DCP)
Cc: Plunkett, Sylvia H.; Gimble, Glenn S.
Subject: Re: Notice Received from [redacted]

The issue is having a deposit rel'shp. Does the info glenn found address that?

From: Brown, Luke H.
Sent: Friday, June 10, 2011 05:23 PM
To: Pearce, Mark (DCP); Miller, Jonathan N.
Cc: Plunkett, Sylvia H.; Gimble, Glenn S.
Subject: RE: Notice Received from [redacted]

All:

Apparently, because of legal considerations, the FDIC has never expressly stated publically that our supervised institutions are not permitted to do business with payday lenders but the payday lending guidance and our public posture makes clear that we view payday loans as extremely risky.

See the information below developed by Glenn Gimble.

In our 2005 press release announcing the payday lending guidance, we state "[t]he FDIC believes that providing high-cost, short-term credit on a recurring basis to customers with long-term credit needs is **not responsible lending**, and increases banks' credit, legal, reputational and compliance risks. If institutions engaged in payday lending activities fail to limit their risk exposure, operate in a safe and sound manner, or comply with all applicable laws, the FDIC may take a range of actions, including formal and informal enforcement actions, which may require institutions to discontinue payday lending."

The 2005 FIL clearly notes numerous risks associated with payday lending that will be highly scrutinized by the FDIC. Specifically, the guidance notes:

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]
From: Pearce, Mark (DCP)
Sent: Friday, June 10, 2011 1:07 PM
To: Miller, Jonathan N.; Brown, Luke H.
Cc: Plunkett, Sylvia H.
Subject: RE: Notice Received from [redacted]

This may be the result of a specific supervisory strategy with this bank. Sylvia?

I'm not aware of policy on this, but would like to know our approach.

[redacted]

[redacted]
From: Miller, Jonathan N.
Sent: Friday, June 10, 2011 12:59 PM Eastern Standard Time
To: Brown, Luke H.; Pearce, Mark (DCP)
Subject: FW: Notice Received from [redacted]

Do we have a policy on this?

[redacted]
From: Nash, Paul
Sent: Friday, June 10, 2011 12:13 PM Eastern Standard Time
To: Miller, Jonathan N.
Cc: Pearce, Mark (DCP)
Subject: FW: Notice Received from [redacted]

Is there a policy to disassociate banks from customer relationships with payday lenders? I know that the business relationship is considered, but I'm being told that banks are being pressured to not serve them as customers.

EXHIBIT 37

No. 14-953-TNM

Message

From: Banfield, Julie V. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=JBANFIELD]
Sent: 10/12/2015 10:03:42 AM
To: Elmquist, Kristie K. [KElmquist@FDIC.gov]
Subject: Comment on banker invitees

Thinking e-mail is working now?

[redacted] from the [redacted] - I have not interacted with him in a couple of years, but he is very neagtive about compliance, and not in a constructive manner. I suggest going another route or if you like I am happy to check with [redacted] to see how things have been lately.

[redacted] is on the alternate list so just a few reminders on it - Redacted Redacted Also they had a big loan to a payday lender that I believe funded its lending operations. It was classified by RMS, and DCP had criticisms related to our payday guidance. What ultimately happened is they moved the loan to the holding company level.

EXHIBIT 38

No. 14-953-TNM

Alderson®

COURT REPORTING

Transcript of **Thomas J. Dujenski**

Wednesday, May 2, 2018

Advance America, et al. v. Federal Deposit Insurance Corporation, et al.

Alderson Court Reporting
1-800-FOR-DEPO (367-9976)
Info@AldersonReporting.com
www.AldersonReporting.com

Alderson Reference Number: 78046

Q. Yeah. What was the practical -- I may not say it exactly -- but as a practical matter for a bank, what were the consequences of it being involved in an activity the FDIC deemed high risk?

A. Well, if the activity was high risk, the examiners would want to make sure that those activities were being monitored and controlled so they could expect that the examiners would look at those areas during examinations to make sure that they're following the guidance, minimizing the risk to the -- to the Deposit Insurance Fund, and that they were following the policies and procedures that were there.

Q. And monitoring and controlling those activities would be things that would impose costs on the bank, correct?

A. I would expect that to be the case, yes. If you're going to engage in making certain loans, you've got to make sure you have loan officers. So if you're going to engage in some activity, you've got to make sure you have the expertise and people hired to do that. You have to make sure, as part of procedures. And if the bank refused to put in proper policies and procedures and controls, then we would consider an enforcement action to address those issues. We have a -- we do our job to address the risks --

Q. Right.

A. -- associated with that to make sure it's properly controlled and monitored.

Q. Okay. What form could an enforcement action take?

A. It could take several forms. It could be in the form of a board -- an informal action or a formal action.

Q. Okay. And what's the distinction between an informal and formal action?

A. Informal actions, for example, are like memorandums of understanding and board resolutions. Things where we reach agreement with the bank. It's my understanding that they're not, quote, technically enforceable.

Whereas, a formal enforcement action is a formal agreement, and it is enforceable.

[redacted]

Q. Okay. I guess my question is: What was your understanding of what Washington expected to be reported? Would it be all banks that were engaged in payday lending regardless of the legality?

A. I would say yes.

Q. Okay. How about banks providing ACH network access to payday lenders, was that something that you understood needed to be reported as well?

A. I would just have reported anything with payday and then would have looked at whatever the risks were that were associated -- you know, I --

I -- I would have reported up any bank that had payday lending relationships. That would have been my understanding.

Q. Okay. Okay. If we flip back to page -- well, just one more question on that.

Who -- who in Washington requested that information?

A. I don't recall, but I would assume it was my bosses that would have requested that.

[redacted]

[redacted]

Q. Okay. Mr. Dujenski, just to follow up on one item we discussed, you said you were aware of two banks that had relationships with payday lenders during your time as regional director.

Did both of those banks terminate those relationships while you were regional director?

A. Yes.

[redacted]

EXHIBIT 39

No. 14-953-TNM

From: Benardo, Michael B.
Sent: Wednesday, November 07, 2012 10:17 AM
To: Michael.Bresnick@usdoj.gov
Cc: Hollifield, Ardie
Subject: FDIC Pay Day Lending Contact

Mike—

Following up on our phone call yesterday, I found someone at the FDIC for you to talk to about Pay Day Lending. Contact information is below:

Ardie Hollifield
Senior Policy Analyst
Division of Depositor and Consumer Protection
Phone: [redacted]
e-mail: AHollifield@FDIC.gov

Thank you,

Mike

Michael B. Benardo
Chief, Cyber Fraud and Financial Crimes Section
Division of Risk Management Supervision
Federal Deposit Insurance Corporation
Telephone: [redacted]

Please consider the environment before printing this email.

EXHIBIT 40

No. 14-953-TNM

From: Sweet, Joel <Joel.Sweet@usdoj.gov>
Sent: Wednesday, April 24, 2013 6:32 PM
To: Cassak, Lance D.; Lesemann, Dana J.; Sagatelian, Marguerite; Benardo, Michael B.; Monica Vaca (MVACA@ftc.gov); Greisman, Lois C.; Senturia, Harris <HSENTURIA@ftc.gov> (HSENTURIA@ftc.gov); Hunter.Wiggins@cfpb.gov; christopher.peterson@cfpb.gov; Blume, Michael S.; Goldberg, Richard; Bresnick, Michael J (ODAG); Burke, Josh; Sexton, Gerard; Jennifer.LaRoche@occ.treas.gov
Cc: Redacted Redacted
Subject: Pay Day Loans

All --

Redacted has proposed a simple and elegant idea about how to protect consumers from predatory PD lenders.

Currently, for PD loan repayment, the PD lender instructs its own TPPP/bank to originate a debit transaction against a borrower's bank account. Essentially, the PD lender instructs its own TPPP/bank: "Take money from that guy's bank account and put it into my account; don't worry, the guy gave me permission to take his money."

To protect consumers, PD lenders' banks should be prohibited from originating debit transactions against the bank accounts of non-customer borrowers. PD loan repayment transactions should be initiated only by the borrower instructing his own bank to originate a debit transaction and to send the money to the PD lender (just as I might call my own bank and instruct it to send a payment to my cable company).

PD lending would continue to be feasible to the extent borrowers understand their loan terms and comply with the terms. PD lenders would have a strong interest to ensure that borrowers understand the loan terms. Some borrowers, of course, may breach their loan agreements. In that case, the PD lender may seek court remedies against the breaching borrower (assuming the loans are lawful under state/tribal law), just like any other lender.

This change would be fair to all parties and will protect consumers' bank accounts from unauthorized withdrawals, or withdrawals based on unfair/deceptive loan terms. Banks that seek to avoid complicity in potentially abusive/illegal payday lending practices should welcome the change. The only parties who would have cause to object would be PD lenders who profit from dishonest/ deceptive/unlawful lending practices.

Comments welcome to the group or privately.

Best,

EXHIBIT 41

No. 14-953-TNM

[redacted]

From: Dujenski, Thomas J. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=TDUJENSKI]
Sent: 2/7/2013 5:56:44 PM
To: Pearce, Mark (DCP) [MaPearce@FDIC.gov]

I am pleased we are getting the banks out of ach (payday, bad practices, etc). Another bank is gripping .... but we are doing good things for them! [redacted]

[redacted]

EXHIBIT 42

No. 14-953-TNM

[redacted]

From: Pearce, Mark (DCP) [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=MAPEARCE]
Sent: 2/7/2013 8:59:50 PM
To: Dujenski, Thomas J. [TDujenski@FDIC.gov]
Subject: RE:

Glad we're on the same page. As you note, failure to be proactive on this will lead to enforcement agencies or reputational issues, which is not in best interest of our institutions.

[redacted]

-----Original Message-----
From: Dujenski, Thomas J.
Sent: Thursday, February 07, 2013 5:57 PM
To: Pearce, Mark (DCP)
Subject:

I am pleased we are getting the banks out of ach (payday, bad practices, etc). Another bank is gripping .... but we are doing good things for them! [redacted]

[redacted]

EXHIBIT 43

No. 14-953-TNM

Message

From:	Drozdowski, Robert C. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=RDROZDOWSKI]
Sent:	3/25/2013 8:30:45 AM
To:	Pearce, Mark (DCP) [MaPearce@FDIC.gov]
CC:	Sen, Surge [ssen@FDIC.gov]; Hollifield, Ardie [ahollifield@FDIC.gov]; Lapin, Laura [LaLapin@FDIC.gov]; Henley Jr, William [whenley@FDIC.gov]; Benardo, Michael B. [MBenardo@FDIC.gov]; Sen, Surge; Hollifield, Ardie; Lapin, Laura; Henley Jr, William; Benardo, Michael B.
Subject:	RE: Pay Day Lender List

We do not have any automated way to determine which bank is serving as an ODFI for a particular transaction; however, that information is most definitely part of the ACH record that is sent to the Receiving Depository Financial Institution that holds the consumer account being debited. While some bank statements may include information about the source of the transaction, most do not. We would have to either ask a bank to identify whether they knowingly originate transactions for any of these entities, or cull through their origination files ourselves which we could incorporate into an exam. That being said, we could ask the operators to consider providing us a list of originators and ODFIs; however, Federal Reserve has taken months to consider such requests in the past. Let me connect with my POC at the FRB to see if they might consider it.

One approach we may want to consider is to update either our payment processor guidelines or payday lending related issuance to emphasize (once again) that payday lending presents significantly higher risks to consumers and that any bank originating payments on behalf of payday lenders directly or indirectly should utilize enhanced due diligence to make certain these transactions comply with applicable state and federal laws. While we already suggest such increased due diligence for "high-risk" areas in the payment processor relationship guidance, we could add a lot more specificity than exists in the current guidance and perhaps require that banks be able to identify to examiners any payday lenders that they originate payments for.

More to follow when I hear back from my FRB Atlanta contact.
-Rob

From: Pearce, Mark (DCP)
Sent: Sunday, March 24, 2013 1:38 PM
To: Drozdowski, Robert C.
Cc: Sen, Surge; Hollifield, Ardie
Subject: FW: Pay Day Lender List

Rob,

How hard/time-consuming do you think it'd be for the FDIC to check the major ODFIs we supervise to see if any of them are processing transactions with these payday lenders?

Is there additional information we'd need to make this work/easier?

[redacted]

Attorneys Eyes Only

[redacted]

From: [redacted]
Sent: Monday, March 18, 2013 3:48 PM
To: Pearce, Mark (DCP)
Subject: FW: Pay Day Lender List

Mark

Per our prior email exchange, here's a list of Payday lenders we have seen in ACH transactions based on what appears in the statement of the consumer and the RDFI (the consumer's bank)

Any help always appreciated!

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

EXHIBIT 44

No. 14-953-TNM

[redacted]

From: Henrie, John P. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=JOHENRIE]
Sent: 12/5/2012 10:59:42 AM
To: Hubby, Timothy J. [THubby@FDIC.gov]; Dujenski, Thomas J. [TDujenski@FDIC.gov]
CC: Hoskovec, Troy H. [THoskovec@FDIC.gov]; Jones, Joyce M. [JoyJones@FDIC.gov]; Spratt, Chevis B. [CSpratt@FDIC.gov]; Hudgins, Gerald E. [GHudgins@FDIC.gov]
Subject: Re: Lending Activities

I like the idea, but I think we trigger the paper reduction act or some other reg that would require prior approval. My suggestion would be to make it a part of any exam or other planned contact with the bank.

----- Original Message -----
From: Hubby, Timothy J.
Sent: Wednesday, December 05, 2012 09:46 AM
To: Dujenski, Thomas J.; Henrie, John P.
Cc: Hoskovec, Troy H.; Jones, Joyce M.; Spratt, Chevis B.; Hudgins, Gerald E.
Subject: Lending Activities

Tom/John,

I forwarded an email to staff letting them know to keep us informed about any banks that may be involved in payday lending. Gerald sent the email below that warrants some consideration on our part. Let me know what you think.

[redacted]

-----Original Message-----
From: Hudgins, Gerald E.
Sent: Wednesday, December 05, 2012 9:32 AM
To: Hubby, Timothy J.
Subject: RE:

At the beginning of the banking crisis, we called our bankers (in the Dallas Region) with a brief survey of what types of lending or activities they were currently involved in and what lending or activities they were considering over the coming 12 months. Since the economy is slowly recovering and bankers are looking for sources of new income, we might want to consider a brief regional survey of bankers as to what products they offer now and what they might contemplate over the next 12 months.

This survey might also be helpful to the regional risk committee.

What do you think? I would be willing to help coordinate the survey and aggregate the results.

[redacted]

EXHIBIT 45

No. 14-953-TNM

[redacted]

[redacted]

[redacted]

----- Original Message -----
From: Dujenski, Thomas J.
Sent: Wednesday, December 05, 2012 10:58 AM
To: Hubby, Timothy J.; Henrie, John P.
Cc: Hoskovec, Troy H.; Jones, Joyce M.; Spratt, Chevis B.; Hudgins, Gerald E.
Subject: Re: Lending Activities

I like idea...but surveys require wo approval...let's discuss

----
[redacted]

----- Original Message -----
From: Hubby, Timothy J.
Sent: Wednesday, December 05, 2012 09:46 AM
To: Dujenski, Thomas J.; Henrie, John P.
Cc: Hoskovec, Troy H.; Jones, Joyce M.; Spratt, Chevis B.; Hudgins, Gerald E.
Subject: Lending Activities

Tom/John,

I forwarded an email to staff letting them know to keep us informed about any banks that may be involved in payday lending. Gerald sent the email below that warrants some consideration on our part. Let me know what you think.

[redacted]

-----Original Message-----
From: Hudgins, Gerald E.
Sent: Wednesday, December 05, 2012 9:32 AM
To: Hubby, Timothy J.
Subject: RE:

At the beginning of the banking crisis, we called our bankers (in the Dallas Region) with a brief survey of what types of lending or activities they were currently involved in and what lending or activities they were considering over the coming 12 months. Since the economy is slowly recovering and bankers are looking for sources of new income, we might want to consider a brief regional survey of bankers as to what products they offer now and what they might contemplate over the next 12 months.

This survey might also be helpful to the regional risk committee.

What do you think? I would be willing to help coordinate the survey and aggregate the results.

Thanks,
Gerald

EXHIBIT 46

No. 14-953-TNM

Message

From: Lowe, M. Anthony [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=MLOWE]
Sent: 8/29/2013 10:29:36 AM
To: RMS-DCP CHI Exec [RMSDCPCHIExec@FDIC.gov]; RMS CHI Field Supervisors [RMSCHIFieldSupervisors@FDIC.gov]; DCP CHI Field Supervisors [DCPCHIFieldSupervisors@FDIC.gov]
Subject: RE: Payday Lenders

...and to ensure clarity, no change in our position: we will continue to review and scrutinize TPPP relationships, direct and indirect payday lending activities, and other transactions for potential risks, as delineated in outstanding FILs, or discussed in the various Supervisory Insight Journals.

M. Anthony Lowe
Regional Director
Chicago

-----Original Message-----
From: Lowe, M. Anthony
Sent: Thursday, August 29, 2013 8:30 AM
To: RMS-DCP CHI Exec; RMS CHI Field Supervisors; DCP CHI Field Supervisors
Subject: FW: Payday Lenders

FYI - please do not distribute further.

M. Anthony Lowe
Regional Director
Chicago

-----Original Message-----
From: Jiminez, Andy
Sent: Thursday, August 29, 2013 7:44 AM
To: Lowe, M. Anthony
Cc: Spitler, Eric J.; Brueger, Kathleen S.
Subject: RE: Payday Lenders

Here's the letter we received Anthony. It's led by Rep. Luetkemeyer, a Member from Missouri, and 23 other members of the House GOP. Nobody from Illinois, but a few Ohio guys.

We've also gotten inquiries from Senator Crapo (R-ID), Senator Toomey (R-PA), and Senator Schatz (D-HI).

Let me know if you need anything else.

Best Regards,
-Andy

M. Andy Jiminez
Legislative Attorney/Advisor
Office of Legislative Affairs
Federal Deposit Insurance Corporation
[redacted]

EXHIBIT 47

No. 14-953-TNM

[redacted]

From: Gardineer, Grovetta [Grovetta.Gardineer@occ.treas.gov]
Sent: 5/10/2013 8:07:52 PM
To: Pearce, Mark (DCP) [MaPearce@FDIC.gov]
Subject: RE: Enjoyed the chance to catch up
Attachments: Payday ODFI and merchants 041113 smaller banks.pptx

Hey there. Sorry for the delay. Let me know if you have any questions or want to discuss further. I'm sending the list to Sandy too.

Have a great weekend!

[redacted]

[redacted]
From: Pearce, Mark (DCP) [mailto:MaPearce@FDIC.gov]
Sent: Friday, May 10, 2013 11:56 AM
To: Gardineer, Grovetta
Subject: RE: Enjoyed the chance to catch up

Sent via OCC Secure Mail

Hey -- where's my list?? :)

I have a meeting next week with staff and want to make sure we're focused in right places...

Also, either Jonathan or I will call you next week on CRA.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

----- [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

EXHIBIT 48

No. 14-953-TNM

Bank Name	Transactions Received 9/8/12 - 3/6/13
[redacted] BANK - [redacted] E Total	2
BANK [redacted] Total	71,552
[redacted] BANK Total	1,093,481
[redacted] BANK Total	133,323
[redacted] Total	655,168
[redacted] BANK [redacted] Total	22,149
[redacted] BANK Total	119,414
[redacted] BANK Total	349,508
[redacted] BANK Total	3,099
[redacted] BANK, [redacted] total	9,342
[redacted] BANK Total	971
[redacted] BANK [redacted] Total	195,469
[redacted] FEDERAL CREDIT UN Total	22
[redacted] BANK [redacted] [redacted] Totals	105,221
[redacted] BANK [redacted] Total	232,281
[redacted] FEDERAL CREDIT UNION Total	35
[redacted] BANK [redacted] Total	32,676
[redacted] BK [redacted] Total	16,929
[redacted] Total	10,319
[redacted] BANK [redacted] Total	332,128
[redacted] BANK Total	233
[redacted] BANK [redacted] Total	1,942,363
[redacted] BANK Total	12,163
TOTAL	**5,337,848**

Attorneys Eyes Only

[redacted]	1,942,363
[redacted] Bank	1,093,481
[redacted]	655,168
[redacted] Bank	349,508
[redacted] Bank	332,128
[redacted] Bank [redacted]	232,281
[redacted] Bank [redacted]	195,469
[redacted] Bank	133,323
[redacted] Bank	119,414
[redacted] Bank [redacted]	105,221
Bank [redacted]	71,552
[redacted] Bank [redacted]	32,676
[redacted] Bank [redacted]	22,149
[redacted] Bank [redacted]	16,929
[redacted] Bank	12,163
[redacted]	10,319
[redacted] Bank	9,342
[redacted] Bank	3,099
[redacted]	971
[redacted] Bank	233
[redacted] Federal Credit Union	35
[redacted] Federal Credit Union	22
[redacted] Bank [redacted]	2

Attorneys Eyes Only

Bank/ODFI Name
[redacted] Bank
[redacted] Bank
[redacted] Bank [redacted]
[redacted] Bank [redacted]
[redacted] Bank
[redacted] Bank
[redacted] Bank [redacted]
[redacted] Bank [redacted]
[redacted] Bank [redacted]
[redacted] Bank [redacted]
[redacted] Bank

Transactions Received 9/8/12 – 3/6/13	Example Payday Clients
1,093,481	[redacted]
349,508	[redacted]
232,281	[redacted]
195,469	[redacted]
133,323	[redacted]
119,414	[redacted] Check into Cash
105,221	[redacted]
32,676	[redacted]
22,149	[redacted]
16,929	[redacted]
12,163	[redacted]

PAYDAY LENDER ACTIVITY BY ODFI

April 2013

STRICTLY PRIVATE AND CONFIDENTIAL

[redacted]

Payday Lender Activity by Originating Depository Financial Institution (ODFI)

The following list the banks that originated ACH transactions into [redacted] customer accounts for merchants that we believe are payday lenders. This list excludes large banks.

Volumes are the number of transactions [redacted] received over a recent 6 month period (September 8, 2012 – March 6, 2013)

Bank/ODFI Name	Transactions Received 9/8/12 – 3/6/13	Example Payday Clients
[redacted] Bank	1,093,481	[redacted]
[redacted] Bank	349,508	[redacted]
[redacted] Bank [redacted]	232,281	[redacted]
[redacted] Bank [redacted]	195,469	[redacted]
[redacted] Bank	133,323	[redacted]
[redacted] Bank	119,414	[redacted] Check into Cash
[redacted] Bank [redacted]	105,221	[redacted]
[redacted] Bank [redacted]	32,676	[redacted]
[redacted] Bank [redacted]	22,149	[redacted]
[redacted] Bank [redacted]	16,929	[redacted]
[redacted] Bank	12,163	[redacted]

PAYDAY LENDER ACTIVITY BY ODFI

[redacted]

[redacted]

Payday lenders and ODFI ranked by the percent of payments returned unpaid

For transactions returned unpaid by [redacted] due to insufficient funds, ranked by percent of item returned – January 2013, excludes large banks

Bank Name	Merchant Name	Returned Unpaid	Total Received	Return Rate
[redacted] BANK	[redacted]	1,699	1,994	85%
[redacted] BANK	[redacted]	5,378	9,132	59%
[redacted] BANK	[redacted]	1,152	2,133	54%
[redacted] BANK [redacted]	[redacted]	7,952	14,885	53%
[redacted] BANK [redacted]	[redacted]	1,047	2,020	52%
[redacted] BANK	[redacted]	1,632	3,149	52%
[redacted] BANK	[redacted]	2,411	4,867	50%
[redacted] BANK [redacted]	[redacted]	4,202	8,841	48%
[redacted] BANK [redacted]	[redacted]	2,678	6,302	42%
[redacted] BANK	[redacted]	1,113	2,910	38%
[redacted] BANK	[redacted]	1,011	2,803	36%
[redacted] BANK [redacted]	[redacted]	2,753	8,026	34%
[redacted] BANK	[redacted]	6,104	20,349	30%
[redacted] BANK [redacted]	[redacted]	1,033	3,579	29%
[redacted] BANK	[redacted]	3,284	11,592	28%
[redacted] BANK	[redacted]	1,595	6,454	25%
[redacted] BANK [redacted]	[redacted]	1,603	7,029	23%
[redacted] BANK [redacted]	[redacted]	1,826	10,183	18%
[redacted] BANK	[redacted]	5,610	33,706	17%
[redacted] BANK	[redacted]	1,262	11,036	11%

PAYDAY LENDER ACTIVITY BY ODFI

2 [redacted]

Attorneys Eyes Only -- Outside Counsel

EXHIBIT 49

No. 14-953-TNM

[redacted]

From: Cashman, Patricia I. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=PCASHMAN]
Sent: 5/31/2013 1:47:12 PM
To: Pearce, Mark (DCP) [MaPearce@FDIC.gov]
CC: Lafleur, David P. [DLafleur@FDIC.gov]; Engen, Daniel T. [DEngen@FDIC.gov]; Plunkett, Sylvia H. [SPlunkett@FDIC.gov]; Dixon, Dianne E. [didixon@FDIC.gov]
Subject: Director Pearce - Inquiry on Banks and TPPP Activities
Attachments: Director Pearce - Inquiry on Banks and TPPP Activities.docx

Mark – here is our response to your questions regarding the list of banks from [redacted] indicating institutions (ODFIs) submitting payday lenders to their customers. Please let me know if you have any follow-up questions. Thanks – Pat

On May 11, 2013, Director Pearce inquired about certain Originating Depository Financial Institutions ("ODFIs") submitting transactions from payday lenders. The affected consumer accounts were held by [redacted] Bank [redacted] which in this scenario is the Receiving Depository Financial Institution ("RDFI"). Director Pearce had the following questions:

(1) <u>Determine which institutions are FDIC-supervised.</u>

Of the banks that originated ACH transactions into [redacted] customer accounts for merchants believed to be payday lenders, the following are FDIC supervised:

(a) [redacted] **Bank**, [redacted] Atlanta Region;
(b) [redacted] **Bank** [redacted] – Kansas City Region;
(c) [redacted] **Bank** [redacted] – Chicago Region;
(d) [redacted] **Bank** [redacted] Kansas City Region; and
(e) [redacted] **Bank** [redacted] – Kansas City Region

(2) <u>Determine what we know and have done related to these institutions in their roles as ODFIs, e.g., actions we have taken through Reports of Examination, consultations with the Regions, discussions with RMS, etc.</u>

[redacted]

[redacted]

➢ Redacted

(b) [redacted]

- [redacted]

[redacted]

- Redacted
- [redacted]

[redacted]

[redacted]

➢ [redacted]

- [redacted]

- [redacted]

- [redacted]

- [redacted] ctivity

[redacted]

[redacted]

- Redacted

- [redacted]

- Redacted

(3) **Develop options and recommendations on whether we should follow up and more importantly how we should follow up.**

([redacted] **Bank** – this matter is currently being processed and may result in a Section 5 violation, Consent Order, and CMP.

[redacted] **Bank** [redacted] – a compliance/CRA examination is tentatively scheduled for [redacted]. The Kansas City Region was asked to ensure that TPPP activities were included in the scope.

[redacted] **Bank** [redacted] - a compliance/CRA examination is tentatively scheduled for [redacted]. The Chicago Region was asked to ensure that TPPP activities were included in the scope.

[redacted] **Bank** [redacted] - a compliance/CRA examination is tentatively scheduled for [redacted]. The Kansas City Region was asked to ensure that TPPP activities were included in the scope.

[redacted] **Bank** – the recent RMS examination indicated that the Bank terminated processing ACH transactions for [redacted].

Redacted

EXHIBIT 50

No. 14-953-TNM

FDIC
Federal Deposit Insurance Corporation
[redacted]
Division of Depositor and Consumer Protection

October 22, 2013

TO: Mark Pearce
Director

FROM: Sylvia Plunkett
Senior Deputy Director, Compliance and CRA Examinations and Enforcement

Jonathan Miller
Deputy Director, Policy and Research

Elizabeth Ortiz
Deputy Director, Consumer and Community Affairs

Nann E. Wright
Associate Director, Administrative Management and Operations

SUBJECT: 2013 Assurance Statement

Redacted

Redacted

Attorneys Eyes Only

Redacted

Attorneys Eyes Only

Redacted

Attorneys Eyes Only

Redacted

Attorneys Eyes Only

October 22, 2013

Redacted

6. **Supervision and Enforcement** – The Division is responsible for identifying significant violations of laws and regulations and identifying and addressing problem institutions through prompt and appropriate corrective actions. This process includes presenting enforcement cases to the Case Review Committee (CRC) and ensuring that guidance on emerging issues is provided to banks that may not have the resources to adapt to new compliance technologies. During 2013, the Division continued its major effort to better align the focus of compliance examinations on detecting, addressing, and preventing consumer harm. The Division addressed these risks through a variety of projects in 2013, as it:

Attorneys Eyes Only

October 22, 2013

Redacted

- Increased monitoring of third-party risks centered on institutions engaged in processing ACH for merchants accepting transactions for higher risk activities such as online gambling, payday lending, and pornography;

Redacted

Redacted

Redacted

Attorneys Eyes Only

Redacted

October 22, 2013

Challenges for 2014

DCP is in compliance with all requirements of the Federal Managers' Financial Integrity Act, the Chief Financial Officers Act of 1990, and FDIC Circular 4010.3, FDIC Enterprise Risk Management Program and does not report any material weaknesses. Nevertheless, we identified challenges that will receive heightened attention in 2014. Many of the following challenges represent a continuation of previously identified issues:

Redacted

October 22, 2013

Redacted

8. **Training -** The Division will continue to build-out the Knowledge Management Program and the Learning and Development Framework will be updated to address 2014 programs and initiatives. [redacted] Likewise, CRA, as well as emerging issues such as payday lending, payment system issues, overdrafts, and mobile financial services will continue to warrant significant attention.

Redacted

EXHIBIT 51

No. 14-953-TNM

Message

From: Gruenberg, Martin J. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=MGRUENBERG]
Sent: 2/27/2013 5:58:54 PM
To: Pearce, Mark (DCP) [MaPearce@FDIC.gov]; Miller, Jonathan N. [JonMiller@FDIC.gov]
Subject: Fw: NYT - Major Banks Aid in Payday Loans Banned by States

Note comments by Jamie Dimon in today's NYT business section. We should discuss.

From: Pearce, Mark (DCP)
Sent: Sunday, February 24, 2013 07:53 PM
To: Gray, Andrew; Gruenberg, Martin J.; Miller, Jonathan N.; Ryan, Barbara A.
Subject: RE: NYT - Major Banks Aid in Payday Loans Banned by States

Yes. We've been focused on the back end of the relationship (e.g., risks of payment processors relationships with banks), not the front end (customer authorizing ACH from bank). Will provide more info tomorrow at priorities mtg, if ok.

Mark.

-----Original Message-----
From: Gray, Andrew
Sent: Sunday, February 24, 2013 06:22 PM Eastern Standard Time
To: Gruenberg, Martin J.; Pearce, Mark (DCP); Miller, Jonathan N.; Ryan, Barbara A.
Subject: Re: NYT - Major Banks Aid in Payday Loans Banned by States

Just for background, the reporter contacted us late Wednesday on the issue to confirm our interest (she had been told this through her research). We referred her to what we have issued publicly, including the third party payment processor guidance issued last year and the supervisory insights article in 2011.

----- Original Message -----
From: Gruenberg, Martin J.
Sent: Sunday, February 24, 2013 05:58 PM
To: Pearce, Mark (DCP); Miller, Jonathan N.; Gray, Andrew; Ryan, Barbara A.
Subject: NYT - Major Banks Aid in Payday Loans Banned by States

FYI. From today's NYT. We should discuss.

EXHIBIT 52

No. 14-953-TNM

Message

From: Hollifield, Ardie [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=AHOLLIFIELD]
Sent: 3/7/2013 6:05:04 PM
To: Brown, Luke H. [LuBrown@FDIC.gov]
CC: Sen, Surge [ssen@FDIC.gov]; Keest, Kathleen [kkeest@FDIC.gov]
Subject: Chairman/[redacted] meeting

Luke, attached is a sketch of the talking points for the Chairman's meeting with [redacted] regarding payday lending. We've identified three potential issues that may be discussed.

Ardie G. Hollifield
Senior Policy Analyst
FDIC Division of Depositor and Consumer Protection
ahollifield@FDIC.gov
[redacted]

CONFIDENTIAL: Internal FDIC use only

We have identified three potential roles that national banks play which maybe facilitating either traditional storefront or online payday lenders. In recent weeks, concerns have resurfaced regarding each role. The potential ways in which regulators might intervene vary for each role.

[redacted]

- **National banks provide corporate accounts, including hundreds of millions in lines of credit, to payday lenders.**

During the meeting with National People's Action on February 26th, it was brought to our attention that many national banks are still facilitating payday loans by extending corporate lines of credit to national payday lending chains. The National Consumer Law Center published a list of these relationships in 2007, including a $250 million credit line to Cash America by JP Morgan Chase. These national banks do not directly offer payday loans due to reputational risk and regulatory scrutiny, however they continue to facilitate other companies offering payday loans via these lines of credit. [redacted]

Whether there are safety and soundness or reputational risk approaches for this concern would have to be explored.

- **National banks function as intermediaries, serving the payment processors for both online and storefront payday lenders.**

Payday lenders require a financial institution to act as the payment processor for the companies' internal processes of extending loans and collecting repayment. As with banks serving payment processors whose clients are involved in telemarketing fraud, banks whose payment processing customers serve clients who make payday loans in violation of applicable state law may be facilitating the law violations. The FDIC has begun to evaluate whether enforcement approaches are warranted, either from a safety or soundness perspective or from a compliance perspective.

Redacted

EXHIBIT 53

No. 14-953-TNM

We have identified three potential roles that banks may play in facilitating either traditional storefront or online payday lenders. In recent weeks, concerns have resurfaced regarding each role. Our options for supervisory action depend on the relationship between the bank and the payday lender. We distinguish these external roles from bank deposit advance where the bank itself is the creditor in a payday-type loan relationship with its customers.

[redacted]

[redacted]

[redacted]

- [redacted]
- [redacted]

- **Nationwide banks provide corporate accounts, including hundreds of millions in lines of credit, to payday lenders.**

  - During the meeting with National People's Action on February 26th it was brought to our attention that national banks may still be facilitating payday loans by extending corporate lines of credit to national payday lending chains.
  - JP Morgan Chase (along with Key Bank and Wells Fargo) increased a line of credit to Cash America, a large national storefront payday lender, by $100 million (to $430 million) in 2011.[3] In 2012 JP Morgan Chase also served as "Lead Arranger and Sole Bookrunner" and lender (along with Wells Fargo, Texas Capital Bank and Amegy Bank) for a $175 million line of credit to First Cash Financial, another large payday lender.[4]
  - Nationwide banks generally do not directly offer payday loans (though at least five are offering deposit advance products which are de facto payday loans) due to reputational risk and regulatory scrutiny, however they continue to facilitate other companies offering payday loans via these lines of credit.
  - We are evaluating whether there are safety and soundness or reputational risks for this concern.

- **Banks are functioning as intermediaries, serving as either the payment processor or as the depository institution for Third-Party Payment Processors for both online and storefront payday lenders.**

  - Payday lenders need a financial institution to act as the intermediary for the companies' internal processes of extending loans and collecting repayment. Banks whose payment processing customers serve clients who make payday loans in violation of applicable state law may be facilitating the law violations.

---

[3] Cash America International, Inc. Form 8-K from the U.S. Securities and Exchange Commission, November 29, 2011. http://secfilings.nyse.com/filing.php?doc=1&attach=ON&ipage=7932062&rid=23

[4] "Amended and Restated Credit Agreement Among First Cash Financial Services Inc. and JP Morgan Chase, N.A., and the Other Lender Parties Hereto," September 11, 2012. http://yahoo.brand.edgar-online.com/displayfilinginfo.aspx?FilingID=8821231-6218-251649&type=sect&dcn=0001171843-12-003387

- Banks may also have a Third-Party Payment Processor (TPPP) as an accountholder and that TPPP may process funds for the payday lender. In this scenario, the payday lender has no direct relationship with the bank.
- Banks are subject to significant risks from TPPPs. FDIC has provided guidance to alert its institutions on third party risks.[5]
- [redacted]

Redacted

[5] Payment Processor Relationships, Revised Guidance, FIL-3-2012, January 3, 2012 and Guidance for Managing Third-Party RiskFIL-44-2008

EXHIBIT 54

No. 14-953-TNM

From: Gruenberg, Martin J.
Sent: Wednesday, March 13, 2013 9:53 AM
To: Pearce, Mark (DCP)
Cc: Ryan, Barbara A.
Subject: Follow up

Mark,

We should follow up on the discussion of bank services to payday lenders.

Marty

EXHIBIT 55

No. 14-953-TNM

Message

From: Benardo, Michael B. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=MBENARDO]
Sent: 3/14/2013 3:50:57 PM
To: Drozdowski, Robert C. [RDrozdowski@FDIC.gov]
Subject: Re: DCP Consultation with [redacted]

Thanks. I would think we may want to let Rae Ann know about it.

From: Drozdowski, Robert C.
Sent: Thursday, March 14, 2013 03:40 PM
To: Benardo, Michael B.
Subject: FW: DCP Consultation with [redacted]

FYI, I have been asked by Mark Pearce to join him on a call with some executives from [redacted] to discuss their approach to minimizing the number of fraudulent payday lenders debiting consumer accounts.
-Rob

From: Drozdowski, Robert C.
Sent: Thursday, March 14, 2013 9:32 AM
To: Lapin, Laura; Henley Jr, William
Subject: DCP Consultation with [redacted]

William/Laura,

I have been invited by Mark Pearce to participate in a consultation with some senior executives from [redacted] regarding their planned response to a [redacted]. The NY Times article criticized the industry for the overall lack of controls in the ACH system that allow originators to debit transactions without consumer consent. It is a fundamental weakness in the ACH system which is why the barriers for returning unauthorized debits are very low.

Luke Brown reached out through Laura last week to ask for my consultation on a related inquiry from the [redacted] and during what turned out to be a 2+hr discussion, Mark Pierce came by to discuss the issue. I assume that is why he invited me to be part of next week's discussion.

He likely does not know it; however, I know [redacted] pretty well from my time on the Senate Banking Committee and with America's Community Bankers.

Do we need to let anyone in RMS senior management know about this?
-Rob

[redacted]

[redacted]

From: Pearce, Mark (DCP) [mailto:MaPearce@FDIC.gov]
Sent: Tuesday, March 12, 2013 03:48 PM Eastern Standard Time
[redacted]
Subject: RE: Following up

[redacted]

A call would be fine.

We are interested in the operational issues in monitoring the ACH transactions from payday lenders (or other higher-risk sources) to effectively identify multiple presentments when they occur, and also how easy it is for bank to implement stop payment requests (or revocation of authorizations) from consumers. [redacted]

[redacted]

[redacted]

[redacted]

[redacted]
Sent: Tuesday, March 12, 2013 2:35 PM
To: Pearce, Mark (DCP)
Subject: Following up

Hi Mark – nice seeing you today! I wanted to follow up on the payday/ACH conversation. Our internal team would be happy to discuss what we're seeing in our research. [redacted]

[redacted]

EXHIBIT 56

No. 14-953-TNM

[redacted]

[redacted] [redacted]
Sent: 3/19/2013 5:57:57 PM
To: Pearce, Mark (DCP) [MaPearce@FDIC.gov]
Subject: Following up

Hi Mark – a couple of follow-ups:

First, I wanted to give you a heads up that we'll be announcing our ACH/payday changes tomorrow (maybe as early as tonight). I'll send along the press release once it's final, but for now please consider the information embargoed. It's consistent with our discussion yesterday.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

EXHIBIT 57

No. 14-953-TNM

Confidential - Pursuant to Protective Order

Alderson®

COURT REPORTING

Transcript of **Mark Pearce**

Thursday, May 3, 2018

Advance America, et al. v. Federal Deposit Insurance Corporation, et al.

Alderson Court Reporting
1-800-FOR-DEPO (367-9976)
Info@AldersonReporting.com
www.AldersonReporting.com

Alderson Reference Number: 78004

[redacted]

Q. Okay. Before reading the IG report, did you express any concern to Mr. Dujenski about his opinions with respect to payday lenders?

A. I did not.

MR. DOBER: Objection.

MR. PATTERSON: Okay.

THE WITNESS: Or I don't recall, I guess,

[redacted]

A. -- general answer, you know, [redacted] [redacted] is one of the largest financial institutions in the world. And its practices and its activities have an impact in the global financial economy. And, again, as a deposit insurer and responsibility for the public confidence in the financial system, having an awareness of what all insured institutions and other major financial parties are doing is something that would be relevant to the FDIC's work.

[redacted]

EXHIBIT 58

No. 14-953-TNM

[redacted]

From: Dujenski, Thomas J. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=TDUJENSKI]
Sent: 11/26/2012 4:47:28 PM
To: Pearce, Mark (DCP) [MaPearce@FDIC.gov]
Subject: Confidential

I have never said this to you (but I am sincerely passionate about this)...but I literally can not stand pay day lending. They are abusive, fundamentally wrong, hurt people, and do not deserve to be in any way associated with banking. I had extensive involvement with this group of lenders and was instrumental in drafting guidance on stopping abuses.

I really hope this bank we discussed truly gets out of this on their own as they are indicating.....I hope my persuasion skills are still effective :). I feel strongly we will do good things here!!!!

[redacted]

EXHIBIT 59

No. 14-953-TNM

Message

From: Pearce, Mark (DCP) [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=MAPEARCE]
Sent: 11/27/2012 8:40:05 PM
To: Dujenski, Thomas J. [TDujenski@FDIC.gov]
Subject: RE: Confidential

I remember!!

Thanks for the briefing today.

[redacted]

-----Original Message-----
From: Dujenski, Thomas J.
Sent: Monday, November 26, 2012 4:47 PM
To: Pearce, Mark (DCP)
Subject: Confidential

I have never said this to you (but I am sincerely passionate about this)...but I literally can not stand pay day lending. They are abusive, fundamentally wrong, hurt people, and do not deserve to be in any way associated with banking. I had extensive involvement with this group of lenders and was instrumental in drafting guidance on stopping abuses.

I really hope this bank we discussed truly gets out of this on their own as they are indicating.....I hope my persuasion skills are still effective :). I feel strongly we will do good things here!!!!

[redacted]

EXHIBIT 60

No. 14-953-TNM

Message

From: Dujenski, Thomas J. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=TDUJENSKI]
Sent: 11/21/2012 3:04:34 PM
To: Pearce, Mark (DCP) [MaPearce@FDIC.gov]
Subject: Re:

By the way...I think you will be pleased....bank with ach is getting out off payday ach and all ach activities....now that is something to celebrate on Thanksgiving! :)

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

EXHIBIT 61

No. 14-953-TNM

Message

From: Rich, Timothy D. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=TRICH]
Sent: 12/5/2012 9:55:09 AM
To: Dujenski, Thomas J. [tdujenski@fdic.gov]
Subject: Re:

Tom, I'm going to have my FS and CM go through their caseloads to confirm no payday lending and also to identify any finance company subs or affiliates.

Do you want us to focus on NM banks only, or do you prefer we contact the other PFRs? Also, when would you want this confirmed? Given current workload, I was considering imposing a deadline of Friday, December 14th.

Thanks,

Tim

----- Original Message -----
From: Dujenski, Thomas J.
Sent: Wednesday, December 05, 2012 09:12 AM
To: Lindsey, Christopher A.; Povlak, Jeffrey L.; Dean, Michael J.; Patton, Phyllis M.; Ovington, Stephanie J.; Wilson, Stephanie S.; Hoskovec, Troy H.; Hubby, Timothy J.; Rich, Timothy D.; Womack, Anthony H.; Vaughn, Benjamin E.; Fulcher, Edith A.; Gray, Franklin III; Henrie, John P.; Smith, Nikita P.; Brown, Sherri W.; Flono, Timothy D.
Subject:

Any banks even remotely involved in payday should be promptly brought to my attention.

Sent from my BlackBerry Wireless Handheld

EXHIBIT 62

No. 14-953-TNM

[redacted]

From: Patton, Phyllis M. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=PPATTON]
Sent: 12/6/2012 1:07:51 PM
To: Dujenski, Thomas J. [TDujenski@FDIC.gov]; Henrie, John P. [JoHenrie@FDIC.gov]; Flono, Timothy D. [TFlono@FDIC.gov]; Hubby, Timothy J. [THubby@FDIC.gov]
Subject: Fw: Payday Lending, Finance Company Subs - Due December 14th

There could be another bank processing ACHs for TPPPs. We will keep you posted..
Phyllis Patton

[redacted]
From: Ovington, Stephanie J.
Sent: Thursday, December 06, 2012 12:53 PM
To: Brown, Sherri W.; Patton, Phyllis M.
Cc: Caldwell, Sullivan L. Jr
Subject: RE: Payday Lending, Finance Company Subs - Due December 14th

Hi Sherri and Phyllis,

We're not aware of any more at this time; however, [redacted] Bank [redacted] may be processing ACHs for TPPPs that are payday lenders. We are having a difficult time identifying the line of business for many of the TPPPs. We are initiating a consultation with UDAP Specialist Mohammad this week. During our upcoming field office meetings, I will reiterate the importance of identifying any ACH/payday/prepaid lending activity with our examiners.

[redacted]

[redacted]
From: Brown, Sherri W.
Sent: Wednesday, December 05, 2012 3:42 PM
To: DCP ATL Field Supervisors; DCP ATL SE; DCP ATL Review Examiners
Cc: Patton, Phyllis M.; Ovington, Stephanie J.
Subject: FW: Payday Lending, Finance Company Subs - Due December 14th

[redacted]

Tom would like to know about any of our banks that are involved in payday lending. Please review your banks and determine if there is any indication of direct or indirect payday lending involvement and which banks have finance company arms, subsidiaries, or affiliates (regardless of whether the FC is known to engage in PD lending). [redacted] Please respond to me, ADRD Patton, and AARD Ovington by noon Friday, December 14th. Additionally, remind your staff to be cognizant of these activities and red flags during examinations and notify the RO immediately upon identification.

Review Examiners - If you are aware of banks meeting the aforementioned characteristics, please forward them to the appropriate FS for inclusion in their response.

[redacted]

EXHIBIT 63

No. 14-953-TNM

[redacted]

From: Dujenski, Thomas J. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=TDUJENSKI]
Sent: 12/5/2012 10:58:23 AM
To: Rich, Timothy D. [TRich@fdic.gov]
Subject: Re:

Just snm for now. Share your approach with other ARD's....that would be great!

[redacted]

----- Original Message -----
From: Rich, Timothy D.
Sent: Wednesday, December 05, 2012 09:55 AM
To: Dujenski, Thomas J.
Subject: Re:

Tom, I'm going to have my FS and CM go through their caseloads to confirm no payday lending and also to identify any finance company subs or affiliates.

Do you want us to focus on NM banks only, or do you prefer we contact the other PFRs? Also, when would you want this confirmed? Given current workload, I was considering imposing a deadline of Friday, December 14th.

[redacted]

[redacted]

----- Original Message -----
From: Dujenski, Thomas J.
Sent: Wednesday, December 05, 2012 09:12 AM
To: Lindsey, Christopher A.; Povlak, Jeffrey L.; Dean, Michael J.; Patton, Phyllis M.; Ovington, Stephanie J.; Wilson, Stephanie S.; Hoskovec, Troy H.; Hubby, Timothy J.; Rich, Timothy D.; Womack, Anthony H.; Vaughn, Benjamin E.; Fulcher, Edith A.; Gray, Franklin III; Henrie, John P.; Smith, Nikita P.; Brown, Sherri W.; Flono, Timothy D.
Subject:

Any banks even remotely involved in payday should be promptly brought to my attention.

[redacted]

EXHIBIT 64

No. 14-953-TNM

[redacted]

From: Rich, Timothy D. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=TRICH]
Sent: 12/5/2012 11:00:49 AM
To: Dujenski, Thomas J. [tdujenski@fdic.gov]
Subject: Re:

Will do, Tom, thanks.

----- Original Message -----
From: Dujenski, Thomas J.
Sent: Wednesday, December 05, 2012 10:58 AM
To: Rich, Timothy D.
Subject: Re:

Just snm for now. Share your approach with other ARD's....that would be great!

[redacted]

----- Original Message -----
From: Rich, Timothy D.
Sent: Wednesday, December 05, 2012 09:55 AM
To: Dujenski, Thomas J.
Subject: Re:

Tom, I'm going to have my FS and CM go through their caseloads to confirm no payday lending and also to identify any finance company subs or affiliates.

Do you want us to focus on NM banks only, or do you prefer we contact the other PFRs? Also, when would you want this confirmed? Given current workload, I was considering imposing a deadline of Friday, December 14th.

[redacted]

[redacted]

----- Original Message -----
From: Dujenski, Thomas J.
Sent: Wednesday, December 05, 2012 09:12 AM
To: Lindsey, Christopher A.; Povlak, Jeffrey L.; Dean, Michael J.; Patton, Phyllis M.; Ovington, Stephanie J.; Wilson, Stephanie S.; Hoskovec, Troy H.; Hubby, Timothy J.; Rich, Timothy D.; Womack, Anthony H.; Vaughn, Benjamin E.; Fulcher, Edith A.; Gray, Franklin III; Henrie, John P.; Smith, Nikita P.; Brown, Sherri W.; Flono, Timothy D.
Subject:

Any banks even remotely involved in payday should be promptly brought to my attention.

[redacted]

EXHIBIT 65

No. 14-953-TNM

[redacted]

[redacted]

[redacted]

[redacted]

From: Dujenski, Thomas J.
Sent: Saturday, January 19, 2013 8:18 AM
To: Lindsey, Christopher A.; Povlak, Jeffrey L.; Dean, Michael J.; Patton, Phyllis M.; Ovington, Stephanie J.; Wilson, Stephanie S.; Hoskovec, Troy H.; Hubby, Timothy J.; Rich, Timothy D.; Womack, Anthony H.; Vaughn, Benjamin E.; Fulcher, Edith A.; Gray, Franklin III; Henrie, John P.; Smith, Nikita P.; Brown, Sherri W.; Flono, Timothy D.
Subject: Fw: Supervisory Pulse 1.18.13

Congrats to NC!

[redacted]

From: Hoskovec, Troy H.
Sent: Friday, January 18, 2013 05:13 PM
To: Dujenski, Thomas J.; Henrie, John P.; Patton, Phyllis M.
Subject: FW: Supervisory Pulse 1.18.13

CRL: **Regions Bank Halts Illegal Payday Lending in N.C.** – Regions Bank has halted payday lending in the state of North Carolina, according to the Center for Responsible Lending (CRL). After much criticism from consumer advocates and various state agencies, the bank has pulled the product. "Especially in the wake of the bad lending that led to the financial crisis, banks should understand that the last thing we need is destructive loans that drag cash-strapped families down even further," said Jeff Shaw of the North Carolina Justice Center in a prepared statement.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

EXHIBIT 66

No. 14-953-TNM

[redacted]

From: Hoskovec, Troy H. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=THOSKOVEC]
Sent: 3/21/2013 6:58:54 AM
To: Dujenski, Thomas J. [tdujenski@fdic.gov]
Subject: RE:

Very interesting- I am glad to see some of the large banks taking a stand to assist in driving these payday lending entities out of banking. Now we will just need all the others to follow suit.

Troy

From: Dujenski, Thomas J.
Sent: Wednesday, March 20, 2013 6:39 PM
To: Hoskovec, Troy H.
Subject: FW:

Good info

From: Womack, Anthony H.
Sent: Wednesday, March 20, 2013 12:23 PM
To: Dujenski, Thomas J.
Cc: Henrie, John P.; Hoskovec, Troy H.; Norton, Michael
Subject:

Tom,

Saw this article and it made me think of [redacted]. I can see this charter has being another channel for these entities to tap.

Tony

https://webapps.fdic.gov/Eclips/StoryView.asp?StoryID=46930

EXHIBIT 67

No. 14-953-TNM

Message

From: Dujenski, Thomas J. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=TDUJENSKI]
Sent: 3/22/2013 9:42:56 AM
To: Brown, Sherri W. [SWBrown@FDIC.gov]; Dean, Michael J. [MiDean@FDIC.gov]; Flono, Timothy D. [TFlono@FDIC.gov]; Fulcher, Edith A. [EFulcher@FDIC.gov]; Gray, Franklin III [FGray@FDIC.gov]; Henrie, John P. [JoHenrie@FDIC.gov]; Hoskovec, Troy H. [THoskovec@FDIC.gov]; Hubby, Timothy J. [THubby@FDIC.gov]; Lindsey, Christopher A. [CLindsey@FDIC.gov]; Ovington, Stephanie J. [SOvington@FDIC.gov]; Patton, Phyllis M. [PPatton@FDIC.gov]; Povlak, Jeffrey L. [JPovlak@FDIC.gov]; Rich, Timothy D. [TRich@FDIC.gov]; Smith, Nikita P. [NSmith@FDIC.gov]; Vaughn, Benjamin E. [BenVaughn@FDIC.gov]; Wilson, Stephanie S. [STWilson@FDIC.gov]; Womack, Anthony H. [AWomack@FDIC.gov]
Subject: FW: Supervisory Pulse 3.21.13

Pay day lenders bring reputational risk, compliance risk, legal risk, and risk management concerns .....nothing good for our banks

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From: Hoskovec, Troy H.
Sent: Friday, March 22, 2013 6:43 AM
To: Dujenski, Thomas J.; Henrie, John P.; Patton, Phyllis M.; Fulcher, Edith A.
Cc: Norton, Michael
Subject: FW: Supervisory Pulse 3.21.13

Articles of Note- I found the stats on the first article and last article to be interesting.

CRL: **Triple-Digit Danger: Bank Payday Lending Persists** – The Center for Responsible Lending (CRL) issued a new report today on payday loans offered by banks. The report finds that:

- Bank payday loans carry an annual percentage rate (APR) that averages 225 to 300 percent.
- In 2011, average bank payday borrower took out 19 loans.
- Bank payday borrowers are two times more likely to incur overdraft fees than bank customers as a whole.
- Over one-quarter of all bank payday borrowers are Social Security recipients.

American Banker: **OCC Targeting Bank Relationships with Payday Lenders** – Regulators are scrutinizing national banks' online and offshore relationships with payday lenders, Comptroller of the Currency Thomas Curry said Wednesday. The agency is particularly interested in how some payday lenders use banks to circumvent state laws, he said. Some large banks were criticized recently for allowing automatic withdrawals for payday loans after depositors attempted to stop it. Consumer advocates have also criticized the regulatory guidance for not being broad enough to stop problems with online and off-shore payday lenders.

New York Times: **Just 5 Banks Prohibit Use of Social Security Numbers** – Despite the risk of fraud associated with the theft of Social Security numbers, just five of the nation's largest 25 banks have stopped using the numbers to verify a customer's identity after the initial account setup, a new report from Javelin Strategy & Research finds.

From: SupervisoryPolicy
Sent: Thursday, March 21, 2013 6:11 PM
To: SupervisoryPolicy
Subject: Supervisory Pulse 3.21.13

Supervisory Pulse

CFPB

CFPB: **CFPB to Hold Auto Lenders Accountable for Illegal Discriminatory Markup** – Today, CFPB released a bulletin explaining that certain lenders that offer auto loans through dealerships are responsible for unlawful, discriminatory pricing. Potentially discriminatory markups in auto lending may result in tens of millions of dollars in consumer harm each year, and the bulletin provides guidance to indirect auto lenders within the CFPB's jurisdiction on how to address fair lending risk.

Consumer Groups

CRL: **Triple-Digit Danger: Bank Payday Lending Persists** – The Center for Responsible Lending (CRL) issued a new report today on payday loans offered by banks. The report finds that:

- Bank payday loans carry an annual percentage rate (APR) that averages 225 to 300 percent.
- In 2011, average bank payday borrower took out 19 loans.
- Bank payday borrowers are two times more likely to incur overdraft fees than bank customers as a whole.
- Over one-quarter of all bank payday borrowers are Social Security recipients.

Industry

American Banker: **How Promontory Financial Became Banking's Shadow Regulator** – With close to 400 employees and some 1,400 consulting engagements under its belt, Promontory Financial Group has built a shadow network between banks and regulators. The firm is a sort of ex-regulator omnibus, capable of forecasting, mimicking and occasionally even substituting for the financial industry's supervisors.

Additional Items

American Banker: **OCC Targeting Bank Relationships with Payday Lenders** – Regulators are scrutinizing national banks' online and offshore relationships with payday lenders, Comptroller of the Currency Thomas Curry said Wednesday. The agency is particularly interested in how some payday lenders use banks to circumvent state laws, he said. Some large banks were criticized recently for allowing automatic withdrawals for payday loans after depositors attempted to stop it. Consumer advocates have also criticized the regulatory guidance for not being broad enough to stop problems with online and off-shore payday lenders.

Bloomberg**: Student-Loan Debt Collectors Will Get Lower Commissions** – The Obama administration says it is reducing the commissions the government pays to private collection companies that pursue delinquent student loans -- from up to 16% of the loan amount to as low as 11%. The move is an effort to help borrowers whom collectors pressure for high payments.

American Banker: **Freddie Mac and Its Regulator Faulted on Servicer Complaints** – Freddie Mac and its regulator must do more to ensure loan servicers properly respond to complaints over handling of mortgages held or guaranteed by the U.S.-owned company, according to a government watchdog's audit report. Servicers who collect payments and deal with borrowers for Freddie Mac failed to implement Federal Housing Finance Agency (FHFA) guidelines for so-called escalated complaints, the FHFA's Office of Inspector General said in the report released Thursday. Freddie Mac failed to supervise the servicers and FHFA, which oversees the company and Fannie Mae, didn't ensure the procedures were followed.

New York Times: **Just 5 Banks Prohibit Use of Social Security Numbers** – Despite the risk of fraud associated with the theft of Social Security numbers, just five of the nation's largest 25 banks have stopped using the numbers to verify a customer's identity after the initial account setup, a new report from Javelin Strategy & Research finds.

****

*The **Supervisory Pulse** is an external monitoring effort focused on the latest consumer protection-related developments in the financial services arena. Items found in this email-based newsletter are excerpts and/or summaries of news from the CFPB, consumer groups, industry, and other sources. For questions about the **Supervisory Pulse** or to subscribe, please send an email to SupervisoryPolicy@FDIC.gov.*

EXHIBIT 68

No. 14-953-TNM

Appointment

From: Bowman, John B. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=JBOWMAN]
Sent: 11/19/2012 8:34:54 AM
To: Dixon, Dianne E. [didixon@FDIC.gov]; Cashman, Patricia I. [PCashman@FDIC.gov]; Hollifield, Ardie [ahollifield@FDIC.gov]; Patton, Phyllis M. [PPatton@FDIC.gov]; Brown, Sherri W. [SWBrown@FDIC.gov]; [redacted]

Subject: [redacted] - "Potential" Payday Lending Connection
Location: Conference Call

Start: 11/27/2012 1:00:00 PM
End: 11/27/2012 1:30:00 PM
Show Time As: Tentative

Required Attendees: Dixon, Dianne E.; Cashman, Patricia I.; Hollifield, Ardie; Patton, Phyllis M.; Brown, Sherri W.; [redacted]

Hi:

This is a rescheduled call that was previously to have occurred on the day the office was closed due to Hurricane Sandy.

We would like to have a brief call to discuss *potential issues* that were brought to our attention by the CFPB. Below for your reference is the body of an email I sent to Associate Director Dianne Dixon regarding the *potential* issue. We want to get your thoughts. We understand the Region is currently conducting an examination of the bank.

[redacted]

Earlier this afternoon I spoke with Ardie Hollifield of the Policy Section regarding the subject bank. Ardie's friend at the CFPB provided the below links to Payday lenders that appear to have a relationship with the subject, which may or may not be similar to the one between [redacted] and the Redacted product. However, the details of the relationship are unclear. Luckily, we are currently conducting a compliance/CRA examination, which started on [redacted] 2012. [redacted]

Can we reach out to the Atlanta Region while [redacted] is still on-site to gather details about the nature of this relationship? This is probably an area that should be explored during the examination anyway given the third-party and reputation risks involved. Thank you!

[redacted]

[redacted]

Attorneys Eyes Only

[redacted] Redacted

EXHIBIT 69

No. 14-953-TNM

[redacted]

From: Patton, Phyllis M. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=PPATTON]
Sent: 12/5/2012 9:31:33 PM
To: Dujenski, Thomas J. [TDujenski@FDIC.gov]; Henrie, John P. [JoHenrie@FDIC.gov]; Brown, Sherri W. [SWBrown@FDIC.gov]; Fulcher, Edith A. [EFulcher@FDIC.gov]; Hoskovec, Troy H. [THoskovec@FDIC.gov]; Jones, Joyce M. [JoyJones@FDIC.gov]
CC: Patton, Phyllis M. [PPatton@FDIC.gov]
Subject: RE: [redacted] Bank, [redacted]

Hello Again,

Additional Information:

EIC [redacted] reviewed [redacted] Program Management Agreement governing the relationship between [redacted] and [redacted] and posed questions to management. [redacted] offers its customers an array of pre-paid cards or can design a custom card to fit the needs of its clients. These cards range from payroll cards to gift cards to even legal settlement funding cards. There is a concern with a few of the [redacted] customers, specifically its arrangements with payday lenders, US Money and [redacted], which offer re-loadable pre-paid cards with an overdraft feature. EIC [redacted]'s interview notes form the preliminary basis of the review; based upon his discussions in the meeting, he will obtain additional information to determine if there are grounds sufficient to considering pursuing a Section 5 violation. During our most recent discussion, EIC [redacted] was requested to obtain additional clarifying information regarding the specifics of the ODP programs in place for both [redacted] and US Money as well as obtain disclosures and statements. Additionally, he will obtain copies of the Bank's due diligence for its customers, beginning with the payday lenders. [redacted]

[redacted]

[redacted]

From: Patton, Phyllis M.
Sent: Monday, December 03, 2012 8:50 PM
To: Dujenski, Thomas J.; Henrie, John P.; Flono, Timothy D.; Fulcher, Edith A.
Cc: Patton, Phyllis M.
Subject: FW: [redacted] Bank, [redacted]

Hello Everyone,

Tom: I briefly mentioned this issue to you in anticipation of receiving the details from Stephanie.

Everyone: Stephanie shared this information with me on yesterday and it's definitely something of serious concern. I've highlighted a few things. The examiner has a list of questions to follow-up on in preparation for tomorrow's call. I'm planning to participate in the call and I will keep you apprised of everything. As indicated below, there is an ongoing examination and this issue will likely adversely impact the rating...

From: Ovington, Stephanie J.
Sent: Sunday, December 02, 2012 4:40 PM
To: Patton, Phyllis M.
Cc: Brown, Sherri W.; Towns, B-Otis; Hudson, Denise Bell; Mohammad, Jamal
Subject: [redacted] Bank, [redacted]

Good afternoon Phyllis,

Per your request, I am providing an update on the conference call and potential issues in reference to [redacted] Bank, [redacted]

On Tuesday, November 27, we participated in a conference call with the Washington Office regarding the subject's potential participation in payday lending activities. The conference call participants were John Bowman, Pat Cashman, Dianne Dixon, B-Otis Towns, Denise Hudson, Jamal Mohammad, [redacted], and Stephanie Ovington. Earlier, the CFPB had notified RE Bowman that [redacted] appeared to have a relationship with several payday lending companies, including [redacted] U S Money. The CFPB became aware of [redacted] relationship with various payday lenders through the CFPB's supervision of [redacted] Bank and their relationship with the [redacted], which may or may not be similar to [redacted] program. [redacted]

We have an ongoing Compliance/CRA examination of subject that commenced [redacted], and EIC [redacted] has just begun to gather information regarding the payday lending products. [redacted]

- **[redacted] does indeed process transactions for up to 20 payday lenders. [redacted]**

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Attorneys Eyes Only

[redacted]

[redacted]

[redacted]

EXHIBIT 70

No. 14-953-TNM

[redacted]

From: Fulcher, Edith A. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=EFULCHER]
Sent: 12/5/2012 9:53:36 AM
To: Dujenski, Thomas J. [TDujenski@FDIC.gov]; Henrie, John P. [JoHenrie@FDIC.gov]; Patton, Phyllis M. [PPatton@FDIC.gov]
CC: Fausti, Cameron A. [CAfausti@FDIC.gov]; Elston, Dennis R. [DElston@FDIC.gov]; Hoskovec, Troy H. [THoskovec@FDIC.gov]; Jones, Joyce M. [JoyJones@FDIC.gov]
Subject: RE: Deposit Advance Products

Pretty sure not...they were described as reloadable prepaid access debit cards with [redacted] as the program manager responsible for processing and servicing the cards. [redacted] provides payroll direct deposit, reloadable debit cards, and one-time stored-value cards. Other services include bill and invoice presentment and payment.

From: Dujenski, Thomas J.
Sent: Wednesday, December 05, 2012 8:52 AM
To: Fulcher, Edith A.; Henrie, John P.; Patton, Phyllis M.
Cc: Fausti, Cameron A.; Elston, Dennis R.; Hoskovec, Troy H.; Jones, Joyce M.
Subject: Re: Deposit Advance Products

Did anyone mention payday?

[redacted]

From: Fulcher, Edith A.
Sent: Wednesday, December 05, 2012 08:41 AM
To: Henrie, John P.; Patton, Phyllis M.; Dujenski, Thomas J.
Cc: Fausti, Cameron A.; Elston, Dennis R.; Hoskovec, Troy H.; Jones, Joyce M.
Subject: FW: Deposit Advance Products

FYI that back in March we previously reported and described the reloadable prepaid access debit card program offered through [redacted]. I am following up with CM Fausti and FS Elston about S&S exam review and findings.

From: Fulcher, Edith A.
Sent: Wednesday, March 07, 2012 10:44 AM
To: Norton, Michael
Cc: Fausti, Cameron A.
Subject: FW: Payday Lending

Mike...the story on small dollar loan program just starting to be offered by [redacted] Bank. Exam is scheduled to begin in [redacted] and we need a full scope review of the prepaid debit card arrangement (TPPP) including a review of IT issues. Thanks.

From: Fulcher, Edith A.
Sent: Thursday, March 01, 2012 5:53 PM
To: Henrie, John P.
Cc: Dean, Michael J.; Lester, Marianne; Elston, Dennis R.; Fausti, Cameron A.
Subject: RE: Payday Lending

John,

We have one situation with small dollar loans offered in connection with a prepaid debit card. Information is just evolving, but what we know is below and in the attached email.

[redacted]

The bank has initiated a Reloadable Prepaid Access Debit Card program with [redacted] as the Program Manager responsible for processing and servicing the cards [redacted] provides payroll direct deposit, reloadable debit cards, and one-time stored-value cards. Other services include bill and invoice presentment and payment. U.S. Debit Card Co., LLC (operating subsidiary - "Check into Cash") owns 50 percent of [redacted]

[redacted]

[redacted]

From: Henrie, John P.
Sent: Wednesday, February 29, 2012 11:52 AM
To: RMS ATL ARDs
Subject: Fw: Payday Lending

What are you hearing from your FOs? DCP's response is below.

Jph

[redacted]

From: Dean, Michael J.
Sent: Wednesday, February 29, 2012 10:47 AM
To: Brown, Luke H.; Hollifield, Ardie; Jackwood, John M.
Cc: Dujenski, Thomas J.; Plunkett, Sylvia H.; Miller, Jonathan N.; Dixon, Dianne E.; Brown, Sherri W.; Patton, Phyllis M.
Subject: Payday Lending

[redacted]

Our FSs canvassed their examination staff and none reported any financial institutions offering "deposit advance products." However, there is one financial institution in [redacted] that is contemplating offering such a product. [redacted] Of course, we are strongly encouraging them to reconsider the decision.

[redacted]

[redacted]

From: Brown, Luke H.
Sent: Friday, February 17, 2012 9:17 PM
To: DCP DRD; DCP ARDs
Cc: Miller, Jonathan N.; Dixon, Dianne E.; Plunkett, Sylvia H.; Jackwood, John M.; Hollifield, Ardie
Subject: Payday Lending

All:

We are looking at payday lending from a FDIC policy perspective, and specifically at a deposit-related consumer credit products generally referred to as "deposit advance products" (these products are also known by other trade names such as "Relationship Advance"). These may look somewhat different from previous deposit advance products in terms of fees and APR disclosure, but have similar structures. They are typically small dollar loans designed to be paid back by the customer's next deposit or within a short time frame, usually 60 days or less.

Based on readily available FDIC records and information and your staff's knowledge and supervisory experience, please provide us with the cert numbers and names of FDIC-supervised institutions in your region that currently offer such products or have business relationships with entities that offer these products, a brief description of the product being offered, and any other information that you think would be helpful to understand what the institutions in your region are doing (or considering doing) in the payday lending space. In addition, if you become aware of any information about these types of products in the future, please also send it to us.

[redacted]

[redacted]

EXHIBIT 71

No. 14-953-TNM

FDIC

FEDERAL DEPOSIT INSURANCE CORPORATION
Division of Depositor and Consumer Protection
[redacted]

Atlanta Regional Office
[redacted]

December 10, 2012

TO: Thomas J. Dujenski
Regional Director

FROM: [redacted]
Examination Specialist, UDAP

[redacted] [redacted] Bank [redacted]
Potential Section 5 Violation Related to Prepaid Card Activity

[redacted]

[redacted]

The Consumer Financial Protection Bureau ("CFPB") notified Senior Examination Specialist [redacted] that [redacted] appeared to have relationships with several payday lenders, [redacted]

[redacted]

[redacted]

[redacted] Check into Cash invested $2MM into [redacted] and has a 50% ownership interest; however, it intends to make an additional investment, which would make it the majority owner. [redacted]

[redacted]

Presently, [redacted] offers approximately seventy program customers prepaid card services, either standard or custom programs, and has issued 27,000 cards, in October 2012. It has an arrangement with Check into Cash (dba US Money) to offer prepaid cards, at its retail locations, which have an associated overdraft protection feature. This overdraft feature requires that the consumer have a direct deposit equal or greater to $500 at least every 35 days, opt-in to the program, and receive SMS text alerts. Approximately, one third of all cards issued were issued through Check into Cash to its consumers. [redacted] Although these prepaid cards with overdraft protection programs share similarities with payday lending, the bank's internal due diligence characterized Check into Cash as being a low-risk client.

[redacted]

[redacted]

[redacted]

[redacted]

EIC [redacted] is conducting a Compliance and CRA examination [redacted] The review of [redacted] prepaid card program is in its initial stages. The review is focused on the arrangements with payday lenders offering prepaid cards with overdraft privileges. [redacted]

[redacted].

EIC [redacted] is continuing to gather information that will help to determine if there are sufficient grounds for pursuing a violation of Section 5. Currently, he has requested and is awaiting responses from [redacted] for the following:

(1) All disclosures, including terms and conditions, for the US Money Cards (Check into Cash) [redacted]
(2) Copies of any due diligence packages [redacted] Bank has for US Money Cards, [redacted]
(3) Any due diligence reviews for customers for which [redacted] did not approve as a prepaid customer;
(4) Customer transaction histories showing overdrafts in order to ascertain that fees were charged according to disclosures;
(5) Customer complaints;
(6) Copies of audits and retail secret shopping results.

[redacted]

EXHIBIT 72

No. 14-953-TNM

TO: Thomas J. Dujenski
Regional Director
FDIC Atlanta Regional Office

THROUGH: Edith A. Fulcher
Assistant Regional Director

Phyllis Patton
Acting Deputy Regional Director
FDIC Atlanta Regional Office

FROM: Cameron A. Fausti
Case Manager

Jamal Mohammad
Examination Specialist (UDAP)
FDIC Atlanta Regional Office

SUBJECT: Regional Office Meeting with Chairman [redacted] Bank, [redacted]
Debit Card/Payday Lending and Asset-based Lending Programs

On January 16, 2013, Chairman [redacted] met with the following regional staff: Regional Director Dujenski, DRD Henrie, RMS ARD Fulcher, RMS CM Fausti, DCP ADRD Patton, DCP AARD Stephanie Ovington, and DCP Examination Specialist (UDAP) Mohammad.

Summary of Meeting

The meeting focused on the bank's prepaid card and asset-based lending (ABL) programs. Concerns with both programs were discussed. Specifically, the debit card program includes payday lending elements, but the program lacks adequate management oversight for consumer compliance, payday lending guidance, and third-party risk. [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

In response to questions from RD Dujenski and ADRD Patton, [redacted] clarified the program. He confirmed that Check into Cash ("CIC") has a fifty percent ownership stake in [redacted]; at the moment, the planned, additional investment (which would give CIC majority ownership) has not occurred. [redacted] described that funds are loaded onto the prepaid cards either through direct deposit or cash transactions (accepted at Western Union, MoneyGram, or CIC locations), with an even distribution between the two methods. He conceded; however, that US Money cards (issued by CIC) were loaded with the proceeds of payday loans. Yet, he stressed that [redacted] was neither involved in payday lending nor did it make any credit decisions. He could not provide; however, the percentage of USMoney cards which were loaded with the proceeds of payday loans. In response to DRD Henrie's question, [redacted] conceded that CIC could seek payment from the prepaid card; however, he could not be certain of how often it had occurred.

ADRD Patton, AARD Ovington, and Examination Specialist Mohammad reminded [redacted] that the review of the prepaid card program is in its preliminary stages. Nevertheless, they detailed their numerous concerns with the program, which were identified to date. [redacted] was informed that the Bank's prepaid program was facilitating payday lending activities by allowing the proceeds of these loans to be loaded onto prepaid cards and through the processing of loan payments using these cards. Additionally, the similarities between the prepaid card ODP and payday lending were explained to [redacted] He was reminded that if the Bank maintains its prepaid card businesses, it would be expected to appropriately manage third-party risk, consistent with outstanding guidance.

[redacted]

EXHIBIT 73

No. 14-953-TNM

[redacted]

Interviewer: [redacted], **FDIC EIC**

Interviewees: [redacted], [redacted] **Payment Systems Managing Director, and** [redacted] **Representative. Also in attendance were** [redacted] **Bank President** [redacted] **and Chief Financial Officer** [redacted].

[redacted] Bank Prepaid Card Program

1. [redacted] Does [redacted] have a business affiliation with [redacted] Check into Cash?

   [redacted] is a brand name for Check into Cash. Check into Cash has an investment in [redacted]. In January 2011, Check into Cash invested $2MM in [redacted] for 50 percent ownership of the company. [redacted].

Redacted

Redacted

4. Article 4.1(e) states that the Program manager will provide to the bank reports detailing transactions and servicing with respect to each Program.

Redacted

b. Please provide a copy of the most recent report for:
    [redacted]
    iii. Check Into Cash, if different from [redacted]

[redacted]

Redacted

6. [redacted]

Redacted

[redacted] Redacted

Redacted

Redacted

Attorneys Eyes Only

Redacted

Redacted

Attorneys Eyes Only

16. Article 8.9.6 of the PMA addresses Secret Shopping.
    a. Has the bank required [redacted] to conduct any secret shopping to monitor sales of prepaid cards?
    b. If not, are there any plans to conduct secret shopping? Provide details.

Check into Cash is the primary retail shop selling prepaid cards. Check into Cash does secret shopping as part of its compliance management program. So, we don't feel that we need to duplicate that.

EXHIBIT 74

No. 14-953-TNM

Alderson®
COURT REPORTING

Transcript of [redacted]

Tuesday, May 1, 2018

Advance America, et al. v. Federal Deposit Insurance Corporation, et al.

Alderson Court Reporting
1-800-FOR-DEPO (367-9976)
Info@AldersonReporting.com
www.AldersonReporting.com

Alderson Reference Number: 77903

a printed copy of the FDIC guidance to banks on payday lending; is that correct?

MS. MARGOLIS: Objection.

THE WITNESS: He did.

Q. (By Mr. Thompson) Then Director Dujenski stated that the bank was involved in a, quote, dirty business, close quote; is that correct?

MS. MARGOLIS: Objection.

THE WITNESS: That is correct.

Q. (By Mr. Thompson) Okay. And that the FDIC would refer any anti-money laundering issues to the Department of Justice. Did he say that?

MS. MARGOLIS: Objection.

THE WITNESS: He did.

Q. (By Mr. Thompson) And he asked if you were aware that bank directors could be subject to criminal prosecution; is that right?

MS. MARGOLIS: Objection.

THE WITNESS: He did.

Q. (By Mr. Thompson) This was a threat, was it not?

MS. MARGOLIS: Objection.

Q. (By Mr. Thompson) Is that how you perceived it at the time?

A. I certainly perceived it as one.

EXHIBIT 75

No. 14-953-TNM

Chronology

Date	Event	Comment
3Q 2009	Completed charge-off/reserve for bad assets. New strategic plan to grow service revenue and specialty, non-real estate lending.	
1H 2010	Narrowed options to prepaid debit cards, small-business factoring.	
August 2010- May 2011	Research, due diligence, contract structuring to launch prepaid card business, focused on payroll and general purpose reloadable. [redacted] as both servicer and marketing partner. Research, due diligence, contract structuring for 51/49 JV with [redacted] based factoring technology service provider.	
April 2011	Notified FDIC and [redacted] of two new businesses in quarterly conference call.	
June 2011	Issued first prepaid card	
July 2011	FDIC [redacted] field office conducted off-site review of all prepaid disclosures and collateral material.	Bank is told verbally in August there would be no written feedback, but that no issues were noted.
September 2011	FDIC Senior Examiner and [redacted] conduct on-site visitation to review prepaid and factoring business.	
December 2, 2011	Written response to September visitation from FDIC Regional Director Dujenski and [redacted]	"Preliminary assessments reflect sufficient due diligence and risk assessment analysis". Comprehensive evaluation to follow in next full-scope exam.
April 2012	Joint FDIC/State Risk Management exam, including IT, ACH, and BSA/AML. Exam as of [redacted] o Detailed presentation on prepaid. EIC provides hard copy of FIL-44-2008 (Guidance for Managing Third-Party Risk), which he states is the relevant guidance. [redacted] reviews its prepaid vendor management program, which the EIC agrees follows FIL-44-2008 point by point. EIC concludes "we are not going to have any problems with Prepaid".	o No weaknesses noted in prepaid other than request that bank amend policy to set a limit on total prepaid deposits as a percent of capital. o Weaknesses found in several areas of administration and control of factoring business. o IT/ACH rated [redacted] Overall CAMEL [redacted]
2Q-4Q 2012	Bank holds factoring business held at existing size (<$8 million) while all processes, training, standards, etc are revalidated and controls are enhanced.	

Date	Event	Comment
September 2012	Regularly scheduled Compliance exam begun by FDIC	EIC [redacted] is filling two jobs; exam proceeds slowly; minimal focus on prepaid; by late November exam is finally winding up with expectations of an exit before Christmas. Draft exit interview document provided that shows minimal issues.
November 2012	Risk Management visitation conducted.	No formal report. Verbal assessment was bank had made good progress in complying with the requirements of the [redacted] 2012 exam and to continue working on them.
Operation Choke Point begins for [redacted]		
Early December 2012	Compliance EIC [redacted] makes "urgent" call to Bank.... Has a long list of questions regarding prepaid "from Washington". o Three rounds of requests were received and responses provided, including several thousand pages of documentation. o [redacted] distributed significant portion of its prepaid cards through one major check casher/payday lender (Check into Cash) since program inception and has agreements with [redacted] for a January 2013 launch, replacing the [redacted] card with a lower cost alternative in [redacted] market. Neither CIC nor [redacted] are TPPP's. Rather, they are agents of the Bank to receive cash loads and forward them to the Bank, subject to money transmitter and AML statues.	Off the record, EIC [redacted] states that "Washington doesn't like community banks to have anything to do with MSBs. I don't think these answers are going to fly."
Mid December 2012	Having satisfied all the document requests, we advise EIC [redacted] that we plan to issue cards in an [redacted] pilot store beginning in early January as scheduled.	

Date	Event	Comment
12/20/2012	Receive urgent request from FDIC for a conference call for that afternoon. 12 participants from FDIC and [redacted] o Asks us to delay [redacted] launch, or FDIC will seek emergency C&D order. o Informs us that they will be opening a Risk Management, IT, ACH, and BSA exam on January 7. o Informs us that they will restart compliance exam as a focused exam, UDAP specialists to conduct. o Requests copy of legal reviews done "that define legality of bank being in the prepaid card business".	Memo from bank prepaid counsel [redacted] provided on December 29. No specific allegations are mentioned.
1/14/2013	Risk Management, IT, ACH, BSA/AML focused exam commences in [redacted]	9 months after April 2012 exam

Date	Event	Comment
1/15/2013	[redacted] meets with Tom Dujenski in Atlanta at [redacted] request of 12/27. ○ Director Dujenski accompanied by Dep Reg Director, 2 Assistant Reg Dir, Case Manager, Udap specialist, 2 others. ○ Director Dujenski opened the meeting by declaring that he was "not big on legal opinions" (referencing [redacted] opinion), but that because [redacted] was allowing its distribution agent to load the proceeds of payday loans onto prepaid cards, [redacted] was acting as a payday lender subject to the FDIC guidance on payday lending. Passed out printed copy of FDIC guidance to banks on payday lending, asked if [redacted] was in full compliance with the guidance. ○ Director Dujenski stated that the Bank was involved in a "dirty business", and that the FDIC would refer any AML issues to the DOJ. He asked if I was aware our bank directors could be subject to criminal prosecution. ○ The balance of the 3 hours was a show of force, revisiting and calling into question every aspect of [redacted] entry into both the factoring and prepaid card business. The Compliance ARD stated that if [redacted] cancelled the prepaid business or cancelled distribution through the MSB channel, "the exam would continue but in a very different manner than if we continued distributing through MSBs". ○ Director Dujenski asked me to make a decision quickly about whether I wanted to continue and let him know.	There was little knowledge in the room about prepaid, nor little evidence that much, if any, of the material that had been provided in December had been reviewed. The was no discussion of the product we were offering or the customers being served, other than [redacted] explained why the check cashing channel provided the highest quality service at the lowest cost in the prepaid market, with the least BSA risk, compared to online, Walmart, chain pharmacies, etc. It was quite obvious the regional staff had been given a mission to get [redacted] out of the business.
1/16/2013	[redacted] informs Director Dujenski via phone that [redacted] will terminate its prepaid card business.	
1/17/2013	Phone call from Compliance ARD Patton to [redacted] wanting him to confirm that [redacted] exit was a "business decision" and not being done on order from the FDIC.	
2/1/2013	Formal cancellation notice sent to prepaid servicer/marketer, starting a 180 day transition process.	

Date	Event	Comment
January-February	FDIC descends on [redacted] Also conducts a three day on-site review at factoring JV, including an FFIEC IT audit to see if JV partner posed systemic risk as a third party servicer. (Total portfolio services < $25 million.)	
1/29-2/25/2013	Detailed discussions with IT EIC about fact [redacted] not being a TPPP. EIC agrees in 2/25 conference call to remove all references to TPPP.	
3/14/2013	Board meets with [redacted] FDIC, et al in [redacted] for exit meeting. [redacted] described accurately as TSP, though many conclusions based on TPPP assertion are not changed.	CAMEL [redacted] MOU required to address deficiencies in vendor management, ACH, factoring risk management
4/25/2013	Bank receives ROE, dated 4/19. The ROE follows the 3/14/2013 meeting notes, with exception of reversion to the invalid TPPP assertion in the "Scope of Exam" and throughout the report.	
6/12/2013	[redacted] response to the Matters Requiring Board Attention from the ROE also requests the FDIC amend the ROE to correct the TPPP error. Attached is 15 page legal opinion from regulatory counsel.	
6/19/2013	Letter to [redacted] Board from Fulcher (FDIC) and [redacted] acknowledging that [redacted] was a TSP and not a TPPP.	
8/6/2013	Last prepaid card account transferred to successor bank. [redacted] program ends.	
Compliance Exam continues		
Feb-August 2013	Periodic inquiries from FDIC UDAP examiner Mohammed, but no indication of progress, until we receive a request for a board exit meeting on short notice for the last week of August, despite having not received any preliminary results of any kind since the "pre Choke Point" draft findings of November 2012. ARD Patton says that the bank can just respond to the ROE. • [redacted] calls Mike Dean, who agrees it is in everyone's best interest to have the ROE be as accurate as possible. • Nevertheless, the FDIC holds the exit meeting with the board in [redacted], but no actual findings are discussed. • Board is advised that the rating will be a [redacted] and an MOU will be required.	

Date	Event	Comment
9/9/2013	FDIC holds actual exit meeting conference call with [redacted] management, provides draft ROE. [redacted] notes numerous inaccuracies, particularly in alleged UDAP violations. Agreed that [redacted] will provide written response to draft ROE.	
10/4/2013	[redacted] provides 24 page response plus exhibits.	
Oct-November, 2013	Series of conference calls and memos attempting to resolve UDAP issues.	
12/2/2013	ROE received, cover letter dated 11/27.	
12/6/2016	[redacted] requests 4 corrections, affirmative response received 12/16.	
1/16/2016	[redacted] esponse to ROE	

EXHIBIT 76

No. 14-953-TNM

Message

From: Dujenski, Thomas J. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=TDUJENSKI]
Sent: 1/17/2013 3:23:04 PM
To: Patton, Phyllis M. [PPatton@FDIC.gov]; Henrie, John P. [JoHenrie@FDIC.gov]; Dean, Michael J. [MiDean@FDIC.gov]; Fulcher, Edith A. [EFulcher@FDIC.gov]; Ovington, Stephanie J. [SOvington@FDIC.gov]
CC: Hoskovec, Troy H. [THoskovec@FDIC.gov]; Brown, Sherri W. [SWBrown@FDIC.gov]
Subject: RE: Follow-up to our phone call of this morning regarding [redacted] Prepaid

great

[redacted]

[redacted]

From: Patton, Phyllis M.
Sent: Thursday, January 17, 2013 03:22 PM Eastern Standard Time
To: Dujenski, Thomas J.; Henrie, John P.; Dean, Michael J.; Fulcher, Edith A.; Ovington, Stephanie J.
Cc: Hoskovec, Troy H.; Brown, Sherri W.
Subject: RE: Follow-up to our phone call of this morning regarding [redacted] Prepaid

I made that clear and [redacted] indicated it's a business decision made by bank management.

From: Dujenski, Thomas J.
Sent: Thursday, January 17, 2013 3:21 PM
To: Patton, Phyllis M.; Henrie, John P.; Dean, Michael J.; Fulcher, Edith A.; Ovington, Stephanie J.
Cc: Hoskovec, Troy H.; Brown, Sherri W.
Subject: RE: Follow-up to our phone call of this morning regarding [redacted] Prepaid

i hope he relays it is the banks decision

[redacted]

[redacted]

From: Patton, Phyllis M.
Sent: Thursday, January 17, 2013 02:14 PM Eastern Standard Time
To: Dujenski, Thomas J.; Henrie, John P.; Dean, Michael J.; Fulcher, Edith A.; Ovington, Stephanie J.
Cc: Hoskovec, Troy H.; Brown, Sherri W.; Patton, Phyllis M.
Subject: FW: Follow-up to our phone call of this morning regarding [redacted] Prepaid

Hello,

I just spoke with [redacted] again to determine if he is able to give a more definitive answer regarding the bank's efforts to sever the entire relationship with [redacted]/Check into Cash. As of now, bank management has a meeting is tentatively scheduled with [redacted] for tomorrow. If [redacted] is unable to meet in person tomorrow, a meeting will take place via conference call next Tuesday or Wednesday. [redacted] stated that based upon provisions within the bank's contract with [redacted], he is obligated to inform and consult with [redacted] regarding the concerns prior to making a business decision to end the relationship. Although bank management will follow the provisions of the contract, [redacted] assured me that bank management is meeting with [redacted] to primarily to let them know that the relationship is ending and why. [redacted]

From: [redacted]
Sent: Wednesday, January 16, 2013 12:13 PM
To: Patton, Phyllis M.
Cc: [redacted]
Subject: Follow-up to our phone call of this morning regarding [redacted] Prepaid

This note is to confirm that we have made the business decision to exit, at a minimum, the distribution and loading of prepaid cards through payday lenders and check cashers. Within the next five business days we will notify [redacted] of that decision as required by our contract.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

EXHIBIT 77

No. 14-953-TNM

Message

From: Patton, Phyllis M. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=PPATTON]
Sent: 1/16/2013 12:05:56 PM
To: Dujenski, Thomas J. [TDujenski@FDIC.gov]; Henrie, John P. [JoHenrie@FDIC.gov]; Fulcher, Edith A. [EFulcher@FDIC.gov]; Dean, Michael J. [MiDean@FDIC.gov]
CC: Mohammad, Jamal [JMohammad@FDIC.gov]; Hoskovec, Troy H. [THoskovec@FDIC.gov]; Patton, Phyllis M. [PPatton@FDIC.gov]
Subject: [redacted] Decision to Exit the Prepaid/Payday Lending Program

Importance: High

Hello,

[redacted] just called to inform us that he's in the process of ending the bank's relationship with [redacted] preference is to terminate the entire relationship; however, he is particularly committed to getting out of the payday lending segment dealing with Check into Cash. He also stated that the next few days will be quite challenging given the resources needed to exit the [redacted] relationship. As a result of needing resources to work to end the relationship, [redacted] asked whether we can halt the examination process and have the examiners to come offsite until Monday, January 28th. Once I've discussed with Tom, John, and others, I committed to calling [redacted] back later today. It's recommended that if the examination is put on hold a few days, we need to have Atlanta Legal to prepare a Preservation of Documents letter and send it to the bank today. The same type of letter was sent to [redacted].

[redacted] has not presented the decision to exit the [redacted] relationship to the Board; however, he plans to do that in the very near future. Further, [redacted] plans to prepare an e-mail articulating the bank's plan to end the [redacted] relationship.

Thanks

Phyllis

EXHIBIT 78

No. 14-953-TNM

[redacted]

From: Fulcher, Edith A. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=EFULCHER]
Sent: 1/25/2013 3:51:14 PM
To: Dujenski, Thomas J. (tdujenski@fdic.gov) [TDujenski@FDIC.gov]; Henrie, John P.
CC: Fausti, Cameron A. [cafausti@fdic.gov]; Patton, Phyllis M. [PPatton@FDIC.gov]; Zinder, Stephen (Tyler) [SZinder@fdic.gov]
[redacted] [redacted]

Tom and John,

Phyllis and I contacted [redacted] as a follow-up to our conversations about the bank's relationship with [redacted] We asked him how things were going with the termination of the bank's contract with [redacted] said they have been working hard this week and that it is "going well". They have had several meetings with [redacted] representatives and he said a termination letter should be drafted next week and will require [redacted] to present a reasonable timeline to unwind the relationship. [redacted] We also reminded [redacted] that our Payday Lending and Third Party Oversight Guidance were the bases for our initial concerns about the bank's relationship with [redacted]. We expressed concern about his email message to his Board stating the FDIC has a "defacto policy to prohibit" the banks we supervise from offering debit cards; especially those tied to payday lenders. We let [redacted] know there is no such policy and reiterated that the basis for our concerns was centered on what we perceived as a lack of awareness of regulatory (payday and third party oversight guidance) and S&S implications of the business. He said he would be sure his Board understood our position and stated "this will not be controversial." [redacted]

[redacted]

[redacted]

EXHIBIT 79

No. 14-953-TNM

[redacted]

From: Dujenski, Thomas J. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=TDUJENSKI]
Sent: 1/25/2013 4:13:42 PM
To: Fulcher, Edith A. [EFulcher@FDIC.gov]; Henrie, John P. [JoHenrie@FDIC.gov]
CC: Fausti, Cameron A. [CAfausti@FDIC.gov]; Patton, Phyllis M. [PPatton@FDIC.gov]
[redacted] [redacted]

☺

From: Fulcher, Edith A.
Sent: Friday, January 25, 2013 3:51 PM
To: Dujenski, Thomas J.; Henrie, John P.
Cc: Fausti, Cameron A.; Patton, Phyllis M.; Zinder, Stephen (Tyler)
[redacted]

Tom and John,

Phyllis and I contacted [redacted] as a follow-up to our conversations about the bank's relationship with [redacted] We asked him how things were going with the termination of the bank's contract with [redacted] said they have been working hard this week and that it is "going well". They have had several meetings with [redacted] representatives and he said a termination letter should be drafted next week and will require [redacted] to present a reasonable timeline to unwind the relationship. [redacted] We also reminded [redacted] that our Payday Lending and Third Party Oversight Guidance were the bases for our initial concerns about the bank's relationship with [redacted] We expressed concern about his email message to his Board stating the FDIC has a "defacto policy to prohibit" the banks we supervise from offering debit cards; especially those tied to payday lenders. We let [redacted] know there is no such policy and reiterated that the basis for our concerns was centered on what we perceived as a lack of awareness of regulatory (payday and third party oversight guidance) and S&S implications of the business. He said he would be sure his Board understood our position and stated "this will not be controversial." [redacted]

[redacted]

[redacted]

EXHIBIT 80

No. 14-953-TNM

[redacted]

From: Dujenski, Thomas J. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=TDUJENSKI]
Sent: 1/19/2013 12:31:35 PM
To: Pearce, Mark (DCP) [MaPearce@FDIC.gov]
Subject: Fw: An article from www.newsobserver.com

Confidential: This guy no longer likes payday.....hmmm.....I think we got our message across and we will explore other products he can offer. This guy is tricky.....I am a firm believer in morale suasion (and mark, I think this is one strength we bring to the table). However, this guy is dangerous to the bank because he is not used to operating in a regulatory environment. I am glad the bank has chosen to exit, but he is no where out of the woods on enforcement side. The goal is always to educate the bank and ensure he operates in a safe and sound manner. Thanks and have a good weekend!

[redacted]

[redacted]
Sent: Saturday, January 19, 2013 11:06 AM
To: Fulcher, Edith A.
Cc: Patton, Phyllis M.; Dujenski, Thomas J.; Henrie, John P.; Fausti, Cameron A.
Subject: RE: An article from www.newsobserver.com

[redacted]

As I tried to communicate, I'm no fan of the institution of payday lending. But I have come to care about the type of consumer that is often their customer. It's a new awareness for me that has come through our prepaid experience. It doesn't seem like traditional bank transaction account products address their needs very well at all. Redacted

Redacted

Redacted

[redacted]

[redacted]

[redacted]

[redacted]

Attorneys Eyes Only

[redacted]

Article on payday lending in NC.

Posted on Friday, Jan. 18, 2013

Regions Bank stops offering controversial loans in N.C.

By David Ranii

Consumer advocacy groups are celebrating that predatory payday loans have been eradicated – again – in North Carolina.

Alabama-based Regions Bank, which has six branches in North Carolina, including two in Raleigh and three in the Charlotte area, recently stopped offering its Ready Advance loans in the wake of protests from consumer groups and state officials. They had vilified the bank for offering what was, in their view, the only payday loan available to consumers in North Carolina.

"This is a great victory for the folks in the state," said Chris Kukla, senior counsel for government affairs at the Center for Responsible Lending. "We certainly hope it's a sign that we are going to continue to keep North Carolina payday-lending free."

Read More...

EXHIBIT 81

No. 14-953-TNM

[redacted]

[redacted] [redacted]
Sent: 1/19/2013 11:06:59 AM
To: Fulcher, Edith A. [efulcher@fdic.gov]
CC: Patton, Phyllis M. [PPatton@FDIC.gov]; Dujenski, Thomas J. [TDujenski@FDIC.gov]; Henrie, John P. [johenrie@fdic.gov]; Fausti, Cameron A. [cafausti@fdic.gov]
Subject: RE: An article from www.newsobserver.com

[redacted]

As I tried to communicate, I'm no fan of the institution of payday lending. But I have come to care about the type of consumer that is often their customer. It's a new awareness for me that has come through our prepaid experience. It doesn't seem like traditional bank transaction account products address their needs very well at all. [redacted]

[redacted]

[redacted]

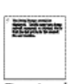
[redacted]

[redacted]

[redacted]

[redacted]

Article on payday lending in NC.



Posted on Friday, Jan. 18, 2013

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By David Ranii

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"This is a great victory for the folks in the state," said Chris Kukla, senior counsel for government affairs at the Center for Responsible Lending. "We certainly hope it's a sign that we are going to continue to keep North Carolina payday-lending free."

Read More...

EXHIBIT 82

No. 14-953-TNM

Message

From: Dujenski, Thomas J. [tdujenski@fdic.gov]
Sent: 9/26/2011 3:05:54 PM
To: Henrie, John P. [johenrie@fdic.gov]
Subject: RE: Important - Unusual Application Matters

A pay day....this is a big deal

[redacted]

[redacted]

From: Villalba, Vanessa I.
Sent: Monday, September 26, 2011 2:50 PM
To: Henrie, John P.
Cc: Dujenski, Thomas J.; Rich, Timothy D.
Subject: RE: Important - Unusual Application Matters

While I am not sure whether I would call this an unusual application, I would say it is an interesting one with some issues. I am working on a management change application for a proposed CEO Redacted Redacted The proposed CEO is [redacted] who was previously employed by [redacted]. Below are the issues with this application: [redacted] Redacted ; he is a director and shareholder of Advance America and Redacted

Redacted

[redacted]

Redacted

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Redacted

[redacted]

Redacted

[redacted]

Redacted

[redacted]

Redacted

[redacted]

Redacted

[redacted]

From: Henrie, John P.
Sent: Monday, September 26, 2011 12:21 PM
To: RMS ATL Case Mgrs
Cc: Dujenski, Thomas J.; RMS ATL ARDs
Subject: FW: Important - Unusual Application Matters

Good Afternoon:

Earlier, I sent this email to the ARDs. I have decided to send it to the Case Managers as well. Please let me know of any unusual applications you are presently working on. CC your ARD when you respond to me directly.

[redacted]

[redacted]

From: Henrie, John P.
Sent: Monday, September 26, 2011 11:18 AM
To: RMS ATL ARDs
Cc: Dujenski, Thomas J.
Subject: Important - Unusual Application Matters

Please let me know of any unusual application matters that you are dealing with (e.g., pay day lending, international wires, etc.). A prompt response would be appreciated.

[redacted]

[redacted]

EXHIBIT 83

No. 14-953-TNM

[redacted]

From: Villalba, Vanessa I. [vavillalba@fdic.gov]
Sent: 9/26/2011 2:49:50 PM
To: Henrie, John P. [johenrie@fdic.gov]
CC: Dujenski, Thomas J. [tdujenski@fdic.gov]; Rich, Timothy D. [TRich@fdic.gov]
Subject: RE: Important - Unusual Application Matters

While I am not sure whether I would call this an unusual application, I would say it is an interesting one with some issues. I am working on a management change application for a proposed CEO Redacted Redacted The proposed CEO is [redacted] who was previously employed by [redacted] Below are the issues with this application: [redacted] Redacted he is a director and shareholder of Advance America Redacted

Redacted

[redacted]

Redacted

[redacted]

[redacted]

[redacted] Redacted

[redacted]

Redacted

[redacted]

Redacted

[redacted]

Redacted

[redacted]

Redacted

[redacted]

Redacted

[redacted]

From: Henrie, John P.
Sent: Monday, September 26, 2011 12:21 PM
To: RMS ATL Case Mgrs
Cc: Dujenski, Thomas J.; RMS ATL ARDs
Subject: FW: Important - Unusual Application Matters

Good Afternoon:

Earlier, I sent this email to the ARDs. I have decided to send it to the Case Managers as well. Please let me know of any unusual applications you are presently working on. CC your ARD when you respond to me directly.

[redacted]

[redacted]

From: Henrie, John P.
Sent: Monday, September 26, 2011 11:18 AM
To: RMS ATL ARDs
Cc: Dujenski, Thomas J.
Subject: Important - Unusual Application Matters

Please let me know of any unusual application matters that you are dealing with (e.g., pay day lending, international wires, etc.). A prompt response would be appreciated.

[redacted]

[redacted]

EXHIBIT 84

No. 14-953-TNM

Message

From: Dujenski, Thomas J. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=TDUJENSKI]
Sent: 9/26/2011 7:06:39 PM
To: Villalba, Vanessa I. [vavillalba@fdic.gov]; Henrie, John P. [johenrie@fdic.gov]; Rich, Timothy D. [TRich@fdic.gov]
CC: Hoskovec, Troy H. [THoskovec@fdic.gov]
Subject: RE: Important - Unusual Application Matters

We need to chat about a director from a payday operation – this has appearance issues for sure

---

From: Villalba, Vanessa I.
Sent: Monday, September 26, 2011 2:50 PM
To: Henrie, John P.
Cc: Dujenski, Thomas J.; Rich, Timothy D.
Subject: RE: Important - Unusual Application Matters

Redacted

Redacted he is a director and shareholder of Advance America and he chairs the Industry Relations Committee; Redacted

Redacted

[redacted]

Redacted

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Redacted

[redacted]

Redacted

[redacted]

Redacted

[redacted]

Redacted

[redacted]

Redacted

Attorneys Eyes Only

Redacted

[redacted]

[redacted]

Redacted

[redacted]

From: Henrie, John P.
Sent: Monday, September 26, 2011 11:18 AM
To: RMS ATL ARDs
Cc: Dujenski, Thomas J.
Subject: Important - Unusual Application Matters

Please let me know of any unusual application matters that you are dealing with (e.g., pay day lending, international wires, etc.). A prompt response would be appreciated.

[redacted]

EXHIBIT 85

No. 14-953-TNM

Federal Deposit Insurance Corporation
Division of Depositor and Consumer Protection
Division of Risk Management Supervision
[redacted]

Chicago Regional Office
[redacted]

January 15, 2013

TO: Mark Pearce
Director – DCP

Sandra Thompson
Director – RMS

FROM: M. Anthony Lowe
Regional Director – Chicago

SUBJECT: December Regional Status Report – Chicago - Amended

REGIONAL RISK PROFILE

[redacted]

Redacted

[redacted]

Redacted

Redacted

Redacted

COMPLIANCE/CRA AND RISK MANAGEMENT – Updates to Items Previously Reported

Bank Name[redacted]	Problems/Issue: Third party processing relationship risk concerns.
Location: [redacted]	[redacted]
Total Assets: [redacted]	Action: None
RMS Contacts: CM Leanean Merritte / ARD David	DCP Contact: ARD Teresa Sabanty

Mangian	

An offsite review reflected significant volume, in number and dollars, of ACH return items from January to August 2012. Most ACH activity stemmed from a relationship with [redacted] which offers short-term, high interest loans to individuals. A joint FDIC RMS/DCP and [redacted] visitation was conducted on [redacted]. Preliminary findings determined that the high volume of ACH returns are reasonable, as ACH transactions are initiated only for the [redacted] customers who have effectively defaulted. After completion of the visitation, we will determine a supervisory strategy for the bank, including considerations for encouraging a termination of the relationship with the payday lender.

Redacted

Redacted

Attorneys Eyes Only -- Outside Counsel

EXHIBIT 86

No. 14-953-TNM

[redacted]

From: Lafleur, David P. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=DLAFLEUR]
Sent: 2/7/2013 9:01:07 AM
To: Pearce, Mark (DCP) [MaPearce@FDIC.gov]
Subject: RE: Supervisory Pulse 2.6.13

Here's the entry on [redacted] from the region's December report. It's an excerpt from the memo that Kristin found in RADD that I have you... there's no overt criticism but they mentioned developing a strategy to encourage the bank to sever ties with the payday lender.

COMPLIANCE/CRA AND RISK MANAGEMENT – Updates to Items Previously Reported

Bank Name: [redacted]	Problems/Issue: Third party processing relationship risk concerns.
Location [redacted]	Redacted
[redacted]	[redacted]
[redacted]	[redacted]

An offsite review reflected significant volume, in number and dollars, of ACH return items from January to August 2012. Most ACH activity stemmed from a relationship with [redacted] which offers short-term, high interest loans to individuals. A joint FDIC RMS/DCP and [redacted] visitation was conducted on [redacted]. Preliminary findings determined that the high volume of ACH returns are reasonable, as ACH transactions are initiated only for the [redacted] customers who have effectively defaulted. After completion of the visitation, we will determine a supervisory strategy for the bank, including considerations for encouraging a termination of the relationship with the payday lender.

[redacted]

From: Pearce, Mark (DCP)
Sent: Thursday, February 07, 2013 8:26 AM
To: Lafleur, David P.
Subject: RE: Supervisory Pulse 2.6.13

Also, can you check one of the last monthly reports from Chicago. I think there may be something there.

From: Lafleur, David P.
Sent: Thursday, February 07, 2013 8:03 AM
To: Pearce, Mark (DCP)
Subject: RE: Supervisory Pulse 2.6.13

Plot thickens – Kristin found a memo in RADD outlining several issues – bank is a 3rd party payment processor for a payday lender and the field office visited the bank last fall. [redacted]

[redacted]

[redacted]

Redacted

[redacted]

[redacted]

Redacted

[redacted]

[redacted]

Redacted

[redacted]

From: Pearce, Mark (DCP)
Sent: Wednesday, February 06, 2013 05:06 PM
To: Lafleur, David P.
Subject: FW: Supervisory Pulse 2.6.13

Is [redacted] Bank one of ours? [redacted]

From: SupervisoryPolicy
Sent: Wednesday, February 06, 2013 4:33 PM

Attorneys Eyes Only--Outside Counsel

To: SupervisoryPolicy
Subject: Supervisory Pulse 2.6.13

Supervisory Pulse

CFPB

None identified.

Consumer Groups

None identified.

Industry

American Banker: **Service Charges Starting to Rebound at Community Banks** – Community banks are starting to regain some traction when it comes to bringing in fees from deposit accounts. The Federal Reserve Board dealt banks a setback in July 2010 with Regulation E, requiring customer permission for enrollment in overdraft programs. It was especially harsh on smaller banks, which have historically struggled with noninterest income. Smaller banks are slowly rebounding, according to American Banker's analysis of more than 150 banks with assets of $35 billion or less that recently reported quarterly results. Deposit fees at those banks, on average, increased 5% from a year earlier.

Bank Credit News: **ICBA Urges Lawmakers to Exempt Community Banks from New Regulation** – The Independent Community Bankers of America urged lawmakers on Monday to exempt community banks from new regulations, saying that the regulatory burden facing community banks has increased significantly in recent years. "To alleviate the burden of excessive regulation on the nation's community banks, ICBA is calling on policymakers to carve out community banks from new regulations while continuing to pursue tiered regulation that distinguishes between community banks and larger and riskier institutions," ICBA President and CEO Camden R. Fine said.

Additional Items

Denver Post: **Bank Regulators and Lawmakers Seeking Ways to Curb Bank Growth** – Top bank regulators and lawmakers are pushing for action to limit the risk that the government again winds up financing the rescue of one or more of the nation's biggest financial institutions. Officials leading the debate, including Federal Reserve Governor Daniel Tarullo, Dallas Fed President Richard Fisher and Sen. Sherrod Brown, share the view that the 2010 Dodd-Frank Act failed to curb the growth of large banks. Strategies under consideration range from legislation that would cap the size of big banks or make them raise more capital to regulatory actions to discourage mergers or require that financial firms hold specified levels of long-term debt to convert into equity in a failure.

[redacted]

Bank Systems & Technology: **Gamification: Are Banks Ready To Play?** – While foreign banks are beginning to launch gaming initiatives in their digital channels, U.S. banks have been hesitant to follow suit. But any bank that's serious about customer experience will have to take a hard look at the growing trend.

****

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EXHIBIT 87

No. 14-953-TNM

[redacted]

From: Pearce, Mark (DCP) [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=MAPEARCE]
Sent: 2/7/2013 9:03:52 AM
To: Lafleur, David P. [DLafleur@FDIC.gov]
Subject: RE: Supervisory Pulse 2.6.13

Thanks.

[redacted]

[redacted]
From: Lafleur, David P.
Sent: Thursday, February 07, 2013 09:01 AM Eastern Standard Time
To: Pearce, Mark (DCP)
Subject: RE: Supervisory Pulse 2.6.13

Here's the entry on [redacted] from the region's December report. It's an excerpt from the memo that Kristin found in RADD that I have you... there's no overt criticism but they mentioned developing a strategy to encourage the bank to sever ties with the payday lender.

COMPLIANCE/CRA AND RISK MANAGEMENT – Updates to Items Previously Reported

Bank Name: [redacted]	Problems/Issue: Third party processing relationship risk concerns.
Location: [redacted]	Redacted
[redacted]	[redacted]

An offsite review reflected significant volume, in number and dollars, of ACH return items from January to August 2012. Most ACH activity stemmed from a relationship with [redacted] which offers short-term, high interest loans to individuals. A joint FDIC RMS/DCP and [redacted] visitation was conducted on [redacted]. Preliminary findings determined that the high volume of ACH returns are reasonable, as ACH transactions are initiated only for the [redacted] customers who have effectively defaulted. After completion of the visitation, we will determine a supervisory strategy for the bank, including considerations for encouraging a termination of the relationship with the payday lender.

[redacted]

[redacted]

From: Pearce, Mark (DCP)
Sent: Thursday, February 07, 2013 8:26 AM
To: Lafleur, David P.
Subject: RE: Supervisory Pulse 2.6.13

Also, can you check one of the last monthly reports from Chicago. I think there may be something there.

From: Lafleur, David P.
Sent: Thursday, February 07, 2013 8:03 AM
To: Pearce, Mark (DCP)
Subject: RE: Supervisory Pulse 2.6.13

Plot thickens – Kristin found a memo in RADD outlining several issues – bank is a 3rd party payment processor for a payday lender and the field office visited the bank last fall. [redacted]

[redacted]

[redacted]

Redacted

[redacted]

[redacted]

Redacted

[redacted]

[redacted]

Redacted

[redacted]

From: Pearce, Mark (DCP)
Sent: Wednesday, February 06, 2013 05:06 PM
To: Lafleur, David P.
Subject: FW: Supervisory Pulse 2.6.13

Is [redacted] Bank one of ours? [redacted]

From: SupervisoryPolicy
Sent: Wednesday, February 06, 2013 4:33 PM
To: SupervisoryPolicy
Subject: Supervisory Pulse 2.6.13

Supervisory Pulse

CFPB

None identified.

Consumer Groups

None identified.

Industry

American Banker: **Service Charges Starting to Rebound at Community Banks** – Community banks are starting to regain some traction when it comes to bringing in fees from deposit accounts. The Federal Reserve Board dealt banks a setback in July 2010 with Regulation E, requiring customer permission for enrollment in overdraft programs. It was especially harsh on smaller banks, which have historically struggled with noninterest income. Smaller banks are slowly rebounding, according to American Banker's analysis of more than 150 banks with assets of $35 billion or less that recently reported quarterly results. Deposit fees at those banks, on average, increased 5% from a year earlier.

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Additional Items

Denver Post: **Bank Regulators and Lawmakers Seeking Ways to Curb Bank Growth** – Top bank regulators and lawmakers are pushing for action to limit the risk that the government again winds up financing the rescue of one or more of the nation's biggest financial institutions. Officials leading the debate, including Federal Reserve Governor Daniel Tarullo, Dallas Fed President Richard Fisher and Sen. Sherrod Brown, share the view that the 2010 Dodd-Frank Act failed to curb the growth of large banks. Strategies under consideration range from legislation that would cap the size of big banks or make them raise more capital to regulatory actions to discourage mergers or require that financial firms hold specified levels of long-term debt to convert into equity in a failure.

[redacted]

Bank Systems & Technology: **Gamification: Are Banks Ready To Play?** – While foreign banks are beginning to launch gaming initiatives in their digital channels, U.S. banks have been hesitant to follow suit. But any bank that's serious about customer experience will have to take a hard look at the growing trend.

****

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EXHIBIT 88

No. 14-953-TNM

[redacted]

From: Oxley, Tara [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=TOXLEY]
Sent: 2/7/2013 9:56:12 AM
To: Lafleur, David P. [DLafleur@FDIC.gov]; Pearce, Mark (DCP) [MaPearce@FDIC.gov]; Dixon, Dianne E. [didixon@FDIC.gov]
CC: Strong, Kristin A. [KStrong@FDIC.gov]
Subject: RE: Question from Mark about a FL Visit

Here is some information that may be helpful. Please let me know if you need anything further.

Redacted

Redacted In December, the FDIC – RMS and CA – along with the [redacted] – investigated [redacted] Bank's relationship with a payday lender [redacted] This investigation was triggered when the Region noted that [redacted] Bank had a lot of ACH activity – which is usually indicative of an involvement with a payment processor. The Region plans to advise the bank to sever its relationship with [redacted]

Redacted

Attorneys Eyes Only -- Outside Counsel

Redacted

Attorneys Eyes Only -- Outside Counsel

Redacted

Redacted

[redacted]

Redacted

[redacted]

[redacted]

[redacted]

Redacted

[redacted]

[redacted]

Redacted

[redacted]

From: Pearce, Mark (DCP)
Sent: Wednesday, February 06, 2013 05:06 PM
To: Lafleur, David P.
Subject: FW: Supervisory Pulse 2.6.13

Is [redacted] Bank one of ours? [redacted]

From: SupervisoryPolicy
Sent: Wednesday, February 06, 2013 4:33 PM
To: SupervisoryPolicy
Subject: Supervisory Pulse 2.6.13

Supervisory Pulse

CFPB

None identified.

Consumer Groups

None identified.

Industry

American Banker: **Service Charges Starting to Rebound at Community Banks** – Community banks are starting to regain some traction when it comes to bringing in fees from deposit accounts. The Federal Reserve Board dealt banks a setback in July 2010 with Regulation E, requiring customer permission for enrollment in overdraft programs. It was especially harsh on smaller banks, which have historically struggled with noninterest income. Smaller banks are slowly rebounding, according to American Banker's analysis of more than 150 banks with assets of $35 billion or less that recently reported quarterly results. Deposit fees at those banks, on average, increased 5% from a year earlier.

EXHIBIT 89

No. 14-953-TNM

Bank Credit News: **ICBA Urges Lawmakers to Exempt Community Banks from New Regulation** – The Independent Community Bankers of America urged lawmakers on Monday to exempt community banks from new regulations, saying that the regulatory burden facing community banks has increased significantly in recent years. "To alleviate the burden of excessive regulation on the nation's community banks, ICBA is calling on policymakers to carve out community banks from new regulations while continuing to pursue tiered regulation that distinguishes between community banks and larger and riskier institutions," ICBA President and CEO Camden R. Fine said.

Additional Items

Denver Post: **Bank Regulators and Lawmakers Seeking Ways to Curb Bank Growth** – Top bank regulators and lawmakers are pushing for action to limit the risk that the government again winds up financing the rescue of one or more of the nation's biggest financial institutions. Officials leading the debate, including Federal Reserve Governor Daniel Tarullo, Dallas Fed President Richard Fisher and Sen. Sherrod Brown, share the view that the 2010 Dodd-Frank Act failed to curb the growth of large banks. Strategies under consideration range from legislation that would cap the size of big banks or make them raise more capital to regulatory actions to discourage mergers or require that financial firms hold specified levels of long-term debt to convert into equity in a failure.

[redacted]

Bank Systems & Technology: **Gamification: Are Banks Ready To Play?** – While foreign banks are beginning to launch gaming initiatives in their digital channels, U.S. banks have been hesitant to follow suit. But any bank that's serious about customer experience will have to take a hard look at the growing trend.

****

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[redacted]

[redacted]

[redacted]

From: Lowe, M. Anthony
Sent: Friday, January 18, 2013 06:45 AM
To: Sabanty, Teresa M.
Subject: RE[redacted] Processing for Payday Lender

Thanks.

[redacted]

[redacted]

[redacted]
From: Sabanty, Teresa M.
Sent: Friday, January 18, 2013 06:31 AM Eastern Standard Time
To: Lowe, M. Anthony
Subject: Re: [redacted]/ Processing for Payday Lender

Have requested Veronica and John to work with [redacted] and [redacted] in securing info and making a priority.

Teresa M. Sabanty
Assistant Regional Director

From: Lowe, M. Anthony
Sent: Friday, January 18, 2013 06:11 AM
To: Mangian, David K.; Sabanty, Teresa M.
Cc: Jackson, Lawrence R.; Childers, Cynthia M.
Subject: [redacted]Processing for Payday Lender

Teresa and Dave -

Our examiners should Give attention to the payday lender (type of loans, charges and fees, targeted customers, etc). As we will be pursuing a strategy to "encourage" the bank to sever the relationship, we should have the basic info regarding the utility of the product offered. Also, we should have info on how long the bank has been involved in this affinity agreement, due diligence conducted and BOD approvals, fees generated by the bank, etc.

Please make a priority, and ensure the visit is not closed out.

[redacted]

EXHIBIT 90

No. 14-953-TNM

[redacted]

From: Mulholland, Mark F. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=MMULHOLLAND]
Sent: 7/23/2015 12:03:04 PM
To: Lowe, M. Anthony [MLowe@FDIC.gov]
Subject: FW: CBAC candidates

Anthony, per our discussion.

Mark

From: Ryan, Barbara A.
Sent: Tuesday, November 13, 2012 11:53 AM
To: Lowe, M. Anthony; Rollin, Claude A.
Cc: Thompson, Sandra L.; Pearce, Mark (DCP); Plunkett, Sylvia H.; Eberley, Doreen R.
Subject: RE: CBAC candidates

Anthony, thanks for letting us know.

From: Lowe, M. Anthony
Sent: Tuesday, November 13, 2012 9:10 AM
To: Ryan, Barbara A.; Rollin, Claude A.
Cc: Thompson, Sandra L.; Pearce, Mark (DCP); Plunkett, Sylvia H.; Eberley, Doreen R.
Subject: RE: CBAC candidates

Barbara and Claude –

We have recently identified an institution in [redacted] [redacted] that is providing ACH processing for a payday lender. As indicated in the commentary immediately below, we are planning a visitation to the bank next month to review the bank's third party activities, including its association with the payday lender. In consideration of this development, the Chicago Region withdraws its recommendation of [redacted] Bank's CEO, for membership on the Advisory Committee.

M. Anthony Lowe
Regional Director
Chicago

[redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

Attorneys Eyes Only -- Outside Counsel

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Attorneys Eyes Only -- Outside Counsel

[redacted]

From: Lowe, M. Anthony
Sent: Thursday, October 04, 2012 12:51 PM
To: Ryan, Barbara A.; Rollin, Claude A.
Cc: Thompson, Sandra L.; Pearce, Mark (DCP); Plunkett, Sylvia H.; Eberley, Doreen R.
Subject: RE: CBAC candidates

Barbara and Claude -

The Chicago Region recommends the following bankers for consideration on the Advisory Committee. Please contact me directly with any questions.

M. Anthony Lowe
Regional Director
Chicago

Redacted

Officer Name and Title:	[redacted], CEO
Institution Name:	[redacted] Bank
City, State:	[redacted]
Federal Regulator:	FDIC
CAMELS Rating:	Redacted
CRA/Compliance Rating:	[redacted]
Total Assets:	[redacted]

Notes: [redacted]

Redacted

Redacted

Attorneys Eyes Only -- Outside Counsel

EXHIBIT 91

No. 14-953-TNM

Message

From: Lowe, M. Anthony [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=MLOWE]
Sent: 11/13/2012 9:10:27 AM
To: Ryan, Barbara A. [BaRyan@FDIC.gov]; Rollin, Claude A. [CRollin@FDIC.gov]
CC: Thompson, Sandra L. [SaThompson@FDIC.gov]; Pearce, Mark (DCP) [MaPearce@FDIC.gov]; Plunkett, Sylvia H. [SPlunkett@FDIC.gov]; Eberley, Doreen R. [DEberley@FDIC.gov]
Subject: RE: CBAC candidates

Barbara and Claude –

We have recently identified an institution in [redacted] Bank, [redacted], that is providing ACH processing for a payday lender. As indicated in the commentary immediately below, we are planning a visitation to the bank next month to review the bank's third party activities, including its association with the payday lender. In consideration of this development, the Chicago Region withdraws its recommendation of [redacted] Bank's CEO, for membership on the Advisory Committee.

M. Anthony Lowe
Regional Director
Chicago

[redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted]

[redacted]

[redacted]

Attorneys Eyes Only-Outside Counsel

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Attorneys Eyes Only-Outside Counsel

EXHIBIT 92

No. 14-953-TNM

CHI 2/19/2013

FDIC

Federal Deposit Insurance Corporation
Division of Depositor and Consumer Protection
Division of Risk Management Supervision
[redacted]

Chicago Regional Office
[redacted]

February 15, 2013

Board of Directors
[redacted]

Members of the Board:

The FDIC continually assesses the risk and appropriateness of the business lines and activities of our supervised institutions. We have recently become aware of [redacted] Bank's involvement in activities related to payday lending, specifically, the processing of transactions on behalf of [redacted] As a result, the FDIC and [redacted] conducted a joint Compliance and Risk Management visitation of your bank as of [redacted].

The focus of our visitation was on the risk associated with this relationship, compliance with consumer protection laws and regulations, and the effectiveness of Board and senior management due diligence and oversight of this relationship and the corresponding payday lending-related activities. It is our view that payday loans are costly, and offer limited utility for consumers, as compared to traditional loan products. Furthermore, the [redacted] relationship carries a high degree of risk to the institution, including third-party, reputational, compliance, and legal risk, which may expose the bank to individual and class actions by borrowers and local regulatory authorities. Consequently, we have generally found that activities related to payday lending are unacceptable for an insured depository institution.

On February 5, 2013, Field Supervisor [redacted] and Supervisory Examiners [redacted] and [redacted] of the FDIC, along with [redacted], held a conference call with President [redacted] and Chief Financial Officer [redacted] to discuss the FDIC's concerns relative to the [redacted] relationship. Members of our Region's Senior Management will contact you in the near term to schedule a meeting to further discuss our concerns relative to the aforementioned relationship.

If you have any questions regarding this correspondence, please contact Assistant Regional Director David K. Mangian at [redacted] or Assistant Regional Director Teresa M. Sabanty at [redacted].

Sincerely, [redacted]

M. Anthony Lowe
Regional Director

cc: [redacted]

EXHIBIT 93

No. 14-953-TNM

[redacted]

From: Sabanty, Teresa M. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=TSABANTY]
Sent: 4/10/2013 8:45:04 PM
To: Lowe, M. Anthony [MLowe@FDIC.gov]
Subject: Re: [redacted] Bank / Processing for PD lender

Will talk to Dave again tomorrow.

Teresa M. Sabanty
Assistant Regional Director

From: Lowe, M. Anthony
Sent: Wednesday, April 10, 2013 07:31 PM
To: Sabanty, Teresa M.
Subject: RE: [redacted] Bank / Processing for PD lender

Thanks Teresa.

We need to get some indication of the bank's intentions, and/or move forward on arranging a meeting.

M. Anthony Lowe
Regional Director
Chicago

From: Sabanty, Teresa M.
Sent: Wednesday, April 10, 2013 9:30 AM
To: Lowe, M. Anthony
Subject: RE: [redacted] Bank / Processing for PD lender

Here was the contents of our letter. We did not ask for a specific response, rather we said we would be in contact with the bank to further discuss. I just spoke with Dave about this on Monday and our plans to meet with the bank. He was going to speak with [redacted] today and see if he had spoken any more to [redacted]. The state will be going in May for RM. I don't see any other responses in RADD. Let me know if you need more.

February 15, 2013

Board of Directors
[redacted] Bank
[redacted]

Members of the Board:

The FDIC continually assesses the risk and appropriateness of the business lines and activities of our supervised institutions. We have recently become aware of [redacted] involvement in activities related to payday lending , specifically , the processing of transactions on behalf of [redacted] As a result, the FDIC and [redacted] conducted a joint Compliance and Risk Management visitation of your bank as of [redacted].

The focus of our visitation was on the risk associated with this relationship, compliance with consumer protection laws and regulations, and the effectiveness of Board and senior management due diligence and oversight of this relationship and the corresponding payday lending-related activities. It is our view that payday loans are costly, and offer limited utility for consumers, as compared to traditional loan products. Furthermore, the [redacted] relationship carries a high degree of risk to the institution, including third-party, reputational, compliance, and legal risk, which may expose the bank to individual and class actions by borrowers and local regulatory authorities. Consequently, we have generally found that activities related to payday lending are unacceptable for an insured depository institution.

On February 5, 2013, Field Supervisor [redacted] and Supervisory Examiners [redacted] and [redacted] of the FDIC, along with [redacted], held a conference call with President [redacted] and Chief Financial Officer [redacted] to discuss the FDIC's concerns relative to the [redacted] relationship. Members of our Region's Senior Management will contact you in the near term to schedule a meeting to further discuss our concerns relative to the aforementioned relationship.

If you have any questions regarding this correspondence , please contact Assistant Regional Director David K. Mangian at [redacted] or Assistant Regional Director Teresa M. Sabanty at [redacted].

Sincerely,

M. Anthony Lowe
Regional Director

[redacted]

From: Lowe, M. Anthony
Sent: Wednesday, April 10, 2013 9:24 AM
To: Sabanty, Teresa M.
Subject: [redacted] Bank / Processing for PD lender

Teresa - have we received any response on the bank's plans?

[redacted]

[redacted]

EXHIBIT 94

No. 14-953-TNM

June 18, 2013

Mr. M. Anthony Lowe
Regional Director
Federal Deposit Insurance Corporation
[redacted]

Re: Correspondence of February 15, 2013 regarding [redacted]

Dear Mr. Lowe:

I am writing on behalf of the members of the Board of Directors of [redacted] Bank and upon the recommendation of Mr. [redacted], of the [redacted] office, to respond to your letter of February 15, 2013. The letter suggested the services provided by [redacted] Bank to [redacted] carry a high degree of risk to the institution (such as reputational, compliance, and legal risk), which may expose [redacted] Bank to adverse actions by borrowers and local regulatory authorities. In light of the concerns raised in the letter, please consider the possible changes to the accounts and the relationship with [redacted] all which are described more completely below.

Initially, we note payday lending is an activity that may be considered in some forms to be an unfair, deceptive or abusive lending practice. [redacted] *Bank is not engaged in payday lending*. Instead, the bank only provides what are commonly understood to be traditional banking services to [redacted] and its customers *subsequent* to the consumer making their choice to engage [redacted] ACH services and prepaid card processing. Based on our current understanding, [redacted] is engaged only in lawful lending activities in the states in which it is active.

We also recognize that the federal bank regulators discourage federally insured institutions from direct participation in the payday lending marketplace. On April 24, 2013, the Consumer Financial Protection Bureau released in white paper form its initial data findings regarding the payday lending industry. While this paper was critical of traditional non-bank payday lenders, it also described a similar product offered by some federally insured institutions known as "deposit advance loans". [redacted] *Bank does not offer this product*. Shortly after the CFPB whitepaper, as part of what appears to be an overall regulatory effect, the FDIC requested comment on its proposed guidance on deposit advance products offered by state chartered nonmember banks such as [redacted] Bank. 78 Federal Register 25268 (April 30, 2013) (Proposed guidance with request for comment on deposit advance products). The Office of the Comptroller of the Currency announced similar proposed Supervisory Guidance for national banks offering such products. The Federal Reserve Board also issued a statement directed to state member banks on the same day on the same topic.

Again, [redacted] *Bank is not engaged in payday lending, deposit advance lending, or any similar activity, nor has it ever been.* Nor has there been any suggestion that [redacted] is engaged in unlawful activities. Nor has any suggestion been made by any party, including the Regulatory

E-Mail Address: [redacted] • Web Page: [redacted]

Team conducting the payments review in December 2012, or during the exit briefing in February 2013, that [redacted] Bank is engaged in unfair or deceptive practices through our services to [redacted] and its customers. Accordingly, we believe that [redacted] Bank throughout the course of its relationship with [redacted] has never been engaged in activities which would give rise to claims under Section 5 of the Federal Trade Commission Act regarding unfair or deceptive acts.

Since 2004, [redacted] Bank has provided low cost ACH origination services to [redacted] During that time, neither the ACH operator (Federal Reserve) nor NACHA have questioned the ACH activities of [redacted] The return rates have not varied from historic levels. Nor has the unauthorized return rate been greater than 1 percent which is the industry benchmark. In addition, [redacted] Bank has provided low cost prepaid cards to [redacted] customers as a method of distributing the proceeds of [redacted] loans to customers. [redacted] maintains a funding account with [redacted] Bank that is used to fund the amounts loaded on to each prepaid card. Neither the ACH origination service nor the prepaid card service raises direct financial or operational risks to [redacted] Bank that are significantly different from the same services provided to other customers. In addition, as a result of these activities, [redacted] maintains a daily deposit at [redacted] Bank with significant balances.

In order to address the concerns raised by your February 15 letter, [redacted] Bank retained the services of a well-known consultant, [redacted], which assisted management in completing the risk assessment of [redacted] Bank's services to [redacted] This comprehensive assessment concludes that the services provided by [redacted] Bank to [redacted] pose no significant risk to the financial institution, including financial, reputational and legal risk. Up until now, that has also been the assessment of the Board and of the management of [redacted] Bank.

The risk assessment, however, identified the need for a more formalized and documented Prepaid Card Risk Assessment and Management Program, among other recommendations. The assessment also suggested certain board reporting processes be implemented and, with respect to the [redacted] prepaid card program, the assessment made a number of specific recommendations that [redacted] Bank has implemented or will implement in the near future.

We understand that managing business risks is an appropriate activity for [redacted] Bank, and we welcome the opportunity to reduce the risks suggested by your letter. To further address those risks, we could propose changes to the ACH origination agreement between [redacted] Bank and [redacted] strengthening the agreement as it relates to [redacted] Bank. We could request the establishment of [redacted] performance standards that will require [redacted] to make changes over time that will result in a permanent, significant reduction of the volume of ACH returns. We also understand [redacted] is pursuing the implementation of advanced technology in order to reduce the level of returns experienced. In addition, we could seek broader contractual protection in the form of additional indemnification, hold harmless and liability limitation provisions from [redacted] against the legal and reputational risks posed to [redacted] Bank through the services it provides to [redacted] and its customers. We could also request more complete and detailed financial and regulatory reporting from [redacted] so that [redacted] Bank can more thoroughly monitor all financial and regulatory risks related to the services we provide to [redacted] We could also request [redacted] provide an opinion of outside counsel that it is engaged in lawful activities in the states in which it is active.

While we believe that in the past we undertook appropriate steps to mitigate the types of risks associated with the activities that we provide to [redacted] your letter and subsequent discussions with Mr. [redacted] have prompted us to consider further how any risk to [redacted] Bank may be reduced or mitigated. The simple and obvious answer is to request that [redacted] terminate their banking relationship with [redacted] Bank. This leads me to several obvious questions. However, before I list them it seems the underlying issue at hand and what the federal regulators are framing and possibly limiting is the consumer's behavior or choice. To the best of my knowledge, none of the customers of [redacted] are forced to participate in any of the transactions; they do so by their own volition. Life is about choice and therefore flush with assorted paths any of us may or may not choose to travel. With that understanding regarding choice, please consider the following questions:

Question #1, Why has the FDIC and others chosen to attempt to safeguard the consumer from payday lending/title lending by becoming the societal watchdog?

What gives this (payday/title lending) a greater priority compared to the hazards of individuals choosing to overindulge on the wrong foods and beverages purchased from legally operated and regulated businesses resulting in an overweight and unfit society? We have all heard or read the statistics and the impact this will have on the cost of healthcare. Therefore, using the current line of thinking, should we discontinue banking grocery and convenience stores?

What gives this a greater priority compared to the hazards created when individuals choose to purchase beer, wine, or liquor from a regulated and licensed store and overindulge? We know individuals make choices to drink and drive causing accidents which may kill impacting not only their life, but the lives of others. Therefore using the current line of thinking, should we discontinue banking the state liquor, grocery, and convenience stores?

What gives this a greater priority compared to the hazards created when individuals choose to purchase and use tobacco products? We know use of this product can kill as well as create grave health issues. Let us not forget the impact upon the societal cost of health care. Therefore, using the current line of thinking should we discontinue banking all retailers/wholesalers of tobacco products?

What gives this a greater priority compared to the fees charged by assorted billers (non-payday lenders and financial institutions) generating a late fee market which is more than <u>three</u> times the fees generated by payday lenders? Therefore using the current line of thinking, should we discontinue banking the likes of public utilities?

There are additional examples which could be identified but from these four I believe you understand my premise that the consumer has the ability and responsibility of choice. With that responsibility are the residual consequences relating to that choice.

- Question #2, Would you please direct me to the FIL which addresses the ability of the FDIC to force an institution to dismiss a relationship when there have been no safety and soundness considerations identified other than potential reputational risks?

- Question #3, Would you please advise if there have been changes to the scopes of Safety and Soundness as well as Compliance examinations to identify if a financial institution is conducting business in some capacity with a Payday Lender or Title Lender, both of which may be operating legally? (We have identified at least five different financial institutions debiting our customers for payday lending activities. I would hate to think we might be operating on an unlevel playing field.)

- Question #4, What assurances are there that [redacted] will not find another ODFI and business begins/continues as usual but with newly implemented tools lowering the return rates to a more "traditional" level? Or are we just moving the problem to another jurisdiction?

- Question #5, Assuming all federal regulators are successful in their attempt to drive the payday lenders from the banking system, what assurances might there be this industry will not go underground or off-shore? If this were to occur, what might be the consequences?

- Question #6, I am sure you have heard of the book titled The One Minute Manager. One of the items discussed in the book encourages people to pose solutions to problems they have identified. From the perspective of the FDIC, what is an equitable product/return given the imbedded risk involved with this type of business?

As was previously shared, [redacted] Bank's business relationship with [redacted] has existed since 2004. It has been a successful relationship for both parties up to this point in time. With all of this said, I would like to schedule a time to discuss the questions and the termination of our relationship with [redacted] at your convenience.

Very truly yours,

[redacted]
Vice Chairman & CEO

Cc: [redacted]

EXHIBIT 95

No. 14-953-TNM

[redacted]

From: Jackson, Lawrence R. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=LJACKSON]
Sent: 7/11/2013 12:56:28 PM
To: Pearce, Mark (DCP) [MaPearce@FDIC.gov]
CC: Lowe, M. Anthony [MLowe@FDIC.gov]
Subject: RE: Secure Email - [redacted] Bank

Mark:

The following latest information was provided by Senior Compliance Examiner [redacted] regarding your first set of questions. Let us know if you need additional information.

[redacted]

- **Most importantly,** when I spoke to CFO [redacted] this morning, he stated that **the bank has officially informed** [redacted] **that** [redacted] **Bank is terminating the** [redacted] **ACH relationship.** [redacted] stated that that no firm cut-off date has yet been established, but that he fully expects this to occur within the next 60 days. [redacted]

[redacted]

[redacted]

From: Pearce, Mark (DCP)
Sent: Tuesday, July 09, 2013 8:20 AM
To: Jackson, Lawrence R.
Subject: FW: Secure Email - [redacted] Bank

L. Ray – Anthony shared a letter he had gotten from [redacted] Bank regarding the termination of the relationship with [redacted].

I had forgotten he was out on leave. Can you look into this?

[redacted]

[redacted]

From: Pearce, Mark (DCP)
Sent: Tuesday, July 09, 2013 9:18 AM
To: Lowe, M. Anthony
Subject: RE: Secure Email - [redacted] Bank

Anthony,

Thanks for sharing; interesting letter.

Can you send me more information on this relationship (e.g. report of visitation)? I'm interested in understanding the nature of the prepaid card program (how it works, fees charged, etc.), the level of ACH returns for [redacted], and the significance of the [redacted] ACH processing compared to other ACH processing done by the bank (e.g. is [redacted] a major relationship or small one?).

Also, am curious how you plan to respond to these questions.

[redacted]

From: Lowe, M. Anthony
Sent: Wednesday, July 03, 2013 10:12 AM
To: Pearce, Mark (DCP)
Subject: FW: Secure Email - [redacted] Bank

Mark – followup to our discussion earlier – enclosed is the correspondence from [redacted] Bank. I have a meeting with him scheduled for later this month.

[redacted]
Chicago

[redacted]

[redacted]

[redacted]

EXHIBIT 96

No. 14-953-TNM

FDIC
Federal Deposit Insurance Corporation
Division of Depositor and Consumer Protection
Division of Risk Management Supervision
[redacted]

Chicago Regional Office
[redacted]

August 12, 2013

TO: Mark Pearce
Director – DCP

Doreen Eberley
Director – RMS

FROM: M. Anthony Lowe
Regional Director

SUBJECT: July Regional Status Report – Chicago

Redacted

Attorneys Eyes Only -- Outside Counsel

Redacted

Attorneys Eyes Only -- Outside Counsel

Redacted

Redacted

COMPLIANCE/CRA AND RISK MANAGEMENT – New Items

Bank Name: [redacted]	Problems/Issue: Third party processing relationship risk
Location: [redacted]	Redacted
Total Assets: Redacted	
RMS Contact: CM Katrice Yokley / ARD Dan Marcotte	DCP Contact: RE Marybeth Apolzan / ARD Teresa Sabanty

A Joint RM and [redacted] examination is in process. Prior to the commencement of examination, we were alerted that TPPP relationships had moved to the bank from [redacted], where several TPPP concerns had been identified. In addition, we received a complaint relative to one of the bank's TPPPs. Preliminary findings evidence several concerns with the bank's TPPP activities, including inadequate due diligence and ongoing oversight. Exam findings evidence a lack of familiarity with FIL-3-2012 and lack of adherence to its guidance. [redacted] The bank acknowledges processing transactions for one payday lender; however examiners identified three other potential payday lending companies within the sampled files. [redacted], [redacted] Earnings risk is manageable, with ACH revenue totaling approximately $100,000 per month. Management has developed an ACH Action Plan which will be reviewed to determine if it can adequately address the weaknesses identified during the examination. Risk management and compliance are working together to fully assess the bank's current procedures and the associated risks. The BSA examination is in progress. A briefing is planned for regional senior management to detail the identified weaknesses and determine supervisory course of action.

COMPLIANCE/CRA AND RISK MANAGEMENT – Updates to Items Previously Reported

Redacted

Bank Name: [redacted]	Problems/Issue: Third party processing relationship risk concerns.
Location: [redacted]	Redacted
Total Assets: Redacted	Action: Supervisory Letter
RMS Contact: CM Leanean Merritte / ARD David Mangian	DCP Contact: ARD Teresa Sabanty

A joint visitation conducted on [redacted] determined that significant ACH activity stemmed from a relationship with [redacted] which offers short-term, high interest loans to individuals. The FDIC's concerns regarding the bank's involvement in payday lending related activities and the supervisory expectation to exit the [redacted] relationship was relayed in a conference call held 2/5/13, and reaffirmed in a supervisory letter dated 2/15/13. [redacted] On 7/17/13, conference call held with President who confirmed exit of [redacted] relationship.

Redacted

Redacted

Redacted

Attorneys Eyes Only -- Outside Counsel

Redacted

Attorneys Eyes Only -- Outside Counsel

EXHIBIT 97

No. 14-953-TNM

[redacted]

From: Jackson, Lawrence R. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=LJACKSON]
Sent: 8/30/2013 12:14:53 PM
To: Lowe, M. Anthony [MLowe@FDIC.gov]; Couch, Cheryl A. [CCouch@FDIC.gov]
Subject: FW[redacted]: payday

This was just brought to my attention. I'm not how much you two are aware, but I didn't think we wanted our banks involved in this type activity. I wasn't aware of any existing relationships. I just want us all to be on the same page.

[redacted]

From: Speece, Craig
Sent: Friday, August 30, 2013 10:53 AM
To: Jackson, Lawrence R.
Cc: Sabanty, Teresa M.; Jagers, Thomas J.
Subject: [redacted] payday

Boss,

Below is the email about [redacted] and payday lending. From my initial read, appears they would only have a deposit and lending relationship. Doesn't appear they would be involved in any payment processing. And as the email states, they already have similar relationships with smaller payday lenders.

We need to know more, but right now this appears to be less of a concern than the [redacted] situations.

[redacted]

-----Original Message-----
From: Gaertner, Lisa A.
Sent: Tuesday, August 27, 2013 2:45 PM
To: VanVickle, David A.
Cc: Bush, Debbie J.
Subject: FW: [redacted]

Dave and Debbie -

I just wanted to make you aware of a new relationship that [redacted] is thinking of engaging in. I sent the below e-mail to Stephanie Bissell and Christina Quinlan in compliance. Christina asked me to inform bank management that they should consult with the RO prior to entering into this relationship due to the concerns surrounding payday lenders. I did so and wanted to inform you as well in case you hear from them. Keep in mind that the bank itself would not be engaging in payday lending, but would have a depository and lending relationship with the payday lender. If you remember from discussions at our last exam, they already have relationships with other MSBs that engage in payday lending, but this company would be much larger.

Lisa

-----Original Message-----
From: Gaertner, Lisa A.
Sent: Tuesday, August 27, 2013 9:12 AM
To: Bissell, Stephanie M.
Cc: Quinlan, Christina A.
Subject [redacted]

Hi Stephanie,

I corresponded with you back in February when we were examining [redacted] because they started a prepaid card program through relationships that had with various money service business (MSB) customers across the country. I am back in the bank this week for a quick visit and the head of the MSB division mentioned to me that they were looking into establishing a relationship (deposit and maybe loan) with [redacted] They are an online payday lender. See below for a link to their website. He is aware of concerns about payday lending related to ensuring that loans are not offered to persons residing in states where they are not permissible. He has been assured that [redacted] follows state laws in which they operate and has controls in place to prevent lending to persons in states where this type of lending is prohibited. He also knows that they limit rollovers of loans, which can be another concern. I thought I would check back with you to see if you were aware of any other issues that have come to light recently with banks involved in these types of relationships, or any concerns with [redacted] in particular. Thanks ,

[redacted]

[redacted]

EXHIBIT 98

No. 14-953-TNM

[redacted]

From: Lowe, M. Anthony [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=MLOWE]
Sent: 8/31/2013 11:23:44 AM
To: Jackson, Lawrence R. [LJackson@FDIC.gov]; Couch, Cheryl A. [CCouch@FDIC.gov]
Subject: [redacted]: payday

Our position has been to use available means, including verbal recommendations, to strongly encourage SNMs to refrain from any activities that provide assistance to the business activities of pd lenders. Let's discuss.

From: Jackson, Lawrence R.
Sent: Friday, August 30, 2013 11:14 AM
To: Lowe, M. Anthony; Couch, Cheryl A.
Subject: FW: [redacted] payday

This was just brought to my attention. I'm not how much you two are aware, but I didn't think we wanted our banks involved in this type activity. I wasn't aware of any existing relationships. I just want us all to be on the same page.

[redacted]

From: Speece, Craig
Sent: Friday, August 30, 2013 10:53 AM
To: Jackson, Lawrence R.
Cc: Sabanty, Teresa M.; Jagers, Thomas J.
Subject: [redacted] payday

Boss,

Below is the email about [redacted] and payday lending. From my initial read, appears they would only have a deposit and lending relationship. Doesn't appear they would be involved in any payment processing. And as the email states, they already have similar relationships with smaller payday lenders.

We need to know more, but right now this appears to be less of a concern than the [redacted] situations.

[redacted]

-----Original Message-----
From: Gaertner, Lisa A.
Sent: Tuesday, August 27, 2013 2:45 PM
To: VanVickle, David A.
Cc: Bush, Debbie J.

Attorneys Eyes Only -- Outside Counsel

Subject: FW: [redacted]

Dave and Debbie -

I just wanted to make you aware of a new relationship that [redacted] is thinking of engaging in. I sent the below e-mail to Stephanie Bissell and Christina Quinlan in compliance. Christina asked me to inform bank management that they should consult with the RO prior to entering into this relationship due to the concerns surrounding payday lenders. I did so and wanted to inform you as well in case you hear from them. Keep in mind that the bank itself would not be engaging in payday lending, but would have a depository and lending relationship with the payday lender. If you remember from discussions at our last exam, they already have relationships with other MSBs that engage in payday lending, but this company would be much larger.

Lisa

-----Original Message-----
From: Gaertner, Lisa A.
Sent: Tuesday, August 27, 2013 9:12 AM
To: Bissell, Stephanie M.
Cc: Quinlan, Christina A.
Subject: [redacted]

Hi Stephanie,

I corresponded with you back in February when we were examining [redacted] because they started a prepaid card program through relationships that had with various money service business (MSB) customers across the country. I am back in the bank this week for a quick visit and the head of the MSB division mentioned to me that they were looking into establishing a relationship (deposit and maybe loan) with [redacted] They are an online payday lender. See below for a link to their website. He is aware of concerns about payday lending related to ensuring that loans are not offered to persons residing in states where they are not permissible. He has been assured that [redacted] follows state laws in which they operate and has controls in place to prevent lending to persons in states where this type of lending is prohibited. He also knows that they limit rollovers of loans, which can be another concern. I thought I would check back with you to see if you were aware of any other issues that have come to light recently with banks involved in these types of relationships, or any concerns with [redacted] in particular. Thanks ,

[redacted]

[redacted]

EXHIBIT 99

[redacted]

From: Lowe, M. Anthony [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=MLOWE]
Sent: 9/5/2013 9:32:48 AM
To: VanMeter, Andria V. [AVanMeter@FDIC.gov]
Subject: [redacted]

Correct - [redacted].

----- Original Message -----
From: VanMeter, Andria V.
Sent: Thursday, September 05, 2013 08:31 AM
To: Lowe, M. Anthony
Subject: RE: [redacted]

I am looking at our bank in [redacted], correct?

Andria
[redacted]

-----Original Message-----
From: Lowe, M. Anthony
Sent: Thursday, September 05, 2013 8:27 AM
To: VanMeter, Andria V.
Subject: [redacted]

Andria - please look through RADD, recent RMS and DCP ROEs, etc, and advise of any mention therein that the bank is involved, directly or indirectly, in payday lending. Some email traffic from the weekend has me concerned that this bank may have been involved in certain activities which have been heavily criticized elsewhere in the Region.

Thanks.

EXHIBIT 100

No. 14-953-TNM

[redacted]

From: Lowe, M. Anthony [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=MLOWE]
Sent: 1/18/2013 6:03:01 AM
To: Dujenski, Thomas J. [TDujenski@FDIC.gov]
Subject: Payday Lender

Tom - our PD lender, for which a bank is conducting processing, goes under the name of [redacted] so I think it's a different entity. We should definitely continue to share and compare info as our cases develop.

[redacted]

EXHIBIT 101

No. 14-953-TNM

Message

From: [redacted] [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=[redacted]]
Sent: 9/16/2013 3:53:42 PM
To: Lowe, M. Anthony [MLowe@FDIC.gov]
CC: Sentell, Veronica [VSentell@FDIC.gov]; Rock, Randy S. [RRock@FDIC.gov]; Mangian, David K. [DMangian@FDIC.gov]; Sabanty, Teresa M. [TSabanty@FDIC.gov]; Merritte, Leanean C. [LMerritte@FDIC.gov]
Subject: RE: Ongoing Exams/Visits with TPPP Issues Identified

Anthony,
I know you are well aware of the situation at [redacted]. Below are the dates of correspondence pertaining to our payday lending concerns. Thanks, [redacted]

2/15/2013 - *Letter to Board of Directors recapping our visitation and concerns associated with their processing transactions for payday lender* [redacted]
6/18/2013 – *Letter from the Bank responding to our 2/15/2013 Letter*

Primary Risk: Third-party, reputational, compliance and legal

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From: Lowe, M. Anthony
Sent: Monday, September 16, 2013 2:38 PM
To: RMS CHI Field Supervisors; DCP CHI Field Supervisors
Subject: FW: Ongoing Exams/Visits with TPPP Issues Identified
Importance: High

Field Supervisors – please also advise of any correspondence, pertaining to payday, that you may be aware of. Thanks.

M. Anthony Lowe
Regional Director
Chicago

From: Lowe, M. Anthony
Sent: Monday, September 16, 2013 1:36 PM
To: RMS-DCP CHI Exec
Subject: RE: Ongoing Exams/Visits with TPPP Issues Identified
Importance: High

ARDs – please advise as soon as possible this afternoon of any correspondence, within the previous two years, that we have sent to banks regarding concerns specifically in regard to ***payday lending.*** Please provide the name of the bank, location, date of correspondence, and primary concern (risk) regarding the activity.

High priority.

M. Anthony Lowe
Regional Director
Chicago

From: Lowe, M. Anthony
Sent: Friday, September 13, 2013 12:55 PM
To: RMS CHI Field Supervisors; DCP CHI Field Supervisors

Cc: RMS-DCP CHI Exec
Subject: FW: Ongoing Exams/Visits with TPPP Issues Identified
Importance: High

Field Supervisors – please see below and provide your best response today. Please coordinate with your Territory disciplinary counterpart, to ensure no duplication. You can supplement on Monday. Please copy me on your response.

M. Anthony Lowe
Regional Director
Chicago

From: LaPierre, James D.
Sent: Friday, September 13, 2013 11:41 AM
To: RDs
Cc: Eberley, Doreen R.; Pearce, Mark (DCP); Miller, Rae-Ann; Miller, Jonathan N. (DCP)
Subject: Ongoing Exams/Visits with TPPP Issues Identified

RDs-

We are looking for information regarding ongoing exams or visits where concerns with Third Party Payment Processors have been identified. Because of the short turnaround, please provide the following information directly to RMS Associate Director Rae-Ann Miller, via email, with a copy to the respective RD.

Name of institution, City, State, Total Assets

Brief description of the activity (number of merchants, business activities of these merchants, volume)

How the issue was identified (Officer's Questionnaire, Fed exception report, found during exam, etc.)

We are looking for an initial "best efforts" reply by COB today, with a final response by COB Monday.

Thanks for your prompt response,
JDL

James D. LaPierre
FDIC Regional Director
Kansas City Region

EXHIBIT 102

No. 14-953-TNM

Message

From: Lowe, M. Anthony [MLowe@FDIC.gov]
Sent: 5/10/2011 7:38:53 AM
To: Sabanty, Teresa M. [tsabanty@fdic.gov]
[redacted]

...ah...I missed that. I'll put a brownie point back in her bank. ☺

M. Anthony Lowe
Regional Director
Chicago

From: Sabanty, Teresa M.
Sent: Tuesday, May 10, 2011 6:38 AM
To: Lowe, M. Anthony
[redacted]

She did copy John....see below highlight???

[redacted]

From: Lowe, M. Anthony
Sent: Monday, May 09, 2011 4:58 PM
To: Sabanty, Teresa M.; Jackson, Lawrence R.; Poskonka, John J.; Dallin, Lynn B
Cc: VanMeter, Andria V.; Ennis, Lisa K.
Subject: [redacted]
Importance: High

Lynn / John –

We should draft a brief letter to the bank requesting that prior to engaging in any business plan change involving PD lending, they consult with us. Throw in some items about rep, legal, et al risk from that type of program, and underwriting and capital needs. Lets try to get out asap this week.

M. Anthony Lowe
Regional Director
Chicago

From: Sabanty, Teresa M.
Sent: Monday, May 09, 2011 4:00 PM
To: Lowe, M. Anthony; Jackson, Lawrence R.
Subject: [redacted]

fyi

[redacted]

[redacted]

From: Khan, Akhtar H.
Sent: Monday, May 09, 2011 3:55 PM
To: Sabanty, Teresa M.
[redacted]

FYI.

From: Ennis, Lisa K.
Sent: Monday, May 09, 2011 4:53 PM
To: George, Steven F.
Cc: Khan, Akhtar H.; Neal, Amy C.; **Poskonka, John J.**
Subject: [redacted]

Heads up in case you get a phone call...

[redacted]

From: McGary, James P.
Sent: Monday, May 09, 2011 3:23 PM
To: Ennis, Lisa K.; Welch, Frederick P.; Baxter, Tiffany M.
Subject: [redacted]

Just had a phone call from [redacted] and [redacted] wants to buy a pay-day lender and make it a wholly owned subsidiary of the bank. I told [redacted] that, based on past experience, the FDIC would likely look unfavorably on this acquistion. He said that the would provide [redacted] with the state's position (he didn't say what it was but I assume that as long as the product/busines is legal it's a matter of managing the risk) and recommend he contact the FDIC for our perspective.

EXHIBIT 103

No. 14-953-TNM

FDIC
Federal Deposit Insurance Corporation
Division of Risk Management Supervision
[redacted]

Chicago Regional Office
[redacted]

MAY12'11 RCVD

May 11, 2011

Board of Directors
[redacted] Bank
[redacted]

Members of the Board:

It has come to the FDIC's attention that your bank is considering acquiring a payday lending business, to be established as a wholly-owned subsidiary of the bank. On May 10, 2011, Case Manager [redacted] discussed the FDIC's concerns with Chief Executive Officer [redacted] regarding engaging in the activity of payday lending. Specifically, the FDIC wants to make the Board aware of the additional legal, reputational, and consumer compliance risks associated with payday lending. Furthermore, engaging in this activity would require comprehensive underwriting policies and practices, and the maintenance of capital and allowance levels commensurate with the additional risk inherent in the payday loan portfolio. We request that the bank inform our office in writing of any proposed change in its business plan pertaining to the acquisition of a payday lending entity prior to engaging in this activity.

If you have any questions or comments regarding the report, please contact Case Manager [redacted], or write to Regional Director M. Anthony Lowe at [redacted]

Sincerely,

[redacted]

John J. Poskonka
Assistant Regional Director

[redacted]

EXHIBIT 104

No. 14-953-TNM

[redacted]

MAY23'11 RCVD

May 16, 2011

John J. Poskonka, Assistant Regional Director
Federal Deposit Insurance Corporation
[redacted]

Re: Payday lending business

Dear Mr. Poskonka,

This letter is to inform you that the Board of Directors of [redacted] Bank, after much consideration at their monthly meeting held on May 10, 2011, has decided not to pursue a payday lending business in light of additional legal, reputational and consumer compliance risks associated with same.

Thank you for your attention and assistance in this matter.

[redacted]

cc: [redacted]
M. Anthony Lowe
[redacted]

EXHIBIT 105

No. 14-953-TNM

[redacted]

[redacted]

Chicago

[redacted]

From: Marcotte, Daniel
Sent: Friday, August 02, 2013 02:02 PM
To: Lowe, M. Anthony; Sabanty, Teresa M.
[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

From: Lowe, M. Anthony
Sent: Wednesday, July 31, 2013 10:07 AM
To: Jackson, Lawrence R.; Couch, Cheryl A.
[redacted]

[redacted]

Once we have sufficient info on what exactly our bank is doing and processing, suggest we consider drafting and sending an "early warning" letter of our concerns regarding the relationship with PD lenders.

[redacted]

From: Jackson, Lawrence R.
Sent: Wednesday, July 31, 2013 10:01 AM
To: Couch, Cheryl A.
Cc: Lowe, M. Anthony
[redacted]
Importance: High

Not sure where Risk is at this point, but we may need to be involved before things get too far down the road on your side. Will know more following conference call with FS.

[redacted]

From: Sabanty, Teresa M.
Sent: Wednesday, July 31, 2013 9:54 AM
To: Jackson, Lawrence R.
Subject: [redacted]
Importance: High

L. Ray,

This is going to blow up quickly. [redacted]

[redacted]

From: Neal, Amy C.
Sent: Wednesday, July 31, 2013 9:48 AM
To: Sabanty, Teresa M.; Apolzan, Marybeth I.; Bissell, Stephanie M.; Blankenship, Jackson W.
Cc: Wagner, Donna J.
[redacted]

[redacted]

We just had a conference call on [redacted] Bank [redacted] with RMS and [redacted]. We now have knowledge of some very serious issues. The bank is generally looking at only credit risk from FIL 44-2008 but that is it. Oversight is weak. I am not intimately familiar with the 2012 TPPP memo, but it does not appear they are following. The examiners found them doing business with payday lenders and the search into the files continues. The bank was not aware of these payday lender relationships. This bank has up to 7200 third parties and $50 to $60 million per day in transactions. Now that we know there is risk, we need to chat ASAP on our DCP strategy. RMS is putting together a memo and still working on the exam, but we need to talk about a plan. A. Do we allow risk to continue without our onsite presence? B. Do we have onsite presence now or wait until the exam and she the results of what risk identifies and the end result from their review...enforcement action, exiting? These are my questions.

[redacted]

[redacted]

EXHIBIT 106

No. 14-953-TNM

CHI 9/4/2013

Early Warning Letter Re: ACH + TPPP Activity

FDIC

Federal Deposit Insurance Corporation
Division of Risk Management Supervision
[redacted]

Chicago Regional Office
[redacted]

September 3, 2013

Board of Directors
[redacted]

Subject: <u>Commercial Automated Clearing House and Third-Party Payment Processing Oversight</u>

Members of the Board:

A safety and soundness examination of your institution commenced on [redacted] 2013, which included a review of the Bank's Automated Clearing House (ACH) and Third-Party Payment Processing (TPPP). Although the examination is continuing, this letter is to advise that we have identified material weaknesses relating to the institution's ability to measure, monitor, and control third-party risks. The examination findings indicate the Board entered into the TPPP program without implementing sufficient policies, procedures, and controls, exposing the Bank to increased reputational, legal, and financial risks.

Based on the preliminary results of the examination, the Board failed to exercise an appropriate level of oversight over the institution's third-party relationships. Noted deficiencies include:

- [redacted]
- [redacted]
- [redacted]
- Failure to establish a method to identify higher risk customers within the current customer base or implement enhanced, risk-focused monitoring procedures for high risk customers.
- [redacted]
- Lack of controls to ensure the Bank does not engage in transactions with payday lenders, illegal gambling businesses, or other high risk entities, resulting in heightened concerns regarding the Bank Secrecy Act related aspects of the program.
- [redacted]
- [redacted]
- [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Members of our Region's Senior Management will contact you in the near term to schedule a meeting to further discuss our concerns relative to the TPPP relationship. In aggregate, the program is operating in an unsafe and unsound manner, and a progressive wind-down of the program is warranted. A final Report of Examination, detailing our examination findings relating to the other Risk Management areas reviewed, will be issued under separate cover.

If you have any questions regarding this correspondence, please contact Assistant Regional Director Daniel Marcotte at [redacted] or Case Manager Katrice Yokley at [redacted].

Sincerely,

[redacted]

M. Anthony Lowe
Regional Director

EXHIBIT 107

No. 14-953-TNM

1.12

CHICAGO REGION TELEPHONE MEMORANDUM

EIC/Caller	Bank/Location/Cert#		Memo Date
[redacted]	[redacted]		September 13, 2013
Total Assets	**Preliminary CAMELS Ratings**		**Current Exam Date / Type**
Redacted			July 22, 2013/Safety & Soundness Examination/FDIC
Last FDIC/[redacted] Exam Date / Rating	**Prior FDIC/[redacted] Exam Date / Rating**	**[redacted] Date / Rating**	**Enforcement Action Date/ Type**
Redacted			October 6, 2009/Compliance Memorandum of Understanding

[redacted]

[redacted]

Redacted

[redacted]

Attorneys Eyes Only

Management Comments: (Management structure, deficiencies, and compliance with outstanding regulatory actions)

- [redacted]
- Of 50 sampled, 10 entities displayed factors indicative of high-risk activities, including payday lenders, nested TPPPs, and merchants with adverse reputational risk factors.
- [redacted].
- Monitoring procedures for smaller customers (bulk of merchants) do not differentiate between high and low risk customers.
- Monitoring procedures do not incorporate non-quantitative considerations to address legal, reputational, or compliance risk.
- Recommendations were made to:
  - [redacted]
  - Adopt due diligence process that complies with the guidance of FIL-3-2012.
  - [redacted]
  - Amend ACH Policy to expressly prohibit processing for payday lenders.
  - [redacted]
- [redacted]

[redacted]

[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]

[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

[redacted]

Redacted

[redacted]

Redacted

[redacted] [redacted]

[redacted]
[redacted]
[redacted]
[redacted]

EXHIBIT 108

No. 14-953-TNM

Message

From: Lowe, M. Anthony [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=MLOWE]
Sent: 1/18/2013 6:11:17 AM
To: Mangian, David K. [DMangian@FDIC.gov]; Sabanty, Teresa M. [TSabanty@FDIC.gov]
CC: Jackson, Lawrence R. [LJackson@FDIC.gov]; Childers, Cynthia M. [CChilders@FDIC.gov]
Subject: [redacted]/ Processing for Payday Lender

Teresa and Dave -

Our examiners should Give attention to the payday lender (type of loans, charges and fees, targeted customers, etc). As we will be pursuing a strategy to "encourage" the bank to sever the relationship, we should have the basic info regarding the utility of the product offered. Also, we should have info on how long the bank has been involved in this affinity agreement, due diligence conducted and BOD approvals, fees generated by the bank, etc.

Please make a priority, and ensure the visit is not closed out.

[redacted]

EXHIBIT 109

No. 14-953-TNM

[redacted]

[redacted]

[redacted]

[redacted]

From: Lowe, M. Anthony
Sent: Thursday, March 06, 2014 8:19 AM
To: Pearce, Mark (DCP); Eberley, Doreen R.
Subject: [redacted]

Mark / Doreen –

[redacted] During the call yesterday, specific mention was made of correspondence sent to the bank in [redacted] regarding its affiliation with a payday lender. [redacted] the language [redacted] is not completely dissimilar from comments the Chairman included in a letter to a consumer advocacy group a few months earlier. Also, our correspondence did not direct the bank to exit the program simply because of payday aspects: the onsite review and subsequent meetings with the bank focused on the absence (or limited) due diligence that was conducted prior to engaging in the relationship.

[redacted] We had multiple discussions with the WO (primarily DCP side) regarding a couple of banks in [redacted] and our inquiring of them about due diligence that was conducted before entering into a new line. We also provided several memos regarding our initial and subsequent meetings with those banks to ensure they were clear on our areas of concern, and we also discussed while Director Pearce was in Chicago for a meeting. [redacted] the topic was a high profile matter, given the trade association and congressional inquiries. [redacted]

Thanks.

M. Anthony Lowe
Regional Director
Chicago

[redacted]

EXHIBIT 110

No. 14-953-TNM

[redacted]

From: Hammerlee, Bradley G. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=BHAMMERLEE]
Sent: 7/31/2013 6:12:28 PM
To: Ivie, Stan [SIvie@FDIC.gov]
CC: Hornberger, Paul T. [PHornberger@FDIC.gov]
Subject: RE:

We have not run into any Oregon SNM bank's that are doing this. We did have this happen in Washington in 2010 at [redacted], but have not had it happen since. We scrutinize TPPP very closely so I suspect he has his facts wrong or it is not one of our banks.

-----Original Message-----
From: Ivie, Stan
Sent: Wednesday, July 31, 2013 2:55 PM
To: Hornberger, Paul T.; Hammerlee, Bradley G.
Subject: Fw:

Do either of you have a perspective on this? [redacted] seems to think there are Oregon banks doing this.

----- Original Message -----
From: Ivie, Stan
Sent: Wednesday, July 31, 2013 02:48 PM
To: Beshara, Alice E.; Moe, Kathy L; Ogren, Michelle A.

Are you buying that we have some snm banks that are facilitating payday lending thru TPPP? I would be surprised.

EXHIBIT 111

No. 14-953-TNM

Message

From: Ivie, Stan [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=SIVIE]
Sent: 7/31/2013 6:21:25 PM
To: Hornberger, Paul T. [PHornberger@FDIC.gov]; Hammerlee, Bradley G. [BHammerlee@FDIC.gov]
Subject: Re:

He's still researching--doesn't have any identified yet.

----- Original Message -----
From: Hornberger, Paul T.
Sent: Wednesday, July 31, 2013 03:19 PM
To: Ivie, Stan; Hammerlee, Bradley G.
Subject: RE:

This is an issue that has not been disclosed to me. I'm a little curious about how [redacted] reached this conclusion and who he suspects so we can take a look.

pth

-----Original Message-----
From: Ivie, Stan
Sent: Wednesday, July 31, 2013 2:55 PM
To: Hornberger, Paul T.; Hammerlee, Bradley G.
Subject: Fw:

Do either of you have a perspective on this? [redacted] seems to think there are Oregon banks doing this.

----- Original Message -----
From: Ivie, Stan
Sent: Wednesday, July 31, 2013 02:48 PM
To: Beshara, Alice E.; Moe, Kathy L; Ogren, Michelle A.

Are you buying that we have some snm banks that are facilitating payday lending thru TPPP? I would be surprised.

EXHIBIT 112

No. 14-953-TNM

[redacted]

Minutes of the Meeting of the Executive Committee

[redacted] 2014

Redacted

Attorneys Eyes Only -- Outside Counsel

Redacted

Redacted

Retail

Redacted

Redacted

[redacted] reported we currently process ACH transactions for [redacted] which operates payday lender offices throughout [redacted] [redacted] is audited by [redacted] and based on internal review appears to adhere to rules in place for payday lending operations. Enhanced due diligence was conducted on their operations. Discussion was held regarding the processing of pre-authorized checks for a payday lender given the government's current position under "Operation Choke Point". Also discussed was the reputation risk and potential for regulatory scrutiny due to association with any type of payday lending. Although [redacted] practices have been validated we would not want to appear as being involved in practices subject to criticism. [redacted] noted we are able to closely monitor any risk through the BSA department. However, the consensus of the Committee is that the fees generated from the [redacted] account are not worth any risk to the reputation of the bank. Based on this discussion, [redacted] was directed to draft a letter to [redacted] advising them that although they are not engaged in any illegal or improper activities under [redacted] law, in light of mandates from the Department of Justice we feel it is prudent to discontinue our relationship with [redacted] and all pay day lenders.

Redacted

Redacted

Attorneys Eyes Only -- Outside Counsel

EXHIBIT 113

No. 14-953-TNM

Message

From:	Lafleur, David P. [/O=FDIC/OU=FDIC/CN=RECIPIENTS/CN=DLAFLEUR]
Sent:	9/10/2013 4:01:59 PM
To:	Pearce, Mark (DCP) [MaPearce@FDIC.gov]
Subject:	Payday Lending Info
Attachments:	Payday Lending Review dpl edits.docx; Copy of RADD Payday Lending Search dpl updates.xlsx

Hey Mark,

Ran into data problems, so I've been working with Suzy Gardner to get the info. They are sending the attached write-up to Rae-Ann, so I wanted to get this to you at the same time. I verified her data, and went and followed up on the on-line v. payday storefront issues using their lists as a starting point instead of the ones I was given.

Essentially they had someone on their data side do a key word query in RADD, but included all exam reports (including compliance and CRA), exam summary comments, and other documents. Their query captured a lot more banks and all of the regions, so I'm trusting it more than what I was given. I also cross referenced and built a pivot table to ID situations where there was a clear on-line component. I've been sharing info back and forth with them all afternoon, so I think we're coming to a good, consistent conclusion. Doreen asked them to ID the # of banks where we concluded with some sort of page 1 recommendation or an enforcement action for payday issues, so it goes to that end, but I've tucked the info that you asked me for into the 2nd paragraph. Essentially, we yielded hundreds of sites, but in reviewing all of them, there are 13 unique banks where there was some reference to a bank actually involved payday lending through an affiliate, directly, or a third party, (ie: not false hits, like a community contact interview etc.) Of these, 9 resulted in the recommendation or order that Doreen asked for.

Last thing I want to mention – the criticisms and exam findings universally relate to management of third party risks, be they RMS or DCP. There isn't a single case that I saw where we're criticizing the payday lending products for the sake of it. Also, I did not see any bans on involvement, we required management of risks and the usual enforcement action type provisions, so I'm comfortable in saying that we didn't tell anyone to get out of payday lending because we don't like the product.

I've also attached the download and the pivot tables, in case you wanted to see the full detail (it starts with all of the key word hits, there are over 500, but you'll see a lot of multiple hits for the same banks. We classified and reduced them down using a coding structure and my pivot tables...

David Lafleur, CRCM
Assistant to the Director, DCP
[redacted]

EXHIBIT 114

No. 14-953-TNM

Payday Lending Review

RMS researched all types (S&S, Compliance, CRA, IT, and BSA) of ROEs, Visitations, SAER comments, or other review comments with a completion date from August 1, 2011 through August 31, 2013. This review may not inc[redacted]ude all ROEs and Visitations performed during this timeframe, as the regions did not begin to input information into RADD at the same time.

We specifically checked for references to payday lending and whether these loans are granted online. References were found in various documents for 13 institutions, of which 6 specifically referenced on-line lending activities. Of these, the review found nine instances where the data reflected that concerns relative to payday and/or online lending resulted in an either an enforcement action or specific recommendations in a Report of Examination or Visitation. These instances are detailed below.

Redacted

Payday and/or Online Lending

1) The FDIC noted concerns that [redacted] was providing ***payday*** and ***online*** lending merchants' access to the ACH Network to originate transactions prohibited in such states or in apparent violation of state usury laws. The bank is under a Section 8b Action.

2) The FDIC included several recommendations in its 2010 ROE for [redacted] to strengthen its review of RCC merchant applications and conduct effective due diligence and ongoing monitoring when establishing and maintaining merchant relationships, especially since many of them were ***online*** companies advertising through ***payday*** affiliate websites. The bank's activities were reviewed for possible UDAP violations. An 8(b) Order was issued on [redacted] for compliance, risk management, and BSA findings related to the third party management. CMPs were issued on [redacted] for BSA and compliance issues.

3) The FDIC included several recommendations in its ROE for [redacted] to strengthen its assessment and vetting process of the risks posed by different types of merchants, including one ***payday*** lender and two adult novelty companies, whose transactions the bank processes and to independently determine the suitability of the payment arrangements. Management agreed to implement all recommendations.

4) The FDIC noted concerns at [redacted] for previously undisclosed ***payday*** lending activities with [redacted] which was indirectly owned by bank's COB. COB said he would sell [redacted], the IT department would cease processing the stored value

cards, and the line of credit was paid off during the Visit. Board was unaware of the payday lending activities and approved a $300M line beginning in 2006 that unknowingly flowed to [redacted] to fund ***online*** lending operations. A subsequent 11/1/11 Board meeting at the RO noted that [redacted] was sold, all payday activity had ceased with the exception of a few remaining stored value cards expected to be extinguished in the near term. The bank is under an MOU.

5) The FDIC noted concerns that [redacted] was not devoting the resources necessary to conduct adequate risk assessment and due diligence procedures with respect to ACH clientele or monitor the nature of the ACH activities that are being processed through the bank, including transactions involving ***payday*** lenders, check cashers, ***online*** money service businesses, and international money transmitters. The bank is under an MOU.

6) The FDIC noted concerns that [redacted] was not validating that the scope of services being offered by multi-state MSB customers are complying with states' ***payday*** lending laws. Payday loans were actually advertised by a third party ERO that the bank offered ***online*** tax refund products through; however, it was unclear as to whether this was solely in-person or if available ***online***. The bank is under a Section 8b action.

7) The FDIC informed [redacted] that its relationship with [redacted], is unacceptable, as it poses a high degree of risk, engages in both auto title loans and ***payday*** loans in 24 states, and requires an insufficient deposit hold amount for ACHs. However, the loans are originated via storefront, not ***online***. Bank's role includes third party payment processing for ACH repayments.

8) The FDIC noted concerns that [redacted] facilitated transactions with illegal ***payday*** lenders, and on one occasion with an unlicensed ***online*** lender [redacted] through wire transfers and ACH transactions on five occasions. Management instructed its correspondent bank, [redacted], to stop any attempts to credit [redacted] accounts with funds from identified payday lenders and [redacted]. The area responsible for ACH transaction processing has blacklisted known payday lenders and [redacted], and will not allow credits or debits from or to these sources.

9) The FDIC noted concerns at [redacted] for inadequate oversight and monitoring of a ***payday*** relationship, specifically the [redacted] relationship. The information did not indicate whether [redacted] operated solely from storefronts, ***online***, or both. The bank terminated its loan and deposit relationship with the payday lender [redacted] on October 5, 2011, by closing the deposit accounts and transferring the loan to the bank's holding company in order to avoid possible legal liability from calling or canceling the loan without cause. The bank was under a Section 8(b), then an MOU.

EXHIBIT 115

No. 14-953-TNM

From: Decker, Sharon
To: Waterhouse, Scott
Subject: RE:
Date: Thursday, April 25, 2013 9:26:22 AM

Yes. Thanks again. Sharon.

From: Waterhouse, Scott
Sent: Thursday, April 25, 2013 8:14 AM
To: Decker, Sharon
Subject: FW:

Did I send this to you?

From: Pfinsgraff, Martin
Sent: Monday, April 15, 2013 8:51 AM
To: Colucci, Susan; Belshaw, Sally
Cc: Waterhouse, Scott
Subject: FW:

[redacted] sent us the attached list of banks that appear to be offering Payday Lending product after a discussion with Tom and I last Wednesday. [redacted] shows up on the list which will beg the question of whether they are compliant with our guidance. We will be issuing guidance on Deposit Advance products that will be very similar to Payday Lending guidance that was intended to discourage banks from offering products due to the reputational risk. Thus, this does not feel like it is fading away as an issue.

From: [redacted]
Sent: Friday, April 12, 2013 10:44 AM
To: Curry, Thomas; Pfinsgraff, Martin
Subject:

Tom and Marty,

Thanks for your time on Wednesday – I thought it was a good meeting.

As a follow up to our conversation, attached are two pages summarizing data for payday lenders. The first page summarizes the total volume of payday lending ACH transactions that each bank originates to [redacted] deposit customers, and the second page lists payday lenders (and the bank that originates their ACH transactions) with the highest return rates.

I'm happy to discuss this data with you in more detail if you'd like.

Talk to you soon,

[redacted]

[redacted]

[redacted]

EXHIBIT 116

No. 14-953-TNM

OCC Comments to KYC Standards

KYC Standards Section	OCC Comment
[redacted]	[redacted]
5	▪ The Private Bank prohibits customers whose SOW is generated from payday lending; shouldn't the KYC Standards reflect this prohibition?
[redacted]	[redacted]

KYC Standards Section	OCC Comment
[redacted]	

KYC Standards Section	OCC Comment
[redacted]	[redacted]

EXHIBIT 117

No. 14-953-TNM

OCC Comments to KYC Standards

KYC Standards Section	OCC Comment	
[redacted]		
5	▪ The Private Bank prohibits customers whose SOW is generated from payday lending; shouldn't the KYC Standards reflect this prohibition?	▪ Also, prohibitions should be consistent across the enterprise. The Private Bank does not allow private clients whose SOW

is payday lending yet the Commercial Bank is bank-rolling the entire industry.

[redacted]

[redacted]

[redacted]

[redacted]

EXHIBIT 118

No. 14-953-TNM

[redacted] Responses to OCC Comments to KYC Standards
August 5, 2013

KYC Standards Section	OCC Comment		[redacted]	
[redacted]				

Attorneys' Eyes Only -- Outside Counsel

KYC Standards Section	OCC Comment		[redacted]	
[redacted]				

KYC Standards Section	OCC Comment	[redacted]
[redacted]		
5	▪ The Private Bank prohibits customers whose SOW is generated from payday lending; shouldn't the KYC Standards reflect this prohibition? Also, prohibitions should be consistent across the enterprise. The Private Bank does not allow private clients whose SOW is payday lending yet the Commercial Bank is bank-rolling the entire industry.	▪ This is a business-specific risk tolerance decision that will not be automatically applied Firm-wide; however, as the LOBs document their risk tolerance statements this year and continue to evaluate de-risking opportunities, they will be discussed at the AML Steering Committee and other cross-LOB governance forums for Firm-wide application, as appropriate.
[redacted]		

KYC Standards Section	OCC Comment		[redacted]	
[redacted]				

KYC Standards Section	OCC Comment		[redacted]	
[redacted]				

KYC Standards Section	OCC Comment		[redacted]	
[redacted]				

KYC Standards Section	OCC Comment	[redacted]
[redacted]		

KYC Standards Section	OCC Comment	[redacted]
[redacted]		

EXHIBIT 119

No. 14-953-TNM

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COURT REPORTING

Transcript of **Kathleen Oldenbor**

Thursday, May 3, 2018

Advance America, et al. v. Federal Deposit Insurance Corporation, et al.

Alderson Court Reporting
1-800-FOR-DEPO (367-9976)
Info@AldersonReporting.com
www.AldersonReporting.com

Alderson Reference Number: 78478

[redacted]

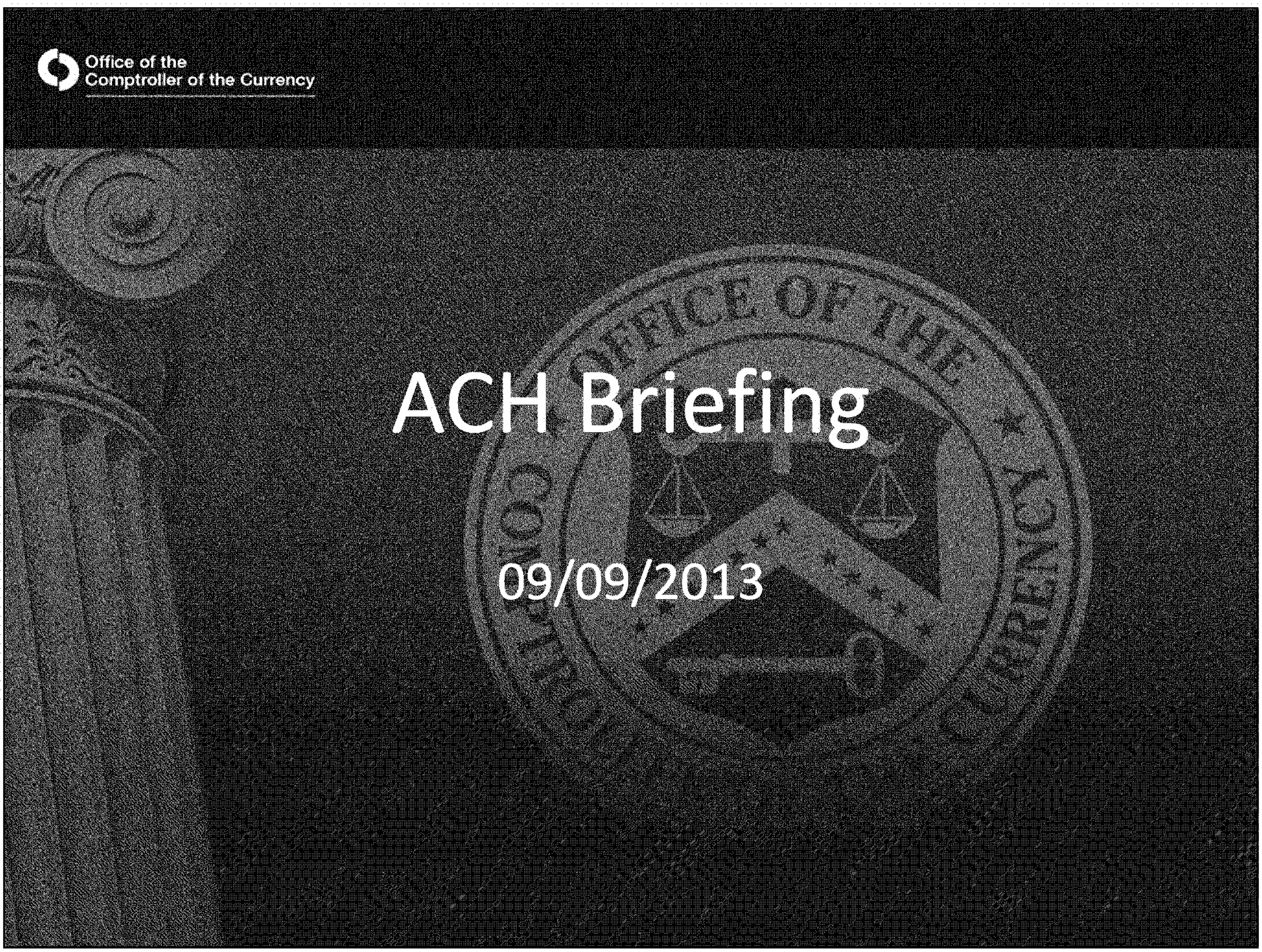
Q. Was this presentation ever made to the
Comptroller of the Currency?

A. We did make a presentation in September.

[redacted]

EXHIBIT 120

No. 14-953-TNM


Office of the
Comptroller of the Currency
ACH Briefing
09/09/2013

Office of the
Comptroller of the Currency

Purpose of Briefing

- Establish baseline understanding of Automated Clearing House Network processing activities including roles, responsibilities and regulatory landscape.

- Discuss current challenges in the system, including Federal and State enforcement authority investigations and actions to date.

Office of the
Comptroller of the Currency

Definitions

- NACHA – Self Regulatory Organization/ rule making body, administrator and enforcement office for the Automated Clearing House Network
- FRB – "switch" for the ACH network i.e. Network Operator – actually processes the payments
- EPN – Network Operator – actually processes payments
- ODFI (Originating Depository Financial Institution)– designated by NACHA as the "gatekeepers" for the Network
- RDFI (Receiving Depository Financial Institution)– subject to NACHA documentation rules for debit authorizations
- TSP – Third-Party Service Provider
- TPPP – Third Party Payment Processor

Office of the Comptroller of the Currency

Key Players, Roles & Responsibilities

Players	Roles	Supervisory Regime
TSP/TPPP	Directs ACH files to ODFI/RDFIs	FTC, Federal & State Banking regulators, FinCen
Merchant Processors	Bank, MDPS, Data Processors	Federal & State Banking Regulators
ISO	Aggregators for merchant processors	Card Network rules
ODFI	Bank providing access to network	Federal & State Banking regulators, FinCen, NACHA
Lenders (Payday/Online/Storefront)	Short term lending	FTC, State Banking &/or FinCen (if licensed MSBs)
Originator	Payment processor – can be bank or non-bank	FTC, State/Federal Banking regulators, FinCen Also subject to NACHA rules through agreement with ODFI
DFI	Depository Financial Institutions	State/Federal Banking regulators, FinCen,
RDFI	Bank receiving transactions through network	Federal & State Banking regulators, FinCen, NACHA

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Types of Activities Banks Provide

- Payroll, Supply Chain and Merchant processing payments for commercial clients
- Processing for third party payment processors
- Access to ACH network as ODFI for correspondent banks and their clients
- Access to ACH network as ODFI through "rent a BIN" for merchant acquirers/aggregators

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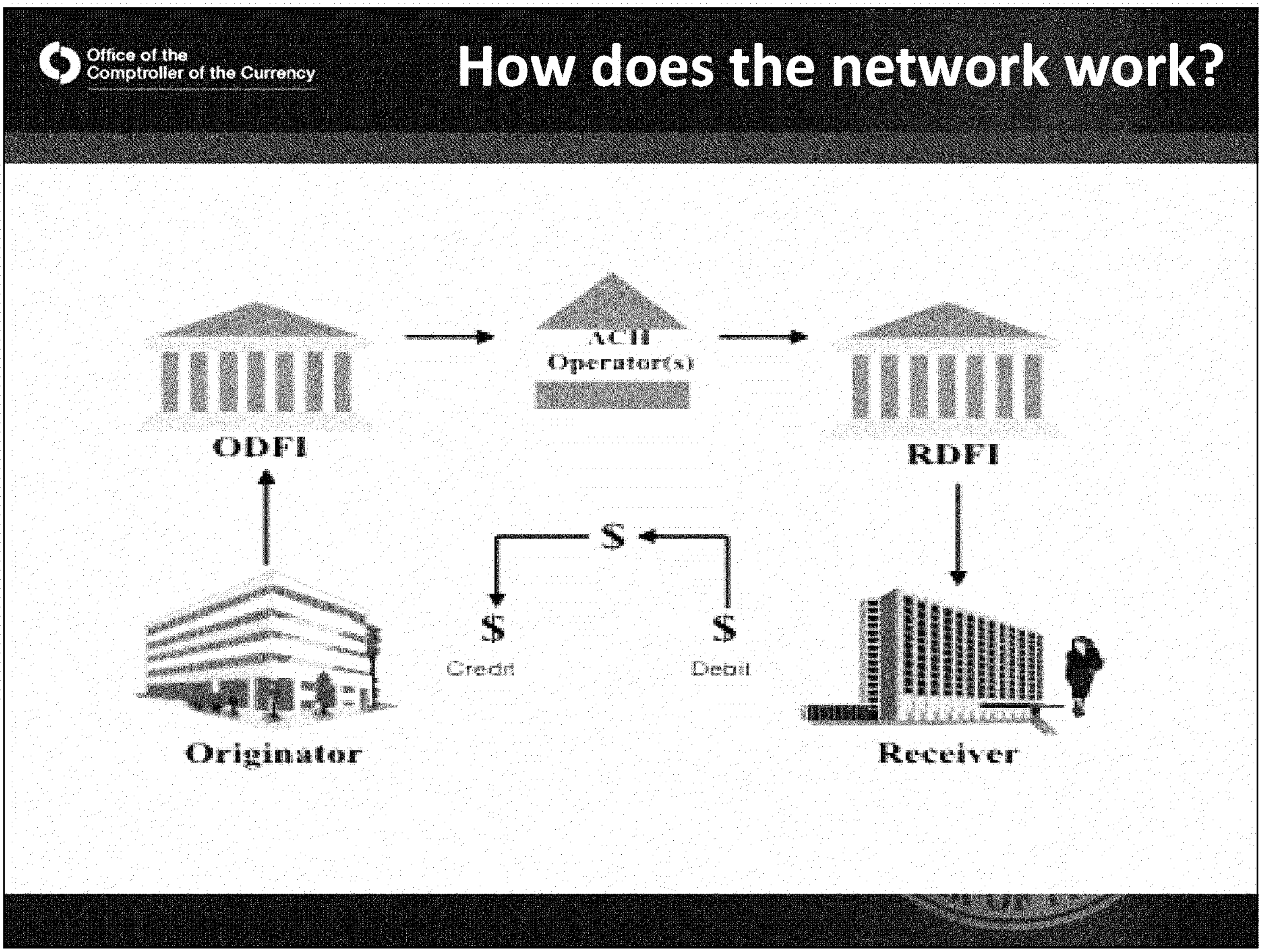
Regulatory Oversight Structure

- **FTC** – UDAP authority
- **State Bank regulators** - $ transmitter licenses, state banking chartering, S&S, AML/BSA, Compliance
- **State AGs** – consumer protection/fiduciary duties
- **FinCen** – Money Laundering, $ transmitter
- **CFPB** – consumer protection
- **OCC/FRB/FDIC/NCUA** – Federal Banking regulators – S & S, AML/BSA, Compliance
- **FFIEC** – MDPS program – entities assigned to OCC/FDIC/FRB/NCUA on a rotating basis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How does the network work?
ODFI
ACH
Operator(s)
RDFI
$
$
Credit
$
Debit
Originator
Receiver

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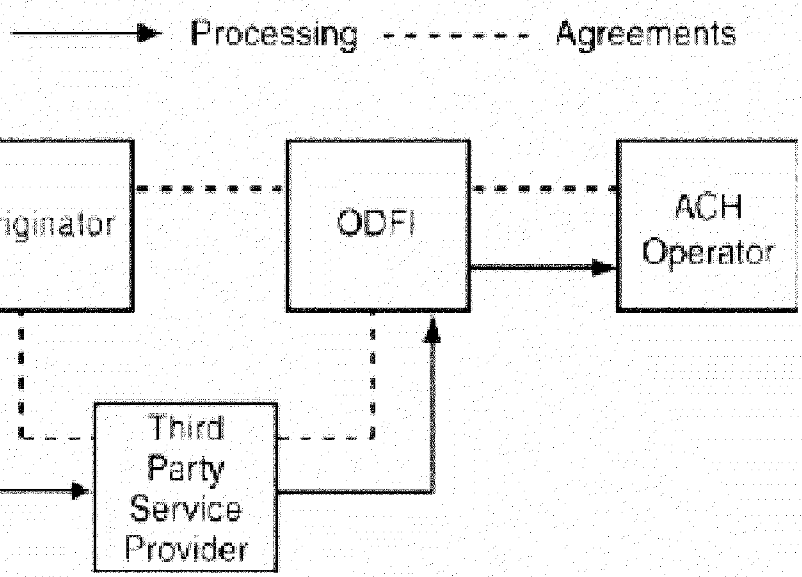
Depicts the funds flow of a Third-Party Service Provider



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Transformational drivers affecting the ACH processing landscape

- Economic – Dodd Frank – changes to interchange fees, error resolution
- Technology – lower costs of processing technology, enabling more competition and less experienced processors
- New use cases (beyond traditional commercial payments)
  - Person to Business (P2B – bill payments)
  - Person to Person (P2P – transfers/remittances)

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Key Risks in ACH business activities

- Operational/Credit
  - charge backs for returned items,
    - Administrative
    - Unauthorized
- Liquidity
  - Operating lines of credit
- Reputation:
  - High risk clients of processors/aggregators (e.g., Payday lenders, internet/online sales)
- Compliance:
  - Reg E – EFT Error resolution
  - Reg DD – Truth in Savings
  - Reg CC – Funds Availability
- AML/BSA:
  - Due diligence on processors, aggregators and their clients
  - Ongoing monitoring for Illegal/fraudulent transactions initiated by high risk clients of aggregators
    - Red flags: high return rates, others.....

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Challenges

Recent Challenges to bank transaction processing involving ACH and payday lending and other high risk transactions:

- **DOJ – Operation Chokepoint**
  - Initiative launched by the Financial Fraud Enforcement Task Force in coordination with Consumer Protection Branch – aimed at Third Party Payment Processors and their Merchant clients. While the focus has been identified as payday lenders clients of payment processors, the method of investigation has been to subpoena approximately 40 banks for data relative to their ACH transaction with all third party payment processors. The subpoenas are broad and include all payment processors for which the bank has originated RCC, RCPO or ACH debit transactions to consumer bank accounts. They are asking for reports of any payment processor who had return rates of 3% or higher in any one month period from January 1, 2009 through the date of compliance with the subpoena.

- **NYS Dept of Financial Services**
  - Investigation alleging banks enabled illegal and fraudulent transactions by processing ACH payments from third party processors for payday lending transactions with state residents that exceeded the state's usury laws.

- **State of [redacted]**
  - Requested investigation by OCC of consumer complaints against banks processing third party payday lending transactions (ACH) involving [redacted] residents where such activity is illegal.

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Challenges cont.

- **DOJ Eastern District of Tennessee**

[redacted]

- **NACHA Stance:**
  - ODFI is the gatekeeper for access to the network, responsible for monitoring for suspicious activities.
  - ODFI has ultimate responsibility for transactions processed by third party processors, correspondents and payment aggregators.
  - Violation of Network rules results in warnings, fines and ultimately loss of network access.

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ACH Fast Facts

Volumes & Values
Total Network Transactions*

	2012	2011
Volume (in billions)	16.750	16.079
Values (in trillions)	$ 34.5	$ 37.4

*Volume includes only transaction transmitted via ACH Operators
Source: NACHA – The Electronic Payments Association

Internet/Payday Lending**
Average Loan $375
Maturity – 2 weeks
Interest rates/fees:

- Banks $35
- Storefront PD Lender $55
- Online PD Lender $95

**Data from PEW Charitable Trusts Small-Dollar Loans Research

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Key supervisory publications – rules, guidance issuances:

OCC
- 2006-39 ACH Risk Management Guidance – ACH activities
- 2008-12 Risk Management Guidance – Payment Processors
- 2007 December – ORP Memo to Examining staff - ORP ACH Origination report and Job Aid
- 2002-14 SW District Risk Tip – Risks Associated with ACH Origination
- Comptrollers Handbook – Merchant Processing Activities
- 2001-47 Third Party Relationships: Risk Management Principles

FFIEC
- FFIEC IT Handbook – Retail Payments
- FFIEC BSA/AML Examination Manual

CFPB
- Regulation E

FTC
- Consumer guides for Small Dollar Lending

NACHA
- Annual - Publication of Complete Operating Rules with Changes
- Use of Terminated Originator Database
- Originators Watch List (OWL)
- October 2012 – NACHA Risk Management Strategy – Executive Summary
- March 2013 ACH Operations Bulletin – High Risk Originators and Questionable Debit Activity

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Actions / Options / Recommendations:

- Issue NRC Supervision Tip on ACH Risk Management – Drafted and circulating
- Create searchable database of return info currently received from the FRB and EPN – Developed and in pilot test mode
- Review existing guidance for update as needed:
  - Consider strengthening the linkage between safety and soundness risks and BSA/AML issues
  - Add reference to NACHA published network return rates and encourage use of such rates to establish return rate limits and monitor actual return rates.
  - Clarify the need to monitor total return rates, not just the unauthorized return rate category
- Incorporate into examination strategies and allocate additional examiner resources as appropriate

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Questions?