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Financial Institution Deals - Getting Regulatory Approval can be the Hardest Part!

By Joseph E. Silvia

Higher valuations, improving multiples, more capital, and the potential for regulatory relief are all contributing to increased consolidation in the financial institutions market. A number of factors are motivating potential sellers, including the continued burden of regulation, competition, unclear succession plans, and the expectation of higher multiples. The time appears ripe for making deals.

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Calculating $10 Billion within the Dodd-Frank Act

By Daniel Patrick Flynn

The Dodd-Frank Act (Dodd-Frank) imposes increased regulatory obligations on banks with consolidated assets of more than $10 billion than banks with consolidated assets of less than $10 billion. In addition to Dodd-Frank regulations for banks with consolidated assets over $50 billion, this provision requires "covered banks" with consolidated assets between $10 billion and $49 billion to conduct annual stress tests to ensure the institution's soundness. Covered banks must also comply with the "Durbin Amendment," which caps the interchange fees charged to merchants for debit card transactions. Covered banks are also regulated primarily by the Consumer Financial Protection Bureau (CFPB), rather than prudential bank regulators. The CFPB's supervisory powers include the authority to examine larger depositories for consumer compliance meaning that the CFPB has "visitorial" powers over $10 billion institutions (which historically have been almost exclusively held by their prudential banking regulators). Once an institution becomes a covered bank, two questions arise. First, what method is used to calculate the bank's total consolidated assets? Second, how long does the bank have to begin complying with these new obligations? This article outlines the competing calculation methods and explains the issues related to events that trigger mandatory compliance timeframes. The article will also make a brief observation on the current state of the $10 billion threshold and its future in the Trump administration.

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Current Issues in Residential Mortgage Litigation

By Andrew Messite, Joseph Teig and Michael Margarella

In New York, the flood of mortgage litigation arising out of the Great Recession and the struggles of the banks, foreclosure law firms, and mortgage servicers to deal therewith, has now resulted in numerous statute of limitations attacks on the enforceability of mortgages, bringing up new questions regarding both the acceleration of mortgage obligations and, post-acceleration, how these
obligations might be de-accelerated.

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Content of an Authorization to Originate Recurring ACH Debit Entries

By Ted Teruo Kitada

Background: Under a "Stipulation and Consent to the Issuance of a Consent Order," dated December 16, 2016, Military Credit Services, LLC ("Respondent"), stipulated to the issuance of a consent order ("Consent Order") by the Consumer Financial Protection Bureau ("CFPB") against it, dated December 20, 2016, regarding, inter alia, Respondent's consumer lending and debt collection practices. Respondent is a financing company that extends revolving credit to consumers and through a commonly owned company collects debts owed under consumer contracts with Respondent. From January 9, 2015, to December 20, 2016, the period covered under the Consent Order, Respondent offered revolving credit arrangements to consumers containing an "ACH Pre-Authorization Payments Agreement," hereinafter "Preauthorization Agreement," to facilitate electronically the collection of payments arising under the arrangements.

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Predictive Coding - A Robust but Efficient Approach for Responding to Recent Regulatory Scrutiny of Sales Practices

By Perry A. Napolitano, Jeffrey M. Weimer, and Christopher R. Brennan

Many financial institutions collect increasingly large amounts of information from and about their customers, including customer complaints. Customers of retail banks complain about everything from the long wait they experienced in the teller line to receiving a checking account or credit card they did not ask for or authorize. This latter issue has been the subject of recent enhanced scrutiny from bank regulators, and it provides a case study for the ways in which customer complaints or similar data can be either a landmine or a goldmine for financial institutions. Properly analyzed, this data can allow banks to respond to regulatory inquiries promptly, accurately and efficiently, and to quickly identify (or even anticipate) future key risks. Handled improperly, this voluminous data can present seemingly insurmountable challenges. This three-part article (1) summarizes current escalations in regulatory scrutiny of retail banking sales practices; (2) explains predictive coding's ability to efficiently and effectively analyze customer complaint data; and (3) outlines additional downstream benefits predictive coding can afford for a bank's compliance management program.

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Know When to Fold 'Em-UIGEA's "Intrastate Safe Harbor" Does Not Authorize Online Casinos

By Darryl Nirenberg and Chelsea Gold

On December 23, 2011, the Office of Legal Counsel (OLC) of the Department of Justice (DOJ) issued an opinion reversing fifty years of interpretation of the
federal Wire Act (OLC Opinion), concluding the Act covers bets and wagers on sporting events and contests only. Three states—Delaware, Nevada, and New Jersey—subsequently enacted laws authorizing online casinos. The legislatures of several other states have considered proposals to join them, while four other states—Georgia, Illinois, Kentucky, and Michigan—permit Internet gambling through their states' lotteries.

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Financial Institution Deals – Getting Regulatory Approval can be the Hardest Part!

By: Joseph E. Silvia

Higher valuations, improving multiples, more capital, and the potential for regulatory relief are all contributing to increased consolidation in the financial institutions market. A number of factors are motivating potential sellers, including the continued burden of regulation, competition, unclear succession plans, and the expectation of higher multiples. The time appears ripe for making deals.

M&A activity has been strong recently and, given the current economic climate, strong M&A fundamentals (if sustained) can be expected to drive high levels of M&A activity for two key reasons. First, analysts are generally bullish on financial institutions due to expected deregulation in the industry. Second, acquirers will leverage their increased share value as currency for future acquisitions or mergers.

The significant cost of regulatory compliance has historically been, and remains, a key reason for seeking a sale. Other frequently noted justifications – lack of economies of scale, shareholder demand for a liquidity event, unproven succession plans – continue to warrant sale considerations.

Strategic buyers will continue to target acquisitions as a growth strategy. However, public reports of intense regulatory scrutiny relating to noncompliance issues continue, placing many of those would-be buyers in the regulatory penalty box. These noncompliance issues not only cause major delays in getting transactions approved, but in some cases have caused deals to fall apart entirely. Banks considering growth via M&A activity must have their own houses in order before seeking expansion that would require regulatory approval.

This article explores the basics of the regulatory approval process after a deal is struck and the common issues applicants face in getting transactions approved. The article concludes with a brief checklist for banks to consider as part of developing a pre-deal regulatory strategy.

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The Deal is Struck – Next Stop, Your Banking Regulator

Once the terms of the deal are struck, the heavy lifting begins. Deal lawyers assemble a team to conduct due diligence and begin structuring the relevant merger agreements and corporate documents, and consultants and accountants sharpen their pencils on the numbers. Simultaneously, conversations begin about the process for getting regulatory approval. However, some institution may consider engaging in a pre-filing process with one of the banking agencies.

Pre-filing

The Board of Governors of the Federal Reserve System (Federal Reserve) has published specific guidance\(^2\) that details a more formal, yet optional, pre-filing process that may be helpful for certain acquiring institutions or expansionary proposals. The OCC includes pre-filing procedures in its licensing manual for engaging with potential bank applicants.\(^3\) Again, the pre-filing stage is optional for engaging with regulators before filing a formal application.

The Federal Reserve notes that “[a]pplicants and notificants with proposals that present unique or novel issues are encouraged to use the Federal Reserve’s pre-filing process described in SR letter 12-12 … to receive feedback on potential issues on a filing prior to submitting a formal filing.”\(^4\) This pre-filing review may also be helpful for community banks with less experience with the application process.\(^5\)

So, what is a “pre-filing?” According to the Federal Reserve, they are “inquiries related to potential applications and notices that include, but are not limited to, information about a specific aspect of a proposal or a potential issue, business plans or pro forma financial information related to a potential

\(^5\) Id.
filing, or presentations outlining specific potential proposals.” If a financial institution decides to engage in this process, then it may request that the Federal Reserve review preliminary draft documents, such as purchase or merger agreements, shareholder agreements, or voting agreements. Prospective applicants may start the conversation by seeking guidance as to the type of a filing necessary.

The Federal Reserve makes clear that prospective applicants should not expect a wholesale review of their application materials. The process is not meant for applicants to submit “draft applications.” Rather, the goal of the pre-filing process is to request and receive helpful feedback on pointed issues or concerns related to potential future filings.

Once the pre-filing review is completed, generally within 60 days of submission, prospective applicants that are instructed that a filing is needed are asked to submit a final filing as soon as practicable thereafter. If a filer has gone through a pre-filing process, then the Federal Reserve notes that “[f]inal submissions generally are expected to be more quickly reviewed and acted upon when previously identified issues or concerns are fully addressed.”

Filing a Formal Application

Once a financial institution or holding company has determined that a filing is necessary, it should endeavor to submit all material information and forms swiftly, checking that all fields are completed and all supporting documentation is attached. This is critical because the timing for review of a formal application generally begins upon the receipt of a completed application. Regardless of how each agency may define a “complete application,” financial institutions applying for regulatory approval will receive any number of additional information requests based on the submission until the agency is satisfied that it has all information necessary to accept the application for review.

Upon confirmation of a complete application, the agency staff begins its review in accordance with the relevant statutory factors and decision criteria found in the Bank Merger Act, Bank Holding

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6 Board of Governors of the Federal Reserve System, supra note 2.
7 Id.
Company Act,\(^9\) or other relevant statutes or regulations. The timing of the formal review is generally to be completed within 30-60 days. Upon submission and during the review period, the applicant and regulator(s) will go back and forth with questions, answers, and clarifications, which will hopefully result in satisfaction of the statutory factors\(^{10}\) or decision criteria\(^{11}\) and approval of the transaction.

Such factors and decision criteria include: \(^{12}\)

1. **Competitive Factors** – Whether the acquisition, merger, or consolidation would result in a monopoly, or any attempt to monopolize the business of banking, or whose effect would be to substantially to lessen competition, unless the anticompetitive effects are clearly outweighed by meeting the convenience and needs of the communities to be served.

2. **Financial and Managerial Factors** – Consideration of the financial and managerial resources and future prospects of the company or companies and the banks concerned, including capital, earnings, and the competence, experience, and integrity of the officers, directors, and principal shareholders of the financial institutions involved.

3. **Supervisory Factors** – Consideration of the supervisory records of the financial institutions involved on both sides of the transaction. These considerations include reviews of the supervisory perspectives, written examination reports, management practices at the institution, and the institution’s compliance record, as well as other safety and soundness factors.

4. **Community Factors** – Consideration of the convenience and needs of the communities to be served. Consideration of the financial institutions’ Community Reinvestment Act (CRA) records of performance.\(^{13}\)

5. **Money Laundering** – Consideration of the effectiveness of the financial institutions involved in combating money laundering activities, including overseas branches, if any.


\(^{10}\) Id.


\(^{13}\) See, e.g., *supra* note 3, at 15.
6. **Financial Stability** – The Federal Reserve will consider the extent to which a proposed acquisition, merger, or consolidation would result in greater or more concentrated risks to the stability of the United States banking or financial system.

**Not So Fast … Something is Delaying (or Derailing!) the Application**

Once the formal review process begins, the relevant banking agency staff reviews the application against the factors and decision criteria outlined above, and may begin to identify substantive issues requiring resolution prior to approval. Some publicly reported examples demonstrate how such substantive issues can wreak havoc on application timelines and outcomes.\(^\text{14}\) For instance, the Federal Reserve’s guidance examines the most common issues that may delay and even derail an acquisition filing.

Where a substantive issue is identified, the first step the agency generally takes is to request additional information from the applicant. Responses may clarify problematic information, or may cause the applicant to amend the filing to avoid the substantive issue, if possible. Where a substantive issue cannot be resolved, the staff may recommend a denial of the application. However, in most cases, the staff will inform the applicant that it would recommend denial of the application, but afford the applicant the opportunity to withdraw the application prior to such recommendation.\(^\text{15}\) So where do things come unglued?

Supervisory issues, enforcement actions, poor ratings, deficiencies in compliance, CRA performance, or combating money laundering are significant problems for applicants, even if the deficiency exists at the target institution.\(^\text{16}\) Additionally, comments received from the public identifying possible lapses in compliance or ineffective performance under the CRA risk delaying the application timeline. In fact, Federal Reserve statistics indicate that the average processing time for applications receiving adverse public comments was 213 days in the first half of 2016 and 375 days in the second half.

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\(^{14}\) See *Pre-Deal Regulatory Checklist* at the end of this article.

\(^{15}\) See *supra* note 4.

\(^{16}\) Recall the statutory factors and decision criteria of bank regulatory agencies.
of 2015.\(^7\) This is in stark contrast with the average processing time of 54 days and 59 days, respectively, for applications not receiving an adverse public comment.\(^8\)

**Supervisory Issues or Enforcement Actions**

Where agencies receive applications from institutions with supervisory issues that have resulted or will result in a less-than-satisfactory rating for safety and soundness, CRA or consumer compliance, and/or the issuance of a formal enforcement action, the application will face significant challenges achieving approval, absent some unique mitigating factor.\(^9\) As many banks understand, the regulatory agencies expect that applicants will have their own houses in order before seeking approval for any expansionary activity, with limited exceptions. Where exam ratings reveal significant supervisory concerns, “the application or notice usually is not consistent with the requirements for approval.”\(^\)\(^10\) Moreover, where an enforcement action, formal or informal, arises during the course of the deal, and certainly after the application has been submitted, the applicants should anticipate an unfavorable outcome. Working through an enforcement action takes a significant amount of time, sometimes years.

**Compliance and CRA Issues**

The agencies will consider the financial institution’s record of compliance with consumer protection laws and regulations under the managerial factor for approval. “Less-than-satisfactory consumer compliance ratings or other significant consumer compliance issues face barriers to approval and have been discouraged.”\(^\)\(^11\) Where an application is submitted by an institution with such issues, the regulatory agency may consider factors such as: the nature and severity of the compliance issues; the corrective action taken by the institution or the size of the problem institution within the overall


\(^8\) Id.

\(^9\) Id.

\(^10\) Id.

\(^11\) Id.
organization; and whether the application materially distracts management from efforts to remediate the compliance issue.\textsuperscript{22}

Likewise, “[a] less-than-satisfactory CRA rating has been an impediment to favorable action on an application or notice.”\textsuperscript{23} However, agencies may consider an application for a branch opening to address a particular weakness in the bank’s CRA performance or for a branch opening in a low- or moderate-income or minority census tract, provided that the opening of the branch would address an unmet need for banking services and not detract from efforts to address any non-branch related CRA deficiencies.”\textsuperscript{24}

\textit{Compliance with the Bank Secrecy Act and Anti-Money Laundering Rules}

In every case, the applicable regulatory agency must consider the effectiveness of an applicant in combating money laundering activities.\textsuperscript{25} Agency staff will review supervisory records, exam findings, and public comments submitted, and may contact other supervisory agencies to obtain information about an applicant’s anti-money laundering compliance record. Where the record of either the applicant or the target institution reveals concerns, the application will face significant hurdles to approval. Like compliance or CRA deficiencies, anything but a spotless record on anti-money laundering compliance will at least delay, and may completely derail, the application.

\textit{Common Financial Issues}

In every case, agency staff must review basic financial factors when evaluating an application or notice. Agencies expect applicants to be in sound financial condition now and on a pro forma basis. “[C]oncerns regarding asset quality, liquidity, or capital, or proposals that would otherwise significantly weaken the financial condition of a financial institution have not been viewed favorably.” Common financial issues identified include: applications where “the resulting organization’s capital levels or

\textsuperscript{22} Id.

\textsuperscript{23} Id.

\textsuperscript{24} Id.

structure do not provide adequate support to the organization”; an inability to demonstrate that a holding company is able to serve as a source of strength for its bank subsidiaries; and proposals funded by acquisition debt where the applicant is unable to show an adequate ability to service such debt.26

Common Managerial Issues

Staff review of managerial issues focuses on the “competence, experience, and integrity of the officers, directors, and principal shareholders of an applicant, its subsidiaries, and the related insured depository institutions and holding companies…”27 Here, agency staff will review biographical and financial information of the proposed principals of the resulting organization. “Principals, particularly directors and managers, whose backgrounds raise questions regarding their integrity, financial responsibility, or competence, or otherwise raise doubt about their ability to fulfill the responsibilities of their respective roles within the organization, have been viewed unfavorably.”

Common managerial issues identified include: proposed directors and managers with insufficient banking experience commensurate with the duties required or the size and type of organization; proposed directors and managers associated with failed or troubled banks, especially those where losses were incurred by the bank or the Deposit Insurance Fund; proposed directors and managers who have failed to meet personal financial responsibilities; and proposed directors and managers with criminal records.28

Other Factors Considered

Business Plans

In addition to the financial and managerial resources and record of meeting the convenience and needs of the community, relevant agency staff will consider the future prospects of the resulting financial institution. To do this, the agency staff will review the business plans of the current and pro forma financial institution. Where the business plans are found to “substantially increase the risk to an organization or raise safety and soundness concerns,” they may be a “barrier to approval” of an

26 See supra note 4.
27 Id.
28 Id.
Problematic business plans have contained overly aggressive strategies for growth or lending; high concentrations of assets, liabilities, revenues, or other activities; deficiencies in management experience; and ineffective attention to the financial institution’s challenges.\textsuperscript{29}

Section 23A and Regulation W Exemption Requests

Applications may also get delayed or derailed where the proposed transaction requires a section 23A or Regulation W exemption, which must be approved by the primary supervisor of the insured depository institution and the FDIC (if the FDIC is not the primary supervisor). In each case, the FDIC must concur and the relevant agencies must find that the exemption is in the public interest and consistent with the purposes of section 23A. The FDIC must also find that the exemption does not present an unacceptable risk to the Deposit Insurance Fund.\textsuperscript{30}

How can Banks Prepare for Acquisitions?

It is critical that buyers – and sellers – look internally before moving forward with a deal. The following checklist may be used a starting point for to head off potential issues that might delay or derail a deal.

\textit{Pre-Deal Regulatory Checklist}

- Do you have any regulatory exams coming up?
- Are there any outstanding enforcement actions (informal or formal)?
- Are there any outstanding MRAs/MRIAs/MRBAs?
- Is your BSA/AML program effective and up to date?
- How has your CRA performance been rated in recent exams?
- Has anything changed that could affect your CRA performance since your last exam?
- Have you conducted a basic compliance check-up?
- Has your compliance history indicated any material or recurring weaknesses?

\textsuperscript{29} \textit{Id.}  
\textsuperscript{30} \textit{Id.}  
\textsuperscript{31} \textit{Id.}
☐ Have you reviewed your capital structure and financial resources?

☐ How has your management been rated? Are there areas to improve before expansion?

☐ Do you have an appropriate business plan for your institution?

☐ Is your corporate governance framework current and adequate?

☐ Will you need a 23A exemption?

☐ Have you engaged with community groups as an enhancement to your serving the community?

☐ Do you have open lines of communication with your primary regulator?

Conclusion

As the environment for M&A continues to encourage financial institutions to think about expansionary activities, including raising capital, consideration of such activities should begin with internal review of operations, ratings, compliance, and the institution’s overall strategy for the future. An inward look now can help avoid costly and time-consuming challenges getting the necessary regulatory approval later.
Calculating $10 Billion Within the Dodd-Frank Act

Daniel Patrick Flynn¹

I. Introduction

The Dodd-Frank Act (Dodd-Frank) imposes increased regulatory obligations on banks with consolidated assets of more than $10 billion than banks with consolidated assets of less than $10 billion.² In addition to Dodd-Frank regulations for banks with consolidated assets over $50 billion, this provision requires “covered banks”³ with consolidated assets between $10 billion and $49 billion to conduct annual stress tests to ensure the institution’s soundness.⁴ Covered banks must also comply with the “Durbin Amendment,” which caps the interchange fees charged to merchants for debit card transactions.⁵ Covered banks are also regulated primarily by the Consumer Financial Protection Bureau (CFPB), rather than prudential bank regulators.⁶ The CFPB’s supervisory powers include the authority to examine larger depositories for consumer compliance meaning that the CFPB has “visitorial”⁷ powers over $10 billion institutions (which historically have been almost exclusively held by their prudential banking regulators). Once an institution becomes a covered bank, two questions arise. First, what method is used to calculate the bank’s total consolidated assets? Second, how long does the bank have to begin complying

¹ Daniel Patrick Flynn serves as Corporate Counsel at Heartland Financial USA, Inc., a multistate bank holding company headquartered in Dubuque, Iowa.
² There are also additional regulations on banks with assets in excess of $50 billion. Those regulations are not addressed in this article.
³ For the purposes of this article, reference to a “covered bank” means a bank which has assets in excess of $10 billion.
⁵ See id., § 920(a).
⁷ 12 C.F.R. §7.4000 defines visitorial powers to include: “(i) Examination of a bank; (ii) Inspection of a bank’s books and records; (iii) Regulation and supervision of activities authorized or permitted pursuant to federal banking law; (iv) Enforcing compliance with any applicable Federal or state laws concerning those activities, including through investigations that seek to ascertain compliance through production of non-public information by the bank.”
with these new obligations? This article outlines the competing calculation methods and explains the issues related to events that trigger mandatory compliance timeframes. The article will also make a brief observation on the current state of the $10 billion threshold and its future in the Trump administration.

II. Competing Calculation Methods

As discussed, three primary issues arise when an institution goes over the $10 billion asset threshold. 1.) Institutions must conduct annual stress tests. 2.) Institutions have debit interchange fees charged to merchants capped at a certain amount. 3.) The CFPB becomes an institution’s primary regulator. At first blush, this seems easy enough. However, it’s important to note that the calculation method of total assets for stress testing requirements, the calculation method of total assets for capping interchange fees, and the calculation method for the CFPB becoming a primary regulator are all different. Moreover, the timing of when the various requirements go into effect is different too. These calculation methods and timeframes may confuse a lawyer who is advising banks nearing the $10 billion asset threshold.

i. How is the $10 billion asset threshold calculated in the context of stress test regulation and once the threshold is met, when do stress testing requirements begin?

The Federal Reserve (the Fed) released a final rule on the appropriate method of calculation in the Federal Register. The Fed defines the asset threshold as, “the average of the total consolidated assets as reported by a bank holding company . . . on its Consolidated Financial

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Statements for Bank Holding Companies (FR Y-9C) for the four most recent consecutive quarters.”

As an example:

If an institution reported $9.5 billion in total consolidated assets as reported on Schedule HC of its FR Y-9C as of March 31 and June 30, 2013, and $11 billion as of September 30 and December 31, 2013, the average total assets over the four-quarter period is calculated as $10.25 billion and the institution would meet the requirement to conduct its first stress test.

Under Dodd-Frank, once a bank’s average total consolidated assets reaches $10 billion it becomes a “covered bank.” In other words, once a fourth consecutive FR Y-9C brings the average total consolidated assets of a bank to $10 billion or more, the institution becomes a covered bank. After it is determined that a bank has attained the asset threshold and is considered a covered bank, the next question is when the stress testing requirements begin.

The timing of the first stress test depends on whether a bank reaches the asset threshold by March 31 of a given year, or after. “A [bank] that becomes a covered bank on or before March 31... shall conduct its first annual stress test... in the next calendar year after the date the [bank] becomes a covered bank. A [bank] that becomes a covered bank after March 31... shall conduct its first annual stress test... in the second calendar year after the date the [bank] becomes a covered bank.”

The FDIC’s commentary in the Federal Register provides clarification through examples. “[A bank] that becomes a covered bank on or before March 31, 2015 would be required to

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9 12 C.F.R. § 252.12(d).
12 12 C.F.R. § 325.203(b)(3).
conduct its first stress test in the stress testing cycle beginning January 1, 2016. A [bank] that becomes a covered bank on June 30, 2015, would be required to conduct its first stress test in the stress testing cycle beginning January 1, 2017.” Thus, as far as the burden of conducting stress testing goes, it makes sense that an institution would want to go over the threshold after March of a given year.

ii. **How is the $10 billion dollar asset threshold calculated in the context of Durbin Amendment regulations and when must banks begin complying with Durbin after the $10 billion threshold is met?**

The Durbin Amendment caps the interchange fees charged to merchants for debit card transactions. Card-issuing banks under the $10 billion threshold are exempt from the Durbin Amendment. In the context of the Durbin Amendment, the asset size of a bank is determined by “. . .its total worldwide banking and nonbanking assets. . .as of December 31 of the preceding calendar year.” If an issuing bank qualifies for an exemption in a particular calendar year (because it had not met the $10 billion threshold), but then, as of the end of that calendar year no longer qualifies for the exemption because at that time it has assets of $10 billion or more, the issuer must begin complying with the Durbin Amendment no later than July 1 of the next calendar year.

To put it another way, if a bank crosses the asset threshold by December 31, 2017, that bank has until July 1, 2018 to become compliant with the Durbin Amendment. If the same bank waits until March 31, 2018 to cross the threshold, it then has until July 1, 2019 to become compliant.

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14 12 C.F.R § 235.3.
15 Id. at § 235.5(a)(1)(ii).
17 See 12 C.F.R. § 235.5(a)(3).
Unlike the stress-testing threshold, however, the Durbin Amendment does not require that a bank be over the $10 billion threshold for four consecutive quarters, but rather requires only that a bank be at or above the $10 billion threshold on December 31 of a particular year. Thus, as far as the penalties of being subject to the Durbin Amendment, it makes sense for an institution to wait until at least January of a given year before going over the $10 billion threshold.

iii. **How is the $10 billion dollar asset threshold calculated in the context of CFPB becoming an institution’s primary regulator?**

In a 2011 joint press release from the CFPB, the Fed, the Office of the Comptroller of Currency and the Federal Deposit Insurance Corporation, the agencies clarified how $10 billion is measured for the purpose of determining when the CFPB becomes an institution’s primary regulator.\(^{18}\) When an institution reaches $10 billion and is subject to CFPB as its primary regulator, it is referred to as a “Large Institution.”\(^{19}\) “The FDIC recognizes an insured depository institution as a “‘Large Institution’ . . . if it reports assets of $10 billion or more in its quarterly Call Report for four consecutive quarters. If the insured depository institution meets this criterion, it is reclassified as a Large Institution for such purposes beginning in the following quarter.”\(^{20}\) Accordingly, if an institution reports over $10 billion in assets on its Call Reports for four consecutive quarters, the following quarter is when the CFPB will become the institution’s primary regulator. This is distinguished by the other calculation methods in that it is neither the asset size averaged over four quarters, nor whether the asset size is in excess of $10 billion at the

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\(^{19}\) Id.

\(^{20}\) Id.
end of a year, but rather whether the total assets were over $10 billion as reflected on four consecutive quarterly Call Reports.

III. The Implications

Thus far, I have explored the confusing ways that asset size is measured for various provisions of Dodd-Frank. These new impositions can be difficult for a bank to handle, and there are many complaints that newly minted $10 billion banks may make. One is the indifference between how a $10 billion bank is regulated and a $49 billion bank is regulated; the former may be more burdened by these impositions than the later. This is simply because the $49 billion bank will have a better ability to hire the talent and engage with expert third parties in order to streamline processes, maintain operational controls on stress testing and adhere to the regulatory demands of the CFPB and other regulators. On its face, this seems to be at odds with what should be prudent federal oversight allocation.

Another issue may be banks purposefully avoiding crossing the $10 billion threshold in order to avoid stress testing and keep interchange fees and the CFPB at bay. For example, one bank saved $5 million in interchange revenue by keeping assets under the $10 billion threshold until after the New Year. This strategic approach to crossing the $10 billion threshold seems at odds with basic healthy, organic bank growth. If an institution holds back on growth for the second half of a year, teetering between $9.5 billion and $9.99 billion in order to avoid going over $10 billion before the New Year, that bank is hampering its short term health for the sake of its long term health. The entire scheme feels backwards. Finally, there is the concern that any costs

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associated with crossing the $10 billion threshold will be shifted onto the bank’s customers via the increase of various customer fees.

IV. Will the $10 Billion Threshold Be Reconsidered?

The Trump administration has expressed support for rolling back certain provisions of Dodd-Frank, including the $10 billion asset threshold. Secretary of Treasury Steve Mnuchin has noted, “[t]he number one problem with Dodd-Frank is that it’s way too complicated. . .”\textsuperscript{22} This author is inclined to agree.\textsuperscript{23} Mnuchin has been a steadfast advocate for regulating banks based on their “complexity and activity, not simply size.”\textsuperscript{24} This approach would require banks engaging in riskier behavior to undergo more regulatory oversight, while banks maintaining traditional banking activity escape the enhanced regulation imposed by the current $10 billion threshold. Whatever steps the Trump administration takes to modify or roll back Dodd-Frank, the objective should be to strike that balance between sufficient oversight of the financial services industry and the ability of banks to operate effectively and efficiently for the communities they serve and their shareholders.

\begin{footnotesize}
\begin{enumerate}
\item See supra, section II (outlining various calculation methods).
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Current Issues in Residential Mortgage Litigation

By Andrew Messite, Joseph Teig and Michael Margarella, Reed Smith LLP

In New York, the flood of mortgage litigation arising out of the Great Recession and the struggles of the banks, foreclosure law firms, and mortgage servicers to deal therewith, has now resulted in numerous statute of limitations attacks on the enforceability of mortgages, bringing up new questions regarding both the acceleration of mortgage obligations and, post-acceleration, how these obligations might be de-accelerated.

DISCUSSION

a. When is a loan accelerated?

First, it is necessary to understand when a mortgage foreclosure action accrues. On an installment loan, a foreclosure claim accrues whenever the borrower defaults by failing to pay a monthly installment payment.\(^1\) When the borrower defaults on any one installment payment, the lender may accelerate the debt and call the entire balance of the loan due.\(^2\)

Where, as is common, “the acceleration of the maturity of a mortgage debt on default is made optional with the holder of the note and mortgage, some “affirmative act” must be taken evidencing the holder’s election to take advantage of the accelerating provision and, until such action has been taken, the provision has no operation.”\(^3\)

Indeed, a loan is not automatically accelerated when the borrower defaults on an installment payment under the loan, as the lender must invoke its right to accelerate by an “affirmative act.”\(^4\) Likewise, a loan is not typically accelerated merely by the mere mailing of a default notice pursuant to the mortgage. The default notice typically informs the borrower that

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\(^1\) Pagano v. Smith, 201 A.D.2d 632 (2d Dep't 1994).
\(^2\) Id.
\(^3\) Green Tree Servicing, LLC v. Edwards, 48 Misc. 3d 1207(A) (Sup. Ct. Richmond Cnty. 2015); Bergman on New York Mortgage Foreclosures, § 4.04A.
the lender “may” accelerate the mortgage, if the loan is not reinstated by a date certain, typically 30 days. The permissive “may” in the default notice confirms that acceleration of the debt following the borrower’s default is an option for the lender to undertake if the default is not cured by a later date. Indeed, the default notices are typically regarded as pre-acceleration letters and do not typically serve as an “affirmative act” to accelerate the debt.5

The commencement of a foreclosure action is the most common way that lenders take that “affirmative act” to accelerate the loan.6 However, lenders can inadvertently take an “affirmative act” to accelerate the loan, too. The First Department recently held that a default notice that informs the borrower that the loan “will” be accelerated by a date certain constitutes an “affirmative act” that accelerates the loan.7 Other Departments have holdings seemingly to the contrary, with cases in the Third and Fourth Department holding that in order to be an act of acceleration, notice must inform the borrower that all sums due under the note and mortgage are immediately due and payable,8 while the Second Department offers a standard that any act of acceleration be “clear and unequivocal” without addressing the “will” vs. “may” language or immediacy, as yet.9

5 U.S. Bank, Nat. Ass'n v. Azad, 51 Misc. 3d 1224(A) (Sup. Ct. Queens Cnty. 2016); Edwards, 48 Misc. 3d 1207(A)(recognizing notices of default as “the pre-acceleration notice required by paragraph 22 of the mortgage, i.e., a 30-day Notice of Default”); Bergman on New York Mortgage Foreclosures, § 4.04A (“this required cure letter is not a correspondence which declares an acceleration. The cure notice is a prerequisite (or condition precedent) to acceleration, but is not the same thing. Sending an acceleration letter is not a substitute for the cure notification and indeed would be of no effect unless the cure notice was first sent.”).
6 Azad, 51 Misc. 3d 1224(A) (“There is no question that in this case that the original loan was accelerated by commencement of the first foreclosure action on October 7, 2008”); Albertina Realty Co. v. Rosbro Realty Corp., 258 N.Y. 472, 476 (1932) (“the unequivocal overt act of the plaintiff in filing the summons and verified complaint and lis pendens constituted a valid election [to accelerate]”).
7 Deutsche Bank Nat. Trust Co. v. Royal Blue Real Estate Holdings, 148 A.D.3d 529 (1st Dep’t 2017) (“The letters from plaintiff’s predecessor-in-interest provided clear and unequivocal notice that it ‘will’ accelerate the loan balance and proceed with a foreclosure sale, unless the borrower cured his defaults within 30 days of the letter. When the borrower did not cure his defaults within 30 days, all sums became immediately due and payable and plaintiff had the right to foreclose on the mortgages pursuant to the letters. At that point, the statute of limitations began to run on the entire mortgage debt.”).
b Why would a lender need to de-accelerate?

Under New York law, the statute of limitations for commencement of an action based on breach of contract, including, for example, the failure to pay mortgage loan installments, is six years.\(^{10}\) For an installment loan such as a mortgage, the limitations period begins to run for any individual installment payment upon a default in making such a payment. However, once the debt has been accelerated, the limitations period for all future installments begins to run as of the date of acceleration, unless the default is subsequently cured by the borrower, the loan is modified, or, relevant to this article, the debt is subsequently de-accelerated by the lender.\(^{11}\)

New York foreclosure actions can take years to resolve, for multiple reasons well-known to practitioners. Thus, a lender may find itself near the end of the limitations period with an involuntary dismissal after protracted litigation or facing a possible involuntary dismissal on standing or notice grounds, for example.\(^{12}\) To avoid a statute of limitations defense to any subsequent foreclosure claim, the lender must timely de-accelerate the debt.

In these instances it is important for a lender to first confirm when a loan was accelerated, as discussed above. Notably, with the exceptions discussed above, the six-year statutory time period does not begin to run when the borrower defaults on the loan or when a default notice is mailed. Oftentimes, the borrower’s default and the mailing of the default notice occur months before a loan is actually accelerated by the commencement of a foreclosure action. When a

\(^{10}\) CPLR 213(4) states that “an action upon a bond or note, the payment of which is secured by a mortgage upon real property, or upon a bond or note and mortgage so secured, or upon a mortgage of real property, or any interest therein” is to be commenced within six years.

\(^{11}\) See Green Tree Servicing, LLC, 48 Misc. 3d 1207(A).

\(^{12}\) Even if a foreclosure is dismissed on standing or notice grounds, a lender will have an additional six months to recommence the foreclosure pursuant to CPLR 205. See CPLR 205; Wells Fargo Bank, N.A. v. Eitani, 148 A.D.3d 193, 197 (2d Dep’t 2017).
lender seeks to de-accelerate the loan, as described below, these months may be valuable in later arguing, if necessary, that the lender did de-accelerate in a timely fashion.

c. How may a lender de-accelerate a mortgage?

After acceleration of a loan, a lender may unilaterally revoke its election to accelerate a mortgage by “an affirmative act of revocation” within the six-year statute of limitations period.13 De-acceleration, or revocation, withdraws the lender’s demand for payment of the entire balance of the loan and restores the loan to its original terms with installments due every month. The loan is still in default, but only the arrears, rather than the accelerated balance, is due. By timely de-accelerating a prior acceleration, a lender is preserving its right to call the entire balance of the loan due in a subsequent action.14

To illustrate the mechanics of the timing procedures, if a lender accelerated a loan on January 1, 2010, the lender would need to revoke the January 2010 acceleration within six years, by January 1, 2016, to ensure that any action subsequent to the January 2010 action is timely. If the lender fails to do so, subsequent lawsuits for recovery on the subject mortgage may be deemed time-barred.

Though the courts have not uniformly described what must be done to de-accelerate a loan, it appears that this “affirmative act” of revocation can be accomplished in at least two ways.15 The first way to de-accelerate a loan, as held by some New York courts in recent unreported decisions, is to obtain a voluntary dismissal of the existing foreclosure lawsuit.16

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15 It should also be noted that courts have found that the mere acceptance of a partial payment of the accelerated debt is not an affirmative act revoking an acceleration. See UMLIC VP, LLC v. Mellace, 19 A.D.3d 684 (2d Dep’t 2005); Lavin v. Elmakiss, 302 A.D.2d 638 (3d Dep’t 2003).
Before discussing the second way to de-accelerate a loan, it is important to note that, while it appears that a lender’s voluntary dismissal of an action will de-accelerate a loan, particularly when coupled with other consistent activity treating the loan as de-accelerated, it is clear that certain dismissals are insufficient to de-accelerate a loan. For example, the following do not revoke the lender’s acceleration: a court’s *sua sponte* dismissal of a foreclosure action;\(^\text{17}\) dismissal based on the lender’s default in failing to appear for a conference;\(^\text{18}\) and dismissal based on lack of personal jurisdiction.\(^\text{19}\) The distinction between a voluntary dismissal and the foregoing appears to be the “affirmative act,” as the voluntary dismissal is the only dismissal whereby the lender affirmatively acted to cause the dismissal.\(^\text{20}\) It should be noted that the voluntary dismissal, alone, may not be sufficient to de-accelerate the loan where the lender cannot demonstrate that it thereafter communicated to the borrower in a manner consistent with the reinstatement of the loan and de-acceleration of the obligations such that only the amount in arrears is due.\(^\text{21}\)

A second affirmative act that can de-accelerate a loan is for a lender to send a de-acceleration notice which unequivocally states that the lender de-accelerates the maturity of the loan, withdraws its prior demand for immediate payments of all sums secured by the security action is discontinued, it is as if it had never been; everything done in the action is annulled and all prior orders in the case are nullified.”); *Soffer v. U.S. Bank*, Index No. 513961/2015 (Sup. Ct. Kings Cnty. 2016) (“[D]efendant has revoked its election to accelerate by both affirmatively moving to discontinue the 2009 foreclosure action as well as affirmatively sending the plaintiff a de-acceleration notice prior to the lapse of the six year statutory period.”); *4 Cosgrove 950 v. Deutsche Bank Nat. Trust*, 2016 WL 2839341 (Sup. Ct. N.Y. Cnty. 2016).

\(^\text{17}\) *Mebane*, 208 A.D.2d at 892.

\(^\text{18}\) *EMC Mtge. Corp.*, 279 A.D.2d at 606.

\(^\text{19}\) *Clayton Nat. v. Guldi*, 307 A.D.2d 982 (2d Dep’t 2003).

\(^\text{20}\) It should be noted that de-acceleration does not stop the running of the statute of limitations as to individual defaults on payments from more than six years prior, as those specific payments still cannot be recovered. *See Sce v. Ach*, 56 A.D.3d 457, 458 (2d Dep’t 2008).

instruments and reinstates the loan as an installment loan.\textsuperscript{22} It should be noted though, that in order for any such unilateral act by the lender to validly de-accelerate the loan, the borrower must not be prejudiced by the de-acceleration.\textsuperscript{23}

Finally, it should also be noted that, where there is a valid acceleration of the mortgage debt, no voluntary dismissal of a foreclosure action or explicit de-acceleration notice, the statute of limitations can still be avoided where there is a reaffirmation of the debt by the borrower. However, partial payments on a loan by a borrower following acceleration will generally not constitute a ratification of the debt.\textsuperscript{24}

CONCLUSION

When a lender analyzes whether a foreclosure action is timely, it is important for the lender to determine whether the loan was previously accelerated, and if so, when it was accelerated and whether it was timely and effectively de-accelerated within six years thereafter. When analyzing when the loan was accelerated and whether it was de-accelerated, a lender must be mindful of the various mechanisms that do, and do not, accomplish acceleration and de-acceleration and act accordingly.

\textsuperscript{22} EMC Mtge. Corp., 279 A.D.2d at 606. Note also that at least one court has held that any such de-acceleration letter must give “actual notice” to the borrower of the lender’s election to revoke in sum. \textit{Bank of NY Mellon v. Slavin}, 2016 NY Slip Op 26382 (Sup. Ct. Rensselaer Cnty. 2016)

\textsuperscript{23} For example, if a borrower executes a new loan agreement with a different lender to pay off the accelerated balance, and the original lender de-accelerates the distressed loan, the borrower is likely prejudiced by the de-acceleration. Avoiding a looming statute of limitations problem does NOT constitute prejudice, however.

\textsuperscript{24} See UMLIC VP, LLC v Mellace, 19 A.D.3d 684 (2d Dep’t 2005); \textit{Lavin v. Elmakiss}, 302 A.D.2d 638 (3d Dep’t 2003). One exception is if partial payment is made after the limitations period has run. "When part payment of an obligation, which would otherwise be unenforceable under the statute of limitations, is made, longstanding common law holds that the statute will run afresh beginning with the date of that payment, provided it may be inferred from the payment that an intention arose therefrom to honor the entire obligation to which it relates." (1-5 Bergman on New York Mortgage Foreclosures § 5.11 [6] [b]; see \textit{National Heritage Life Ins. Co. v. Hill St. Assoc.}, 262 A.D.2d 378 (2d Dep’t 1999), citing \textit{Roth v. Michelson}, 55 N.Y.2d 278 (1982); see also \textit{General Obligations Law} § 17-107; \textit{Big Chief Lewis, Inc. v. Stim}, 99 A.D.2d 501 (2d Dep’t 1984).
CONTENT OF AN AUTHORIZATION
TO ORIGINATE RECURRING ACH DEBIT ENTRIES

By
Ted Teruo Kitada

February 20, 2017

Background: Under a “Stipulation and Consent to the Issuance of a Consent Order,” dated December 16, 2016, Military Credit Services, LLC (“Respondent”), stipulated to the issuance of a consent order1 (“Consent Order”) by the Consumer Financial Protection Bureau (“CFPB”) against it, dated December 20, 2016, regarding, inter alia, Respondent’s consumer lending and debt collection practices. Respondent is a financing company that extends revolving credit to consumers and through a commonly owned company collects debts owed under consumer contracts with Respondent.2 From January 9, 2015, to December 20, 2016, the period covered under the Consent Order, Respondent offered revolving credit arrangements to consumers containing an “ACH Pre-Authorization Payments Agreement,” hereinafter “Preauthorization Agreement,” to facilitate electronically the collection of payments arising under the arrangements.

Under this Preauthorization Agreement, Respondent obtained consumers’ bank account numbers and withdrew monthly payments from consumers’ deposit and credit accounts throughout the term of the credit arrangements. Specially, the Preauthorization Agreement contained the following debit authorization to enable Respondent to collect payments under the credit arrangements, with emphasis added:

I (we) hereby authorize [Respondent] to use my Credit Card … or my Visa/MasterCard Check Card, or my (our) checking or savings account (identified below) to pull my (our) monthly payment. The depository named below is also authorized to charge the same to my (our) account…; and

Payments must be drafted on or before the contractual due date and may be subject to a $25.00 service charge for all non-sufficient funds….3

Analysis: According to the Consent Order, Respondent’s practice described above violates federal law. The practice also raises compliance questions under a clearing house rule.

1 A copy of the Consent Order is available at the following link:
2 Consent Order, p. 3.
3 Consent Order, p. 5.
Violation of federal law: As detailed in the Consent Order, the Preauthorization Agreement failed to comply with federal law. To the extent a consumer’s deposit account is subject to a debit under the Preauthorization Agreement, these bank account withdrawals are preauthorized debit entries covered under the federal Electronic Fund Transfer Act (“EFTA”) and Regulation E issued under this law, as “electronic fund transfers.” The EFTA and Regulation E require any agreement governed thereunder, including the Preauthorization Agreement, to be clear and readily understandable to consumers. Under the Consent Order, the CFPB ruled that the Preauthorization Agreement provisions detailed above were not clear and readily understandable to consumers because they merely provide that the transfer will be made “on or before the contractual due date.” As discussed in more detail below, the Preauthorization Agreement apparently failed to stipulate the amount and date of payment, among other shortcomings, at least as to the provisions shown in the Consent Order.

While the Consent Order curiously fails to raise this point, Respondent could also be in violation of Regulation E § 1005.10(d)(1), if it does not provide a notice varying in amount with respect to payments due under a revolving credit arrangement:

When a preauthorized electronic fund transfer from the consumer’s account will vary in amount from the previous transfer under the same authorization or from the preauthorized amount, the designated payee or the financial institution shall send the consumer written notice of the amount and date of the transfer at least 10 days before the scheduled date of transfer.

Additionally, for payments varying in amount, Respondent may in lieu of the above notice employ the options in Regulation E § 1005.10(d)(2):

The designated payee or the institution shall inform the consumer of the right to receive notice of all varying transfers, but may give the consumer the option of receiving notice only when a transfer falls outside a specified range of amounts or only when a transfer differs from the most recent transfer by more than an agreed-upon amount.

The Consent Order is unclear whether Respondent failed to comply with these additional federal regulatory requirements as well; however, given the paucity of terms under the Preauthorization Agreement, we may remain skeptical.

Violation of the NACHA Operating Rules: In addition to the requirements for an authorization under the EFTA and Regulation E, an electronic payment through the automated clearing house (“ACH”) is subject to the National Automated Clearing House Association

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4 15 U.S.C. § 1693c; 12 C.F.R. part 1005, Supp. I, Official Staff Interpretations, § 1005.10(b)-6: Requirements of an authorization. An authorization is valid if it is readily identifiable as such and the terms of the preauthorized transfer are clear and readily understandable.
Operating Rules and Guidelines ("Operating Rules"), 2017 edition. At Operating Rules subsection 2.3.2.3(b), an authorization must:

(b) have clear and understandable terms. A purported authorization that is not clear and readily understandable as to its terms (including the amount or timing of debits), or that is otherwise invalid under applicable Legal Requirements, does not satisfy the requirements of this Section 2.3;….

Thus, not only does the Preauthorization Agreement fail to satisfy the requirements for an authorization under the EFTA and Regulation E, it likely fails to satisfy the Operating Rules authorization requirements because it too presumably is not clear and readily understandable as, among other reasons, it does not include the amount and timing of the debits.

In order for Respondent, as Originator, to originate an entry against a consumer’s account, as Receiver, the Operating Rules at § 2.3.1 require the Originator to obtain an authorization in conformity with the requirements of the Operating Rules from the Receiver. Under the Operating Rules at § 2.2.2(b), an Originator must agree to be bound by the Operating Rules. This authorization requirement applies to both ACH debits against a consumer’s deposit account, but also debits against a consumer’s credit account. In contrast, the requirements under the EFTA and Regulation E apply to a deposit or other asset account, but not to a credit account.

In regard to the content of an authorization under the Operating Rules, that content may turn in part on the specific ACH entry at issue. Please look, for example, to the Operating Rules at OG221 setting forth in comprehensive detail the requirements applicable to a single or recurring PPD debit or credit entry. A PPD debit or credit entry is a “Prearranged Payment and Deposit” by an organization against or to a consumer’s account. For a PPD authorization granted by a consumer under the Operating Guidelines within the Operating Rules, it must comply with the following:

AUTHORIZATION REQUIREMENTS

As with any ACH transaction, the Originator must obtain the Receiver’s authorization to initiate PPD entries through the ACH Network to the Receiver’s account. For PPD debit entries, the authorization must

1. be in writing;
2. be readily identifiable as an ACH authorization;
3. have clear and readily understandable terms;
4. provide that the Receiver may revoke the authorization only by notifying the Originator in the manner specified in the authorization; and

5. be either signed or similarly authenticated by the consumer. (Refer to the discussion below on the use of the similarly authenticated standard with PPD entries.)

The Originator must provide the Receiver a copy of the authorization for all debit entries. For credit entries to a consumer’s account, the authorization may be obtained in writing, or it may be obtained orally or by other non-written means.5

As demonstrated from the terms of the Operating Rules, the authorization granted by a consumer in favor of an Originator, including a creditor, must contain significantly more detail under the Operating Guidelines than merely the amount and date of the anticipated debits as provided under Operating Rules subsection 2.3.2.3(b) cited above applicable generally to all authorizations.

**Conclusion:** When a creditor obtains an authorization from a consumer debtor to debit through the ACH system the consumer’s deposit or credit account, in light of this Consent Order, the creditor is encouraged to review carefully the terms of the written authorization to confirm that the requirements under federal law and the Operating Rules are satisfied, particularly stipulating the amount and timing of the regularly recurring debit entries. The failure to comply with this mandate may be costly: Under the Consent Order, Respondent is required to pay a civil money penalty of $200,000.00 to the CFPB.

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5 Note the distinct difference between an authorization applicable to a PPD debit entry vis-à-vis a credit entry.
Predictive Coding - A Robust but Efficient Approach for Responding to Recent Regulatory Scrutiny of Sales Practices

By: Perry A. Napolitano, Esq., Jeffrey M. Weimer, Esq., and Christopher R. Brennan, Esq.¹

Many financial institutions collect increasingly large amounts of information from and about their customers, including customer complaints. Customers of retail banks complain about everything from the long wait they experienced in the teller line to receiving a checking account or credit card they did not ask for or authorize. This latter issue has been the subject of recent enhanced scrutiny from bank regulators, and it provides a case study for the ways in which customer complaints or similar data can be either a landmine or a goldmine for financial institutions. Properly analyzed, this data can allow banks to respond to regulatory inquiries promptly, accurately and efficiently, and to quickly identify (or even anticipate) future key risks. Handled improperly, this voluminous data can present seemingly insurmountable challenges. This three-part article (1) summarizes current escalations in regulatory scrutiny of retail banking sales practices; (2) explains predictive coding’s ability to efficiently and effectively analyze customer complaint data; and (3) outlines additional downstream benefits predictive coding can afford for a bank’s compliance management program.

Part 1 – Scrutiny of Financial Institution Sales Practices Shines Light on Customer Complaint Systems

Beginning in the third quarter of 2016, state and federal financial services regulators, led by the Office of the Comptroller of the Currency (“OCC”) and Consumer Financial Protection Bureau (“CFPB”), announced new enforcement activity and associated guidance targeting certain retail sales practices that resulted in heightened risks to consumers, including

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unauthorized or unnecessary account openings and product enrollments. As described by the CFPB, “production incentives,” such as aggressive sales quotas and payments based on referrals of new products to customers, can foster an “unrealistic culture of high-pressure targets” and may create the following consumer risks:

- enrolling customers in services without their knowledge or consent and in turn charging improper fees, enforcing improper collection activities and/or adversely affecting consumer credit scores;
- deceptive product marketing;
- overcharging customers, selling customers less favorable products, or selling customers more credit than they need; and
- encouraging customers to purchase products that do not fit their interests and objectives.2

To combat these issues, the CFPB and OCC issued guidance stressing that banks must deploy a robust compliance management system appropriate for the institution’s size and risk profile.3 Regulators also noted that a core component of such a system is a consumer complaint management program capable of “collecting and analyzing consumer complaints for indications that incentives are leading to violations of law or harm to consumers in order to identify and resolve the root causes of any such issues.”4 In testimony before the United Stated Senate, Thomas Curry, Comptroller of the Currency, highlighted the need for “effective enterprise-wide customer complaint process[es]” and “audit services to identify [risks] or to aggregate sales practice issues into an enterprise view.”5 Mr. Curry’s testimony also warned that banks should expect their OCC examiners to issue Supervisory Letters and Matters Requiring Attention

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2 See CFPB, Compliance Bull. No. 2016-03, Detecting and Preventing Consumer Harm from Production Incentives (Nov. 28, 2016).
3 EDITOR'S NOTE: Missing proper citation.
4 EDITOR'S NOTE: Missing proper citation
5 Thomas J. Curry, Comptroller of the Currency, Testimony before the US Senate Committee on Banking, Housing and Urban Affairs (Sept. 20, 2016).
(“MRAs”) for failures to develop operational risk compliance programs and complaint reporting systems.\textsuperscript{6}

Since issuing this guidance, regulators have engaged in widespread examinations targeting national and regional banks to assess compliance management systems for sales practices. As reported by industry analysts, customer and employee complaint data plays a central role in these examinations:

Customer and whistle blower complaints are likely to be the initial point of regulatory focus because they are leading indicators of potentially systemic harmful practices. Therefore, banks should have enterprise-wide policies, procedures and processes for reviewing, tracking and evaluating complaints, and for escalating issues to senior managers. . . . Eventually this process can be automated and supplemented with artificial intelligence to better identify and categorize issues.\textsuperscript{7}

Thus, customer complaint data has become an essential component of banks’ compliance management systems for two distinct, but equally-important purposes. First, customer complaint data serves as the primary evidence in regulatory investigations of banks’ historical sales practices, and banks must be able to evaluate their existing data in order to respond to bank examination inquires. Second, the systems that manage this data must be sufficiently robust to detect and deter future sales practice risks before they become toxic to the bank’s overall sales culture.

Though simple in theory, these objectives will require many banks to reevaluate and transform their existing customer complaint reporting processes and associated analytics. The following section discusses these challenges in detail and suggests how predictive coding

\textsuperscript{6} Id.
\textsuperscript{7} Adam Gilbert, Armen Meyer, Dan Ryan & Mike Alix, PwC, Sales Practices: OCC Exams and Beyond (Oct. 2016).
technologies provide financial institutions a cost-effective solution for extracting valuable business intelligence from often voluminous customer complaint data.

**Part 2 – Leveraging Predictive Coding to Assess and Monitor Enterprise-Wide Customer Complaint Data**

Financial institutions must develop robust tools to ensure that customer complaint data adequately serves the dual purposes discussed above, to: (1) identify historic complaints that align with current regulatory priorities (i.e. complaints related to sales tactics currently under scrutiny); and (2) prospectively monitor emerging trends in sales practice risks that often first surface through new customer complaints. The non-uniformity of customer complaint data, however, threatens substantial cost and resource obstacles to institutions that are now expected to analyze this data in new and more precise ways. This section focuses on how financial institutions can cut through the “noise” of customer complaint data, provide timely responses to bank examiners, and gain actionable business intelligence with predictive coding data analysis techniques.

A) **Traditional Review Methodologies Are Ineffective in Analyzing Enterprise-Wide Customer Complaint Data**

To understand the need for predictive coding methodologies, one must appreciate both the benefits and the pitfalls that customer complaint data pose for financial institutions. The breakneck advances of IT systems and the rise of “big data” have resulted in an exponential increase in customer data collection by financial institutions. A host of new platforms, from social media to online chat and mobile apps, allow customers to communicate with banks without setting foot in a branch. As Toos Daruvala, Senior Advisor with McKinsey & Company, notes, “[T]he advanced-analytics opportunity quite simply is an opportunity to redefine the
playing field. I think some banks will seize that opportunity and will be able to truly
differentiate themselves using data and analytics.”

But this ever-growing trove of data also presents substantial challenges and costs when
regulators compel banks to review and produce information from these data sources. Third party
data suggests that customer complaint volume for financial institutions is substantial and
growing over time. For example, the CFPB publishes a monthly report of consumer complaints
that it receives regarding financial institutions. Since July 2011, the CFPB has logged more than
1.1 million complaints. Based on the most recent three month average (Nov. 2016 – Jan. 2017),
as compared to the same three month period in the prior year, complaint volume increased 21
percent.9 Traditional litigation review practices that use linear, document-by-document
determinations of relevance cannot efficiently or effectively scale and adapt to voluminous
customer complaint data. Furthermore, customers and bank personnel may describe a similar
complaint in different, unpredictable and imprecise ways, which undermines the
comprehensiveness of a review based on keyword searching.

This data “noise” also bleeds into structured data, such as a complaint logging system
where personnel categorize complaints by type, because the average customer is unlikely to
describe their concerns in a way that consistently aligns with a predetermined list of complaint
types. Moreover, it is unreasonable to expect that any set of predetermined complaint categories
will always align with new issues or different risks identified by regulators over time. As a
result, while these categorizations can be helpful for other purposes, they cannot supplant a
review of the substantive description of the complaint as provided by the customer (or via the

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employee receiving and inputting the complaint). To the extent that the likely volume of complaints exceeds a few hundred entries – which is probable for any large financial institution – linear review methods are unlikely to provide timely and comprehensive results.

B) The Basics of Predictive Coding

Predictive coding – an increasingly common and reliable litigation discovery strategy – is also adaptable to effectively analyze customer complaint data. At its core, predictive coding utilizes a software application (the “system,” offered by various providers) that applies machine learning technology to assess the likely relevance of documents (in this context, customer complaints) based on user-defined criteria.\(^\text{10}\) A predictive coding review begins with a series of training sessions during which one reviewer or a small, coordinated team views random samples of complaints and determines which complaints are relevant based on the defined criteria.

For example, if the focus of an inquiry (from a regulator or the bank’s management) were on unauthorized credit card applications, the reviewer could identify that type of complaint as relevant from the random sample sets of complaints, thereby distinguishing those complaints from those involving applications for other products or other issues concerning credit cards, which would be irrelevant.

These user decisions are continuously analyzed against the overall complaint population and inform the system’s selection of complaints in subsequent review sets. This training continues until the predictive coding algorithm “stabilizes” – i.e., additional training does not materially impact the system’s ability to discern the relevance of a given complaint.

\(^{10}\) The Sedona Conference recently published an excellent case law primer on predictive coding (also referred to as “technology-assisted review” or “TAR”), which also includes a discussion on various elements of the predictive coding review process. See The Sedona Conference, The Sedona Conference TAR Case Law Primer, 18 Sedona Conf. J. 37-42 (forthcoming 2017), available at https://thesedonaconference.org/download-pub/5023.
Once active training concludes, the system deploys this learning across the entire complaint population and “scores” each file on its likely relevance and generates statistical measures for the overall population. The review team then selects a cut-off relevance score (which corresponds to a statically-valid estimate of recall and precision) to define the subset of documents in the overall population that are likely to be relevant. For example, in a population of 10,000 complaints, the system can determine that 90% of the likely responsive files (with margin of error +/- 5%) are within an identified subset of 2,500 complaints. In other words, these 2,500 complaints will include 90% of the likely responsive documents that are scattered throughout the total 10,000 complaint population.

C) The Advantages of Predictive Coding Applied to Enterprise-Wide Customer Complaint Data

Because predicative coding relies on a machine learning process, it can cut through the noise and volume of enterprise-wide customer complaint data with greater speed and accuracy than traditional linear document review, while simultaneously minimizing overall costs.\(^\text{11}\) The speed and cost advantages of predictive coding are realized because the review team is required to view only a small fraction of the overall complaint population in order to train the predictive coding algorithm. It is often possible to complete system training and reach stability based on a human review of only 20-30% of the total population of complaints.

Once the likely responsive set is identified, the review team is able to set aside the remainder of the population, which is statistically unlikely to contain a material number of relevant complaints.\(^\text{12}\) Returning to our hypothetical universe of 10,000 complaints, predictive

\(^{11}\) Of course, these results assume that the predictive coding process is handled by an experienced team that is well-versed in the various stages of predictive coding and best practices for document processing, training and analytics. The quality of a predictive coding review for any data set is determined by the expertise applied at each stage, and depends heavily on correctly identifying relevant documents during system training.

\(^{12}\) Best practices suggest that the review team conduct a limited sample of the likely unresponsive subset to confirm the relevant cut-off score – a process referred to as “elusion” testing.
coding would provide a bank a statistically-backed basis to determine that the substantial majority of complaints (7,500) are highly unlikely to contain responsive information and do not merit human review. These efficiencies are impossible under a linear review process – where the bank can only determine relevance by reviewing each and every complaint.

Gains in accuracy accrue because the system’s predictive coding algorithm is not subject to the differences in decision-making that naturally exist among a team of human reviewers. Additionally, the algorithm is able to filter and rank patterns of relevant information without resorting to imprecise and static keywords. Continuing with the same example, the iterative training phase in the predictive coding process allows the algorithm to learn that the occurrence of the terms “card” and “application” are indicative of relevant documents, but less so than similar terms such as “credit card” and “credit application.” This flexibility is particularly valuable for customer complaint data because it is impossible to develop a keyword list that would capture all potential variations in customer and employee language, while also excluding likely irrelevant complaints.

Equally important for financial institutions, government agencies and the courts have been increasingly vocal advocates of predictive coding. A decision from the U.S. District Court for the Southern District of New York listed the following benefits of predictive coding:

> [P]arties can (and frequently should) rely on latent semantic indexing, statistical probability models, and machine learning tools to find responsive documents. Through iterative learning, these methods (known as ‘computer-assisted’ or ‘predictive’ coding) allow humans to teach computers what documents are and are not responsive to a particular FOIA or discovery request and they can significantly increase the effectiveness and efficiency of searches.\(^\text{13}\)

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Additionally, model document requests from the Federal Trade Commission and Department of Justice provide guidance on, and thereby at least implicitly endorse, the use of predictive coding in responding to agency requests.\textsuperscript{14}

Finally, the benefits of predictive coding do not stop when the identification of responsive complaints is completed. As discussed in the next section, the knowledge gained through the predictive coding process affords numerous downstream benefits for banks responding to regulatory examinations. Predictive coding techniques also can be adapted to develop key risk indicators and other monitoring tools to identify new trends or concentrations of complaints and to assist banks in staying current with evolving regulatory priorities.

### Part 3 – Additional Advantages to Predictive Coding

Predictive coding cannot alleviate a financial institution’s obligation to carefully investigate and address complaints involving alleged improper sales practices. But predictive coding can provide banks greater agility in responding to relevant complaints and lay the groundwork for further helpful data analytics. For example, a key regulatory focus in any examination will be determining that complaints involving improper sales practices have been fully and promptly investigated by the bank and appropriately resolved. The speed of the predictive coding process allows banks, in only a matter of days if necessary, to triage and prioritize the complaints that require further follow-up or intervention with the customer and/or employees for a particular issue. Financial institutions can also monitor whether relevant complaints are appropriately categorized at intake.

In addition, with a quickly identifiable and sufficiently narrow universe of relevant complaints, financial institutions can analyze the data to identify important trends meriting

\textsuperscript{14} 18 Sedona Conf. J. 42-44 (forthcoming 2017).
further investigation. As an example, banks could determine that a higher-than-normal volume of complaints involved a particular geographic area, product or marketing strategy, or time period. And in response to any such trends, policies and procedures can be appropriately revised, additional training implemented and/or employee disciplinary action imposed. Banks also can assess whether complaints are escalated to more senior management appropriately and in accordance with the compliance management program, depending on the level of severity of the underlying alleged conduct.

Going forward, the results of a predictive coding review of historic complaints can provide a solid baseline for ongoing monitoring of key risks. Whether by subsequent periodic predictive coding reviews of new complaint data and/or by adapting an institution’s other compliance management programs, the “learning” achieved by the predictive coding exercise offers real value in identifying (in a statistically defensible way) the characteristics of complaints that garner regulatory scrutiny.

In sum, predictive coding can empower banks to quickly, cost-effectively and accurately analyze non-uniform data and isolate complaints regarding improper sales practices (or other future enforcement priorities by bank regulators) that merit greater internal investigation and monitoring.
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Know When to Fold ‘Em—UIGEA’s “Intrastate Safe Harbor” Provides No Safe Harbor For Online Casinos

Darryl Nirenberg and Chelsea Gold

Introduction

On December 23, 2011, the Office of Legal Counsel (OLC) of the Department of Justice (DOJ) issued an opinion reversing fifty years of interpretation of the federal Wire Act (OLC Opinion), concluding the Act covers bets and wagers on sporting events and contests only.¹ Three states—Delaware, Nevada, and New Jersey—subsequently enacted laws authorizing online casinos. The legislatures of several other states have considered proposals to join them,² while four other states—Georgia, Illinois, Kentucky, and Michigan—permit Internet gambling through their states’ lotteries.³

Earlier this year, following a commitment from Attorney General Jeff Sessions to “revisit” the OLC Opinion, several states began considering legislation authorizing Internet gambling, citing as authority the “intrastate safe harbor” provision in the federal Unlawful

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³ Minnesota had authorized its lottery to engage in online sales, but subsequently repealed that authority.
Internet Gambling Enforcement Act (UIGEA).\(^4\) This assertion of authority is misplaced. UIGEA’s safe harbor provision for intrastate transactions does not authorize Internet gambling—even when those gambling transactions originate and end within a single state—and use of U.S. financial instruments to facilitate such transactions is barred under the Act.

**I. The Unlawful Internet Gambling Enforcement Act: An Overview**

UIGEA prohibits the acceptance of any financial instrument for “unlawful Internet gambling.”\(^5\) Congress made clear in the legislation that no provision of UIGEA may be read to alter, limit, or extend any federal, state, or tribal law “prohibiting, permitting, or regulating gambling within the United States.”\(^6\) UIGEA was not enacted to render any form of Internet gambling legal; rather it aimed to provide law enforcement additional tools to combat the activity.\(^7\)

In enacting UIGEA, Congress included a narrow safe harbor provision exempting certain intrastate transactions from the definition of “unlawful Internet gambling.”\(^8\) For the safe harbor to apply, three requirements must be met. First, “the bet or wager” must be “initiated and

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\(^{6}\) 31 U.S.C. § 5361(b).

\(^{7}\) See 152 Cong. Rec. E2152 (daily ed. Dec. 8, 2006), https://www.congress.gov/crec/2006/12/08/CREC-2006-12-08-pt1-PgE2152-4.pdf (statement of Representative Spencer Bachus (R-Alabama) (“The new law [UIGEA] does not change the legality of any gambling activity in the United States. The sole purpose of this law is to enforce against activities that are already illegal under the Wire Act and other Federal and State statutes.”)) [hereinafter Bachus UIGEA Statement].

\(^{8}\) See generally 31 U.S.C. § 5362; H. Rep. 109-412, at 17 (2006) (clarifying that purely intrastate transactions conducted in accordance with state laws with appropriate security controls will not be considered unlawful Internet gambling).
received or otherwise made exclusively within a single state.” 9 Second, the bets must be expressly authorized by state law, and the state law must include age and location verification requirements. 10 And finally, the bet or wager must not violate the provisions of other federal laws, specifically the Interstate Horseracing Act of 1978, the Professional and Amateur Sports Protection Act, the Gambling Devices Transportation Act, and the Indian Gaming Regulatory Act. 11

Some claim this intrastate safe harbor provision acts as a broad authorization of Internet gambling so long as it is conducted (meaning initiated and received) within a single state that has authorized the activity. However, no such authority exists, as is evidenced by several factors discussed below.

II. Analysis

a. The OLC Opinion Fails to Answer the Question Asked.

In enacting UIGEA, Congress relied upon the longstanding position of the DOJ that all online gambling was illegal. 12 In 2011, the DOJ opined on the lawfulness of online intrastate lotteries in response to 2009 inquiries from Illinois and New York. 13 The requests from the states concerned the lawfulness of their states’ respective proposals to use the Internet and out-

9 Id. § 5362(10)(B)(i).
10 Id. § 5362(10)(B)(ii)(I).
11 Id. § 5362(10)(B)(iii).
12 See Wire Act Opinion, supra note 1, at 2 (acknowledging that the DOJ has “uniformly taken the position the Wire Act is not limited to sports wagering and can be applied to other forms of interstate gambling”); see Establishing Consistent Enforcement Policies in the Context of Online Wagers Hearing Before the H. Comm. on the Judiciary, 110th Cong. 10, 13-14 (2007) (statement of Catherine L. Hanaway, United States Attorney, East District of Missouri, U.S. Department of Justice) (stating that the DOJ believes that “all forms of Internet gambling, including sports wagering, casino games, and card games, are illegal under federal law”); id. at 11, 13 (noting that the DOJ interpreted existing federal statutes—including the Wire Act and UIGEA—as pertaining to and prohibiting Internet gambling); id. at 11, 14-15 (advancing the view of the DOJ that “Internet gambling was illegal under existing federal criminal statutes even before UIGEA”); Bachus UIGEA Statement, supra note 7 (“[O]nline gambling has been illegal in this country from its inception”).
13 See generally 2011 Wire Act Opinion, supra note 1.
of-state transaction processors to sell lottery tickets to in-state adults. In their letters, the states sought guidance regarding the Wire Act’s interplay with UIGEA.

In response to these letters, the Criminal Division at DOJ requested guidance from the OLC, as it was concerned that, under certain interpretations, “the Wire Act may criminalize conduct that UIGEA suggests is lawful.” Despite this opportunity to respond to the applicability and interpretability of the safe harbor in UIGEA, the DOJ refused to state that UIGEA permits intrastate Internet gambling, avoiding that analytical question altogether. Instead, in the OLC Opinion, the DOJ focused solely on the Wire Act’s reach. Using tortured logic and selective reading of the legislative history of the Wire Act, the Department administratively created a loophole in the Act, opining that the Wire Act is limited to bets or wagers related to a “sporting event or contest.”

The OLC Opinion’s altered interpretation of the Wire Act is as significant for what it said as what it left unsaid. The DOJ was unable to interpret the “intrastate safe harbor” of UIGEA as permitting online intrastate lotteries, and did not even address the issue. It could not read an interpretation into the statute that was not there to begin with and that would otherwise run

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14 See id. at 1.

15 Id. at 2 (inquiring as to whether the Wire Act is inapplicable in such situations because it does not cover communications related to non-sports wagering and whether their prosed lotteries are lawful under UIGEA).

16 Id. at 3 (identifying the tension based on the fact that the DOJ has “consistently argued under the Wire Act that, even if the wire communication originates and terminates in the same state, the law’s interstate commerce requirement is nevertheless satisfied if the wire crossed state lines at any point in the process”).

counter to the Department’s past actions, including its general treatment of all Internet transactions as interstate in nature.\(^{18}\)

\textbf{b. The Internet is Inherently Interstate.}

Federal courts have consistently concluded, and the DOJ has consistently argued, that the Internet is inherently an interstate technology even when communications are sent and subsequently received in the same state.\(^{19}\) Apart from the online gambling context,\(^{20}\) in the years leading up to UIGEA’s passage, several courts contemplated the interstate nature of the Internet in cases concerning issues ranging from child pornography\(^{21}\) to extortion and threats.\(^{22}\) In each of these cases, the common conclusion is that “the Internet is an instrumentality and channel of interstate commerce.”\(^{23}\) The use of such a system that is “inexorably intertwined with interstate commerce” is therefore sufficient to many courts (and the DOJ) to meet any interstate requirement in a statute.\(^{24}\)

Based on the case law, and DOJ’s clear position in its argument of those cases, Congress knew that the Internet served as an interstate modality. As Representative Spencer Bachus (R-
Alabama) noted in a statement supporting the passage of UIGEA, “[t]he advantage and the disadvantage of the Internet is that it has no borders.”25 And some courts have characterized it as “an international network of interconnected computers”26 for which, unless monitored specifically, it is nearly impossible to know the exact route taken by an Internet user’s website connection request.27 It is based on this concept that some courts argue that once a user submits a connection request to, or in this case places a bet with, a website server, the data has traveled in interstate commerce.28 The same is true when funds, tokens, or chips are deposited from a website server back to the user.29

The interstate nature of the Internet is notably apparent in the online gambling context. For decades, federal anti-gambling laws have been interpreted to prohibit virtually all forms of Internet gambling because of the Internet’s inherently interstate nature.30 The argument follows that, because Internet gaming transmissions are inevitably channeled out of state, whether as a request from a user or a gambling website, and cannot be made exclusively within a single state, such transactions are ineligible to fall under the intrastate safe harbor established by UIGEA. To suggest otherwise, that for legal purposes, the Internet does not cross state lines when used for gambling, would establish a precedent which could undermine enforcement of other federal criminal laws including those which are used to prosecute child predators and extortionists.31

25 Bachus UIGEA Statement, supra note 7.
27 MacEwan, 445 F.3d at 244.
28 Id.
29 Id.
30 E.g., Pic-A-State, 76 F.3d at 1301 (finding that Congress’ power to regulate interstate commerce reaches the transmission of information by computer for the purpose of purchasing lottery tickets); see also Martha A. Sabol, Recent Developments Could Shape Internet Gaming Future, Law360 (Mar. 10, 2014, 2:45PM) (subscription required) (noting that prior to the 2011 Wire Act memorandum, the DOJ had long maintained that because the Internet is inherently interstate, even intrastate Internet wagers violated the Wire Act).
31 See supra note 19.
Of note is that certain states have shed any pretense that their online casinos operate solely intrastate. Delaware and Nevada have signed a multistate agreement essentially authorizing interstate online gambling between the member states. Such compacts allow residents of the member states to sit down at the same virtual table for an online poker game.\textsuperscript{32} There is no viable means to interpret such an agreement as anything but interstate online gambling, an activity explicitly prohibited under federal law and certainly outside the bounds of the UIGEA’s \textit{intrastate} safe harbor—even misreading the safe harbor as somehow permitting online casinos where wagers are placed and received in the same state.

c. UIGEA Cannot be Implied to Preempt or Repeal Federal Laws Banning Internet Gambling.

An alternative justification for the permissive treatment of online intrastate gambling is that UIGEA was meant to implicitly preempt or repeal the Wire Act and other federal statutes prohibiting online gambling conduct. This argument, however, fails to pass muster.

At a foundational level, as mentioned above, UIGEA includes a rule of construction stating that “no provision [of UIGEA] shall be construed as altering, limiting, or extending any Federal or State law or Tribal-State compact prohibiting, permitting, or regulating gambling within the United States.”\textsuperscript{33} Even a cursory reading of this provision indicates that Congress did not intend to have UIGEA supersede other federal laws prohibiting online gambling.

Furthermore, the judicial doctrine of implied repeal, which allows Congress, in the course of enacting legislation, to declare an intent to repeal preexisting laws without mention or

\begin{footnotes}
\item[33] 31 U.S.C. § 5361(b).
\end{footnotes}
reference to such laws is inapplicable with respect to UIGEA and its application to federal statutes proscribing Internet gambling.\textsuperscript{34} A statute cannot be interpreted to abrogate existing law merely by implication; “the intention of the legislature to repeal must be clear and manifest,”\textsuperscript{35} and, whenever possible, statutes should be read consistently.\textsuperscript{36}

Courts will generally find repeal by implication in only two instances: (1) where provisions in the two acts are in irreconcilable conflict and the later act—to the extent of conflict—constitutes an implied repeal of the earlier act; and (2) if the later act covers the whole subject of the earlier act and is clearly intended as a substitute, it will operate similarly as a repeal of the earlier act.\textsuperscript{37}

Given that UIGEA does not cover the whole subject matter encompassed in the Wire Act, the former requirement would be the only one at issue. The argument, however, would be woefully inadequate and futile. The relationship of UIGEA to the Wire Act—or any other federal online gambling legislation for that matter—does not result in a finding of irreconcilable differences. Congress enacted UIGEA having received testimony from the DOJ that the Wire Act and other federal laws cover and proscribes all forms of Internet gambling, and with a stated goal of providing tools to enforce those gambling prohibitions.\textsuperscript{38} Rather than creating an irrefutable conflict, the congressional intent behind UIGEA naturally weaves itself into the

\textsuperscript{34} Norman Singer & Shambie Singer, § 23:9: \textit{Implied Repeal, Sutherland Statutes and Statutory Construction} (Nov. 2016) (explaining that when two statutes are “repugnant” or “irreconcilable” in any of their provisions, “the later act, even without a specific repealing clause, operates to the extent of the repugnancy to repeal the first.”).

\textsuperscript{35} Elephant Butte Irrigation Dist. of N.M. v. Dep’t of Interior, 269 F.3d 1158, 1164 (10th Cir. 2001) (noting that repeal by implication is generally not favored by the courts).


\textsuperscript{37} Posadas v. National City Bank of N.Y., 296 U.S. 497, 503-04 (1936) (stating that the test does \textit{not} mean that “the mere fact that the latter act covers the whole subject and embraces new provisions demonstrates an intention completely to substitute the latter act for the first”).

\textsuperscript{38} \textit{See} Section II.A; \textit{supra} note 44 (including within the current interstate gambling prohibitions laws such as the Wire Act, federal prohibitions on lotteries, and the Gambling Ship Act).
statutory framework created by related federal legislation—that it serve as a tool to enforce the Wire Act and other federal laws banning all forms of Internet gambling.

Moreover, even if they were in conflict, the enactment of civil gambling laws has generally not been treated as preemptsing or repealing criminal laws. For example, in his statement that accompanied the signing of an amendment to the Interstate Horseracing Act of 1978, then-President Bill Clinton noted that:

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\text{[S]ection 629 . . . amends the Interstate Horseracing Act of 1978 to include within the definition of the term “interstate off-track wager,” pari-mutuel wagers on horseraces that are placed or transmitted from individuals in one State via the telephone or other electronic media and accepted by an off-track betting system in the same or another State. The Department of Justice, however, does not view this provision as codifying the legality of common pool wagering and interstate account wagering even where such wagering is legal in the various States involved for horseracing, nor does the Department view the provision as repealing or amending existing criminal statutes that may be applicable to such activity, in particular, sections 1084, 1952 and 1955 of Title 18, United States Code.}\]

Similarly, when testifying at a hearing before the House Commerce Subcommittee on Telecommunications, Trade, and Consumer Protection, Mr. Kevin DiGregory, Deputy Assistant Attorney General at the DOJ’s Criminal Division made a point of distinguishing the effect of the Interstate Horseracing Act—a civil regulatory act—and other criminal prohibitions. As such, it

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is unlikely the DOJ, or the courts, would read UIGEA as preempting or repealing criminal laws that may apply to such activity.

Based on the above, for some to suggest that the UIGEA safe harbor implicitly repeals a series of federal laws “is to prove far too much.”

Since an implied repeal ought to ordinarily be evident from the language or operation of the statute, the lack of such manifest incompatibility between UIGEA and the Wire Act would be enough to answer any court’s inquiry. The legislative history and the totality of UIGEA fail to adequately demonstrate that Congress intended to override the Wire Act and other federal laws proscribing Internet gambling; in fact, they do quite the opposite.

d. Legislative History Supports a Reading that Online Gambling is Not Permitted Under the Act.

UIGEA’s language and legislative history reveal that Congress understood online gambling activities—such as online lotteries—to fall within the gambit of “unlawful Internet gambling” and intended for such activities to remain classified as unlawful after UIGEA’s passage. The authors of the legislation make clear through the legislative history that the safe harbor was merely a technical amendment inserted to ensure that UIGEA did not unintentionally impede retail lottery terminals from interacting with a processing center within the same state or prevent casinos within a state from transmitting data to one another. As explained in the Report drafted by the House Committee on Financial Services and the UIGEA portion of the

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41 Kremer, 456 U.S. at 470.

42 When drafting UIGEA, Congress did not define what constitutes “unlawful Internet gambling.” This was, in part, because the Department of Justice had made clear that it believed that all forms of Internet gambling were illegal under federal law. See H. Rep. 109-412, at 10 (2006).

Conference Report accompanying the Security and Accountability For Every (SAFE) Port Act of 2006:

The safe harbor would leave intact the current interstate gambling prohibitions such as the Wire Act, federal prohibitions on lotteries, and the Gambling Ship Act so that casino and lottery games could not be placed on websites and individuals could not access these games from their homes or businesses. The safe harbor is intended to recognize current law which allows states jurisdiction over wholly intrastate activity, where bets or wagers, or information assisting in bets or wagers, do not cross state lines.44

As this passage notes, Congress contemplated online casino and lottery games when it passed UIGEA and expressly did not legalize them or in any way suggest that they should be legalized.45

During consideration of the Unlawful Internet Gambling Funding Prohibition Act—a precursor to UIGEA—members of the House of Representatives clarified the intent and scope of the bill’s intrastate provisions. Representative Sue Kelly (R-New York) noted that “some parties [. . . ] raised concerns that [the bill] could be read broadly to allow the transmission of casino or lottery games in interstate commerce, for example, over the Internet, simply because one state authorizes its businesses to do so.”47 She continued, however, emphasizing that a broad reading

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44 H. Comm. Rep. 109-412, at 10 (2006) (emphasis added); see also 152 Cong. Rec. H8029, supra note 13. As discussed infra, Internet transactions are inherently interstate, and thus fail to meet the “wholly intrastate” and “do not cross state lines” tests.

45 Tony Batt, UIGEA: Ten Years After, GAMBLING COMPLIANCE (Oct. 13, 2016), https://gamblingcompliance.com/premium-content/news_analysis/uigea-ten-years-after (subscription required) (quoting Behnam Dayanim, a gaming attorney at Paul Hastings in Washington, D.C., as he identified the legalization of Internet gambling as an “unintended consequence.” In fact, he expressed his confidence that “the primary sponsors of UIGEA would have been distressed at the prospect of states actually legalizing and regulating Internet gambling.”).


would result in a misinterpretation of the legislation, reaffirming that the exemption was not intended to “expand the reach of gambling in any way.”

If Congress had intended to override existing interpretations of federal law to allow online gambling, it would have done so by affirmatively including online lotteries and other forms of gambling in the enumerated exceptions of the definition of “unlawful Internet gambling.” Indeed, Congress would have needed to explicitly exempt online casinos so as to address the conflict that permitting Internet gambling would have with other federal laws which it understood at the time, pursuant to advice from the Department of Justice, to ban all forms of Internet gambling. Congress, however, opted not to permit online gambling, and it is not listed among the exceptions. As the Conference Report indicates, “casino and lottery games placed on websites” were intentionally excluded from the list of exceptions.

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48 See id. (explaining that the safe harbor is intended to “recognize current law that allows states jurisdiction over wholly intrastate activity, where bets or wagers, or information assisting bets or wagers, do not cross state lines or enter into interstate commerce.” It would, however, leave intact current interstate gambling prohibitions, the federal prohibitions on lotteries, and others, “so that casino and lottery games could not be placed on the Internet.”).

49 Id. (emphasis added) (“Internet gambling is illegal, and according to the Department of Justice and the FBI there is no effective way to regulate it. The only way to stop it is to cut off the financial flow to the illegal Internet casino industry, which is precisely what this legislation before us does.”).

50 See supra note 44, at 10.

51 It warrants noting that the Department of Justice had testified before Congress during the years UIGEA was developed that it deemed the Wire Act to ban all forms of Internet gambling, thus any reading of UIGEA as permitting such gambling would conflict with that criminal statute as interpreted at the time.

Additionally, regardless of whether UIGEA could be interpreted to permit intrastate online casinos, other federal laws on the books bar certain forms of online gambling—laws specifically not preempted by UIGEA’s statutory language declaring that “no provision [of UIGEA] shall be construed as altering, limiting, or extending any Federal or State law or Tribal-State compact prohibiting, permitting, or regulating gambling within the United States.” 31 U.S.C.A. § 5361(b); see e.g., The Interstate Transportation of Wagering Paraphernalia Act of 1961, 18 U.S.C. § 1953 (1961); The Anti-Lottery Act and Interstate Wagering Amendment of 1994, 18 U.S.C. § 1301 et seq. (1994).

52 See supra note 47.
III. Conclusion

The OLC Opinion reinterpreting the Wire Act does not carry the force of law. It is Congress that writes laws and the courts that apply them. DOJ may not be enforcing the Wire Act against online casinos (to the extent those casinos do not accept bets on sporting events) while the OLC Opinion is in effect. But, nothing prevents the DOJ from returning to its original interpretation, nor does the Opinion shield any entity operating an online casino from civil liability. The “interstate safe harbor” provision of UIGEA provides no such protection either. Rather, a court may find that UIGEA continues to proscribe the use of U.S. financial instruments for facilitating any online wagering—and based on a thorough analysis of the Wire Act’s statutory construction, related judicial holdings, and legislative history, likely would so find.

53 In fact, in 2015, former Attorney General Loretta Lynch stated as much, noting in response to questions submitted by Senator Lindsey Graham (R-South Carolina) during her confirmation process that “[i]t was [her] understanding that OLC opinions customarily are treated as authoritative by executive agencies.” She was not aware, however “of any statute or regulation that gives OLC opinions the force of law.”

54 Indeed, there is some basis for concluding such casinos are not shielded from criminal liability either.

55 See generally Darryl Nirenberg, David Fialkov, & Ryan McClafferty, Understanding the Wire Act: Why the Department of Justice Missed the Market When It Overturned Fifty Years of Interpretation, 20 GAMING L. REV. & ECON. 254 (2016).