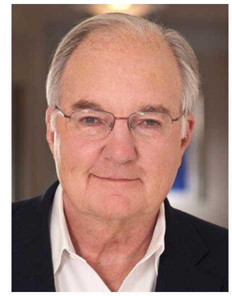
Banks Should Ponder Self-Reporting In Light Of DOJ Updates

By **Fred Heather, Julie Gerchik and James Sargent** (June 26, 2023)

The latest pronouncements by the U.S. Department of Justice last month may spur increased voluntary self-reporting by financial institutions, even though financial institutions are already subject to extensive examination by their prudential regulators.



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In fact, there has already been a marked increase in self-reporting under the DOJ's voluntary self-disclosure policies[1] that were rolled out over the last several months, as reported by Law360 on May 24.

Self-reporting under this regime may enable the entity to avoid prosecution or help the entity obtain other potential benefits. Though the policy applies to all companies, this article focuses on banks and financial institutions.

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Prudential banking regulators and other agencies, such as the Consumer Financial Protection Bureau, already have policies in place to encourage self-reporting.

However, historically there has been significant hesitancy by entities to voluntarily report because of the perception that regulators may fail to provide adequate credit for doing so. This is conceivably true, especially where the regulator believes that the wrongful activity was about to be reported by others, such as whistleblowers or plaintiffs lawyers.

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DOJ's Revised Policy

Where a corporate entity voluntarily reports "misconduct" by employees or agents to a U.S. attorney's office prior to the wrongdoing being publicly disclosed "or otherwise known to the government," the government will credit that entity's disclosure with more lenient treatment — including declinations and reduced penalties — when evaluating charging decisions in connection with the reported conduct.

Banks, however, should take careful note of a threshold limitation. At a minimum, to qualify as a voluntary disclosure under the policy, the disclosure must be timely made following discovery, be complete in its disclosure of relevant facts, and not fall within one of the categories of mandatory disclosures.

As a result, some disclosures may not qualify because the bank may already be obligated to report certain events to its regulators in examinations or other reporting. Likewise, a protected DOJ voluntary disclosure must be made prior to an imminent threat of disclosure, including by the prudential regulator in a pending or actual examination.

The reporting obligation is a continuing obligation, and requires cooperation and full remediation — which may include restitution and disgorgement — where there is customer harm.

Benefits of Voluntary Disclosure

Most policies established by prudential regulators provide that financial institutions that voluntarily self-disclose will receive resolutions under more favorable terms than if the government learns of the misconduct through other means. The same is true for the DOJ.

The policy provides that absent aggravating factors — such as a grave threat to national security, pervasive conduct throughout the company or executive management involvement in the conduct — the government will not seek a criminal plea from the company. Instead, the government may decline prosecution, defer prosecution or enter into a nonprosecution agreement.

Even where aggravating factors exist, or where the disclosure does not fully meet the policy standards, the government may reduce the amount of the fine it seeks and/or decline to appoint a monitor if the company fully disclosed, cooperated, instituted remedial measures and demonstrated that it has "implemented and tested an effective compliance program."

Risks of Voluntary Disclosure

Voluntary self-reporting admittedly is a high-risk venture. The DOJ retains a great deal of discretion in determining whether a disclosure fully qualifies as voluntary under the policy, and whether and how to credit the disclosing entity as a result of its disclosure.

Likewise, the term "misconduct" is not defined and could encompass conduct that is not criminal, which companies may not believe should be reported to the government.

Also, it is unclear whether a decision to report such noncriminal misconduct to the prudential regulator, but not to the DOJ, would be considered by the government in the event the government investigates the company for other alleged misconduct.

Companies run the risk that they may not be able to determine if the government is already aware of the conduct being voluntarily disclosed, in which case the disclosure may not qualify for the benefits of the policy. Disclosure carries with it substantial obligations regarding cooperation, remediation and implementation of robust compliance programs to deter future violations.

In short, there are no guarantees other than the good faith of both the company and the government in determining whether a voluntary disclosure will result in a complete pass by the government regarding potential criminal charges.

However, what is clear is that the failure to voluntarily disclose criminal wrongdoing uncovered by a company, and/or the failure to have an adequate and tested compliance program, will result in a greater likelihood of prosecution, fines and, in some cases, the appointment of a monitor for a specified amount of time.

The Need for Preventive Internal Compliance Investigations

A proactive, relatively low-risk measure that entities may wish to undertake, particularly in light of increased scrutiny, is conducting regular independent compliance reviews to identify where compliance policies may exist in name only and to determine whether the entity may have engaged, or may still be engaging, in conduct that arguably falls within the scope of what should be considered for self-reporting to the government.

Examples of Particular Areas of Risk in the Financial Services Sector

Historically, banks, investment firms and other financial institutions have been a principal focus of investigations, civil lawsuits and prosecutions, both by their prudential regulators and by others — including the DOJ, U.S. attorney's offices, and other regulators, such as the U.S. Securities and Exchange Commission.

Fines and settlements resulting from such government actions have totaled billions of dollars — in some cases for a single institution. The recent bank failures will undoubtedly heighten the attention government prosecutors and regulators pay to potential misconduct in the financial services industry.

Banks and other financial institutions should review and test their compliance policies to determine if there are ongoing violations that could land the entity in hot water. Where violations are discovered, the entity should then evaluate the wisdom of self-reporting and correct the violations before the government or, worse, a bevy of sophisticated plaintiffs counsel discovers them.

Areas of particular risk include insider stock sales before public announcements — a common theme in securities suits — and insider transactions such as the sale or purchase of assets involving insiders.

Another area of risk prevention is carrying out due diligence to confirm that the numbers are what they purport to be. For example, Wells Fargo is alleged to have pumped its account numbers by opening accounts without customer knowledge. This and other practices led to a $1 billion settlement.[2]

Entities should also evaluate whether bank personnel have engaged in any misconduct with respect to trade secrets. A recent suit by First Citizens Bank alleges that another bank obtained Silicon Valley Bank trade secrets from top SVB loan officers who were hired away by the other bank.

And lastly, entities should evaluate whether the bank maintained and enforced adequate written policies to prevent the misuse of material nonpublic information and whether the bank engaged in misrepresentations with respect to the securitization of residential and commercial mortgage loan portfolios.

Conclusion

The recent collapse of three major regional banks has raised legitimate concerns that some banks may face substantial civil liabilities and even criminal prosecution for certain conduct that may have contributed to a bank failure or substantial shareholder or customer losses.

With the latest pronouncements by the DOJ, financial institutions should more closely study the requirements, potential benefits and risks of voluntary disclosure.

To that end, it is imperative that financial institutions understand whether and how to self-report consistent with the policy, since the financial services industry in particular is confronting new and serious economic challenges on a daily basis.

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[1] https://www.justice.gov/d9/pages/attachments/2023/02/23/usao_voluntary_self-disclosure_policy.pdf.

[2] https://news.bloomberglaw.com/banking-law/wells-fargo-to-pay-1-billion-in-class-action-lawsuit-1.