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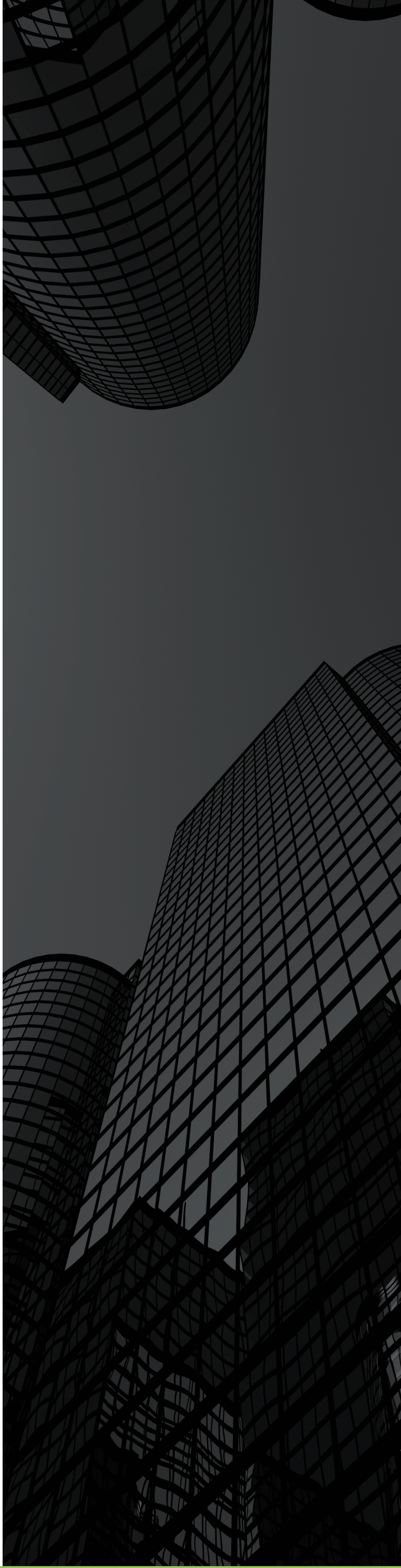
FINANCIAL SERVICES ADVISORY AND COMPLIANCE

FINANCIAL SERVICES ENFORCEMENT ACTIONS TRACKER – Q2 2017



HIGHLIGHTS FROM Q2 2017:

- **46 total actions** were levied against financial institutions by federal, state, and local regulators in Q2 2017. A total of 287 actions have been issued over the last five quarters, the highest being the 72 actions issued in Q4 2016. As was the case in Q4 2016 and Q1 2017, the frequency of actions in Q2 2017 are generally on par with that of the same quarter in the prior year, despite the expectations of some that the pace of enforcement would decrease significantly due to the change in administration.
- State and local regulators were involved in 11 actions, or **24% of all actions**, surpassing the Federal Deposit Insurance Corporation as the most frequent actors in the period. State regulators have posted a slight increase in percentage of total actions from 23% that were initiated in Q1 2017.
- Regulators most commonly used Settlements and Formal Agreements/Consent Orders to enforce regulatory requirements, issuing **12 of each for 52% of the total Q2 2017 actions**. The next most commonly used methods of enforcement were Civil Money Penalties and Lawsuits, which occurred nine times each in Q2 2017 for 39% of the total actions. While the frequency of both Settlements and Formal Agreements/Consent Orders have decreased since Q2 2016, the frequency of Lawsuits and Civil Money Penalties have increased since the same time last year.
- **26% of actions** were the result of unfair or deceptive acts or practices in the last five quarters or 85 out of 327 total enforcement occurrences, followed by improper mortgage loan practices at 18% or 58 out of 327 total enforcement occurrences.
- Over **$22.5 billion in monetary fines, penalties, or borrower restitution** was ordered for improper mortgage lending practices over the last five quarters, with $937 million coming in Q2 2017. This is nearly twice the amounts levied for the next most frequent infraction in Q2 – which was Securities, Commodities, or FX violations for $506 million.

Q2 2017 SUMMARY

The number of regulatory enforcement actions decreased in Q2 2017 from Q1 2017, as seen in Figure 1, to a level comparable to the frequency observed in Q2 2016. 67% of enforcement actions were issued by the five major federal agencies, with 10 from the Federal Deposit Insurance Corporation (FDIC), seven from the Consumer Financial Protection Bureau (CFPB), five from the Federal Reserve Bank (FRB), and four each from the Office of the Comptroller of the Currency (OCC) and Department of Justice (DOJ) (See Figure 2), the third-highest proportion of actions from the five major federal agencies observed in the last five quarters. State or local regulators were involved in a total of 11 actions, surpassing the FDIC as the most frequent actors in the period. The CFPB's actions centered around unfair, deceptive, or otherwise improper mortgage practices or other consumer lending practices in violation of Truth in Lending Act (TILA), Real Estate Settlement Procedures Act (RESPA), and Fair Credit Reporting Act

(FCRA), while the FDIC, the OCC, and the FRB issued actions for violations of rules and regulations including Bank Secrecy Act (BSA)/Anti-Money Laundering (AML), compliance with capital adequacy requirements, the National Flood Insurance Program, and general governance deficiencies.

STATE AND LOCAL REGULATORS AND Q2 LEGAL ACTIONS UPDATE

Regulators have continued to resort to litigation as a means of enforcement into the second quarter of 2017, matching the first quarter's nine lawsuits. Three of these lawsuits were filed by the CFPB, including their suit against mortgage servicer Ocwen Financial for alleged violations of FCRA, RESPA, TILA, and other deficiencies in servicing. An additional four suits were brought by state attorneys general or other local regulators.

The CFPB is increasingly resorting to litigation as financial institutions are refusing to accept what they consider to be unacceptable settlement offers and have subsequently responded with countersuits challenging the regulator. Press sources suggest that the CFPB is not able to effectively manage this volume of litigation as the agency contains fewer attorneys and has less trial experience than other regulatory bodies.[1] However, while the CFPB may be spread thin with recent litigation, state and local regulators appear to be stepping up their role as active enforcers and are supplementing CFPB legal action with lawsuits and orders of their own.

Perhaps the most notable example in the quarter is the state response to the CFPB's April 20th lawsuit against mortgage servicer Ocwen Financial.[2] The Florida attorney general, Florida Office of Financial Regulation,[3] and Massachusetts attorney general[4] responded with additional litigation initiated in the week following the CFPB suit. Furthermore, regulators from an additional 20-plus states issued cease and desist orders against the top servicer the day following the CFPB suit that barred the servicer from either acquiring new mortgage servicing rights or originating residential mortgages to be serviced by Ocwen and, in some states, from proceeding with all foreclosure actions or from continuing any servicing activities in the state.[5]

FALSE CLAIMS ACT

While the CFPB and state and local regulators have been utilizing litigation with more frequency, the DOJ has continued to settle, particularly in violations of the False Claims Act, which has accounted for nearly one-third of DOJ actions in the last five quarters. A total of nine settlements were reached with DOJ or HUD over the last five quarters related to False Claims Act violations, with total penalties assessed over $400 million.

The False Claims Act was enacted in 1863 to address concerns of goods suppliers defrauding the Army during the Civil War,[6] but has evolved substantially in its purpose to encompass any instances of knowingly submitting false claims to the government, particularly during the post-2008 housing crisis Obama administration. In 2011, the DOJ and the U.S. Department of Housing and Urban Development (HUD) collaborated to target errors in underwriting Federal Housing Administration (FHA) mortgages that culminated in a 2012 settlement for $25 billion against five of the country's largest servicers.[7] While some believed that DOJ action under the False Claims Act would subside with the new administration, enforcement has continued under President Trump, with a renewed focus on FHA reverse mortgages or Home Equity Conversion Mortgage loans.[8]

The DOJ and HUD jointly sought $89 million from reverse mortgage servicer Financial Freedom in a settlement announced on May 16. The action was brought based on allegations from a whistleblower that Financial Freedom was claiming insurance payments for interest from FHA without properly disclosing that the mortgages were not eligible for such interest due to the failure of meeting required timelines for property appraisal, claims submission, and foreclosure. This whistleblower will receive $1.6 million from the settlement.[9] HSBC also reached a settlement with the DOJ for a False Claims Act violation filed on April 10 for approximately $2 million, as the result of declaration of wrongdoing brought by a whistleblower. The bank is accused

1. Kate Berry. "Is CFPB being stretched thin by litigation?" American Banker, June 7, 2017. https://www.americanbanker.com/news/is-cfpb-being-stretched-thin-by-litigation
2. U.S. District Court, Southern District of Florida. *Consumer Financial Protection Bureau v. Ocwen Financial Corporation.* http://news.tcfbank.com/press-release/arizona/tcf-financial-corporation-issues-statement%C2%A0regarding-lawsuit-filed-cfpb
3. U.S. District Court, Southern District of Florida. *Office of the Attorney General, State of Florida and Office of Financial Regulation, State of Florida v. Ocwen Financial Corporation, Ocwen Mortgage Servicing, Inc., and Ocwen Loan Servicing, LLC.* http://myfloridalegal.com/webfiles.nsf/WF/JMAR-ALLN3V/$file/Complaint+Against+Ocwen.pdf
4. Ben Lane. "Massachusetts sues Ocwen for 'abusive' mortgage servicing practices," Housingwire, May 2, 2017. https://www.housingwire.com/articles/40028-massachusetts-sues-ocwen-for-abusive-mortgage-servicing-practices
5. Ben Lane. "Here's a detailed breakdown of Ocwen's new restrictions by state," Housingwire, April 21, 2017. https://www.housingwire.com/articles/39932-heres-a-detailed-breakdown-of-ocwens-new-restrictions-by-state
6. "The False Claims Act: A Primer," Justice.gov. https://www.justice.gov/sites/default/files/civil/legacy/2011/04/22/C-FRAUDS_FCA_Primer.pdf
7. "The False Claims Act Has No Place in Housing," MBA Newslink, July 18, 2017. https://www.mba.org/mba-newslinks/2017/july/mba-newslink-tuesday-7-18-17/national/the-false-claims-act-has-no-place-in-housing?_zs=7rTwB1&_zl=nlst3
8. Brad Finkelstein and Brian Collins. "DOJ's False Claims Act focus shifts to reverse mortgage servicers," National Mortgage News, July 3, 2017. https://www.nationalmortgagenews.com/news/dojs-false-claims-act-focus-shifts-to-reverse-mortgage-servicers
9. Justice News. "Financial Freedom settles alleged liability for servicing of federally insured reverse mortgage loans for $89 million," U.S. Department of Justice, May 16, 2017. https://www.justice.gov/opa/pr/financial-freedom-settles-alleged-liability-servicing-federally-insured-reverse-mortgage

of seeking reimbursement for 42 defaulted loans from the Small Business Administration that had previously been identified as fraudulent or potentially fraudulent.[10]

Continued use of the False Claims Act by the DOJ and HUD as a vehicle to penalize lenders for servicing errors has brought concern from the industry, namely due to the financial burden it places on servicers. David H. Stevens, president and CEO of the Mortgage Bankers Association, claims that the use of large financial penalties allowed by the False Claims Act, as opposed to models used by Fannie Mae and Freddie Mac of assessing risk-based penalties such as orders to resolve errors or repurchases, has resulted in lenders either leaving the FHA program or significantly scaling back their participation to limit their risk. This, in turn, hurts homeownership and FHA borrowers.[11]

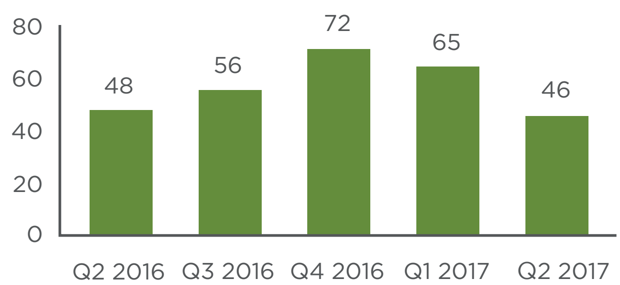
Additional commentary on Q2 2017 financial enforcement action, and related charts and graphs, can be found here.

Actions by Regulators (Figures 1-2)

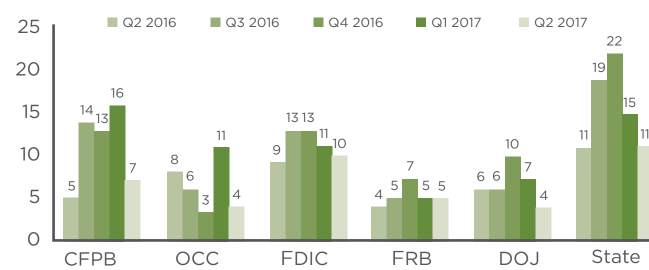
Highlights:

- The total regulatory actions identified in Q2 2017 decreased by approximately 29% from Q1 2017 to total 46. This is generally on par with the number of actions in Q2 of the previous year, which accounted for 48 total enforcement actions.
- The CFPB, OCC, FDIC, FRB, and DOJ were the primary actors in the quarter, with the agencies' combined actions accounting for 67% of the total. One of these actions was taken in conjunction with state regulatory bodies, and an additional 10 actions were taken by state or local regulators, independent from one of the key federal regulatory agencies.
- Enforcement action by all major actors declined in Q1 2017, with the exception of the FRB, which stayed consistent with five actions in the last two quarters.

Unique Regulatory Action Quarterly Counts (Figure 1)



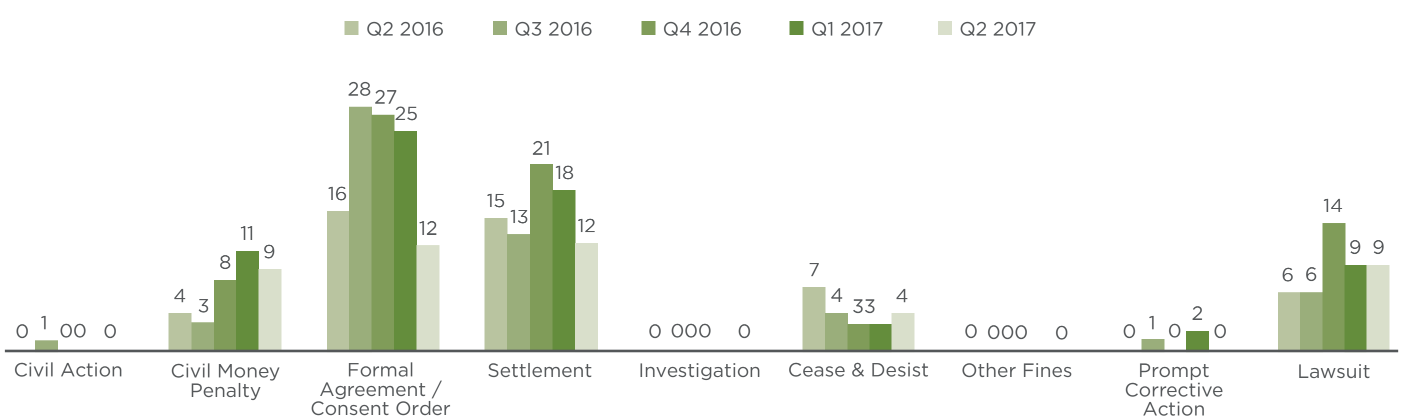
Regulatory Actions Taken by Top Five Federal Regulators and State/Local Regulators (Figure 2)



Note: Multiple regulatory bodies may be involved as part of one action taken.

Regulatory Trends by Action/Violation and Enforcement Occurrences (Figures 3-5)

Major Regulatory Actions Trends (Figure 3)



10. "Acting Manhattan U.S. Attorney Settles Civil Lawsuit Against HSBC Bank USA, N.A., Regarding Failure To Disclose Fraud Or Potential Fraud In Guaranteed Loans," U.S. Department of Justice, April 14, 2017. https://www.justice.gov/usao-sdny/pr/acting-manhattan-us-attorney-settles-civil-lawsuit-against-hsbc-bank-usa-na-regarding
11. *Ibid.* Footnote 7.

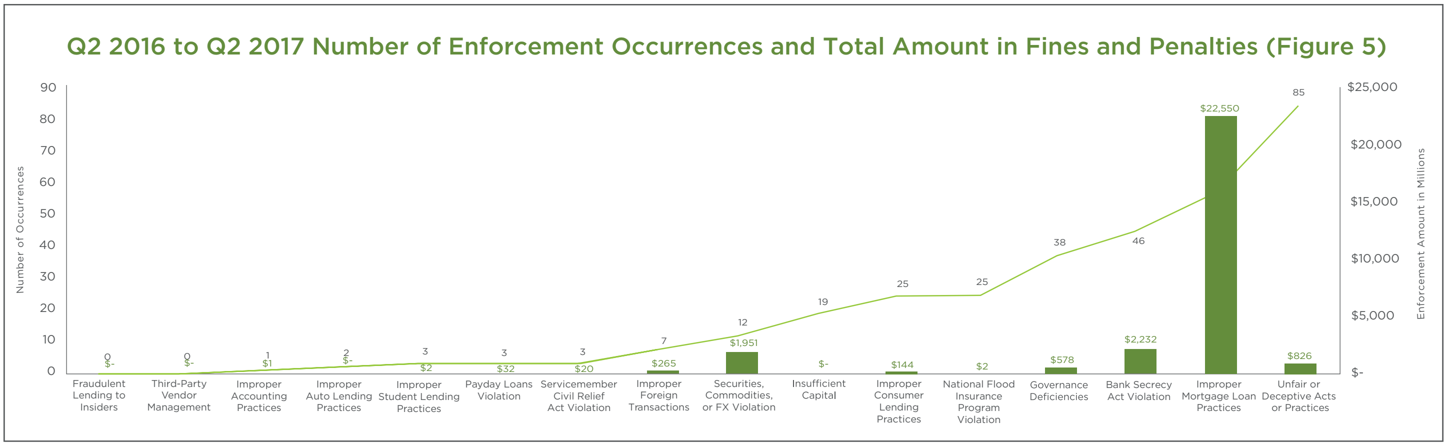
Q2 2016 to Q2 2017 Regulation/Regulating Agency Types of Violations (Figure 4)

REGULATORY VIOLATION TYPE	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	TOTAL	% OF TOTAL
Allowance for Loan and Lease Losses	3	0	1	2	1	7	2.1%
Bank Secrecy Act/Anti-Money Laundering Act	9	13	10	8	4	44	13.2%
Basel - Capital Requirements	3	3	4	6	1	17	5.1%
Commodities or Securities Exchange Act	2	0	1	0	0	3	0.9%
Fair Housing Act	3	1	5	4	2	15	4.5%
Financial Industry Regulatory Authority	0	1	0	0	0	1	0.3%
Generally Accepted Accounting Principles	1	0	0	0	0	1	0.3%
Gramm-Leach-Bliley Act	1	0	0	0	0	1	0.3%
National Flood Insurance Program	4	2	4	9	6	25	7.5%
Office of Foreign Assets Control	0	0	0	0	2	2	0.6%
Regulation AB: Asset-Backed Securities & RBMS Violations	2	1	6	10	2	21	6.3%
Regulation B: Equal Credit Opportunity Act	3	1	2	2	0	8	2.4%
Regulation C: Home Mortgage Disclosure Act	0	0	0	1	0	1	0.3%
Regulation E: Electronic Funds Transfer Act	0	0	2	1	0	3	0.9%
Regulation H: Membership of State Banking Institutions in The Federal Reserve System	0	0	1	0	0	1	0.3%
Regulation O: Loans to Executive Officers, Directors, and Principal Shareholders	0	0	0	0	0	0	0.0%
Regulation V: Fair Credit Reporting Act	1	2	0	5	1	9	2.7%
Regulation X: Real Estate Settlement Procedures	1	0	1	5	5	12	3.6%
Regulation Y: Bank Holding Companies and Change in Bank Control	0	1	0	0	1	2	0.6%
Regulation Z: Truth in Lending Act	0	7	6	1	2	16	4.8%
Servicemembers Civil Relief Act	0	3	0	0	0	3	0.9%
State Foreclosure Laws	0	0	0	0	0	0	0.0%
State Payday Lending Statutes	0	0	3	2	0	5	1.5%
Unfair, Deceptive, or Abusive Acts or Practices	11	12	23	20	12	78	23.4%
Other	10	14	15	7	13	59	17.7%
Total	55	60	84	83	52	334	100.0%
Percentage of Total	16.5%	18.0%	25.1%	24.9%	15.6%	100.0%	100.0%

Note: Multiple violations types may be counted as part of one consent order or action taken by federal and state regulators.

Highlights:

- The top areas of violations over the last five quarters were: issues around Unfair, Deceptive or Abusive Acts and Practices (UDAAP) (23.4%); Bank Secrecy Act/Anti-Money Laundering (13.2%); National Flood Insurance Program (7.5%); Regulation AB: Asset-Backed Securities & RMBS Violations (6.3%); and Basel/Capital Requirements (5.1%).
- Two violations were issued by the Office of Foreign Asset Control in Q2 2017, after no actions in the four previous quarters, making this the only regulatory violation type with an increase in actions observed from Q1 2017 to Q2 2017.
- Frequency of violations of RESPA were consistent with those in Q1 2017, with five actions in each of the last two quarters.



Note: Multiple violations types may be counted as part of one consent order or action taken by federal and state regulators.

Highlights:

- Improper mortgage loan practices accounted for the highest total related fines over the last five quarters; Bank Secrecy Act/Anti-Money Laundering-related violations accounted for the second-most total dollars in fines and penalties.
- UDAAP violations (26%), improper mortgage loan practices (18%), BSA/AML violations (14%), governance deficiencies (12%), and improper consumer lending practices (8%) were the largest enforcement occurrences over the last five quarters.

METHODOLOGY

Navigant's dedicated internal research team leverages regulatory agency publications, Factiva, SNL Financial, and LSM to monitor regulatory action in the financial services space by key federal, state, and local regulators.

Our internal research team collected information about actions taken over the last five quarters by the following regulators:

- Office of the Comptroller of the Currency (OCC)
- Federal Deposit Insurance Corporation (FDIC)
- Federal Reserve Bank (FRB)
- Consumer Financial Protection Bureau (CFPB)
- Department of Justice (DOJ)
- State and local regulators

The agencies focused on regulatory issues related to violations of:

- Unfair, Deceptive or Abusive Acts and Practices (UDAAP)
- Real Estate Settlement Procedures Act (RESPA)
- Bank Secrecy Act/Anti-Money Laundering (BSA/AML)
- Servicemembers Civil Relief Act (SCRA)
- Equal Credit Opportunity Act (ECOA)
- Truth in Lending Act (TILA)
- Fair Credit Reporting Act (FCRA)
- Various state laws

Actions against individuals, removal or prohibition orders, termination of insurance, Section 19 letters, 1829 letters, and Securities Enforcement Actions are not captured in this tracker. Actions published after July 31, 2017, are not included in this report.

APPENDIX

Enforcement Tracker Violation Type Definitions

Bank Secrecy Act Violation: Failure of the financial institution to meet internal controls and monitoring requirements set forth by the Bank Secrecy Act or Anti-Money Laundering Rules.

Fraudulent Lending to Insiders: Extension of credit to an insider, as defined by Regulation O and Regulation W, that exceed limits set by Regulation O or Regulation W, or provide the insider with any preferential treatment.

Governance Deficiencies: Failure of a financial institution and/or its board to fulfill its fiduciary responsibilities in various areas of bank management, such as compliance risk management, operational efficiency, or interest rate risk management. (This category includes Directors & Officers Actions; Compliance Risk Management; Management Replacement and Operations; Credit Risk and Interest Risk Management).

Improper Accounting Practices: Failure to follow Generally Accepted Accounting Principles through means such as fraudulent reporting, omission of assets or liabilities, etc.

Improper Auto Lending Practices: Violation of law or regulation in the origination or servicing of an auto loan.

Improper Foreign Transactions: Violation of any law or regulation governing interactions with foreign entities; commonly an OFAC violation.

Improper Mortgage Loan Practices: Violation of a law or regulation in the origination or servicing of a mortgage loan or mortgage-backed securities.

Improper Student Lending Practices: Violation of law or regulation in the origination or servicing of an education loan.

Improper Consumer Lending Practices: Violation of law or regulation in the origination or servicing of a consumer loan, other than mortgage, auto, or student loans.

Insufficient Capital: Failure of a financial institution to meet minimum capital requirements set forth by Basel.

National Flood Insurance Program Violation: Violation of the National Flood Insurance Program requirements or related acts and regulations, such as the National Flood Insurance Act or Flood Disaster Protection Act (Regulation H).

Payday Loans Violation: Violation of any law or regulations in the issuance or servicing of payday loans.

Securities, Commodities, or FX Violation: Violation of any law or regulation in the distribution, monitoring, or trading of securities, commodities, or forex.

Servicemembers Civil Relief Act Violation: Violation of any law or regulation in the origination of servicing of a line of credit to an active duty member of the U.S. armed forces.

Third-Party Vendor Management: Failure by an institution to ensure that third-party vendors are operating in compliance with pertinent laws and regulations.

Unfair and Deceptive Practices: Any unfair or deceptive statement, disclosure, or action that causes material harm to the consumer.

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