New York
Northern California
Washington DC
São Paulo
London
Paris
Madrid
Hong Kong
Beijing
Tokyo

Davis Polk

Kenneth L. Wainstein

Davis Polk & Wardwell LLP
901 15th Street, NW
Washington, DC 20005

202 962 7141 tel
ken.wainstein@davispolk.com

PRIVILEGED & CONFIDENTIAL
ATTORNEY - CLIENT PRIVILEGE
ATTORNEY WORK PRODUCT

May 27, 2020

Re: Review of the FDIC Supervisory Approach Toward Banks Servicing "High-Risk List" Merchants

The Honorable Jelena McWilliams
Chairman, Federal Deposit Insurance Corporation
550 17th Street NW
Room MB-6028
Washington, DC 20429

Dear Chairman McWilliams:

This letter summarizes Davis Polk & Wardwell's ("Davis Polk") review of the Federal Deposit Insurance Corporation's ("FDIC") supervisory approach during the Review Period[1] toward banks that provided services to certain lawfully operating merchants, including payday lenders, that were on a "high-risk list" created by FDIC supervisory staff and used by the Department of Justice ("DOJ") in connection with its initiative known as Operation Choke Point.[2]

Our limited review included a preliminary assessment, based on an examination of the following materials: (1) the FDIC OIG September 2015 report of the audit of the FDIC's supervisory approach toward high-risk list merchants; (2) nonconfidential documents provided by the FDIC to the House Committee on Oversight and Government Reform in the course of its investigation into Operation Choke Point; and (3) other publicly available documents relating to Operation Choke Point, including publicly available pleadings in the *Advance America* litigation. We also undertook a follow-on assessment based on two lengthy meetings with FDIC OIG staff, a review of a limited number of nonpublic documents prepared by the FDIC and FDIC OIG in relation to the FDIC's supervisory approach, and a review of a limited number of documents produced by

[1] The Review Period runs from 2010, the starting point for the focus of the FDIC OIG's audit, to September 2015, the publication of the FDIC OIG's report. *See* Office of Audits and Evaluations Report No. AUD-15-008, "The FDIC's Role in Operation Choke Point and Supervisory Approach to Institutions that Conducted Business with Merchants Associated with High-Risk Activities" (hereafter, "the FDIC OIG Report" or "the Report") at 1, 43.

[2] The FDIC Office of Inspector General ("FDIC OIG") dates the origins of DOJ's Operation Choke Point to a November 2012 proposal from attorneys within DOJ's Civil Division. *See id.* at 3. Our review, however, and the FDIC OIG Report itself, was intended to be broader, and considers events prior to that date.

the FDIC during the *Advance America* litigation. As set forth below, this review left us with an unclear understanding of the FDIC's supervisory policy toward banks serving payday lenders and other merchants on the high-risk list during the Review Period, and the facts and circumstances that led to that policy. Nonetheless, our review did provide a clear understanding of the agency's remedial measures since then to prevent the improper use of supervisory authority to discourage banks from servicing lawful businesses simply because they operate in an industry that some might disfavor.

I. Background of the FDIC OIG Audit

On June 5, 2014, a payday lender and a payday lending trade association filed suit against the FDIC (and the other federal banking regulators) alleging that the FDIC had participated in the DOJ's Operation Choke Point and had included payday lenders on its list of high-risk merchants in violation of the Administrative Procedure Act and the plaintiffs' constitutional rights.[3] Shortly thereafter, on June 9, 2014, Representative Jim Jordan and former Representative Darrell Issa requested information from the FDIC concerning its cooperation with the DOJ on Operation Choke Point and its supervisory approach with respect to merchants on the high-risk list. The FDIC produced over 7,500 pages of documents in response to the letter and on December 8, 2014, the House Committee on Oversight and Government Reform issued a staff report, "Federal Deposit Insurance Corporation's Involvement in Operation Choke Point."

Prior to the publication of the staff report, on October 23, 2014, Republican members of the House of Representatives sent a letter to the then-acting FDIC Inspector General requesting that the FDIC OIG undertake "an immediate investigation into the involvement of the [FDIC] with the [DOJ] program known as Operation Choke Point, and of the FDIC officials and staff involved in any aspect of its creation and/or execution." In response to this request, on November 7, 2014, the FDIC OIG undertook an audit into the role of the FDIC in Operation Choke Point and its supervisory practices with respect to merchants on the high-risk list. On December 17, 2014, the then-FDIC Chairman requested that the FDIC OIG expand its audit to include a fact-finding review of the actions of five senior FDIC officials.

II. Findings of the FDIC OIG Report

On September 16, 2015, the FDIC OIG issued the findings of its audit, addressing three critical questions:

1. What was the FDIC's role in the DOJ's Operation Choke Point?

2. Was the FDIC's supervisory approach to banks that conducted business with merchants on the high-risk list consistent with relevant statutes and regulations?

3. What was the involvement of the five senior FDIC officials in the DOJ's Operation Choke Point, and did they act to deny lawful businesses access to the banking sector based on personal, political, or moral agendas?

[3] *Advance America, Cash Advance, et al. v. FDIC, et al.*, No.1:14-cv-00953 (D.D.C.).

The Report made the following findings with respect to each question:

1. The FDIC had limited contacts with the DOJ related to Operation Choke Point, and the FDIC's involvement was limited to a few inconsequential instances of FDIC staff communicating with DOJ employees regarding implementation of the initiative.[4]

2. The FDIC's supervisory approach to banks that conducted business with merchants on the high-risk list "was within the Corporation's broad authorities granted under the FDI Act and other relevant statutes and regulations [but] the manner in which the supervisory approach was carried out was not always consistent with the FDIC's written policy and guidance."[5]

3. The five FDIC senior officials did not pursue their own personal, political, or moral agendas in discouraging lawful businesses access to the banking sector. Rather, the FDIC OIG Report concluded that they had acted in accordance with a "widely-held understanding" of the FDIC's policy priorities.[6]

III. Davis Polk's Engagement

In October 2018, Representative Blaine Luetkemeyer requested that Chairman McWilliams "investigate [the FDIC staff's role in Operation Choke Point] and take immediate and firm action against those who have so blatantly abused the power vested in them."[7] Similarly, in November 2018, Senator Mike Crapo and other Republican senators requested that the FDIC "review all options available to ensure lawful businesses are able to continue to operate without fear of significant financial consequences" and that the FDIC communicate to its staff that "lawful businesses should not be targeted by the FDIC for operating in an industry that a particular administration might disfavor."[8] The FDIC then retained Davis Polk to review the FDIC OIG's report about the FDIC's involvement in Operation Choke Point and other records associated with the matter. We also assessed whether and what additional steps or avenues could have or should have been pursued.[9]

IV. Davis Polk's Review Process

Davis Polk's review proceeded in two phases: (1) a preliminary review culminating in a presentation to the Chairman in February 2019; and (2) engagement with FDIC OIG personnel resulting in our current assessment.

In our preliminary review, we examined the following materials:

- The FDIC OIG Report;

---

[4] *See* FDIC OIG Report at 14-16.

[5] *See id.* at 11.

[6] *See id.* at 28-31.

[7] October 15, 2018 letter to Chairman McWilliams from Representative Luetkemeyer.

[8] November 7, 2018 letter to Chairman McWilliams from Senator Mike Crapo, et al.

[9] As explained *infra* Section IV, our engagement evolved primarily from a review of the FDIC OIG Report into a broader assessment of the nature of the FDIC's supervisory approach to banks providing services to merchants on the high-risk list during the Review Period.

- The House Committee on Oversight and Government Reform Staff Report;

- Certain Congressional correspondence, testimony, and nonconfidential documents produced in connection with the House Committee staff report;

- Certain relevant media coverage; and

- Certain publicly available filings in the *Advance America* litigation.

Based on that document review, we formulated a preliminary assessment of the FDIC's supervisory approach to banks that serviced merchants on the high-risk list. We then presented that preliminary assessment to the FDIC Chairman in February 2019, and advised the Chairman that we were unable to fully assess the FDIC's supervisory approach due to the evidentiary and analytical gaps in the Report. Based on that presentation, the Chairman directed us to speak with FDIC OIG personnel about the audit and what it revealed about three questions concerning the FDIC's actions during the Review Period that we believe are central to our analysis:

1. Did FDIC staff discourage banks from providing services to lawfully-operating businesses, particularly payday lenders?

2. Did FDIC leadership direct FDIC staff to discourage banks from providing services to lawfully operating businesses, particularly payday lenders?

3. Was there a legal and regulatory basis for the FDIC's use of reputation risk as a justification for discouraging banks from providing services to lawfully operating businesses, particularly payday lenders?

Upon the Chairman's instructions, we engaged with the FDIC OIG's Assistant Inspector General for IT Audits and Cyber[10] and the FDIC OIG General Counsel, who generously made themselves available for two lengthy meetings to discuss our questions in detail. The FDIC OIG attorney assigned to the audit also attended our second meeting.[11] In addition to these meetings, we also then reviewed:

- Three Corrective Action Closure memoranda and supporting documentation prepared in response to the FDIC OIG Report;

- Relevant guidance issued by the FDIC since 2015; and

- Documents produced by the FDIC during the *Advance America* litigation that the plaintiffs submitted as exhibits in support of their summary judgment motion.

[10] At the time of the FDIC OIG Report, the current Assistant Inspector General for IT Audits and Cyber served as Assistant Inspector General for Audits, and in this role was responsible for planning and managing a national program of audits focused on FDIC programs and operations, including the audit at issue here.

[11] During our review, we requested a number of audit documents. While we received a few of these documents, most were withheld. We understand that this decision was motivated by concerns regarding confidentiality and independence. We offered to receive redacted versions of certain documents in order to assuage confidentiality concerns, but were informed that disclosure would still have implications for the FDIC OIG's independence.

We shared a draft of this letter with the FDIC OIG, and subsequently made ourselves available for a conference call in which we answered the FDIC OIG staff's questions about our review and findings, which questions largely focused on the scope and methodology of our review. We then offered the FDIC OIG an opportunity to raise any concerns or propose any changes to the language or the findings in this letter, but they declined our offer, citing their concerns regarding confidentiality and OIG independence.

This letter is the result of our review and our assessment of the FDIC's supervisory approach to banks that served merchants on the high-risk list.

V. Davis Polk's Findings

Our assessment is both methodological and substantive. We first assess the methodology used in the FDIC OIG audit, as the inherent limitations of that methodology led directly to the evidentiary and analytical gaps that we were unable to reconcile. We then assess the audit's substantive findings and the extent to which they answer – or do not answer – the above three questions about the FDIC's supervisory approach during the Review Period.

A. Methodology

The methodology used in preparing the Report undercut the FDIC OIG's ability to fully "assess the FDIC's supervisory approach to financial institutions that conducted business with merchants associated with high-risk activities for consistency with relevant statutes and regulations."[12] The decision to undertake an audit dictated that methodology. As we understand it, the FDIC OIG can select among three types of inquiries when exploring an issue: (1) audits, which review and assess the FDIC's programmatic approach (e.g., its policies and procedures) with respect to a given regulatory area; (2) special inquiries, which examine not only the FDIC's programmatic approach but also the conduct and involvement of specific individuals with respect to that programmatic approach; and (3) investigations, which focus on allegations of criminal or unethical conduct.

At the outset of this matter, the FDIC OIG decided that an audit – i.e., a programmatic review of the FDIC's supervisory approach – was the appropriate way to examine these issues.[13] That decision to pursue an audit – as opposed to a special inquiry or an investigation – limited the scope and depth of the ensuing inquiry in several significant respects related to document collection and review, interview questioning, and credibility determinations.

---

[12] FDIC OIG Report, Executive Summary at i.

[13] Based on our review, there appear to be three reasons that the FDIC OIG decided to conduct an audit in this situation. First, government auditing standards apply to and purportedly bolster the legitimacy of audit reports but do not apply to special inquiries and investigations. Second, and relatedly, the FDIC OIG routinely opts to conduct an audit in response to a Congressional inquiry on the premise that Congress is comfortable with the audit process and the applicability of the auditing standards. Third, it did not appear that a special inquiry or an investigation was warranted because the FDIC OIG staff were aware of no allegations of individual wrongdoing at the time they undertook the audit. To the contrary, as discussed *infra* Section V.B.2, they were already aware that payday lending was widely disfavored throughout the FDIC, including at its highest levels, and therefore appeared to believe there was no reason to identify and assess individual responsibility for implementing what was a longstanding and unquestioned policy preference within the agency.

1. Document Collection and Review

The FDIC OIG Report states that the FDIC OIG "[r]eviewed FDIC email communications and related documentation to assess" the role of FDIC officials in Operation Choke Point and the FDIC's supervisory approach.[14] The FDIC OIG reviewed "all 7,640 pages of FDIC staff emails and documentation" sent by the FDIC to Congress and selectively reviewed emails among the more than 423,000 emails it collected.[15]

Despite the FDIC OIG's extensive document collection and review efforts, we were unable to conclude that they afford a sufficient basis for the findings of the Report or for a complete assessment of the FDIC's supervisory approach.[16] The rigor and reliability of the document review were limited by the process that the FDIC OIG employed. Specifically, instead of using a document review platform and analytics to filter documents for review, the FDIC OIG collected emails as native .PST files and conducted ad hoc searches for relevant emails by entering search terms into Outlook's built-in search functionality. Outlook, however, was not designed as a scalable document review platform, and its search tools are limited, especially for the review of a large volume of documents. In addition, the filings in the *Advance America* litigation make reference to pertinent emails that were not referenced in the FDIC OIG Report.

For these reasons, we are not convinced that the FDIC OIG's document review – despite its best efforts to review a large volume of documents – identified all or even most of the emails that would have shed light on the FDIC's supervisory approach during the Review Period.

2. Interview Selection and Questioning

While the FDIC OIG conducted over one hundred interviews during the audit, including of FDIC Board members, bank examiners, and bank personnel, we are unable to conclude that the selection or the questioning of the interviewees in the audit provided sufficient clarity on the FDIC's supervisory approach.

As for the selection of interviewees, we are unable to assess its adequacy because we were not able to review interviewee lists or interview memos, due to OIG concerns for confidentiality and independence. Because we lack this information, we cannot assess whether the FDIC OIG interviewed all the FDIC personnel likely to have been involved in discouraging banks from providing services to payday lenders. Nor can we assess the extent to which the FDIC OIG interviewed bank personnel from the regions most likely to have been subject to such discouragement.[17]

[14] FDIC OIG Report at 45.

[15] *Id.* The FDIC OIG Report states that "due to the large volume of emails," the FDIC OIG "judgmentally selected emails for review." *Id.*

[16] As noted, our ability to fully assess the scope of the document review was limited by OIG concerns for confidentiality and independence. For example, we requested, but did not receive, a list of custodians (i.e., persons whose emails or other documents were collected and reviewed during the audit), information on how custodians were identified, a list of search terms, the written protocol by which the review was conducted, or an accounting of how many of the more than 423,000 emails were individually reviewed. *See id.* ("In response to [FDIC OIG's] requests for this information, the FDIC provided [FDIC OIG] with more than 423,000 emails . . . .").

[17] For example, while the FDIC OIG identified 130 institutions "that facilitated payday lending either directly or indirectly through third parties, had high ACH returns, were subpoenaed by DOJ in connection with Operation

Moreover, it is our understanding from our review that the interviews were conducted in a less than probing manner, which is understandable in that audit interviews tend to be conducted more as an opportunity for the interviewee to share his or her knowledge of the regulatory program under review and less as a probing examination of an interviewee's conduct in relation to that program. For example, the Report states that Senior FDIC executives who were interviewed as part of the audit uniformly stated that they had never had any discussions with DOJ regarding Operation Choke Point.[18] There is no indication, however, that the executives explained – or were even asked – whether they ever became aware of, or had a hand in promoting, the practice of discouraging banks from servicing payday lenders outside the context of Operation Choke Point.

3. Credibility Determinations

Finally, in keeping with the approach typically utilized in an audit, the FDIC OIG's interviews were conducted and memorialized in the Report without an effort to assess interviewee credibility or to reconcile material discrepancies between the accounts of different interviewees. The best example of the latter is the account from the former Chicago Regional Director of a meeting in which the former Senior Deputy Director, DSC, instructed him and other Regional Directors to require any bank in the business of servicing payday lenders to submit a plan for exiting that line of business.[19] The Report states that the FDIC OIG asked the former Senior Deputy Director, DSC, about this meeting and he denied that he had given any such instruction.[20] Unlike the typical investigative report, this audit report makes no effort to reconcile the differing recollections of the former Chicago Regional Director and the former Senior Deputy Director, DSC, or to determine whose version of events is better supported by other evidence. As a result, we are left without clarity about an alleged supervisory directive that is directly relevant to the issue under review.

B. The Three Central Questions

With these methodological limitations in mind, this section addresses the extent to which the FDIC OIG Report and our meetings with the FDIC OIG staff did or did not answer the three questions that we believe are central to our understanding of the FDIC's supervisory approach toward merchants on the high-risk list.

1. Did FDIC staff discourage banks from providing services to lawfully operating businesses, particularly payday lenders?

The FDIC OIG found that the FDIC staff did discourage banks from providing services to payday lenders based on concerns about reputational risk, but that those occurrences were relatively few

---

Choke Point, conducted business pertaining to [refund anticipation loans], or terminated business relationships with high-risk merchants," it selected 25 institutions for a detailed review "to include representation from each of the FDIC's six Regional Offices and representation of the criteria used to identify the 130 institutions" as opposed to focusing on the regional concentration of payday lenders and the banks that service them. *Id.* at 47-48.

[18] *Id*. at 16.

[19] *Id.* at 27.

[20] *Id*.

in number.[21] The FDIC OIG based this conclusion on emails[22] and one written communication[23] it found that reflected the use of moral suasion to discourage banks from providing services to payday lenders.

There are at least three reasons that we cannot be confident the FDIC OIG identified all such occurrences. First, as noted above, the technology and techniques employed in the process were unlikely to ensure that all concerning emails would have been identified and reviewed, a conclusion reinforced by the absence from the Report of relevant emails referenced in the *Advance America* litigation. Second, the FDIC kept few written records of informal oral communications between examiners and the supervised banks. It is our understanding that, in the banking industry, moral suasion would likely have taken place in the context of such conversations. The extent of these communications would have been discovered only through an investigative-style interview approach that appears not to have been conducted as part of the audit. Third, at the time the audit was conducted, the FDIC OIG did not have the technical capacity to search memoranda of understanding or other agreements between the FDIC and banks arising out of informal enforcement actions, which may have captured additional instances of concerning FDIC supervision – for example, by incorporating into such an agreement a directive that a bank cease doing business with lawfully operating merchants on the high-risk list.[24]

2. Did FDIC leadership direct FDIC staff to discourage banks from providing services to lawfully operating businesses, particularly payday lenders?

Typically, a primary purpose of a full investigation into organizational conduct is to determine whether and how the organization's leadership may have directed or suggested that its staff

[21] The FDIC OIG found no instances of regulatory pressure to terminate customer relationships with merchants on the high-risk list other than payday lenders. *Id.* at 17.

[22] The Report cites six examples of internal FDIC email communications, discussing the use of moral suasion, but does not specify the total number of instances of the use of moral suasion that the FDIC OIG identified. *See id.* at 23.

[23] The Report describes one formal letter sent by the Chicago Regional Director in which he used moral suasion to attempt to discourage a bank from providing ACH processing services to payday lenders. *See id.* at 25-28.

[24] We also found that two specific conclusions in the Report about the limited incidence of such supervision were not supported, and were indeed contradicted, by our review. First, the Report states that there was "no evidence that the FDIC used the high-risk list to target financial institutions." *Id.* at 11. But the Report later details "instances in which moral suasion was used to discourage institutions from providing these types of banking services to, or on behalf of, payday lenders" (which were included on the high-risk list). *Id.* at 23. In examining this seeming contradiction, we learned that the first conclusion was simply meant to convey that there was no evidence that FDIC personnel specifically used the high-risk list to decide *which financial institutions* to discourage. That conclusion may well be accurate, but it sidesteps the question of whether FDIC officials targeted financial institutions for discouragement based on criteria or considerations other than the high-risk list.

In addition, the Report explains that any chilling effect on banks' provision of services to payday lenders and other merchants on the high-risk list was due to the banks' "misperception that the merchant categories [on the high-risk list] were prohibited or discouraged," *id.* at 32, which was based on their misreading of "previously-issued FDIC guidance and the informational article in a Summer 2011 *Supervisory Insights* Journal." *Id*. This statement suggests that the Report was attributing any chilling effect to nothing more than the banks' misperception of discouragement, when, in fact, there was actual evidence of discouragement in the form of regulatory pressure exerted on banks by the FDIC.

engage in that conduct. In this audit – where the purpose was to assess programmatic policies and procedures – relatively little focus was placed on the direction from leadership.

The Report found that there was a "widely-held understanding" that the highest levels of the agency disfavored providing banking services to payday lenders, which led to FDIC personnel discouraging banks from providing services to these businesses. As we understand it, that "widely-held understanding" is attributable to historical statements by FDIC leaders that criticized payday lending and the policy statement the FDIC made when it effectively prohibited FDIC-supervised banks from directly engaging in payday lending in 2006. The Report does not address, however, whether that "widely-held understanding" was to any degree attributable to statements and actions of FDIC leadership during the post-2006 time period, when certain banks were being steered away not only from engaging in payday lending themselves but also from providing services to lawfully operating payday lenders. It is our understanding that it was beyond the scope of an audit to focus on the role of specific individuals in fostering that "widely-held understanding" and the resulting supervisory approach.

3. *Was there a legal and regulatory basis for the FDIC's use of reputation risk as a justification for discouraging banks from providing services to lawfully operating businesses, particularly payday lenders?*

The FDIC OIG Report concluded that the FDIC's supervisory approach toward payday lenders "was within the [FDIC's] broad authorities granted under the FDI Act and other relevant statutes and regulations," but it provided no support for this conclusion.[25] Nor did we see any FDIC or FDIC OIG written legal analysis that addressed – much less supported – the legality and appropriateness of the FDIC's efforts to suppress lawful payday lending activities.[26]

VI. Conclusion

The FDIC OIG's decision in November 2014 to undertake an audit, pursuant to established practice, has left us with a limited understanding of the FDIC's supervisory approach to banks providing services to payday lenders and other merchants on the high-risk list during the Review Period.[27] Our understanding is further limited by the FDIC OIG's decision not to provide us the

[25] The FDIC OIG appears to have largely based its conclusion on the FDIC's consumer protection authority. By contrast, the Report cites two instances where the "FDIC's principal stated concern was the reputation risk to the institutions due to their potential or existing relationship with a payday lender." *Id.* at 12.

[26] In fact, the FDIC issued a 2015 Financial Institution Letter clarifying that the provision of banking services to lawfully operating customers of any category is neither "prohibited nor discouraged." *See* FIL-5-2015, *Statement on Providing Banking Services*, January 28, 2015 ("Financial institutions that can properly manage customer relationships and effectively mitigate risks are neither prohibited nor discouraged from providing services to any category of customer accounts or individual customer operating in compliance with applicable state and federal law.").

[27] It is worth noting that the FDIC OIG became aware of another supervisory concern during the course of its audit and undertook a review and analysis of that concern. As explained in the Report, the FDIC OIG staff became aware that certain banks were issuing a lawful credit product known as a Refund Anticipation Loan ("RAL"), and "that . . . . the FDIC took unusual and aggressive actions to prohibit institutions from offering this credit product." *See id*. at 35. While the FDIC OIG "concluded that the actions taken with respect to the . . . institutions that offered RALs fell within the Corporation's broad statutory authorities," they found that the "execution of [those] actions and the role of the individuals involved warrant[ed] further review." *Id*. at 40. The OIG then undertook a review of the appropriateness of the FDIC's supervisory approach to financial institutions that offered RALs, and suggested that the FDIC "candidly consider its leadership practices, its process and

documentation of its audit out of understandable confidentiality and independence concerns. We therefore cannot rule out the possibility that further review of the FDIC's supervisory approach during the Review Period toward banks servicing merchants on the high-risk list could uncover additional relevant information, potentially including:

- Additional instances of FDIC personnel discouraging banks from providing services to lawfully operating businesses, including payday lenders;

- Directives or other communications from then-FDIC leadership directing staff to discourage banks from providing services to lawfully operating businesses;

- Further clarification of the origin and scope of then-FDIC leadership's disfavor of both payday lending and the provision of banking services to payday lenders; and

- Further internal analysis or discussion of the propriety of using the FDIC's supervisory authority to discourage the provision of banking services to lawful businesses.

Notwithstanding these investigative gaps, it should be noted that the FDIC has undertaken remedial measures intended to address the supervisory issues identified in the Report. Those efforts include:

- In July 2014, removing from official guidance and informational articles the high-risk merchant list created by FDIC supervisory staff in 2011, which was later incorporated into DOJ subpoenas during Operation Choke Point.[28]

- In 2015, clarifying the FDIC's supervisory approach to payment processing relationships with merchant customers that engage in higher-risk activities to explain that financial institutions that can properly manage customer relationships are neither prohibited nor discouraged from providing services to any category of business customers or individual customers operating in compliance with applicable state and federal law.[29]

- In 2015, prohibiting examiners from directing a bank to discontinue serving a business without putting that recommendation in writing, obtaining approval from a Regional Director in consultation with counsel, and articulating a supervisory basis, beyond reputational risk, for the closure recommendation.[30] This requirement has since been reemphasized through a Regional Director ("RD") memo, a statement of the Board of

---

procedures, and the conduct of multiple individuals who made and implemented the decision to require banks to exit RALs" and "address how it can avoid similar occurrences in the future." Executive Summary of Report No. OIG-16-001, "Report of Inquiry into the FDIC's Supervisory Approach to Refund Anticipation Loans and the Involvement of FDIC Leadership and Personnel" at iii-iv.

[28] FIL-41-2014, *FDIC Clarifying Official Guidance and Other Information Related to Third-Party Payment Processors*, July 28, 2014.

[29] *See* FIL-5-2015, *supra* note 26. This guidance appears to build upon FIL-43-2013, *FDIC Supervisory Approach to Payment Processing Relationships With Merchant Customers That Engage in Higher-Risk Activities*, September 27, 2013 (revised July 2014), which the Report notes had been introduced after "FDIC officials determined that there were misperceptions about the FDIC's supervisory approach . . . ." FDIC OIG Report at 31.

[30] *See* Regional Director ("RD") Memo 2015-1, *Requirements for Account Terminations*.

Directors, and an RMS/DCP all-hands call in 2016[31] as well as a further RD memo in 2017.[32]

- In 2015, addressing the FDIC OIG's concerns about the use of "moral suasion" by revising its written guidance to provide clear guidance as to the form of discussions that examiners may have with bank management when seeking to address and mitigate weaknesses in a bank's risk management practices or operating conditions.[33]

- In 2018, conducting focus groups for RMS and DCP examiners to determine whether they understood and had fully internalized the supervisory guidance that limited their ability to exercise their regulatory authority to the detriment of lawful businesses. We understand that the FDIC OIG reviewed and provided feedback on the questions used in the focus groups.

- In November 2018, issuing a message from Chairman McWilliams to all employees acknowledging that certain FDIC employees acted in a manner inconsistent with FDIC policies in connection with Operation Choke Point, reinforcing that the exercise of FDIC authority should never be based on personal beliefs or political motivations, and highlighting limitations on account terminations and training for examiners to ensure the highest standards of conduct and respect for the rule of law.

- In connection with the May 2019 settlement of the *Advance America* litigation, acknowledging that "certain employees acted in a manner inconsistent with FDIC policies with respect to payday lenders," releasing a statement summarizing the FDIC's current policies regarding payday lending, and committing to conducting additional training of examiners to ensure that they "adhere to the highest standards of conduct and respect the rule of law."[34]

- In 2019, launching new training for RMS and DCP case managers and examiners on the appropriate use of supervisory authority toward banks providing services to payday lenders. The training contains relevant case studies and analyzes the legality of the provision of automated clearing house services to third-party payment processors, including payday lenders. The Director, Division of Risk Management Supervision, has delivered the training to all RMS commissioned community bank examiners, case managers, and field and regional managers. The FDIC has also delivered a computer-based version of the training to all RMS pre-commissioned and large bank examiners as well as DCP examiners, review examiners, and field and regional managers. We

[31] *See* RD Memo 2016-17, *Communicating and Coordinating with Institution Management in Carrying Out Forward-Looking, Risk-Based Supervision* (requiring that communications involving policy or supervisory recommendations be in writing on FDIC letterhead or in a Report of Examination); Statement of FDIC Board of Directors on the Development and Communication of Supervisory Recommendations, July 29, 2016, available at: https://www.fdic.gov/about/governance/recommendations.html; Corrective Action Closure Memo Regarding OIG's Review of Recommendation 1 from the Operation Choke Point Audit Report (Report No. AUD-15-008), July 5, 2017 (enclosing a transcript of the August 3, 2016, RMS/DCP all-hands meeting call).

[32] *See* RD Memo 2017-12, *Supervisory Recommendations, Including Matters Requiring Board Attention*, (implementing the statement of the Board of Directors).

[33] *See* RD Memo 2015-5, *Anticipatory Supervision Language Changes in Outstanding Guidance*.

[34] Statement of the Federal Deposit Insurance Corporation, May 22, 2019, available at: https://www.fdic.gov/transparency/legal-misc/statement-and-letter-on-bank-customer-relationships.pdf.

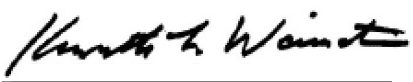
understand that the training programs have been reviewed by counsel for the plaintiffs in the *Advance America* litigation and the FDIC General Counsel.

- In furtherance of her effort to ensure that the agency fully acknowledges and learns from its "high-risk" supervisory experience, the Chairman commissioned us to conduct this review and assess the agency's current knowledge about this chapter of its regulatory history, and has participated in multiple meetings during which we have briefed her on our findings.

These remedial measures suggest that the FDIC leadership is working hard to establish a culture that trains supervisory staff to understand the bounds of the agency's supervisory authority over banks that service lawful businesses. To the extent that further review of the FDIC's supervisory approach during the Review Period were to uncover additional incidents where supervisory authority was used to suppress lawful business activity, these remedial measures appear reasonably designed to protect against a recurrence of such incidents in the future.

It has been an honor to work with you and your very professional Legal Division and OIG staff on this important matter. If you have any questions, please do not hesitate to contact me at (202) 962-7141 or the email address provided above.

Very truly yours,



Kenneth L. Wainstein

/s/ Sidney Bashago

Sidney Bashago

/s/ Will Schildknecht

Will Schildknecht

Electronic Transmission