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REGULATING BANK REPUTATION RISK

*Julie Andersen Hill**

In the aftermath of a school shooting in Florida, the New York State bank regulator urged banks to manage the “reputation risk” posed by doing business with the National Rifle Association (a gun rights advocacy group). As part of Operation Choke Point, a federal regulator told banks to end relationships with payday lenders because those activities posed “reputation risk.” Another federal regulator warns banks their reputations might be damaged by lending to oil and gas companies that are perceived to cause environmental harm. Reputation risk is the risk that bank stakeholders will negatively change their perception of the bank. It was almost unmentioned in banking regulation until the mid-1990s, but as these examples illustrate, it is now ubiquitous.

This Article surveys reputation risk guidance and enforcement efforts. It shows reputation risk regulation is usually an ancillary consideration to credit risk, operational risk, or other primary risk. In these instances, reputation risk adds little because regulators have strong tools to address the root problems. Sometimes, however, regulators justify guidance or enforcement primarily in terms of controlling reputation risk. Regulators use reputation risk to weigh in on hot-button political topics afield from bank safety and soundness like gun rights, payday lending, and fossil fuels. Because regulators believe reputation risk is

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present in every facet of banking, little prevents them from using it to address other controversies.

This Article argues expansive regulation of reputation risk is harmful. There is little evidence that regulators can accurately predict and prevent bank reputational losses. Moreover, because reputation risk is largely subjective, regulators can use it to further political agendas apart from bank safety and soundness. Unnecessary politicization of banking regulation undermines faith in the regulatory system and correspondingly erodes trust in banks.

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I. INTRODUCTION

There is an adage that it is better to under-promise and over-deliver. This statement is an acknowledgment of reputation risk. Banks that fail to live up to customers', shareholders', and other stakeholders' expectations incur reputation losses. Consider four examples.

First, Wells Fargo employees, in an apparent attempt to meet sales quotas and earn bonuses, opened millions of unauthorized customer accounts.¹ Because opening unauthorized accounts violates the law,² the bank faced federal, state, and local government investigations and fines.³ In addition, Wells Fargo spent \$3.2 million on customer refunds and settled a class action suit for \$142 million.⁴ But the harm to Wells Fargo extends beyond its legal costs. C.E.O. John Stumpf resigned,⁵ and more than 5,300 employees were fired.⁶ New customers seem to be avoiding the bank.

¹ James Rufus Koren, *Wells Fargo to Pay \$185 Million Settlement for 'Outrageous' Sales Culture*, L.A. TIMES (Sept. 8, 2016), <https://www.latimes.com/business/la-fi-wells-fargo-settlement-20160907-snap-story.html>; E. Scott Reckard, *Wells Fargo's Pressure-Cooker Sales Culture Comes at a Cost*, L.A. TIMES (Dec. 21, 2013), <https://www.latimes.com/business/la-fi-wells-fargo-sale-pressure-20131222-story.html>.

² See, e.g., 15 U.S.C. § 1642 (2012) ("No credit card shall be issued except in response to a request or application therefor."); *id.* § 5536(a)(1)(B) ("It shall be unlawful for . . . any covered person or service provider . . . to engage in any unfair, deceptive, or abusive act or practice . . .").

³ The Consumer Financial Protection Bureau fined Wells Fargo a record \$100 million. Wells Fargo Bank, N.A., CFPB No. 2016-CFPB-0015 (2016). The Office of the Comptroller of the Currency (OCC) assessed a \$35 million penalty. Wells Fargo Bank, N.A., OCC Docket No. AA-EC-2016-67, OCC EA No. 2016-079 (Sept. 6, 2016). Wells Fargo paid \$50 million to the City and County of Los Angeles. Stipulated Judgment, *California v. Wells Fargo & Co.*, No. BC580778 (Cal. Super. Ct. L.A. County Sept. 13, 2016). Wells Fargo's Securities and Exchange Commission (SEC) filings indicate that it is still facing investigations from "[f]ederal, state, and local government agencies, including the Department of Justice, the . . . SEC[], and the United States Department of Labor; state attorneys general, including the New York Attorney General; and prosecutors' offices, as well as Congressional committees." Wells Fargo & Co., Quarterly Report 116 (Form 10-Q) (Aug. 2, 2019).

⁴ Press Release, Wells Fargo & Co., Wells Fargo Expands Class-Action Settlement for Retail Sales Practices to \$142 Million, Adds Accounts as Early as May 2002 (Apr. 21, 2017), <https://newsroom.wf.com/press-release/wells-fargo-expands-class-action-settlement-retail-sales-practices-142-million-adds>.

⁵ James Rufus Koren, *Wells Fargo CEO Retires Amid Accounts Scandal and Is Replaced by a Longtime Company Insider*, L.A. TIMES (Oct. 12, 2016, 4:55 PM), <https://www.latimes.com/business/la-fi-wells-fargo-stumpf-resigns-20161012-snap-story.html>.

⁶ Nathan Bomey, *Wells Fargo CEO Refuses to Push for Exec Pay Clawback*, USA TODAY (Sept. 20, 2016, 5:55 PM), <https://www.usatoday.com/story/money/2016/09/20/wells-fargo-ceo->

Year-on-year credit card applications are down 55 percent and checking account applications are down 40 percent.⁷ “And the bank’s stock has suffered. It declined sharply in the weeks after the scandal broke, and despite a recovery, has continued to underperform compared to its peers.”⁸

Second, when Bank of America announced a monthly \$5 fee for using a debit card, customer Kristen Christian posted her complaints about the fee on Facebook and urged her friends to transfer their accounts elsewhere.⁹ Ms. Christian’s complaint drew a nationwide following that reportedly resulted in customers moving “billions of dollars in deposits” from large banks.¹⁰ Bank of America ultimately rescinded the fee.¹¹

Third, Wells Fargo agreed to participate in a syndicated loan to finance construction of the Dakota Access Pipeline—an underground pipeline to transport oil from the shale fields in North Dakota to Illinois.¹² Environmental and Native American groups

john-stumpf-congress-testimony/90726424/ (noting that two percent of Wells Fargo’s workforce was fired).

⁷ See Kevin Dugan, *Customers Still Hate Wells Fargo Following Fake-Accounts Scandal*, N.Y. POST (Mar. 20, 2017, 9:46 PM), <https://nypost.com/2017/03/20/customers-still-hate-wells-fargo-following-fake-accounts-scandal/> (“It’s official: Bank customers still hate Wells Fargo.”).

⁸ James Rufus Koren, *It’s Been a Year Since the Wells Fargo Scandal Broke—and New Problems Are Still Surfacing*, L.A. TIMES (Sept. 8, 2017, 3:00 AM), <https://www.latimes.com/business/la-fi-wells-fargo-one-year-20170908-story.html> (“Since Sept. 7[, 2016], the day before the scandal broke, Wells Fargo shares are up just 3%. The KBW Nasdaq Bank Index, a benchmark for the banking industry, is up 27% over that period.”).

⁹ Aaron Passman, *How Kristen Christian Came to Launch Bank Transfer Day*, CREDIT UNION J., Dec. 19, 2011, at 1.

¹⁰ Sarah Bloom Raskin, Governor, Bd. of Governors of the Fed. Reserve Sys., Speech at the 2013 Banking Outlook Conference (Feb. 28, 2013), <https://www.federalreserve.gov/newsevents/speech/raskin20130228a.htm>.

¹¹ See, e.g., Jason Kessler & Blake Ellis, *Bank of America Axes \$5 Debit Card Fee*, CNN MONEY (Nov. 1, 2011, 3:08 PM), https://money.cnn.com/2011/11/01/pf/bank_of_america_debit_fee/index.htm.

¹² John Heltman, *Will Big Banks Pay Price for Dakota Pipeline?*, AM. BANKER (Feb. 17, 2017, 5:32 PM), <https://www.americanbanker.com/news/can-bank-divestment-stop-the-dakota-access-pipeline>.

opposed the pipeline.¹³ Their large protests drew media attention.¹⁴ The Seattle City Council, citing the pipeline financing, voted 9-0 to end the City's banking relationship with Wells Fargo.¹⁵ The California cities of Alameda, Berkeley, Davis, and Santa Monica followed suit.¹⁶ Although Wells Fargo remained committed to financing the pipeline,¹⁷ it "hired an independent human rights law firm, Foley Hoag, to advise them on the project."¹⁸

Fourth, in rural China, rumors circulated that Jianguo Sheyang Rural Commercial Bank had "turned down a customer's request to

¹³ Justin Worland, *A High-Plains Showdown over the Dakota Access Pipeline*, TIME (Nov. 3, 2016), <https://time.com/4556055/a-high-plains-showdown-over-the-dakota-access-pipeline/>. The Standing Rock Sioux tribe opposed the pipeline, although it did not cross reservation land, because it traveled near their primary source of drinking water and crossed a burial ground. *Id.* Environmental groups opposed the pipeline primarily because it further invested in fossil fuels infrastructure. *Id.*

¹⁴ Alene Tchekmedyan & Melissa Etehad, *2 Years of Opposition, 1,172 Miles of Pipe, 1.3 Million Facebook Check-Ins. The Numbers to Know about the Standing Rock Protests*, L.A. TIMES (Nov. 1, 2016, 6:00 AM), <https://www.latimes.com/nation/la-na-standing-rock-numbers-20161101-story.html>.

¹⁵ Lynda V. Mapes, *Seattle City Council Votes to Cut Ties with Wells Fargo over Dakota Access Pipeline Lending*, SEATTLE TIMES (Feb. 22, 2017, 2:58 PM), <https://www.seattletimes.com/seattle-news/environment/seattle-city-council-to-vote-on-pulling-billions-from-wells-fargo/>.

¹⁶ See Felicia Alvarez, *City of Davis Votes to Divest from Wells Fargo Bank*, DAVIS ENTER. (Feb. 8, 2017, 7:23 AM), <https://www.davisenterprise.com/local-news/city-of-davis-votes-to-divest-from-wells-fargo-bank/> ("[T]he Davis City Council voted unanimously to seek out a new banking service in light of the bank's ties to the Dakota Access oil pipeline and other recent controversies."); Kate Cagle, *In Solidarity with Standing Rock, City Moves Forward to Cut Ties with Wells Fargo*, SANTA MONICA DAILY PRESS (Feb. 16, 2017, 7:00 AM), <https://www.smdp.com/in-solidarity-with-standing-rock-city-moves-forward-to-cut-ties-with-wells-fargo/159811> ("[T]he Santa Monica City Council moved forward with plans to end the City's banking relationship with Wells Fargo bank."); Tom Lochner, *City Will Withdraw Wells Fargo Business - Institution "Will Have to Compete with Other Banks" for Future City Business*, BERKELEY VOICE, June 9, 2017, at 1A ("The city will continue to do business with Wells Fargo at least through May 2018 as it develops 'socially responsible banking' criteria for future bidders."); Riley McDermid, *Alameda Moves to Divest More than \$36 Million from Wells Fargo*, S.F. BUS. TIMES (Feb. 23, 2017, 10:16 AM), <https://www.bizjournals.com/sanfrancisco/news/2017/02/23/alameda-moves-to-divest-more-than-36-million-from.html> ("The City Council of Alameda voted unanimously this week to divest more than \$36 million it has in accounts with Wells Fargo from the bank, citing its funding of the Dakota Access pipeline and ongoing investigations into its banking practices.").

¹⁷ See Phuong Le, *Seattle Splits from Wells Fargo over Dakota Access Pipeline—CEO Sloan Says Bank Remains Committed*, STAR TRIB., Feb. 9, 2017, at 3D ("Wells Fargo is committed to helping finance the pipeline, Chief Executive Tim Sloan said . . .").

¹⁸ Melodie Michel, *Post-Truth Reputational Risk: The Wells Fargo Saga*, GLOBAL TRADE REV. (Sept. 5, 2017), <https://www.gtreview.com/magazine/volume-15issue-5/post-truth-reputational-risk-wells-fargo-saga/>.

withdraw 200,000 yuan (\$32,200).¹⁹ Although “[b]ankers and local officials say it never happened,” customers raced to the bank to withdraw their money.²⁰ As word spread via social media, customers began withdrawing money from the nearby Rural Commercial Bank of Huanghai.²¹ “In response, local officials and bank managers kept branches open 24 hours a day and trucked in cash by armored vehicle to satisfy hundreds of customers, some of whom brought large baskets to carry their cash out of the bank.”²² Banks began “stack[ing] piles of yuan behind teller windows” to bolster customer confidence.²³ The run lasted three days.²⁴

Each instance illustrates that banks can suffer losses from reputational damage. Since the 1990s, bank regulators have increasingly focused their attention on reputation risk.²⁵ This Article examines and assesses the regulation of reputation risk at financial institutions in the United States. It argues regulation of reputation risk is unlikely to prevent any of the previous examples of reputational losses. Instead, regulating reputation risk threatens to destabilize the banking industry by unnecessarily politicizing bank supervision.

Today, the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve (Federal Reserve), the Office of the Comptroller of the Currency (OCC), the National Credit Union Administration (NCUA), and state bank regulators have a very broad conception of reputation risk. Regulators say it is present in every aspect of banking.²⁶ Banks need not do something wrong to

¹⁹ John Ruwitch, *How Rumor Sparked Panic and Three-Day Bank Run in Chinese City*, REUTERS (Mar. 25, 2014, 8:41 PM), <http://www.reuters.com/article/us-china-banking/how-rumor-sparked-panic-and-three-day-bank-run-in-chinese-city-idUSBREA2P02H20140326>.

²⁰ *Id.*

²¹ *See id.* (noting that people gathered outside banks to withdraw cash).

²² *Id.*

²³ *Id.*

²⁴ *Big but Brittle*, ECONOMIST (May 5, 2016), <https://www.economist.com/special-report/2016/05/05/big-but-brittle> (“On the third day of the panic[,] the China Banking Association, an industry group, entered the fray and declared the rural banks to be healthy—in effect, pledging to stand behind them. That ended the run. It had taken the full weight of the nation’s banks acting in concert to restore calm.”).

²⁵ *See infra* Section III.A (describing the emergence of reputation risk in bank regulation).

²⁶ *See* NAT’L CREDIT UNION ADMIN., CREDIT UNION EXAMINER’S GUIDE, RISK FOCUSED EXAMINATION, RISK CATEGORIES (2002) [hereinafter NCUA EXAMINER’S GUIDE], https://publishedguides.ncua.gov/examiner/Pages/default.htm#ExaminersGuide/Risk-Focused_Program/Risk%20Categories.htm%3FTocPath%3DRisk-Focused%2520Examination%7C_____8 (“Reputation risk exposure appears throughout the credit union organization.”); OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER’S

spark reputation risk. Untrue rumors²⁷ or third-party (customers, suppliers, etc.) conduct unrelated to banking can generate negative public opinion.²⁸ And anything that leads to a negative public opinion of the bank presents reputation risk.²⁹ Regulators make it clear that it is not just bank shareholders, counterparties, employees, and customers whose perceptions matter; reputation risk also arises when “regulators” or “the community” think negatively about a bank.³⁰

Despite this broad conception of reputation risk, most regulation of reputation risk is superfluous. Reputation risk arises most often as an ancillary risk to some other problem already addressed in banking law.³¹ For example, when a bank violates anti-money

HANDBOOK: LARGE BANK SUPERVISION 64 (Sept. 2019 ed. 2018) [hereinafter OCC, LARGE BANK SUPERVISION HANDBOOK 2018] (“Reputation risk is inherent in all bank activities . . .”).

²⁷ See BD. OF GOVERNORS OF THE FED. RESERVE SYS., SR 95-51, RATING THE ADEQUACY OF RISK MANAGEMENT PROCESSES AND INTERNAL CONTROLS AT STATE MEMBER BANKS AND BANK HOLDING COMPANIES (Nov. 4, 1995) [hereinafter FED. RESERVE, RISK MANAGEMENT PROCESSES] (“Reputational risk is the potential that negative publicity regarding an institution’s business practices, whether true or not, will cause a decline in customer base, costly litigation, or revenue reductions.”).

²⁸ See FED. DEPOSIT INS. CORP., FINANCIAL INSTITUTION LETTER 44-2008, GUIDANCE FOR MANAGING THIRD-PARTY RISK (2008) [hereinafter FDIC, THIRD-PARTY RISK GUIDANCE] (“[A]ny negative publicity involving the third party, whether or not the publicity is related to the institution’s use of the third party, could result in reputation risk.”); OFFICE OF THE COMPTROLLER OF THE CURRENCY, OCC BULL. NO. 2013-29, THIRD-PARTY RELATIONSHIPS: RISK MANAGEMENT GUIDANCE (Oct. 30, 2013) [hereinafter OCC, THIRD-PARTY RELATIONSHIPS GUIDANCE] (“Publicity about adverse events surrounding the third parties also may increase the bank’s reputation risk.”).

²⁹ See FDIC, THIRD-PARTY RISK GUIDANCE, *supra* note 28 (defining reputation risk as “arising from negative public opinion”); FED. RESERVE, RISK MANAGEMENT PROCESSES, *supra* note 27 (defining reputation risk as “the potential [for] negative publicity”); NCUA EXAMINER’S GUIDE, *supra* note 26 (defining reputation risk as “arising from negative public opinion or perception”).

³⁰ See OCC, LARGE BANK SUPERVISION HANDBOOK 2018, *supra* note 26, at 64 (listing “customers, counterparties, correspondents, investors, regulators, employees, and the community” as relevant bank stakeholders); see also BASEL COMMITTEE ON BANKING SUPERVISION, ENHANCEMENTS TO THE BASEL II FRAMEWORK ¶ 47 (2009) (defining the relevant stakeholders as “customers, counterparties, shareholders, investors, debt-holders, market analysts, other relevant parties [and] regulators”).

³¹ See *infra* Sections IV.C–D (describing formal and informal enforcement efforts mentioning reputation risk); see also Sergio Scandizzo, *An Asset-Liability View of Banks’ Reputation* (“Most academic literature and corporate policies tend to treat reputation along the same lines as brand, that is, as an intangible asset that can be impaired by operational mistakes or inappropriate behaviour.”), in REPUTATIONAL RISK MANAGEMENT IN FINANCIAL INSTITUTIONS 21, 23 (Thomas Kaiser & Petra Merl eds., 2014); Clifford Rossi, *Opinion, Headlines from Recent Bank Scandals Are Their Own Problem*, AM. BANKER (Nov. 4, 2016,

laundering laws, regulators might require the bank to consider compliance and reputation risk when opening new accounts.³² Or regulators might instruct a bank with credit quality problems to develop risk management plans considering reputation and other risks.³³ In these kinds of cases, reputation risk regulation does little work because regulators already have ample authority to address the primary problem. Regulators do not need authority over reputation risk to punish Wells Fargo for illegally opening customer accounts.

When reputation is not tied to other risks, regulators cannot reliably forecast and prevent it. Part of the reason reputation is difficult to forecast is that each bank has a variety of stakeholders.³⁴ Actions that some stakeholders perceive positively, others may perceive negatively.³⁵ Shareholders may like Bank of America's new account fee, while customers do not.³⁶ Workers building the Dakota Access Pipeline might have been happy for Wells Fargo's financing, while some community groups were not.³⁷ Regulators are not equipped to determine which stakeholders' views should be prioritized. Another reason reputation risk is hard to predict is that it is broad. Regulators have little way of knowing when untrue rumors will circulate about a bank or when stakeholders will attribute the non-banking actions of a third-party to a bank.³⁸ As

11:00 AM), <https://www.americanbanker.com/opinion/headlines-from-recent-bank-scandals-are-their-own-problem> ("Reputation risk usually manifests itself by way of some other risk.").

³² See, e.g., U.S. Trust Corp., 2001 WL 855087, at *4 (Fed. Reserve Bd. July 12, 2001) (requiring an enhanced customer due diligence program "to ensure effective management and mitigation of reputational and legal risks and compliance with the [Bank Secrecy Act]").

³³ See, e.g., Written Agreement Between Putman Cty. Nat'l Bank of Carmel and the OCC, OCC EA No. 2006-76, 2006 WL 5432098, at *1 (July 12, 2006) (instructing a bank to develop "action plans and time frames to reduce risks where exposure is high, particularly with regard to credit risk, which impacts directly on liquidity, compliance, strategic, and reputation risks").

³⁴ See OCC, LARGE BANK SUPERVISION HANDBOOK 2018, *supra* note 26, at 64 (identifying "customers, counterparties, correspondents, investors, regulators, employees, and the community" as bank stakeholders).

³⁵ See *infra* note 381.

³⁶ See *supra* notes 9–11 and accompanying text (discussing negative reaction to the account fee).

³⁷ See *supra* notes 12–18 and accompanying text (discussing negative reaction to the funding of the Dakota Access Pipeline).

³⁸ See *infra* notes 359–64, 360–65 and accompanying text.

much as they might like to, regulators cannot reliably forecast runs like the one at Jianguo Sheyang Rural Commercial Bank.³⁹

Nevertheless, regulators do sometimes require banks to take action not required to prevent violations of the law or serious financial harm. The best known example of this aggressive reputation regulation is Operation Choke Point—an initiative run by the Department of Justice with help from banking regulators aimed at pressuring banks to cut off services to payday lenders and other high-risk customers.⁴⁰ But Operation Choke Point is not the only instance of regulatory enforcement aimed primarily at reputation risk. Before Operation Choke Point, the FDIC used reputation risk to require a bank to end a payment processing relationship with a company associated with payday lenders.⁴¹ More recently, the FDIC used Operation Choke Point-like tactics to force banks to stop tax refund anticipation loans deemed reputationally risky.⁴² OCC and FDIC enforcement actions have required banks to close all customer accounts posing reputation risk.⁴³ And the New York state banking regulators urged banks to consider reputation risk when offering banking services to the National Rifle Association (NRA) and “similar gun promotion organizations.”⁴⁴ The NRA claims the regulator followed this guidance with “backroom exhortations,” pressuring banks to end banking relationships.⁴⁵

Reputation risk allows regulators to justify these regulatory measures without identifying violations of the law or serious threats

³⁹ See *supra* notes 19–24 and accompanying text (discussing the run sparked by untrue rumors at two banks in rural China).

⁴⁰ See Alan Zibel & Brent Kendall, *Probe Turns Up Heat on Banks: Prosecutors Target Firms that Process Payments for Online Payday Lenders, Others*, WALL ST. J. (Aug. 7, 2013, 10:27 PM), <https://www.wsj.com/articles/probe-turns-up-heat-on-banks-1375923859> (discussing Operation Choke Point); see also *infra* Section IV.D.1.

⁴¹ See Bank of Agric. & Commerce, FDIC Order No. FDIC-08-408b, 2009 WL 998563, at *4 (Feb. 19, 2009) (requiring a bank to end a payment processing relationship with a company associated with payday lenders).

⁴² See *infra* notes 309–17 and accompanying text.

⁴³ See *infra* notes 250–54 and accompany text (discussing money laundering enforcement actions with broad remedial measures).

⁴⁴ Letter from Maria T. Vullo, Superintendent, N.Y. Dep’t of Fin. Servs., to the CEO or Equivalents of N.Y. State Chartered or Licensed Fin. Insts. (Apr. 19, 2018) [hereinafter Vullo Letter], www.dfs.ny.gov/docs/legal/dfs/DFS_Guidance_Risk_Management_NRA_Gun_Manufacturer_s-Banking.pdf.

⁴⁵ Original Complaint & Jury Demand at 1, 22, 25, 30, *Nat’l Rifle Ass’n of Am. v. Cuomo*, 350 F. Supp. 3d 94 (N.D.N.Y. 2018).

to the financial integrity of the bank.⁴⁶ Indeed, regulators seem to believe reputation risk regulation is warranted because some stakeholders (particularly the regulators) dislike payday lenders,⁴⁷ gun rights groups,⁴⁸ and tax refund anticipation loans.⁴⁹

These examples may only be the tip of the iceberg. A glut of regulatory guidance pressures banks to reduce or eliminate a wide range of reputation risks.⁵⁰ For example, the OCC warns: “Lending to [oil and gas] companies . . . perceived by the public to be negligent in preventing environmental damage, hazardous accidents, or weak fiduciary management can damage a bank’s reputation.”⁵¹ Because banks are heavily regulated, they are incentivized to eliminate identified risk rather than upset regulators.⁵² Moreover, because much of the regulatory process happens in secret,⁵³ regulators can

⁴⁶ See *infra* notes 199–206, 257–59 and accompanying text.

⁴⁷ For example, in implementing Operation Choke Point, one FDIC official explained: “I literally can not [sic] stand pay day lending. They are abusive, fundamentally wrong, hurt people, and do not deserve to be in any way associated with banking.” E-mail from Thomas J. Dujenski, FDIC Reg’l Dir., Atlanta Region, to Mark Pearce, FDIC Dir., Div. of Depositor & Consumer Prot. (Nov. 26, 2012, 4:47 PM), in STAFF OF H. COMM. ON OVERSIGHT & GOV’T REFORM, 113TH CONG., FEDERAL DEPOSIT INSURANCE CORPORATION’S INVOLVEMENT IN “OPERATION CHOKE POINT” 14 (Comm. Print 2014) [hereinafter H. COMM. ON OVERSIGHT & GOV’T REFORM STAFF REPORT, FDIC], <https://republicans-oversight.house.gov/wp-content/uploads/2014/12/Staff-Report-FDIC-and-Operation-Choke-Point-12-8-2014.pdf>.

⁴⁸ New York’s gun promotion guidance was issued at the direction of Governor Andrew Cuomo who contemporaneously called the NRA “an extremist organization.” Andrew Cuomo (@NYGovCuomo), TWITTER (Apr. 20, 2018, 8:58 AM), <https://twitter.com/NYGovCuomo/status/987359763825614848>; Press Release, N.Y. Dep’t of Fin. Servs., Governor Cuomo Directs Department of Financial Services to Urge Companies to Weigh Reputational Risk of Business Ties to the NRA and Similar Organizations (Apr. 19, 2018), <https://www.dfs.ny.gov/about/press/pr1804191.htm>.

⁴⁹ The FDIC began its crackdown on tax refund anticipation loans after FDIC Chairman Sheila Bair received a letter from consumer advocacy groups criticizing the loans. OFFICE OF INSPECTOR GEN., FED. DEPOSIT INS. CORP., REPORT NO. OIG-16-001, EXECUTIVE SUMMARY, REPORT OF INQUIRY INTO THE FDIC’S SUPERVISORY APPROACH TO REFUND ANTICIPATION LOANS AND THE INVOLVEMENT OF FDIC LEADERSHIP AND PERSONNEL i n.2 (2016) [hereinafter FDIC OIG REFUND ANTICIPATION LOANS REPORT]. Apparently convinced the loans were problematic, she asked “why FDIC-regulated institutions would be allowed to offer [refund anticipating loans].” *Id.* at i.

⁵⁰ See *infra* Sections III.B–C.

⁵¹ OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER’S HANDBOOK: OIL AND GAS EXPLORATION AND PRODUCTION LENDING 17 (Oct. 2018 ed. 2016) [hereinafter OCC, OIL AND GAS LENDING HANDBOOK], <https://www.occ.treas.gov/publications-and-resources/publications/comptrollers-handbook/files/oil-gas-exploration-prod-lending/index-oil-gas-exploration-production-lending.html>.

⁵² See *infra* Section IV.D.3.

⁵³ See *infra* notes 261–67 and accompanying text.

informally use guidance to pressure banks in ways that will never receive public scrutiny.

This Article argues that regulation of reputation risk in the absence of a violation of law or financial threat to the institution is harmful because it unnecessarily politicizes bank regulation. Banks rely not just on their own reputations, but also on those of their regulators. Part of the reason people trust banks is that regulators enact and enforce an extensive set of rules to keep banks financially stable.⁵⁴ Regulators engender this trust by cultivating reputations as technical experts who do not pander to political pressure.⁵⁵ Regulation of reputation risk at banks undermines this by inviting regulators to consider and sometimes resolve political questions afield from banking.

Amid criticism of Operation Choke Point, federal regulators now say they do not require banks to close accounts based solely on reputation risk.⁵⁶ This, however, is not enough to prevent regulatory overreach. Indeed, before Operation Choke Point, regulators had assured bankers that they did not actively supervise reputation risk.⁵⁷ Today, regulators maintain expansive definitions of reputation risk,⁵⁸ voluminous guidance cataloguing reputation risks,⁵⁹ and an aggressive interpretation of their enforcement authority.⁶⁰ Little prevents regulators from using their enforcement tools to stop a wide variety of bank activities they perceive as reputationally risky. Instead, this Article recommends legislative measures to limit regulatory authority over reputation risk.

The Article proceeds in five parts. Part II defines reputation risk and explains why it is especially important to banks. Part III surveys the explosion of reputation risk in regulatory guidance. Part IV catalogues regulators' enforcement efforts involving reputation risk. Part V argues that expansive regulation of reputation risk does not improve banks and might harm them. It recommends Congress act to limit regulatory authority over reputation risk. Part VI concludes.

⁵⁴ See *infra* notes 94–100 and accompanying text.

⁵⁵ See *infra* notes 403–06 and accompanying text.

⁵⁶ See *infra* notes 231–33 and accompanying text.

⁵⁷ See *infra* notes 226–30 and accompanying text.

⁵⁸ See *infra* Section III.A.

⁵⁹ See *infra* Sections III.B–C.

⁶⁰ See *infra* Section IV.A.

II. REPUTATION RISK AND BANKS

First, what is reputation risk and how does it impact banks?

A. REPUTATION RISK DEFINED

Every business has a reputation. “Customers have expectations when they buy products or services, employees have them when they accept jobs, vendors have them when they partner, creditors and investors have them, and even regulators have them. Not to be left out, members of society at large have expectations too.”⁶¹ When banks do not live up to stakeholder expectations, stakeholders change their behavior. “Customers stop buying, employees leave, vendors lose interest in servicing, and regulators, litigators and reporters inevitably pile on.”⁶² Reputation risk, then, is the risk that “stakeholders [will negatively] change their expectations and behaviors.”⁶³

Stakeholders can negatively adjust their expectations for a variety of reasons. “Any risk event, market, credit, operational, or strategic, can have a reputational impact.”⁶⁴ For example, if a bank suffers large losses on its mortgage loan portfolio (credit risk), investors may become worried about the bank’s future earnings and sell or avoid stock.⁶⁵ If a bank illegally opens customer accounts without authorization from the customer (legal and compliance risk), customers might become upset and close their accounts.⁶⁶ Or

⁶¹ Nir Kossovsky, *How to Manage Reputation Risk*, RISK MGMT., Apr. 2014, at 18.

⁶² *Id.*; see also Robert G. Eccles, Scott C. Newquist & Roland Schatz, *Reputation and Its Risks*, HARV. BUS. REV., Feb. 2007, at 1, 3 (“When the reputation of a company is more positive than its underlying reality, this gap poses a substantial risk. Eventually, the failure of a firm to live up to its billing will be revealed, and its reputation will decline until it more closely matches the reality.”).

⁶³ Kossovsky, *supra* note 61.

⁶⁴ See Philippa X. Girling, *Reputational Risk and Operational Risk*, in OPERATIONAL RISK MANAGEMENT: A COMPLETE GUIDE TO A SUCCESSFUL OPERATIONAL RISK FRAMEWORK 255 (2013); see also George Stansfield, *Some Thoughts on Reputation and Challenges for Global Financial Institutions*, 31 GENEVA PAPERS ON RISK & INS. 470, 470 (2006) (listing a number of potential sources of “reputational damage,” including “poor compliance practices” and “poor operating or financial performance over an extended period”).

⁶⁵ See Girling, *supra* note 64, at 259 (noting that significant credit losses can “lead to serious questions about the ability of the firm to operate effectively in the markets and this can lead to loss of clients, and loss of share value”).

⁶⁶ See Hema Parekh, *Reputational Risk in the Universe of Risks: Boundary Issues* (“The biggest threat to reputation is seen to be a failure to comply with regulatory or legal

if a bank is the victim of a cyber-attack (operational risk), business partners might avoid the bank because they are worried the security breaches could impact them.⁶⁷

When a risk event triggers a negative change in stakeholders' behavior, the bank may lose money.⁶⁸ Reputation risk losses are those losses beyond the loss directly attributable to the event itself.⁶⁹ The losses on the unpaid mortgage loans are credit losses, but the losses attributable to the increased difficulty in attracting investors are reputational losses. The losses due to theft in a cyber-attack are operational losses, but the losses from a smaller customer base are reputation losses.⁷⁰

In this sense, reputation risk is a derivative risk. It is a risk that "arises as a result of something else and that potentially magnifies the consequences of other exposures."⁷¹

But viewing reputation risk as a purely derivative risk masks some of its nuance. Reputation losses can occur in the absence of other identifiable risk.⁷² Stakeholders may negatively adjust their view of a bank when the bank engages in otherwise non-risky

obligations."), in *REPUTATIONAL RISK MANAGEMENT IN FINANCIAL INSTITUTIONS*, *supra* note 31, at 37, 45.

⁶⁷ See Dante Disparte & Daniel Wagner, *The Growing Severity of Cyber-Attacks and How to Protect Against Them*, HUFFINGTON POST (Dec. 14, 2016, 9:21 AM), https://www.huffpost.com/entry/the-growing-severity-of-c_b_13601810 (noting that for businesses "cyber-attacks can pose an existential threat, not just operationally, but in terms of reputation risk"). *But see* Daniel Wagner, *Reputation Risk in Cyber Attacks Is a Myth*, SUNDAY GUARDIAN (Jan. 13, 2018, 10:45 PM), <https://www.sundayguardianlive.com/opinion/12369-reputation-risk-cyber-attacks-myth> (arguing that cyber-attacks "have become so commonplace that the general public has become numb to their occurrence and impact").

⁶⁸ Christian Eckert & Nadine Gatzert, *Modeling Operational Risk Incorporating Reputation Risk: An Integrated Analysis for Financial Firms*, 72 *INS.* 122, 124 (2017).

⁶⁹ See Ingo Walter, *Reputation Risks and Large International Banks* ("[A] reputation-sensitive event might trigger an identifiable monetary decline in the market capitalization of the bank. After subtracting from this market-cap loss the present value of direct and allocated costs, such as fines and penalties and settlements under civil litigation, the balance can be ascribed to the impact on the firm's reputation."), in *THE FUTURE OF LARGE, INTERNATIONALLY ACTIVE BANKS* 29, 39 (Asli Demirgüç-Kunt et al. eds., 2016).

⁷⁰ See Eckert & Gatzert, *supra* note 68, at 124 (explaining the framework for identifying "reputational losses" and "operational losses").

⁷¹ Scandizzo, *supra* note 31, at 23. Indeed, this nexus between reputation risk and other risks has prevented scholars from converging on an accepted definition of reputation risk. "Opinion is divided as to whether reputational risk is a category of risk in its own right, or merely the consequence of a failure to manage other risks." Parekh, *supra* note 66, at 38.

⁷² Girling, *supra* note 64, at 259 ("In addition to reputational impact arising from other risk types, it can also arise out of activities that are not risky in any other sense.").

conduct that some stakeholders consider immoral or irresponsible.⁷³ For example, although Wells Fargo's funding of the Dakota Access Pipeline did not violate the law or pose excessive credit risk, it was nevertheless unpopular with some customers and community groups.⁷⁴ Stakeholder expectations "may go well beyond what a bank is legally obliged to do and may encompass a very wide spectrum of domains, from customer service to corporate citizenship all the way to outright macroeconomic responsibility."⁷⁵

Finally, because reputation is based on perception, "[r]eputation, through no fault of one's own, can be tarnished."⁷⁶ Untrue rumors about either a particular bank or banks in general can motivate depositors to withdraw deposits.⁷⁷ "Given that what external audiences perceive about [a bank] is often filtered through third parties (especially the media)," stakeholder perceptions of banks are sometimes based on incomplete, inaccurate, or untruthful information.⁷⁸

B. BANK REPUTATION RISK

While all businesses have some exposure to reputation risk, banks face unique reputation concerns: (1) their business is based on reputation to a greater extent than other businesses, and (2) an

⁷³ Walter, *supra* note 69, at 40–41; Scandizzo, *supra* note 31, at 25 ("[R]eputation can also be seen as tied to a set of obligations, arising from the bank's dealings with its stakeholders, which place on it duties and responsibilities to be fulfilled over time.").

⁷⁴ See *supra* notes 12–18 and accompanying text.

⁷⁵ Scandizzo, *supra* note 31, at 25.

⁷⁶ Raskin, *supra* note 10, at 1.

⁷⁷ See Annarita Trotta, Antonia Patrizia Iannuzzi & Vincenzo Pacelli, *Reputation, Reputational Risk and Reputational Crisis in the Banking Industry: State of the Art and Concepts for Improvements* ("[S]cholars have noted that in the financial sector, particularly when the economic condition is adverse, a contraction of the reputational capital of a bank (particularly if it has systemic importance) can certainly affect the reputation and equities prices of other financial intermediaries."), in *MANAGING REPUTATION IN THE BANKING INDUSTRY: THEORY AND PRACTICE* 3, 17 (Stefano Dell'Atti & Annarita Trotta eds., 2016); Jack Ewing & Georgi Kantchev, *Feud Between Oligarchs Seen as Cause of Bank Run in Bulgaria*, N.Y. TIMES (June 30, 2014), <https://www.nytimes.com/2014/07/01/business/international/feud-between-oligarchs-seen-as-cause-of-bank-run-in-bulgaria.html> (explaining how social media rumors arising from a feud between two oligarchs led to runs at a Bulgarian bank); *supra* notes 19–24 and accompanying text (explaining how untrue rumors about a bank in rural China sparked a run at that bank and a neighboring bank).

⁷⁸ Peter O. Foreman, David A. Whetten & Alison Mackey, *An Identity-Based View of Reputation, Image, and Legitimacy: Clarifications and Distinctions Among Related Constructs*, in *THE OXFORD HANDBOOK OF CORPORATE REPUTATION* 179, 183 (Michael L. Barnett & Timothy G. Pollock eds., 2012).

erosion of that reputation can be even more damaging to society.⁷⁹ Regulators address these concerns by providing deposit insurance and monitoring banks to ensure they comply with the law.⁸⁰ In essence, the reputation of bank regulators acts as a partial substitute for bank reputation.

Banks rely on reputation because people and businesses must be willing to deposit money at a bank. This requires some level of trust that the depositor will be able to withdraw the money later.⁸¹ But there are a seemingly infinite number of ways unscrupulous bankers can defraud customers.⁸² The nature of finance can make it difficult for even sophisticated depositors to know when they are likely to be defrauded,⁸³ or even to prove afterward that they have been defrauded.⁸⁴

Although trust is vital, it is difficult for banks themselves to effectively signal they can be trusted. A manufacturing firm might signal its product can be trusted by offering a warranty.⁸⁵ Buyers of a refrigerator trust a manufacturer warranty because they believe

⁷⁹ See Belén Ruiz, Juan A. García & Antonio J. Revilla, *Antecedents and Consequences of Bank Reputation: A Comparison of the United Kingdom and Spain*, 33 INT'L MARKETING REV. 781, 781 (2016) ("The intangible nature of banking services makes them difficult to assess with more relevance being placed on reputation, whereas reputational losses, which are negative in any industry, are particularly critical in banking." (citations omitted)); Trotta, Iannuzzi & Pacelli, *supra* note 77, at 6 ("Reputation is a concept related both to the '*raison d'être*' of banks and the *special* nature of banking business in the context of contemporary financial intermediation theories.").

⁸⁰ See *infra* notes 94–100 and accompanying text.

⁸¹ See Eckert & Gatzert, *supra* note 68, at 123 ("In general, the potential impact of a bad reputation on the financial situation of the company can be fatal, and reputation is even more important in the financial industry, especially for banks and insurers, whose activities are based on trust."); Paola Sapienza & Luigi Zingales, *A Trust Crisis*, 12 INT'L REV. FIN. 123, 124 (2012) ("While trust is fundamental to all trade and investment, it is particularly important in financial markets, where people part with their money in exchange for promises.").

⁸² JONATHAN R. MACEY, *THE DEATH OF CORPORATE REPUTATION: HOW INTEGRITY HAS BEEN DESTROYED ON WALL STREET* 14 (2013) ("There are so many ways for unscrupulous financial institutions to defraud their customers that it is difficult to list them all.").

⁸³ See David T. Llewellyn, *Trust and Confidence in Financial Services: A Strategic Challenge*, 13 J. FIN. REG. & COMPLIANCE 333, 341–42 (2005) (listing numerous characteristics of financial transactions that make "the transaction costs for the consumer in verifying the value of contracts" abnormally high).

⁸⁴ See MACEY, *supra* note 82, at 26–27 (noting financial products "decline in value for complex and opaque reasons, and it is not always clear whether the failure is the result of dishonesty or of unavoidable factors").

⁸⁵ See *id.* at 26 (noting that manufacturers "highlight their good reputations by offering warranties").

only a small number of refrigerators will turn out to be defective.⁸⁶ The warranty assures the buyer will not bear the loss for a defective product. Bank deposits are different. When a bank experiences difficulty, all of the bank's deposits are in peril. Thus, a bank warranting that it will repay deposits gives the depositor little additional comfort.⁸⁷ In sum, although banking relies on reputation, traditional tools for bolstering reputations are ineffective in banking.

At the same time, trust in banking is fragile. Stakeholders adjust their expectations and perceptions over time. For banks, negative changes in reputation are dangerous because they can trigger a run or panic.⁸⁸ Banks' borrowing consists of deposits that customers can withdraw at any time. Under normal circumstances this "demand" nature of deposits poses no problems for banks because most depositors leave their money in the bank.⁸⁹ If, however, many depositors suddenly "withdraw their money at the same time, then the bank has a problem because it doesn't have the funds on hand."⁹⁰ Rather than keeping all deposits in a bank vault, banks lend money to borrowers. Their loans typically have longer terms—for example, a three-year car loan or a thirty-year mortgage. To satisfy unexpected depositor demands, a bank may have to sell its assets quickly at low fire-sale prices, until the bank is eventually unable to meet depositor demands.⁹¹

Because depositors "generally have a limited capacity to assess the strength of any individual bank and cannot determine how *their own* bank will withstand an economic shock," a bank run can spread like a contagion from one bank to the next until a full-blown banking

⁸⁶ See *id.* at 19–20 (explaining "one refrigerator can break while dozens of others work perfectly," but financial products "do not fail one by one").

⁸⁷ *Id.* at 19.

⁸⁸ See Ingo Walter, *Reputational Risk in Banking and Finance: An Issue of Individual Responsibility?*, 7 J. RISK MGMT. FIN. INSTS. 299, 301 (2014) (stating reputation risk is "significantly more serious" for banks than for non-financial firms "because they deal with other people's money, and . . . because problems that arise in financial intermediation trigger serious external costs").

⁸⁹ See MICHAEL S. BARR, HOWELL E. JACKSON & MARGARET E. TAHYAR, *FINANCIAL REGULATION: LAW AND POLICY* 236 (2016) (explaining the generally justified assumption that "not all depositors will demand their funds back at the same time").

⁹⁰ RICHARD SCOTT CARNELL, JONATHAN R. MACEY & GEOFFREY P. MILLER, *THE LAW OF FINANCIAL INSTITUTIONS* 202 (6th ed. 2017).

⁹¹ See BARR, JACKSON & TAHYAR, *supra* note 89, at 236 (explaining that "because loans are . . . hard to value, potential buyers can capitalize on this forced sale to purchase the assets at a deep discount, often called a fire sale").

panic occurs.⁹² It is not just banks that suffer. Banking panics damage economic output in the real economy. They can cause or contribute to recessions or depressions.⁹³

Relying on bank reputation alone might create a sub-optimally small and unstable banking market. Instead, banks rely at least partly on government regulation to bolster their reputations and attract stable deposits.⁹⁴ “Regulation . . . works by making fraud illegal and then enforcing the rules against those who break them.”⁹⁵ Depositors need less trust in banks if they believe regulators are keeping a close eye on banks. Regulation, however, only works to bolster reputation when depositors believe the regulator will effectively monitor banks for compliance with the law and punish violations of the law.⁹⁶ If regulators are under-zealous or over-zealous depositors will not trust them.⁹⁷ Moreover, banks

⁹² *Id.* at 237; see also Charles W. Calomiris & Gary Gorton, *The Origins of Banking Panics: Models, Facts, and Bank Regulation* (“In an environment with asymmetric information, a panic can occur as follows. Bank depositors may receive information leading them to revise their assessment of the risk of banks, but they do not know which individual banks are most likely to be affected. Since depositors are unable to distinguish individual bank risks, they may withdraw a large volume of deposits from all banks in response to a signal.”), in FINANCIAL MARKETS AND FINANCIAL CRISES 109, 124 (R. Glenn Hubbard ed., 1991).

⁹³ See generally Michael Bordo et al., *Is the Crisis Problem Growing More Severe?*, 16 ECON. POL’Y 51 (2001) (studying banking crises in twenty-one countries over a 120-year period); see also Andrew J. Jalil, *A New History of Banking Panics in the United States, 1825–1929: Construction and Implications*, 7 AM. ECON. J. 295, 297 (2015) (showing “banking panics have rapid, large, and strongly negative effects on both output and prices” in the real economy).

⁹⁴ Christopher McKenna & Rowena Olegario, *Corporate Reputation and Regulation in Historical Perspective* (“Faith in the financial regulators [has] increasingly replaced dependence on the corporate reputations of financial institutions.”), in THE OXFORD HANDBOOK OF CORPORATE REPUTATION, *supra* note 78, at 260, 268; John C. Coffee, Jr., *Systemic Risk After Dodd-Frank: Contingent Capital and the Need for Regulatory Strategies Beyond Oversight*, 111 COLUM. L. REV. 795, 815–16 (2011) (“[T]o maintain investor confidence and avert runs, financial regulators have long engaged in ‘safety and soundness’ regulation that is designed (at least in part) to convince creditors that their institution can handle sudden increases in . . . the rate of depositor withdrawal . . .”).

⁹⁵ MACEY, *supra* note 82, at 10.

⁹⁶ Hans Caspar von der Crone & Johannes Vetsch, *Reputation and Regulation, in REPUTATION CAPITAL: BUILDING AND MAINTAINING TRUST IN THE 21ST CENTURY* 179, 182–83 (Joachim Klewes & Robert Wreschniok eds., 2009).

⁹⁷ See Sharon Gilad, Moshe Maor & Pazit Ben-Nun Bloom, *Organizational Reputation, the Content of Public Allegations and Regulatory Communication*, 25 J. PUB. ADMIN. RES. & THEORY 451, 457–58 (2015) (noting that over-regulation and under-regulation are both potentially damaging to a regulator’s reputation); see also Ann-Marie Nienaber, Marcel Hofeditz & Rosalind H. Searle, *Do We Bank on Regulation or Reputation? A Meta-Analysis and Meta-Regression of Organization Trust in the Financial Services Sector*, 43 INT’L J. BANK

may reduce their efforts to comply with the law.⁹⁸ In essence, bank regulators substitute their reputations for the reputation of banks.

Federal deposit insurance is also a substitute for bank reputation.⁹⁹ Deposit insurance seeks to eliminate the incentive for depositors to run because the government promises insured depositors will receive their money whether they are the first to ask for it or not.¹⁰⁰ As long as depositors believe the government will honor the terms of the insurance, depositors have less incentive to participate in a bank run.

Although financial regulation and deposit insurance act as partial substitutes for bank reputation, they do so by relieving depositors of the incentive to monitor their banks.¹⁰¹ This creates moral hazard.¹⁰² Banks may be more willing to take risks (perhaps even reputation risks) because they know insured depositors are unlikely to run.¹⁰³ Consequently, regulators monitor banks' risk profiles.¹⁰⁴ In a sense then, much of banking regulation is aimed at reputation risk. Capital rules, liquidity rules, anti-fraud rules, asset

MARKETING 367, 378 (2014) (concluding “[s]trong regulations and control mechanisms have a greater effect on organizational trust in the financial industry than in other industries”).

⁹⁸ See MACEY, *supra* note 82, at 12 (“[I]f businesses think that the government will undermine their reputations by charging them with fraud falsely or unfairly, they will be less likely to invest in developing their reputations in the first place.”).

⁹⁹ See GARY GORTON, SLAPPED BY THE INVISIBLE HAND: THE PANIC OF 2007, at 159 (2010) (“Deposit insurance (possibly implicit) has been the (nearly) universal regulatory response to the possibility of banking panics because it eliminates the motivation for depositors to demand cash in exchange for deposits.”).

¹⁰⁰ Douglas W. Diamond & Philip H. Dybvig, *Bank Runs, Deposit Insurance, and Liquidity*, 91 J. POL. ECON. 401, 402 (1983).

¹⁰¹ See CARNELL, MACEY & MILLER, *supra* note 90, at 223 (“When deposit insurance enters the picture, depositors lose much of the incentive to monitor banks. They don’t care very much whether their bank is taking risks because they are certain to be paid even if the bank closed.”); John Crawford, *The Moral Hazard Paradox of Financial Safety Nets*, 25 CORNELL J.L. & PUB. POL’Y 95, 97 (2015) (“Creditors who believe the government will make them whole when the borrower defaults are unlikely to impose discipline on risky financial institutions by, for example charging higher interest rates to compensate for the risk of default.”).

¹⁰² See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 121 (5th ed. 1998) (describing moral hazard as “[t]he tendency of an insured to relax his efforts to prevent the occurrence of the risk that he has insured against because he had shifted the risk to an insurance company”).

¹⁰³ See Asli Demirgüç-Kunt & Edward J. Kane, *Deposit Insurance Around the Globe: Where Does It Work?*, 16 J. ECON. PERSP. 175, 176 (2002) (“Banks can offer high interest rates to depositors and in turn try to earn the money to pay those high interest rates by making high-risk loans. In this manner, both banks and depositors can engage in imprudent banking practices, secure in the knowledge that if the high-risk loans do not pay off, deposit insurance protects their principal.”).

¹⁰⁴ GORTON, *supra* note 99, at 160.

concentration rules, insider lending rules, and many more are all designed to give stakeholders confidence in banks and the banking industry.

Of course, regulators' job is not to eliminate all risk, or even all shareholder loss. That would be impossible and counterproductive.¹⁰⁵ Instead, regulators should focus on reducing risks that would cause widespread negative externalities. Against this backdrop, the question is not whether banks can be harmed by reputation risk. They can. The relevant question is whether regulating reputation risk directly enhances the regulatory framework. Regulators should only focus on reputation risk regulation if it can address harmful behavior that banking law would otherwise ignore. Can regulation of reputation risk reduce the likelihood that short-term debt holders will perceive the bank negatively, thus averting a run or panic? Can regulation of reputation risk reduce some of the moral hazard introduced by deposit insurance?¹⁰⁶ If so, direct regulation of reputation may be warranted. In claiming new responsibility, however, regulators should be mindful of their own reputations. If they regulate in a way that seems incompetent or unfair, they may destabilize the banking system.

III. REGULATING REPUTATION RISK

Before evaluating the efficacy of reputation risk regulation, it is useful to understand how it works. This Part describes how

¹⁰⁵ See George J. Benston & George G. Kaufman, *The Appropriate Role of Bank Regulation*, 106 *ECON. J.* 688, 692 (1996) (arguing that even bank failures, "distressing though they may be, are not externalities for which government intervention is justified"); Jennifer Shasky Calvery, Dir., Fin. Crimes Enf't Network, Speech at Mid-Atlantic AML Conference (Aug. 12, 2014), <https://www.fincen.gov/sites/default/files/2016-08/20140812.pdf> ("I think we can all agree that it is not possible for financial institutions to eliminate all risk.").

¹⁰⁶ Reputation risk regulation's ability to prevent panics might depend partly on the reason for the panic. Scholars have disagreed about the precise cause of banking panics. See Kathryn Judge, *Guarantor of Last Resort*, 97 *TEX. L. REV.* 707, 715–16 (2019) (discussing banking panic theories). To the extent that a panic is rooted in "random deposit withdrawals unrelated to changes in the real economy," prudential regulation of banks may have little impact. Franklin Allen, Ana Babus & Elena Carletti, *Financial Crises: Theory and Evidence*, 1 *ANN. REV. FIN. ECON.* 97, 99 (2009). Similarly, a panic rooted in concerns about general economic conditions might not be forestalled by reputation risk regulation aimed at individual banks. See *id.* at 100 (discussing the view that "crises are not random events, but responses of depositors to the arrival of sufficiently negative information on the unfolding economic circumstances").

reputation risk became part of the bank regulatory framework. Part IV discusses how reputation risk regulation is implemented through enforcement.

A. REGULATORS DEFINE REPUTATION RISK

As Part II illustrates, “[r]eputation[] risk in banking and finance is nothing new.”¹⁰⁷ Nevertheless, regulators were slow to specifically regulate reputation risk. Occasionally, policy makers would use reputation risk to justify a new regulation¹⁰⁸ or an administrative decision,¹⁰⁹ but mostly it lurked in the background as regulators concentrated on the banking basics of credit and market risk.¹¹⁰

All of that changed in the mid-1990s with a shift toward risk-focused regulation. Banks then had survived crises in the late 1980s.¹¹¹ The industry had consolidated.¹¹² Most banks were financially stable and making money.¹¹³ New technology and

¹⁰⁷ Walter, *supra* note 69, at 29–30 (noting that reputation risk “can be found in historical accounts dating at least to biblical times, cementing the ‘specialness’ of banking in the public discourse and engaging thinkers as diverse as Machiavelli, Adam Smith, Walter Bagehot, Frederick the Great and Alexander Hamilton”).

¹⁰⁸ For example, in the mid-1980s, Congress considered and ultimately passed more stringent money laundering laws. See Money Laundering Control Act of 1986, Pub. L. No. 99-570, 100 Stat. 3207-18 (codified as amended at 18 U.S.C. §§ 1956–57). That legislation was justified in part by the potential negative impact of money laundering on the reputation of banks and the banking industry. See 131 CONG. REC. 4,541 (1985) (statement of Rep. McCollum) (“Even if a financial institution is unwittingly made a conduit for laundering, the mere fact that money launderers saw fit to use that institution may seriously affect the public’s perception of the institution.” (quoting PRESIDENT’S COMM’N ON ORGANIZED CRIME, THE CASH CONNECTION: ORGANIZED CRIME, FINANCIAL INSTITUTIONS, AND MONEY LAUNDERING 62 (1984))).

¹⁰⁹ See Office of the Comptroller of the Currency, Interpretive Letter on Exercise of Trust Powers: Collective Investment Funds (June 23, 1992), 1992 WL 486902 (denying a bank’s request not to disclose possible fluctuation in the value of a taxable common trust fund because “prudent banking practices require the Bank to provide this information to limit legal and reputational risk in the event a customer claimed he or she was misled about the nature of the product”).

¹¹⁰ See Rossi, *supra* note 31 (“In general the banking sector has not historically placed a high priority on reputational risk—compared to credit, market or operational risks.”).

¹¹¹ See Susan M. Phillips, Governor, Fed. Reserve Sys., Remarks at Houston Baptist University: Trends and Challenges in Federal Reserve Bank Supervision (Oct. 30, 1997), <https://www.federalreserve.gov/boarddocs/speeches/1997/19971030.htm> (“By the end of the 1980s, more than 200 banks were failing annually, and there were more than 1,000 banks on the FDIC problem list.”).

¹¹² See *id.* (“The number of independent commercial banking organizations has declined 40 percent since 1980 to 7,400 in June of [1987].”).

¹¹³ *Id.*

financial products led to an evolution of the business of banking.¹¹⁴ From credit cards to derivatives, banks were considering activities and products with which they and their regulators had little experience.¹¹⁵ Eye-popping derivative losses in other industries emphasized that new financial products brought risk.¹¹⁶ And finance increasingly became an international industry.¹¹⁷

In response to this changing landscape, policymakers and financial regulators across the globe focused on risk regulation.¹¹⁸ In the United States, the OCC and the Federal Reserve both developed new “risk-focused” supervisory approaches.¹¹⁹ The NCUA

¹¹⁴ *Id.*

¹¹⁵ See Eugene A. Ludwig, Comptroller, Office of the Comptroller of the Currency, Remarks at Georgetown University Center for Business-Government Relations (Sept. 26, 1995), <https://www.occ.treas.gov/news-issuances/speeches/1995/nr-occ-1995-101a.pdf> (discussing the rise of Internet transactions, an increase in consumer lending through credit cards and mortgages, and the development of mutual funds and major financial innovations); see also Douglas E. Harris, Senior Deputy Comptroller for Capital Mkts., Office of the Comptroller of the Currency, Remarks Before the Bankers Roundtable Lawyers Council on Bank Derivatives Activities (May 18, 1995) (noting “the notional amount of U.S. banks’ over-the-counter derivatives had grown to \$11.5 trillion” in 1993), in 14 OCC Q.J. no. 3, 1994-95, at 59.

¹¹⁶ In 1993, the German conglomerate Metallgesellschaft AG disclosed derivatives losses in excess of \$1 billion. See Narayanan Jayaraman & Milind Shrikhande, *Financial Distress and Recovery at Metallgesellschaft AG: The Role of Corporate Governance and Bankruptcy Laws*, FIN. PRAC. & EDUC., Fall/Winter 1997, at 7–18. In 1994, Orange County declared bankruptcy after its derivatives investments soured. Floyd Norris, *Orange County’s Bankruptcy: The Overview*, N.Y. TIMES, Dec. 8, 1994, at D1. And in 1995, Barings Bank, the oldest British investment bank, collapsed after a rogue derivatives trader racked up \$2.2 billion in losses. See Laura Proctor, Note, *The Barings Collapse: A Regulatory Failure, or a Failure of Supervision?*, 22 BROOK. J. INT’L L. 735, 737–42 (1997).

Other scholars have linked the international emergence of operational risk regulation to these scandals. See Michael Power, *The Invention of Operational Risk*, 12 REV. INT’L POL. ECON. 577, 579 (2005) (stating that the derivatives scandals of the 1990s were “retrospectively constructed as an ‘operational risk’ management failure”). Because reputation risk emerged alongside operational risk in the new risk-centered regulatory approaches, it makes sense to consider these scandals as part of the landscape that germinated reputation risk. Cf. Harris, *supra* note 115 (discussing prominent derivatives scandals in the context of the OCC’s risk-based derivative regulation).

¹¹⁷ See Ludwig, *supra* note 115 (“We see the increasing globalization of financial markets. The foreign exchange market has evolved from a \$1 billion-a-day business in 1974 to one where \$1 trillion is traded daily.”).

¹¹⁸ See Power, *supra* note 116, at 582 (describing increased international attention in bank risk management in the mid-1990s).

¹¹⁹ FED. RESERVE, RISK MANAGEMENT PROCESSES, *supra* note 27 (announcing examiners would begin to assign “a formal supervisory rating to the adequacy of an institution’s risk management processes, including its internal controls”); Harris, *supra* note 115 (explaining the Federal Reserve adopted a “risk-oriented supervisory approach for many new financial instruments”); Ludwig, *supra* note 115 (announcing a “new program [called] ‘supervision by risk’”).

adopted its own risk-focused approach several years later.¹²⁰ Of the four primary federal bank regulators, only the FDIC declined to adopt risk-focused supervision.¹²¹

The first task for implementing risk-focused supervision was to define a list of risks that would be monitored.¹²² Although each regulator's list of risks was slightly different, each chose to include reputation risk. According to the OCC:

Reputation risk is the risk to earnings or capital arising from negative public opinion. This affects the institution's ability to establish new relationships or services, or continue servicing existing relationships. This risk can expose the institution to litigation, financial loss, or damage to its reputation. Reputation risk exposure is present throughout the organization and includes the responsibility to exercise an abundance of caution in dealing with its customers and community. This risk is present in such activities as asset management and agency transactions.¹²³

Later, the OCC broadened the definition in two ways. First, the OCC lengthened the list of stakeholders beyond "customers and community." Under the current definition, bank "management should deal prudently with stakeholders, such as customers, counterparties, correspondents, investors, regulators, employees, and the community."¹²⁴ The OCC also broadened the definition to include risks beyond those to earnings and capital.¹²⁵ Now

¹²⁰ NAT'L CREDIT UNION ADMIN., LETTER NO. 02-FCU-09, RISK-FOCUSED EXAMINATION PROGRAM (May 2002) [hereinafter NCUA, RISK FOCUSED EXAMINATION PROGRAM].

¹²¹ See PRICEWATERHOUSECOOPERS, THE REGULATORY RISK MANAGEMENT HANDBOOK 19 (2001-2002) ("Unlike the OCC and the [Federal Reserve], the FDIC has not developed a catalog of named risks to which an institution may be exposed.").

¹²² See Ludwig, *supra* note 115 ("[I]t was necessary for the OCC to define a common set of risks for our supervision staff to focus on, or if you will a common vocabulary of risk.").

¹²³ *Id.*

¹²⁴ OCC, LARGE BANK SUPERVISION HANDBOOK 2018, *supra* note 26, at 64. The "prudently manage" language was included in 2018. Earlier versions stated: "Reputation risk . . . requires management to exercise an abundance of caution in dealing with stakeholders, such as customers, counterparties, correspondents, investors, regulators, employees, and the community." OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER'S HANDBOOK: LARGE BANK SUPERVISION 65 (2017).

¹²⁵ See OFFICE OF THE COMPTROLLER OF THE CURRENCY, OCC BULL. NO. 2015-48, RISK ASSESSMENT SYSTEM (Dec. 3, 2015) [hereinafter OCC, RISK ASSESSMENT SYSTEM] (explaining

“[r]eputation risk is the risk to current or projected financial condition and resilience arising from negative public opinion.”¹²⁶

The Federal Reserve’s definition was less verbose: “Reputational risk is the potential that negative publicity regarding an institution’s business practices, whether true or not, will cause a decline in the customer base, costly litigation, or revenue reductions.”¹²⁷ Like the OCC’s definition, it focused on harm from “negative publicity,” but unlike the OCC, the Federal Reserve explicitly noted that the negative publicity need not be true.¹²⁸ The Federal Reserve still uses this definition of reputation risk.¹²⁹

The NCUA’s definition of reputation risk was the most succinct: “Risk of negative public opinion or perception leading to a loss of confidence and/or severance of relationships.”¹³⁰ The NCUA later revised its definition to more closely match the OCC’s. Currently the NCUA Examiner’s Guide provides:

Reputation risk is the current and prospective risk to earnings or net worth arising from negative public opinion or perception. Reputation risk affects the credit union’s ability to establish new relationships or services, or to continue servicing existing relationships. This risk, which occurs in activities such as asset management decisions and transactions, can expose the credit union to litigation, financial loss, or a decline in membership base.¹³¹

The next step was for the regulators to develop a system for evaluating reputation risk at financial institutions. The OCC armed examiners with a non-exhaustive, non-mandatory checklist of items

the definition was broadened to include considerations of “the bank’s ability to withstand periods of stress”). This 2015 Bulletin is now incorporated into OCC, LARGE BANK SUPERVISION HANDBOOK 2018, *supra* note 26, as stated in OFFICE OF THE COMPTROLLER OF THE CURRENCY, OCC BULL. NO. 2018-18, COMPTROLLER’S HANDBOOK: REVISED AND UPDATED BOOKLETS AND RECESSIONS (June 28, 2018).

¹²⁶ OCC, LARGE BANK SUPERVISION HANDBOOK 2018, *supra* note 26, at 64.

¹²⁷ FED. RESERVE, RISK MANAGEMENT PROCESSES, *supra* note 27.

¹²⁸ *Id.*

¹²⁹ BD. OF GOVERNORS OF THE FED. RESERVE SYS., DIV. OF SUPERVISION & REGULATION, COMMERCIAL BANK EXAMINATION MANUAL § 1012.1 (May 2019 ed. 2016) [hereinafter FED. RESERVE BANK EXAMINATION MANUAL].

¹³⁰ NCUA, RISK FOCUSED EXAMINATION PROGRAM, *supra* note 120.

¹³¹ NCUA EXAMINER’S GUIDE, *supra* note 26 (click to second tab, then follow “Risk-Focused Examination” hyperlink; click to fourth tab, then follow “Risk Categories” hyperlink).

to consider for each type of risk.¹³² The OCC has adjusted the list over the years and now requires that examiners, at a minimum, consider:

- The bank's core values and conduct of employees.
- Volume and types of assets and number of accounts under management or administration.
- Number and types of third-party relationships.
- Merger and acquisition plans and opportunities.
- Potential or planned entrance into new businesses, product lines, or technologies (including new delivery channels), particularly those that may test legal boundaries.
- Nature and amount of exposure from litigation, monetary penalties, violations of laws and regulations, and customer complaints.
- The market's or public's perception of the bank's financial stability.
- The market's or public's perception of the quality of the bank's products and services.
- Effect of economic, industry, and market conditions; legislative and regulatory change; technological advances; and competition.¹³³

Recognizing that reputation risk was "less quantifiable" than credit or market risk,¹³⁴ OCC examiners initially only decided if the

¹³² OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER'S HANDBOOK: BANK SUPERVISION AND EXAMINATION PROCESS: LARGE BANK SUPERVISION, Appendix A: Risk Assessment System (Dec. 1995) [hereinafter OCC, LARGE BANK SUPERVISION HANDBOOK 1995]. The OCC established a similar set of factors for assessing reputation risk at small banks. OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER'S HANDBOOK: BANK SUPERVISION PROCESS 24 (Apr. 1996) [hereinafter OCC, BANK SUPERVISION PROCESS HANDBOOK 1996] (describing the evaluation process for large and small banks); OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER'S HANDBOOK: COMMUNITY BANK SUPERVISION HANDBOOK 187–88 (July 2003) [hereinafter OCC, COMMUNITY BANK SUPERVISION HANDBOOK 2003] (assessing, among other things, whether management "adequately responds to changes of a market or regulatory nature" and "adequately self-polices risks").

¹³³ OCC, LARGE BANK SUPERVISION HANDBOOK 2018, *supra* note 26, at 30–31.

¹³⁴ OCC, LARGE BANK SUPERVISION HANDBOOK 1995, *supra* note 132, at Introduction (noting strategic risk and reputation risk "affect the bank's franchise value but are not direct risks that examiners can precisely measure in an examination").

composite reputation risk was high, moderate, or low and whether reputation risk was increasing, decreasing, or stable.¹³⁵ In 2015, however, the OCC revised its guidance to additionally assess the quality of reputation risk management.¹³⁶ When determining the quality of reputation risk management, examiners consider the bank's past performance in managing reputation risk, risk management policies and procedures, responsiveness to changes and complaints, and stakeholder and social media communications.¹³⁷

Similarly, the Federal Reserve instructed its examiners to begin assigning "a formal supervisory rating to the adequacy of an institution's risk management processes, including its internal controls."¹³⁸ Examiners assign a number on a 1 to 5 scale.¹³⁹ A "1" rating indicates "that management effectively identifies and controls all major types of risk posed by the institution's activities," but a "5" "indicates a critical absence of effective risk management practices."¹⁴⁰ In assigning the management rating, examiners consider whether the bank has the following:

- active board and senior management oversight;
- adequate policies, procedures, and limits;
- adequate risk measurement, monitoring, and management information systems; and
- comprehensive internal controls.¹⁴¹

Unlike OCC examiners, Federal Reserve examiners do not consider reputation risk independently. Rather, it is one of the types of risk examiners consider in reviewing the institution's risk management systems.¹⁴² In 2016, the Federal Reserve revised the review of risk management systems at institutions with assets less

¹³⁵ *Id.* at app. B; OCC, BANK SUPERVISION PROCESS HANDBOOK 1996, *supra* note 132, at 23–24; OCC, COMMUNITY BANK SUPERVISION HANDBOOK 2003, *supra* note 132, at 187.

¹³⁶ See OCC, RISK ASSESSMENT SYSTEM, *supra* note 125; see also *supra* note 125 (noting the incorporation of this bulletin into the 2018 Handbook).

¹³⁷ OCC, LARGE BANK SUPERVISION HANDBOOK 2018, *supra* note 26, at 31 (listing the core assessment factors examiners are required to review to determine the quality of reputation risk management).

¹³⁸ FED. RESERVE, RISK MANAGEMENT PROCESSES, *supra* note 27.

¹³⁹ *Id.*

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² *Id.*

than \$50 billion.¹⁴³ The new guidance for smaller institutions does not discuss reputation risk.¹⁴⁴ Nevertheless, the earlier guidance including reputation risk still applies to large institutions.¹⁴⁵

The NCUA's system considers each of seven risk categories, including reputation risk, individually. Examiners assess whether the level of each risk is low, moderate, or high.¹⁴⁶ The examiners also assess the "direction of risk (increasing, decreasing, or unchanged)."¹⁴⁷ The NCUA provides its examiners with a guidance document containing a list of factors and characteristics that would classify a credit union as low, moderate, or high risk.¹⁴⁸ For example, if "[v]iolations, noncompliance, or litigation are insignificant, as measured by their number or seriousness," the credit union could be rated a low reputation risk.¹⁴⁹ But if "[v]iolations, noncompliance, or litigation expose the credit union to significant impairment of reputation, value, earnings, or business opportunity" the credit union should be rated as a high reputation risk.¹⁵⁰ The NCUA also considers, among other things, a credit union's ability to respond to change, implement risk management policies and procedures, address complaints and errors, and train its employees.¹⁵¹

B. FEDERAL REGULATION

Once federal regulators included reputation risk in the lists of official risks, it became ubiquitous. Regulators warn reputation risk is everywhere.¹⁵² They began adding references to reputation risk in all types of agency guidance.

¹⁴³ See BD. OF GOVERNORS OF THE FED. RESERVE SYS., SR 16-11, SUPERVISORY GUIDANCE FOR ASSESSING RISK MANAGEMENT AT SUPERVISED INSTITUTIONS WITH TOTAL CONSOLIDATED ASSETS LESS THAN \$50 BILLION (June 8, 2016).

¹⁴⁴ *Id.* (identifying only credit, market, liquidity, operational, compliance and legal risk).

¹⁴⁵ *Id.* (stating that OCC, RISK MANAGEMENT PROCESSES, *supra* note 27, "remains applicable to state member banks and bank holding companies with \$50 billion or more in total assets until superseding guidance is issued for these institutions").

¹⁴⁶ NCUA EXAMINER'S GUIDE, *supra* note 26.

¹⁴⁷ *Id.*

¹⁴⁸ NCUA, RISK FOCUSED EXAMINATION PROGRAM, *supra* note 120.

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² See NCUA EXAMINER'S GUIDE, *supra* note 26 ("Reputation risk exposure appears throughout the credit union organization."); OCC, LARGE BANK SUPERVISION HANDBOOK 2018, *supra* note 26, at 64 ("Reputation risk is inherent in all bank activities . . ."); OFFICE OF THE COMPTROLLER OF THE CURRENCY, BD. OF GOVERNORS OF THE FED. RESERVE SYS., FED.

In 1996 alone, the OCC issued four bulletins with significant discussion of reputation risk. The bulletins covered stored value cards,¹⁵³ data communications networks,¹⁵⁴ securitization,¹⁵⁵ and credit derivatives.¹⁵⁶ In each bulletin, the OCC explained how the product or service posed reputation risk. For example, the OCC warned:

Because credit derivatives are new and take many different forms, the OCC is concerned that dealer banks may enter into transactions with counterparties that do not fully understand the terms and risks of the transactions. These risks could expose the bank to litigation, financial loss, or damage to its reputation.¹⁵⁷

In 1996, the OCC re-wrote portions of its examination manuals covering credit card lending, mortgage banking, and allowances for loan and lease losses to include detailed discussions of reputation risk in those contexts.¹⁵⁸

The other federal regulators also began integrating reputation risk into their supervisory framework. Even the FDIC, who had not adopted a risk-centered regulatory approach,¹⁵⁹ started referencing

DEPOSIT INS. CORP. & OFFICE OF THRIFT SUPERVISION, INTERAGENCY STATEMENT ON THE PURCHASE AND RISK MANAGEMENT OF LIFE INSURANCE (Dec. 7, 2004) [hereinafter INTERAGENCY STATEMENT ON LIFE INSURANCE], <https://www.federalreserve.gov/boarddocs/srletters/2004/SR0419a1.pdf> (noting that reputation risk “arises from virtually all bank products and services”).

¹⁵³ OFFICE OF THE COMPTROLLER OF THE CURRENCY, OCC BULL. NO. 96-48, STORED VALUE CARD SYSTEM: INFORMATION FOR BANKERS AND EXAMINERS (Sept. 10, 1996) [hereinafter OCC, STORED VALUE BULLETIN].

¹⁵⁴ OFFICE OF THE COMPTROLLER OF THE CURRENCY, OCC BULL. NO. 96-39, DATA COMMUNICATIONS NETWORKS (July 24, 1996).

¹⁵⁵ OFFICE OF THE COMPTROLLER OF THE CURRENCY, OCC BULL. NO. 96-52, SECURITIZATION (Sept. 25, 1996).

¹⁵⁶ OFFICE OF THE COMPTROLLER OF THE CURRENCY, OCC BULL. NO. 96-43, CREDIT DERIVATIVES: GUIDELINE FOR NATIONAL BANKS (Aug. 12, 1996).

¹⁵⁷ *Id.*

¹⁵⁸ OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER'S HANDBOOK: ASSETS, ALLOWANCE FOR LOAN AND LEASE LOSSES, RISKS ASSOCIATED WITH THE ALLOWANCE (June 1996); OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER'S HANDBOOK: ASSETS, CREDIT CARD LENDING, RISKS ASSOCIATED WITH CREDIT CARD LENDING (Oct. 1996); OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER'S HANDBOOK: OTHER INCOME PRODUCING ACTIVITIES, MORTGAGE BANKING, RISKS ASSOCIATED WITH MORTGAGE BANKING (Mar. 1996).

¹⁵⁹ See *supra* note 121 and accompanying text.

reputation risk in its guidance.¹⁶⁰ Together, the federal regulators revamped the uniform system for rating the safety and soundness of financial institutions.¹⁶¹ The revised system kept the long-used CAMELS (capital, assets, management, earnings, liquidity, and sensitivity to market risk) rating factors, but clarified that reputation risk should be considered when rating asset quality and management.¹⁶² Later the regulators collaborated on guidance for reverse mortgage products and social medial management.¹⁶³ Both guidance documents emphasized reputation risk.¹⁶⁴

Now when regulators offer guidance on bank products or practices, the guidance often includes a discussion of reputation risk. For example, bank-owned life insurance poses reputation risk particularly if the bank materially gains from the death of an officer or employee.¹⁶⁵ Offering overdraft protection on deposit accounts poses reputation risk because “[b]anks may be subject to negative news coverage and public scrutiny from reports of high fees and customers taking out multiple advances to cover prior advances and everyday expenses.”¹⁶⁶ Selling foreclosed residential property poses reputation risk, especially when “disposition practices . . . favor, as

¹⁶⁰ See, e.g., FED. DEPOSIT INS. CORP., FIL-48-97, NEW EXAMINATION PROCEDURES FOR RETAIL NONDEPOSIT INVESTMENT PRODUCT SALES (May 7, 1997) (explaining “poor disclosures, inappropriate investment recommendations, or even fraudulent practices” can lead to reputation risk in a bank’s marketing of mutual funds, annuities, and other nondeposit investment products).

¹⁶¹ Uniform Financial Institutions Rating System, 61 Fed. Reg. 67,021, 67,027 (Dec. 19, 1996).

¹⁶² *Id.*

¹⁶³ Reverse Mortgage Products: Guidance for Managing Compliance and Reputation Risks, 74 Fed. Reg. 66,652 (Dec. 16, 2009); Social Media: Consumer Compliance Risk Management Guidance, 78 Fed. Reg. 76,297 (Dec. 17, 2013).

¹⁶⁴ Social Media: Consumer Compliance Risk Management Guidance, 78 Fed. Reg. 76,297, 76,303 (Dec. 17, 2013) (“Privacy and transparency issues, as well as other consumer protection concerns, arise in social media environments. Therefore, a financial institution engaged in social media activities is expected to be sensitive to, and properly manage, the reputation risks that arise from those activities.”); Reverse Mortgage Products: Guidance for Managing Compliance and Reputation Risks, 74 Fed. Reg. 66,652, 66,657 (Dec. 16, 2009) (explaining that because reverse mortgages are “offered to borrowers who typically have limited income and few assets other than the home securing the loan . . . lenders must institute controls to protect consumers and to minimize the . . . reputation risks”).

¹⁶⁵ INTERAGENCY STATEMENT ON LIFE INSURANCE, *supra* note 152.

¹⁶⁶ OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER’S HANDBOOK: DEPOSIT-RELATED CREDIT 8 (Mar. 2015).

purchasers of foreclosed properties, investors (paying cash) over owner-occupants (paying with financing).¹⁶⁷

Regulators also warn about third-party reputation risk; they worry that if a bank does business with a third party with a bad reputation, the bad reputation might rub off on the bank.¹⁶⁸ For example, selling delinquent consumer debt to debt buyers poses reputation risk “if consumers continue to view themselves as bank customers” and the debt purchaser engages in “abusive practices.”¹⁶⁹ Similarly, offering stored value cards poses reputation risk because stakeholders might blame the bank if the issuer of the cards goes bankrupt or if the cards experience “malfunctions or security breaches.”¹⁷⁰

Regulators raise reputational risk concerns even when the third party’s bad reputation is not directly related to banking. For example, “[l]ending to [oil and gas] companies found or perceived by the public to be negligent in preventing environmental damage, hazardous accidents, or weak fiduciary management can damage a bank’s reputation.”¹⁷¹ The FDIC sums up third-party reputation risk this way: “any negative publicity involving the third party, whether or not the publicity is related to the institution’s use of the third party,” could damage the reputation of the bank.¹⁷²

Slowly but surely, reputation risk worked its way into nearly every aspect of banking regulatory guidance. Today, the Federal Reserve’s bank examination manual uses “reputation” or “reputational” 184 times.¹⁷³ The FDIC’s risk management manual

¹⁶⁷ OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER’S HANDBOOK: OTHER REAL ESTATE OWNED 15 (Sept. 2013).

¹⁶⁸ See BD. OF GOVERNORS OF THE FED. RESERVE SYS., SR 13-19 / CA 13-21, GUIDANCE ON MANAGING OUTSOURCING RISK (Dec. 5, 2013) (“Reputational risks arise when actions or poor performance of a service provider causes the public to form a negative opinion about a financial institution.”); OCC, THIRD-PARTY RELATIONSHIP GUIDANCE, *supra* note 28 (“Third-party relationships that do not meet the expectations of the bank’s customers expose the bank to reputation risk. Poor service, frequent or prolonged service disruptions, significant or repetitive security lapses, inappropriate sales recommendations, and violations of consumer law and other law can result in . . . negative perceptions in the marketplace.”).

¹⁶⁹ OFFICE OF THE COMPTROLLER OF THE CURRENCY, OCC BULL. NO. 2014-37, CONSUMER DEBT SALES: RISK MANAGEMENT GUIDANCE (Aug. 4, 2014).

¹⁷⁰ OCC, STORED VALUE CARD BULLETIN, *supra* note 153.

¹⁷¹ OCC, OIL AND GAS LENDING HANDBOOK, *supra* note 51.

¹⁷² FDIC, THIRD-PARTY RISK GUIDANCE, *supra* note 28.

¹⁷³ FED. RESERVE BANK EXAMINATION MANUAL, *supra* note 129.

uses “reputation” 51 times.¹⁷⁴ The OCC’s large bank examination manual uses “reputation” 58 times.¹⁷⁵ The NCUA’s examination manual uses “reputation” more than 125 times.¹⁷⁶ Even specialized examination manuals, like those for information technology¹⁷⁷ and anti-money laundering¹⁷⁸ are replete with references to reputation. This is impressive considering that reputation risk was hardly mentioned twenty-five years ago.

While references to reputation risk are most prevalent in federal agency guidance, reputation risk has also worked its way into some banking rules. OCC rules governing banks’ investment in securities require that banks consider reputation risk.¹⁷⁹ The NCUA’s rules governing capital planning require that credit unions consider reputation risk.¹⁸⁰ And rules requiring that financial institutions maintain programs to detect and prevent identity theft discuss accounts that pose reputation risk.¹⁸¹

C. STATE REGULATION

Because financial institutions in the United States can be chartered by either the federal or state government, states can also regulate bank reputation risk.¹⁸² A survey of reputation risk

¹⁷⁴ FED. DEPOSIT INS. CORP, RISK MANAGEMENT MANUAL OF EXAMINATION POLICIES (Dec. 2019 ed.), <https://www.fdic.gov/regulations/safety/manual/> [hereinafter FDIC, RISK MANAGEMENT MANUAL].

¹⁷⁵ OCC, LARGE BANK SUPERVISION HANDBOOK 2018, *supra* note 26.

¹⁷⁶ The NCUA Examiner’s Guide is currently in a state flux spread partly between chapters in Portable Document Format and a new online web-linked version. The total count includes both portions of the guide. NCUA EXAMINER’S GUIDE, *supra* note 26; NAT’L CREDIT UNION ADMIN., EXAMINER’S GUIDE (2002), <https://www.ncua.gov/regulation-supervision/Pages/manuals-guides/examiners-guide.aspx> (linking to PDF chapters).

¹⁷⁷ The interagency information technology examination handbook uses variants of the word “reputation” 103 times. FED. FIN. INST. EXAMINATION COUNCIL, IT EXAMINATION HANDBOOK (2016), <https://ithandbook.ffiec.gov/it-booklets.aspx>.

¹⁷⁸ The interagency anti-money laundering examination handbook mentions “reputation” ten times. FED. FIN. INST. EXAMINATION COUNCIL, BANK SECRECY ACT/ANTI-MONEY LAUNDERING HANDBOOK (2014), https://bsaaml.ffiec.gov/docs/manual/BSA_AML_Man_2014_v2_CDDBO.pdf.

¹⁷⁹ 12 C.F.R. § 1.5 (2018).

¹⁸⁰ 12 C.F.R. § 702.504 (2018).

¹⁸¹ 12 C.F.R. § 41.90 (2018) (OCC); 12 C.F.R. § 222.90 (2018) (Federal Reserve); 12 C.F.R. § 334.90 (2018) (FDIC); 12 C.F.R. § 717.90 (NCUA).

¹⁸² See 12 U.S.C. § 1813(a)(2) (2012) (defining the term “[s]tate bank” as “any bank . . . incorporated under the law of any state”); 12 C.F.R. § 5.20 (2018) (describing the OCC’s process for chartering a national bank); Cassandra Jones Havard, “Goin’ Round in Circles” . . . and Letting the Bad Loans Win: When Subprime Lending Fails Borrowers: The

regulation in each state is beyond the scope of this article. Still, the New York bank regulator's approach is instructive.¹⁸³ Of the state banking regulators, New York's arguably has the most influence because it regulates the most financial institution assets.¹⁸⁴ Moreover, it has a reputation as an aggressive regulator.¹⁸⁵

As federal regulators began to integrate reputation risk in the regulatory framework, so did New York. For foreign bank branches, the New York Department of Financial Services conducts its examinations jointly with the Federal Reserve and generally follows its procedures.¹⁸⁶ Thus, when the Federal Reserve began considering reputation risk, so did New York.¹⁸⁷

New York's regulatory guidance also discusses reputation risk. For example, when New York considers a bank's application to offer a new financial product, the regulator expects the bank to address

Need for Uniform Broker Regulation, 86 NEB. L. REV. 737, 766 (2008) (describing the supervisory authority of both federal and state regulators).

¹⁸³ Prior to 2011, New York-chartered financial institutions were regulated by the State of New York Banking Department. In 2011, the New York State Legislature consolidated the Banking Department and the Insurance Department into a single entity called the New York State Department of Financial Services. N.Y. FIN. SERVS. LAW § 102 (McKinney 2018).

¹⁸⁴ See Ken Sweet, *Wells Fargo under Fire, This Time for Insurance: At Least 3 Lawsuits Filed Against Bank over Car Practices*, CHI. TRIB., Aug. 8, 2017, at C2 (calling the New York Department of Financial Services "a banking regulator with an outsized role in overseeing the industry because of the number of banks based in New York"); *State-Chartered Banks by State*, CONF. OF ST. BANK SUPERVISORS (Oct. 17, 2019), <https://www.csbs.org/state-chartered-banks-state> (noting New York has 87 state-chartered banks with collectively more than \$900 billion in total assets). In addition, New York regulates foreign banking organizations with U.S. branches or offices located in New York. N.Y. DEP'T OF FIN. SERVS. ANNUAL REPORT 22 (2017), https://www.dfs.ny.gov/docs/reportpub/annual/dfs_annualrpt_2017.pdf.

¹⁸⁵ See Kristin Broughton, *Bad Actors, Beware: N.Y. Gov. Cites Wells Fargo in Calling for 'Bold Steps'*, AM. BANKER (MAGAZINE), Feb. 1, 2017, at 8 (stating the New York State Department of Financial Services is "widely viewed as one of the nation's most aggressive state regulators").

¹⁸⁶ See BD. OF GOVERNORS OF THE FED. RESERVE SYS., EXAMINATION MANUAL FOR U.S. BRANCHES AND AGENCIES OF FOREIGN BANKING ORGANIZATIONS § 1000.1 (Sept. 1997) (noting the Federal Reserve's manual was prepared with assistance from the New York regulator and "reflects general policies and procedures to be used in conducting examination of individual branches and agencies of foreign banking organizations"); see also *Client Update: The Rise in Foreign Bank Enforcement Actions in New York*, DEBEVOISE & PLIMPTON, L.L.P. (July 1, 2013), https://www.debevoise.com/~media/files/insights/publications/2013/07/the%20rise%20in%20foreign%20bank%20enforcement%20actions%20in%20___/files/view%20client%20update/fil_eattachment/theriseinforeignbankenforcementactionsinnewyork.pdf ("DFS does not have a separate examination manual, but rather generally follows the approach of the FRB.").

¹⁸⁷ See generally BD. OF GOVERNORS OF THE FED. RESERVE SYS., *supra* note 186 (using the word "reputation" or "reputational" 21 times).

the reputation risk posed by the product.¹⁸⁸ New York has issued guidance that subprime mortgage products,¹⁸⁹ derivative transactions,¹⁹⁰ incentive compensation arrangements,¹⁹¹ bank-owned life insurance,¹⁹² cyber fraud,¹⁹³ and debit cards¹⁹⁴ pose reputation risk.

Consistent with its reputation as an aggressive regulator, some of the New York regulator's guidance uses a zealous tone. For example, on payday lending, the guidance states:

Banks that offer [payday] loans may export the interest rate permitted in their home state. However, banks that choose to offer this type of loan product at exorbitant interest rates are blatantly abusing this authority. These types of actions, when judged in the court of public opinion, can lead to a groundswell of outrage resulting in reputational harm and safety and soundness problems.¹⁹⁵

Similarly, on providing services to gun rights groups, the guidance states:

¹⁸⁸ See generally STATE OF N.Y. BANKING DEP'T, ALL INSTITUTIONS LETTER CONCERNING BANKING DEPARTMENT PROCEDURES FOR REVIEW AND/OR APPROVAL OF CERTAIN NEW PRODUCTS OF BANKING ORGANIZATIONS (Jan. 10, 2007), 2007 WL 7950795.

¹⁸⁹ See STATE OF N.Y. BANKING DEP'T, STATEMENT ON SUBPRIME MORTGAGE LENDING (July 30, 2007), 2007 WL 7950804 (criticizing adjustable rate mortgages targeted to subprime borrowers with little documentation of borrowers' income).

¹⁹⁰ See STATE OF N.Y. BANKING DEP'T, SUPPLEMENTAL GUIDANCE OF PROCEDURE FOR REVIEW AND/OR APPROVAL OF CERTAIN NEW PRODUCTS/ACTIVITIES OF BANKING ORGANIZATIONS (Oct. 25, 2010), 2010 WL 9444769 ("[O]ffering and trading complex products such as derivatives . . . can easily subject the institution to undue risks, including litigation or reputation risk.").

¹⁹¹ See STATE OF N.Y. DEP'T OF FIN. SERVS., RE: GUIDANCE ON INCENTIVE COMPENSATION ARRANGEMENTS (Oct. 11, 2016), 2016 WL 6141359 (explaining, in the aftermath of the Wells Fargo fake account scandal, that rewarding employees for sales could pose compliance and reputation risks).

¹⁹² See STATE OF N.Y. BANKING DEP'T, GUIDANCE ON BANK OWNED LIFE INSURANCE (BOLI) PROGRAMS (Jan. 6, 2003), 2003 WL 26454151 (instructing that when a bank purchases bank-owned life insurance as part of a management compensation program, the amount of the insurance should be "appropriate" and adequately disclosed to shareholders).

¹⁹³ See STATE OF N.Y. BANKING DEP'T, INDUSTRY LETTER: ALERT TO INCREASED CYBER FRAUD THROUGH WEB-BASED PAYMENT SERVICES (Sept. 23, 2010), 2010 WL 9444765 (noting new FDIC guidance on cyber fraud and its reputational risk).

¹⁹⁴ See STATE OF N.Y. BANKING DEP'T, BEST PRACTICES FOR ISSUERS OF DEBIT CARDS (Jan. 1, 2004), 2004 WL 6219932.

¹⁹⁵ STATE OF N.Y. BANKING DEP'T, PAYDAY LOANS (June 13, 2000), 2000 WL 36094619.

[T]he Department encourages its chartered and licensed financial institutions to continue evaluating and managing their risks, including reputational risks that may arise from their dealings with the NRA or similar gun promotion organizations, if any, as well as continued assessment of compliance with their own codes of social responsibility. The Department encourages regulated institutions to review any relationships they have with the NRA or similar gun promotion organizations, and to take prompt actions to manage these risks and promote public health and safety.¹⁹⁶

In these instances, New York's regulatory guidance discourages controversial, but otherwise legal, practices due to reputation risk.

IV. ENFORCING REPUTATION RISK

As Part III explains, federal and state bank regulators see reputation risk throughout banking. Regulators' guidance recommends that banks consider and manage the reputation risk of various products, services, and practices. Regulators, of course, do not just offer helpful tips for running a profitable bank—regulators are tasked with enforcing the law. In banking, it is especially important to understand how regulators exercise their enforcement powers. Enforcement sometimes diverges from regulations¹⁹⁷ and guidance.¹⁹⁸

This Part first discusses regulators' authority to bring enforcement actions based on reputation risk as well as their public statements about when enforcement is warranted. It then examines formal and informal enforcement efforts discussing reputation risk. This Part concludes that although authority to regulate reputation is ambiguous, regulators sometimes regulate nonetheless. In most

¹⁹⁶ Vullo Letter, *supra* note 44.

¹⁹⁷ For example, regulators allow some banks to service state-legal marijuana businesses even though accepting those funds likely violates anti-money laundering laws. See Julie Andersen Hill, *Banks, Marijuana, and Federalism*, 65 CASE WESTERN RES. L. REV. 597, 607–17, 632–33 (2015).

¹⁹⁸ Julie Andersen Hill & Douglas K. Moll, *The Duty of Care of Bank Directors and Officers*, 68 ALA. L. REV. 965, 1007–10 (2017) (explaining the FDIC brings negligence claims against directors of failed banks even though its guidance suggests it does not bring such negligence claims).

enforcement actions, reputation risk is an ancillary consideration to other practices that violate the law or are financially risky. Regulators, however, sometimes use reputation risk to justify enforcement measures when they have no other legal basis for the action.

A. ENFORCEMENT AUTHORITY

Regulators claim broad enforcement authority over anything that presents an abnormal risk. Yet courts might overturn enforcement actions aimed at reputation risk when there is no significant threat to the financial integrity of the bank.

When regulators want to correct a bank's action they have a spectrum of enforcement tools, from cease-and-desist orders,¹⁹⁹ to written agreements,²⁰⁰ to informal actions.²⁰¹ Regulators can only wield these powers when they find an "unsafe or unsound" practice at the bank, when they find a violation of a statute or regulation, or when they find a violation of an agreement between the institution and the regulator.²⁰² As described in Part III, most regulatory references to reputation risk are in guidance documents rather than statutes or regulations. Technically, regulatory guidance is not legally binding and should not be the basis for enforcement.²⁰³

¹⁹⁹ 12 U.S.C. § 1818(b)(1) (2012); N.Y. BANKING LAW § 39 (McKinney 2018).

²⁰⁰ 12 U.S.C. §§ 1818(b)(1), 1818(e)(1)(A)(i)(IV), 1818(i)(2)(A)(iv), 1818(u)(1)(A) (2012); 12 C.F.R. § 325.2(z) (2018). The New York Department of Financial Services also regularly enters written agreements, sometimes in conjunction with one of the federal regulators.

²⁰¹ The regulators acknowledge they have informal regulatory powers outside the formal tools granted by banking statutes. See FDIC, RISK MANAGEMENT MANUAL, *supra* note 174, at § 15.1 (stating that "examiners can use examination comments and supervisory recommendations or informal agreements to correct problems"); FED. RESERVE BANK EXAMINATION MANUAL, *supra* note 129, § 5040.1, at 5–6 (noting the regulator can seek commitments, board resolutions, and memoranda of understanding from regulated institutions); OFFICE OF THE COMPTROLLER OF THE CURRENCY, PPM 5310-3: BANK ENFORCEMENT ACTIONS AND RELATED MATTERS 4 (2018) ("The OCC typically first cites a violation or documents a concern in [a matter requiring attention] in a formal written communication to address a bank's deficiencies."). For a more comprehensive look at federal regulators' enforcement tools, see Julie Andersen Hill, *Bank Capital Regulation by Enforcement: An Empirical Study*, 87 IND. L.J. 645, 658–63 (2012).

²⁰² 12 U.S.C. § 1818(b)(1) (2012); see also N.Y. BANKING LAW § 39 (McKinney 2018) (allowing enforcement orders for violations of law and unauthorized or "unsafe and unsound" practices).

²⁰³ See BD. OF GOVERNORS OF THE FED. RESERVE SYS., FED. DEPOSIT INS. CORP., NAT'L CREDIT UNION ADMIN. & OFFICE OF THE COMPTROLLER OF THE CURRENCY, FRB SR 18-5 / CA 18-7, FDIC FIL-49-2018, OCC NR 2018-97, INTERAGENCY STATEMENT CLARIFYING THE ROLE OF SUPERVISORY GUIDANCE (Sept. 11, 2018) [hereinafter INTERAGENCY STATEMENT CLARIFYING THE ROLE OF SUPERVISORY GUIDANCE] (stating regulators do not take

Therefore, most enforcement actions aimed at reputation risk would have to be justified by an “unsafe or unsound” practice. This term introduces ambiguity.

“The meaning of unsafe or unsound banking practices has been the subject of some debate because Congress never provided a comprehensive definition.”²⁰⁴ The federal regulators rely on a definition provided by John Horne, then-Chairman of the Federal Home Loan Bank Board:

Generally speaking, an “unsafe or unsound practice” embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operations, the possible consequences of which, if continued, would be *abnormal risk* or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.²⁰⁵

In the OCC’s view, there is no requirement that the “abnormal risk” threaten the viability of the financial institution.²⁰⁶ Under this interpretation, regulators can bring enforcement actions for violations of accepted standards of prudent operations even when the only harm is increased reputation risk.

Not all courts, however, interpret the phrase “safety and soundness” so broadly. Some find an unsafe or unsound practice only if the practice threatens the stability of the financial institution. In the early 1980s, a federal regulator issued a cease

enforcement actions based on regulatory guidance); *see also* Nina A. Mendelson, *Regulatory Beneficiaries and Informal Agency Policymaking*, 92 CORNELL L. REV. 397, 407 n.58 (2007) (“Courts have struck down agency attempts to bind a regulated entity through a policy or guidance because those documents failed to conform with APA rulemaking provisions.” (citing *Appalachian Power Co. v. EPA*, 208 F.3d 1015, 1020–21 (D.C. Cir. 2000); *McLouth Steel Prods. Corp. v. Thomas*, 838 F.2d 1317, 1323 (D.C. Cir. 1988); *Cnty. Nutrition Inst. v. Young*, 818 F.2d 943, 949 (D.C. Cir. 1987))).

²⁰⁴ Heidi Mandanis Schooner, *Big Bank Boards: The Case for Heightened Administrative Enforcement*, 68 ALA. L. REV. 1011, 1021 (2017).

²⁰⁵ *Financial Institutions Supervisory and Insurance Act of 1966: Hearings on S. 3158 and S. 3695 before the H. Comm. on Banking and Currency*, 89th Cong. 50 (1966) (memorandum submitted by John Horne, Chairman of the Federal Home Loan Bank Board) (emphasis added); *see also* *Gulf Fed. Sav. & Loan Ass’n v. Fed. Home Loan Bank Bd.*, 651 F.2d 259, 264 (5th Cir. 1981) (citing the Horne definition).

²⁰⁶ Adams, OCC Docket No. AA-EC-11-50, OCC EA No. N12-001, 2014 WL 8735096, at *3 (Sept. 30, 2014) (“The OCC and the other Federal banking agencies consistently have relied on [the Horne] definition in bringing enforcement cases in the decades since then.”).

and desist order to Gulf Federal Saving and Loan for failing to calculate interest on loans in the manner specified in the loan contracts.²⁰⁷ The contracts stated that interest would be computed as if there were 365 days in a year, when in fact interest was computed as if there were 360 days in a year.²⁰⁸ Nevertheless, the contracts had correctly disclosed both the interest rate and the monthly payments.²⁰⁹ The regulator argued that “entering into contracts and, thereafter, breaching them was an ‘unsafe or unsound practice’” because the bank faced potential liability for overcharged interest, and because the practice might result in a “loss of public confidence” in the bank.²¹⁰ The court found that of the borrowers impacted, “only one noticed the discrepancy,” none “threatened to sue,” and “most either signed or were willing to sign agreements amending the original contract and approving use of the [365 day] method.”²¹¹ This left only the potential “loss of public confidence”—essentially reputation risk—to justify the action.

The U.S. Court of Appeals for the Fifth Circuit held that an “undifferentiated” increase in reputation risk did not justify an enforcement action.²¹² The court explained that the regulator’s interpretation of the safety and soundness standard “would permit [the regulator] to decide, not that the public has lost confidence in Gulf Federal’s financial soundness, but that the public may lose confidence in the fairness of the association’s contracts with its customers.”²¹³ Allowing regulators to bring enforcement for increases in reputation risk without any evidence of reputational loss would make the regulator “the monitor of every activity of the association in its role of proctor for public opinion.”²¹⁴

Acceptance of the *Gulf Federal* holding is mixed. The Third, Fifth, and District of Columbia Circuit Courts of Appeals have

²⁰⁷ *Gulf Fed.*, 651 F.2d at 261.

²⁰⁸ *Id.*

²⁰⁹ *Id.* at 262.

²¹⁰ *Id.* at 263–64.

²¹¹ *Id.* at 262.

²¹² *Id.* at 264.

²¹³ *Id.* at 265.

²¹⁴ *Id.* The *Gulf Federal* court left open the possibility that a large loss of confidence like the one that “engendered the bank failures of the 1930s” would be sufficient to justify an enforcement action. *Id.*

adopted the *Gulf Federal* standard.²¹⁵ They require some threat to the financial condition of a bank before finding an unsafe or unsound practice. In addition, the Ninth and Tenth Circuits have both offered a definition of unsafe or unsound practices requiring “a reasonably direct effect” on a bank’s financial soundness.²¹⁶ On the other hand, the Second, Eighth, and Eleventh Circuits have concluded that Horne’s “abnormal risk or loss” definition does not require a financial threat to the bank.²¹⁷

Banks, however, have some control over which circuit decides their appeals. Appeals of cease and desist actions can be brought “in the court of appeals of the United States for the circuit in which the home office of the depository institution is located, or in the United States Court of Appeals for the District of Columbia Circuit.”²¹⁸ Because the D.C. Circuit follows *Gulf Federal*,²¹⁹ banks can choose to require that regulators have evidence of a threat to the financial viability of the bank.²²⁰

Notwithstanding the D.C. Circuit’s adoption of a standard requiring a financial threat to the bank, regulators continue to assert they can bring enforcement actions for increased risk alone.²²¹ Under an expansive view of the term “unsafe or unsound

²¹⁵ *E.g.*, *Johnson v. Office of Thrift Supervision*, 81 F.3d 195, 204 (D.C. Cir. 1996); *Seidman v. Office of Thrift Supervision*, 37 F.3d 911, 928 (3d Cir. 1994); *First Nat’l Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674, 681 (5th Cir. 1983).

²¹⁶ *See Frontier State Bank Okla. City v. Fed. Deposit Ins. Corp.*, 702 F.3d 588, 604 (10th Cir. 2012); *Simpson v. Office of Thrift Supervision*, 29 F.3d 1418, 1425 (9th Cir. 1994).

²¹⁷ *See Gully v. Nat’l Credit Union Admin. Bd.*, 341 F.3d 155, 165 (2d Cir. 2003); *Greene Cty. Bank v. Fed. Deposit Ins. Corp.*, 92 F.3d 633, 636 (8th Cir. 1996); *Cavallari v. Office of the Comptroller of the Currency*, 57 F.3d 137, 142 (2d Cir. 1995); *Doolittle v. Nat’l Credit Union Admin.*, 992 F.2d 1531, 1538 (11th Cir. 1993); *First Nat’l Bank of Eden v. Dep’t of the Treas.*, 568 F.2d 610, 611 n.2 (8th Cir. 1978).

²¹⁸ 12 U.S.C. § 1818(h)(2) (2012).

²¹⁹ *See Dodge v. Comptroller of the Currency*, 744 F.3d 148, 156 (D.C. Cir. 2014) (requiring evidence that banker misconduct “threaten[ed] the financial integrity of the [Bank]” (quoting *Johnson*, 81 F.3d at 204)); *Landry v. Fed. Deposit Ins. Corp.*, 204 F.3d 1125, 1138 (D.C. Cir. 2000) (“[A] loss, without more, does not prove that an act posed an abnormal risk . . .” (citing *Johnson*, 81 F.3d at 204)); *Johnson*, 81 F.3d at 204 (holding that “[t]he ‘unsafe or unsound practice’ provision . . . refers only to practices that threaten the financial integrity of the association” (quoting *Gulf Fed.*, 651 F.2d at 267)).

²²⁰ *See Eric M. Fraser, David K. Kessler, Matthew J.B. Lawrence & Stephen A. Calhoun, The Jurisdiction of the D.C. Circuit*, 23 CORNELL J.L. & PUB. POL’Y 131, 147 (2013) (noting that when there is a non-exclusive jurisdiction statute like the one here “a litigant is likely to opt for the D.C. Circuit when he believes that Circuit is more likely to reverse an agency decision than the other available circuits”).

²²¹ *See Adams*, OCC Docket No. AA-EC-11-50, OCC EA No. N12-001, 2014 WL 8735096 (Sept. 30, 2014) (rejecting “*Gulf Federal*’s restrictive gloss, which requires that a practice

practice,” regulators could eliminate any condition that increases reputation risk. Indeed, the OCC definition of reputation risk does not require direct financial harm; it only requires the bank be less resilient to other risk events in the future.²²²

Because regulators make the initial decision about whether to institute enforcement actions, activities that pose “abnormal” reputation risk may result in enforcement actions without any showing of significant risk to the financial condition of the institution. A bank may be able to successfully appeal such an enforcement action in the D.C. Circuit, but not all banks will have the resources or stomach for a protracted legal battle with regulators that are constantly supervising the bank.²²³

B. ENFORCEMENT GUIDANCE

Perhaps the ambiguity of regulators’ enforcement authority has tempered regulators’ statements about when reputation risk merits enforcement. Federal regulators have consistently stated that the focus of reputation risk enforcement is procedural; banks should monitor and consider reputation risk.²²⁴ Regulators have even sometimes promised that, in contrast to other risks, reputation risk alone will not result in enforcement actions.²²⁵

produce specific effects that threaten an institution’s financial stability”); Keith R. Fisher, *Nibbling on the Chancellor’s Toesies: A “Roguish” Concurrence with Professor Baxter*, 56 L. & CONTEMP. PROBS. 45, 66 (1993) (noting that banking agencies have not always followed the Gulf Federal standard in bringing enforcement actions); Thomas L. Holzman, *Unsafe or Unsound Practices: Is the Current Judicial Interpretation of the Term Unsafe or Unsound?*, 19 ANN. REV. BANKING L. 425, 440–41 (2000) (arguing that in the personal view of the FDIC attorney author, the banking agencies are justified in their practice of “hew[ing] closely to the definition of unsafe and unsound practice articulated in the Horne memorandum”).

Regulators may apply an even more lenient standard than “abnormal risk or loss.” Professor Heidi Mandanis Schooner observes that “[s]ome administrative orders depart from the ‘abnormal risk or loss’ language and replace it with ‘unacceptable risk of loss or damage,’ ‘undue risk,’ ‘unnecessary risk,’ or any risk ‘other than those inherent in doing business, whether in a bank or elsewhere.’” Heidi Mandanis Schooner, *Fiduciary Duties’ Demanding Cousin: Bank Director Liability for Unsafe or Unsound Banking Practices*, 63 GEO. WASH. L. REV. 175, 195–96 (1995) (citations omitted).

²²² See *supra* notes 125–26 and accompanying text.

²²³ See *infra* notes 331–42 and accompanying text (explaining why banks might be hesitant to challenge their regulators).

²²⁴ See *infra* notes 226–35 and accompanying text.

²²⁵ See *infra* notes 231–35 and accompanying text.

When federal regulators first adopted risk-based assessments, they assured banks no major changes were required.²²⁶ Instead the OCC and the NCUA emphasized that the risk assessment would help them tailor each institution's examination to its unique risk profile.²²⁷ The Federal Reserve explained its risk review was designed primarily to ensure banks had adequate risk management systems consisting of oversight, policies, monitoring, and internal controls.²²⁸ These, of course, were measures regulators expected of banks even before the new risk-focused examinations.²²⁹ The OCC even clarified its examiners would just monitor—not “actively supervise”—reputation risk.²³⁰

More recently, federal regulators have offered statements suggesting reputation risk alone will rarely warrant enforcement. The NCUA's statement is the most definitive. In 2014, then-NCUA-Chairman Debbie Matz stated the “NCUA neither pursues enforcement nor otherwise takes action against supervised federally insured credit unions based on reputation risk alone.”²³¹ The other federal regulators emphasize banks should consider reputation risk, but most decisions about reputation risk are

²²⁶ See, e.g., Ludwig, *supra* note 115 (“I want to be clear . . . that we are not requiring banks to adopt our risk vocabulary or do anything particular with it. The vocabulary is for the use of our examination team. Armed with the new risk definitions, our examiners will evaluate the risks present in each national bank.”).

²²⁷ *Id.* (explaining the risk evaluations would “feed into the examination strategy for each bank and allow [the OCC] to focus future supervision on what we deem to be the higher risk areas within the bank, while limiting our examination of lower-risk areas that bank management is addressing effectively”); NCUA, RISK FOCUSED EXAMINATION PROGRAM, *supra* note 120 (explaining that because “[e]xaminers allocate time and apply the most scrutiny to activities posing the highest risk,” regulators may spend less examination time at the credit union).

²²⁸ *Risk Assessment: Hearing before the H. Comm. on Banking & Fin. Servs.*, 104th Cong. 12–14 (1996) (testimony of Richard Spillenkothen, Dir., Div. of Banking Supervision & Regulation, Bd. of Governors of the Fed. Reserve Sys.).

²²⁹ See *id.* at 13 (explaining that Federal Reserve examiners “have long reviewed internal controls”).

²³⁰ Susan F. Krause, Senior Deputy Comptroller for Bank Supervision Pol’y, Office of the Comptroller of the Currency, Remarks Before the Robert Morris Associates Risk Management Conference: On Risk Management in Bank Supervision (Dec. 11, 1995) (“We have had a lot of questions about the identification of strategic and reputation risk as separate risks. These risks are included in order to have a set of risk categories that represent the *entire* risk profile of a bank. We do not actively supervise these two risks, but we need to consider them in order to do a complete risk assessment.”), in 15 OCC Q.J. no. 1, 1996, at 125, 127.

²³¹ Letter from Debbie Matz, Chairman, Nat’l Credit Union Admin., to Jeb Hensarling, Chairman, H. Comm. on Fin. Servs. (June 12, 2014).

business decisions to be made by the bank, not the regulator.²³² In 2015 litigation, the OCC explained it “does not prohibit national banks and federal savings associations from engaging in transactions and relationships that it identifies as involving greater reputation risk.”²³³ Rather, it seeks to ensure banks are properly monitoring reputation risk.²³⁴

In litigation, the New York Department of Financial Services asserts that its strongly worded guidance does not imply it will punish banks that do business with the NRA.²³⁵

C. FORMAL ENFORCEMENT

A review of formal enforcement actions mentioning reputation risk reveals that most are aimed at correcting other problems—often violations of law or excessive credit risk. When an enforcement action requires the bank to take remedial measures related to reputation risk, those remedial measures typically require new risk management policies or monitoring of reputation risk. There are some enforcement actions, however, that require remedial action based on reputation risk alone—one enforcement action is focused

²³² *The Department of Justice’s “Operation Choke Point”: Hearing before the Subcomm. on Oversight & Investigation of the H. Comm. on Fin. Servs.*, 113th Cong. 13 (2014) [hereinafter *DOJ’s Operation Choke Point Hearing*] (testimony of Daniel Stipano, Deputy Chief Counsel, Office of the Comptroller of the Currency) (“We expect banks to assess the risks posed by individual customers on a case-by-case basis and to implement appropriate controls to manage their relationships.”). On the specific question of reputation risk presented by customer accounts, the OCC has stated that it only requires banks to cease activity where “the bank cannot properly manage the risk presented by a customer, or a customer has engaged in suspected criminal or other illegal activity.” *Id.*; see also *id.* at 33 (testimony of Richard J. Osterman, Acting General Counsel, FDIC) (“[A]s long as banks have appropriate risk mitigation measures in place, we are not going to prohibit or discourage them from doing business with anyone with whom they want to do business.”); *id.* at 9 (testimony of Scott Alvarez, Gen. Counsel, Bd. of Governors of the Fed. Reserve Sys.) (“The decision to establish, limit or terminate a particular customer relationship is a decision for the banking organization It is not the Board’s policy to discourage banking organizations from offering services to any class of law-biding [sic] financial services customers.”).

²³³ Defendants OCC & Thomas J. Curry’s Memorandum in Support of Motion to Dismiss Plaintiffs’ Amended Complaint for Declaratory & Injunctive Relief at 8, *Cmt’y Fin. Servs. Ass’n of Am., Ltd. v. Fed. Deposit Ins. Corp.*, 132 F. Supp. 3d 98 (D.D.C. 2015) (No. 14-CV-00953-TNM).

²³⁴ *DOJ’s Operation Choke Point Hearing*, *supra* note 232, at 13 (testimony of Daniel Stipano).

²³⁵ Memorandum of Law in Support of Defendants’ Motion to Dismiss the First Amended Complaint Pursuant to FRCP 12(B)(6) at 13, *Nat’l Rifle Ass’n of Am. v. Cuomo*, 350 F. Supp. 3d 94 (N.D.N.Y. 2018) (noting the guidance “did not include or imply any threats of State action of any kind, whether regulatory or criminal”).

nearly exclusively on reputation risk.²³⁶ These latter enforcement measures are inconsistent with the regulatory statements discussed above.

The FDIC, Federal Reserve, OCC, and NCUA have all issued formal enforcement actions involving reputational risk.²³⁷ These enforcement actions can be largely grouped into four types.

First, some enforcement actions mention reputation risk, but require no specific corrective action aimed at reputation risk. In these cases, enforcement is justified because the bank violated or was likely to violate the law, or because the bank engaged in some other unsafe or unsound behavior. In the NCUA's only action mentioning reputation risk, the Charleston County Teachers Federal Credit Union made large loans to insiders and then made little effort to collect them.²³⁸ Noting this posed reputation risk, the enforcement action required the credit union to comply with laws prohibiting lending to officers under terms more favorable than those offered to the general public.²³⁹ In another instance, the FDIC entered a cease and desist order to First Asian Bank in Las Vegas, Nevada.²⁴⁰ The order criticized the bank for unsatisfactory loan underwriting, operating losses, inadequate capital, and "operating with inadequate provisions for liquidity in relation to the bank's reputation risk in the community."²⁴¹ Among other things, the enforcement action required the bank to hire new management, appoint independent directors, improve capital ratios, and develop new lending policies.²⁴² A number of enforcement actions criticize banks for failing to maintain adequate procedures to prevent money

²³⁶ Bank of Agric. & Commerce, FDIC Order No. FDIC-08-408b, 2009 WL 998563, at *2 (Feb. 19, 2009).

²³⁷ To identify enforcement actions involving reputation risk, I searched Westlaw's database of enforcement decisions for each regulator using variants of the word "reputation." Because "reputation risk" did not emerge as a regulatory term until 1995, I limited my review to enforcement decisions after 1994. I manually reviewed the results to sort those involving reputation risk from others that use the word "reputation." The FDIC, Federal Reserve, and OCC all have multiple enforcement actions mentioning reputation risk. *See infra* notes 243–63 and accompanying text (providing representative examples of these enforcement actions). I located only one NCUA action involving reputation risk. *See* Letter of Understanding and Agreement by and between the NCUA and Charleston Co. Teachers Fed. Credit Union, 2003 WL 25488457 (June 6, 2003) [hereinafter Letter of Understanding].

²³⁸ Letter of Understanding, *supra* note 237.

²³⁹ *Id.* (citing 12 C.F.R. § 701.21 (2019)).

²⁴⁰ First Asian Bank, FDIC Order No. FDIC-08-239b, 2008 WL 4899137 (Sept. 25, 2008).

²⁴¹ *Id.* at *1.

²⁴² *Id.* at *2.

laundering, possibly leading to legal, compliance, and reputation risk. These actions require improved policies and procedures, but do not specifically mention reputation risk policies.²⁴³ In these types of enforcement actions, reputation risk is ancillary to the focus of the order. While the corrective measures might indirectly impact reputation risk, they are not aimed at reputation risk. These enforcement actions reinforce the derivative nature of reputation risk. Indeed, it is hard to imagine a type of enforcement action that could not plausibly include reputation risk in this manner. Nevertheless, not all enforcement actions discuss reputation risk. Although Wells Fargo's practice of opening unauthorized accounts is widely cited as an example of reputation risk,²⁴⁴ none of the enforcement orders it spawned mention reputation risk.²⁴⁵

Second, some enforcement actions not aimed at reputation risk nevertheless require improved policies or monitoring of reputation risk as part of a larger risk management strategy.²⁴⁶ When the OCC

²⁴³ See, e.g., Citigroup Inc., FRB Docket No. 13-004-B-HC (Mar. 21, 2013) (stating the financial holding company "lacked effective systems of governance and internal controls to adequately oversee the activities of the Banks with respect to legal, compliance, and reputational risk related to the Banks' respective BSA/AML compliance programs"); U.S. Bancorp, FRB Docket No. 11-027-B-HC (Feb. 28, 2013) (noting the enforcement action was entered because of the bank and Federal Reserve's common goal "that [the Bank] and its subsidiaries effectively manage their legal, reputational, and compliance risks"); ABN Amro Bank N.V., FRB Docket No. 05-035-CMP-FB (Dec. 19, 2005) (stating the Bank "lacked effective systems of governance, audit, and internal control to oversee the activities of the Branches with respect to legal, compliance, and reputational risk, and failed to adhere to those systems that it did have, especially those relating to anti-money laundering policies and procedures").

²⁴⁴ See, e.g., Jonas Sickler, *What Is Reputation Risk and How to Manage It*, REPUTATIONMANAGEMENT.COM (Feb. 8, 2019), <https://www.reputationmanagement.com/blog/reputational-risk/> (citing the Wells Fargo account scandal as "the best example of the impact of reputational risk").

²⁴⁵ See Wells Fargo & Co., FRB Docket No. 18-007-B-HC (Feb. 1, 2018); Wells Fargo Bank, N.A., OCC Docket No. AA-EC-2016-67, OCC No. 2016-079 (Sept. 6, 2016). The OCC's Office of Enterprise Governance and the Ombudsman reviewed the OCC's supervision of Wells Fargo and found the OCC's supervision of reputation risk was lacking because it did not adequately "consider[] the nature and amount of exposure from customer complaints." OFFICE OF THE COMPTROLLER OF THE CURRENCY, OFFICE OF ENTERPRISE GOVERNANCE AND THE OMBUDSMAN, LESSONS LEARNED REVIEW OF SUPERVISION OF SALES PRACTICES AT WELLS FARGO 10 (Apr. 19, 2017), <https://www.occ.gov/publications-and-resources/publications/banker-education/files/lessons-learned-review-of-sup-of-sales-practices-at-wells-fargo.html>.

²⁴⁶ See, e.g., J.P. Morgan Chase & Co., FRB Docket Nos. 16-22-B-HC, 16-22-CMP-HC (Nov. 17, 2016) (requiring "measures to ensure that senior management periodically reassesses risks associated with the Firm's Referral Hiring Practices to proactively identify practices vulnerable to legal and reputational risks" after discovering evidence the firm was hiring government officials and their relatives in violation of anti-bribery laws); Lender Processing

brings an enforcement action for credit quality problems, it is common for the action to require the bank to develop “action plans and time frames to reduce risks where exposure is high, particularly with regard to credit risk, which impacts directly on liquidity, compliance, strategic, and reputation risks.”²⁴⁷ In other enforcement actions, banks are instructed to develop liquidity management plans that will, among other things, “monitor[] the projected impact on reputation, economic and credit conditions in the [banks’] market(s).”²⁴⁸ Finally, in some anti-money laundering actions, banks are instructed to “*consider* closing any existing account of a customer if the information available to the [b]ank indicates that the customer's relationship with the [b]ank would be detrimental to the reputation of the [b]ank.”²⁴⁹ In this type of

Servs., Inc., FRB Docket Nos. 11-052-B-SC-1, 11-052-B-SC-2, 11-052-B-SC03, FDIC Order No. FDIC-11-204b, OCC Docket No. AA-EC-11-46, OCC EA No. 2011-054, OTS Order DC-11-039 (Apr. 13, 2011) (requiring a mortgage servicer to develop a risk assessment program that considers reputation risk after it was discovered the servicer robo-signed mortgage foreclosure documents); Harvest Bank of Md., FDIC Order No. FDIC-10-349b (July 2, 2010) (requiring that before the bank engages in new activities the board conduct an assessment that “include[s] identification and monitoring of credit, operating, transaction, liquidity, market, reputation, strategic, compliance, legal, and other risks”); Written Agreement by and between Bank of Am., N.A. and the OCC, OCC Docket No. AA-EC-04-35, OCC EA No. 2005-10 (Feb. 9, 2005) (requiring the bank to develop policies that consider reputational risk after an investigation into the bank’s market timing and late trading practices); First Bank of N. Ky., Inc., FDIC Order No. FDIC-03-215b (Jan. 6, 2004) (requiring a strategic plan that identifies “existing credit, interest rate, liquidity, transaction, compliance, strategic, reputation, price, and foreign currency translation risks, if any, and a written analysis of those risks to the extent they exist”); Written Agreement by and between Citibank, N.A. and the OCC, OCC EA No. 2003-77 (July 28, 2003) (requiring the bank to “[i]mplement an appropriate, formal internal process to independently assess reputational and legal risks of each complex structured finance transaction” after a review of the bank’s complex structured finance transactions with Enron).

²⁴⁷ See, e.g., Agreement by and between the Putnam Cty Nat’l Bank of Carmel and the OCC, OCC EA No. 2006-76 (July 12, 2006); Agreement by and between First Nat’l Bank of Gonzales and the OCC, OCC EA No. 99-113 (Sept. 9, 1999).

²⁴⁸ Goldwater Bank, N.A., OCC Docket No. AA-EC-10-32, OCC EA No. 2010-092 (May 11, 2010); see also First Nat’l Bank of Edinburg, Tex., OCC Docket No. AA-EC-09, OCC EA No. 2012-004 (Jan. 18, 2012); Amcore Bank, N.A., OCC Docket No. AA-EC-09-46, OCC EA No. 2009-080 (June 25, 2009).

²⁴⁹ Agreement by and between City Nat’l Bank of Fla. and the OCC, OCC EA No. 2010-076 (Apr. 19, 2010) (emphasis added); see also Agreement by and between Citic Ka Wah Bank Ltd. and the OCC, OCC EA No. 2007-007, 2006 WL 5440479 (Dec. 20, 2006); FirstMerit Bank, N.A., OCC EA No. 2006-134 (Nov. 20, 2006); Agreement by and between Big Lake Nat’l Bank and the OCC, OCC EA No. 2005-146 (Oct. 19, 2005). Cf. SunFirst Bank, FDIC Order No. FDIC-10-845b (Nov. 9, 2010) (requiring a full risk assessment, including reputation risk for each third-party payment processing account); Regal Fin. Bank, FDIC Order No. FDIC-09-558b (Nov. 30, 2009) (requiring a risk assessment, including reputation risk, for each customer using automated clearinghouse payments); U.S. Trust Corp., 2001 WL 855087 (Fed.

action, regulators reaffirm reputation risk should be considered part of the bank's overall risk management strategy. The changes required by these enforcement actions are essentially procedural, as opposed to substantive, in nature. This is the most common type of enforcement action addressing reputation risk.

Third, some enforcement actions not aimed at reputation risk nevertheless require that banks take remedial action based only on reputation risk. All of the enforcement actions of this type focus on money laundering.²⁵⁰ For example, the OCC found deficiencies in anti-money laundering policies and practices at Pacific National Bank, a subsidiary of Ecuador's state-owned Banco del Pacifico. The enforcement order required the bank to close any customer accounts that are "detrimental to the reputation . . . of the Bank."²⁵¹ The FDIC has also required that banks close accounts based on reputation risk.²⁵² Although there are anti-money laundering laws and detailed regulatory guidance,²⁵³ no statute, regulation, or agency guidance requires the closure of customer accounts that pose reputation risk.²⁵⁴ These enforcement actions require banks to take action not required by other law based entirely on reputation risk.

Reserve Bd. July 12, 2001) (requiring an enhanced customer due diligence program "to ensure effective management and mitigation of reputational and legal risks and compliance with the BSA and the applicable BSA and SAR reporting provisions").

²⁵⁰ See, e.g., N. Am. Sav. Bank, FSB, OCC Docket No. AA-EC-2012-160, OCC EA No. 2013-010 (Feb. 1, 2013); United Ams. Bank, N.A., OCC Docket No. AA-EC-10-85, OCC EA No. 2010-210 (Oct. 7, 2010); E. Nat'l Bank, OCC EA No. 2008-038 (June 4, 2008).

²⁵¹ Pac. Nat'l Bank, OCC Docket No. AA-EC-10-106, OCC EA No. 2010-253 (Dec. 15, 2010) ("The Bank shall not open any account for a customer and shall close any existing account of a customer if the information available to the Bank indicates that the customer's relationship with the Bank would be detrimental to the reputation or safety or soundness of the Bank.").

²⁵² For example, the FDIC found Bank Secrecy Act compliance problems with Meridian Bank's electronic payments program. Meridian Bank, FDIC Order No. FDIC-12-367b (Oct. 22, 2012). The FDIC ordered the bank to develop policies and procedures governing electronic payments that "include a comprehensive list of entities that present elevated risk or potential for consumer harm and for which the bank will not process transactions." *Id.* Earlier in the action, the FDIC identified legal, compliance, reputation, and fraud as the relevant risks. *Id.* Thus, the enforcement action requires policies that require the bank to close accounts presenting elevated reputation risk.

²⁵³ See generally Greg Dekermenjian, Note, *Anti-Money Laundering*, 25 ANN. REV. BANKING & FIN. L. 137 (2006) (providing a primer on U.S. anti-money laundering laws and noting the OCC's anti-money laundering examination manual is more than 300 pages long).

²⁵⁴ This is confirmed by other enforcement actions where the OCC affords the bank more leeway in deciding whether to close accounts posing reputation risk. See *supra* note 249 and accompanying text (discussing enforcement actions where the bank is instructed to "consider" reputation risk in closing accounts).

Finally, one enforcement action seems aimed directly at reputation risk. The FDIC brought an enforcement action against the Bank of Agriculture and Commerce in Stockton, California based on the bank's relationship with Petz Enterprises, Inc.²⁵⁵ Together, Petz and the Bank "provid[e] electronic deposits for consumers receiving benefit payments (such as Social Security payments and other benefit payments) through a direct deposit program."²⁵⁶ Petz's account at the Bank received electronic deposits from the government for consumers. The Bank then provided a check to the consumer, less fees, that the consumer could pick up at a payday lender, check casher, or retail merchant. The FDIC's problem with this practice was that the payday lenders and check cashers (not the Bank) also provided short term loans. The consumers would sometimes use nearly the entire benefits check to pay the loans. "[N]either [Petz] nor the Bank monitored these short term lending practices related to the consumers in [Petz's] direct deposit program run through the Bank."²⁵⁷ The FDIC stated this failure to monitor exposed the Bank to "reputational and legal risk."²⁵⁸ While the FDIC mentioned legal risk, the only specific "law" the FDIC cited was the FDIC's Guidance for Managing Third-Party Risk.²⁵⁹ The enforcement action does not suggest the Bank lost any money in connection with the program. Thus, the enforcement action seems primarily driven by the idea that the Bank's reputation could be tarnished by doing business with a customer that does business with payday lenders and check cashers. The FDIC action ultimately required the Bank to "unwind[] . . . its benefit payment deposit account business with [Petz]."²⁶⁰

D. INFORMAL ENFORCEMENT

Reviewing public formal enforcement actions gives an incomplete view of enforcement. Not all enforcement actions are public. Regulators can keep formal enforcement actions confidential if

²⁵⁵ Bank of Agric. & Commerce, FDIC Order No. FDIC-08-408b, 2009 WL 998563 (Feb. 19, 2009).

²⁵⁶ *Id.* at *1.

²⁵⁷ *Id.* at *2.

²⁵⁸ *Id.*

²⁵⁹ *Id.*

²⁶⁰ *Id.* at *4.

revealing the action “would be contrary to the public interest.”²⁶¹ Other informal enforcement efforts take place through the examination process²⁶²—a process that is entirely confidential.²⁶³ As part of the examination process, regulators routinely identify “matters requiring attention,” “supervisory recommendations,” or “examiner’s findings.”²⁶⁴ Bankers know they “ignore [these examination statements] at their peril.”²⁶⁵ Failing to respond to informal enforcement can lead to formal enforcement.²⁶⁶ In some

²⁶¹ 12 U.S.C. § 1818(u) (2012).

²⁶² See *supra* notes 132–51 and accompanying text (discussing the reputation risk evaluations conducted as part of bank examinations).

²⁶³ See 12 C.F.R. §§ 4.32(b)(2), 4.36 (2014) (OCC); §§ 261.2(c)(1), 261.20(g), 261.22(e) (Federal Reserve); §§ 309.5(g)(8), 309.6(a), 350.9 (FDIC); § 792.30 (2014) (NCUA); Bd. of Governors of the Fed. Reserve Sys., Fed. Deposit Ins. Corp., Office of the Comptroller of the Currency, Office of Thrift Supervision, FRB SR 05-4, FDIC FIL-13-2005, OCC BULL. NO. 2009-15, INTERAGENCY ADVISORY ON THE CONFIDENTIALITY OF THE SUPERVISORY RATING AND OTHER NONPUBLIC SUPERVISORY INFORMATION (Feb. 28, 2005), <https://www.fdic.gov/news/news/press/2005/pr1805a.html> (citing the criminal penalties associated with revealing examination reports in violation of 18 U.S.C. § 641); see also Kenneth Culp Davis, *Administrative Procedure in the Regulation of Banking*, 31 L. & CONTEMP. PROBS. 713, 713 (1966) (“The banking agencies of the federal government have long maintained systems of secret evidence, secret law, and secret policy.”); Margaret E. Tahyar, *Are Bank Regulators Special?*, 6 BANKING PERSP., no. 1, 2018, at 23 (noting that Professor Davis’s observation about secrecy in banking regulations “remains fresh today”).

²⁶⁴ Bd. of Governors of the Fed. Reserve Sys., SR 13-13 / CA 13-10, SUPERVISORY CONSIDERATIONS FOR THE COMMUNICATION OF SUPERVISORY FINDINGS (June 17, 2013) (“[Matters requiring attention] constitute matters that are important and that the Federal Reserve is expecting a banking organization to address over a reasonable period of time”); FDIC, RISK MANAGEMENT MANUAL, *supra* note 174, § 16.1 (“The term ‘supervisory recommendation’ refers to FDIC communications with a bank that are intended to inform the bank of the FDIC’s views about changes needed in its practices, operations or financial condition.”); NCUA EXAMINER’S GUIDE, EXAMINATION REPORT WRITING, *supra* note 26 (“The Examiner’s Findings reflect problems that management must address, but can do so in the normal course of business.”); OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER’S HANDBOOK: BANK SUPERVISION PROCESS 46–48 (Sept. 2019 ed. 2018) [hereinafter OCC, BANK SUPERVISION PROCESS HANDBOOK 2018] (“The OCC uses [matters requiring attention] to communicate concerns about a bank’s deficient practices.”).

²⁶⁵ Kiah Lau Haslett & Carolyn Duren, *Reconsidering Regulatory Warnings*, BANKING EXCHANGE (Jan. 31, 2018, 2:35 PM), <http://m.bankingexchange.com/news-feed/item/7338-reconsidering-regulatory-warnings> (quoting banking attorney Jeffery Smith); *Guidance, Supervisory Expectations, and the Rule of Law: How Do the Banking Agencies Regulate and Supervise Institutions?: Hearing Before the S. Comm. on Banking, Hous. & Urban Affairs*, 116th Cong. (2019) (written testimony of Greg Baer, President and CEO, Bank Policy Institute) (describing how matters requiring attention are “treated as binding regulations or orders”); FDIC, RISK MANAGEMENT MANUAL, *supra* note 174, § 16.1–2 (acknowledging “bankers take seriously supervisory recommendations made by FDIC personnel”).

²⁶⁶ See OCC, BANK SUPERVISION PROCESS HANDBOOK 2018, *supra* note 264, at 49–50 (“When a bank’s deficiencies are severe, uncorrected, repeat, or unsafe or unsound, or negatively affect the bank’s condition, the OCC may use formal enforcement actions to

cases, regulators do not even need to document enforcement efforts to persuade banks to change course. “[T]hreats of prosecution, [or] even raised eyebrows” can sometimes be “equally effective” as formal enforcement actions.²⁶⁷ Only in unusual circumstances will the public learn about these informal enforcement measures.

In two cases, third parties have sued bank regulators alleging informal reputation risk enforcement harmed their banking relationships. Payday lenders sued the FDIC arguing that, as part of Operation Choke Point, the regulator used reputation risk to pressure banks to end relationships with payday lenders without due process of law in violation of the Fifth Amendment.²⁶⁸ In addition, the NRA sued the New York Department of Financial Services, arguing that it used reputation risk to pressure banks to stop providing services to gun rights advocacy groups in violation of the NRA’s First Amendment free speech rights.²⁶⁹ Documents in these cases (and, in the payday lending case, additional disclosures partly prompted by the publicity of the government’s actions) provide a rare look into the private world of informal reputation risk regulation. When viewed in combination with the glut of reputation risk guidance, there is reason to believe that informal enforcement

support the agency’s supervisory objectives.”); Nicholas R. Parrillo, *Federal Agency Guidance and the Power to Bind: An Empirical Study of Agencies and Industries*, 36 YALE J. ON REG. 165, 192–93 (2019) (“If problems caught during the examination are sufficiently bad and go uncorrected, the agency can bring a public enforcement action that may result in fines, removal of officers, or ultimately the shutdown of the bank by revocation of its charter.”).

²⁶⁷ Jerry L. Mashaw, *Reinventing Government and Regulatory Reform: Studies in the Neglect and Abuse of Administrative Law*, 57 U. PITT. L. REV. 405, 420–21 (1996) (“[T]he banking regulatory agencies can probably be equally effective through threats of prosecution, even raised eyebrows.”).

²⁶⁸ See Complaint for Declaratory & Injunctive Relief at 4, 7, *Cmty. Fin. Servs. Ass’n of Am. v. Fed. Deposit Ins. Corp.*, 132 F. Supp. 3d 98 (D.D.C. 2015) (No. 14-CV-953-GK) (“[T]he Defendant agencies have . . . pressure[d] the institutions to sever their long-standing and mutually beneficial banking relationships with members of CFSA and other payday lenders.”); see also *Advance Am., Cash Advance Ctrs., Inc. v. Fed. Deposit Ins. Corp.*, 251 F. Supp. 3d 78, 79 (D.D.C. 2017) (explaining that the plaintiffs alleged federal banking regulators participated in “a campaign . . . to force banks to terminate their business relationships with payday lenders”); *Cmty. Fin. Servs.*, 132 F. Supp. 3d at 120 (“Plaintiffs allege that Defendants engaged in a campaign of backroom pressure against banks and payday lenders, relying on the definition of ‘reputation risk’ outlined in the Agency Documents.”).

²⁶⁹ See First Amended Complaint & Jury Demand, *supra* note 45, at 19–20 (“Defendants’ unlawful exhortations to New York . . . banks . . . that they, among other things, ‘manag[e] their risks, including reputational risks, that may arise from their dealings with the NRA . . . constitute[s] a concerted effort to deprive the NRA of its freedom of speech . . .”).

is used to police reputation risk in the absence of significant financial harm or violation of law.²⁷⁰

1. Operation Choke Point.

In 2014, a group of payday lenders sued the FDIC alleging the “regulator[] . . . with active support from the Department of Justice[,] . . . engaged in a concerted campaign to drive them out of business by exerting back-room pressure on banks and other regulated financial institutions to terminate their relationships with payday lenders.”²⁷¹ The complaint asserted that as part of a DOJ initiative dubbed “Operation Choke Point,” the regulators “target[ed] a variety of lawful businesses that are disfavored by [the regulators], such as firearms and tobacco sales, coin dealers, . . . dating services, [and] the payday loan industry.”²⁷² The plaintiffs explained “[t]he ostensible basis of [the regulator’s] campaign against the payday lending industry (and other lawful but disfavored industries) is that providing financial services to such industries exposes the banks to ‘reputation risk.’”²⁷³

The FDIC eventually settled the case by admitting “certain employees acted in a manner inconsistent with FDIC policies with respect to payday lenders in what has been generically described as ‘Operation Choke Point,’ and that this conduct created misperceptions about the FDIC’s policies.”²⁷⁴ Investigations by the FDIC Office of Inspector General and Republican-led House Committee on Oversight and Reform similarly found evidence the

²⁷⁰ See *infra* Section IV.D.3.

²⁷¹ Complaint for Declaratory & Injunctive Relief, *supra* note 268, at 3. The plaintiffs originally included the Federal Reserve and the OCC as defendants but later dismissed them from the suit. See Stipulation of Dismissal at 1, *Advance Am. Cash Advance Ctrs., Inc. v. Fed. Deposit Ins. Corp.*, No. 14-953-TNM (D.D.C. Sept. 24, 2018) (stipulating to the dismissal of the Federal Reserve); Press Release, OCC, “Operation Choke Point” Lawsuit Dismissed, NR 2019-53 (May 23, 2019) (stating that “the OCC has not entered into any settlement agreement or made any other concessions to plaintiffs in exchange for their agreement to dismiss all claims against the agency”). The other federal regulator, the NCUA, was never included in the suit and categorically denied participating in Operation Choke Point. See Letter from Debbie Matz to Jeb Hensarling, *supra* note 231 (“NCUA has not and will not participate in Operation Choke Point or any similar operation.”).

²⁷² Complaint for Declaratory & Injunctive Relief, *supra* note 268, at 3.

²⁷³ *Id.* at 40.

²⁷⁴ Letter from Floyd Robinson, Deputy Gen. Counsel, FDIC, to David H. Thompson, Attorney, Cooper & Kirk, PLLC (May 22, 2019), <https://www.fdic.gov/news/news/press/2019/pr19040a.pdf>.

FDIC, citing reputation risk, pressured banks to stop doing business with payday lenders.²⁷⁵

By all accounts, Operation Choke Point investigations were spearheaded by the DOJ.²⁷⁶ The goal of the investigations was “to attack Internet, telemarketing, mail, and other mass market fraud against consumers, by choking fraudsters’ access to the banking system.”²⁷⁷ The DOJ issued more than sixty subpoenas to financial institutions.²⁷⁸ It hoped the investigations would cause all banks “to scrutinize their account relationships and, if warranted, to terminate fraud-tainted processors and merchants.”²⁷⁹

But the DOJ’s subpoenas were not without bank regulators’ fingerprints. In fact, a copy of FDIC and OCC guidance on third-party payment processing was included with the subpoenas.²⁸⁰ These guidance documents emphasized the reputation risk presented by third-party payment processing.²⁸¹ The

²⁷⁵ See generally H. COMM. ON OVERSIGHT & GOV’T REFORM STAFF REPORT, FDIC, *supra* note 47; STAFF OF H. COMM. ON OVERSIGHT & GOV’T REFORM, 113TH CONG., THE DEPARTMENT OF JUSTICE’S “OPERATION CHOKE POINT”: ILLEGALLY CHOKING OFF LEGITIMATE BUSINESSES? (Comm. Print 2014) [hereinafter H. COMM. ON OVERSIGHT & GOV’T REFORM STAFF REPORT, DOJ], <https://republicans-oversight.house.gov/wp-content/uploads/2014/05/Staff-Report-Operation-Choke-Point1.pdf>; OFFICE OF INSPECTOR GEN., FED. DEPOSIT INS. CORP., 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 (2015) [hereinafter FDIC OIG CHOKE POINT REPORT], <https://www.oversight.gov/sites/default/files/oig-reports/15-008AUD.pdf>.

²⁷⁶ See Memorandum from Michael S. Blume, Dir. Consumer Prot. Branch, Dep’t of Justice, to Stuart F. Delery, Ass’t Att’y Gen., Civ. Div., Dep’t of Justice (Sept. 9, 2013), in H. COMM. ON OVERSIGHT & GOV’T REFORM, DOJ, *supra* note 275, at app. 1 HOCR-3PPP000329 to HOCR-3PPP00340. FIRREA allows the U.S. Attorney General to seek civil penalties from entities and individuals that have committed fraud “affecting a federally insured financial institution.” *Id.* (citing 12 U.S.C. § 1833a(c)(2) (2012)).

²⁷⁷ Memorandum from Joel M. Sweet, Ass’t U.S. Att’y, to Stuart F. Delery, Acting Ass’t Att’y Gen. (Nov. 5, 2012) (proposing Operation Choke Point), in H. COMM. ON OVERSIGHT & GOV’T REFORM STAFF REPORT, DOJ, *supra* note 275, at app. 1 HOCR-3PPP00017.

²⁷⁸ FDIC OIG CHOKE POINT REPORT, *supra* note 275, at 3 (showing the DOJ issued these subpoenas “to entities for which the Department determined it had evidence of potential consumer fraud”).

²⁷⁹ Memorandum from Joel M. Sweet to Stuart Delery, *supra* note 277, at HOCR-3PPP00019.

²⁸⁰ FDIC OIG CHOKE POINT REPORT, *supra* note 275, at 14 (“DOJ employees informed us that many of the subpoenas issued pursuant to Operation Choke Point contained copies of publicly available guidance on payment processors that was issued by the FDIC, the Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN), and the OCC.”).

²⁸¹ FED. DEPOSIT INS. CORP., FIL-3-2012, PAYMENT PROCESSOR RELATIONSHIPS REVISED GUIDANCE (Jan. 31, 2012) [hereinafter FDIC, PAYMENT PROCESSOR GUIDANCE] (“Deposit relationships with payment processors expose financial institutions to . . . legal, reputational,

FDIC's guidance listed "credit repair services, debt consolidation and forgiveness programs, online gambling-related operations, government grant or will-writing kits, payday or subprime loans, pornography, online tobacco or firearms sales, pharmaceutical sales, sweepstakes, and magazine subscriptions" as high-risk businesses.²⁸² The FDIC had also published an article in its *Supervisory Insights* journal listing thirty types of high-risk businesses, including dating services, firearms sales, home-based charities, payday loans, pornography, racist materials, telemarketing, and tobacco sales.²⁸³

Reports soon surfaced that banks, in response to regulatory pressure about reputation risk, had closed accounts of lawful businesses. Payday lenders,²⁸⁴ firearms retailers,²⁸⁵ porn stars,²⁸⁶

and other risks, including risks associated with a high or increasing number of customer complaints . . ."); OFFICE OF THE COMPTROLLER OF THE CURRENCY, OCC BULL. NO. 2008-12, PAYMENT PROCESSORS: RISK MANAGEMENT GUIDANCE (Apr. 24, 2008) ("Banks should also consider carefully the legal, reputation, and other risks presented by relationships with processors including risks associated with customer complaints, returned items, and potential unfair or deceptive practices.").

²⁸² FDIC, PAYMENT PROCESSOR GUIDANCE, *supra* note 281 (noting the list is "not all-inclusive").

²⁸³ Fed. Deposit Ins. Corp., *Managing Risks in Third-Party Payment Processor Relationships*, SUPERVISORY INSIGHTS, Summer 2011, at 6 (warning that "[i]n those instances where examiners determine that a financial institution fails to have an adequate program in place to monitor and address risks associated with third-party payment processor relationships, formal or informal enforcement actions may be appropriate").

²⁸⁴ See Danielle A. Douglas, *Banks to Payday Lenders: Quit the Business or We'll Close Your Account*, WASH. POST, Apr. 11, 2014, at A13 (reporting two instances where a bank told a payday lender its account would be closed due to regulatory pressure); Zibel & Kendall, *supra* note 40 (noting regulators were pressuring banks to discontinue payment processing services for payday lenders citing reputation risk).

²⁸⁵ See Chuck Ross, *Audio Tapes Reveal How Federal Regulators Shut Down Gun Store Owner's Bank Accounts*, DAILY CALLER (Jan. 14, 2015, 2:51 PM), <http://dailycaller.com/2015/01/14/audio-tapes-reveal-how-federal-regulators-shut-down-gun-store-owners-bank-accounts/> (reporting NCUA pressure to close the account of a gun store).

²⁸⁶ See Andy Peters, *Porn Account Closures Show Banks Erring on Far Side of Caution*, AM. BANKER (May 12, 2014, 4:01 PM), <https://www.americanbanker.com/news/porn-account-closures-show-banks-erring-on-far-side-of-caution> (detailing the stories of at least two porn stars whose accounts were closed because of federal regulators' pressure).

churches,²⁸⁷ coal mines,²⁸⁸ and condom companies complained.²⁸⁹ Payday lenders, who appeared to be at the center of the enforcement target, sued.²⁹⁰ Members of Congress became concerned that bank regulators were working with the DOJ to cut off banking access to legal industries. They held hearings,²⁹¹ collected documents,²⁹² and requested that the FDIC Office of Inspector General conduct an investigation.²⁹³

Documents gathered in the investigations reveal the FDIC's strategy to get banks to end third-party payment processing relationships with risky industries. The first step was to write the *Supervisory Insights* article identifying risky businesses.²⁹⁴ The next step was to issue guidance—a Financial Institutions Letter.²⁹⁵ The letter would be followed with additional instruction for

²⁸⁷ See Sheila Tandy, Opinion, *De-Risking Threatens Religious Access to Banking Services*, AM. BANKER (Jan. 27, 2015, 12:00 PM), <https://www.americanbanker.com/opinion/de-risking-threatens-religious-access-to-banking-services> (reporting that a bank had closed the account of a church with cash donations and some cross-border transactions because the church “‘just didn't fit with the model of the kind of entity’ that the bank wanted to do business with”).

²⁸⁸ See *DOJ's Operation Choke Point Hearing*, *supra* note 232, at 29–30 (statement of Rep. Andy Barr reading correspondence from a landowner whose bank, citing regulatory pressure over reputation risk, was closing an account because the landowner leased property to a surface coal mine).

²⁸⁹ See Zach Carter, *What Do Chase Bank, Condoms, The Tea Party, and Petty Fraud Have in Common*, HUFFINGTON POST (Mar. 29, 2014, 5:58 PM), https://www.huffpost.com/entry/bank-petty-fraud_n_5055720 (reporting JPMorgan Chase had declined to open an account for a condom company citing federal regulations on what kind of businesses they could work with).

²⁹⁰ *Advance Am., Cash Advance Ctrs., Inc. v. Fed. Deposit Ins. Corp.*, 257 F. Supp. 3d 56, 56 (D.D.C. 2017).

²⁹¹ *E.g.*, *DOJ's Operation Choke Point Hearing*, *supra* note 232, at 29–30; see also *The Federal Deposit Insurance Corporation's Role in Operation Choke Point: Hearing before the Subcomm. on Oversight & Investigations of the H. Comm. on Fin. Servs.*, 114th Cong. (2015) [hereinafter *FDIC's Role in Operation Choke Point Hearing*].

²⁹² H. COMM. ON OVERSIGHT & GOV'T REFORM STAFF REPORT, FDIC, *supra* note 47, at 2–3 (noting that at Congress's request “the Justice Department produced 853 pages of internal memoranda, communications, and presentations on Operation Choke Point” and the FDIC “provid[ed] over 7,500 pages of internal communications, memoranda, and official correspondence with supervised institutions”).

²⁹³ Letter from Blane Luetkemeyer, et al., Members of Congress, to Fred W. Gibson, Acting Inspector General, FDIC (Oct. 23, 2014), https://luetkemeyer.house.gov/uploadedfiles/10_23_14_fdic_letter.pdf.

²⁹⁴ E-mail from Frank A. Hartigan, Deputy Reg'l Dir., FDIC, to Mark Pearce, Dir. Div. of Depositor & Consumer Protection, FDIC and Sylvia H. Plunkett, Sr. Deputy Dir. Div. of Depositor & Consumer Prot., FDIC (Apr. 17, 2011), in H. COMM. ON OVERSIGHT & GOV'T REFORM STAFF REPORT, DOJ, *supra* note 275, at app. 1 FDICHOGR00002582.

²⁹⁵ See *id.*

examiners and a telephone conference call with banks discussing the guidance.²⁹⁶

Documents also show that the FDIC used reputation risk to pressure banks to end relationships with payday lenders.²⁹⁷ In one instance, a bank asked regulators about its relationships with a payday lender. The FDIC Field Supervisor in the Atlanta Region noted the relationships would trigger “in-depth” Bank Secrecy Act and information technology reviews by the FDIC.²⁹⁸ The Field Supervisor also warned that “[e]ven under the best circumstances, if this venture is undertaken with the proper controls and strategies to try to mitigate risks, since your institution will be linked to an organization providing payday services, your reputation could suffer.”²⁹⁹ This suggests that the FDIC did not think there were ways for the bank to adequately mitigate reputation risk while still providing services to payday lenders.³⁰⁰

The documents show the informal enforcement efforts to stop banking services to payday lenders were not focused on violations of law or significant financial consequences to banks. If they had been, there would have been no need to justify them on the basis of reputation risk. The FDIC relied on reputation risk because it had no other justification.³⁰¹ As one field supervisor wrote: “In the end we are getting [a bank] out of [ACH processing for a payday lender] through moral persuasion and as you know from a legal perspective

²⁹⁶ See *id.*

²⁹⁷ See H. COMM. ON OVERSIGHT & GOV'T REFORM STAFF REPORT, FDIC, *supra* note 47, at 1, 8 (finding the FDIC had “targeted legal industries,” particularly payday lenders); see also FDIC OIG CHOKE POINT REPORT, *supra* note 275, at 12 (finding “two instances in which the FDIC [cited reputation risk to] discourage[] institutions from providing ACH processing to payday lenders in written communications to the institutions”). Admittedly, the number of instances of reputation risk enforcement uncovered by the Office of Inspector General Report is small, which is not surprising given the limited scope of the investigation. See *id.* at 48 (noting the investigation was limited to reviewing regulatory efforts at twenty-three banks that provided services to “high-risk” customers). Moreover, because “[t]he FDIC does not centrally track its written communications to financial institutions that involve ACH processing concerns,” the Office of Inspector General was “unable to determine how often” communication discouraging ACH processing had occurred. *Id.* at 12.

²⁹⁸ See H. COMM. ON OVERSIGHT & GOV'T REFORM STAFF REPORT, FDIC, *supra* note 47, at 13 (highlighting the problems regarding relationships with payday lenders).

²⁹⁹ *Id.*

³⁰⁰ See *id.* (noting the troubles banks face in mitigating payday lender risk).

³⁰¹ See FDIC OIG CHOKE POINT REPORT, *supra* note 275, at 27 (noting that the payday lender relationship “posed no significant risk to the institution, including financial, reputation, or legal risk”).

we don't have much of a position, if any."³⁰² In another e-mail, an FDIC official explained that officials in San Francisco had hoped to bring more formal enforcement actions against banks with third-party payment processing relationships; the effort had stalled, however, because "[l]egal was a major obstacle."³⁰³

The FDIC turned to informal enforcement of reputation risk because it did not like payday lenders. One FDIC official wrote: "I literally can not [sic] stand pay day lending. They are abusive, fundamentally wrong, hurt people, and do not deserve to be in any way associated with banking."³⁰⁴ Others described payday lending as "unsavory"³⁰⁵ and "a particularly ugly practice."³⁰⁶

How far the FDIC's informal enforcement extended beyond payday lending is unclear. Initially, the FDIC Office of Inspector General did not find evidence of reputation risk enforcement aimed at accounts of other high-risk businesses.³⁰⁷ But it did find "a perception among some bank executives . . . that the FDIC discouraged institutions from conducting business with [high-risk] merchants."³⁰⁸ The Office of Inspector General also announced it would conduct a follow-up investigation examining tax refund anticipation loans.³⁰⁹ Although refund anticipation loans "were not on the [FDIC's] high-risk list," the Office of Inspector General "observed that the FDIC's supervisory approach to institutions that offered this type of credit product involved circumstances that were similar to those that prompted" the Operation Choke Point investigation.³¹⁰

The follow-up investigation found FDIC examiners had used Operation Choke Point-like tactics to coerce banks to stop offering

³⁰² *Id.*

³⁰³ E-mail from Frank A. Hartigan to Mark Pearce, *supra* note 294.

³⁰⁴ E-mail from Thomas Dujenski to Mark Pearce, *supra* note 47.

³⁰⁵ See E-mail from Redacted, Counsel, Legal Div., Consumer Enf't Unit, FDIC, to Marguerite Sagatelian, Senior Counsel, Consumer Enf't Unit, FDIC (Aug. 28, 2013) (comparing payday lending to pornography and gambling), in H. COMM. ON OVERSIGHT & GOV'T REFORM STAFF REPORT, FDIC, *supra* note 47, at 11.

³⁰⁶ E-mail from Redacted, Counsel, Legal Div., Consumer Enf't Unit, FDIC, to Marguerite Sagatelian, Senior Counsel, Consumer Enf't Unit, FDIC (Mar. 8, 2013), in H. COMM. ON OVERSIGHT & GOV'T REFORM STAFF REPORT, FDIC *supra* note 47, at 10.

³⁰⁷ See FDIC OIG CHOKE POINT REPORT, *supra* note 275, at 11 ("We found no evidence that the FDIC used the high-risk list to target financial institutions.").

³⁰⁸ *Id.* at 11–12 (noting that "[t]his perception was most prevalent with respect to payday lenders").

³⁰⁹ *Id.* at 14.

³¹⁰ *Id.* at 13.

tax refund anticipation loans.³¹¹ In letters to three banks, the FDIC warned:

We find that [refund anticipation loans] are costly and offer limited utility for consumers as compared to traditional loan products. They also carry a high degree of risk to an institution, including third-party[,] reputation[,] compliance[,] and legal exposures. These risks may expose the bank to individual and class actions by borrowers and local regulatory authorities. Consequently, we find [refund anticipation loans] unacceptable for the bank.³¹²

The FDIC followed the letters with “what it termed ‘strong moral suasion’ to persuade . . . the banks to stop offering [refund anticipation loans]. What began as persuasion degenerated into meetings and telephone calls where banks were abusively threatened by an FDIC attorney.”³¹³ After two of the three banks had already stopped offering tax refund anticipation loans, the FDIC “deploy[ed] an unprecedented 400 examiners to examine 250 tax preparers throughout the country and the remaining bank offering [refund anticipation loans].”³¹⁴ This show of strength was “used as leverage in negotiations to get the final bank to exit [refund anticipation loans], . . . but for little else.”³¹⁵

The FDIC pursued this aggressive enforcement strategy even though refund anticipation loans “were, and remain, legal

³¹¹ FDIC OIG REFUND ANTICIPATION LOANS REPORT, *supra* note 49, at iii (describing the FDIC’s use of “strong moral suasion” and threats). The FDIC Office of Inspector General did not release its report on tax refund anticipation loans, citing the “sensitive information” it contained. Instead, the Office of Inspector General released an executive summary of the report. *Id.* Additional information about the Office of Inspector General’s tax refund anticipation loan investigation can be gleaned from a congressional hearing on the topic. See generally *The FDIC’s Targeting of Refund Anticipation Loans, Hearing before the Subcomm. on Oversight & Investigations of the H. Comm. on Fin. Servs.*, 114th Cong. (2016) [hereinafter *Refund Anticipation Loan Hearing*].

³¹² *Refund Anticipation Loan Hearing*, *supra* note 311, at 22 (statement of Rep. Randy Hultgren quoting letter language). This language is very similar to language sent to banks pressuring them to end relationships with payday lenders. Compare *id.* with FDIC OIG CHOKE POINT REPORT, *supra* note 275, at 26 (examining a letter sent from the Chicago Regional office to a bank regarding the need to end relationships with payday lenders).

³¹³ FDIC OIG REFUND ANTICIPATION LOANS REPORT, *supra* note 49, at iii.

³¹⁴ *Id.*

³¹⁵ *Id.*

activities” and, as the FDIC Office of Inspector General found, there was no “significant examination-based evidence of harm caused by the [refund anticipation loan] programs.”³¹⁶ Somewhat ironically, the Office of Inspector General concluded that the FDIC’s enforcement tactics caused “reputational damage to the banks” involved.³¹⁷

The investigations surrounding Operation Choke Point show that regulators sometimes rely on reputation risk as an enforcement tool when a bank is not violating the law. They also show that regulators sometimes turn to reputation risk even when the regulator does not believe the financial institution faces a serious financial threat.

2. Gun Advocacy Groups.

The other lawsuit involving informal regulation of reputation risk was brought by the NRA after the New York Department of Financial Services issued a guidance letter instructing banks to consider reputation risk when providing banking services to gun rights groups.³¹⁸ According to the lawsuit, the New York regulator “coerce[d] . . . banks into terminating business relationships with the NRA.”³¹⁹ The complaint alleges the guidance letter and “accompanying backroom exhortations” made it clear that banks must terminate relationships with the NRA and other gun rights groups.³²⁰

The NRA also noted that the press releases accompanying the gun advocacy guidance praised “businesses [that] have ended relationships with the NRA.”³²¹ New York Governor Andrew Cuomo made it clear he had directed the Department of Financial Services to issue the guidance calling “gun safety . . . a top priority for every individual, company, and organization that does business across the state.”³²² He later emphasized: “The NRA is an extremist organization. I urge companies in New York State to revisit any ties

³¹⁶ *Id.* at ii.

³¹⁷ *Id.*

³¹⁸ Vullo Letter, *supra* note 44.

³¹⁹ Original Complaint & Jury Demand, *supra* note 45, at 17.

³²⁰ *Id.* at 1, 22, 25, 30.

³²¹ Press Release, N.Y. Dep’t of Fin. Servs., *supra* note 48.

³²² *Id.* (quoting Governor Cuomo).

they have to the NRA and consider their reputations, and responsibility to the public.”³²³

The New York Department of Financial Services denies it engaged in any “backroom exhortations” aimed at chilling the NRA’s gun rights advocacy.³²⁴ It claims the guidance letter is not binding and was “plainly intended to convince companies to work toward ‘positive social change’ without threat of regulatory action.”³²⁵

The case has not yet reached a resolution.³²⁶ It remains to be seen whether the NRA can prove its allegations of informal reputation risk enforcement. The New York Department of Financial Services does not seem eager to provide information about its regulatory activities in discovery.³²⁷ Even if there is significant discovery, we may not learn much more about the regulatory process because the parties have agreed to a protective order.³²⁸

3. Guidance as Evidence of Informal Enforcement.

It is not surprising there is little direct evidence regarding informal reputation risk enforcement. Informal enforcement is, by

³²³ Andrew Cuomo (@NYGovCuomo), TWITTER (Apr. 20, 2018, 11:58 AM), <https://twitter.com/NYGovCuomo/status/987359763825614848>.

³²⁴ Answer at 30, 33–34, 36–37, 47, *Nat’l Rifle Ass’n of Am. v. Cuomo*, 350 F. Supp. 3d 94 (N.D.N.Y. 2018).

³²⁵ Memorandum of Law in Support of Defendants’ Motion to Dismiss the First Amended Complaint Pursuant to 12(B)(6), *supra* note 235, at 36.

³²⁶ See *Nat’l Rifle*, 350 F. Supp. 3d at 119 (denying New York’s motion to dismiss the NRA’s First Amendment freedom of speech claim and stating that “[w]hile the NRA may not be able to establish the factual predicates for these claims, it has presented sufficient allegations to allow them to go forward”). The court dismissed claims that the NRA brought under 42 U.S.C. § 1983 and claims for money damages against the Division of Financial Services and Governor Cuomo and Superintendent Vullo in their official capacities. *Nat’l Rifle Ass’n of Am. v. Cuomo*, No. 18-CV-0056, 2019 WL 2075879 (N.D.N.Y. May 10, 2019).

³²⁷ For example, the New York Department of Financial Services sought to prevent the NRA from deposing Maria Vullo, the former Superintendent at the New York Department of Financial Services who had issued the guidance letter, but U.S. Magistrate Judge Christian Hummel ruled Ms. Vullo could be deposed. *Nat’l Rifle Ass’n of Am. v. Cuomo*, No. 18-CV-00566-TJM-CFH, 2019 WL 2918045, *5 (N.D.N.Y. Mar. 20, 2019). The regulator also seeks to prevent the NRA from discovering documents related to “research, analyses, models, or estimates developed or compiled by DFS regarding ‘reputational risks.’” *Nat’l Rifle Ass’n of Am. v. Cuomo*, No. 18-CV-00566-TJM-CFH, 2019 WL 3765929 (N.D.N.Y. Aug. 8, 2019) (concluding the requested documents are relevant and ordering the Division of Financial Services to produce the documents for in camera review so that the court can determine whether attorney-client or work product privileges apply).

³²⁸ *Nat’l Rifle Ass’n of Am. v. Cuomo*, No. 18-CV-00566-TJM-CFH, slip op. at 1 (N.D.N.Y. Apr. 24, 2019).

design, private.³²⁹ It receives public scrutiny only in unusual circumstances. But the lack of direct evidence does not mean that informal reputation risk enforcement does not routinely occur. In fact, it is likely that the deluge of ostensibly unenforceable reputation risk guidance operates as de facto reputation risk enforcement.

Bankers frequently complain that regulators treat unenforceable guidance as binding.³³⁰ As part of a recent study, Professor Nicholas Parrillo interviewed bank regulators, banking attorneys, and a former consultant in the consumer finance industry.³³¹ He found that banks' "intense" and ongoing interactions with their regulators provide powerful motivation to comply with even non-binding guidance.³³² Banks are repeat players with their regulators.³³³ They need to maintain good relationships with regulators to be profitable.³³⁴ A former regulator who now advises banks recalled an examiner who "criticized [a] . . . bank for a regulatory violation by citing an article that he (the examiner) had written in the Federal Reserve's magazine. The interviewee and her colleagues thought this was improper. But the bank opted not to resist, saying, 'we don't want to fight with our examiner.'"³³⁵ She explained regulators "can 'make life miserable' for a bank in all sorts of ways, and noncompliance on one dimension can have bad consequences on other dimensions."³³⁶

³²⁹ See *supra* notes 262–63 and accompanying text.

³³⁰ See, e.g., John Heltman, *Next on Banks' Reg Relief Wish List: More Consistent Exams*, AM. BANKER (Nov. 19, 2018, 2:03 PM), <https://www.americanbanker.com/news/next-on-banks-reg-relief-wish-list-more-consistent-exams> ("Greg Baer, CEO of the Bank Policy Institute, said banks routinely complain that supervisors flag things amounting to organization preferences, not safety and soundness threats. Examiners cite guidance as the basis for 'Matters Requiring Attention' or 'Matters Requiring Immediate Attention,' Baer said, even though agency leaders insist disobeying guidance is not grounds for punitive action.").

³³¹ See Parrillo, *supra* note 266, at 192–95 (describing interviews with these people).

³³² *Id.* at 194.

³³³ *Id.* at 192–93; Arthur E. Wilmarth, Jr., *Turning a Blind Eye: Why Washington Keeps Giving in to Wall Street*, 81 U. CIN. L. REV. 1283, 1418 (2013).

³³⁴ A former Federal Reserve official who now counsels banks told Professor Parrillo: "If I am a depository institution . . . I have a great need to make sure that [the regulators] like me . . . If you lose the trust of the regulations nothing else matters[.] . . . there is no salvaging that." Parrillo, *supra* note 266, at 194.

³³⁵ *Id.* at 195.

³³⁶ *Id.* Another banking attorney explained it this way:

[R]egulators can possess the memories of elephants. Even if they allow you to escape the axe today, they can nip and scratch at you over an extended period of time, worrying you with criticisms small and large. You can die

Moreover, banks operate in a regulatory system where perfect compliance is unattainable. As Professor Parrillo explains:

The rationale for generally following guidance, said [a former Federal Reserve official], is that it is practically impossible for a bank to comply with all legislative rules all the time, so you want the examiner to think that any mistakes you make were made in a good-faith effort to comply. In particular, the bank must show that it has internal procedures in place to check itself, the presence of which can show that any problems the bank has are not systemic; these internal procedures are patterned on agency bulletins (guidance), but it doesn't matter if these bulletins are "guidance or [legislative rules] or what."³³⁷

Another of Professor Parrillo's interviewees explained that guidance itself is a way for regulators to change bank behavior, short of formal enforcement.³³⁸ Just as "parents can often get their children to change behavior by informal means ('raising an eyebrow' rather than 'spelling out rules'), . . . an agency can [change bank behavior] through guidance."³³⁹ Personnel throughout the agency then reinforce the guidance's message informally through the bank examination process.³⁴⁰

from a saber thrust through the throat, or you can slowly bleed to death of a thousand tiny cuts. It can be decades before your supervisory personnel are ready to retire on their government pensions

Kevin Funnell, *Martyrdom Postponed*, BANK L. BLOG (Oct. 29, 2012, 9:47 PM), https://www.banklawyersblog.com/3_bank_lawyers/2012/10/martyrdom-postponed.html.

³³⁷ Parrillo, *supra* note 266, at 195.

³³⁸ *Id.*

³³⁹ *Id.*

³⁴⁰ In interagency guidance, regulators have stated they "do not take enforcement action based on supervisory guidance." INTERAGENCY STATEMENT CLARIFYING THE ROLE OF SUPERVISORY GUIDANCE, *supra* note 203. However, the guidance further explains that [d]uring examinations and other supervisory activities, examiners may identify unsafe or unsound practices or other deficiencies in risk management, including compliance risk management, or other areas that do not constitute violations of law or regulation. In some situations, examiners may reference (including in writing) supervisory guidance to provide examples of safe and sound conduct, appropriate . . . risk management practices, and other actions for addressing compliance with laws or regulations.

Id. This use of the guidance reinforces the message that banks should follow the guidance.

This is not to say that banks never challenge guidance. Still, this is rare unless there is “a lot of money at stake and following the guidance would . . . constrain the bank on something core to its business model.”³⁴¹ Even the process of departing from guidance is “delicate” because in escalating the matter up the examination chain of command, the bank risks the “bad consequences” of “ticking off” its examiner.³⁴²

Professor Parrillo’s observations about bank guidance accurately describe how both regulators and banks view reputation risk guidance. Indeed, the OCC’s definition of reputation risk identifies “regulators” as important stakeholders whose perceptions matters.³⁴³ This emphasizes the danger in departing from regulators’ wishes.³⁴⁴ Furthermore, the Operation Choke Point documents show that bank fears about escalating informal enforcement are valid. Banks that did not cut off relationships with payday lenders or end tax refund anticipation loans after reading regulatory guidance faced follow-up warnings and intensified regulatory scrutiny.³⁴⁵

In this regulatory environment, reputation risk guidance serves as an informal enforcement measure. When guidance warns banks about the reputation risk of lending to oil and gas companies, or providing payment services to payday lenders, or dealing with gun promotion organizations, we can expect most banks to get the message and cut off services. If they do not, examination staff may emphasize the guidance using other informal enforcement means. Banks will be especially unwilling to fight regulators over

Professor Parrillo identifies a number of factors that encourage regulators to be inflexible in their application of guidance. Among them are pressures for consistency, costs associated with evaluating departures, costs of obtaining agency approval for departure, and superiors’ institutional motivations to affirm subordinates. See Parrillo, *supra* note 266, at 231–57.

³⁴¹ Parrillo, *supra* note 266, at 195.

³⁴² *Id.* at 255.

³⁴³ OCC, LARGE BANK SUPERVISION HANDBOOK 2018, *supra* note 26, at 64.

³⁴⁴ Bank regulators are likely aware of guidance’s coercive power. Certainly, the regulators and former regulators Professor Parrillo interviewed seemed aware of the power of guidance. Parrillo, *supra* note 266, at 178, 192–95. Nevertheless, Professor Parrillo concludes that “even when regulated parties are strongly pressured, or when officials are inflexible, this is normally not because agency officials are engaged in some sort of bad-faith effort to coerce the public without the legally required [administrative] procedures.” *Id.* at 174. Regardless of regulators’ intent, the result is the same: regulatory guidance about reputation risk coerces banks into taking action they would not otherwise take. *Id.*

³⁴⁵ See *supra* notes 297–300, 313–15 and accompanying text.

third-party reputation risk when the third parties impacted are small industries with whom the bank does little business. The coercive power of guidance combined with the power dynamic within the regulatory relationship compels this result.

V. AGAINST REPUTATION REGULATION

As regulators see it then, the concept of reputation risk is quite expansive and, consequently, the power to regulate is quite broad. Reputation risk exists in every aspect of banking.³⁴⁶ Regulators claim authority to regulate reputation risk even when there is no significant financial harm and no violation of statute or regulation.³⁴⁷ By defining themselves as one of the relevant stakeholder groups, regulators may raise reputation risk even if they are the only ones troubled by a particular practice.³⁴⁸ In addition, regulators note reputation risk might be caused by untrue information beyond the control of the financial institution³⁴⁹ or third-party conduct unrelated to banking.³⁵⁰ While publicly available enforcement actions do not show that regulators routinely exercise the full range of power they claim, there are examples of enforcement aimed at reputation risk without further justification and without significant threat of serious financial consequence.³⁵¹ In addition, the rapid deployment of reputation risk throughout federal regulatory guidance³⁵² and recent regulatory efforts aimed at payday lenders,³⁵³ tax refund anticipation loans,³⁵⁴ and gun rights groups³⁵⁵ suggest that regulators may be more aggressive in their regulation of bank reputation in the future.

³⁴⁶ See *supra* note 152 and accompanying text.

³⁴⁷ See *supra* note 221 and accompanying text.

³⁴⁸ See Peter Weinstock, Opinion, *Bank Think: Examiners' Growing Misuse of 'Reputation Risk,'* AM. BANKER (July 2, 2013, 9:00 AM), <https://www.americanbanker.com/opinion/examiners-growing-misuse-of-reputation-risk> (noting that "parties outside the bank (examiners?) can define reputation risk by their perceptions"); *supra* note 124 and accompanying text (discussing the OCC's expansive definition of relevant stakeholders).

³⁴⁹ See *supra* notes 127–28 and accompanying text.

³⁵⁰ See *supra* notes 171–72 and accompanying text.

³⁵¹ See *supra* notes 257–62, 298–307 and accompanying text.

³⁵² See *supra* Part III.

³⁵³ See *supra* Section IV.D.1.

³⁵⁴ See *supra* notes 309–17 and accompanying text.

³⁵⁵ See *supra* Section IV.D.2.

This is the wrong path for regulators. First, regulation focused specifically on reputation risk does little to alleviate panics or reduce moral hazard. In most cases, reputation risk is derivative to other risks directly addressed by banking law. When reputation risk occurs without other risks, regulators have difficulty accurately predicting when it will arise. Second, by expansively regulating reputation risk, regulators could damage their own reputations and introduce systemic risk. This makes regulation less effective as a substitute for bank reputation and makes the entire banking industry less stable.

Regulators, courts, and legislatures can all take measures to limit the regulation of reputation risk. Of these, Congress is best positioned to broadly and permanently curtail bank reputation regulation.

A. REPUTATION REGULATION IS INEFFECTIVE

The nature of reputation risk makes it difficult to regulate in a way that adds meaningful value to the regulatory system. Reputation risk is often a derivative risk.³⁵⁶ Because bank regulators have broad powers over other more direct risks, reputation risk often does little work. When Wells Fargo employees illegally opened unauthorized accounts, they violated the law and created reputation risk.³⁵⁷ When banks violate anti-money laundering laws, they create reputation risk.³⁵⁸ When banks have credit quality problems, they create reputation risk.³⁵⁹ Enforcement actions in those situations do not need to be grounded in reputation risk. Enforcement can be grounded in other law. Reputation risk adds little to the regulatory toolbox.

If reputation risk regulation is going to have a useful impact, it must operate in areas not already covered by existing banking law. The trouble is that the nature of reputation risk makes it difficult for regulators to assess.³⁶⁰ Regulators themselves sometimes

³⁵⁶ See *supra* notes 64–71 and accompanying text.

³⁵⁷ See *supra* notes 1–8, 244–45 and accompanying text.

³⁵⁸ See *supra* notes 108, 243, 250–54 and accompanying text.

³⁵⁹ See *supra* notes 65, 241, 247 and accompanying text.

³⁶⁰ See Rolland Johannsen, Opinion, *Reputational Risks Are Heightened by Tense Political Climate*, AM. BANKER (Feb. 22, 2017), <https://www.americanbanker.com/opinion/reputational-risks-are-heightened-by-tense-political-climate> (“Of all the risks facing banks, reputational risk is the most difficult to anticipate, measure and manage.”); Viveca Ware, *Questioning ‘Reputational’ Risk*, INDEP. BANKER (Sept. 26, 2014),

acknowledge reputation risk is difficult to identify and measure.³⁶¹ The most difficult of all reputation losses to predict and avoid are probably those caused by untrue statements. These days “consumers, competitors, disgruntled former employees” need nothing more than the internet to quickly spread misinformation.³⁶² While banks and their regulators are well aware of this type of threat, there is little they can do to predict or prevent it. There are laws to discourage third-parties from lying about banks,³⁶³ but these measures do not allow regulators to peer into the minds of third parties to determine when they might lie. Even armed with reputation risk regulation as a tool, regulators will be unable to prevent runs like the one at Jiangsu Sheyang Rural Commercial Bank in China. Certainly, as Jiangsu Sheyang did, a bank can take measures to ameliorate harm after an incomplete, inaccurate, or false statement is discovered.³⁶⁴ However, once liquidity concerns arise, regulators have other tools to manage liquidity risk.³⁶⁵ Again, reputation risk regulation adds little value.

Even in circumstances where the reputation risk arises from accurate information, it is not clear that regulators are able to effectively forecast reputational losses. Reputation is based on ever changing stakeholder values and social expectations. Values can

<http://independentbanker.org/2014/09/reputation-reputation/> (“Unlike other types of risk (credit, market, liquidity, operational and legal), reputational risk is highly subjective and difficult to measure.”).

³⁶¹ See, e.g., OCC, RISK ASSESSMENT SYSTEM, *supra* note 125 (noting that “measuring the quantity of [reputation] risk remains difficult”). This 2015 Bulletin was incorporated into OCC, LARGE BANK SUPERVISION HANDBOOK 2018, *supra* note 26, and other OCC publications, but this particular language does not appear to have been retained. See OFFICE OF THE COMPTROLLER OF THE CURRENCY, OCC BULL. NO. 2018-18, COMPTROLLER’S HANDBOOK: REVISED AND UPDATED BOOKLETS AND RECESSIONS (June 28, 2018).

³⁶² Whitney Gibson & Jordan Cohen, *Internet Defamation and the Banking Industry*, BANKERS’ STATEMENT (Winter 2016), <https://www.vorys.com/publications-1632.html>.

³⁶³ Louisiana and Mississippi discourage lies about banks by making it a crime to make a false statement that is “calculated to injure” a bank’s “reputation or businesses.” LA. STAT. ANN. § 6:930 (2017); MISS. CODE ANN. § 81-12-199 (2017). Defamation laws may also discourage third parties from making untrue statements. Robert F. Somers, *Slander? Prove It: Why a Two Hundred-Year-Old Defamation Law Should Be Changed*, 19 SW. J. INT’L L. 133, 173 (2012).

³⁶⁴ See *supra* notes 19–24 and accompanying text (discussing the Jiangsu Sheyang bank run).

³⁶⁵ See 12 C.F.R. § 50.2 (2015) (allowing the OCC to require additional liquidity based on the circumstances of an individual bank). The availability of other regulatory tools once losses manifest themselves probably explains why the regulators have focused their reputation risk guidance on anticipating and preventing harm rather than on remediating reputational harm. See *supra* Parts III & IV (discussing reputation risk guidance and enforcement).

“evolve” slowly or expectations may adjust abruptly under the spotlight of media attention.³⁶⁶ When Bank of America sparked Bank Transfer Day by instituting a \$5 monthly fee for debit cards, Wells Fargo had already instituted a \$3 fee.³⁶⁷ Nevertheless, “Bank of America received the brunt of the criticism.”³⁶⁸ It seems unlikely that Bank of America’s regulators could have accurately predicted the negative press and reputational impact. As one bank industry consultant explains, “[t]here’s almost no way to predict how customers are going to react” to corporate scandals or negative press.³⁶⁹

Anticipating reputation losses may be even more difficult for regulators when the negatively perceived behavior is not directly attributable to the bank. Regulatory guidance cautions that banks may incur reputational harm if they do business with gun rights groups³⁷⁰ or oil companies that might be “perceived by the public to be negligent in preventing environmental damage.”³⁷¹ Indeed, regulators warn that any third-party relationship poses reputational risk, even when the perceived negative actions of the third party do not relate to the banking relationship.³⁷²

Transferring reputation risk from third parties to banks in these circumstances is a three-step process. First, the third party must be perceived negatively. Second, bank stakeholders must transfer that negative perception from the third party to the bank. Third, the negative stakeholder perception must not be offset by other benefits from the relationship. Regulators have trouble assessing the risk in each of these steps.

Certainly, regulators can identify some industries subject to frequent public criticism (although the reputational risk to these industries themselves has yet to drive them from the market). If the aim of regulators, however, is to warn banks about any potentially

³⁶⁶ Walter, *supra* note 69, at 42.

³⁶⁷ Aaron Passman & Palash Ghosh, *Bank Transfer Day Returns, but Will Lightning Strike Twice?*, CREDIT UNION J., Oct. 3, 2016, at 1.

³⁶⁸ *Id.*

³⁶⁹ Tom Groenfeldt, *Calculating Elusive Reputation Risk—A Task for a Dartboard?*, FORBES (Mar. 13, 2018, 1:41 PM), <https://www.forbes.com/sites/tomgroenfeldt/2018/03/13/calculating-elusive-reputational-risk-a-task-for-a-dartboard/#3e313d6b2951> (quoting Danielle Tierney, senior analyst at Aité Group).

³⁷⁰ See Vullo Letter, *supra* note 44; *supra* note 196 and accompanying text.

³⁷¹ See OCC, OIL AND GAS LENDING HANDBOOK, *supra* note 51, at 17.

³⁷² See *e.g.*, FDIC, THIRD-PARTY RISK GUIDANCE, *supra* note 28, at 3.

problematic customer or industry, the guidance falls short. Some controversial groups have, so far, escaped regulatory attention.³⁷³ Furthermore, any industry or third-party partner could at some point be perceived negatively.³⁷⁴ A restaurant might serve tainted food. An airline might have a fatal crash. A once-thought-safe-product may be found to cause cancer. Banks and regulators would expend insurmountable resources to monitor every third-party customer or partner for possible reputation risk to the bank. Both must make some assessment that many businesses and people with their own reputational risks do not pose significant risk as a bank customer or partner.

Bank regulators, though, are not well suited to determine when a third party's reputational damage will be transferred to a bank. In areas where regulators have indicated broad reputational concerns arising from third parties, like fossil fuels, guns, and payday loans, there is little evidence that reputation risk alone has ever caused a bank material loss—let alone a run or panic. If third-party reputation risk caused material bank losses, we would likely see some evidence of it in the press, in regulatory enforcement, and perhaps in studies of bank failures. We do not. Instead, press reports tend to show some unhappy stakeholders, but no material impact on bank health.³⁷⁵ Regulatory enforcement

³⁷³ See William M. Isaac, Opinion, *DOJ's 'Operation Choke Point': An Attack on Market Economy*, AM. BANKER (Mar. 21, 2014, 10:00 AM), <https://www.americanbanker.com/opinion/dojs-operation-choke-point-an-attack-on-market-economy> (noting the same justifications for regulating third-party relationships with payday lenders could be used to choke off banking services to “convenience stores selling large sugary sodas, restaurants offering foods with high trans-fat content or family planning clinics performing abortions”); Todd Zywicki, “Operation Choke Point,” WASH. POST (May 24, 2014, 2:17 PM), <https://www.washingtonpost.com/news/volokh-conspiracy/wp/2014/05/24/operation-choke-point/> (noting the FDIC's list of high-risk businesses did not include “abortion clinics, radical environmental groups, or . . . marijuana shops”).

³⁷⁴ Derek E. Bambauer, *Against Jawboning*, 100 MINN. L. REV. 51, 123 (2015) (“Reputation risk is seemingly boundless: any entity that suffers bad publicity and that does business with a depository institution potentially creates legally actionable risk for that bank.”).

³⁷⁵ On the issue of fossil fuels, Well Fargo's financing of the Dakota Access Pipeline is probably the most criticized action, but it did not jeopardize Well Fargo's financial condition. A “Defund DAPL” webpage encouraged individuals, cities, and tribes to move money from banks financing the pipeline. #DEFUNDDAPL, www.defunddapl.org (last visited Jan. 24, 2020). It asked those that closed accounts to provide information about the size of accounts closed, and reports banks lost \$4.324 billion in city deposits. *Id.* Other sources report that the Defund DAPL webpage gathered information suggesting individuals moved \$86.2 million from the participating banks. CARLA F. FREDERICKS, MARK MEANEY, NICHOLAS PELOSI & KATE R. FINN, FIRST PEOPLES WORLDWIDE U. COLO. BOULDER, SOCIAL COST AND MATERIAL

officials sometimes tepidly acknowledge there is no reason to suspect financial loss from third-party activities.³⁷⁶ And bank failure reports do not mention reputation risk.³⁷⁷ While past performance does not necessarily predict future results, it seems that material reputational losses from third-party relationships are so rare that regulators have few guideposts to help them predict future loss.

Finally, regulators are not well-positioned to determine whether the reputational harm might be offset by benefits, or whether the reputational harm of one course of action is less than the reputational harm of alternative actions. Each bank has many different stakeholder groups.³⁷⁸ These stakeholder groups do not necessarily have the same public perception of the bank or its

LOSS: THE DAKOTA ACCESS PIPELINE 39 (Nov. 2018), https://www.colorado.edu/project/fpiip/sites/default/files/attached-files/social_cost_and_material_loss.pdf. It is not clear whether this crowd-sourced data gathered by an advocacy group is reliable. For example, although the City of Seattle initially intended to close its account, it ended up maintaining its account with Wells Fargo. See Ashley Stewart, *Back on the Wagon: Here's Why Wells Fargo Continues to Be Seattle's Best Banking Option*, PUGET SOUND BUS. J. (Feb. 8, 2019, 6:00 AM), <https://www.bizjournals.com/seattle/news/2019/02/08/city-council-wells-fargo-contract-dap-public-bank.html> (noting few banks qualified for the contract and other banks were worried about the vague social responsibilities set by Seattle). However, even assuming the data is reliable and the closures were entirely attributable to Wells Fargo, the result is not material. In 2017, Wells Fargo reported \$1.3 trillion in average total deposits. Wells Fargo & Co. (Form 10-K), at 1 (2017).

Even Wells Fargo's account scandal does not appear to have "led to serious financial harm that imperiled [the] bank's solvency." Greg Baer, *Rethinking Safety and Soundness Supervision*, 5 BANKING PERSP. no. 3, 2017, at 42, 44. One way to see this is to look at Wells Fargo's credit default swap spread. As Greg Baer explains:

Over the past 10 years, Wells Fargo's [credit default swap] spreads, like those of other companies, have varied based on economic and financial conditions. However, the "reputational risk" of the [account] scandal clearly has proven immaterial to those spreads. At all points since the issue first came to light on September 8, 2016, however, spreads have remained significantly below their 10-year average. Indeed, they remain near their 10-year lows.

Id.

³⁷⁶ See *supra* notes 302–03 and accompanying text.

³⁷⁷ A search of the FDIC Office of Inspector General reports prepared after bank failures does not yield any instances where the failure of the bank was attributed to reputation risk, let alone third-party reputation risk. *Reports of Bank Failures*, FEDERAL DEPOSIT INSURANCE CORPORATION OFFICE OF INSPECTOR GENERAL, <https://www.fdicog.gov/reports-bank-failures> (last visited Jan. 24, 2020).

³⁷⁸ See, e.g., OCC, LARGE BANK SUPERVISION HANDBOOK 2018, *supra* note 26, at 64 (identifying "customers, counterparties, correspondents, investors, regulators, employees, and the community" as bank stakeholders).

decisions.³⁷⁹ For example, shareholders might like a fee that generates income, while customers would prefer not to pay the fee. Even individuals within the same stakeholder group do not necessarily perceive the bank in the same manner.³⁸⁰ This means a bank might face criticism regardless of the course of action it takes.³⁸¹ Moreover, all banks do not have the same stakeholder bases. The depositors of some banks may care about things quite different from the depositors of another banks.³⁸² Shareholders of one bank might be troubled by a practice that shareholders of another bank endorse.

Lending to the fossil fuel industry provides one example of how difficult it can be to assess the reputational impact of various decisions. As we see with the criticism over Wells Fargo's financing of the Dakota Access pipeline, lending for fossil fuel projects can sometimes spark negative stakeholder backlash.³⁸³ But the opposite is also true. In 2018, Bank of the West announced it would not finance a variety of fossil fuel projects.³⁸⁴ Although the Sierra Club (an environmental advocacy group) immediately praised the

³⁷⁹ Violina P. Rindova & Luis L. Martins, *Show Me the Money: A Multidimensional Perspective on Reputation as an Intangible Asset* (“[T]he same firm can have different reputations for different attributes with different stakeholders because specific types of actions are perceived and valued differently by different stakeholder groups.”), in *THE OXFORD HANDBOOK OF CORPORATE REPUTATION*, *supra* note 78, at 16, 20; Eccles, Newquist & Schatz, *supra* note 62, at 4 (“Of course, different stakeholders’ expectations can diverge dramatically, which makes the task of determining acceptable norms especially difficult.”).

³⁸⁰ Cf. CLAIRE A. HILL & RICHARD W. PAINTER, *BETTER BANKERS, BETTER BANKS: PROMOTING GOOD BUSINESS THROUGH CONTRACTUAL COMMITMENT* 2–3 (2015) (suggesting institutional bank customers view “some sorts of problematic behavior [as] a sign of intelligence and skill,” while individual customers do not).

³⁸¹ For example, after liberal groups criticized advertisers on Sean Hannity’s Fox News Channel program, USAA (parent company of USAA Bank) announced it was pulling its advertising there. David Bauder, *USAA Reverses Course, Puts Ads Back on ‘Hannity,’* HOUSTON CHRON., May 31, 2017, at B2. USAA’s decision led to “heavy criticism . . . from many of the military members and veterans that it serves.” *Id.* USAA eventually reversed course and reinstated the advertising. *Id.*

³⁸² See Chris Nichols, *Is Your Bank a Democrat or Republican?*, CENTERSTATE CORRESPONDENT DIVISION (Nov. 7, 2016), <https://csbcorrespondent.com/blog/your-bank-democrat-or-republican> (explaining that because “[p]ockets of Republicans and Democrats are not evenly dispersed and neither are [bank] branches,” it is likely that different banks skew Republican or Democrat).

³⁸³ See *supra* notes 12–18 and accompanying text.

³⁸⁴ *Bank Dropping Oil, Gas Investment*, BOS. HERALD, Aug. 13, 2018, at 15 (stating that Bank of the West will “no longer finance oil and gas exploration or production projects in the Arctic,” “coal mines or coal-fired power plants that are not actively involved in the energy transition,” and “companies whose main activity is tied to oil and gas from shale or tar sands”).

decision,³⁸⁵ many with economic ties to fossil fuels were not happy. In Craig, Colorado, Bank of the West branch manager Stacy Razzano resigned because she was worried about the impact of the bank's move on her community.³⁸⁶ The Wyoming state government and some cities announced plans to end deposit relationships with Bank of the West.³⁸⁷ Some retail depositors in Wyoming were also upset. The Wyoming press reported that Bank of the West's competitors were "crazy busy' opening new accounts."³⁸⁸ Reliant Federal Credit Union, a four-branch financial institution based in Casper, Wyoming,³⁸⁹ put up a large sign welcoming energy workers.³⁹⁰

On controversial issues, bank regulators are ill-equipped to determine which course of action will result in the least negative reputational impact for any particular financial institution. Wells Fargo, Bank of the West, Reliant Federal Credit Union, and other financial institutions talk with their customers and employees every day. Banks interact with their shareholders, business partners, community members, and local press. When they need more information about customers or potential customers, they might conduct market research. This gives banks some basis for assessing the reaction of stakeholders and making decisions about whether actions are likely to harm the overall reputation of the bank. In contrast, regulators rarely talk to customers, employees,

³⁸⁵ Sarah Skidmore Sell & Mead Gruver, *Bank of the West's Environmental Stand Faces Blowback*, ASSOCIATED PRESS (Aug. 10, 2018), <https://apnews.com/0e7d1b7aad3b4a4c994c89893c02e3e7> ("Ben Cushing, campaign manager for the Sierra Club's Beyond Dirty Fuels campaign, said this is an example of the growing movement to defund fossil fuels. 'Banks that continue with business as usual will soon be left behind,' he said.").

³⁸⁶ See Valerie Richardson, *Bank of the West's Climate Change Mission Fuels Coal Country Backlash*, WASH. TIMES (Aug. 14, 2018), <https://www.washingtontimes.com/news/2018/aug/14/bank-west-climate-change-stance-fossil-fuel-reject/> (noting Ms. Razzano was "a self-described 'coal miner's daughter'").

³⁸⁷ Sell & Gruver, *supra* note 385 ("State Treasurer Mark Gordon threatened . . . to stop depositing with the bank certain state funds intended to encourage local lending. The state has deposited \$63 million with Bank of the West in Wyoming through the program over the years.").

³⁸⁸ Mary Stewart, *War over Coal, Gas Hits Bank: Bank of the West Parent's Policy Faces Backlash*, DOUGLAS BUDGET (Aug. 15, 2018), http://www.douglas-budget.com/news/article_acee32a6-a0d3-11e8-9ca8-63497eca806d.html.

³⁸⁹ *About Us*, RELIANT FED. CREDIT UNION, <https://www.reliantfcu.com/about/index.shtml> (last visited Jan. 24, 2020).

³⁹⁰ Stewart, *supra* note 388.

shareholders, or community members.³⁹¹ Thus, banks are better positioned than regulators to make already difficult decisions about the reputation risks posed by their activities.

This is not to suggest that banks, if left to their own devices, will always make the correct calculation with respect to reputation risk. They will not. Banks make incorrect decisions for a variety of reasons, some rather innocent³⁹² and others more corrupt.³⁹³ To the extent banks make incorrect decisions because they failed to adequately consider reputation risk, regulatory guidance and enforcement encouraging banks to consider reputation risk might be helpful.³⁹⁴ Beyond this, though, regulation of reputation risk does little to prevent bank runs and panic or reduce moral hazard. Regulators already have a variety of tools to stop corrupt and

³⁹¹ Of all the types of examinations, those for compliance with the Community Reinvestment Act (“CRA”) are the ones most focused on customers and community experiences. As part of that exam, regulators conduct interviews with “local community contacts” to, among other things, “[u]nderstand perceptions on the performance of financial institutions in helping to meet local credit needs.” See OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER’S HANDBOOK: COMMUNITY REINVESTMENT ACT EXAMINATION PROCEDURES 8 (May 1999), <https://www.occ.treas.gov/publications/publications-by-type/comptrollers-handbook/cra-exam-procedures/pub-ch-cra-exam-procedures.pdf>.

Regulators “conduct CRA exams for banks with assets above \$250 million once every two or three years. Banks with assets below \$250 million undergo CRA exams once every four or five years.” John Taylor & Josh Silver, *The Community Reinvestment Act at 30: Looking Back and Looking to the Future*, 53 N.Y. L. SCH. L. REV. 203, 205 (2008/09). Credit unions are not examined for CRA compliance. See 12 U.S.C. §§ 2902–03 (2012) (excluding credit unions from the definition of financial institutions covered by the CRA).

³⁹² As previously explained, reputation risk is difficult to predict. Therefore, even diligent, well-meaning managers will sometimes make incorrect decisions. It would not be reasonable for banks to avoid every action that might result in some harm to reputation. See Michael Alix, Senior Vice President, Fed. Reserve Bank of N.Y., Remarks at the Risk USA 2012 Conference (Nov. 14, 2012), <https://www.newyorkfed.org/newsevents/speeches/2012/alix121114> (noting that banks should not have “a zero tolerance for reputational damage [because] it is impossible to operate without absorbing some reputational risk”).

³⁹³ See Walter, *supra* note 69, at 44 (noting that “[p]erformance-driven managers, through compensation and other incentives, it is argued, have sometimes encouraged behavior that has inflicted major reputational damage on their firms and destroyed some of them”).

³⁹⁴ Even warning about reputation risk may not help the stability of the banking industry. Evidence from other fields suggests that when people are repeatedly warned about situations posing little risk, they might discount all warnings, including warnings of serious dangers. See Lisa A. Robinson, W. Kip Viscusi & Richard Zeckhauser, *Consumer Warning Labels Aren’t Working*, HARV. BUS. REV. (Nov. 30, 2016), <https://hbr.org/2016/11/consumer-warning-labels-arent-working> (discussing warnings about mercury in seafood). If this held true for banks, repeated regulatory warnings about reputation risk might distract banks from adequately managing more serious risks.

financially dangerous conduct.³⁹⁵ When reputation risk arises in situations not covered by other regulatory tools, it is unlikely regulators will be able to accurately predict reputation risk.

B. DANGERS OF POLITICIZATION

Regulation of bank reputation risk is not just ineffective; it is dangerous. Recall that bank regulation acts as a partial substitute for bank reputation. Regulation, however, only works when regulators have a reputation for effectiveness.³⁹⁶ Regulators, like the banks they regulate, can tarnish their reputation through action or inaction that causes stakeholders to negatively adjust their perception of the regulator.³⁹⁷ And because the banking industry is relying on the reputation of its financial regulators to attract deposits, regulator reputation risk can hurt the industry. Regulating bank reputation risk can hurt regulators' reputations by politicizing them. Stakeholders who previously thought of regulators as apolitical experts might have less confidence in a politicized regulator.

Although the structure of bank regulators varies somewhat, each has features providing insulation from political pressure.³⁹⁸ For example, regulators set their own budgets and do not rely on legislative appropriations.³⁹⁹ Most top officials can only be removed for cause.⁴⁰⁰ The FDIC and NCUA are led by boards with members

³⁹⁵ See *supra* notes 357–59 and accompanying text.

³⁹⁶ See *supra* notes 94–98 and accompanying text.

³⁹⁷ Moshe Maor, *Theorizing Bureaucratic Reputation*, in ORGANIZATIONAL REPUTATION IN THE PUBLIC SECTOR 12, 24 (Anid Wæraas & Moshe Maor eds., 2014).

³⁹⁸ See HENRY B. HOGUE, MARC LABONTE & BAIRD WEBEL, CONG. RESEARCH SERV., R43391, INDEPENDENCE OF FEDERAL FINANCIAL REGULATORS: STRUCTURE, FUNDING, AND OTHER ISSUES (2017) (noting regulator independence is designed to “make policy making more technical and less ‘political’ or ‘partisan’”); see also Neil Devins & David E. Lewis, *Not-So-Independent Agencies: Party Polarization and the Limits of Institutional Design*, 88 B.U. L. REV. 459, 463 (2008) (noting that political insulation is “intended to facilitate a non-political environment where regulatory experts can apply their knowledge to complex policy problems”).

³⁹⁹ The FDIC and NCUA are funded primarily by deposit insurance premiums. HOGUE, LABONTE & WEBEL, *supra* note 398, at 27. The OCC is funded with fees paid by regulated banks. *Id.* The Federal Reserve also charges fees and earns income from securities and loans that it holds. *Id.* State bank regulators are also funded through fee assessments on banks, rather than with appropriations. Christine E. Blair & Rose M. Kushmeider, *Challenges to the Dual Banking System: The Funding of Bank Supervision*, 18 FDIC BANKING REV. 1, 6 (2006).

⁴⁰⁰ According to statute, the President may remove members of the Federal Reserve Board of Governors “for cause.” 12 U.S.C. § 242 (2012). Statutes governing the FDIC and NCUA do not specify grounds for removal, but it is generally thought that these officials can only be

from both political parties.⁴⁰¹ These designs are intended “to free policymaking from political interests, allow it to be set in reliance on objective scientific facts, and avoid the delays and distortions of politics.”⁴⁰² The structures bolster regulators’ credibility as apolitical experts.

Federal bank regulators value being perceived as apolitical and work to cultivate reputations as technocratic experts that do not pander to political pressures.⁴⁰³ The OCC, for example, instructs:

The integrity and effectiveness of the examination process depends upon its being kept completely free from any appearance of being influenced by political considerations Thus, OCC employees should have no communications with national banks or federal savings associations that could be perceived as suggesting that the examination process is in any way influenced by political issues or considerations, or that the bank or savings association should take a particular position on political or legislative issues.⁴⁰⁴

removed for cause. See HOGUE, LABONTE & WEBEL, *supra* note 398, at 16 (“In other cases, the for cause removal standard for independent agency heads was not explicitly set out by Congress, but is understood to exist under legal precedent.” (citing *Weiner v. United States*, 357 U.S. 349 (1958))); Charles Kruly, Essay, *Self-Funding and Agency Independence*, 81 GEO. WASH. L. REV. 1733, 1747 (2013) (noting that “it is unclear whether the absence of a statutory for-cause removal provision would bar a court from assuming that such protection exists”). Of the federal regulators, only the Comptroller serves at the pleasure of the President. See 12 U.S.C. § 2 (2012) (stating that the Comptroller may be “removed by the [P]resident, upon reasons to be communicated by him to the Senate”).

⁴⁰¹ 12 U.S.C. §§ 1752a(b), 1812(a)(2) (2012). The Federal Reserve does not have a bipartisan balance requirement. *Id.* § 242. But the multi-member board structure of the Federal Reserve may nevertheless “limit[] the President’s power to immediately remake the agency in his or her own image.” Kruly, *supra* note 400, at 1748.

⁴⁰² Adam J. Levitin, *The Politics of Financial Regulation and the Regulation of Financial Politics: A Review Essay*, 127 HARV. L. REV. 1991, 2038 (2014).

⁴⁰³ *Id.* at 2000.

⁴⁰⁴ See OFFICE OF THE COMPTROLLER OF THE CURRENCY, OCC ETHICS RULES—A PLAIN ENGLISH GUIDE, <https://careers.occ.gov/careers/apply/occ-ethics-rules-a-plain-english-guide.html#ethics-rules> (last visited Nov. 6, 2019); see also FED. DEPOSIT INS. CORP., RMS MANUAL OF EXAMINATION POLICIES § 1.1 (2018) (“FDIC employees should avoid any form of political communication with insured depository institutions that could be perceived as suggesting the examination process is influenced by political considerations, or that the bank should take a particular position on legislative issues. Examinations must be kept free from political considerations, or the appearance of being influenced by political considerations, in order to maintain the integrity and effectiveness of the examination process.”).

FDIC Chairman Jelena McWilliams recently stated that under her leadership, “the FDIC’s oversight responsibilities will be exercised based on our laws and our regulations, not on personal or political beliefs.”⁴⁰⁵ After Federal Reserve Chairman Jerome Powell had dinner at the White House, the Federal Reserve issued a statement reaffirming its independence.⁴⁰⁶

Regulating reputation risk threatens to upset the reputation of regulators as apolitical. Broad definitions of reputation risk invite regulatory scrutiny of political factors not directly related to bank safety and soundness. This is especially true when regulators take action based on regulatory risk alone (without a violation of the law or the likelihood of serious financial impact). One need not look far for examples of reputation risk regulation perceived as political. Payday loans, guns, and fossil fuels are all hot button political topics. Regulators’ use of reputation risk to address these issues has drawn accusations of political abuse.⁴⁰⁷ When regulators “throw themselves into highly emotional debates,” they incur reputational damage.⁴⁰⁸

If bankers perceive regulators as politicized, banks may be more difficult to regulate. To properly supervise banks, regulators rely on bankers’ willingness to share information. Nevertheless, bankers who believe that regulation is clouded by partisanship may be less willing to share information.⁴⁰⁹ Bankers who believe that regulation

⁴⁰⁵ Letter from Jelena McWilliams, Chairman, FDIC, to Blaine Luetkemeyer, Member, House of Representatives (Nov. 15, 2018), https://luetkemeyer.house.gov/uploadedfiles/fdic_response_to_rep._luetkemeyer.pdf.

⁴⁰⁶ Gina Heeb, *Janet Yellen Is Concerned about Trump’s Public Criticism of the Fed. She’s Not the Only One*, BUS. INSIDER (Feb. 8, 2019, 10:09 AM), <https://markets.businessinsider.com/news/stocks/trump-fed-criticism-concerns-janet-yellen-others-2019-2-1027937340>.

⁴⁰⁷ See *Examining Regulatory Relief Proposal for Community Financial Institutions, Part II: Hearing before the Subcomm. on Fin. Insts. & Consumer Credit of the H. Comm. on Fin. Servs.*, 113th Cong. 149, 156 (2014) (statement of William M. Isaac, Senior Managing Director, FIT Consulting, Inc., former chairman FDIC) (noting reputation risk has “been a major factor in shifting the banking agencies from their primary role as guardians of the safety and soundness and stability of the financial system to amorphous financial social welfare agencies”); see also Letter from Jeb Hensarling, Chairman, H. Comm. on Fin. Servs, to Janet Yellen, Chair, Bd. of Governors Fed. Reserve Sys. (May 22, 2014) (“The introduction of subjective criteria like ‘reputational risk’ into prudential bank supervision can all too easily become a pretext for the advancement of political objectives, which can potentially subvert both safety and soundness and the rule of law.”).

⁴⁰⁸ See Maor, *supra* note 397, at 24.

⁴⁰⁹ See GARY J. MILLER & ANDREW B. WHITFORD, ABOVE POLITICS: BUREAUCRATIC DISCRETION AND CREDIBLE COMMITMENT 176 (2016) (observing that regulators use their

is driven by politics may also be less willing to follow regulatory rules and guidance without significant regulatory oversight.⁴¹⁰ In a politicized environment, regulators may have to spend more resources to achieve the same level of compliance with bank safety and soundness laws.

At the same time, regulating reputation risk diverts resources from banking safety and soundness to reputation.⁴¹¹ At regulators headed by bipartisan boards, polarization of some regulation might impede decision-making as a whole.⁴¹² This may also lead to worse regulatory outcomes.⁴¹³ Over time, this could result in a loss of confidence in bank regulators and the banking system, followed by destabilization, and even runs and panics.⁴¹⁴ In a politicized regulatory environment, banks may also have to divert resources from safety and soundness concerns (or customer service) to instead adjust operations to the reputational concerns of each new presidential administration.⁴¹⁵

Finally, reputation risk regulation may force banks to take positions that increase their reputation risk. In the past, many banks chose to minimize reputation risk by maintaining customer

reputations as “long-term, culture-bound professionals” to gather needed information from financial institutions).

⁴¹⁰ See Ephraim Clark & Octav Jokung, *The Role of Regulatory Credibility in Effective Bank Regulation*, 50 J. BANKING & FIN. 506, 509 (2015) (noting that “[w]hen the regulatory system is perceived as credible, intervention dictates will be observed with a minimum of oversight”).

⁴¹¹ See Sharon Gilad, *Political Pressures, Organizational Identity and Attention to Tasks: Illustrations from Pre-Crisis Financial Regulation*, 93 PUB. ADMIN. 593, 594–95 (2015) (noting that when regulators have multiple tasks they must choose how to prioritize those tasks).

⁴¹² See generally Brian D. Feinstein & M. Todd Henderson, *Pathways of Power: The Rise of Hill Staffers-Turned-Commissioners* (Univ. of Chi., Working Paper No. 703, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3338092 (noting anecdotal evidence of a more dysfunctional decision-making process at regulatory boards after an increase in politicization).

⁴¹³ See Jonathan R. Macey & Geoffrey P. Miller, *Bank Failure: The Politicization of a Social Problem*, 45 STAN. L. REV. 289, 292 (1992) (“As regulatory agencies become more responsive to popular opinion, the regulatory process becomes more guided by political expediency than by economic reality.”).

⁴¹⁴ Cf. MILLER & WHITFORD, *supra* note 409, at 191 (concluding that politicization of the Office of Thrift Supervision caused “the loss of belief in the agency’s willingness and ability to make professional decision” and ultimately resulted in the four largest institutions supervised by the regulator failing in the same year).

⁴¹⁵ See Edward J. Balleisen & Melissa B. Jacoby, *Consumer Protection after the Global Financial Crisis*, 107 GEO. L.J. 813, 814 (2019) (noting that the “controversial” Operation Choke Point “was particularly vulnerable to a change in presidential administration and political climate”).

privacy and avoiding political statements on issues not directly related to banking.⁴¹⁶ Bank stakeholders largely seemed content with the arrangement.⁴¹⁷ But when regulators begin scrutinizing reputation risk, banks are forced to rethink their risk calculus. Banks must weigh the possibility of damaging their reputation with regulators⁴¹⁸ against the possibility of reputational harm from taking a political position. And because regulators are not as well situated as banks themselves to evaluate competing reputation risks,⁴¹⁹ complying with reputation risk guidance or regulation may increase reputation risk for some banks.

Some may discount the harm from politicization caused by reputation risk regulation. They may note that financial regulators are not in fact politically neutral.⁴²⁰ Even seemingly technical rules (for example bank capital requirements) can have politically important consequences, such as influencing the price and accessibility of banking services.⁴²¹ If all banking laws are to a certain extent political, what is the harm of reputation risk regulation that explicitly considers political consequences? Why allow bank regulators to make some politically important decisions but not others?

The answer is that we allow bank regulators to make decisions with politically important consequences when the decisions are

⁴¹⁶ Rolland Johannsen, Opinion, *Reputational Risks Are Heightened by Tense Political Climate*, AM. BANKER (Feb. 22, 2017, 12:00 PM), <https://www.americanbanker.com/opinion/reputational-risks-are-heightened-by-tense-political-climate> (“[B]anks have avoided taking public positions on broader political . . . issues. Instead, they have focused their political activity on those issues that directly impact the bank or the industry. The reasons are straightforward. Most banks serve a broad, politically diverse customer base, and have an equally diverse group of employees.”).

⁴¹⁷ See Rolland Johannsen, Opinion, *Managing Reputation Risk Is Getting More Complicated*, AM. BANKER (Apr. 22, 2019, 10:28 AM), <https://www.americanbanker.com/opinion/managing-reputation-risk-is-getting-more-complicated> (“Historically, few people have known, or even cared, if a particular bank was doing business with a specific company or financing a specific project.”).

⁴¹⁸ See *supra* notes 332–42 and accompanying text (explaining why banks want to avoid damaging relationships with their regulators).

⁴¹⁹ See *supra* notes 378–91 and accompanying text.

⁴²⁰ See Levitin, *supra* note 402, at 2036 (“[T]here are hard political decisions underlying bank regulatory policy.”); see also Richard J. Pierce, Jr., Response, *Presidential Control Is Better than the Alternatives*, 88 TEX. L. REV. 113, 124 (2009) (noting administrative decision making is “invariably complicated and inherently political”).

⁴²¹ See Shekhar Aiyar, Charles W. Calomiris & Tomasz Wieladek, *Bank Capital Regulation: Theory, Empirics, and Policy*, 63 IMF ECON. REV. 955, 958 (2015) (noting that requiring banks to hold more capital might result in “costs borne by . . . nonfinancial sectors—especially by would-be bank borrowers”).

clearly within the scope of the regulators' unique authority and competence.⁴²² For example, if a bank regulator did not set or enforce capital rules, it would be abdicating responsibility assigned by Congress,⁴²³ and may not be able to effectively protect depositors or the deposit insurance fund.⁴²⁴ Nevertheless, we should be skeptical of politicized decisions that are afield from regulators' authority and competence. As explained in Section IV.A, there is little reason to think regulators will be good at regulating reputation risk. Moreover, when reputation risk occurs in the absence of any other violations of law and without serious financial consequences, the risk is outside the regulators' recognized authority.⁴²⁵ Bank regulators have not been charged with deciding whether oil pipelines can be built, whether people can purchase firearms, or whether non-banks can offer payday loans. Transforming regulators into what the *Gulf Federal* court called "proctor[s] for public opinion"⁴²⁶ threatens to upset the trust that banks and the public have in them.

C. LIMITING REPUTATION REGULATION

If bank reputation regulation is dangerous, what is the best way to limit it? Regulators, courts, and legislative bodies all have some ability to constrain reputation regulation. Of these, Congress is best positioned to adopt meaningful reform.

⁴²² Professors Sharon Gilad and Tamar Yogeve describe regulators' management of their own reputation risk like this:

Regulators seek to demarcate for themselves a reputation for the proficient execution of a unique role, which is consistent with their internal identity. They might further seek to avoid tasks that carry high risk of reputation damage. However, they will not/cannot forgo tasks that fall squarely within their constructed identity reputation, even when the execution of these tasks carries a high risk of failure and reputation damage. Resisting such tasks can itself damage their reputation.

Sharon Gilad & Tamar Yogeve, *How Reputation Regulates Regulators: Illustrations from the Regulation of Retail Finance*, in THE OXFORD HANDBOOK OF CORPORATE REPUTATION, *supra* note 78, at 320, 334.

⁴²³ See 12 U.S.C. § 3907 (2012) (requiring minimum levels of capital).

⁴²⁴ See CARNELL, MACEY & MILLER, *supra* note 90, at 238–43 (explaining that capital acts as a cushion to prevent depositors and other creditors of the bank from loss).

⁴²⁵ See Balleisen & Jacoby, *supra* note 415, at 820 (noting that Operation Choke Point "pressed the limits of legitimate regulatory authority"); Bambauer, *supra* note 374, at 125 (stating that the FDIC's and DOJ's actions as part of Operation Choke Point "put the government far afield from its statutory authority").

⁴²⁶ *Gulf Fed. Sav. & Loan Ass'n v. Fed. Home Loan Bank Bd.*, 651 F.2d 259, 265 (5th Cir. 1981).

1. Regulators.

To be sure, regulators can (and should) take measures to decrease the likelihood that their reputations will be damaged by reputation risk regulation. Regulators can instruct examiners that politics has no place in bank examinations. Regulators can also adopt procedures that make it more difficult for examiners to regulate reputation risk in the absence of a violation of the law or serious financial harm. For example, following the scrutiny of Operation Choke Point, the FDIC instructed its examiners that any directive to a bank to close a customer account “must be in writing, must identify the legal and regulatory basis for the action, must be approved by the relevant Regional Director before taking effect, and must be reported quarterly to the FDIC Board.”⁴²⁷ These types of policies and procedures work best to deter low-level agency staff from idiosyncratically regulating reputation risk.

Reputation risk regulation, however, can come from the top of the regulatory agency. Regulatory guidance is vetted by the top agency officials.⁴²⁸ The New York regulator’s guidance about gun rights advocacy groups was driven by the Governor and the Superintendent of Financial Services, not by overzealous examiners.⁴²⁹ Even enforcement decisions might be driven by the top of the agency rather than the bottom. Indeed, it appears that top regulatory officials drove the FDIC’s regulation of payday

⁴²⁷ See *FDIC’s Role in Operation Choke Point Hearing*, *supra* note 291, at 7 (statement of Martin J. Gruenberg, Chairman, FDIC).

⁴²⁸ See, e.g., Statement of Policy on the Development and Review of Regulations and Policies, 78 Fed. Reg. 22,771–72 (Apr. 17, 2013) (noting that FDIC guidance is issued by the FDIC’s board of directors).

⁴²⁹ See Press Release, N.Y. Dep’t of Fin. Servs., *supra* note 48 (stating that “Governor Andrew M. Cuomo . . . directed the Department of Financial Services” to act).

lending⁴³⁰ and tax refund anticipation loans.⁴³¹ There are few intra-agency checks to prevent top officials from taking similar actions.⁴³² Indeed, regulators have previously promised they would not enforce reputation risk,⁴³³ but they have.⁴³⁴ There is no reason to believe that new regulatory statements are any more binding.

2. Courts.

Courts may be able to play a limited role in limiting politicized reputation risk enforcement. As explained in Section III.A, banks may be able to successfully appeal enforcement actions brought without evidence of financial harm that threatens their financial integrity. The trouble with waiting for courts to make the correction is that banks rarely challenge regulatory action in court.⁴³⁵ Banks have strong incentives to keep their regulators happy and may be especially unwilling to fight regulators over third-party reputation risk when the third-parties impacted are small industries with whom the bank does little business.⁴³⁶

⁴³⁰ The FDIC's Office of Inspector General report states:

The Chicago Regional Director informed us that he pursued a strategy of persuading the institution to terminate its payment processing relationship with the payday lender because it was his perception that senior FDIC management in the Washington, D.C. office, including the current and former Chairmen, did not favor banking services that facilitated payday lending.

FDIC OIG CHOKE POINT REPORT, *supra* note 275, at 27. Other regional directors also believed that "senior FDIC executives in Washington, D.C., up to and including the former and current FDIC Chairmen, had serious concerns regarding the facilitation of payday lending by FDIC-supervised institutions." *Id.* at 28. The perceptions of these regional regulators are confirmed by e-mails showing that the FDIC's Director of the Division of Depositor and Consumer Protection, based in Washington, D.C., participated in discussions about informal enforcement strategies aimed at ending bank relationships with payday lenders. *Id.* at 26.

⁴³¹ The FDIC efforts to drive banks out of tax refund anticipation loans started after then-FDIC Chair Sheila Bair voiced her displeasure with the product. FDIC OIG REFUND ANTICIPATION LOANS REPORT, *supra* note 49, at i. In addition, the FDIC's letters to banks warning them of the reputation risk of the loans were "coordinated through the [FDIC's] Washington, D.C., office." FDIC OIG CHOKE POINT REPORT, *supra* note 275, at 37.

⁴³² Maor, *supra* note 397, at 30 (noting regulators might adopt positions that are not in the long-term interest of their agency to advance personal political ambitions).

⁴³³ See *supra* Section IV.B.

⁴³⁴ See *supra* Sections IV.C–D.

⁴³⁵ John D. Hawke, Jr., *Assuring Safety and Soundness: The Role of the Enforcement Process*, 5 ANN. REV. OF BANKING L. 167, 170 (1986) (explaining that "few cases are litigated" and that "[t]he effectiveness of the formal enforcement process greatly depends on the consent of the institutions that are confronted with enforcement action"); cf. Hill, *supra* note 199, at 675 (noting that ninety percent of capital enforcement actions between 1993 and 2010 involving capital requirements were entered with the consent of the bank).

⁴³⁶ See *supra* notes 331–42 and accompanying text.

Third parties harmed by reputation risk regulation can also seek redress in court. The lawsuits brought by payday lenders and the NRA illustrate this possibility.⁴³⁷ These cases, however, may be the exception rather than the rule. Because bank examination reports and other informal actions are confidential,⁴³⁸ it is difficult for bank customers or other third parties to know when regulatory action prevents them from receiving banking services. Did Bank of the West exit the fossil fuel industry because it was concerned about profit or because one of its regulators pressured it to divest? Bank of the West's public statements suggest it was motivated by a concern for the environment.⁴³⁹ However, after the FDIC pressured banks to stop service to payday lenders, the FDIC then pressured banks to make it seem as though the decision was driven by bank economics rather than regulatory demands.⁴⁴⁰ If third parties do not know regulators are curtailing their banking opportunities through reputation risk regulation, they will be unable to object.

Even when third parties learn about problematic regulatory action, they may not have the resources or inclination to sue. Moreover, the settlement of the payday lender suit suggests that remedies in these cases may be limited. Although government reports described how regulatory overreach caused banks to terminate payday lender accounts,⁴⁴¹ the plaintiffs settled for an admission that "certain employees acted in a manner inconsistent with FDIC policies" and a reiteration of the FDIC's "longstanding policies and guidance regarding the circumstances in which the FDIC recommends that a financial institution terminate a customer's deposit account."⁴⁴² This result may be of little use to the

⁴³⁷ See Complaint for Declaratory & Injunctive Relief, *supra* note 268; Original Complaint & Jury Demand, *supra* note 45; see also *supra* Sections IV.D.1–2 (discussing these cases).

⁴³⁸ See *supra* notes 262–63 and accompanying text.

⁴³⁹ Sell & Gruver, *supra* note 385 (noting Bank of the West's desire to "contribut[e] to more sustainable and equitable growth").

⁴⁴⁰ Plaintiffs' Statement of Undisputed Material Facts at ¶ 126, *Advance Am., Cash Advance Ctrs, Inc., v. Fed. Deposit Ins. Corp.*, No. 14-CV-953-TNM (D.D.C. Oct. 12, 2018) ("When regional [FDIC] officials learned that [a Bank's] Chairman had communicated to the Bank's board that the FDIC had established a de facto policy against bank relationships with payday lenders, [FDIC] Deputy Director [Phyllis] Patton reached out to him to 'express[] concern' about that characterization and to reiterate 'that the basis for our concerns was centered on what we perceived as a lack of awareness of regulatory (payday and third party oversight guidance) and [safety and soundness] implications of the business.'").

⁴⁴¹ See *supra* Section IV.D.1.

⁴⁴² Press Release, FDIC, FDIC Resolved Payday Lender Lawsuit (May 22, 2019), <https://www.fdic.gov/news/news/press/2019/pr19040.html>.

plaintiffs and does little to discourage similar agency behavior in the future.⁴⁴³

3. Congress.

This leaves legislation as the best avenue to restrain reputation risk regulation. In 2017, the U.S. House of Representatives passed a bill providing:

An appropriate Federal banking agency may not formally or informally request or order a depository institution to terminate a specific customer account or group of customer accounts or to otherwise restrict or discourage a depository institution from entering into or maintaining a banking relationship with a specific customer or group of customers unless—the agency has a valid reason for such request or order; and such reason is not based solely on reputation risk.⁴⁴⁴

The bill also included measures designed to strengthen oversight of regulatory action involving third parties. It required regulators to provide banks with the legal justification for account closures and required that banks relay that information to the affected customers.⁴⁴⁵ Thus, customers would have notice of regulatory action affecting them. Finally, the bill required regulators to annually report to Congress the number of customer accounts the regulator requested closed and the legal authority for doing so.⁴⁴⁶ Although the bill had broad bipartisan support in the House, it never received a vote in the Senate.⁴⁴⁷ Lawmakers may have lost

⁴⁴³ See C. Boyden Gray, *The FDIC's 'Operation Chokepoint' Settlement Doesn't Make Victims Whole*, REALCLEARMARKETS (June 26, 2019), https://www.realclearmarkets.com/articles/2019/06/26/the_fdics_operation_chokepoint_settlement_doesnt_make_victims_whole_103798.html (noting the settlement will not restore lost banking relationships, give banks “confidence to re-establish relationships,” or “prevent this abuse of power from happening again”).

⁴⁴⁴ H.R. 2706, 115th Cong. § 2(a) (as passed by the House, Dec. 11, 2017).

⁴⁴⁵ See *id.* § 1(b)–(c).

⁴⁴⁶ See *id.* § 1(d).

⁴⁴⁷ See H.R. REP. NO. 115-1122, at 106 (2019) (noting the bill passed the House with a vote of 395-2 and was received by the Senate).

interest in the measure after regulators repeatedly assured them Operation Choke Point had ended and would not be resumed.⁴⁴⁸

Reform for reputation risk regulation should not depend on the status of Operation Choke Point. As Part III explains, Operation Choke Point is not the only time regulators have required action based on reputation risk alone. Indeed, regulators have taken enforcement action based on reputation risk even after explaining that they do not do so.⁴⁴⁹ Operation Choke Point was not the anomalous result of overzealous regulators with a disdain for payday lending. It was a natural outgrowth of a regulatory structure that sees reputation risk everywhere.⁴⁵⁰ It is the outgrowth of a definition of reputation risk that regulates any negative publicity whether true or not.⁴⁵¹ It is the outgrowth of a definition of reputation risk where regulators themselves are one of the constituencies whose opinions must be considered.⁴⁵² And it is an outgrowth of a system where regulators insist they have power to regulate even when there is little evidence of serious financial harm.⁴⁵³ At best, the current reputation risk framework encourages regulators to regulate banks based on regulators' uncertain forecasts of negative publicity. At worst, it provides regulators cover for implementing their own political agenda unrelated to the safety or soundness of banks.

⁴⁴⁸ See Karen Kidd, *With Bipartisan Support, Bill to Undo Obama-Era 'Operation Choke Point' Awaits Action in Senate*, LEGAL NEWSLINE (Jan. 22, 2018), <https://legalnewsline.com/stories/511318521-with-bipartisan-support-bill-to-undo-obama-era-operation-choke-point-awaits-action-in-senate> (noting there was “no apparent opposition to the legislation in the Senate but [also] no apparent urgency to take it up either”). In late 2018, the FDIC again repudiated “Operation Choke Point” stating regulators should act based on laws and regulations and not on “personal beliefs or political motivations.” Letter from Jelena McWilliams to Blaine Luetkemeyer, *supra* note 413. At the same time, the OCC stated: “To be clear, the OCC has no policy or program that targets any business operating within state and federal law, and I am committed to ensuring that it does not have such policy or program in the future.” Letter from Joseph M. Otting, Comptroller of the Currency, to Blaine Luetkemeyer, Member, House of Representatives (Nov. 19, 2018), https://luetkemeyer.house.gov/uploadedfiles/occ_response_to_rep_luetkemeyer.pdf.

⁴⁴⁹ See *supra* Section IV.B (detailing regulatory guidance on reputation risk enforcement); Sections IV.C–D (describing reputation risk enforcement).

⁴⁵⁰ See *supra* note 152 and accompanying text.

⁴⁵¹ See *supra* notes 127–28 and accompanying text.

⁴⁵² See *supra* note 124 and accompanying text.

⁴⁵³ See *supra* note 221 and accompanying text.

VI. CONCLUSION

Rocker Joan Jett famously sings: “I don’t give a damn ‘bout my reputation.”⁴⁵⁴ If bank regulators think Joan Jett has a bad reputation unrelated to banking, should they be able to tell banks not to do business with her? Currently bank regulators claim broad regulatory authority over reputation risk—the risk that bank stakeholders will negatively change their perceptions. Bank regulators say reputation risk is present in every aspect of banking. It can even arise from untrue rumors or from third-party conduct unrelated to banking.

This broad regulation of reputation risk is unnecessary and harmful. Bank regulators already have broad powers to correct violations of law and conditions likely to cause serious financial harm. At the same time, regulating reputation risk threatens to politicize bank regulators. Regulators have already used reputation risk to weigh in on hot-button political topics afield from bank safety and soundness, like payday lending, fossil fuels, and gun rights. There is little to prevent regulators from using reputation risk to address other controversies. They might even extend reputation risk enforcement to prevent banking services to individuals like Joan Jett. Bankers and the public will have less faith in financial regulators and in the banking system if regulators spend their time regulating political causes afield from bank safety and soundness.

⁴⁵⁴ JOAN JETT, *Bad Reputation*, on BAD REPUTATION (Boardwalk Records 1981).

