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The Rise of a Regulator – New York's Department of Financial Services Takes Matters Into Its Own Hands

New York's state-level financial regulator – the Department of Financial Services ("DFS") – regulates all banks and insurance companies located in New York. It has always been a robust regulator, but until lately, it has operated largely in the background, particularly in high profile investigations. That appears to be changing. As shown by recent penalties imposed by DFS, unilaterally, on Standard Chartered Bank and PriceWaterhouseCoopers ("PwC"), DFS is clearly willing and eager to exercise its authority without the participation, or even agreement, of federal or other state authorities. So in this piece, we point a spotlight on DFS and its recent rise to prominence.

Standard Chartered

DFS' efforts to chart its own course, separate from the larger group of financial regulators and prosecutors, began several years ago. In August 2012, in an unprecedented move, DFS broke with other regulators involved in the investigation of Standard Chartered Bank for having illegally processed transactions to and from Iran in violation of U.S. sanctions. Calling Standard Chartered a "rogue institution," DFS Superintendent Benjamin Lawsky made an independent demand that Standard Chartered pay $340 million in penalties to the State of New York. Faced with potential revocation of its license to do business in New York – a severe punishment that would all but halt the bank's U.S. dollar clearing business – Standard Chartered agreed. But that was not the end of the bank's problems, as Standard Chartered still had to settle with the other prosecutors and regulators involved in its investigation – which it did in December 2012, when it agreed to an additional $327 million in fines. Recently, DFS went after Standard Chartered again this time for deficiencies in its anti-money laundering compliance program. That investigation resulted in an additional $300 million fine.

Beyond Banking: DFS' Expanding Investigations and Enforcement

Lately major accounting firms that provide services to the financial industry have found themselves in DFS' crosshairs. In 2013, Deloitte agreed to a $10 million fine and a one-year consulting ban to settle allegations that the firm mishandled anti-money laundering work for Standard Chartered. And in August, DFS fined PwC $25 million and imposed on it a two-year suspension from certain consulting work for New York regulated banks. DFS stated that PwC had issued a report that minimized a regulated bank's compliance violations.

In 2013, DFS flexed its regulatory muscles toward the insurance industry when it demanded information from international insurance companies about their dealings with Iran, including insurers participating in the Lloyd's market and Swiss Reinsurance Co. (See our previous article at http://www.lewisbaach.com/assets/attachments/73.pdf.) While DFS, as a state regulator, has no jurisdiction over sanctions enforcement per se, it has demonstrated its willingness to use its control over New York banking and insurance licenses to demand strict compliance both in areas traditionally within the scope of a state regulator, but also in matters seemingly far afield.

There is little doubt that DFS' regulatory interests will continue to expand. Most recently, DFS proffered the first set of regulations to govern Bitcoin and other virtual currencies – a brand-new regulatory regime that will even further increase the scope of DFS' influence. If nothing else, by acting to create comprehensive regulations for virtual currencies, DFS has demonstrated that its willingness to act on its own exists in the prudential space as well as enforcement.

These recent actions make clear that DFS is a player to be reckoned with in the complex firmament of U.S. regulation. Banking and insurance companies doing business in New York need to pay attention to DFS in their ongoing regulatory relationships, and, most importantly, need to be cognizant of its enormous authority and its increasing willingness to use its leverage, independent of other authorities, to meet its own regulatory ends. Ignoring DFS has proved perilous for targets in the past, and the wise company, with skilled advisors, should learn from their mistakes.

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