



JONES DAY
COMMENTARY

THE DEPARTMENT OF FINANCIAL SERVICES: NEW YORK'S NEWEST FINANCIAL REGULATOR

A new financial regulator recently opened its doors for business in New York and instantly became a formidable agency with broad regulatory powers, including the authority to bring both criminal and civil law enforcement actions. Headed by Benjamin Lawsky, a former federal and state prosecutor who also served as Chief of Staff to New York Governor Andrew Cuomo and before that was Chief Counsel to Senator Charles Schumer, New York's Department of Financial Services ("DFS") began operations on October 3, 2011. DFS will be among the most important financial regulators in the United States. The agency will regulate more than 3,900 banks, insurance companies, credit unions, mortgage brokers, and other financial institutions operating in New York state and elsewhere, with about \$5.7 trillion in combined assets.¹ DFS has an annual budget of \$236 million and roughly 1,500 employees.

DFS'S PURPOSE AND POWERS

The enacting legislation for DFS, the Financial Services Law, introduced as part of Governor Cuomo's 2011 budget, combined the functions and authority of the New York State Banking Department and the New York State Insurance Department.² Governor Cuomo created DFS to "modernize regulation by allowing the agency to oversee a broader array of financial products and services, rather than the previous system of limiting regulation to services provided by only certain types of institutions."³ The Banking Department, which was created in 1851, had been the oldest bank regulatory agency in the United States until it was abolished pursuant to the Financial Services Law. The Insurance Department also had a long history stretching to its creation in 1859.

¹ Liz Rappaport, "Wall Street's New Watcher," *The Wall Street Journal*, Oct. 3, 2011; Adam Sichko, "New York opens new Wall Street regulatory agency," *The Business Review*, Oct. 4, 2011.

² N.Y. Laws §2812 (Feb. 1, 2011) (the "Financial Services Law").

³ DFS's web site, <http://www.dfs.ny.gov/about/history.htm> (last visited Nov. 21, 2011).

DFS has broad powers to take any necessary action to:

- Foster the growth of the financial industry in New York.
- Spur state economic development through regulation and supervision.
- Ensure the continued solvency, safety, soundness, and prudent conduct of the providers of financial products and services.
- Ensure fulfillment of the financial obligations of such providers.
- Protect users of financial products and services from financially impaired or insolvent providers of such services.
- Encourage high standards of honesty, transparency, fair business practices, and public responsibility.
- Eliminate financial fraud, other criminal abuse, and unethical conduct in the industry.
- Educate and protect users of financial products and services.⁴

DFS'S BROAD POWERS TO INVESTIGATE FINANCIAL CRIMES

DFS has indicated that it plans to “exponentially” increase the size of its criminal-enforcement unit and jointly bring criminal cases with state and federal authorities.⁵ Such cooperation rarely occurred before DFS was created, and, when it did, it occurred with much tension and many jurisdictional turf battles. The DFS Superintendent has the express power to “cooperat[e] with, assist[] and, when appropriate, refer[] matters to the attorney general in the carrying out of the attorney general’s legal enforcement responsibilities for the protection of consumers of and investors in financial products and services.”⁶ The Financial Services Law also created the Financial Frauds and Consumer Protection Division (“FFCPD”) within DFS, which may pursue civil and criminal investigations of activities in violation of the Financial Services Law, Banking Law, Insurance Law, and certain other laws, and bring

enforcement proceedings. Specifically, the DFS Superintendent has the power to investigate whenever FFCPD “has a reasonable suspicion that a person or entity has engaged, or is engaging, in fraud or misconduct with respect to the banking law, the insurance law” or other relevant laws.⁷

OTHER POWERS

DFS has other unique programs and powers, including:

- **Liquidation Bureau**—a separate office charged with rehabilitating or liquidating insurance companies.
- **Banking Development District Program**—created to encourage the establishment of bank branches in areas with a demonstrated need for banking services.
- **Captive Insurance Group**—provides streamlined licensing procedures to ensure efficient incorporation and licensing of captive insurance companies, as well as legal, financial, and capital market expertise for companies regarding captive insurance.

In the future, DFS may regulate and even run a health insurance exchange, which the federal health care overhaul requires states to establish by 2014.⁸

DFS'S OPENING MOVES

The DFS Superintendent did not wait long to flex DFS’s newly enacted regulatory muscle. In DFS’s first month in existence, it announced agreements with several major health insurance companies to make public more data, including data on costs, spending, and projected costs and revenues.⁹ The companies involved provide coverage to 85 percent of the health care insurance market in New York. Since 2010, insurance companies must receive prior approval from the state before increasing premiums. Before reaching these agreements, insurance companies had argued that the data supporting the requests for rate increases was confidential. On

4 DFS’s web site, <http://www.dfs.ny.gov/> (last visited Nov. 21, 2011); Financial Services Law, Art. 2, §201.

5 Liz Rappaport, “Wall Street’s New Watcher,” *The Wall Street Journal*, Oct. 3, 2011.

6 Financial Services Law, Art. 3, §301.

7 Financial Services Law, Art. 4 (emphasis added).

8 Adam Sichko, “New York opens new Wall Street regulatory agency,” *The Business Review*, Oct. 4, 2011.

9 “Major NY health insurers to open rate-hike data,” AP, Oct. 27, 2011.

November 15, 2011, Governor Cuomo announced that the health insurer rate filings were publicly available on DFS's web site, stating, "This is a great day for transparency and the public's right to know how their health insurance premiums are set."¹⁰

DFS has also reached agreements with a few financial institutions, mortgage lenders, and mortgage servicers to adhere to groundbreaking mortgage servicing practices that DFS believes will protect homeowners.¹¹ The Superintendent stated, "Our agreement sets a new higher standard for the residential mortgage servicing industry, whose troubling foreclosure and servicing practices we have been investigating along with other regulators across the country."¹² The new mortgage servicing practices include: 1) ending "robo-signing," 2) imposing more stringent pleading requirements in foreclosure actions so that only parties and entities possessing a legal right to foreclose can sue borrowers, 3) requiring servicers to provide a dedicated "Single Point of Contact representative" for all borrowers seeking loss mitigation or who are in foreclosure, 4) imposing new standards for application of borrowers' mortgage payments to prevent layering of late fees, and 5) requiring regular review of foreclosure documents prepared by counsel. Superintendent Lawsky also stated, "We will continue to do everything we can to make these reforms the norm in the servicing industry."¹³ Given that policy, DFS will look to impose similar requirements on other financial institutions and mortgage servicers.

Finally, in another show of DFS's new enforcement and investigative muscle, DFS recently announced that its investigation led to the arrest of Robert R. Robinson, the president and chief executive officer of the Otsego County Chamber, for running a fraudulent insurance scheme.¹⁴ Robinson is accused of creating a fictitious membership category within the Otsego County Chamber so that New York City residents

could be enrolled in the Chamber's health plan. Residents of New York City were enticed to buy insurance coverage through Robinson because the premiums offered through the plan were significantly lower than health plans available in the New York City metropolitan area. When the fraud was discovered, at least 520 people had their coverage cancelled.

Given DFS's rare combination of criminal and civil law enforcement authority, and its broad regulatory purview over financial services institutions, it would be prudent for compliance professionals and others at any banking, insurance, or other financial services company doing business in New York to familiarize themselves with DFS's new rules and regulations, and to monitor this new agency's regulatory and law enforcement activities.

LAWYER CONTACTS

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¹⁰ Press Release, DFS, "Governor Cuomo Announces Health Insurer Rate Filings Now Available To Public," Nov. 15, 2011.

¹¹ Press Release, DFS, Sept. 1, 2011; Press Release, DFS, Nov. 10, 2011.

¹² Press Release, DFS, Sept. 1, 2011.

¹³ Press Release, DFS, Nov. 10, 2011.

¹⁴ Press Release, DFS, "Superintendent Lawsky Announces Otsego County Chamber President Arrested For Fraud," Nov. 17, 2011.