No. 22-842

IN THE
Supreme Court of the United States

THE NATIONAL RIFLE ASSOCIATION OF AMERICA,
Petitioner,
v.
MARIA T. VULLO,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF FINANCIAL AND BUSINESS LAW SCHOLARS AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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INTEREST OF THE *AMICI CURIAE*[1]

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Petitioner's case is important to *amici* because it involves financial regulators' unique powers to bind regulated firms even via informal and indirect statements and guidance.

SUMMARY OF THE ARGUMENT

The court below erred in finding that the lack of explicit binding language or threats from the New York Department of Financial Services in its guidance letters meant that no reasonable regulated firm would consider itself bound by those letters. The reality of banking and insurance regulation is that firms frequently feel that they risk sanction if they do not comply with nominally non-binding guidance.

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[1] No counsel for any party has authored this brief in whole or in part, and no entity or person, aside from *amici curiae*, the Mercatus Center, and their counsel, made any monetary contribution intended to fund the preparation or submission of this brief.

Further, the use of guidance and reputation risk as tools of regulation has shown itself to enable abuses where regulators sought to enforce their policy preferences, rather than the law, under the guise of protecting the safety and soundness of regulated financial firms.

Finally, the nature and logic of reputation risk regulation, even if applied by a neutral regulator, enables a regulator-enforced "economic hecklers veto" by parties with sufficient economic power over a regulated firm.

ARGUMENT

In its opinion upholding the dismissal of Petitioner's suit, the Second Circuit opined that because Superintendent Vullo's statements were "written in an even-handed, nonthreatening tone" and "employed words intended to persuade rather than intimidate," they did not "intimat[e] that some form of punishment or adverse regulatory action [would] follow the failure to accede to the … request."[2] The Second Circuit relied on this conclusion to hold that Petitioner's complaint failed to "plausibly alleg[e] unconstitutional threats or coercion."[3]

But the Second Circuit did not appreciate that the unique relationship between financial regulators and their regulated firms tends to make those firms feel bound, on penalty of sanction, by even the most

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[2] Pet.App.29.

[3] Pet.App.31.

prosaic sounding statements.[4] Regulated firms have historically faced formal and informal penalties for failure to conform to guidance that was nominally non-binding.

Even if the regulator does not intend to coerce firms, a regulator applying the logic of reputation risk on the basis of a customer's controversial speech still risks changing the regulatory cost/benefit analysis of regulated firms in a way that empowers those seeking to silence speech.

This Court should reverse the decision below.

I. Banks and Insurance Firms Are Subject to a Uniquely Vague and Opaque Regulatory Environment.

Banking and insurance are vital services without which it is hard, if not impossible, to function in the modern economy.[5] Yet banks and insurance firms are

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[4] The statements made by Respondent and her superiors to regulated firms were not prosaic, and they were followed by sanctions against those firms. *See infra* note 54 and accompanying text.

[5] *See United States v. Phila. Nat'l Bank*, 374 U.S. 321, 327 (1963) ("the proper discharge of [banking operations] is indispensable to a healthy national economy"); *United States v. Se. Underwriters Ass'n*, 322 U.S. 533, 540 (1944) ("Perhaps no modern commercial enterprise directly affects so many persons in all walks of life as does the insurance business. Insurance touches the home, the family, and the occupation or the business of almost every person in the United States."); George A. Mocsary, *Administrative Browbeating and Insurance Markets*, 68 VILL. L. REV. 579, 582–87 (2023) (discussing importance of insurance); Brian Knight &

subject to a regulatory regime that enables regulators to exercise significant discretion with very limited transparency.[6] Regulators are able to exercise a level of control over regulated firms that can make them look more like co-managers of the firm than outside regulators, including, for example: influencing what lawful products they offer or decline to offer,[7] and deciding whether banks can open new locations or change locations,[8] whether they can do business at all,

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Trace Mitchell, *Private Policies and Public Power: When Banks Act as Regulators Within a Regime of Privilege*, 13 N.Y.U. J. L. & LIBERTY 66, 132–33 (2020) (discussing the importance of banking).

[6] *See 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., and Urb. Affs.*, 116th Cong. 36 (2019) (statement of Margaret E. Tahyar, Partner, Davis Polk and Wardwell LLP) ("[Bank] [s]upervision happens behind closed doors. It relies on secrecy and involves a system of discretionary actions by supervisory staff."); Mocsary, *supra* note 5, at 588–89 (discussing the opacity and limited political accountability of insurance regulation); Julie Hill, *Regulating Bank Reputation Risk*, 54 GA. L. REV. 523, 568–70 (2020).

[7] Hill, *supra* note 6, at 576–78 (discussing efforts by the FDIC, using aggressive tactics, to discourage banks from offering tax refund anticipation loans, a lawful product disfavored by regulators); Mocsary, *supra* note 5, at 593–94 (discussing efforts by an insurance regulator, first, to cover uninsured induced earthquakes, and then to offer "'enhanced earthquake coverage'" that covers such earthquakes).

[8] 12 C.F.R. §§ 5.30–5.31 (OCC regulations requiring OCC approval before national banks and federal savings associations may establish or move branches); N.Y. BANKING LAW §§ 28, 29 (McKinney) (requiring NYDFS Superintendent approval before a New York bank may change location or open a branch).

and whether to remove the firms' directors and officers and even ban them from the industry.[9]

Banks and insurance firms are subject to pervasive ongoing supervision. Regulators actively monitor firms for current and future compliance, rather than merely react to perceived problems.[10] Examination and supervision are usually done confidentially, with the conversations and determinations made by supervising regulators remaining out of public view.[11]

1. Since the mid-1990s, bank and insurance regulators have largely adopted a "risk-focused" regulatory approach where regulators monitor firms for business-and-stability threatening risks.[12] In addition to obvious risks such as credit risk and legal risk, regulators monitor banks' "reputation risk." The definition varies somewhat by regulator, and the concept is broad. For example, the Office of the Comptroller of the Currency states that reputation risk includes "risk to [the bank's] current or projected

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[9] 12 U.S.C. § 1818; N.Y. INS. LAW § 1102(d) (McKinney); N.Y. BANKING LAW § 41 (McKinney); N.Y. COMP. CODES R. & REGS. tit. 3, §§ 2.2, 2.4; Knight & Mitchell, *supra* note 5, at 75–82 (discussing government-imposed barriers to entry in banking).

[10] Randal K. Quarles, Vice Chair, Bd. of Governors of the Fed. Rsrv. Sys., Law and Macroeconomics: The Global Evolution of Macroprudential Regulation, Address at Geo. Univ. L. Ctr. (Sept. 27, 2019), https://www.federalreserve.gov/newsevents/speech/quarles20190927a.htm.

[11] *Guidance, Supervisory Expectations, and the Rule of Law*, *supra* note 6, at (statement of Margaret E. Tahyar, Partner, Davis Polk and Wardwell LLP).

[12] Hill, *supra* note 6, at 544–46 (discussing rise of risk-based regulation).

financial condition and resilience arising from negative public opinion."[13] The relevant audience for assessing risk to a bank's reputation includes not only customers, but also "shareholders, regulators, … other stakeholders, and the community at large."[14] The Federal Reserve does not list specific audiences but rather states that "[r]eputational 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."[15] These definitions are sweeping and vague, and provide significant discretion to examiners.

Despite, or perhaps because of, this ambiguity, the concept of reputation risk has permeated federal banking regulatory guidance.[16] It has expanded to include not only reputation risk caused by the bank's conduct, but also by the bank's customers, on the theory that a controversial customer—even one who does nothing illegal—may alienate other

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[13] OFF. OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER'S HANDBOOK: SAFETY AND SOUNDNESS, CORPORATE AND RISK GOVERNANCE 4 (July 2019).

[14] *Id.*

[15] BD. OF GOVERNORS OF THE FED. RSRV. 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) (emphasis added).

[16] Hill, *supra* note 6, at 549–53 (discussing the proliferation of reputation risk in federal banking regulation).

constituencies and harm the bank's financial position.[17]

Reputation risk is also unique in that there need not be a concrete triggering event to which regulators can point, and regulators themselves acknowledge that reputation risk is not as quantifiable—i.e., objective—as other risks like legal or credit risk.[18] The logic of reputation risk is also amoral. Risk can stem from the perceptions of the customers, potential customers, and those with influence, no matter how faulty, fickle, or malicious they may be.

At the federal level, reputation risk is usually raised in regulatory guidance rather than codified in a rule or statute.[19] As Professor Julie Hill notes, this means that enforcement actions targeting reputation risk would generally need to be tied to an "unsafe or unsound" practice to have a legal basis.[20]

But that fails to serve as a meaningful check because the exact scope of what constitutes an "unsafe or unsound" practice that can enable a regulator to act is likewise open-ended and often disputed. In the federal context, bank regulators have asserted a broad definition that includes any action or nonaction posing an "abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the

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[17] *Id*. at 552.

[18] *Id*. at 547–48.

[19] *Id*. at 557.

[20] *Id*. at 557–58.

insurance funds[,]" even if the loss would not imperil the institution.[21]

Courts are divided on how broadly "unsafe and unsound" is defined in federal law. Although the Third, Fifth, and D.C. Circuits have narrowed the definition to encompass only risks that threaten bank stability,[22] the Second, Eighth, and Eleventh Circuits have embraced the broader standard advocated by federal regulators—i.e., any "abnormal risk."[23] Given the Second Circuit's outsized influence in matters of finance, its broad approach to allowing such investigations is significant.

Taken together, regulators can launch investigations into institutions' "reputation risk" premised only on how the regulators themselves may view, or how they *perceive* the public to view, the institution and its customers, often with no meaningful consideration of whether that "risk" actually affects the institution's financial soundness. This lets regulators tie legal oversight of an institution's provision of services to entities or individuals who are unpopular in some camps or with whom the regulator disagrees as a policy matter.

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[21] *Id.* at 558 (quoting *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, Fed. Home Loan Bank Bd.)).

[22] *Id.* at 558–60.

[23] *Id.* at 560.

The regulatory structure also discourages regulated firms from challenging their regulators and makes it hard to point to a concrete act that could give rise to a discrete legal challenge. Because banks and insurance firms are locked into an ongoing supervisory relationship with their regulators, they know that resistance to the regulator on one topic may result in informal—but no less painful—reprisal over time.[24] The regulator can make the regulatory process itself the punishment. This makes it difficult or impossible to challenge in court. Moreover, a lawsuit would only further alienate the regulator.

Despite its broad application, it is unclear whether reputation risk helps make banking or insurance safer and sounder. In an analysis of federal public enforcement actions against banks, Professor Hill found that in almost all cases, reputation risk was either not cited as a justification for the enforcement action or was included with other, more objective types of risk (e.g., credit risk or legal compliance risk) that would provide a sufficient, independent basis for enforcement.[25] She found only one enforcement action that was based solely on reputation risk.[26] This is not surprising given that "[r]eputation risk arises most

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[24] *Id.* at 579–83 (discussing Nicholas R. Parrillo, *Federal Agency Guidance and the Power to Bind: An Empirical Study of Agencies and Industries*, 36 YALE J. REG. 165, 174 (2019)).

[25] *Id.* at 563–68

[26] *Id.* at 568.

often as an ancillary risk to some other problem already addressed in banking law."[27]

Moreover, in those cases where reputation risk is not covered by other aspects of the law, there is no reason to expect regulators to be able to predict or prevent risk.[28] Insurers are risk experts whose success depends on managing risks well.[29] They are aware of the risks involved with entering a given market space.[30] More still, although a regulated firm routinely interacts with the myriad constituencies involved with its business, regulators rarely do.[31] That puts the regulated firms into an advantaged position vis-à-vis regulators to determine whether serving a particular constituency is likely to be beneficial or harmful to its reputation.[32] Indeed, there is reason to believe that the Superintendent's pressuring and forcing, via letters and consent orders, insurers to stop doing business with Petitioner and other "gun promotion organizations"[33] may have hurt the insurers' financial

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[27] *Id.* at 530.

[28] *Id.* at 531–32; *accord* Mocsary, *supra* note 5, at 610–12.

[29] Mocsary, *supra* note 5, at 610–11. So are banks, inasmuch as they regularly have to gauge the risks involved with loans and other investments.

[30] *Id.*

[31] *Id.* at 612.

[32] *Id.*

[33] Letter from Maria T. Vullo, Superintendent, N.Y. Dept of Fin. Servs., to the CEO or Equivalents of N.Y. State Chartered or Licensed Fin. Insts. (Apr. 19, 2018) [hereinafter Vullo Bank

soundness by decreasing demand for their products and causing them to be less diversified.[34]

2. As Professor Hill acknowledges, public enforcement actions do not cover the universe of bank regulator interventions; many occur outside public view.[35] But such informal enforcement has also enabled significant regulatory abuse of the sort alleged in this case.[36]

While the New York State Department of Financial Services (NYDFS) is governed by New York rather than federal law, its regulation of banks and insurance companies has many parallels. The NYDFS is tasked with ensuring that banks[37] and insurance[38]

Letter], https://perma.cc/D2YT-HVKQ; Letter from Maria T. Vullo, Superintendent, N.Y. Dept of Fin. Servs., to the CEO or Equivalents of All Insurers Doing Business in the State of New York (Apr. 19, 2018) [hereinafter Vullo Insurance Letter], https://perma.cc/PDP7-JPSN; Consent Order Under Sections 1102 and 3420 of the Insurance Law, *In re* Chubb Grp. Holdings Inc. & Ill. Union Ins. Co. 6–7 (May 7, 2018), https://perma.cc/4CFE-RELT; Consent Order Under Articles 21, 23, and 34 of the Insurance Law, *In re* Lockton Affinity, LLC & Lockton Cos., LLC 12–13 (May 2, 2018), https://perma.cc/A4F2-RVQR.

[34] Mocsary, *supra* note 5, at 611–12.

[35] Hill, *supra* note 6, at 568–70.

[36] *See infra* notes 58–96 and accompanying text; *see also infra* notes 97–105 and accompanying text (discussing abuses in the insurance context).

[37] N.Y. BANKING LAW § 14(q) (McKinney).

[38] N.Y. INS. LAW § 309 (McKinney); *see also* ROBERT H. JERRY, II & DOUGLAS R. RICHMOND, UNDERSTANDING INSURANCE LAW §§ 20, 22 (5th ed. 2012).

companies operate in a safe and sound manner. New York law grants the NYDFS broad latitude to pursue this objective. For example, the Superintendent of the NYDFS has the discretion to refuse to grant an insurance license if she does not believe that granting a license would be in the best interest of New Yorkers.[39] Likewise, the Superintendent may reject a request to form a bank under the laws of New York if she believes the bank would not promote the "public convenience and advantage."[40]

This significant power does not end after initial permission is granted. For example, the NYDFS has broad authority to examine banks[41] and insurance companies.[42] It also uses the concept of reputation risk in its regulation of banks and insurance firms.[43] In fact, reputation risk was explicitly highlighted in the industry letters sent by NYDFS asking banks and insurance firms to evaluate their relationships with the National Rifle Association of America (NRA) and other "gun promotion organizations."[44] In its opinion below, the Second Circuit summarized the basis for the Superintendent's actions: "a business's response to social issues can directly affect its financial

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[39] N.Y. INS. LAW § 1102(d) (McKinney).

[40] N.Y. BANKING LAW § 24 (McKinney).

[41] *Id.* § 36.

[42] N.Y. INS. LAW § 309 (McKinney).

[43] Hill, *supra* note 6, at 553–56 (discussing the NYDFS's use of reputation risk in regulation).

[44] Vullo Bank Letter, *supra* note 33; Vullo Insurance Letter, *supra* note 33.

stability" and fall within the ambit of NYDFS's jurisdiction.[45]

Thus, just as with federal regulators, the NYDFS can directly invoke regulatory power simply because financial institutions serve customers that can be cast as unpopular or with whom the State's or NYDFS's leadership disagrees on policy matters.[46]

* * *

Banking and insurance operate within a uniquely nebulous and opaque regulatory environment. They are also under regular supervision and must rely on their regulator for permission to operate. These traits contribute to an environment where banks and insurance firms are likely to believe that guidance is de facto binding, including specifically in the realm of providing services to customers with whom the regulators may disagree politically.

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[45] Pet.App.30.

[46] *E.g.*, Press Release, Governor Andrew M. Cuomo, 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), (URL unavailable) [https://perma.cc/DLK3-7S5K] ("Governor Andrew M. Cuomo today directed the Department of Financial Services to urge insurance companies … in New York to review any relationships they may have with the National Rifle Association and other similar organizations."). In another example, New York courts once upheld a pre-NYDFS Superintendent's decision to liquidate a beneficial organization on the basis that it was hazardous to the public because it "operated as an arm of the Communist party." *In re Int'l Workers Order, Inc.*, 280 A.D. 517, 519 (N.Y. App. Div. 1952).

II. The Nature of Banking and Insurance Regulation Encourages Regulated Firms to Feel Bound by Guidance and Subject to Sanction for Noncompliance.

Banking and insurance face unique regulatory structures and incentives that cause firms to treat regulatory guidance as binding. As such, there is often an implied threat of sanction even when agency guidance lacks an explicit threat. Banking or insurance firms would thus reasonably believe that failure to comply with NYDFS guidance would result in some sort of punishment, either formally or informally.

For example, a study for the Administrative Conference of the United States (ACUS) by Professor Nicholas Parrillo found that in the context of federal regulation, regulated parties "often face overwhelming practical pressure to follow what a guidance document 'suggests.'"[47] He notes that banks are likely to find themselves bound by guidance because they are so dependent on maintaining good relationships with their regulators.[48] This ranges from receiving regulator approval for engaging in certain business activities, like opening branches, to being subject to regular examination by their regulator. Because complete compliance with banking regulations is likely impossible, banks are concerned that failing to comply with guidance will cause

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[47] Parrillo, *supra* note 24, at 174; *see also* Nicholas R. Parrillo, *Federal Agency Guidance: An Institutional Perspective,* ADMIN. CONF. OF THE U.S. (Oct. 12, 2017).

[48] Parrillo, *supra* note 24, at 192.

regulators not to work cooperatively with them on other issues.[49]

This problem is exacerbated by the strong incentive for entities not to challenge regulator decisions because the regulator can "'make life miserable' for a bank in all sorts of ways"[50] that do not necessarily involve a formal enforcement action. In short, bank regulators fully understand that they can control bank behavior by merely "raising an eyebrow."[51]

Informed by Parrillo's study, ACUS promulgated a recommendation on how agencies could avoid giving the mistaken impression that their guidance statements were legally binding.[52] One of its recommendations was that an agency's statement should prominently disclaim that it was binding and explicitly state that the target of the guidance could take alternative lawful approaches.[53] Although the ACUS recommendation is nonbinding and not directly aimed at state regulators like NYDFS, it is noteworthy that the NYDFS's statements lacked

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[49] *Id.* at 192–95.

[50] *Id.* at 195; Hill, *supra* note 6, at 579–83.

[51] Parrillo, *supra* note 24, at 195; *see also* Hill, *supra* note 6, at 581–82.

[52] ADMIN. CONF. OF THE U.S., ADMINISTRATIVE CONFERENCE RECOMMENDATION 2017-5, AGENCY GUIDANCE THROUGH POLICY STATEMENTS (Dec. 14, 2017), https://www.acus.gov/sites/default/files/documents/Recommendation%202017-5%20%28Agency%20Guidance%20Through%20Policy%20Statements%29_2.pdf.

[53] *Id.* at 7.

language comparable to the ACUS recommendation.[54] Quite the opposite, its letters were written in a "'zealous tone'" that villainized NYDFS and the New York governing administration's political enemies with whom NYDFS's regulated entities conducted business.[55]

III. Prior Incidents in Banking and Insurance Regulation Make Clear that Failing to Adhere to Guidance Could Result in Sanction.

Banks and insurance firms that have failed to adhere to nominally nonbinding guidance have repeatedly suffered reprisal at the hands of their regulators. These incidents generated sufficient controversy that bankers and insurance companies were well aware of them by the time NYDFS released its guidance regarding the NRA and "other gun promotion organizations." The lessons from these incidents would have colored regulated firms' assessment of whether they would face sanction for failing to comply with the NYDFS's guidance.[56] This is especially so with the NYDFS, which is "widely

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[54] Rare is the regulator that would so honestly disclaim its own asserted powers. The exception that proves the rule is the 15-month period from October to 2019 to January 2021 during which Executive Order 13,891 was in effect, which "require[d] that [federal] agencies treat guidance documents as non-binding both in law and in practice." *See* Exec. Order No. 13,891, § 1, 84 Fed. Reg. 55,235 (Oct. 15, 2019), *revoked by* Exec. Order No. 13,992, 86 Fed. Reg. 7,049 (Jan. 25, 2021).

[55] Mocsary, *supra* note 5, at 596–97; *see id.* at 595, 616–20.

[56] *Id.* at 597 nn.96–98.

viewed as one of the nation's most aggressive state regulators."[57]

1. The most poignant example is the Federal Deposit Insurance Corporation's (FDIC's) recent effort to use risk, including "reputation risk," as a justification to pressure banks to stop offering refund anticipation loans (RALs) to consumers and to stop providing banking services to so-called "payday lenders." In both cases, the FDIC could not prohibit the banks' conduct outright but instead relied on guidance combined with "moral suasion" and ratcheting up the intensity of supervisory and examination activities to "persuade" the banks that it was not in their best interest to maintain relationships with the disfavored industries.[58]

RALs are lawful products but became disfavored after advocacy organizations lobbied FDIC leadership

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[57] Kristin Broughton, *Bad Actors, Beware: N.Y. Gov. Cites Wells Fargo in Calling for 'Bold Steps,'* AM. BANKER, Feb. 1, 2017, at 8 ("[T]he New York State Department of Financial Services is 'widely viewed as one of the nation's most aggressive state regulators.'").

[58] *See* OFF. OF INSPECTOR GEN., FED. DEPOSIT INS. CORP., REPORT NO. OIG-16-001, REPORT OF INQUIRY INTO THE FDIC'S SUPERVISORY APPROACH TO REFUND ANTICIPATION LOANS AND THE INVOLVEMENT OF FDIC LEADERSHIP AND PERSONNEL iii–iv (Feb. 2016) [hereinafter FDIC OIG REPORT NO. OIG-16-001] (the FDIC OIG did not release the full report because it contained "sensitive information"); OFF. OF INSPECTOR GEN., FED. DEPOSIT INS. CORP., REPORT NO. AUD-15-008, THE FDIC'S ROLE IN OPERATION CHOKE POINT AND SUPERVISORY APPROACH TO INSTITUTIONS AND CONDUCTED BUSINESS WITH MERCHANTS ASSOCIATED WITH HIGH-RISK ACTIVITIES *passim* (Sept. 2015) [hereinafter FDIC OIG REPORT NO. AUD-15-008].

in 2008.[59] FDIC leadership began pressuring the handful of banks that provided the service to stop.[60] As the FDIC's Office of the Inspector General (OIG) notes, because RALs were legal, FDIC staff relied on "risk management" as a justification to engage the banks. According to the OIG, the justification for discouraging RALs "morphed over time."[61] The FDIC promulgated no rule or guidance related to RALs, but instead used "more generic guidance" as the standard to which they sought to hold banks.[62]

The FDIC was ultimately successful in driving banks out of the RAL market, [63] but only through what the OIG described as "unprecedented efforts to use the FDIC's supervisory and enforcement powers" and the "circumvention of certain controls surrounding the exercise of enforcement powers."[64]

The OIG found that FDIC officials in Washington directed staff to lower the Safety and Soundness report ratings of banks offering RALs, with the downgrade being predetermined before examination in at least one case.[65] The OIG also found that FDIC officials refused to accept a risk analysis that showed

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[59] Hill, *supra* note 6, at 533 n.49 (citing FDIC OIG REPORT NO. OIG-16-001, *supra* note 58, at i & n.2).

[60] FDIC OIG REPORT NO. OIG-16-001, *supra* note 58, at i–ii.

[61] *Id.* at ii.

[62] *Id.*

[63] *Id.*

[64] *Id.*

[65] *Id.*

banks' ability to mitigate risk and that those same officials reworked the analysis until they got their desired result.[66] The FDIC prohibited a bank from pursuing its desired strategy of buying failed institutions unless it discontinued offering RALs.[67]

Additionally, the FDIC used its supervisory authority as a stick to gain compliance. An FDIC attorney "abusively" threatened the banks' leadership, in one instance telling a bank's board that "nothing would be off the table" if it refused to cease offering RALs, including the use of "extraordinary examination resources," where over four hundred examiners would examine banks that offered RALs and their tax preparer partners, in an effort to find violations the FDIC could use to justify punishing banks that refused to abide by the FDIC's guidance.[68]

The FDIC's tactics ultimately prevailed, but as the OIG noted, the FDIC's actions significantly harmed the target banks, including (perhaps ironically) their reputations, even though there was a lack of "examination-based evidence of harm caused by RAL programs."[69]

It is worth noting that the FDIC's actions against banks offering RALs demonstrate many of the factors

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[66] *Id.* at iii.

[67] FDIC OIG REPORT NO. AUD-15-008, *supra* note 58, at 38.

[68] FDIC OIG REPORT NO. OIG-16-001, *supra* note 58, at iii; FDIC OIG REPORT NO. AUD-15-008, *supra* note 58, at 39.

[69] FDIC OIG REPORT NO. OIG-16-001, *supra* note 58, at ii.

that Professor Parrillo cites[70] for why firms often feel bound by guidance. The FDIC was able to prevent one bank from pursuing an unrelated business strategy by withholding permission unless the bank complied with guidance. The FDIC was also able to leverage its examination power to intimidate and punish banks that refused to comply.[71]

2. Following the RAL controversy, the FDIC became embroiled in the infamous "Operation Choke Point." Operation Choke Point began as a Department of Justice (DOJ) initiative to get banks and payments processors to cut off fraudulent companies' access to the Federal Reserve's payments system.[72] While the exact degree of the FDIC's direct involvement in DOJ's operation is disputed,[73] it is clear that FDIC guidance was used by DOJ. At a minimum, DOJ

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[70] *See supra* notes 47–51 and accompanying text.

[71] FDIC OIG Report No. OIG-16-001, *supra* note 58, at ii–iii; FDIC OIG Report No. AUD-15-008, *supra* note 58, at 38–40.

[72] Hill, *supra* note 6, at 572; FDIC OIG REPORT NO. AUD-15-008, *supra* note 58, at 1.

[73] *Compare* FDIC OIG REPORT NO. AUD-15-008, *supra* note 58, at ii ("FDIC's involvement in Operation Choke Point [was] inconsequential to the overall direction and outcome of the initiative."), *with* STAFF OF SUBCOMM. ON ECON. GROWTH, JOB CREATION, AND REGULATORY AFFAIRS, H. COMM. ON OVERSIGHT AND GOV'T REFORM, 113TH CONG., FEDERAL DEPOSIT INSURANCE CORPORATION'S INVOLVEMENT IN "OPERATION CHOKE POINT" 15–16 (Comm. Print 2014), https://republicans-oversight.house.gov/report/federal-deposit-insurance-corporations-fdic-involvement-operation-choke-point/ [hereinafter H. COMM. REP. ON OPERATION CHOKE POINT] (alleging an active partnership between DOJ and FDIC).

included with its subpoenas to banks a copy of the FDIC's Financial Institution Letter (FIL) FIL-3-2012. This document discussed alleged risks posed to banks from relationships with payment processors that served certain industries.[74] The FDIC guidance included a footnote with what it claimed was a non-exclusive list of industries that may have a higher incidence of fraud, including firearms, payday loans, and tobacco.[75] The guidance did not explain the FDIC's methodology or how it arrived at the list of industries.

Roughly contemporaneously with DOJ's efforts, the FDIC engaged in its own efforts to influence banks' customer choices. Before the previously mentioned guidance, the FDIC ran an article in its *Supervisory Insights* magazine that discussed risks posed to banks by third-party relationships.[76] The article identified some general criteria for what may constitute a high-risk payment.[77] The article then provided a nonexclusive list of thirty merchant categories that it identified as being associated with high-risk activities, including firearms, coin dealers, and payday loans.[78]

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[74] H. COMM. REP. ON OPERATION CHOKE POINT, *supra* note 73, at app. 141, https://republicans-oversight.house.gov/wp-content/uploads/2014/12/Appendix-1.pdf.

[75] *Id.* at app. 141 n.1.

[76] *Id.* at app. 152.

[77] *Id.* at app. 155–56.

[78] *Id.* at app. 156.

Shortly after the release of these guidance documents, reports began of banks dropping customers in the allegedly high-risk industries.[79] It is disputed whether the FDIC intended to use the high-risk list to motivate banks to cut ties with payments processors who served those industries, either directly or through motivating examiners to view such relationships more skeptically.[80]

But the *effect* of discouraging banks from serving industries on the high-risk list is undisputed.[81] The FDIC acknowledged as much because it revised its summer 2011 *Supervisory Insights* journal article[82] to remove the list of high-risk industries.[83] It also published new and revised guidance to make clear that banks that can manage the risk posed by a lawful relationship are not prohibited from doing business.[84]

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[79] Hill, *supra* note 6, at 573–74.

[80] *Compare* FDIC OIG REPORT NO. AUD-15-008, *supra* note 58, at 17, *with* H. COMM. REP. ON OPERATION CHOKE POINT, *supra* note 73, at 3–7.

[81] FDIC OIG REPORT NO. AUD-15-008, *supra* note 58, at 19; H. COMM. REP. ON OPERATION CHOKE POINT, *supra* note 73, at 7.

[82] H. COMM. REP. ON OPERATION CHOKE POINT, *supra* note 73, at app. 152.

[83] FDIC OIG REPORT NO. AUD-15-008, *supra* note 58, at 19.

[84] *Id.* (citing FED. DEPOSIT INS. CORP., FIL-41-2014, FDIC CLARIFYING SUPERVISORY APPROACH TO INSTITUTIONS ESTABLISHING ACCOUNT RELATIONSHIPS WITH THIRD-PARTY PAYMENT PROCESSORS (July 28, 2014), and FED. DEPOSIT INS. CORP., FIL-43-2013, FDIC SUPERVISORY APPROACH TO PAYMENT PROCESSING RELATIONSHIPS WITH MERCHANT CUSTOMERS THAT

3. The efforts of FDIC officials to have banks cut ties with disfavored industries, especially payday lending, did not stop at general guidance. Several FDIC officials used "moral suasion" to discourage banks from doing business with payday lenders, despite recognizing that there was no legal ground to force the banks to quit the relationships.[85] In at least one case, an FDIC Regional Director directly told a bank that partnering with a payday lender was generally "unacceptable for an insured [] institution," despite there being no legal prohibition against it,[86] as an FDIC official later acknowledged.[87] Although the bank's state regulator had no objection to the arrangement, the bank opted to terminate its relationship with the payday lender.[88] In a letter to the FDIC Chicago Regional Office, the bank's CEO criticized the FDIC's use of supervision as a tool to pressure the bank to end a business relationship

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ENGAGE IN HIGHER-RISK ACTIVITIES (Sept. 27, 2013, *revised* July 2014)).

[85] Hill, *supra* note 6, at 575–76; FDIC OIG REPORT NO. AUD-15-008, *supra* note 58, at 23–28.

[86] Letter from M. Anthony Lowe, Reg'l Dir., Chi. Reg'l Off., Fed. Deposit Ins. Corp., to Bd. of Dirs. of [name redacted], FDIC-ICR-0085 (Feb. 15, 2013), *reprinted in* H. COMM. REP. ON OPERATION CHOKE POINT, *supra* note 73, at app. 121.

[87] FDIC OIG REPORT NO. AUD-15-008, *supra* note 58, at 27 ("In the end, we are getting them out of [ACH processing for a payday lender] through moral persuasion and as you know from a legal perspective we don't have much of a position, if any.").

[88] *Id.* at 27–28.

without there being identified risks to the bank's safety and soundness other than reputation risk.[89]

The motivations, propriety, and actions of FDIC officials against payday lenders remain disputed. A lawsuit[90] filed by lenders against the FDIC and other regulators[91] alleged that they improperly pressured banks to cut ties with the plaintiffs, driven in part by the policy preferences of regulatory officials.[92] In settling the suit, the FDIC acknowledged that "certain employees acted in a manner inconsistent with FDIC policies with respect to payday lenders" and that this "created misperceptions about the FDIC's policies."[93] The letter further denounced "[r]egulatory threats, undue pressure, coercion, and intimidation designed to restrict access to financial services for lawful businesses."[94] The FDIC also clarified that banks were "neither prohibited nor discouraged" from providing services to lawful customers provided they

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[89] *Id*. at 27.

[90] *Advance Am., Cash Advance Ctrs., Inc. v. FDIC*, 251 F. Supp. 3d 78 (D.D.C. 2017).

[91] Initially the FDIC, Federal Reserve, and OCC were all sued. The claims against the Federal Reserve were dismissed prior to the suit being resolved. Complaint at 1, *Advance Am.*, 251 F. Supp. 3d 78 (No. 1:14-cv-00953).

[92] *Id*. at 14–22.

[93] Letter from Floyd Robinson, Deputy Gen. Counsel, Fed. Deposit Ins. Corp., to David H. Thompson (May 22, 2019), https://www.fdic.gov/news/press-releases/2019/pr19040a.pdf#page=4 (found on document page 4).

[94] *Id*.

could manage the risk.[95] The FDIC also announced new training for examiners and a tip line where improper examiner conduct could be reported.[96]

4. Insurance firms have likewise risked sanction if they do not follow agency guidance. In March 2015, for example, the Oklahoma Insurance Commissioner issued a bulletin regarding earthquake insurance.[97] Oklahoma had seen a marked increase in earthquakes that the U.S. Geological Survey, Oklahoma Geological Survey, and others attributed to injection of wastewater as part of oil and gas extraction (i.e., fracking).[98] This is relevant because

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[95] Statement of the Fed. Deposit Ins. Corp. Summarizing Internal Policies in which FDIC Recommends a Financial Institution to Terminate a Customer's Deposit Account and Reiterating Guidance about Providing Banking Services and Carrying Out Bank Secrecy Act Obligations (May 22, 2019), https://www.fdic.gov/news/press-releases/2019/pr19040a.pdf (found on document page 1).

[96] Letter from Jelena McWilliams, Chairman, Fed. Deposit Ins. Corp., to Rep. Blaine Luetkemeyer (Nov. 15, 2018), https://www.fdic.gov/news/press-releases/2019/pr19040a.pdf (found on document page 6).

[97] JOHN D. DOAK, OKLA. INS. COMM'R, OKLA. INS. DEP'T, EARTHQUAKE INS. BULL. NO. PC 2015-02, EARTHQUAKE INSURANCE, EXCLUDED LOSS, INSPECTION OF INSURED PROPERTY AND ADJUSTER TRAINING (Mar. 3, 2015), https://www.oid.ok.gov/wp-content/uploads/2019/10/030415_Earthquake-Bulletin-3-3-15.pdf [https://perma.cc/GCX8-J9ZJ] [hereinafter Doak Bulletin].

[98] Mocsary, *supra* note 5, at 591–92.

most earthquake policies sold at the time excluded damage from "man-made" earthquakes.[99]

In that bulletin, the Oklahoma Insurance Commissioner claimed that there was "no agreement at a scientific or government level" about whether the quakes were caused by fracking.[100] The bulletin contained no explicitly binding language, but noted that the Commissioner was concerned that insurance companies might be denying claims on the basis of the "unsupported belief" that the quakes were caused by fracking. The Commissioner said that insurers denying such claims should expect "appropriate action to enforce the law."[101] The bulletin also announced the intention of the Oklahoma Insurance Commissioner's Office to pursue market conduct examinations of insurers to investigate the high rates of coverage denials.[102] The bulletin also restated the duty of the Insurance Commission to determine whether insurers were "employing fair claims practices" and expressed an expectation that adjusters would receive adequate training in claims involving earthquakes.[103]

In the wake of this guidance bulletin, premiums for earthquake insurance increased 260%, deductibles increased, and the number of insurers who offered

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[99] *Id*. at 592.

[100] Doak Bulletin, *supra* note 97; Mocsary, *supra* note 5, at 593.

[101] Doak Bulletin, *supra* note 97.

[102] *Id*.

[103] *Id*.; Mocsary, *supra* note 5, at 593.

earthquake insurance declined.[104] This is compelling circumstantial evidence that insurers in Oklahoma believed they had to comply with the thrust of the guidance, which was to avoid excluding coverage, or face regulatory sanction through examination.

Scholars have collected examples like these from across the country—they are hardly limited to New York and Oklahoma.[105]

IV. Even a Neutral Application of Reputation Risk Based on a Customer's Controversial Nature Could Provide an "Economic Heckler's Veto."

Even where reputation risk is not used as a tool by regulators to attack disfavored industries directly, it could still pose a threat to controversial speakers even when the regulator employs it neutrally.

The logic of reputation risk, especially stemming from a firm serving a controversial but legal client, does not depend on either the regulated firm or controversial client doing anything wrong.[106] Instead, it is an economic calculation as to whether serving a controversial client will alienate another constituency that is more important to the firm's financial condition. It does not matter whether the alienated constituency has bad motives, such as a desire to

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[104] Mocsary, *supra* note 5, at 594.

[105] *Id.* at 590 n.52 (citing examples of insurance regulators pressuring in California, Florida, and nationwide).

[106] *See supra* notes 16–18 and accompanying text.

suppress speech. What matters is who is more important for the firm's economic prospects.[107]

Regulation based on reputation risk could invite something akin to regulatory support of a secondary boycott. Take a situation in which a group ("A"), such as potential customers or employees, has leverage over a market participant ("B"), like banks and insurance companies, that do business with another actor ("C"), such as a controversial advocacy group. A can threaten B with boycott unless it severs its relationship with C.

A real-world example of such an effort, which predates the use of reputation risk, is the attempt by Arab states in the 1970s to use their economic power to harm Israeli and- Jewish interests. Arab states engaged in a secondary and tertiary boycott to pressure firms to cut ties with Israel and firms that

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[107] *See, e.g.*, OFF. OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER'S HANDBOOK, BANK SUPERVISION PROCESS 28 (Version 1.1, Sept. 2019) ("Reputation risk is the risk *to current or projected financial condition and resilience* arising from negative public opinion. This risk may impair a bank's competitiveness by affecting its ability to establish new relationships or services or continue servicing existing relationships.") (emphasis added), https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/bank-supervision-process/pub-ch-bank-supervision-process.pdf; DIV. OF SUPERVISION AND REGUL., BD. OF GOVERNORS OF THE FED. RSRV. SYS., BANK HOLDING CO. SUPERVISION MANUAL § 1060.31.2 ("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*.") (emphases added), https://www.federalreserve.gov/publications/files/bhc.pdf.

worked with Israel.[108] While denied by Arab states, there was also evidence that the boycott extended to non-Israeli Jews.[109]

As part of this boycott, Arab governments sought to use the promise of business or the threat of losing business to impose conditions on U.S. banks. Examples include requiring banks to condition letters of credit used for international trade to stipulate that the goods being paid for were not made in Israel or shipped by Israeli vessels.[110] There were also allegations that Arab customers offered large deposits to U.S. banks, provided the banks did not have Jewish board members or significant owners.[111] Finally, there were concerns that Arab governments and companies might use their economic leverage to coerce U.S.

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[108] Jack G. Kaikati, *The Arab Boycott: Middle East Business Dilemma*, 20 CAL. MGMT. REV., Spring 1978, at 32, 35–36, https://journals.sagepub.com/doi/abs/10.2307/41165280.

[109] *See, e.g., id.* at 33, 39; OFF. OF THE COMPTROLLER OF THE CURRENCY, BANKING BULLETIN NO. 75-3 (Feb. 24, 1975) [hereinafter OCC BANKING BULLETIN 75-3] (discussing alleged offer of large deposits by foreign investors to US banks provided no Jews sit on the bank's board or have a large ownership stake).

[110] John H. Allan, *The Arab Boycott and the Banks*, N.Y. TIMES, Sept. 12, 1976, at F9, https://www.nytimes.com/1976/09/12/archives/the-arab-boycott-and-the-banks-clauses-in-the-credit-letters-are-at.html.

[111] OCC BANKING BULLETIN 75-3, *supra* note 109.

banks with which they did business to refuse to extend credit to Jewish businessmen.[112]

Arab governments and businesses ("A") were motivated to threaten to refuse to do business with U.S. banks ("B"), because Israel ("C") was disliked by A. The United States's response, citing banks' grant of special powers by public policy and need to serve their communities and refrain from discrimination, was to discourage or outright prevent banks from being used as a tool to harm Israel or American Jews.[113] For example, one justification for expanding the Equal Credit Opportunity Act to cover discrimination based

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[112] *Equal Credit Opportunity Act Amendments and Consumer Leasing Act—1975: Hearings on S. 483, S. 1900, S. 1927, S. 1961, and H.R. 5616 Before the Subcomm. on Consumer Affs. of the S. Comm. on Banking, Hous., and Urb. Affs.*, 94th Cong. 332 (1975) (statement of J. Stanley Pottinger, Assistant Att'y Gen., C.R. Div., Dep't of Just.).

[113] *See, e.g.,* OCC BANKING BULLETIN 75-3, *supra* note 109; Statement of President Gerald R. Ford, Jr., Announcing Measures to Respond to Discriminatory Foreign Boycott Practices, 2 PUB. PAPERS 1893 (Nov. 20, 1975), *reprinted in* Meyer Eisenberg, *Actions of Directors Regarding the Arab Boycott of Israel*, 31 THE BUS. LAW. 1409 app. A, at 1418–21 (1976); Letter from Bd. of Governors of the Fed. Rsrv. Sys. to the Presidents of all Fed. Rsrv. Banks and the Officers in Charge of Branches (Dec. 12, 1975), *reprinted in* 61 FED. RSRV. BULL., at 913–916 (1975), https://fraser.stlouisfed.org/title/federal-reserve-bulletin-62/december-1975-21492. The Federal Reserve subsequently clarified that banks were not required to comply with the previous notification. Kaikati, *supra* note 108, at 42.

on national origin and religion was the threat posed by the Arab boycott to Jewish bank customers.[114]

Absent the changes to the law that explicitly prohibited discrimination, the logic of reputation risk regulation could have obligated a neutral bank regulator to caution—or worse—banks about the potential risks of alienating their larger Arab state clients, in effect turning American bank regulation into a tool of policy for foreign governments.

Similar concerns exist in the domestic setting, where constituencies that oppose controversial speakers or industries may seek to convince firms that serving those controversial customers will cost the firms more business than they gain.[115] Even if those

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[114] Statement Announcing Measures To Respond to Discriminatory Foreign Boycott Practices, *supra* note 113; *Hearings on S. 483, S. 1900, S. 1927, S. 1961, and H.R. 5616*, *supra* note 112, at 332 (statement of J. Stanley Pottinger, Assistant Att'y Gen., C.R. Div., Dep't of Just.).

[115] Efforts to pressure banks and other financial services to cut ties with controversial industries are used by groups across the political spectrum, with industries as diverse as firearms, abortion, pornography, fossil fuels, and private prisons used by the United States as part of its immigration policy all being targeted. *See, e.g.,* Nate Hochman, *Lessons from the Porn Wars*, NAT'L REV. (Sept. 3, 2021), https://www.nationalreview.com/2021/09/lessons-from-the-porn-wars (Right-Left coalition targeting pornography); Meaghan Winter, *Why It's So Hard to Run an Abortion Clinic—And Why So Many Are Closing*, BLOOMBERG (Feb. 24, 2016), http://tinyurl.com/3abvy7dw (discussing efforts to stigmatize banks doing business with abortion clinics); Andrew Ross Sorkin, *How Banks Could Control Gun Sales If Washington Won't,* N.Y. TIMES (Feb. 19, 2018),

constituencies do not convince the firm, they may still prevail if they convince the regulator. And if the regulator does not explicitly order the firm to cut ties, the firm will still have to adjust its cost-benefit calculus based on the regulatory risk. In the process, the regulator would be providing groups seeking to suppress speech and advocacy an economic heckler's veto.[116]

V. The Court Should Reverse the Second Circuit.

The court below assumed that firms would not consider themselves bound by guidance or at risk of sanction for noncompliance unless there was some express threat by regulators. Such an assumption is

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https://www.nytimes.com/2018/02/19/business/banks-gun-sales.html (advocating banks restrict access to financial services to legal gun companies unless they stop offering legal products.); Morgan Simon, *GEO Group Running Out of Banks as 100% of Known Banking Partners Say 'No' to the Private Prison Sector*, FORBES (Sept. 30, 2019), https://www.forbes.com/sites/morgansimon/2019/09/30/geo-group-runs-out-of-banks-as-100-of-banking-partners-say-no-to-the-private-prison-sector/?sh=5aca20f63298 (discussing efforts by activists to get banks to cut ties with private prison companies); Michael Copley & Paula Moura, *Climate Activists Target Nation's Big Banks, Urging Divestment from Fossil Fuels*, NPR (Mar. 22, 2023) http://tinyurl.com/3hd4tyk4 (discussing activist efforts to get banks to divest from fossil fuel companies).

[116] Whether banks and insurers should be allowed to cut ties with some customers to placate others if the decision is not influenced by regulators, or whether banks and insurers should be prohibited by law from doing so, such as when the customer is being targeted because they are a member of legally protected class, is outside the scope of this case.

inconsistent with the nature of banking and insurance regulation.

The decision below is also emblematic of a growing effort by financial regulators to use their awesome powers to effect social change, even at the expense of protected constitutional rights. Financial services are essential to participating in the modern economy, and financial regulators have expansive, opaque power over the firms they regulate. Regulators, those whom they regulate, and the public writ large have recognized that financial regulations can be used as a tool to drive broader societal change outside the legislative process.[117]

This poses serious questions about the legitimate scope of the power of financial regulators and the interplay between those powers and other important considerations, most especially the constitutional rights of those targeted or disadvantaged by the actions of those regulators. The legitimate power of a regulator to protect financial safety and soundness[118] should not be used to cause regulated firms to

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[117] Hill, *supra* note 6, at 533 n.49 (discussing how FDIC crackdown on RALs began after consumer advocates sent a letter to FDIC Chairman Shelia Bair calling such loans harmful to consumers); *see also* Jonathan Stempel, *New York Governor Presses Banks, Insurers to Weigh Risk of NRA Ties*, REUTERS (Apr. 19, 2018), https://www.reuters.com/article/us-usa-guns-new-york/new-york-governor-presses-banks-insurers-to-weigh-risk-of-nra-ties-idUSKBN1HR04P (quoting Governor Cuomo as saying, "This is not just a matter of reputation, it is a matter of public safety").

[118] How far that power can or should sweep is an important question but outside the scope of this brief.

reconsider or subject to extra scrutiny a particular lawful practice or customer relationship. This is especially true where such a move impedes the exercise of constitutional rights.

This particular case involving the NYDFS and the National Rifle Association is not the first example of regulators potentially abusing their unique positions of power for political, rather than *bona fide* regulatory, purposes. Unless it is curtailed, it will not be the last. The Court should address this recurring matter of great significance and reverse the decision below.

CONCLUSION

The Court should reverse.

Respectfully submitted,

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