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Implications of **Remaining Silent** Before **Banking Regulators**

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A bank executive served with an investigative testimonial subpoena by a bank regulator often faces a difficult decision, particularly when the executive believes that he or she may be a target of the investigation. If the executive testifies, the regulator may elicit statements that will be used against the executive in a subsequent criminal proceeding. If the executive refuses to testify, this refusal can be used against the executive by the regulator in a civil proceeding. In addition, because a bank executive typically will have to interact with banking regulators throughout his or her career, resisting a regulator's subpoena can be daunting.

Because of the serious implications of this decision, it is critical for attorneys advising bank executives (or board members) in regulatory investigations to understand the legal terrain. A mistake made at an early stage of what appears to be a civil regulatory investigation can haunt a defense team for years.

SHUTTERSTOCK

Right to Take the Fifth

The starting point for a legal analysis of how to respond to a subpoena to testify as part of a bank investigation is determining whether the witness may refuse to answer questions by asserting rights under the Fifth Amendment. A witness served with a subpoena can invoke the Fifth Amendment right not to answer a question if the witness reasonably believes that the answer could be used against the witness in a criminal prosecution or could lead to other evidence that might be so used.[1] This privilege is to be accorded "liberal construction in favor of the right it was intended to secure."[2] In light of this liberal construction, demonstrating the *possibility* of prosecution, regardless of the court or regulatory body's assessment of the actual *likelihood* of prosecution, should be sufficient.[3]

Anything You Say May Be Used Against You

If a witness testifies pursuant to a subpoena issued in a regulatory investigation, the government may use this testimony as evidence in a later criminal trial (assuming it is otherwise admissible under applicable evidentiary rules) so

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long as the government does not act in bad faith in its pursuit of the regulatory proceedings.[4] For example, in *United States v. Kordel*, the U.S. Supreme Court upheld the government's use at a criminal trial of interrogatory responses obtained in a prior FDA civil proceeding. While the Supreme Court held that the government did not act in bad faith, it suggested that it would have found bad faith if the government had "brought a civil action solely to obtain evidence for its criminal prosecution" or had "failed to advise the defendant in its civil proceeding that it contemplates his criminal prosecution."[5]

With regard to "good faith" disclosures, it is important to keep in mind that different regulators have different policies on the nature of the disclosures that they make to witnesses testifying in response to a subpoena. For example, the SEC routinely informs witnesses that information gathered in civil proceedings can be used against them in a later criminal proceeding, while the FDIC does not typically provide this disclosure. In addition, some regulatory counsel are willing to disclose a witness's status within the regulatory investigation and whether a parallel criminal investigation exists, while others are not. Accordingly, it is always a good practice to ask a bank regulator (1) whether there are any parallel investigations or proceedings, (2) what the witness's status is within the regulatory investigation, (3) what the witness's status is within any parallel investigation or proceeding. To the extent that a bank regulator provides this information, it should be confirmed in writing by the witness's counsel and/or included in the transcript of the compelled testimony.

Adverse Consequences

Invoking the Fifth Amendment right not to testify at a regulatory proceeding has its own negative consequences. While the fact that a witness asserted the Fifth Amendment right not to testify cannot be used against a defendant at a criminal trial, the same is not true in a civil proceeding. The Supreme Court held in *Baxter v. Palmigiano*, 425 U.S. 308 (1976), which involved the defendant's invocation of silence at a prison disciplinary hearing, that "the Fifth Amendment does not forbid adverse inferences against parties to civil actions when they refuse to testify in response to probative evidence against them." Citing *Baxter*, the FDIC Board of Directors has held that in a bank regulatory enforcement action "adverse inferences can be drawn from both a failure to testify and the invocation of the Fifth Amendment during testimony."[6]

> When presented with what can appear to be a Hobson's choice between testifying or not testifying, a witness who knows of the existence of a criminal proceeding should strongly consider **pursuing a stay of the civil proceeding pending resolution of the criminal matter.**

Nor are adverse inferences the only potential consequence. Because a witness invoking the Fifth Amendment can interfere with a regulator's ability to learn about and obtain evidence, courts sometimes issue preclusion orders relating to evidence the witness later attempts to introduce that might have been refuted by the witness's testimony or evidence obtained due to that testimony. For example, in *SEC v. Cymaticolor*, 106 F.R.D. 545 (S.D.N.Y. 1985), a defendant asserted the privilege in response to interrogatories from the SEC. The court responded by issuing a total preclusion order barring the defendant from offering into evidence any matter relating to the facts concerning which he asserted his Fifth Amendment rights. Under some circumstances, a court may even take the draconian step of preventing a defendant from testifying about the matter concerning which the defendant refused to testify. As one court reasoned, "by his initial obstruction of discovery and his subsequent assertion of the privilege, defendant has

forfeited the right to offer evidence disputing the plaintiff's evidence or supporting his own denials." *SEC v. Benson*, 657 F. Supp. 1122, 1129 (S.D.N.Y. 1987).

Regulator Still Has to Prove Its Case

While a regulatory agency, or a court presiding over a regulatory proceeding, may restrict a defendant's ability to introduce evidence in that proceeding based on the defendant's assertion of a Fifth Amendment right, they cannot impose the ultimate penalty at issue based solely on the defendant's invocation of the privilege.[7] While invocation of the privilege may be costly in a civil proceeding, the agency "must still prove its case." *In the Matter of Randolph W. Lenz*, FDIC-02-174(e) at ¶4 (Dec. 4, 2003). The defendant will still be able to cross-examine witnesses and, depending on the scope of his assertion, introduce his own witnesses and documentary evidence. Civil money penalties or a prohibition order barring an executive from banking will not issue solely on the basis of the invocation of the privilege.

Beware, however: The Fifth Amendment does not apply to self-regulatory organizations (SROs), such as FINRA. It applies only to government agencies. SROs can, and often do, automatically sanction defendants for refusing to testify, taking to heart Justice Louis Brandeis's admonition that "silence is often evidence of the most persuasive character."

Requesting a Stay

When presented with what can appear to be a Hobson's choice between testifying or not testifying, a witness who knows of the existence of a criminal proceeding should strongly consider pursuing a stay of the civil proceeding pending resolution of the criminal matter. However, banking regulators, and courts presiding over a regulatory proceeding, are not always willing to stay the proceeding. For example, in *Lenz*, a bank officer under investigation by the FDIC for unsafe and unsound banking practices requested a stay of the FDIC proceeding based on the existence of a criminal investigation. The ALJ granted the stay; but the FDIC appealed, and the Executive Secretary of the FDIC reversed. He noted that pre-indictment requests for stays are generally declined, "particularly in cases like the present where there is no clear indication when or even if an indictment will be issued." While remarking that the bank officer's "dilemma in invoking the Fifth may have some surface appeal," a defendant facing parallel investigations "has no absolute right not to be forced to choose between testifying in a civil matter and asserting his Fifth Amendment privilege."[8]

Conclusion

If your client has been subpoenaed to testify by a banking regulator, or discovery has been requested, you must carefully consider the possible use of the evidence sought in a potential future criminal proceeding. While the consequences at the civil level for invoking the privilege may be significant, they generally pale in comparison with possible jail time.

1. *Kastigar v. United States*, 406 U.S. 441, 444 (1972).
2. *FDIC v. Mahajan*, 2014 U.S. Dist. LEXIS 92805, *8 (N.D. Ill. July 9, 2014); *Hoffman v. United States*, 341 U.S. 479, 486 (1951).
3. *In re Corrugated Container Antitrust Litigation*, 661 F.2d 1145, 1151 (7th Cir. 1981).
4. *United States v. Kordel*, 397 U.S. 1, 11 (1970).
5. Id. at 11-12.
6. *In the Matter of Harold Hoffman*, FDIC Enf. Decisions & Orders ¶5140, a-1494 (1989).
7. See *SEC v. Musella*, 578 F. Supp. 425 (S.D.N.Y. 1984) (citing *Lefkowitz v. Cunningham*, 431 U.S. 801 (1977)).
8. Citing *Keating v. Office of Thrift Supervision*, 45 F.3d 322, 326 (9th Cir. 1995).

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