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When A Money Laundering Investigation Turns Into a Class Action Complaint: The Latest Round in BofI's Fight to Put Money Laundering Allegations in the Rearview Mirror

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In February 2017, we blogged about a whistleblower complaint filed against Bank of the Internet ("BofI") by its former internal auditor. The blog post addressed what the whistleblower believed was BofI's wrongdoing in relation to responding to a subpoena from the Securities and Exchange Commission ("SEC"), and when dealing with a certain loan customer in potential violation of the Anti-Money Laundering ("AML") rules of the Bank Secrecy Act ("BSA").

Less than two months after our blog post, three BofI stockholders brought a putative class action complaint against BofI seeking to represent a class of individuals who purchased BofI stock, in a case captioned *Mandalevey v. BofI Holding, Inc*. These plaintiffs alleged BofI violated the Securities Exchange Act through, among other alleged misrepresentations, falsely denying the company was under investigation for money laundering violations. A federal court recently dismissed all claims against BofI.

This post focuses on that decision, the allegations relating to the federal investigation of BofI, and the Court's interesting reasoning in dismissing these plaintiffs' claims. Although the bank won this latest round, the saga involving BofI underscores how financial institutions face an increasing risk that alleged AML and Counter-Terrorism Financing ("CTF") violations will lead to follow-on allegations of securities law violations – allegations brought not only by the government (see here), but also by investor class action suits (see here, here and here).

Background

On March 31, 2017, the New York Post published an article entitled "Feds Probe [BofI] for Possible Money Laundering." The article stated the Department of Justice was leading an investigation into "possible money laundering" at BofI. In addition to detailing allegations against the company, the article provided the response of BofI's Chief Legal Counsel. According to the article, he initially refused to answer questions about any possible criminal probe. However, he then provided a written statement to the Post, which read, "There are no material investigations that would require public disclosure and BofI remains in good regulatory standing." BofI also issued a press release the same day. The press release addressed certain of the allegations in the Post article, and added, "the

Company has received no indication of, and has no knowledge regarding, such purported money laundering investigation." By the end of March 31, BofI stock dropped 5.26%.

Interestingly, during earnings conference calls in 2016 and in a Form 8-K filed in March 2016, BofI had represented that a major law firm had performed an internal investigation into the whistleblower's allegations and found no support for the conclusion that the bank or management had engaged in wrongdoing.

On October 25, 2017, the New York Post published another article about BofI, this one entitled, "Bank of Internet Was Under 16-Month SEC Investigation." As the title suggests, the article stated the SEC had investigated BofI for 16 months, but the investigation ended several months earlier without the SEC taking any action. Notably, the article's information was based upon "government documents" obtained "through the Freedom of Information Act." On October 26, BofI stock fell 4.57%.

The Plaintiffs' Allegations and the Court's Analysis

Referencing these two articles, the plaintiffs in *Mandalevey v. BofI Holding, Inc.* alleged BoFi's statements from March 31, 2017 must have been false. To support their claim, the plaintiffs also provided a statement from a "confidential witness" who stated there was "no way" BofI officials could not have known about the investigation.

The Court agreed with the plaintiffs, stating they "sufficiently demonstrated" the March 31 statements must have been false for the purposes of a motion to dismiss (in which a court reviews a complaint only to determine if it contains sufficient facts which, if accepted as true, state a claim to relief that is plausible on its face). Another step, however, still was necessary to sufficiently allege a claim under the Securities Exchange Act: the plaintiffs were required to allege acequately "loss causation."

"Loss Causation"

To plead "loss causation," a plaintiff must allege plausibly that the defendant's fraud was revealed to the market and caused the resulting losses. For this element, the Court focused on the plaintiff's ability to identify a "corrective disclosure." The plaintiffs alleged the October 25 article was the relevant "corrective disclosure" for the March 31 misrepresentation.

BofI countered by arguing that the October 25 article did not disclose any previously non-public information. That is, BofI pointed to the fact the October 25 article relied on documents obtained through FOIA. This argument raised the novel question: Is information available from a federal agency through FOIA "publicly available"?

Ultimately, the Court determined information obtained by FOIA ***is*** "publicly available" and therefore the information is deemed to be incorporated into the stock's market price. The Court reasoned that, "in the nearly seven months between BofI's denial and the October 25 article, a market participant would have made the sensible step of asking the SEC whether BofI's denial was accurate." Recognizing a market participant "would have had to jump through a bureaucratic hoop" to obtain this information, that information is nevertheless considered "public" for the purpose of the plaintiff's claims because market participants are always presumed to be "information-hungry."

For a company facing a securities class action case, the *Mandalevey* decision provides a potential new defense—that information is publicly available via a FOIA (or other public records) request, and

therefore not actionable. Perhaps more important is the public relations takeaway for a company under investigation by law enforcement. BofI's initial response in its call with the Post reporter was to say nothing. Only later did it make the statements that the Court determined could be found to be demonstrably false. And despite BofI stating it was unaware of an investigation, BofI's stock dropped significantly in the wake of the Post's article.

Needless to say, a company faces a difficult balance when responding to a public report of an ongoing investigation, whether it involve allegations of money laundering or otherwise. Althought BofI's defense to date has been successful, the effects of an alleged false statement regarding an ongoing investigation are often felt well into the future. Moreover, and regardless of the actual merits of the complaint against BofI or other banks, the mere existence of such shareholder lawsuits reflects that financial institutions must concern themselves not only with FinCEN, the Department of Justice, and the relevant examiner, but also with putative investor plaintiffs and the SEC – thereby increasing the stakes regarding decisions over the disclosure in SEC filings of possible violations of AML/BSA requirements.

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