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## IN-DEPTH ANALYSIS

# Fines for misconduct in the banking sector – what is the situation in the EU?

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Scrutiny paper on the Single Supervisory Mechanism  
provided at the request of the Economic and Monetary Affairs Committee

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Provided in advance of the public hearing  
with the Chair of the Supervisory Board of the ECB  
in ECON  
on 23 March 2017

#### **Abstract**

The US system for addressing bank misconduct through fines delivers a number of lessons for the EU with regard to the design of bank enforcement architecture and the need to develop common approaches across national and EU levels with a view to avoiding regulatory arbitrage. Following the crisis, the highest money penalties imposed on banks in the US related to mis-selling of financial products – a criminal offence falling under the remit of Department of Justice – rather than to breaches of prudential supervisory requirements.

This paper was requested by the European Parliament's Economic and Monetary Affairs Committee.

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## **ABOUT THE EDITOR**

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## LIST OF ABBREVIATIONS

<b>CFPB</b>	Consumer Financial Protection Bureau
<b>CMP</b>	Civil Money Penalties
<b>DDA</b>	Dodd-Frank Act
<b>DOJ</b>	US Department of Justice
<b>FDIC</b>	Federal Deposit Insurance Corporation
<b>FFIEC</b>	Federal Financial Institutions Examination Council
<b>FIRREA</b>	Financial Institutions Reform, Recovery and Enforcement Act
<b>OCC</b>	Office for Comptroller of Currency
<b>RMBS</b>	Residential Mortgage Backed Securities
<b>SSM</b>	Single Supervisory Mechanism
<b>USC</b>	United States Code

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## EXECUTIVE SUMMARY

Misconduct in the banking sector – despite its detrimental effects on both financial stability of the banking sector and the real economy – does not have a single legal definition. This makes addressing this risk particularly challenging in jurisdictions such as the US, where oversight and enforcement powers are distributed within a complex supervisory architecture repartitioning competences among numerous bank and activity-specific agencies. Even where a narrow definition of misconduct is adopted – that is the inappropriate supply of financial services – without adequate coordination, such complexity comes at the price of diluting enforcement action and exasperating informational asymmetries of the supervisor. The US experience shows that coordination and a holistic approach to the activities of banks is a precondition for an enforcement through money penalty regimes, in particular in cases of criminal bank misconduct such as fraud.

The US repartitions of oversight over the banking sector between various federal and state agencies, depends on the type of banking activity and the place of authorisation of the bank. In addition, the Department of Justice has played an essential role in enforcing rules related to misconduct through the imposition of money penalties for banks which have engaged in fraudulent activity over the course of the crisis. By looking at the US legal framework as well as empirical evidence concerning the levels of fines imposed, the present paper argues that the level of the fines in the US can be explained by the active pursuit by the DoJ of criminal misconduct, which sought further to overcome limitations stemming from a lack of adequate coordination by different bank supervisors.

The US system for addressing bank misconduct through fines delivers a number of lessons for the EU with regard to the design of bank enforcement architecture and the need to develop common approaches across national and EU levels to avoid regulatory arbitrage. Following the crisis, the highest money penalties imposed on banks in the US related to mis-selling of financial products – a criminal offence falling under the remit of the Department of Justice – rather than to breaches of prudential supervisory requirements.

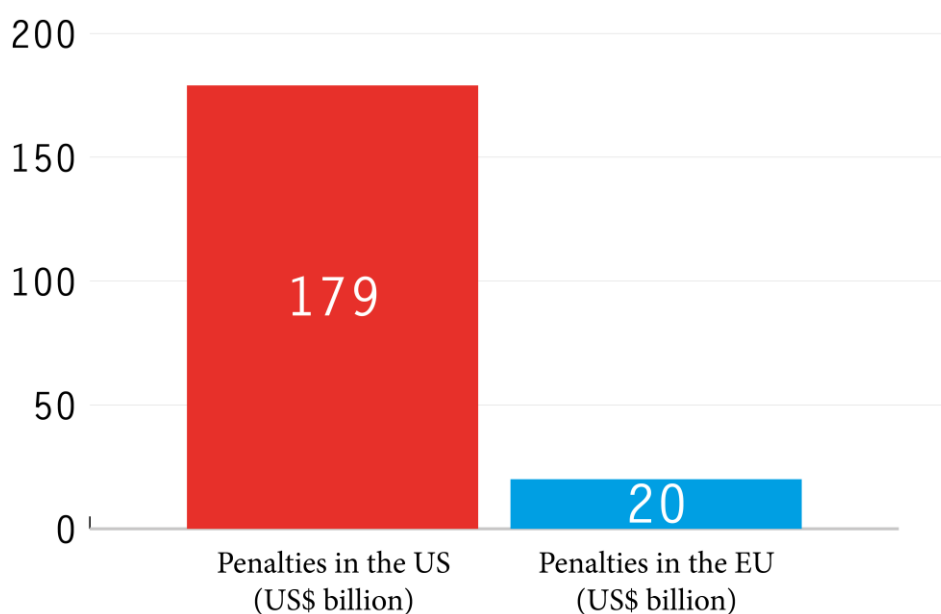
## 1. INTRODUCTION

*This paper was requested by the European Parliament under the supervision of its Economic Governance Support Unit.*

Misconduct is a broad term denoting conduct undesirable from the perspective of customers, investors or proper functioning of markets. A non-exhaustive typology of misconduct includes (a) mis-selling of financial products to retail customers, (b) mis-selling of financial products to professional clients; (c) violation of national and international rules and regulations (tax rules, anti-money laundering rules, anti-terrorism rules, economic sanctions, etc.), and (d) manipulation of financial markets, for instance the manipulation (ESRB, 2015). Misconduct can be linked to violation of specific banking and general rules and laws – in particular those linked to inappropriate supply of financial services – and as such is linked to enforcement of the regulatory framework as a whole.

An effective enforcement framework is a necessary precondition for the post-crisis banking regulation – and the Banking Union specifically – to achieve its objectives and enjoy credibility. The US civil money penalty regime can provide valuable lessons in terms of assigning competences between regulators, at and across, various levels. US regulators have been more active in imposing fines on banks over the course of the crisis than their European counterparts. The cost of US fines and settlements incurred by banks in the period 2009-2016 is estimated at USD 321 billion. According to a study from the Boston Consulting Group, US regulators have received USD 179 billion in penalties from banks over the period 2009-2016 while European regulators collected only USD 20 billion for the same period (BCG 2017), see Graph 1 below.

**Figure 1: Penalties in the US and the EU 2009-2016**



Source: Author's own elaboration, data from BCG (2017)

In order to draw relevant comparisons and lessons for the EU, this paper will outline the US legal framework for civil and criminal penalties on banks as imposed by federal bank agencies and judicial authorities.

## 2. ENFORCEMENT MECHANISMS IN THE BANKING SECTOR

*Ex post* penalties in the form of fines are the traditional deterrence technique of regulators. They rely on the disincentivising effect of a pecuniary fine for a particular conduct, in addition to reputational cost incurred by the offending institution. Penalties can target individuals or entire corporations; their goal being deterrence of particular conduct or compensation of harms inflicted on customers. In the case of banking, recently a shift towards emphasis on individual responsibility for misconduct can be observed (FSB, 2016). Administrative penalties, such as fines, should be distinguished from criminal penalties, such as imprisonment. Where fines “price” misconduct, criminal penalties “sanction” it. To this end, differences prevail across the Atlantic. The US model is traditionally more reliant on money penalties as an enforcement technique, in addition to having a long tradition of criminalisation of certain types of bank misconduct, in particular related to fraud, that is misrepresentation towards customers and investors (Coffee, 2007).

With increasing sophistication of regulation and supervision mechanisms in the banking sector, focus of policies addressing misconduct has shifted to *ex ante* guidance, through intensive relationship between the regulator and the bank. The development of a robust banking culture is thus considered key to addressing misconduct risk. Prevention-oriented approaches emphasize that misaligned incentives, which induce banks to produce negative externalities on society through its activities, in addition to moral hazard and informational asymmetry conditions lead to misconduct (ESRB, 2015). The question therefore is how responsibility for addressing these failures should be repartitioned between shareholders, other stakeholders of the bank and public authorities. Post-crisis oversight approaches and efforts at global level encourage a holistic and granular approach as well as a forward-looking orientation of supervisors, leaving broad scope for discretion of supervisors to calibrate the enforcement strategies to the type of behaviour of the regulated entity. Money penalties remain a last resort tool (in addition to the withdrawal of bank’s authorisation), which under this approach entail reputational costs for supervisors and banks alike.

To achieve optimum level of deterrence and ensure proper conduct by banks, the institutional design of the penalty system must strike a balance between options available – that is between deterrence of particular conduct through *ex post* penalties and *ex ante* oversight and forward-looking guidance of supervisors through informal enforcement means. Furthermore, the multiproduct nature of modern banking activity requires coordination between different supervisors and enforcement agencies, *inter alia* in order to prevent regulatory arbitrage. The legal design of the sanctioning tools has implications for the incentives of supervisors and other authorities to use them. Diverging regulatory cultures and traditions play a role in this regard, and are of concern for reasons related to enforcement arbitrage in particular in the context of the Banking Union (Coffee, 2007). This is all the more valid in the EU given the constraints of the legal framework and in particular the distribution of competences between national supervisors and the ECB within the SSM, as discussed below.

### 3. US BANK OVERSIGHT ARCHITECTURE

#### 3.1 Federal financial institutions regulatory agencies

The US system of oversight of banks is characterised by a complex architecture, meaning that oversight and enforcement powers are repartitioned between various agencies competent for particular types of credit institutions at federal level, in addition to state supervisors, without a clear framework for cooperation at the level of enforcement. Four authorities are relevant in the context of fines for bank misconduct specifically: the Board of Governors of the Federal Reserve System (“**Federal Reserve**”), the Federal Deposit Insurance Corporation (“**FDIC**”), the Office of the Comptroller of the Currency (“**OCC**”) and the Consumer Financial Protection Bureau (“**CFPB**”) created under the Dodd-Frank Act.

The US has a dual banking system, meaning that banks can be chartered and regulated at federal and state level, where notwithstanding federal pre-emption rules, enforcement can take place at both levels. The **Federal Reserve** supervises bank holding companies, state-chartered banks that are members of the Federal Reserve System, and the U.S. activities of foreign banks. The **FDIC** is the primary regulator for state-chartered banks that are not members of the Federal Reserve System as well as state-chartered thrifts. The **OCC** is an independent bureau of the U.S. Department of the Treasury led by the Comptroller of the Currency that charters, regulates, and supervises all national banks and federal savings associations as well as federal branches and agencies of foreign banks. An agency's regulatory and supervisory authority is not limited to the institutions it charters – the **FDIC** and the **CFPB** have extensive powers in this regard, for example with regard to consumer protection or cybercrime. The **CFPB** is an independent bureau within the Fed with a mandate to enforce federal consumer financial protection laws. The **CFPB** consolidates consumer protection laws and regulations previously handled by other regulatory agencies.

Bank regulatory agencies have a wide array of enforcement actions they can bring against a bank, its officers or directors, or any affiliated party (such as independent attorneys and accountants) for legal or regulatory violations, breaches of fiduciary duty, or unsafe or unsound banking practices. These include informal and formal enforcement action powers. Informal enforcement powers include resolution and enforcement letters as well as Memoranda of Understanding between the supervised entity and the regulator – these are non enforceable and typically used in cases of less harmful offences. Formal enforcement powers include cease and desist orders (which may be appealed before the courts) and civil money penalties. As will be discussed in detail below, civil money penalties may be imposed on any bank, its officers or directors, or any affiliated party on the basis of an organisation's violation of a formal enforcement order or on the violation of certain laws and regulations (including loans to insiders, affiliate transactions, tying arrangements and change in control requirements). Civil money penalties are enforceable in federal district court and may be appealed to the relevant US Court of Appeals.

#### 3.2 Department of Justice

In addition to sectoral banking regulators, a key role in policing bank misconduct is played by the US Department of Justice (DoJ). Under its statutory competences, the DoJ prosecutes misconduct related to criminal offences (see below section 4.2) as well as anticompetitive conduct under Section One of the Sherman Antitrust. The DoJ is led by the Attorney General, appointed by the US President, and acts as the chief law enforcement officer of the Federal Government.

## 4. CIVIL MONEY PENALTIES FOR MISCONDUCT

Civil money penalties in the US can be imposed both by the bank regulators, and – under the specific FIRREA regime – the Department of Justice, where the latter can impose penalties in cases of criminal predicate offences.

**Table 1:** US money penalties for misconduct

TYPE OF MISCONDUCT	AUTHORITY RESPONSIBLE	NATURE OF THE PENALTY
<b>Bank fraud (criminal)</b>	US Department of Justice	Criminal / Civil
<b>Civil violations</b>	Bank regulators	Civil

Source: Author’s own elaboration

### 4.1 Federal financial institutions regulatory agencies

The primary basis for imposition (or “assessment” in the language of US law) of civil money penalties by federal financial institutions regulatory agencies can be found in the US Civil Code (12 U.S.C. 1786(k)(2)(G) and 1818(i)(2)(G)). Common principles apply to the assessment of fines regardless of the regulator; to this end relevant factors for the determination of the total fine amount are: the size of financial resources, the presence of good faith, the gravity of the violation, and the history of previous violations. Agencies are authorised to assess civil money penalties (CMPs) for violations of any law or regulation, any final or temporary order, including a cease and desist, suspension, removal, or prohibition order, any condition imposed in writing in connection with the grant of any application or other request, any written agreement; and regulatory reporting requirements. Agencies may also assess fines for unsafe or unsound practices and breaches of fiduciary duty.

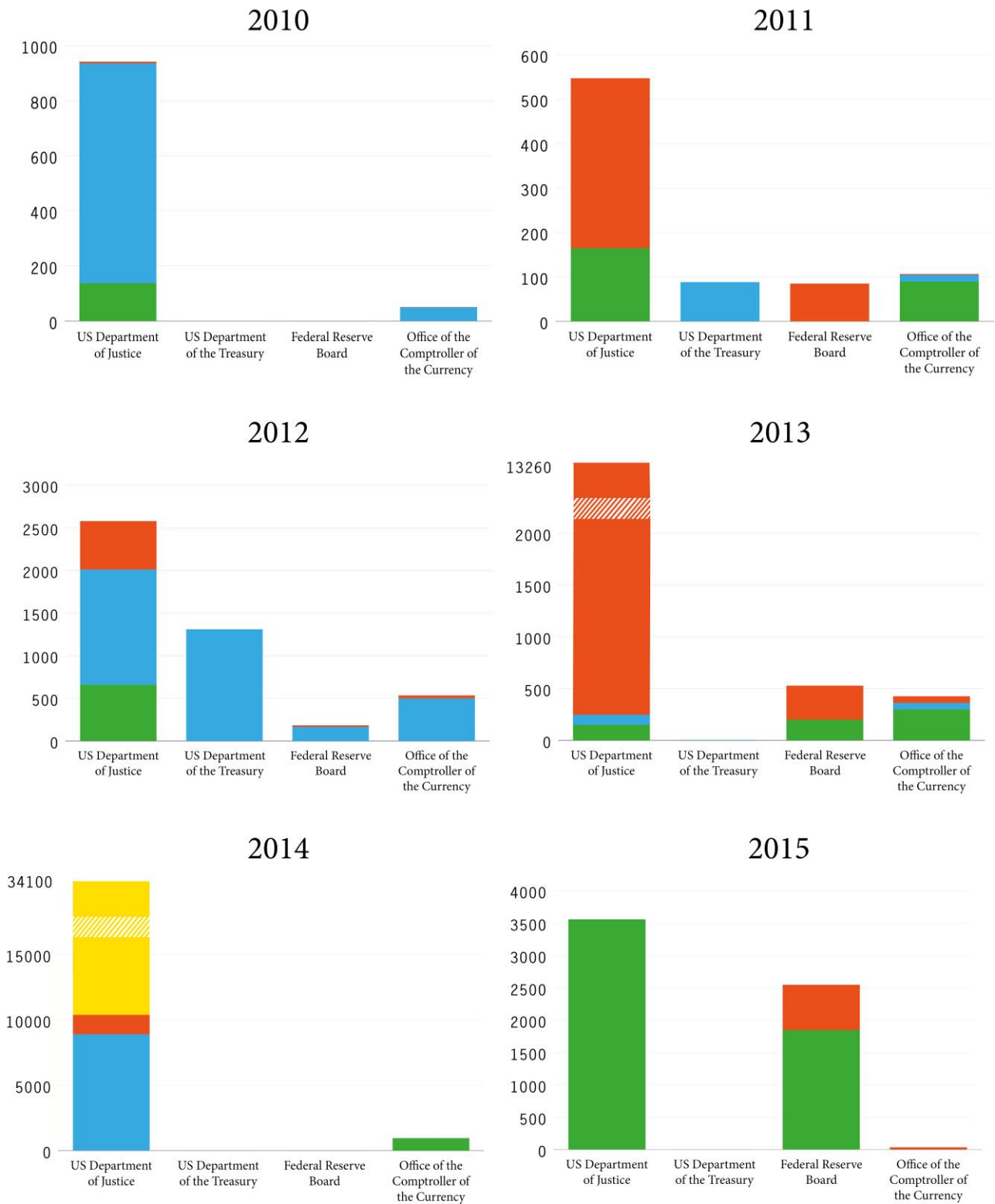
Three tiers of civil penalties are foreseen under US law, imposed depending on the severity of violation. Under section 8(i) of the Federal Deposit Insurance Act (FDIA), 12 U.S.C. 1818, **Tier 1** penalty “prices” any violation of laws or regulations at USD 5,000 per day. **Tier 2** violations, which cause “more than minimum loss” and result in pecuniary gain to the violator, are fined at USD 25,000 per day. **Tier 3** covers knowing violations, which cause “substantial loss” to the bank, and are priced at USD 1,000,000. To clarify its approach to imposition of penalties, FDIC published a CMP Matrix<sup>1</sup> indicating considerations relevant for the purposes of initiating a civil money penalty procedure. The matrix allows the regulator to assess the levels of severity of various statutory violations, being an example of calibration methodology of supervisory enforcement. The Matrix has been developed on the basis of factors identified by FFIEC – the formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions and to make recommendations to promote uniformity in the supervision of financial institutions – fostering also convergence across the agencies, even if in a non-binding manner - where they have overlapping mandates for the imposition of money penalties, e.g. in areas such as lending practices and consumer protection. In this regard the US oversight system has been criticised for duplication of supervisory efforts, in particular in cases of financial institutions which operate above the borders foreseen by the oversight architecture (for example federally chartered banks, which are part of bank

<sup>1</sup> See CMP Matrix in Section 14 : Civil Money Penalties, *DSC Risk Management Manual of Examination*, Federal Deposit Insurance Corporation, 2016 reproduced in the Annex



**Figure 2: DOJ settlements in RMBS cases 2010-2015 (in US\$ Millions)**

- Market manipulation
- Sanctions / Money laundering / Tax evasion
- Lending / Consumer practices
- Residential mortgage-backed securities



Source: Author's own elaboration, data from the FT

As can be seen from Table 2 and Graph 2 above, four broad categories of fines in the banking sector imposed by federal authorities specifically on global cross-border banks can be distinguished in the US: fines for market manipulation; money laundering, tax evasion and violation of international sanctions; consumer protection. In the early phases of the crisis despite the broad mandates of supervisors to impose fines for violations of any rule or regulation, in practice penalties were assessed predominantly for offences related to market manipulations and violations of international sanction regimes. A clear tendency can be seen however, in particular in 2013 and 2014 and in terms of the overall amounts, for judicial authorities in the US to impose fines related to mis-selling practices in the financial sector, in great part covering compensation to harmed consumers. Virtually no fines for breaches of prudential regulation can be identified, fines imposed by federal agencies (such as OCC) are relatively smaller than those imposed by DoJ. This tilted further in favour of consumer compensation with RMBS actions of the Department of Justice (see section 4.2) picking up after 2015.

In addition to sector specific supervisors, a new federal agency is gaining reputation for forceful actions against mis-selling type misconduct. The Consumer Financial Protection Bureau (CFPB) – was created in the aftermath of the financial crisis and authorized under the Dodd-Frank Act 2011 to impose civil money penalties specifically for violations of federal financial consumer protection laws, e.g. in cases of deceptive credit card marketing practices (Section 1055(c) DDA). Only in 2016, the CFPB’s supervisory and enforcement actions resulted in financial institutions providing more than USD 58 million in redress to over 516,000 consumers, and orders through enforcement efforts for approximately USD 247 million in total relief for consumers who fell victim to various violations of consumer financial protection laws, along with over USD 83.7 million in civil money penalties, used to compensate the consumers. As will be shown below, however, the amounts were significantly lower than in the case of actions pursued by the Department of Justice.

Though federal pre-emption rules apply to financial regulation, a more decentralised enforcement has been allowed under the Dodd-Frank Act, expanding the powers of state law authorities to bring lawsuits under state laws against national banks (12 C.F.R. § 7.4000) and authorizing state attorney generals to commence lawsuits against national banks and federal thrifts to enforce rules issued by the CFPB. Decentralisation of enforcement, together with empowerment of a new consumer protection agency, implies a multi-pronged approach.

Different agencies, given also their divergent mandates, have different enforcement cultures. However, in the aftermath of the financial crisis a tendency of agencies to cooperate in enforcement actions can be observed: the USD 13 billion settlement of JP Morgan Chase involved no less than 13 agencies at both state and federal level under the lead of DoJ, while the USD 0,7 billion penalty imposed by the CFPB in 2015 on the Citigroup, provided for the penalty to be paid both to the consumer compensation fund as well as to OCC.

## **4.2 Department of Justice**

In addition to civil money penalties which can be imposed by federal financial institutions regulatory institutions, a specific civil money penalty regime is provided for cases of credit institutions for violations related to fraud under the Financial Institutions Reform, Recovery and Enforcement Act 1989 (FIRREA), promulgated in the aftermath of the Savings & Loans crisis in the US. A particularity of FIRREA is a bifurcated system of enforcement, which allows for predicate offences (in particular mail and wire fraud, that is mis-selling) to be prosecuted either through civil (money penalties) or criminal (imprisonment) means, where it “affects a credit institution.”

FIRREA criminalises a number of conducts by financial institutions including: bank fraud (18 U.S.C. §1344) and mail and wire fraud (18 U.S.C. § 1343). FIRREA distinguishes between civil and criminal penalties, authorising the DoJ to bring a civil money penalty claim against a bank for criminal

offences specified under the Act. Imposition of a civil fine and/or settlement does not eliminate the possibility of DoJ persecuting the offence through criminal means.

Civil penalties under FIRREA have been actively pursued by the DoJ in the post-crisis context, for a number of reasons. The broad scope of FIRREA allows the DOJ to pursue civil money penalties for any frauds committed by financial institutions and their employees ('institution affiliated parties'). The burden of proof in civil cases is set at a lower level than in the case of criminal charges, that is the DoJ must prove with "preponderance of the evidence" that the bank in question committed the predicate offence, rather than "beyond reasonable doubt" as in the case of criminal offences. FIRREA further grants broad investigatory powers to the DOJ, including taking depositions of witnesses and request of information (12 U.S.C. § 1833a(g)) and has a relatively long statute of limitations (10 years under 12 U.S.C. § 1833a(h), compared to 5 years in the case of violations under the SSM discussed below.

FIRREA authorizes penalties up to USD 1.1 million per violation, or USD 1.1 million per day/ USD 5.5 million per violation in cases of continuing misconduct (see Table 4 for comparison of fines levels). Barring a settlement, the total amount of the fine is set by the Court. US Court of Appeals case *United States v Menendez* determined the following criteria for determining the amount of fine: the good or bad faith of the defendant and the degree of scienter; the injury to the public and loss to other persons; the egregiousness of the violation; the isolated or repeated nature of the violation; the defendant's financial condition and ability to pay; the criminal fine that could be levied for the conduct; the amount of the defendant's profit from the fraud; and the penalty range available under FIRREA.

US Courts have interpreted the goals of FIRREA broadly – in *United States v The Bank of New York Mellon*, in the light of the legislative history of the Act, the US Court of Appeals stated that the objective of civil moneys penalties is to deter fraud which puts federally insured depositors at risk, as well as to protect the taxpayer. Consequently, DoJs mandate extends beyond what is traditionally the mandate of financial supervisors. Furthermore, the DoJ enjoy a larger room for manoeuvre in terms of time limits and required burden of proof, but can also impose higher fines on offending institutions.

#### **4.2.1 Residential Mortgage Backed Securities (RMBS)**

DoJ prosecuted fraudulent conduct in relation to was investigated by the US Department of Justice within Residential Mortgage Backed Securities (RMBS) Working Group set up by President Obama in 2012 acting under provisions of FIRREA. They have led to resolution through record settlements being applied by the DoJ (see Table 3) in cases where marketing practices of the banks with regard to specific products, with fines imposed on 8 banks in the period 2013-2016 amounting to almost 30% of total penalties imposed.

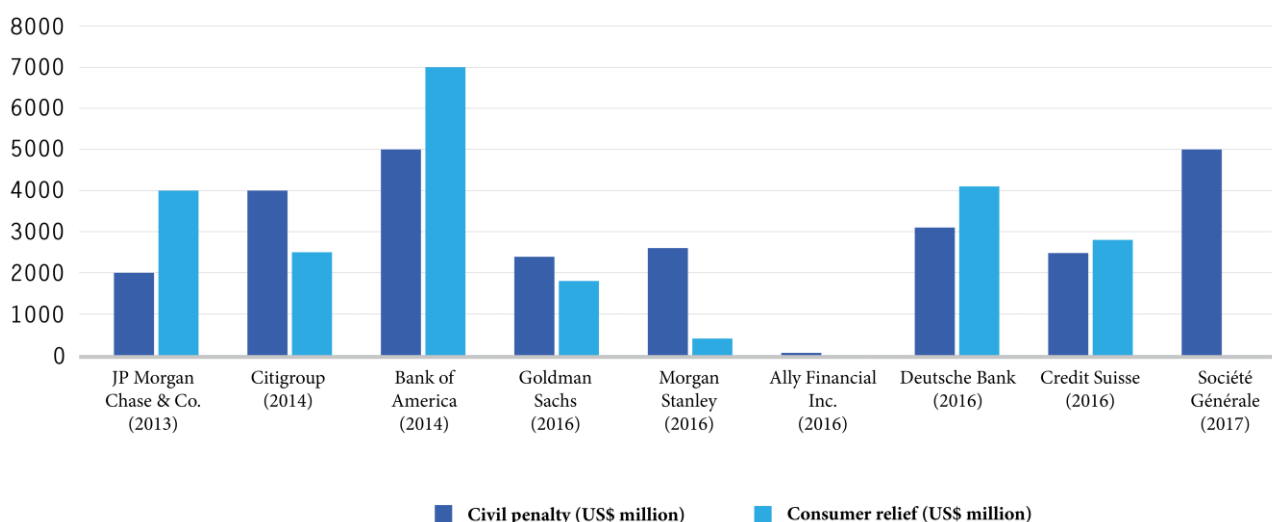
Violations identified pursuant to DoJ's competences under FIRREA concerned false representations with regard to due diligence processes related to the development of particular financial products (e.g. in *Société Générale* case). In the case of Deutsche Bank settlement it was reported that "Deutsche Bank repeatedly assured investors that its RMBS were safe investments. Instead of ensuring that its representations to investors were accurate and transparent, so that investors could make properly informed investment decisions, Deutsche Bank repeatedly misled investors and withheld critical information about the loans it securitized." A critical condition for the settlement was recognition of misconduct by the bank, implying the reputational aspect ('stigmatisation') was a key component of the DoJ's enforcement strategy.

**Table 3:** DoJ settlements in RMBS cases

Bank	Date of settlement	Settlement amount (Civil Penalty and consumer relief, in USD million)
JPMorgan Chase & Co.	19/11/13	6,000
Citigroup	14/07/14	6,500
Bank of America	21/08/14	13,000
Goldman Sachs	14/01/16	4,300
Morgan Stanley	11/02/16	3,000
Ally Financial Inc.	21/11/16	52
Deutsche Bank	22/12/16	7,200
Credit Suisse	23/12/16	5,300
Société Générale	17/01/17	5,000

Source: Author's own elaboration

**Figure 3:** DoJ settlements in RMBS cases



Source: Author's own elaboration

Notwithstanding the impressive amounts of fines imposed, the use of civil penalties as opposed to pursuit of criminal convictions in the US has been criticised on charges of falling short on three fronts: condemnation, deterrence and punishment. The reliance of DoJ on the civil money regime was attributed to the high burden of proof necessary to be satisfied to successfully prosecute a criminal offence under the act. By analogy, recent reforms in the UK indicate that particularly harmful misconduct in the banking sector may require a lower threshold to be applied also in criminal cases.

Even where types of offences prosecuted by the DoJ relate to protection of customers and investors – as in the case of many of the actions brought by the federal agencies – the gravity of criminal offence means the level of fines was substantially higher, also as provided under the relevant acts (as seen in Graph 2 above). While pursued by the DoJ, significant cooperation between judicial and sectoral agencies was in place. The 2014 Bank of America settlement for example, which amounted to a total of USD 13 billion, was held to resolve investigations conducted by the Securities and Exchange Commission (SEC) and litigation filed by the Federal Deposit Insurance Company (FDIC).

### 4.3 SSM sanction regime

EU’s regulators have imposed fines for breaches and violations of banking regulation over the course of the financial crisis at national level. SSM Regulation confers on the ECB the power to impose administrative penalties (Art. 18 SSM) in cases of violations by the regulated credit institution of prudential regulation (Art. 122 SSM Framework Regulation) – but not other types of bank misconduct. CRD IV further authorises supervisors to impose non-pecuniary sanctions (including public statements, order to cease conduct, withdrawal of authorisation, temporary ban against members of management bodies) as well as administrative pecuniary payments of up to 10% of the total annual turnover/ EUR 5 million. (67(1)(a)-(d) CRD IV). Table 4 offers a comparison of the EU (SSM) sanctioning regime with the US examples discussed above. With regard to non-pecuniary administrative sanctions, provisions of CRD IV have been transposed differently, across Member States, e.g. with Italy for example not implementing the “public statement” sanction.

**Table 4:** Levels of fines foreseen in the US and the EU

FEDERAL AGENCIES	DoJ (FIRREA)	SSM
<b>Tier 1:</b> \$5,000	<b>Single violation:</b> \$1,100,000	<b>Legal person:</b> up to 10% of the total annual net turnover
<b>Tier 2:</b> \$25,000	<b>Continuing misconduct:</b> \$1,100,000 per day or \$5,500,000 total	
<b>Tier 3:</b> \$1,100,000 or 1% of total assets		<b>Natural person:</b> up to €5,000,000

Source: FDIA, FIRREA, SSM Regulation

Possible divergences at national level within the SSM are important, as only money penalties, as an administrative sanction defined under the CRD IV, have been expressly conferred on the SSM. To this end, the ECB may impose administrative pecuniary penalties of up to twice the amount of the profits gained or losses avoided, or up to 10% of the total annual turnover, as defined in the relevant Union law, of a legal person in the preceding business year or such other pecuniary penalties as may be provided for in the relevant Union law. The pecuniary fine regime is organised around principles of effectiveness, proportionality and dissuasiveness – that is in a much more broad brush manner than the US frame for civil money penalties described above. Specific breaches of prudential regulation for which the above sanctions can be imposed include: failure of internal governance to meet supervisory requirements, failure to report required information (e.g. on own funds) or hold required assets (e.g. liquid assets) as well as serious breach on obligations on money laundering and financial terrorism, though competence for the latter stays with the national supervisors. The ECB can direct national supervisors to impose sanctions. To date, however, no pecuniary sanctions have been imposed under the SSM, though in January 2017 the licence of a Maltese bank was withdrawn for regulatory infringements in accordance with procedures provided for in the SSM Regulation.

Where the SSM covers only prudential regulation, provisions related to customer protection and money laundering have been expressly excluded from the scope of the SSM Regulation and as such remain within the purview of national supervisors, also with regard to sanctioning and enforcement. With the exception of EU competition law, where the European Commission is competent for imposition of fines in cases of market manipulation (e.g. case of LIBOR price fixing), no other non-bank specific EU authority is competent for imposing fines for bank misconduct.

## 5. CONCLUSIONS

A coherent and comprehensive approach is required to ensure bank misconduct is effectively deterred to complement the post-crisis global regulatory reform and fulfil its objectives of restoring financial stability, improving safeness and soundness of the financial sector. It will further contribute to restoring trust in the sector, where the sheer scale of banks' misdeeds has undermined it significantly.<sup>3</sup> At the same time, a delicate balance needs to be struck in the design of sanctioning instruments, where bank misconduct has potentially detrimental effects on systemic stability (Carletti, 2015). In the EU context, further convergence in enforcement strategies (for example through a 'Single Rulebook for Enforcement') is needed to prevent regulatory arbitrage in particular.

The complexity of the US fines system makes a direct comparison with the EU difficult; however a number of insights can be drawn from the legal framework and practice outlined above. First, despite repartitioning responsibilities for imposition of civil money penalties across different institutions, with different enforcement strategies, the overarching framework strives to establish common principles for the assessment of penalties by different federal agencies, thus far however in a non-binding manner. Where overlap and duplication in competences for oversight of misconduct, such as that related to safety and soundness of credit institutions, occurs, it warrants establishment of common principles to provide legal certainty to supervised institutions. Where arguably adequate coordination with regard to addressing specific type of bank misconduct related to mis-selling was lacking in the US, the Department of Justice stepped in as the *de facto* enforcer. Still, RMBS actions under the leadership of the DoJ involved a number of other federal and state agencies, showing cooperation is necessary in cases banks operating across jurisdictions or engage in multiple misdeeds.

Secondly, while federal pre-emption rules apply and a degree of convergence is encouraged and so is cooperation between agencies at federal level, enforcement of consumer protection legislation especially is pursued also at state level as provided for in the Dodd-Frank Act, thus allowing for a degree of regulatory competition.

Thirdly, while the civil money penalty regime allows for regulators to impose penalties for a broad range of offences ('any violation of law or regulation'), in practice most of the penalties have been imposed in the context of violations related to fraudulent market practices, misselling, market manipulation or violation of laws related to money laundering and violation of international sanctions. Recent settlements reached by authorities suggest further that it is consumer protection, anti-fraud laws and compensation claims which drive the assessment of penalties by federal regulators, rather than violations of prudential regulation (such as capital requirements).

Where US supervisors are competent to impose civil money penalties for specific violations of banking laws and regulations, the judicial authorities (Department of Justice) can impose civil money penalties in cases of criminal offences such as fraud, a specific type of misconduct. Application of FIRREA by the DoJ shows that while civil penalties can act as a substitute for prosecution of criminal offences, a bifurcated system – which allows for imposition of civil money penalties for criminal offences (such as fraud), can be an effective and flexible tool at the hands of public authorities, given the high threshold of criminal cases. Empirical evidence following the crisis demonstrated above<sup>4</sup> has shown that the DoJ has been much more forceful in imposing civil money penalties than bank supervisors, including the new financial customer protection agency, at least in terms of total amounts, suggesting that sectoral regulators rely more on other techniques of enforcement than pecuniary fines (see also Bloomberg, 2016). In particular, given the ongoing supervisory relationships, incentives of supervisors to pursue imposition of fines, as opposed to other administrative sanctions (such as orders and directions to the bank), differ from those of judicial

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<sup>3</sup> see R. Jenkins' *List of banks misdeeds* available at: <http://www.finance-watch.org/hot-topics/blog/1186-jenkins-bank-misdeeds>

<sup>4</sup> A useful overview is also provided here <https://www.bna.com/bna-insights-bank-n73014445225/>

authorities. Imposition of sanctions might result in reputational consequences for the supervisor itself. A separate authority wielding such powers mitigates risk of regulatory failures and forbearance at decentralised level – given also the dispersed and multi-peak nature of US bank oversight architecture.

EU bank regulation reforms need to be complemented by a common enforcement framework, in order to avoid risk of arbitrage, but also to ensure compliance and effective deterrence across the common market and also to avoid conflicts between the supranational/central level and individual Member States. US provides an example of an oversight and enforcement system where a certain degree of regulatory competition exists, with overlapping and broad mandates of a number of federal financial agencies – it is counterbalanced however by a centralised judicial authority of the DoJ. Where the SSM framework has centralised sanctioning powers, including through money penalties, it applies in cases of violation of prudential regulation – and not other areas such as consumer protection or money laundering or tax evasion, however this limitation is a consequence also of the Treaty base of SSM, that is Article 127(5) TFEU.

Recent trends at global level, including under Basel III, go in the direction of a reflexive approach of regulators to misconduct, classifying it as an operational risk to be addressed through capital add-ons within the SREP process. Nevertheless, misconduct covers a broad range of conducts harmful to consumers and society. A focus on prevention cannot substitute effective *ex post* sanctioning measures, including civil money penalties. Evidence from the US shows that the judicial system is more effective in levying fines than the national authorities, in particular in cases related to consumer harm compensation. Where obstacles to harmonisation of criminal law with regard to misconduct exist, the extension of the sanctioning regime, including through money penalties, to certain types of conduct (such as fraud) can be considered, inasmuch as it has consequences for financial stability. Furthermore, further efforts to foster convergence across authorities operating at national and EU level under the multi-peak regulatory architecture are necessary – to this end EBA could develop a ‘A Single Rulebook for Enforcement’ comparable to those in place for substantive prudential rules.

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ANNEX 1

**Table 5: Civil Money Penalties Matrix**

Boxes on the Matrix (including the empty boxes) should be used to reflect progressive levels of severity. As used in the Matrix, the term "violations" also refers to reckless unsafe and unsound practices and breaches of fiduciary duty.

	0	1	2	3	4	WGT.	POINTS
<b>Intent</b>	No		Should Have Known		Clear Intent	5	
<b>Pecuniary Gain or Other Benefit to Institution Affiliated Party (IAP) or Related Interest</b>	No			Indirect Benefit to IAP or Related Interest	Direct Benefit to IAP or Related Interest	4	
<b>Previous Administrative Action or Criticism</b>	None	Previous Criticism for Similar Violation	Violation or Criticism on Point Cited in Exam or Visit Report	MOU or Supervisory Letter on Point	8(a), C&D, Agreement, Condition in Writing or Prior Assessment on Point	3	
<b>History</b>	None	Unrelated Prior Violations	At least One Similar Violation	Several Similar Violations	Frequent Similar Violations	2	
<b>Loss or Risk of Loss to Bank</b>	No Loss and No Risk of Loss	No Loss or Minimal Risk	Minimal Loss or Moderate Risk		Substantial Actual or Potential Loss	6	
<b>Number of Violations at Issue</b>					Numerous Violations	2	
<b>Duration of Violations Prior to Notification</b>					Violations Outstanding for Long Time	2	
<b>Continuation after Notification</b>	Violation(s) Ceased Prior to Notification	Violation(s) Ceased Immediately Upon Notification		Violation(s) Continued for Period of Time After Notification	Violation(s) Still Continuing	3	
<b>Concealment</b>	None			Purposely Complicated Transaction to Make it Difficult to Uncover	Active Concealment	5	
<b>Impact Other Than Loss</b>	No Impact on Bank or Banking Industry		Substantial Impact on Bank. No Impact on Banking Industry	Moderate Impact on Banking Industry or on Public Perception of Banking Industry	Substantial Impact on Banking Industry or on Public Perception of Banking Industry	6	
<b>Loss or Harm to Securities Holders or Consumers (Securities or Consumer Laws Only)</b>	No Loss and No Harm	No Loss or Minimal Harm	Minimal Loss or Moderate Harm		Substantial Loss or Harm	5	
<b>Subtotal 1</b>							
<b>Restitution</b>	No Restitution	Complete Restitution Under Compulsion	Partial Restitution	Complete Restitution Immediately After Loss or Violation Brought to Attention	Complete Restitution Voluntarily, Before Bank or Examiner Uncovered Loss	2	
<b>Good Faith (prior to Notification)</b>	None				Unintentional Violation	3	
<b>Full Cooperation (after Notification)</b>	None				Forthcoming in Interviews	2	
<b>Subtotal 2</b>							
<b>Total (subtract 2 from 1)</b>							

Source: Federal Deposit Insurance Corporation.

**Table 6: CMP Matrix (Continued)**

<u>Points</u>	<u>Suggested Action</u>	<u>Responsibility</u>
0-30	Consider not making referral.	Examiner reviews fineable offense(s) and applies Matrix. Workpapers should support decision to not refer.
31-40	Consider sending supervisory letter.	Examiner reviews fineable offense(s) and applies Matrix. Prepares referral to Regional Office. Regional Director considers sending 15-day letter. After consideration of response and referral, Regional Office applies Matrix. Regional Director considers sending a supervisory letter which would inform that, while a penalty assessment will not be pursued, policies which will prevent recurrence of the fineable offense(s) must be adopted and implemented. If decision is made to send a supervisory letter, such letter is sent by the Regional Director.
41-50	Consider assessment of \$1M up to \$5M.	Examiner reviews fineable offense(s), applies Matrix, and prepares referral to Regional Office. Regional Director sends 15-day letter. After consideration of response and referral, Regional Office applies Matrix. If recommendation is to assess a penalty, case should be submitted to the Washington Office. Prior to submission to Washington Office, Regional Office should determine that recommended penalty does not exceed maximum penalty permitted. Washington Office reviews recommendation and takes appropriate action.
51-60	Consider assessment of greater than \$5M up to \$10M.	Same as immediately above.
61-80	Consider assessment of greater than \$10M up to \$25M.	Same as above.
81-100	Consider assessment of greater than \$25M up to \$75M.	Same as above.
101-120	Consider assessment of greater than \$75M up to \$125M.	Same as above.
120+	Consider assessment of greater than \$125M.	Same as above.

Source: Federal Deposit Insurance Corporation.



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