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Do enforcement actions by US federal banking regulators against Banks for unsound and unsafe banking practices deter further and future wrongdoing?

A way forward.

Thesis Statement

Because current deterrent measures have consistently proved to be ineffective, a more rigorous punishment such as jail time is necessary for CEO's directors, management, and employees of financial institutions who engage in unsound and unsafe banking practices.

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Loyola Chicago School of Law

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I. INTRODUCTION

“Wells Fargo fined \$1 billion for ‘reckless unsafe or unsound practices.’”¹ The story behind this headline in the Washington Post on April 20, 2018, set out the problem. Wells Fargo engaged in “unsafe or unsound practices”² by charging customers for services that Wells Fargo should have absorbed and administering a compulsory insurance scheme that unnecessarily increased borrowers auto loans financial obligation without approval.³ According to the Office of the Comptroller of the Currency (OCC), “Since at least 2011, the Bank⁴ (Wells Fargo) has failed to implement and maintain a compliance risk management program commensurate with the Bank’s size, complexity and risk profile.”⁵ The OCC also found that “a comprehensive plan to address compliance risk management deficiencies, fill critical staffing positions,”⁶ enforce “a reliable risk assessment and testing program and report compliance concerns adequately to the board was”⁷ not implemented.”⁸

¹ Renae Merle, Wells Fargo fined \$1 billion for 'reckless unsafe or unsound practices' The Washington POST (2018), https://www.washingtonpost.com/business/economy/wells-fargo-fined-1-billion-for-reckless-unsafe-or-unsound-practices/2018/04/20/3d68340e-449e-11e8-bba2-0976a82b05a2_story.html?utm_term=.636a442fc3f1 (last visited Jul 27, 2019).

² “Unsafe and unsound practices” is used interchangeably with, illegal conduct, bad behavior, wrongdoing and misbehavior

³ https://files.consumerfinance.gov/f/documents/cfpb_wells-fargo-bank-na_consent-order_2018-04.pdf

⁴ The terms, bank, banking institution, institution and financial institution are used interchangeably.

⁵ *Id.* 3

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

This was not the first enforcement action by regulators⁹ against Wells Fargo. Two years earlier (2016), Wells Fargo was fined \$185 million over what the Consumer Financial Protection Board (CFPB) called "the widespread illegal practice of secretly opening unauthorized deposit and credit card accounts."¹⁰ Responding to Wells Fargo's 2016 and 2017 extensive customer exploitation and other compliance failures, the Federal Reserve Board required Wells Fargo to dismiss four of its board members and restricted the firm from growing any larger than its 2017 asset size.¹¹

Previous enforcement actions did not appear to deter Wells Fargo from subsequent "unsound and unsafe" banking practices. According to a summary from Violation Tracker, a comprehensive database on organizational wrongdoing that covers banking, since 2000, leading up to 2018, Wells Fargo has racked up over fourteen billion dollars in fines from federal regulatory agencies (\$14, 943,253,793).¹²

Announcements of various enforcements' actions and settlements show how banks, in addition to Wells Fargo, routinely engage in illegal conduct.¹³ For example, in June 2014, BNP was fined "\$8.9 billion for breaching of U.S. sanctions against"¹⁴ Iran, Sudan and Cuba.¹⁵ Twenty-three other financial institutions were collectively fined over \$1.2 billion for sanction's

⁹ For purposes of this thesis, regulators will be variously referred to as, Federal banking regulator (s), enforcement authorities, banking regulators and enforcement bodies.

¹⁰ https://files.consumerfinance.gov/f/documents/092016_cfpb_WFBconsentorder.pdf,

¹¹ <https://www.federalreserve.gov/newsevents/pressreleases/enforcement20180202a.htm>,

¹² Wells Fargo: Violation Tracker, WELLS FARGO | VIOLATION TRACKER, <https://violationtracker.goodjobsfirst.org/parent/wells-fargo> (last visited Jul 27, 2019).

¹³ <https://www.americanbanker.com/slideshow/the-seven-largest-sanctions-related-fines-against-banks>,

¹⁴ *Id*

¹⁵ *Id*

violation by the Office of Foreign Assets and Control (OFAC) in 2014.¹⁶ “In August 2014, Bank of America paid approximately \$17 billion for offering subprime loans that brought about the 2008 financial crisis and distorted the standard of the loans to regulatory authorities - Federal Housing Authority, Freddie Mac and Fannie Mae.”¹⁷ Banks’ eagerness and willingness to settle for these huge monetary fines and sanctions show willful intent to violate the law and an intended way of doing business. Equally, the government’s preparedness to mete out the same punishment repeatedly while creating an enabling atmosphere for the banks to conduct business by granting waivers¹⁸ guarantees the continuance of misconduct.”¹⁹

Evidently, after each sanction the bank returns to business as usual. The market’s response to the offending bank is usually positive. Loss in stock value is usually short-lived.²⁰ The CEO’s, directors, officers and or employees responsible for the illegality do not serve jail time even though their actions sometimes results in the wiping away of individuals’ life savings. At most, the offending officer or employee is dismissed and the matter is ended. However, the consequences of continuous and widespread violations of the law by banks erode the people’s faith and confidence in governmental institutions.

¹⁶ VICTORIA ANGLIN *, NOTE: Why Smart Sanctions Need a Smarter Enforcement Mechanism: Evaluating Recent Settlements Imposed on Sanction-Skirting Banks, 104 Geo. L.J. 693, (2016), available at <https://advance-lexis-com.flagship.luc.edu/api/document?collection=analytical-materials&id=urn:contentItem:5J99-R9G0-02BM-Y2M4-00000-00&context=1516831>.

¹⁷ <https://www.justice.gov/opa/pr/bank-america-pay-1665-billion-historic-justice-department-settlement-financial-fraud-leading>,

¹⁸ JOEL SLAWOTSKY *, *ARTICLE: REINING IN RECIDIVIST FINANCIAL INSTITUTIONS*, 40 Del. J. Corp. L. 280, (2015), available at <https://advance-lexis-com.flagship.luc.edu/api/document?collection=analytical-materials&id=urn:contentItem:5HBC-NV60-01DR-M005-00000-00&context=1516831>.

¹⁹ *Id*

²⁰ *Id*.

It is against this backdrop of systemic wrongdoing by banks that section 1 of this paper introduces the continuous engagement of banks in unsound and unsafe practices despite regulatory enforcement actions. Section II of this paper will set forth the history and purpose of federal banking regulations. The objective is to be reminded that the purpose of banking regulation was always to guarantee the safety and soundness of financial institutions for the government to provide services to the people. Section III examines the various types of unsound and unsafe banking practices federal regulation is intended to prevent.

This section also discusses the possible reasons for the systemic and widespread unsound practices'. Because, the courts and regulators differed on what constituted unsound and unsafe banking practices, this paper narrowly examines that as a definitional issue. For the purposes of this thesis, the word "unsound and unsafe banking practices" is used interchangeably with illegal conduct, bad practices and unacceptable behavior. Section IV will analyze the intent and purpose of various enforcement actions to understand why illegal conduct by banks is not deterred. Section V concludes that current enforcement actions do not deter wrongdoing by banks. Banks have continued to engage in illegal conducts, despite the imposition of hefty fines and punitive orders. The same banks penalized lately had been punished before in settlements that was expected to reform and sanitize the system.

Section V also proposes a harsher punishment through new legislation that will deter wrongdoing. New legislation is warranted because both banks and the government exploit current legislation that serves their self-interests in reaching settlements that do not deter further and future wrongdoing. A federal Judge, Jed Rakoff wondered why no high-level bank executive

was prosecuted post 2008 financial crisis.²¹ Government prosecutors may be eyeing these banks as clients in a future career hence the reluctance to prosecute.²² The new legislation would take away the discretionary authority of the regulatory authorities to enter into any settlement or consensual orders in certain severe cases with serial offenders. Recommendations would include mandatory minimum jail times, breaking up of offending banks sometimes among other punitive measures.

II. FEDERAL BANKING REGULATION

a. History of Federal Banking Regulation

Federal banking regulations shows from the onset that banking was going to be regulated in order to finance the government in the provision of services to the people.²³ That is, the safety and soundness of banks would be paramount if the government was going to be successful. Banking regulation would be central to the American political system.²⁴ The First Bank of the United States was chartered on February 17, 1791 as the first Central Bank of the United States for twenty years to control, supervise and solidify the development of state-chartered banks,

²¹ Jed S. Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?*, N.Y. REV BOOKS (Jan. 9, 2014), <http://www.nybooks.com.flagship.luc.edu/articles/2014/01/09/financial-crisis-why-no-executive-prosecutions/> [<http://perma.cc/V5BQ-C2E9>]; see also Robert Quigley, *The Impulse Towards Individual Criminal Punishment After the Financial Crisis*, 22 VA. J SOC. POL'Y & L. 103 (2015); David Zaring, *Litigating the Financial Crisis*, 100 VA. L. REV. 1405, 1410-11 (2014), .

²² Robert Schmidt, *SEC Goldman Lawyer Says Agency Too Timid on Wall Street Misdeeds*, BLOOMBERG BUS. (Apr. 8, 2014), archived at <http://perma.cc/Q4MT-AR7Y>, .

²³ Michael Wade Strong *, *ARTICLE: Rethinking the Federal Reserve System: A Monetarist Plan for a More Constitutional System of Central Banking*, 34 Ind. L. Rev. 371, (2001), available at <https://advance-lexis-com.flagship.luc.edu/api/document?collection=analytical-materials&id=urn:contentItem:43HV-4S70-00CV-F0SH-00000-00&context=1516831>.

²⁴ *Id.*

finance the federal government and offer loans to the public.²⁵ At the end of the twenty -year charters, the second Central Bank was chartered for twenty years on April 10, 1816 to continue to finance the government in providing services.²⁶ The duty of the banks to provide fiscal services to the government was reasserted by the US Supreme Court in *Osborn v. Bank of the United States*.²⁷ With the establishment of the Federal Reserve in December 23, 1913, the permanence of the Central Bank as the overall supervising authority over all banking activities was accomplished - with restoring financial stability, as it's primary mandate.

b. Evolutionary Trends of Federal Banking Regulation

Most Federal banking regulations that were enacted was in response to a financial crisis caused by banks' unsound and unsafe practices (illegal conduct). These unsound and unsafe practices attracted enforcement actions that included hefty fines.²⁸ For example, Bank of America was sanctioned in 2014 for contributing to the 2008 financial crisis by originating risky loans, among other infractions.²⁹ But pervasive illegal conducts have also attracted new regulatory burden especially when there has been a resultant crisis.³⁰ It was the systemic widespread violations of existing laws and illegal conduct by banks that resulted in the 2008 financial crisis that in turn evolved into an enactment of a new banking legislation- "Dodd-Frank

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Osborn*, 22 U.S. at 861..

²⁸ *Id.* 9

²⁹ *Id.*

³⁰ *Id.*

Wall Street Reform and Consumer Protection Act. Dodd-Frank created the Consumer Financial Protection Bureau³¹ (“CFPB”) and an enactment of the Volcker Rule.³²

The CFPB was established to prevent bank’s from engaging in predatory mortgage lending and the Volcker rule was enacted to limit banks investment options, by restricting speculative trading and abolishing proprietary trading.³³

The evolutionary trend of federal banking regulations shows the regulation of all sorts of issues such as privacy, disclosure, fraud, money laundering, terrorism, usury and lending were to try to curb and prevent unsound and unsafe practices.

That there have been many successive federal banking regulations over the years is further proof that enforcement actions have not succeeded in deterring illegal conduct by banks.

c. Federal Banking Regulators

Banking regulatory agencies are government departments responsible for the actions of banking institutions. The most important reason for the regulation of Banks is to guarantee the soundness and safety of banking institutions, protect customers and depositors, and ensure an overall effective financial and economic system.³⁴

³¹ . <https://www.investopedia.com/terms/d/dodd-frank-financial-regulatory-reform-bill.asp>

³² . <https://www.investopedia.com/terms/d/dodd-frank-financial-regulatory-reform-bill.asp>

³³ *Id.*

³⁴ <https://www.kansascityfed.org/publicat/bankingregulation/RegsBook2000.pdf>.

Banking regulation is carried out mostly through the following financial regulatory authorities that are charged with supervising banking functions, enforcing applicable laws and prosecuting enforcement actions against banks:

i. Comptroller of the Currency

The Office of the Comptroller of the Currency is the oldest federal bank regulatory agency.³⁵ The National Currency Act of 1863 established the OCC and the National Bank Act of 1864 strengthened the OCC's powers.³⁶ The OCC supervises and exercises control over operations of national banks.³⁷ Furthermore, the OCC has oversight responsibilities with the authority to approve the formation and review of national bank, its branches and merger requests.

ii. Federal Reserve System

The Federal Reserve was established in 1913 with regulatory powers over all U.S. banks that are a part of the Federal Reserve System, all foreign banks in the U.S., all U.S. banks in foreign countries, large clearing systems, security's corporations, loan and savings corporations, bank holding corporations, financial holding corporations.³⁸

iii. Federal Deposit Insurance Corporation

³⁵ *Id*

³⁶ *Id*

³⁷ *Id*

³⁸ <https://crsreports.congress.gov/product/pdf/R/R44429>

The Banking Act of 1933 established the Federal Deposit Insurance Corporation (FDIC) with responsibility for regulating federally insured depository institutions and state banks.³⁹

iv. Department of Treasury

The U.S. Department of the Treasury is the chief revenue collector for the U.S. government and printer of money. Additionally, the Treasury Department regulates banks and savings and loans through the operations the Office of the Comptroller of the Currency and the Office of Thrift Supervision.⁴⁰

v. Department of Justice

The US antitrust laws are enforced by the Department of Justice's (DOJ) - antitrust division. Banking is not exempt from antitrust enforcement as was established by the 1963, Supreme Court ruling in the *United States v. Philadelphia National Bank*⁴¹. Additionally, the DOJ along with other regulatory agencies have powers under the Bank Merger Acts of 1960, 1966 and the Bank Holding Company Act of 1956 to determine the competitive effect of bank mergers, acquisitions and consolidations request before approval.⁴²

vi. Securities and Exchange Commission

³⁹ *Id*

⁴⁰ *Id*

⁴¹ *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963)

⁴² *Id* 27

The Securities and Exchange Commission (SEC) was established in 1934 with regulatory powers over all activities involving securities whether in a financial bank or in any investment entity.⁴³

vii. Federal Trade Commission

The Federal Trade Commission (FTC) is charged with investigating deceptive or misleading business practices targeted at consumers. The FTC's, main responsibility is limited to enforcing all consumer protection legislation including Truth in Lending Act. Namely, the FTC does not have enforcement powers over financial institutions.⁴⁴

viii. Office of Thrift Supervision and other Thrift Regulators

The Office of Thrift Supervision (OTS) is under the Treasury Department. The OTS regulates all thrift institutions and its activities including licensing and operations of federal savings associations and federal saving's banks.⁴⁵

III. UNSOUND AND UNSAFE BANKING PRACTICES

The previous chapter discussed the history and evolution of federal regulations today. Additionally, federal regulatory agencies were highlighted with their various supervisory and enforcement powers over banks (activities), their directors, executives, and employees.

⁴³ *Id*

⁴⁴ *Id*

⁴⁵ *Id*

The purpose of federal banking regulatory agencies (among others) is the prevention of unsafe and unsound banking practices. It is so important to understand the meaning of the term, “unsound and unsafe banking practice” that justifies enforcement actions.

a. Definitional issues of unsafe and unsound banking practices

The term “unsound and unsafe practice” appears to have been first used in banking law without definition in 1933 when “the Board of the Federal Reserve System”⁴⁶ (“Federal Reserve”) adopted the term in dismissing a bank official from office.⁴⁷ It was later used in two provisions terminating insurance coverage.⁴⁸

As a phrase, “unsound and unsafe banking practice” is not defined formally in any federal regulation. However, “John Horne, then Chairman of the Federal Home Loan Board”⁴⁹ in a material provided to Congress in 1966 defined “unsound and unsafe banking practice” as “any action, or lack of action, contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.”⁵⁰ The Office of

⁴⁶ ⁴⁶ T. Holzman, “*Unsafe or Unsound Practices: Is the Current Judicial Interpretation of the Term Unsafe or Unsound?*.” 19 Ann. Rev. Banking L. 425, 428-29 (2000).

⁴⁷ T. Holzman, “*Unsafe or Unsound Practices: Is the Current Judicial Interpretation of the Term Unsafe or Unsound?*.” 19 Ann. Rev. Banking L. 425, 428-29 (2000).

⁴⁸ *Id.*

⁴⁹ *Financial Supervisory Act of 1966: Hearings on S. 3158 Before the House Comm. On Banking and Currency*, 89th Congress., 2d. Sess. 49 (1966) Statement of John E. Horne, Chairman of FHLBB), 112 CONG. REC. 26, 474 (1966).

⁵⁰ *Financial Supervisory Act of 1966: Hearings on S. 3158 Before the House Comm. On Banking and Currency*, 89th Congress., 2d. Sess. 49 (1966) Statement of John E. Horne, Chairman of FHLBB), 112 CONG. REC. 26, 474 (1966).

the Comptroller of Currency (OCC) and other federal regulatory agencies adopted and continue to use Horne’s definition of “unsound and unsafe practices” in all its enforcement actions.

However, the courts have differed among themselves, with the OCC and federal regulatory agencies in its definition and application of what are unsound and unsafe banking practices.⁵¹

In differing with the OCC and federal regulatory agencies in what is unsound and unsafe practices, the Fifth Circuit Court of Appeals in *Gulf Federal Savings & Loan Association v. Federal Home Loan Bank Board* rejected Horne’s widely used definition of unsound and unsafe practices in enforcement proceedings.⁵² Instead, the Fifth Circuit defined “unsafe or unsound practice” as “conduct that when engaged in, would be contrary to generally accepted standards of prudent operation (that is, it constituted an imprudent act), the possible consequences of which, if continued, created an abnormal risk or loss or damage to the financial stability of the Bank.”⁵³

b. Types of Unsound and Unsafe Banking Practices

The conflicting federal decisions created no uniformity in what amounted to unsound and unsafe practices in enforcement actions. As a result, the OCC seized the opportunity “*In The Matter of Patrick Adams*, OCC AA-EC-11-50,” and issued a comprehensive guidance rejecting other contrary Federal Courts definition on what constituted unsound and unsafe practice in lieu of its enforcement powers.⁵⁴ The OCC confirmed Horne’s definition of unsound and unsafe

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<http://montanabankinglawyer.com/uploads/3/4/0/1/3401471/padamsfinaldecision093014.pdf>

⁵² *Gulf Federal Savings & Loan Association v. Federal Home Loan Bank Board*, 651 F.2d 259 (5th Cir. 1981).

⁵³ *Id.*

⁵⁴ *Id.* 29

practices which OCC and all federal regulatory agencies have relied on in enforcement actions, which is “any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.”⁵⁵

The Comptroller of OCC also declined its own Administrative Law Judge’s (ALJ) recommendations to follow the decision of the fifth and D.C. circuits (the two circuits with jurisdiction over the Comptroller’s decision).⁵⁶ Citing a Supreme Court Case, *Brand X*,⁵⁷ the Comptroller held the OCC was not bound by the (Courts) two circuits decisions because a judicial construction of an ambiguous statutory term in a statute an agency is responsible for administering does not preclude the agency from reaching a contrary decision if the judicial ruling was not based on the plain meaning of the statute.⁵⁸ The Comptroller further stated that since “unsound and unsafe practice” had never been determined to have a plain meaning the OCC was not bound to follow any court’s ruling.

Unfortunately, the OCC’s definition is self-serving because it allows the regulators to determine after-the-fact and with little advanced guidance whether a given practice is unsafe or unsound. In fact, the Federal Deposit Insurance Corporation (FDIC) Inspector General criticized - the FDIC in one of its enforcement activity for creating - “rules by enforcement” instead of

⁵⁵ *Id.* 28

⁵⁶ *Id.* 34

⁵⁷ *National Cable & Telecommunications Assn. v. Brand X Internet Services*, 545 U.S. 967 (2005)

⁵⁸ *Id.*

issuing formal guidance.⁵⁹ Following up in the criticism of FDIC’s approach in a related congressional hearing, Rep. Sean Duffy explained:

“It is hard enough to comply with rules that are put out that people are trying to read and try to comply with but it is even harder when you have a regulatory body of our financial industry that tries to enforce first and give guidance later. We should know what the rules are, the rules of the game should be clear.”⁶⁰

In sum, definitional issues have not prevented regulatory authorities from continuous enforcement actions. Given the regulators “creating rules by enforcement approach” and to avoid an enforcement action, banking institutions and its employees should follow the OCC’s definition – by desisting from unusual activities (new acts not approved by regulators), actions that potentially cause financial harm to banks, investors or supervising governmental agencies. An analysis of enforcement actions of the Federal Reserve⁶¹ shows that federal regulators have - and could term any improper conduct as unsound and unsafe. Conducts that have been termed unsound and unsafe are:

- a. Improper loan application procedures
- b. Bad underwriting of a loan
- c. Extending credit contrary to bank policy
- d. Negligent supervision of institution lending practices

⁵⁹ <https://www.americanbanker.com/news/lawmakers-troubled-by-fdics-supervisory-treatment-of-banks>

⁶⁰ *Id.*

⁶¹ <https://www.federalreserve.gov/newsevents/pressreleases/enforcement20190606a.htm>

- e. Extension or acquisition of non-performing loans
- f. Acquisition of personal loans from the bank
- g. Failure to comply with federal reporting requirements
- h. Unfair late fees
- i. Failure to perform due diligence in opening accounts.
- j. Removal of an employers' Confidential Supervisory Information (CSI) and proprietary information by an employee and forwarding to the employee's personal email⁶²

c. Consequences of Unsound and Unsafe Practices

On the Economy

Financial corruption causes lack of trust needed for “we” the people to do business with our financial institution that will in turn build up the economy.⁶³ Furthermore, lack of trust leads to insufficient savings needed for economic growth.⁶⁴

The trust, necessary for the stability and functioning of the banking system is eroded.⁶⁵ In 2012, shortly after the financial crisis 23 percent and 19 percent of Americans trusted the banks and big corporations respectively.⁶⁶ A 2007 research by two economic Professors found that trust impacted per capita income of 30 countries from 1949-2003.⁶⁷ A 2005 journal review of research on trust and economics found that trust is a contributory factor to economic, political and societal success.⁶⁸

⁶² <https://www.federalreserve.gov/newsevents/pressreleases/files/enf20190606a1.pdf>

⁶³ <https://ritholtz.com/2012/05/people-are-losing-trust-in-all-institutions/>

⁶⁴ *Id.* 52

⁶⁵ <https://www.americanbanker.com/opinion/time-to-clean-house-at-wells-fargo>

⁶⁶ *Id.* 52

⁶⁷ *Id.*

On the People

People believe the system is corrupt and lose faith in government's ability to deliver on promises.⁶⁹ Unwillingness to comply with regulations possibly becomes the norm.⁷⁰

On Governance

Getting people to support reforms and developing and driving policy becomes more difficult.⁷¹ Working for the government becomes an unattractive professional career.⁷²

People become incentivized to engage in corrupt practices like tax evasion.⁷³

The consequences of unsound and unsafe practices on the fabric of a nation cannot be overstated. Nobel laureate economist, Kenneth Arrow writes that, "Virtually every commercial transaction has within itself an element of trust."⁷⁴ Ultimately, trust in the financial system is the engine of an economy, a failure of which is disastrous.⁷⁵

d. Why Banks engage in Unsound and Unsafe Practices?

Evidently, despite seemingly harsh financial penalty and other enforcement actions documented in this paper against banks, and in some instances the same banks, banks continue to

⁶⁸ *Id*

⁶⁹ *Id*

⁷⁰ https://www.oecd-ilibrary.org/docserver/gov_glance-2013-6-en.pdf?expires=1573439905&id=id&accname=guest&checksum=FB8D900B392410C51B98C9A5D3661CC8

⁷¹ *Id*

⁷² *Id*

⁷³ *Id*

⁷⁴ *Id*

⁷⁵ *Id*

engage in unsound and unsafe practices as a way of doing business. It is probably safe to conclude that the current enforcement mechanism has failed to deter banks and its employees (who mastermind these illegal conducts) from they're intentional wrongdoing for various reasons.

Bank CEOs much like the typical CEOs in other industries appear not to be worried of any current form of enforcement actions.⁷⁶ The following case study illustrates the lukewarm and disrespectful mindset of CEOs towards consequential outcomes, enforcement authorities and enforcement actions.

Federal Reserve versus Jacob Goldstein⁷⁷

The Federal Reserve banned Jacob Goldstein, CEO of NBRFS financial a Maryland bank from working in the banking industry for unsound and unsafe practices, which led to the failure of the bank in 2014.

Goldstein allegedly breached the bank's trust by engaging in a pattern of self- dealing. Specifically, Goldstein voted with the board to approve a disguised loan of \$250,000 for a director's son's real estate investment - when in fact it was for his (Goldstein) personal use. Furthermore, Goldstein and the bank gave an unsecured \$100,000 loan to a company he had one – sixth interest in.

According to the Federal Reserve, “The bank failed, in part, because of Goldstein's dominant influence over the bank's operations which limited the institution's ability to overcome its deteriorating financial condition and Goldstein's engaging in improper business practices for his

⁷⁶ <https://www.housingwire.com/articles/46502-former-president-and-ceo-of-failed-bank-nbrs-financial-banned-from-banking/>

⁷⁷ *Id*

benefit.” Goldstein resigned from the bank and failed to respond to charges against him by the Federal Reserve. Goldstein was later banned from the banking industry by default. Goldstein’s snobbish actions offer an insight into the nonchalant attitude of CEOs towards federal enforcement actions.

Further to the CEOs controlling mindset, recently, the “Business Roundtable” came up with what they thought the purpose of a corporation ought to be.⁷⁸ The statement of purpose was changed to read, “ no longer should decisions be based solely on whether they will yield higher profits for shareholders, rather corporate leaders should take into account “all stakeholders” – which is, employees, customers and society writ large.”⁷⁹ The Business Roundtable is a group, led by JPMorgan Chase & Co. (a bank) CEO James Dimon.⁸⁰ However, these CEOs were not authorized by their respective shareholders to add or alter their respective purposes. The Council of Institutional Investors in disapproving, said the new statement of purpose gives CEOs cover to dodge shareholder oversight and there was no mechanism of accountability to anyone else.⁸¹ Some CEOs declined to endorse the statement of purpose stating that the CEOs endorsing the concept were CEOs who like to be in control and don’t like to be subject to market demands.⁸²

⁷⁸ https://www.wsj.com/articles/business-roundtable-steps-back-from-milton-friedman-theory-11566205200?reflink=share_mobilewebshare

⁷⁹ *Id*

⁸⁰ *Id*

⁸¹ *Id*

⁸² *Id*

The shareholders of these financial institutions shoulder the responsibility of the hefty monetary penalty imposed rather than the CEOs and other bank employees.⁸³ Regulators have levied over \$305 billion in penalties on financial institutions (shareholders) since 2000 for unsound and unsafe practices.⁸⁴

There is also an apparent hesitation to truly punishing financial institutions. According to a former SEC regulator, senior regulators at SEC, "were more focused on getting high-paying jobs after their government service than on bringing difficult cases."⁸⁵ The persistent wrongdoing of financial institutions suggests insufficiency of current enforcement actions as a deterrence and incentive to change behavior.⁸⁶ Passivity and disinclination to amend the defective system manifest to new banking institutions and disincentives regulatory compliance while encouraging bad behavior. When investors are the ones paying the fines rather than the directors or officers, who perpetrated the acts, deterrence as a motive for enforcement actions becomes ineffectual.⁸⁷ The fines imposed on these offending institutions pale compared to their humongous profits.⁸⁸ Selfish purposes of the principal actors: regulators, prosecutors and

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https://violationtracker.goodjobsfirst.org/prog.php?major_industry_sum=financial+services

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⁸⁴ *Id*

⁸⁵ Robert Schmidt, SEC Goldman Lawyer Says Agency Too Timid on Wall Street Misdeeds, BLOOMBERG BUS. (Apr. 8, 2014), archived at <http://perma.cc/Q4MT-AR7Y>

⁸⁶ *Id*.

⁸⁷ Ted Kaufman, Lopsided Approach to Wall Street Fraud Undermines the Law, N.Y. TIMES DEALBOOK (May 8, 2014), archived at <http://perma.cc/D7VY-36ZJ> (arguing that large fines paid by the shareholders of megabanks for the egregious fraud on Wall Street will not stop similar violations).

⁸⁸ Matt Taibbi, Everything is Rigged: The Biggest Price-Fixing Scandal Ever, ROLLING STONE (Apr. 25, 2013), archived at <http://perma.cc/P6KL-CSNT>.

government coffers - enable the unsound and unsafe practices of financial institutions and its employees.⁸⁹

IV. BANKING ENFORCEMENT ACTIONS

a. History of Banking Enforcement Actions

Historically, mandatory jail time for bankers and its employees for unsound and unsafe practices have never been required by any law as part of an enforcement action. Various enforcement actions have however, been key supervisory tools for regulatory authorities to maintain the safety and soundness of banking institutions. Thirty years after the FDIC's creation, and because of the punitive nature of its power to end an institution's deposit insurance and its limited scope, congress passed the Financial Institution Supervisory Act (FISA) in 1996. Per FISA, federal regulators issued Cease and Desist Orders for violations of existing laws or detrimental acts that impacted soundness of financial institution and orders for corrective action.

The Financial Institution Regulatory and Interest Rate Control Act (1978)⁹⁰ gave regulators expanded powers to levy Civil Money Penalties (CMP's) for continuous violation of existing laws and, or, failure to comply with previous Enforcement Actions (EA). Following the savings and loan crisis in the 1980s, the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA)⁹¹ and the Federal Deposit Insurance Corporation Improvement Act

⁸⁹ *Id.* 10

⁹⁰ The Financial Institutions Regulatory And Interest Rate Control Act Of 1978, Federal Banking Agencies, And The Judiciary: The Struggle To Define The Limitation Of Cease And Desist Order Authority, 44 Wash. & Lee L. Rev. 1357 (1987), <https://scholarlycommons.law.wlu.edu/wlulr/vol44/iss4/10>

⁹¹ Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), P.L. 101-73, 103 Stat. 183 (1989).

(FDICIA)⁹² was passed in 1989 and 1991, respectively, giving regulator's more enforcement powers. FIRREA and FDICIA gave regulators powers - to set capital requirements, overhaul the deposit insurance system, to demand that banks change management, remove/suspend personnel, limit growth, and cease dividend payments. Per FIRREA, actions of institution-affiliated parties (IAPs) who relate and deal with banking organizations such as brokers, attorneys, or third-party technology service providers (TSPs), could now be regulated. Enforcement Actions (EA) were now required to be publicly disclosed. Subsequently, since 2000, most EAs are now available on each regulatory authority's website.

More recently, various titles in the Dodd Frank Act⁹³ strengthened federal banking regulators' oversight of the banking industry and intensified their focus on governance and risk management.⁹⁴ The Dodd-Frank Act established the CFPB⁹⁵ to consolidate and bolster policymaking and enforcement powers in the consumer protection area.⁹⁶ No doubt, the banking regulatory authorities have grown to possess expansive powers to prevent and correct unsafe and unsound banking practices by financial institutions, its employees, and other associated persons and organizations.⁹⁷ The outcome of the regulatory agencies preventive and corrective powers is the application of various types of banking enforcement actions on erring financial institutions.

⁹² "Federal Deposit Insurance Corporation Improvement Act of 1991".

⁹³ *Id.* 24

⁹⁴ *Id.*

⁹⁵ *Id.* 26

⁹⁶ *Id.*

⁹⁷ Responding to Proposed Enforcement Actions by the Federal Banking Agencies - Reed Smith, Mondaq Business Briefing, November 1, 2004, available at <https://advance-lexis-com.flagship.luc.edu/api/document?collection=news&id=urn:contentItem:4DPB-H6N0-00B3-W4X0-00000-00&context=1516831>.

b. Types of Banking Enforcement Actions

Regulatory enforcement actions are divided into informal and formal enforcement actions none of which includes mandatory jail time.

i. Informal Enforcement Actions

Informal actions are designed to correct identified deficiencies and ensure compliance with banking laws and regulations.⁹⁸ Informal actions include commitments by the Board of Directors/trustees of a financial institution.⁹⁹ Voluntary commitment is utilized to obtain written commitments from a bank's board of directors to ensure that identified problems and weaknesses will be corrected.¹⁰⁰ Memorandum of Understanding is another form of informal action. MOUs are drafted and used by regulating authorities to get the banking institution to adequately address the deficiencies noted" during an examination.¹⁰¹ Informal actions are not disclosed publicly and not lawfully enforceable.¹⁰² Although informal actions are not legally enforceable, however, failure to honor any commitment will give rise to a formal enforcement action.

ii. Formal Enforcement Actions

Formal enforcement actions by banking regulatory authorities are usually punitive statutorily mandated actions against banking institutions and their employees for various acts of

⁹⁸ FDIC Compliance Manual (June 2009) II-8.1

⁹⁹ *Id.*

¹⁰⁰ OCC PPM 5310-3 at 4 (Sept. 9, 2011).

¹⁰¹ *Id.* 50

¹⁰² *Id.*

unsound and unsafe practices. The following enforcement actions have been brought by the Banking Regulators on a regular basis:¹⁰³

Formal Enforcement Action Against Institutions

1. Cease and Desist Orders: Banking regulatory authorities have the power to issue a C&D order to a financial institution when that financial institution is about to get involved, in an unsafe or unsound banking practice or a breach of the law.¹⁰⁴ Occasionally, C&D Orders are also called Consent Orders when it is based on the result of an agreement between a banking institution and the regulator.¹⁰⁵ Other times, a C&D order is called a temporary C&D when it is used to shield a bank from a possible danger or wrongfully depleting its resources.¹⁰⁶ Significantly, C&D's usually obligates the institution to restrictions, reporting requirements and consequences for non - compliance.¹⁰⁷
2. Formal Written Agreements/Supervisory Agreements (MOUs): These are "agreements" (also called Memorandum of Understanding) where the bank agrees to take actions and specific steps to remedy identified problems that could impact the safety and soundness

¹⁰³ Responding to Proposed Enforcement Actions by the Federal Banking Agencies - Reed Smith, Mondaq Business Briefing, November 1, 2004, available at <https://advance-lexis-com.flagship.luc.edu/api/document?collection=news&id=urn:contentItem:4DPB-H6N0-00B3-W4X0-00000-00&context=1516831>.

¹⁰⁴ 12 U.S.C. § 1818(b).

¹⁰⁵ *Id*

¹⁰⁶ *Id* 87

¹⁰⁷ https://www.venable.com/files/Publication/ed11e237-451b-4c74-b191-f60094293edc/Presentation/PublicationAttachment/cc588b18-bc65-497b-91b7-fec425d67dd9/Responding_Federal_Banking_Agencies_5-19.pdf

of the institution.”¹⁰⁸ Before, Memorandum of Understanding (MOU’s) as they were mostly called, was not required to be disclosed and was unenforceable.¹⁰⁹ But per FIRREA¹¹⁰, MOUs like C&D orders now require public disclosure upon execution, are enforceable and attract severe monetary penalties for non-compliance.¹¹¹ Nonetheless, banking institutions prefer to style agreements as MOUs because MOUs are perceived less negatively than C&D orders.¹¹²

3. Prompt Corrective Actions (PCA): The Law gives regulators the authority to require any bank depending on its precarious circumstances to raise its capital base to a mandatory minimum to protect its insurance funds.¹¹³ Under the “PCA” authority, regulators can confiscate a banking institution whose assets are less than 2 percent of its holdings.¹¹⁴
4. Deposit Insurance Threat: The Federal Deposit Insurance Corporation (FDIC) can suspend or, otherwise end a banking institution’s deposit insurance under the Federal Deposit Insurance Corporation Improvement Act (FDICIA).¹¹⁵ To with, the banking institution could be stopped from operating for illegal conduct or a breach of the law.¹¹⁶

The FDIC mostly initiates these types of proceedings, which puts the institution in the

¹⁰⁸ section 8 of the FDI Act.

¹⁰⁹ https://www.venable.com/files/Publication/ed11e237-451b-4c74-b191-f60094293edc/Presentation/PublicationAttachment/cc588b18-bc65-497b-91b7-fec425d67dd9/Responding_Federal_Banking_Agencies_5-19.pdf

¹¹⁰ The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA)

¹¹¹ *Id.* 99

¹¹² *Id.*

¹¹³ section 38 of the FDI Act. 12 U.S.C. §1831o.

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ *Id.*

precarious position of being seized by the primary regulator or state authorities where the bank is located.¹¹⁷

5. Civil Money Penalty Orders (CMP): Civil Money Penalties are fines imposed on banking institutions for its unacceptable conduct.¹¹⁸
6. Restitution Orders: Restitution orders require the banking institution to pay the displeased parties or the regulatory body for losses created or for illegal earnings by the institution.¹¹⁹
7. Call Report Infractions: Delay in reporting infractions required by law attracts financial sanctions.¹²⁰
8. Sanctions Due to a Home Mortgage Disclosure Act¹²¹ (HMDA) Violation: Prior to the Dodd – Frank Wall Street Reform and Consumer Protection Act of 2010¹²² (Dodd-Frank Act), banking institutions were required to report their lending data under the HMDA – failing to do so attracted some financial penalty.¹²³ Dodd-Frank Act, has now transferred

¹¹⁷ https://www.venable.com/files/Publication/ed11e237-451b-4c74-b191-f60094293edc/Presentation/PublicationAttachment/cc588b18-bc65-497b-91b7-fec425d67dd9/Responding_Federal_Banking_Agencies_5-19.pdf

¹¹⁸ 12 U.S.C. § 1818(i)(2)

¹¹⁹ *Id*

¹²⁰ *Id*

¹²¹ 12 USC 2801–2810.

¹²² *Id.* 24

¹²³ *Id.* 105

the enforcement of the reporting need of banking institutions to report their lending data to the - Consumer Financial Protection Bureau (CFPB).¹²⁴

9. Safety & Soundness Orders (SASO): SASO orders outline specific actions that must be undertaken by banking institutions to remedy an identified issue by a regulatory authority.¹²⁵ These actions are plans developed by the errant institution.¹²⁶

10. Federal Deposit Insurance Corporation Intervention Powers: Under FDI Act,¹²⁷ the FDIC may intervene and begin an enforcement action against an institution if the institution's primary regulator fails to do so after a 60-day notice to the institutions primary regulator.¹²⁸

Formal Enforcement Action Against Individuals (Institutions Affiliated Parties (IAP))¹²⁹

1. Notifications: These are usually letters issued by a regulatory authority banning an Institution Affiliated Party (IAP) from use in a financial banking institution - upon criminal conviction of an unacceptable infraction - unless allowed by Law or a regulatory body to do so.¹³⁰

¹²⁴ <https://www.fdic.gov/regulations/compliance/manual/5/v-9.1.pdf>

¹²⁵ Sec 39 of the FDI Act. 12 U.S.C. §1831p-1.

¹²⁶ *Id*

¹²⁷ Section 8(t) of the FDICIA

¹²⁸ *Id*

¹²⁹ 12 U.S.C. § 1813(u))

¹³⁰ 12 U.S.C. § 1829.

2. Cease & Desist Orders against Individuals (C&D): These are orders against IAPs to stop some type of conduct or further punitive action would follow.¹³¹
3. Civil Money Penalty Orders against Individuals (CMP): These are imposed fines against directors, officers and employees of institutions and Institution Affiliated Parties (IAPs) such as financial brokers and attorneys for some type of unacceptable act or conduct.¹³² Regulators often use this measure to get institutions to comply to a mandated corrective action.¹³³
4. Notices Filed (NFI): This is a notification to any of the Institutions Associated Parties (broker, attorney, etc.) that an "OCC Complaint" to either bar, suspend, or otherwise exact one form of punishment or another has been filed against the party before an Administrative Judge.¹³⁴
5. Removal/Prohibition Orders (REM): Directors and IAPs who are subject to prohibition orders are prohibited from participating in the affairs of any insured depository institution without prior regulatory approval.¹³⁵ A prohibition could potentially permanently bar an institution's employee and an Industry Associated Party from employment in the banking industry.¹³⁶

¹³¹ 12 U.S.C. § 1818(b)

¹³² 12 U.S.C. § 1818(i)(2)

¹³³ https://www.venable.com/files/Publication/ed11e237-451b-4c74-b191-f60094293edc/Presentation/PublicationAttachment/cc588b18-bc65-497b-91b7-fec425d67dd9/Responding_Federal_Banking_Agencies_5-19.pdf

¹³⁴ *Id* 105

¹³⁵ 12 U.S.C. §§ 1818(e) or 1818(g)

¹³⁶ *Id*

6. Restitution Orders (REST): This is an order on an IAP who has garnered an unjust enrichment to pay back the financial institution that has sustained the loss or the FDIC.¹³⁷
7. Securities Enforcement Actions against Individuals (SEI): These are wide ranging types of penalties by a regulatory authority against IAPs for violating securities law by engaging in an unacceptable trading related activity.¹³⁸
8. Prejudgment Asset Seizure Powers: Under the FDICIA, Banking Regulators on obtaining a court order, may proceed to confiscate a bank employee's property.¹³⁹ Regulators, however appear to use this powers sparingly.¹⁴⁰

In addition to the listed enforcement actions, regulatory authorities have very broad latitude to impose sanctions for whatever they subjectively term unsound and unsafe practices. Regulators also have discretionary authority to capital directives (regarded as administratively un-reviewable by the courts) to an institution requiring immediate compliance.

iii. Consequences of Enforcement Actions

An enforcement order in whatever shape or form could quickly become an unexpected source of liability for the financial institution. Enforcement orders usually reveal illegal conduct, which led to the sanctioning of the institution consequently opening up an avenue for a class

¹³⁷ 12 U.S.C. §1818(b)

¹³⁸ *Id*

¹³⁹ Section 8(i) of the FDICIA Act

¹⁴⁰ *Id.* 123

action lawsuit by investors against the bank's directors and management.¹⁴¹ The institution's resources may be further committed in defending additional enforcement actions usually directed at management employees at the institution, who perpetrated the conduct that triggered the investigation.¹⁴²

Enforcement actions attract unneeded negative and adverse publicity. The Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) and the Federal Deposit Insurance Corporation Improvement Act (FDICIA) requires regulators to publish issuance of final C&D orders and MOUs.¹⁴³

Furthermore, public corporations must report and disclose pending enforcement actions and contents of orders and agreements.¹⁴⁴ Also, privately held corporations are not exempt from the disclosure requirement.¹⁴⁵ There is a heightened degree of personal liability for senior members and officers of an institution when executing a C&D and an MOU. This is because, the senior member of management who signed the C&D and MOU on behalf of the institution will be held personally responsible if the institution fails to take the promised remedial action.

¹⁴¹ https://www.venable.com/files/Publication/ed11e237-451b-4c74-b191-f60094293edc/Presentation/PublicationAttachment/cc588b18-bc65-497b-91b7-fec425d67dd9/Responding_Federal_Banking_Agencies_5-19.pdf

¹⁴² *Id*

¹⁴³ *Id*

¹⁴⁴ *Id*

¹⁴⁵ *Id*

Because of the complexity of enforcement actions and skill and experience required to provide effective representation, the cost of legal representation can be significant to the banking institutions, particularly in complex complicated cases.¹⁴⁶

The consequences of enforcement actions on financial institutions, and its staff could be strangulating and quite draconian. Yet, institutions continue to engage in unsound and unsafe practices as a way of doing business.

Since current enforcement actions have failed to deter future and further wrongdoing, a more rigorous mandatory punishment such as jail time instead of the - sometimes discretionary jail time, rarely imposed under a criminal statute - is necessary for directors and employees of these financial institutions who engage in illegal conduct.

Much has also been written on exacting mandatory jail time on CEOs and employees of financial institutions for unsound and unsafe practices. However, these recommendations amounted to nothing - a result of various reasons already discussed in this paper.

¹⁴⁶ *Id*

c. Analysis of Banking Enforcement Actions

An analysis of banking enforcement actions is how often CEO's, executives and employees of banking financial institutions are jailed for unsound and unsafe practices.

i. How often are Bankers Jailed for Unsound and Unsafe Practices?

CEOs of financial institutions have been jailed before for unsound and unsafe practices. During the eighty's loans and savings crisis¹⁴⁷, over seven hundred people (including CEOs) were prosecuted, convicted and jailed.¹⁴⁸ Nevertheless, the overwhelmingly sentiment is that CEOs, executives and employees of banks are often not prosecuted and jailed for their crimes.

ii. No banker was jailed for the most recent financial crisis. Myth or Reality?

There is also the perception that no top financial banker in the U.S. was jailed for unsound and unsafe practices that led to the most recent financial crisis. Publications on this capture this widely held view. The Washington Post writes, "Zero Wall Street CEOs are in jail,"

¹⁴⁷ <https://www.investopedia.com/terms/s/sl-crisis.asp>

¹⁴⁸ <https://www.newyorker.com/magazine/2017/07/31/why-corrupt-bankers-avoid-jail>

for wrecking the world economy.¹⁴⁹ New York, Review of Books carries an article (2014) that wonders why no executives have been prosecuted five years after the financial crisis.¹⁵⁰

However, in 2018, the Financial Times (FT) - after searching records and news reports across Europe and the US to uncover how many bank CEOs and employees received jail sentences for the financial crisis - concluded that one high ranking banking official in the U.S. was prosecuted and jailed.¹⁵¹ Kareem Serageldin, “an executive at Credit Suisse was sentenced to 30 months in jail for lying about the value of his bank’s securities-Serageldin approved the concealment of hundreds of millions in losses in Credit Suisse’s mortgage-backed securities portfolio.”¹⁵² The Judge described Serageldin’s conduct as “a small piece of an evil climate within the bank and with many other banks.”¹⁵³

According to the Judge, other banker’s conduct was far worse. Credit Suisse hid \$2.7 billion in losses.¹⁵⁴Merill Lynch hid \$4 billion.¹⁵⁵ Lehman Brothers, AIG, Citigroup, Countrywide and other financial institutions admitted reporting fewer losses that they incurred.¹⁵⁶ Yet, only one person was reportedly jailed. It is important to point out that prosecutions that resulted in jail time were carried out under criminal statutes with – usually - five-year statute of limitations.

¹⁴⁹ <https://www.washingtonpost.com/news/wonk/wp/2013/09/12/this-is-a-complete-list-of-wall-street-ceos-prosecuted-for-their-role-in-the-financial-crisis/>

¹⁵⁰ <https://www.nybooks.com/articles/2014/01/09/financial-crisis-why-no-executive-prosecutions/>

¹⁵¹ <https://ig.ft.com/jailed-bankers/>

¹⁵² <https://www.nytimes.com/2014/05/04/magazine/only-one-top-banker-jail-financial-crisis.html>

¹⁵³ *Id*

¹⁵⁴ *Id*

¹⁵⁵ *Id*

¹⁵⁶ *Id*

However, the fact still remains that prosecuting and jailing bankers is not the norm considering the enormity and consequences of their illegal conduct on their various institutions, families, society, economy and the world at large. Most widely applied consequences for illegal conduct by financial officials, is punitive fines and disbarment of culpable officials.

iii. Convergent Factors Enabling Government Reluctance to Prosecute and Jail Bankers

The reluctance to jail CEOs and other high level executives of financial institutions is mostly convergent factors. Ironically, the reluctance to prosecute and jail culpable bankers has enabled these unsound and unsafe practices (already discussed in this paper).

There is also a general belief that the enormous powers of the CEOs accompanying with an aggressive ever- ready legal team have intimidated the prosecutors into timidity to prosecute.¹⁵⁷ Additionally, the government believes that a publicized prosecution may impact an already compromised economy by furthering financial instability.¹⁵⁸ A former U.S. attorney general (serving as AG then) said, “I am concerned that the size of some of these institutions becomes so large that it does become difficult for us to prosecute them when we are hit with indications that if you do prosecute, if you do bring a criminal charge, it will have a negative

¹⁵⁷ <https://www.washingtonpost.com/news/wonk/wp/2013/09/12/this-is-a-complete-list-of-wall-street-ceos-prosecuted-for-their-role-in-the-financial-crisis/>

¹⁵⁸ *Id*

impact on the national economy, perhaps even the world economy.”¹⁵⁹ He later denied the statement even though he was on record.

iv. Jailing Bankers would Lead to Loss of Needed Financial Talent

There is a feeling that the imposition of jail time for unsound and unsafe practices would drive away needed talent in the financial industry. This is however not supported by facts. There is no evidence to suggest that the banking industry has ever been in want of talent. Or, that the banking industry has had difficulty-recruiting personnel. After banking CEO’s and executives were jailed for the savings and loan’s scheme in the 80’s, financial talents did not dry up for employment. Additionally, current enforcement actions such as cease and desist orders and outright dismissal of crooked executives from employment has not prevented future bankers from seeking a career in the financial industry.

Moreover, the assumption that jailing crooked executives and employees for unsound practices would drive away talented bankers infers that the banking industry’s success is inherently driven by corrupt practices. And that is definitely not true. Another idea is that jailing CEO’s and employees would undermine the public’s confidence and trust in their public institutions. In any case, the public’s trust in public institutions is already low and has been the case for quite some time. In 2016, only 27 percent of US adults had confidence and trust in their banking institutions.¹⁶⁰ 2006 to 2009 recorded a 27 percent drop in the people’s confidence in

¹⁵⁹ *Id*

¹⁶⁰ <https://www.washingtonpost.com/posteverything/wp/2017/03/03/americans-have-lost-faith-in-institutions-thats-not-because-of-trump-or-fake-news/>

banks.¹⁶¹ Nonetheless, most economists believe that prosecuting and jailing criminals is necessary to restore trust needed to build the economy.¹⁶²

v. Abuse of Prosecutorial Discretion

Indeed under American Law, government prosecutors have nearly absolute unreviewable power to decide what charges, if any, to bring.¹⁶³ The issue now becomes, even after needed legislation is passed, how do we ensure that perpetrators are prosecuted when prosecutorial discretion is exercised in favor for not prosecuting perpetrators for unsound and unsafe practices?

One way is through public pressure usually exacted through congressional hearings. The Congress has oversight responsibilities over executive agencies including the Department of Justice. The President appoints the US attorney's charged with criminally prosecuting unsound and unsafe practices. Public pressure can force prosecutors to bring indictments against crooked bankers.

V. CONCLUSION

Mandatory Minimum Jail Time For Unsound Practices

It is recommended that CEO's, executives and employees serve mandatory minimum jail sentences for unsound and unsafe practices. The recommended mandatory minimum jail time

¹⁶¹ *Id*

¹⁶² <https://ritholtz.com/2012/05/people-are-losing-trust-in-all-institutions/>

¹⁶³ <https://www.splcenter.org/fighting-hate/intelligence-report/2003/are-there-limits-prosecutorial-discretion>

and the wider consistent clamor for some type of custodial sentence for culpable CEO's and bankers, should not imply that the Department of Justice (DOJ) was ever constrained in their ability to bringing charges with jail sentences. In that context, the DOJ could always charge perpetrators of unsound and unsafe banking practices for various violations such as mail and wire fraud (which attracts a maximum of 20 years imprisonment), or a more general "securities fraud" (with maximum 25 years imprisonment), and possibly even racketeering, tax evasion, and/or obstruction of justice.¹⁶⁴ However, specific targeted legislation such as the Insider Trading Act of 1988¹⁶⁵ (dedicated for Insider Trading offenses) is needed for "unsound and unsafe banking" practice's infractions.

The Insider Trading Act of 1988 increased the liability penalties to all involved parties to illegal insider trading¹⁶⁶ to include serving up to 20 years – a significant jail time. Under this act, in 2011, Raj Rajaratnam, "billionaire hedge fund manager was sentenced to 11 years in prison for illegal insider trading."¹⁶⁷ Also in 2012, Matthew Kluger, a corporate lawyer was sentenced to serve 12 years by a New Jersey Judge for illegal tipping.¹⁶⁸ A Reuter's business news analysis in 2014 concluded that illegal insider traders in the US faced longer prison terms for violations.¹⁶⁹

¹⁶⁴ <https://www.mystockoptions.com/content/what-are-the-criminal-penalties-for-insider-trading>

¹⁶⁵ <https://www.investopedia.com/terms/i/insider-trading-act-of-1988.asp>

¹⁶⁶ The SEC defines illegal insider trading as "buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material, nonpublic information about the security."

¹⁶⁷ <https://www.investopedia.com/articles/investing/021815/how-sec-tracks-insider-trading.asp>

¹⁶⁸ <https://www.reuters.com/article/us-insidertrading-prison-insight/insider-traders-in-u-s-face-longer-prison-terms-reuters-analysis-shows-idUSKBN0GX0A820140902>

¹⁶⁹ *Id*

Arguably, it can be surmised that longer prison terms for illegal insider trading has brought more discipline and compliance to security laws and consequently deters criminal activity, at least to some extent.

Legislation for unsound and unsafe practices that prescribes the following is recommended: mandatory minimum jail time for perpetrators in egregious situations such as bank failures and wasteful investment of depositor's funds; eliminating the discretionary powers of regulatory authorities to enter into settlement and or consensual orders in certain severe cases that involve serial offenders; breaking up of offending very large banks; elimination of statute of limitations in all prosecutions for the perpetrators; prevention of prosecutors and regulators from employment in the financial institutions they prosecuted for at least the numbers of years in which there is a pending supervisory agreement and concerning fines- no employment for at least 3 years with the fined institution; and prevention of any government bailout fund for any institution that has engaged in any unsound practice.

Enacting legislation that takes away some discretionary sentencing powers of courts and exacts a mandatory minimum jail time on culpable bank officials could probably have a deterrent effect in preventing unsound and unsafe banking practices as has been so in illegal insider trading.

Mandatory minimum jail time for CEO's and bank employees would be effective as a deterrence against engaging in unsound and unsafe practices. Arguably, large financial institutions are not deterred from illegal conduct by hefty fines anymore as they probably see it

as a new normal and a cost of doing business. Furthermore, an emerging wider consensus is that obligatory promises from banking institutions to change their corporate culture after admitting wrongdoing are a farce. Rather, it is believed that sending culpable executives to jail would have a greater effect in deterring unsound and unsafe banking practices.