

RATIONALIZING ENFORCEMENT IN THE U.S. FINANCIAL SYSTEM




JUNE 2018

Staff Report

**RATIONALIZING ENFORCEMENT IN
THE U.S. FINANCIAL SYSTEM**

June 2018



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COMMITTEE ON CAPITAL MARKETS REGULATION



The Committee is an independent 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations. The Committee's membership includes thirty-five leaders drawn from the finance, business, law, accounting, and academic communities. The Committee Co-Chairs are R. Glenn Hubbard, Dean of Columbia Business School, and John L. Thornton, Chairman of the Brookings Institution. The Committee's Director is Hal S. Scott, Nomura Professor and Director of the Program on International Financial Systems at Harvard Law School.

Founded in 2006, the Committee undertook its first major report at the request of the incoming U.S. Secretary of the Treasury, Henry M. Paulson. Over ten years later, the Committee's research continues to provide policymakers with an empirical and non-partisan foundation for public policy.

This Report has been prepared by the Committee Staff. It represents the first comprehensive review of the U.S. public enforcement system as it applies to the U.S. financial system. It is based on research by the Committee Staff, led by Senior Research Fellow Brenton Speed with direction from Hal Scott, Director of the Committee, and John Gulliver, Deputy Director of the Committee.

Invaluable technical and data analysis support was provided by Brian Franzone. Staff and Research Associates who contributed to the Report include: Megan Vasios, Byron Crowe, Harrison Fregeau, Carson Hele, Joshua Dayton, Chelsea Pizzola, Shirley Chan, Jeffrey Himelson, Daniel Johnson, Min Hee Kim, Zachary Lenox, Pratik Mehta, Michael Moss, Samuel Nadler, Andrew Palmer, Ed Stein, and Peter Zhu.

The Committee Staff sets forth recommendations that are intended to enhance coordination among U.S. public enforcement agencies and the overall transparency of the enforcement system. We (the Committee Staff) believe that agencies should voluntarily adopt our reforms and that Congress should consider enshrining them in legislation.

Table of Contents

CCMR Staff Recommendations..... vi

Background ix

Executive Summary..... xi

Chapter 1: Enhancing the Structure of the U.S. Enforcement System – Improving Coordination and Procedural Fairness 2

I. Fragmented Structure of the U.S. Enforcement System 3

A. Division of Federal Enforcement Powers Among Federal Enforcement Authorities 5

B. State Enforcement 17

C. Enforcement by Non-U.S. Government Actors 20

II. Possible Overlapping Enforcement Activities for the Same Misconduct..... 28

A. Ways that Overlapping Enforcement Actions May Occur..... 28

B. Potential Concerns with Overlapping Enforcement Actions by Multiple Enforcement Authorities 31

III. Coordination of Enforcement Activities Among U.S. Enforcement Authorities 33

A. Statutorily Mandated Coordination..... 33

B. Presidential Orders of Coordination 35

C. Individual Agency Policies, Procedures and Practice 36

D. Recommendations to Formalize and Standardize Coordination..... 41

IV. Forum Selection and Procedural Fairness..... 43

A. SEC, CFTC, and CFPB Power to Choose a Forum..... 43

B. Differences Between a Federal Court Case and Administrative Proceeding 45

C. Constitutional Challenges to the SEC’s Administrative Proceedings 47

D. Policy Concerns and Recommendation..... 49

Chapter 2: Rationalizing the Setting of Sanctions..... 53

I. Remedies Available to Enforcement Authorities 54

A. Monetary Sanctions 54

B. Non-Monetary Sanctions 57

C. Automatic Disqualifications..... 61

II. Laws, Rules, and Guidelines Governing Setting of Monetary Sanctions 65

A. Restitution, Disgorgement, and Consumer Relief 65

B. Civil and Criminal Monetary Penalties 68

C. Rationalizing the Determination of Penalties with Guideposts 87

III. Data on Monetary Sanctions 91

A. Data Collection Process and Limitations of Available Data..... 91

B. Data Findings on Enforcement Activity and Monetary Sanctions 93

C. Conclusion 102

Chapter 3: Ensuring Appropriate Use of Monetary Sanctions 104

I. Constitutional and Statutory Provisions Requiring Collected Monies be Deposited with Treasury..... 105

A. The Constitution’s Appropriations Clause..... 105

B. Statutory Provisions that Supplement the Appropriations Clause..... 105

C. Issue of Collecting Monies to be Deposited into the Treasury..... 106

II. Congressionally Approved Statutory Programs for the Use of Penalties	108
A. Increasing Transparency on the Use of Monetary Sanctions	108
B. Investor and Consumer Compensation Funds	108
C. SEC and CFTC Whistleblower Programs	113
D. DOJ Three Percent Fund	116
III. Extraordinary Restitution	124
A. The Legal Basis for the DOJ’s Use of Extraordinary Restitution	124
B. Examples of Extraordinary Restitution in DOJ Settlements	125
C. Recent DOJ Reforms and Committee Staff Recommendations	130
IV. States’ Use of Monetary Sanctions.....	133
A. Power of Attorneys General to Allocate Settlement Funds	133
B. 2012 National Mortgage Settlement Case Study	134
C. Concerns with States’ Use of Settlement Funds.....	136
Chapter 4: Promoting Individual Accountability	138
I. The Importance and Establishment of Individual and Firm Accountability.....	139
A. Importance of Individual Accountability.....	139
B. Importance of Firm Liability	141
C. The Relationship Between Individual and Firm Liability	142
II. The Government’s Tools and the Challenges of Holding Individuals Accountable.....	146
A. Investigative Powers and Tools	146
B. Remedies.....	147
C. Challenges of Making Cases Against Individuals	148
III. U.S. Enforcement Authorities’ Emphasis on Individual Accountability	151
A. The DOJ’s Internal Policies Target Individuals.....	151
B. The SEC’s Emphasis on Individuals	154
C. Data Shows that the Government Does Target Individuals	155
IV. Promoting Individual Accountability through Effective Compliance Programs	160
A. Expanded Liability Mirrored on the U.K. Senior Managers Regime	160
B. Subjecting Executive Compensation to Clawbacks.....	162
C. Promoting Individual Accountability Through an Affirmative Defense	164
D. Promoting Individual Accountability by Enhancing Transparency Surrounding Criminal and Civil Violations and Implementing Industry Wide Bans	169
Appendix A: List of Report Recommendations.....	171
Appendix B: Summaries of National Mortgage Settlement and Bank of America Settlement Referenced in Chapter 1.....	174
Appendix C: OCC Civil Monetary Penalty Matrix.....	176
Appendix D: Data Collection Efforts	179
Appendix E: Supplemental Enforcement Data	181

CCMR Staff Recommendations

The Staff of the Committee on Capital Markets Regulation recommends the following reforms to the U.S. public enforcement regime:¹

Chapter 1: Enhancing the Structure of the U.S. Enforcement System – Improving Coordination and Procedural Fairness

1. Each enforcement authority should develop formal, written policies, subject to public notice and comment, that detail how the enforcement authority will coordinate with other enforcement authorities in conducting investigations, requesting access to documents and witnesses, and negotiating settlements.
2. Federal enforcement authorities should collaborate with one another on the development of their coordination policies.
3. Enforcement authorities should consider the sanctions that other enforcement authorities, including foreign enforcement authorities, have imposed or are about to impose when setting sanctions in their own enforcement actions. Enforcement authorities should explain how they have taken such other sanctions into consideration.
4. When enforcement authorities have lawful discretion to choose to bring a case in federal court or an administrative proceeding, like the SEC, CFTC, and CFPB do, defendants should have the right to remove a case filed in an administrative forum to federal court in non-settled matters.

Chapter 2: Rationalizing the Setting of Sanctions

5. Automatic disqualifications (whether statutory or otherwise) prohibit a firm from engaging in certain activities when the firm or an affiliate has resolved certain criminal or civil enforcement matters. These disqualifications should only be triggered when there is a clear nexus between the conduct underlying the triggering enforcement action and the disqualification. Where a clear nexus does not exist, disqualifications should have to be affirmatively imposed by the relevant regulator using appropriate due process protections.
6. Enforcement authorities should adopt publicly available core principles or guideposts setting forth the key considerations to be made in setting monetary penalties. FSOC should establish these principles or guideposts and they should include: (1) ensuring that the penalties are proportionate; (2) accounting for the enforcement target's remedial efforts;

¹ Certain acronyms are used in this list of recommendations. They are defined in the Executive Summary and again in the body of the Report. For the convenience of the reader, the acronyms have the following meanings: CFPB (Consumer Financial Protection Bureau), CFTC (Commodity Futures Trading Commission), DOJ (Department of Justice), DPA (deferred prosecution agreement), FCA (False Claims Act), FIRREA (Financial Institutions Reform, Recovery, and Enforcement Act), FSOC (Financial Stability Oversight Council), NPA (non-prosecution agreement), and SEC (Securities and Exchange Commission).

(3) avoiding duplicative penalties for the same underlying misconduct; and (4) relying on historical precedents for consistency. Enforcement authorities should explain how the guideposts were applied in each enforcement action.

7. The DOJ should establish similar publicly available guideposts for the setting of sanctions imposed in both DOJ civil matters under FIRREA and the FCA, as well as in criminal matters, including those resolved through NPAs and DPAs.
8. Each enforcement authority should establish an easily accessible, searchable, centralized database of all of its enforcement actions.

Chapter 3: Ensuring Appropriate Use of Monetary Sanctions

9. Enforcement authorities should provide an annual accounting that discloses the amount of monetary sanctions assessed through orders, judgments, and settlements, and the amount of such monetary sanctions actually collected.
10. Each federal enforcement authority should provide an annual accounting of how monetary sanctions imposed in their enforcement actions are used. The accounting should include: (1) the amount of monetary sanctions that the enforcement authority collected and deposited with the Treasury; and (2) the amount of monetary sanctions that the enforcement authority directed to Congressionally authorized programs (itemized by program).
11. The SEC should publicly disclose annually the amount of funds distributed through its Fair Funds authority and the amount of money in Fair Funds that remains available for distribution (on both an aggregate and individual fund basis).
12. The CFPB should conduct a retrospective analysis of the Civil Penalty Fund that evaluates whether: (1) the Civil Penalty Fund is effectively compensating injured consumers; (2) victims are being adequately identified; and (3) there should be a cap on the total amount of money that can remain in the Civil Penalty Fund (with the balance distributed to the Treasury) to encourage efficient distribution of funds to injured consumers.
13. The DOJ Three Percent Fund should be reformed so that: (1) the DOJ can only use money from the Three Percent Fund as Congress intended – i.e., on activities to collect delinquent debts; and (2) the DOJ provides a public annual accounting of the amount of money deposited into the Three Percent Fund, the amount of money distributed from the Three Percent Fund, and how money distributed out of the Three Percent Fund was spent.
14. Third parties that receive settlement funds from extraordinary restitution should be prohibited from using those funds to engage in political activities. Federal enforcement authorities should adopt policies and guidelines to effectively implement the ban.
15. Each federal enforcement authority should provide an annual accounting of the amount of settlement funds paid out as extraordinary restitution.

16. The states should adopt legislation: (1) requiring an annual accounting from state officials of how state settlement funds are spent; and (2) prohibiting third parties that receive state settlement funds from using those funds to engage in political activities.

Chapter 4: Promoting Individual Accountability

17. The DOJ should publish annual statistics analyzing trends of criminal actions against financial professionals. Useful data would disclose the annual number of cases brought and average and median penalties imposed in categories of white-collar crimes committed by officers and directors of firms and gatekeepers such as lawyers and accountants.
18. An affirmative compliance and cooperation defense should be established in the United States to further promote effective compliance programs and harness their strengths to help identify and prevent individual misconduct. A successful application of the defense should require that the firm establish that the compliance procedures meet a baseline of reasonableness; and the firm promptly, transparently, and wholly disclosed known violations and all non-privileged relevant information uncovered during an internal investigation or review.
19. Enforcement authorities should coordinate to compile a single, publicly-available resource that aggregates information on final judgments or orders imposing criminal or civil sanctions against financial professionals and present it in a user-friendly format.²

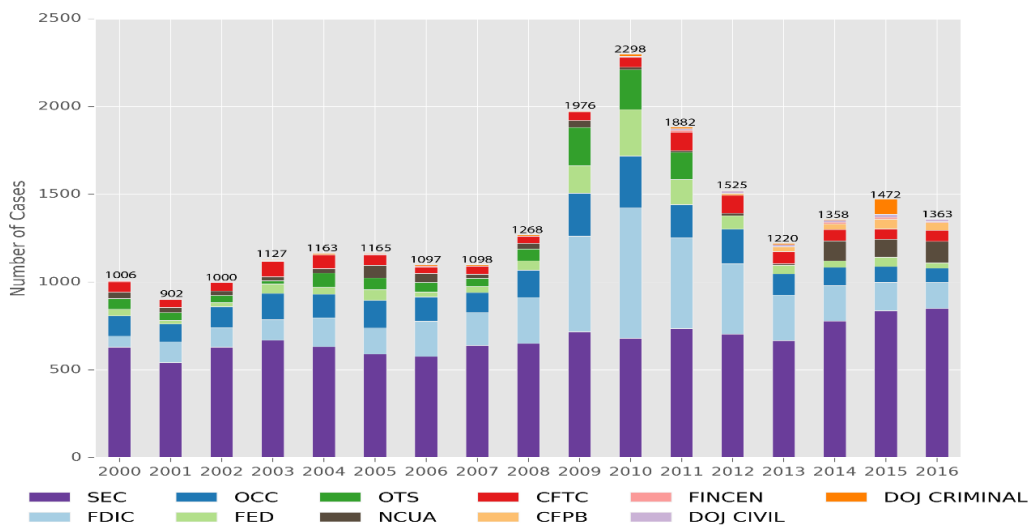
² This recommendation differs from recommendation number 8 because the Committee Staff is recommending that enforcement actions against individuals that impose civil or criminal sanctions be provided by all the enforcement authorities in one accessible location as part of a comprehensive database. In recommendation 8, the Committee Staff is recommending that each enforcement agency develop its own searchable database of all enforcement action outcomes against any type of defendant.

Background

Before addressing the structure of the U.S. public enforcement system for the U.S. financial system, we think that it is useful to provide comprehensive enforcement action data to better understand how that system operates in practice. To do so, we have collected such information on 12 federal and state enforcement authorities from 2000-2016.³ It is the first comprehensive effort to collect such data.

First, we collected data on the total number of financial system-related enforcement actions brought by federal enforcement authorities each year for the past 17 years. **Figure 1**, below, illustrates that after the financial crisis there was a substantial increase in the total number of enforcement actions each year. **Figure 1** also shows that the total number of enforcement actions is now moderately higher than the years preceding the crisis.

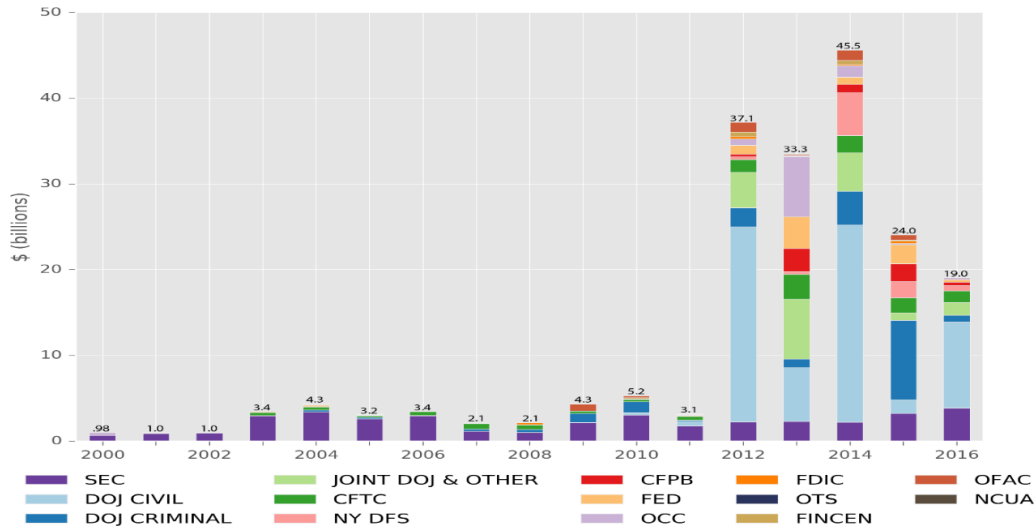
Figure 1: Total Number of Enforcement Actions



³ Those enforcement authorities included the Consumer Financial Protection Bureau (“CFPB”), Commodity Futures Trading Commission (“CFTC”), Department of Justice (“DOJ”), Federal Reserve (“Fed”), Federal Deposit Insurance Corporation (“FDIC”), Financial Crimes Enforcement Network (“FinCEN”), National Credit Union Administration (“NCUA”), New York Department of Financial Services (“NY DFS”), Office of the Comptroller of the Currency (“OCC”), Office of Foreign Assets Control (“OFAC”), Office of Thrift Supervision (“OTS”), and Securities and Exchange Commission (“SEC”). OFAC is excluded in the analysis in Figure 1 because in the early 2000’s, OFAC brought a significant number of cases involving minimal financial penalties against individuals for activities such as travelling illegally to Cuba, which are outside the scope of the Report’s focus on capital markets and the financial system.

In **Figure 2**, we show the total amount of monetary sanctions imposed in financial system-related enforcement actions by each agency in each of the past 17 years.⁴ We note that the total amount of monetary sanctions substantially increased after the financial crisis and remains significantly higher than the years preceding the crisis.

Figure 2: Total Monetary Sanctions



While this aggregate data is important to understand the frequency with which each agency brings financial system-related enforcement actions and the significance of monetary sanctions as an enforcement tool, it does not address whether the U.S. enforcement system is operating efficiently, fairly, and in a transparent manner. To do so, the Report will examine the following questions:

- How is jurisdiction among enforcement authorities structured?
- Do enforcement agencies have mechanisms and policies in place to coordinate effectively?
- What types of sanctions can enforcement authorities impose?
- What laws, rules, policies, and guidelines govern how monetary sanctions are set?
- What laws, rules, and policies regulate how monetary sanctions are spent?
- How, in fact, are monetary sanctions that are collected spent?
- Are there ways to increase accountability of individuals who engage in misconduct?

⁴ The “Joint DOJ & Other” amounts are comprised of amounts awarded to states or to agencies like the FDIC, NCUA or FHA as receivers for failed institutions in actions settled or brought together with the DOJ action. The amounts awarded to receivers of failed institutions are not included in the individual agency amounts as they are not included in the enforcement actions on those agencies’ websites because rather than acting as regulatory authorities in those instances, the agency is standing in the shoes of the failed institution asserting private legal claims. The chart also includes penalty amounts from enforcement actions by the NY DFS.

Executive Summary

In the last decade, public enforcement of the laws governing the U.S. financial system has received widespread attention, but neither policymakers, academics nor private institutions have produced a comprehensive overview and assessment of the public enforcement system for the U.S. financial system. This Report, *Rationalizing Enforcement of the U.S. Financial System* (the “**Report**”), attempts to do just that. While we make recommendations aimed at improving aspects of the enforcement system, the primary purpose of this Report is to lay out a succinct description for the public, policymakers, and others about how the enforcement system works.

The Report is divided into four chapters: Chapter 1: Enhancing the Structure of the U.S. Enforcement System – Improving Coordination and Procedural Fairness; Chapter 2: Rationalizing the Setting of Sanctions; Chapter 3: Ensuring Appropriate Use of Monetary Sanctions; and Chapter 4: Promoting Individual Accountability.

Chapter 1 describes the highly-fragmented structure of the U.S. public enforcement system and the potential for overlapping enforcement actions by multiple agencies resulting from the same underlying misconduct. We also describe the lack of laws and policies mandating coordination, with the DOJ’s new anti-“piling on” policy being a recent exception, and separately, the discretion some agencies have to engage in forum shopping by unilaterally selecting the forum in which they bring enforcement actions. The chapter sets forth recommendations to formalize and standardize coordination policies and limit the ability of agencies to engage in forum shopping.

Chapter 2 sets forth the laws, rules and policies that guide and constrain the setting of monetary sanctions in enforcement actions. We explain that agencies generally have vast discretion in setting sanctions because statutes and policies provide limited practical constraints. We recommend that agencies develop core principles or guideposts to avoid arbitrary, inconsistent and disproportionate penalties. We then describe the byzantine approach many agencies take to publicly disclosing information about enforcement action outcomes and present our own data analysis on monetary sanctions over a 17-year period. The chapter concludes with recommendations for enhancing transparency of enforcement action outcomes.

Chapter 3 describes how monetary sanctions collected in enforcement actions are spent. In particular, the chapter describes the lack of public disclosure and sets forth recommendations to increase transparency and appropriately restrict the use of collected monetary sanctions.

Chapter 4 explores the issue of individual accountability. We find that while the government has significant legal and investigative tools to identify and hold culpable individuals and firms accountable, it can face more significant challenges with respect to individuals. We set forth recommendations that we believe will better enable enforcement authorities and firms to work together to identify culpable individuals and build successful cases against them.

Introduction

An enforcement system that prevents and punishes wrongdoing and that has the public’s confidence can increase investor confidence in capital markets and in financial institutions.⁵ As a result, there may be more investor participation in capital markets thus increasing economic growth and job creation. Moreover, consumers who are confident that they will be treated fairly by financial institutions may be more comfortable and willing to purchase financial products and services. That, in turn, can expand their access to goods and services. Furthermore, financial service companies that are confident that they are subject to a fair and predictable enforcement regime are likely to be more willing to provide a greater selection of products and services to the marketplace.

Effective enforcement of the law accomplishes two principal objectives: (1) it prevents prohibited behavior (deterrence) through punishment of individuals and firms that have engaged in unlawful conduct; and (2) it stops any ongoing misconduct while also undoing any harm caused by that misconduct (remediation).

Regulators,⁶ academics,⁷ and courts⁸ generally agree that credible deterrence is crucial in any enforcement regime. Deterrence is most effective when “would-be wrongdoers perceive that the risks of engaging in misconduct outweigh the rewards and when non-compliant attitudes and behaviors are discouraged.”⁹ Deterrence can be achieved through different types of punishment, including fines, jail time, disgorgement of ill-gotten gains, and industry bans or suspensions.

A second goal of an effective enforcement system is remediation. If prohibited behavior has occurred or continues to occur, enforcement actions allow for remedial measures to halt the violation and, in some cases, compensate victims for the harm they have suffered. In this respect, effective remedial measures are generally “designed to limit the capacity of respondents to injure investors.”¹⁰ Remediation is also achieved through measures that generally focus on restoring victims to their pre-violation state.¹¹ Effective and resolute remedial measures complement a credible deterrence strategy.¹²

⁵ See, e.g., Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-Based Evidence*, 93 J. FIN. ECON. 207 (2009); Douglas Cumming, April Knill & Nela Richardson, *Firm Size and the Impact of Securities Regulation*, 43 J. COMP. ECON. 417 (2015).

⁶ See Mary Jo White, Chair, U.S. Sec. & Exch. Comm’n, Speech at the Council of Institutional Investors Fall Conference: Deploying the Full Enforcement Arsenal (Sept. 26, 2013); David M. Becker, *What More Can Be Done to Deter Violations of the Federal Securities Laws?*, 90 TEX. L. REV. 1849, 1849–60 (2012); Paul S. Atkins & Bradley J. Bondi, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program*, 13 FORDHAM J. CORP. & FIN. L. 366 (2008).

⁷ See Stavros Gadinis, *The SEC and the Financial Industry: Evidence from Enforcement Against Broker-Dealers*, 67 BUS. LAWYER 679, 683–84 (2012); Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 UNIV. PENN. L. REV. 2173, 2178–80 (2010); Robert A. Prentice, *The Inevitability of a Strong SEC*, 91 CORNELL L. REV. 775, 828 (2006).

⁸ See *Decker v. SEC*, 631 F.2d 1380, 1384 (10th Cir. 1980).

⁹ INT’L ORG. OF SEC. COMM’NS, CREDIBLE DETERRENCE IN THE ENFORCEMENT OF SECURITIES REGULATION 6 (2015), <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD490.pdf> [hereinafter IOSCO Report]

¹⁰ Becker, *supra* note 6, at 1852–54.

¹¹ See IOSCO Report, *supra* note 9, at 37.

¹² *Id.* at 29, 37.

Chapter 1: The Structure of the U.S. Enforcement System – Improving Coordination and Procedural Fairness

The U.S. public enforcement system is highly fragmented. Enforcement powers are delegated to numerous federal and state government agencies, which are referred to throughout this Report as “**enforcement authorities.**” This decentralized structure creates the potential for multiple enforcement authorities to conduct investigations, bring enforcement actions, and impose sanctions for the same underlying misconduct. Absent effective coordination and cooperation, the fragmented enforcement system can produce a duplicative and unfair process. Moreover, the unilateral discretion given to some enforcement authorities to choose the forum where an enforcement action is brought also produces potential procedural concerns. Chapter 1 covers these matters in four parts.

i. Fragmented Structure of the U.S. Public Enforcement System

Part I explains how enforcement at the federal level is spread out among capital markets regulators (Securities and Exchange Commission (“**SEC**”) and Commodity Futures Trading Commission (“**CFTC**”)); a consumer protection regulator (Consumer Financial Protection Bureau (“**CFPB**”)); banking regulators (Federal Deposit Insurance Corporation (“**FDIC**”), the Federal Reserve (“**Fed**”), National Credit Union Administration (“**NCUA**”), and the Office of the Comptroller of the Currency (“**OCC**”)); regulators that oversee laws governing trade restrictions, money laundering and terrorist financing (Financial Enforcement Network (“**FinCEN**”) and Office of Foreign Assets Control (“**OFAC**”)); and the Department of Justice (“**DOJ**”).¹³

In all, there are ten key federal enforcement authorities that have enforcement jurisdiction over various laws pertinent to the capital markets and broader financial system. But the U.S. public enforcement system is further fragmented because the U.S. has a federalist system in which states also have their own laws and enforcement powers. The State of New York, a large state at the center of the financial markets, serves as an example of how states can have a significant role in enforcement. The Report also explores how authorities outside the U.S. government, specifically self-regulatory organizations (“**SROs**”) (i.e., member-based organizations such as the Financial Industry Regulatory Authority that regulates broker-dealers (“**FINRA**”) and foreign regulators, also regulate and sanction misconduct, which adds even more complexity to the system.

ii. Multiple Enforcement Activities for the Same Misconduct

Part II provides a taxonomy of situations in which multiple enforcement authorities could bring enforcement actions resulting from the same underlying misconduct because of the fragmentation of enforcement jurisdiction.

¹³ Other federal authorities may also be involved in enforcement matters relevant to financial markets on a less regular basis, and are not a focus of this Report, such as the Department of Labor or the Federal Energy Regulatory Commission.

The ability of multiple enforcement authorities to conduct investigations or bring enforcement actions for the same underlying activities creates a number of potential issues: (1) the risk that enforcement authorities will not coordinate investigations or requests for information, which results in greater than necessary costs to both enforcement targets and the government; (2) the uncertainty that enforcement targets can face about whether they have responded to all requests for information or if all possible enforcement actions have been resolved; and (3) the potential for duplicative and thus disproportionate sanctions that could result from enforcement authorities all independently assessing their own sanctions without considering the total amount of sanctions an enforcement target will pay.

iii. Coordination of Enforcement Activities Among U.S. Enforcement Authorities

Part III shows that enforcement authorities lack a standardized and transparent system to coordinate investigations, as well as enforcement actions, settlements and sanctions. Indeed, few statutes require enforcement authorities to coordinate with one another, and to the extent statutorily mandated coordination exists, the statutes are narrowly tailored and limited in scope. Additionally, publicly available individual agency policies suggest that to the extent enforcement authorities coordinate their activities, they appear to do so largely on an ad hoc or case-by-case basis. While the Committee Staff recognizes that an ad hoc approach may result in effective cooperation and coordination in a particular case, we believe a formal and standardized approach would better ensure consistency across all cases.

Therefore, the Committee Staff provides recommendations aimed at formalizing and standardizing the coordination process to ameliorate issues that have the potential to arise from the fragmented enforcement structure:

- **Recommendation 1:** Each enforcement authority should develop formal, written policies, subject to public notice and comment, that detail how the enforcement authority will coordinate with other enforcement authorities in conducting investigations, requesting access to documents and witnesses, and negotiating settlements.
- **Recommendation 2:** Federal enforcement authorities should collaborate with one another on the development of their coordination policies.
- **Recommendation 3:** Enforcement authorities should consider the sanctions that other enforcement authorities, including foreign enforcement authorities, have imposed or are about to impose when setting sanctions in their own enforcement actions. Enforcement authorities should explain how they have taken such other sanctions into consideration.

iv. Forum Selection and Procedural Fairness

Chapter 1 concludes by tackling an issue of procedural fairness – namely, the ability of the SEC, CFTC and CFPB to unilaterally choose whether to bring an enforcement proceeding in federal court or before an administrative law judge (“ALJ”).

We present data showing that the SEC has increased its use of the administrative forum, with roughly 80% of all SEC cases now filed in the administrative forum versus 50% in 2010. The ability of agencies to unilaterally choose the administrative forum when it best suits them creates both real and perceived issues of procedural fairness.

From a substantive perspective, enforcement authorities may find it advantageous to choose an administrative forum when there are unsettled legal interpretation issues because it allows the agency (through its own judges and commissioners) rather than federal judges to shape and interpret the law. Those legal conclusions are then subject to deferential review by federal judges. In addition, enforcement authorities can choose an administrative forum to be able to admit evidence that they could not in federal court – for example, under SEC rules, hearsay is generally admissible while it is not in federal court under the Federal Rules of Evidence. From an optics perspective, such unfettered discretion is problematic because the agency can be viewed as the judge and jury, which undermines the public’s view of the justice process as impartial and independent. To alleviate procedural and optical concerns, the Committee Staff recommends that:

- **Recommendation 4:** When enforcement authorities have lawful discretion to choose to bring a case in federal court or an administrative proceeding, like the SEC, CFTC, and CFPB do, defendants should have the right to remove a case filed in an administrative forum to federal court in non-settled matters.¹⁴

Chapter 2: Rationalizing the Setting of Sanctions

A critical aspect of any enforcement regime is the sanctions that are imposed when an enforcement agency successfully litigates a case or settles with an enforcement target. Effective sanctions can deter future misconduct, punish wrongdoing, and signal the egregiousness of an act to the public. Sanctions that are proportionate to the wrong committed, including the harm caused to victims, are important in ensuring public confidence in the enforcement authorities as balanced arbiters of justice. Proportionate sanctions are also important to avoid situations in which well-intentioned actors avoid lawful and productive financial activities for fear of being wrongly targeted and subject to arbitrary and disproportionate sanctions.

Chapter 2 sets forth the types of sanctions enforcement authorities can impose, and focuses primarily on monetary sanctions, which play an especially important role in the enforcement of the laws and rules governing the financial system and capital markets. Our ultimate concern is that the existing processes for the setting of sanctions leaves too much discretion with enforcement authorities and lacks transparency. Statutes provide little direction for setting sanctions and whatever restrictions they impose are often meaningless because they impose penalty maximums on a “per violation” basis. The determination of how many violations have occurred is subject to excessive discretion. Beyond statutory limits, enforcement authorities take widely disparate approaches to providing guidance to their enforcement attorneys about determining or calculating an appropriate monetary sanction amount. Many provide no guidance at all and take a purely case-

¹⁴ This recommendation is similar to provisions contained in the Financial CHOICE Act of 2017. Financial CHOICE Act of 2017, H.R. 10, 115th Cong. §§ 714, 823 (2017).

by-case approach. Others have policies, but those policies do not meaningfully constrain the discretion of enforcement authorities. The nearly unfettered discretion resulting from the current approach raises concerns about the arbitrariness and proportionality of sanctions. These concerns are exacerbated by the fact that financial institutions, as a practical matter, often do not believe that they have the ability to litigate enforcement actions. In criminal matters, a conviction after trial could result in the failure of the firm, like in the Arthur Andersen matter. In civil matters, institutions do not want to sour relations with their supervisory regulators. As a result, cases are rarely litigated and therefore judges and courts often cannot be relied upon as a check on agency discretion. We recommend that enforcement authorities adopt guideposts that apply in all cases to avoid veering too far off course and imposing arbitrary and disproportionate penalties. Chapter 2 addresses the setting of sanctions in three parts.

i. Remedies Available to Enforcement Authorities

Part I begins by describing the remedies that enforcement authorities have at their disposal to sanction and remediate misconduct. It includes a taxonomy of both the monetary and non-monetary sanctions that agencies can use. Monetary sanctions include civil and criminal monetary penalties, disgorgement and restitution, and consumer relief. Data gathered and analyzed by the Committee Staff show that all three categories of monetary sanctions play a significant role. Non-monetary sanctions include cease-and-desist orders and injunctions; bars, suspensions, and removals; requirements to take actions such as making governance changes; and revocations of registrations, charters, or insurance. These non-monetary sanctions can be useful tools to stop an ongoing violation and make it difficult for someone to harm consumers or investors in the future by removing them from an industry or institution.

We also raise concerns about the automatic loss of privileges that a firm can lose when an enforcement action is resolved against it or an affiliate (“**automatic disqualifications**”). Automatic disqualifications are especially prevalent in the securities statutes and rules overseen by the SEC, so we focus our discussion there.¹⁵ These disqualifications are problematic because they can be triggered by conduct wholly unrelated to the affected party’s activities in the securities markets, and that may have been committed by a distant related company. Thus, the nexus between the automatic disqualification and the triggering conduct can be extremely attenuated. To relieve the problems that arise from automatic disqualifications where the connection between the disqualification and the underlying misconduct is remote, we recommend the following.

- **Recommendation 5:** Automatic disqualifications (whether statutory or otherwise) prohibit a firm from engaging in certain activities when the firm or an affiliate has resolved certain criminal or civil enforcement matters. These disqualifications should only be triggered when there is a clear nexus between the conduct underlying the triggering enforcement action and the disqualification itself. Where a clear nexus does not exist, disqualifications

¹⁵ Automatic disqualifications also exist in other contexts. One example is the Department of Labor’s Qualified Professional Asset Manager exemption from Section 406 of ERISA, which investment advisers and managers use to conduct business on behalf of an ERISA plan with fewer restrictions. This exemption, however, is not available when the asset manager or any affiliate has been subject to certain enforcement actions within a ten year look back period. 75 Fed. Reg. 38,837.

should have to be affirmatively imposed by the relevant regulator using appropriate due process protections.

ii. Laws, Rules, and Guidelines Governing Setting of Monetary Sanctions

Part II examines the approaches that enforcement authorities take to determine monetary sanction amounts. While restitution and disgorgement can be calculated by determining the injuries caused to victims or the profit made by the wrongdoer, consumer relief payments and monetary penalties are subject to a wide array of approaches.

In general, the statutes that empower enforcement authorities to seek and impose penalties provide minimal guidance about determining the appropriate penalty in a given case. However, certain enforcement authorities have voluntarily issued public guidance clarifying their approach. We therefore categorize enforcement authorities as generally falling into one of two categories: (1) those with little or no agency guidance on how monetary penalties are to be determined; and (2) those with written and formal policies that provide some guidance about how penalty amounts are to be calculated. However, in practice, we find that both categories of enforcement authorities effectively retain complete discretion in setting penalty amounts.

The absence of formal policies that standardize penalty setting practices creates the risk of arbitrary and disproportionate penalties. Disproportionate penalties are those that go beyond what is needed to: remediate any harm caused; ensure that the wrongdoer does not profit from its misconduct; and impose a sufficient punishment that deters future misconduct.

Arbitrary and disproportionate penalties are concerning for several reasons. First, they serve no additional deterrent or remedial purpose. Second, well-intentioned actors may avoid lawful and productive financial activities from fear of being wrongly targeted by enforcement authorities and subjected to disproportionate penalties.

Third, arbitrary and disproportionate penalties undermine confidence in the enforcement system that can reduce compliance rates, because firms are more likely to respect and comply with a system that they perceive as fair and legitimate. A fair system is also more likely to promote feedback and interaction between regulators and market participants that can facilitate compliance.

Fourth, unbridled agency discretion also creates the risk that enforcement targets who have engaged in similar conduct could be treated differently. That would undercut key American principles of equal treatment under the law and that government actions should be rational and fair.

Enforcement authorities, including the Fed, OCC, and FDIC, have adopted more concrete policies that apply penalty guidelines and matrices on a case-by-case basis. While these guidelines can provide a common starting point in settlement negotiations about what the important factors are, and a way for both government officials and enforcement targets to ground negotiations, they have not effectively restrained agency discretion. First, these enforcement authorities' guidelines are non-binding and do not apply in all cases, particularly in cases with the largest sanctions.

Second, the guidelines and matrices can be applied to reach a predetermined or desired outcome. We explain how, with a particular focus on enforcement authorities' discretion when it comes to determining the *number* of wrongful acts committed by an enforcement target, and the impact that this determination has on the overall penalty.

The DOJ is unique. DOJ criminal cases that result in convictions or guilty pleas are subject to the U.S. Sentencing Guidelines that determine penalty amounts based on pre-determined rules and must be considered by judges before imposing sentences. However, the Sentencing Guidelines do not apply to DOJ civil matters, including matters under the False Claims Act (“FCA”) or the Financial Institutions Reform, Recovery, and Enforcement Act (“FIRREA”). Furthermore, even in the criminal context the Sentencing Guidelines do not always apply because the DOJ often negotiates resolution of criminal matters outside a guilty plea or conviction through extrajudicial agreements known as nonprosecution and deferred prosecution agreements (referred to as “NPAs” and “DPAs”). The DOJ is not legally bound by the U.S. Sentencing Guidelines in those matters and no laws or agency rules prescribe how penalty amounts in those matters should be set.

We conclude that the public cannot have confidence that penalties are being set in a rational, consistent and appropriate manner when enforcement authorities are using so many differing approaches, and the risk of arbitrary and disproportionate penalties remains very real. Our concerns are exacerbated by the fact that, as a practical matter, institutions often do not believe that they have the ability to litigate enforcement actions and have a court independently determine penalty amounts. That is because criminal convictions resulting from a trial could threaten the survival of a firm and, in civil matters, institutions often prefer to settle to maintain better relations with regulatory supervisors. Government discretion should be subject to appropriate constraints, and therefore, the Committee Staff offers several policy recommendations that seek to implement a more rational and transparent approach to penalty setting:

- **Recommendation 6:** Enforcement authorities should adopt publicly available core principles or guideposts setting forth the key considerations to be made in setting monetary penalties. FSOC should establish these principles or guideposts and they should include: (1) ensuring that the penalties are proportionate; (2) accounting for the enforcement target's remedial efforts; (3) avoiding duplicative penalties for the same underlying misconduct; and (4) relying on historical precedents for consistency. Enforcement authorities should explain how the guideposts were applied in each enforcement action.
- **Recommendation 7:** The DOJ should establish similar publicly available guideposts for the setting of sanctions imposed in both DOJ civil matters under FIRREA and the FCA, as well as in criminal matters, including those resolved through NPAs and DPAs.

iii. Data on Monetary Sanctions

Part III sets forth the general shortcomings in publicly available information regarding U.S. enforcement actions and their outcomes. Specifically, major enforcement authorities like the SEC and CFTC do not have publicly accessible databases that allow the public, academics, or others to readily identify and analyze the sanctions imposed against defendants in specific cases. Indeed,

the CFTC does not even have an internal database that keeps track of the outcomes of enforcement actions.

We believe that such information is critical to understand trends in enforcement. The Committee Staff has conducted a data analysis of the monetary sanctions imposed on individuals and firms participating in financial markets over a roughly 17-year period. The Committee Staff's data show clear upward trends in the total aggregate monetary sanctions imposed in enforcement actions and the size of the mean and median monetary sanctions imposed on enforcement targets during the period. However, due to the lack of formal and standardized policies and procedures for the setting of monetary penalties, the drivers of the increase in monetary sanctions are unclear. Policies or guideposts could provide confidence to the public that increases in the sanctions imposed in the typical (median) or average (mean) case are actually driven by changes in behavior, including more egregious conduct or harm to investors, rather than a simple ratcheting up of sanctions for similar acts.

To improve the public's access to information about the outcomes in specific enforcement actions, we make a recommendation to enhance transparency:

- **Recommendation 8:** Each enforcement authority should establish an easily accessible, searchable, centralized database of all of its enforcement actions.

Chapter 3: Ensuring Appropriate Use of Monetary Sanctions

Chapter 3 explores how monetary sanctions obtained in enforcement actions are used by enforcement authorities so that the public and policymakers can judge whether monetary sanctions are being used to advance the public interest, including to remediate harm caused to victims.

We find that important programs exist to compensate victims of wrongdoing, fund government efforts to collect on unpaid judgments, and incentivize individuals with knowledge of wrongdoing to come forward with information. However, in many cases, transparency about how funds are being used is lacking and there is a potential for funds to be used for activities unrelated to enforcement or the aims of enforcement. These issues are explored in four parts.

i. Constitutional and Statutory Provisions Requiring that Collected Monies be Deposited with Treasury

Part I describes the core constitutional and statutory framework governing the allocation of monetary penalties recovered by federal enforcement authorities. These laws provide that monetary penalties paid to the federal government should generally be deposited with the U.S. Treasury for Congress to appropriate with other sources of revenue for the government, such as tax revenue.¹⁶

¹⁶ The states have differing practices. Some states require through constitutional or statutory provisions that collected penalties must be deposited into the state's general fund to be appropriated by the state legislature. *See* U.S. CHAMBER OF COMMERCE, ENFORCEMENT SLUSH FUNDS: FUNDING FEDERAL AND STATE AGENCIES WITH

However, before any monies can be deposited in the U.S. Treasury, they must first be collected, and we find that enforcement authorities often do not recover the monetary sanctions owed to them, and provide limited disclosure regarding their collection efforts. That deprives the government of money that belongs to taxpayers and undermines the deterrent and remedial effects of monetary sanctions. To increase transparency about the success (or lack thereof) *in collecting* monetary sanctions, and to incentivize enforcement authorities to pursue uncollected amounts, we make the following recommendation:

- **Recommendation 9:** Enforcement authorities should provide an annual accounting that discloses the amount of monetary sanctions assessed through orders, judgments, and settlements, and the amount of such monetary sanctions actually collected.

ii. Congressionally Approved Statutory Programs for the Use of Penalties

Part II explores instances where Congress has used its appropriations authority to earmark penalties collected by certain agencies for specific uses. In these cases, the funds are used as directed and not deposited with Treasury.

These programs include: (a) investor and consumer relief funds, such as the SEC “Fair Funds” to distribute penalties to victims of securities law violations and the CFPB Civil Penalty Fund to compensate consumers harmed by unlawful conduct; (b) SEC and CFTC whistleblower funds to compensate whistleblowers who helped advance an enforcement action; and (b) the Three Percent Fund at the DOJ to fund DOJ operations.

These programs serve valuable functions. The investor and consumer relief funds are used to remediate harm caused by wrongdoing; the whistleblower funds can be used to incentivize people with information about misconduct to come forward so that enforcement authorities can uncover, stop, and punish unlawful activities; and the DOJ Three Percent Fund can incentivize the DOJ to aggressively pursue monies that are owed to the government so that judgments, orders and settlements are enforced.

However, it is difficult to evaluate whether the programs are working as intended because they lack transparency. Generally, the enforcement authorities are not required, and fail on a consistent basis, to disclose the amount of money used in Congressionally approved programs. The SEC, for example, is not required to disclose the annual amount of money deposited into a specific fair fund (or across all fair funds) or distributed out of a fair fund (or distributed from all fair funds). Therefore, we make the following recommendations:

ENFORCEMENT PROCEEDS 34-41 (2015), http://www.instituteforlegalreform.com/uploads/sites/1/Enforcement_Slush_Funds_web.pdf. Other states, however, allow the state attorney general to determine how to disperse penalties or to use penalties to fund other enforcement activities.

- **Recommendation 10:** Each federal enforcement authority should provide an annual accounting of how monetary sanctions imposed in their enforcement actions are used. The accounting should include: (1) the amount of monetary sanctions that the enforcement authority collected and deposited with the Treasury; and (2) the amount of monetary sanctions that the enforcement authority directed to Congressionally authorized programs (itemized by program).
- **Recommendation 11:** The SEC should publicly disclose annually the amount of funds distributed through its Fair Funds authority and the amount of money in fair funds that remains available for distribution (on both an aggregate and individual fund basis).

Moreover, the CFPB Civil Penalty Fund is a relatively new program and the CFPB and Congress have not conducted a formal, public analysis of whether the Civil Penalty Fund is working as intended to identify and compensate injured consumers. In addition, we have serious concerns about whether the DOJ Three Percent Fund has exceeded its original scope and intended purpose as it is now largely used by the DOJ as a general source of funds rather than to track down delinquent debt owed to the government. Moreover, the DOJ is not required to and does not produce annual reports about what money it has deposited into or distributed from the Three Percent Fund. To address these concerns, we make the following recommendations:

- **Recommendation 12:** The CFPB should conduct a retrospective analysis of the Civil Penalty Fund that evaluates whether: (1) the Civil Penalty Fund is effectively compensating injured consumers; (2) victims are being adequately identified; and (3) there should be a cap on the total amount of money that can remain in the Civil Penalty Fund (with the balance distributed to the Treasury) to encourage efficient distribution of funds to injured consumers.
- **Recommendation 13:** The DOJ Three Percent Fund should be reformed so that: (1) the DOJ can only use money from the Three Percent Fund as Congress intended – i.e., on activities to collect delinquent debts; and (2) the DOJ provides a public annual accounting of the amount of money deposited into the Three Percent Fund, the amount of money distributed from the Three Percent Fund, and how money distributed out of the Three Percent Fund was spent.

iii. Extraordinary Restitution

Part III then examines how enforcement authorities, particularly the DOJ, can structure settlement agreements to direct funds to consumers and certain pre-approved third parties who were not necessarily victims. These allocations are not subject to Congress’ appropriation authority. This practice is often referred to as “extraordinary” restitution, because the recipients are not necessarily injured parties. An analysis of ten large cases against financial institutions arising out of the financial crisis shows that in those matters, extraordinary restitution accounted for approximately 50% of the settlement amount and ranged from 0% to 80% in particular cases.

The use of extraordinary restitution can be valuable in some circumstances. First, when direct harm is large in the aggregate, but is widely dispersed, it can be difficult to identify specific victims or administratively challenging to determine the harm done to specific individuals. Extraordinary restitution can therefore be used to provide remedial compensation indirectly. Second, when wrongdoing has negative externalities on many individuals in society who become indirect victims of unlawful conduct, extraordinary restitution can serve as a means to provide compensation.

However, the use of extraordinary restitution in civil matters is generally not subject to restrictions or guidelines and is thus subject to the appearance of abuse. Specifically, there is a risk that payments could be directed to political allies of enforcement officials or that money given to third-party organizations could be used for political activities or purposes rather than providing assistance to people affected directly or indirectly by the misconduct. Political activities include activities like running issue advocacy ads, electioneering, and lobbying.

In 2017, the DOJ took steps to limit the use of extraordinary restitution as a remedy in DOJ settlement agreements. However, we believe that the DOJ's policy is overinclusive because it institutes a virtually complete ban on extraordinary restitution payments in DOJ settlements, eliminating the use of extraordinary restitution provisions by the DOJ even when they could be valuable. We make two recommendations that seek to permit the continued use of extraordinary restitution while imposing restrictions to prevent abuse and enhancing transparency about how extraordinary restitution is spent:

- **Recommendation 14:** Third parties that receive settlement funds from extraordinary restitution should be prohibited from using those funds to engage in political activities. Federal enforcement authorities should adopt policies and guidelines to effectively implement the ban.
- **Recommendation 15:** Each federal enforcement authority should provide an annual accounting of the amount of settlement funds paid out as extraordinary restitution.

iv. States' Use of Monetary Sanctions

Part IV concludes by describing the discretion the state attorneys general have in allocating settlement funds. In some states, attorneys general have broad legal authority to disperse settlement funds and in others, where the law is unclear, attorneys general have attempted to structure settlement agreements to delineate how the funds will be spent. Those powers or efforts to exert such power raise similar concerns about the political use of settlement funds. Moreover, the use of settlement funds by states, whether directed by state legislatures, or officials like attorneys general, is very opaque. A case study of the allocation of \$2.5 billion from the 2012 National Mortgage Settlement, using data from the National Conference of State Legislatures, shows how difficult it is to track the use of state settlement funds.

To address these concerns:

- **Recommendation 16:** The states should adopt legislation: (1) requiring an annual accounting from state officials of how state settlement funds are spent; and (2) prohibiting third parties that receive state settlement funds from using those funds to engage in political activities.

Chapter 4: Promoting Individual Accountability

The final chapter of the Report focuses on the topic of individual accountability, which many, including the SEC co-heads of enforcement, have said is the most effective way to deter misconduct. Individual accountability is particularly effective because when culpable individuals are held accountable they directly bear and internalize the cost of punishment, whereas when firms are penalized, the costs are largely borne by shareholders who played no part in the wrongdoing.

At the outset, it is critical to understand that enforcement actions against firms do not prevent enforcement agencies from also targeting individuals. Indeed, we can find no major recent settlement between the government and a financial entity that included terms protecting the individuals at that firm from government prosecution.

In this Chapter, we first explore the importance of holding individuals *and* firms accountable. We then describe the government's tools and powers to hold both culpable individuals and firms liable for misconduct and describe the existing policies for identifying and penalizing individuals. Next, we explain that there are certain challenges unique to individual accountability that can make it more difficult for enforcement authorities to punish individuals as opposed to firms. Finally, we present recommendations to further promote the laudable aim of identifying and holding guilty individuals accountable for their actions that avoid the problems that we identify in other potential proposals. These issues are explored in four parts.

i. The Importance and Establishment of Individual and Firm Accountability

Individual liability is critical because civil and/or criminal liability against an individual imposes a direct cost on the person who engaged in wrongdoing. In addition, in criminal matters, the criminal penalty of imprisonment can be applied to individuals but not firms, thus providing a greater deterrent effect. Firm liability is also important because the threat of firm liability incentivizes firms to take steps to prevent employee wrongdoing, monitor employees' compliance with the law, and adopt internal accountability structures and systems. In some instances, a firm may also be in the best position to compensate injured consumers or investors.

One major difference between individual and firm liability is that while individuals can generally only be held liable for their own actions, knowledge, and intent, firm liability is dependent and based on the conduct attributed to its employees in two ways. First, firms are vicariously, or strictly, liable for the conduct of their employees in the course of their employment. Therefore, if a particular employee can be held liable for wrongdoing, so can the firm. Second, and critically, under an unsettled theory of liability known as collective scienter, the actions,

knowledge, and intent of employees can be *aggregated* and imputed to the firm, meaning that the firm can be held liable for a legal violation due to the collective actions of its employees, even when no individual employee has violated a law.

For example, a firm could be held liable for violating certain disclosure requirements for selling securities even if there is no single individual at that firm that directly violated such standards. Under an aggregation theory, all that is required for firm liability is that there are individuals that *collectively* violated the standard. Thus, if one individual at a firm knows that the disclosure materials for a security are untrue and another individual at that firm actually markets and sells the security (without such knowledge), then an enforcement authority could aggregate the one individual's knowledge with the others act of marketing and selling the security and take the position that the *firm* was in violation of securities law. This is true even though neither individual is in violation of securities law. In fact, this was a theory apparently employed by the U.S. government in several major crisis-era mortgage cases, and could offer a partial explanation for why in many cases firms agreed to accept liability for wrongdoing but no individuals were held liable. This corporate liability theory, however, stands on shaky legal ground and we urge enforcement authorities not to rely on it.

ii. The Government's Tools and the Challenges of Holding Individuals Accountable

Part II examines the investigative tools and powers that enforcement authorities have to identify and pursue suspected wrongdoers. We generally find that enforcement authorities have significant investigative tools available to them to identify bad actors and punish them whether they are individuals or firms.

With respect to investigative tools, for example, the DOJ, in criminal matters, can convene a grand jury, issue subpoenas for documents, records, property, electronic communications, and other information, compel witnesses to testify, and obtain warrants to search buildings and electronic devices, use confidential informants or cooperating witnesses, and conduct wiretap operations. Indeed, in recent years the DOJ has been very aggressive in seeking warrants to conduct wiretaps in insider trading cases against individuals. These investigative tools are generally the same if the DOJ is pursuing an individual or firm.

However, there are some challenges that enforcement authorities face when trying to establish cases against individuals relative to firms. First, from a substantive legal perspective, it can be easier to prove a case against a firm because, as discussed previously, the activities, knowledge, and intent of one of its employees can be attributed to the firm.

Second, certain non-legal factors may make it more difficult to hold individuals accountable. In particular, enforcement authorities face limits on their resources, and firms are more likely than individuals to settle and therefore permit the government to avoid facing a costly trial. Indeed, firms can be rationally motivated to settle matters that they do not believe result from actual wrongdoing to: minimize the distraction of management; avoid the reputational harm that could result from a prolonged trial; and quickly determine the financial cost of the matter for business planning purposes, especially given the unpredictable outcome of a litigated enforcement

action. Firms may also be more likely to settle because in criminal matters, no financial institution that we are aware of has survived a contested criminal conviction and in civil matters institutions wish to avoid litigating with their supervisory regulators. For these reasons, enforcement officials may find it more attractive to pursue a matter against a firm, settle, and move on to other matters.

In addition, enforcement authorities are subject to political pressure. Large settlements with firms that grab headlines may be a better use of resources from a political perspective than pursuing relatively unknown individuals. Indeed, in some instances, it may even be politically toxic to pursue low-level employees who did commit crimes or civil violations if the public could perceive that as the government punishing the “little guy” when a firm can pay a fine and continue to operate.

iii. U.S. Enforcement Authorities’ Emphasis on Individual Accountability

Part III describes the policies and public statements of government authorities regarding individual liability showing that enforcement authorities appear to understand the importance of individual accountability and have recently placed an added priority on it. This is important given the legal and non-legal factors that may make firm-level cases more attractive to enforcement authorities.

The DOJ, in particular, has modified its policies over time to leverage the threat of corporate liability to build cases against individuals. Beginning in the late 1990s, the DOJ made its first public statement that corporate liability was not a substitute for individual liability. The DOJ’s policies sought to incentivize corporations to cooperate with investigators and internally discipline wrongdoers. By doing so, corporations could face lighter penalties, and the effect would be a greater likelihood that the DOJ could uncover wrongdoing by specific individuals. Later the DOJ revised its policies to require DOJ lawyers to consider whether the prosecution of individuals would obviate the need to pursue a corporation, which again sought to incentivize a corporation to help identify the responsible individuals. In 2015, the DOJ made individual accountability its top priority by requiring that investigators focus on individuals at the inception of an investigation and establish plans for resolving cases against individuals before a case against a firm can be resolved.

Recent data indicate that enforcement actions against individuals are an important priority for enforcement authorities. For example, the percentage of SEC and CFTC cases with only firm defendants has declined from 60% in 2000 to roughly 40% in 2016. However, the DOJ does not publicly disclose useful information about the percentage of white collar criminal cases brought against firms as opposed to individuals. We therefore recommend that:

- **Recommendation 17:** The DOJ should publish annual statistics analyzing trends of criminal actions against financial professionals. Useful data would disclose the annual number of cases brought and average and median penalties imposed in categories of white-collar crimes committed by officers and directors of firms and gatekeepers such as lawyers and accountants.

iv. Promoting Individual Accountability

Given the importance of individual accountability to a credible enforcement system and the challenges authorities may face in executing their stated desires to hold culpable individuals accountable, we believe that it is appropriate to consider if there are ways to allow the government to bring and make more effective cases against culpable individuals.

We begin by exploring whether the legal standard for imposing liability on individuals should be lowered from intentional wrongdoing to a negligence or strict liability regime.

We first consider proposals that the U.S. adopt a liability regime similar to the U.K. Senior Manager’s Regime, which imposes personal liability on high-level officers and directors who act *negligently* in ensuring legal compliance within their firms. We are concerned that such an expansion of liability would encourage excessive government second-guessing of business decisions and could be an impediment to recruiting qualified officers and directors.

We also explore the possibility that existing government rules for clawbacks of executive compensation could be expanded to require companies’ boards of directors to clawback executive compensation if a firm pays monetary sanctions. Under such rules, the clawed back compensation would in effect offset some of the penalties paid by the firm, and thus the executives would directly bear some of the cost of the settlement.

Mandatory clawbacks would impose strict liability, an even lower bar than negligence, as clawbacks could be required even if the executive played no role or had no knowledge of the wrongdoing resulting in the settlement. We do not believe that the government should have additional powers to cause the forfeiture of compensation. First, doing so would pose the same problems identified in the U.K. Senior Manager’s Regime proposal. Second, clawback policies are inherently complex and the government is not well positioned to dictate terms. Clawback issues include: what compensation should be subject to clawback; what actions trigger a clawback; exactly what officers or directors should be subject to a clawback in a specific instance; and what discretion the board should have to waive its right to seek a clawback, among many others. Given the numerous details that must be worked out in each instance, we believe that shareholders and the board of directors should direct any clawback efforts. This would allow for a diversity of approaches across firms and experimentation rather than a top-down, one-size fits all approach.

Rather, we believe it is important to recognize the importance of efforts to develop and implement compliance programs that prevent individual wrongdoing and catch it when it does occur. Well-designed and implemented programs can increase compliance and result in faster detection and remediation of bad behavior. Yet, even when firms have sensible programs in place, they can face significant sanctions. Thus, firms are not fully incentivized to develop and implement such programs.

We also believe it is important that firms, investors, and consumers be able to identify individuals who have been punished for wrongdoing in the past, so they can avoid doing business with such persons if they so choose. Presently, a single database with the names and details of

financial professionals that have been held liable for criminal or civil sanctions for financial wrongdoing does not exist.¹⁷

We set forth two recommendations to enhance individual accountability:

- **Recommendation 18:** An affirmative compliance and cooperation defense should be established in the United States to further promote effective compliance programs and harness their strengths to help identify and prevent individual misconduct. A successful application of the defense should require that the firm establish that the compliance procedures meet a baseline of reasonableness; and the firm promptly, transparently, and wholly disclosed known violations and all non-privileged relevant information uncovered during an internal investigation or review.
- **Recommendation 19:** Enforcement authorities should coordinate to compile a single, publicly-available resource that aggregates information on final judgments or orders imposing criminal or civil sanctions against financial professionals and present it in a user-friendly format.

¹⁷ We are aware that those formally charged or convicted of a crime have a “rap sheet” that can be accessed as part of a background check. However, a “rap sheet” does not include civil enforcement matters. Moreover, a public database would make access to such information easier for those, like consumers, who may not run a formal background check on someone.

Chapter 1: Enhancing the Structure of the U.S. Enforcement System – Improving Coordination and Procedural Fairness

Chapter 1: Enhancing the Structure of the U.S. Enforcement System – Improving Coordination and Procedural Fairness

The U.S. public enforcement system is highly fragmented. Enforcement powers are delegated to numerous federal agencies and state government agencies, which are referred to throughout this Report as “**enforcement authorities.**” This decentralized structure creates the potential for investigations, enforcement actions, and sanctions by multiple enforcement authorities for the same underlying misconduct. The involvement of multiple enforcement authorities has the potential to result in inefficiency, uncertainty, and duplicative penalties if enforcement activities are not adequately coordinated. We find that coordination occurs largely on a case-by-case or ad hoc basis and believe that a more formal and standardized approach would better ensure adequate and effective coordination.

Part I of this chapter discusses how enforcement at the federal level is spread out among capital markets regulators, a consumer protection regulator, banking regulators, and the Department of Justice (“**DOJ**”). Part I also describes the role that states play in the U.S. enforcement system, using New York as an example. To provide a complete picture of the enforcement system, it also explores how authorities outside the U.S. government, specifically self-regulatory organizations (“**SROs**”) and foreign government authorities, also regulate and sanction misconduct, which adds even more complexity to the system.

Part II provides a taxonomy of situations in which multiple enforcement authorities could bring enforcement actions resulting from the same underlying misconduct because of the fragmentation of enforcement jurisdiction. It then discusses concerns that could potentially arise when multiple enforcement authorities are pursuing the same enforcement target.

Part III shows that enforcement authorities lack a standardized and transparent system to coordinate investigations and enforcement actions. Few statutes require enforcement authorities to coordinate with one another, and to the extent they do, the statutes are narrowly tailored and limited in scope. Publicly available individual agency policies suggest that to the extent enforcement authorities coordinate their activities, they appear to do so largely on an ad hoc or case-by-case basis. Part III sets forth recommendations aimed at formalizing and standardizing the coordination process to ameliorate issues that have the potential to arise from the fragmented enforcement structure.

Part IV concludes the chapter by examining an issue of procedural fairness – namely, the ability of the Securities and Exchange Commission (“**SEC**”), Commodity Futures Trading Commission (“**CFTC**”), and Consumer Financial Protection Bureau (“**CFPB**”) to unilaterally choose whether to bring an enforcement proceeding in federal court or before an administrative law judge. We set forth a recommendation to alleviate fairness concerns.

I. Fragmented Structure of the U.S. Enforcement System

To begin our overview of the structure of the U.S. enforcement system, it is helpful to visualize the dispersion of enforcement responsibilities among various enforcement authorities with jurisdiction over laws governing U.S. capital markets and the financial system. **Table 1.1**, below, provides a high-level summary of the jurisdiction of enforcement authorities. The table sets forth examples of (a) the major areas of law that each agency oversees and enforces and (b) the types of individuals and entities that could be subject to each agency’s enforcement jurisdiction.

Table 1.1: Summary of Enforcement System Structure

Enforcement Authority	Examples of the Areas of Law Enforced	Examples of the Types of Individuals and Entities Subject to Enforcement
Federal Securities Regulators		
Securities and Exchange Commission (“SEC”)	Offerings of securities; disclosure by publicly held companies; trading in securities; functioning of national securities markets; independence of public company auditors; activities of investment companies and investment advisers	Publicly held companies; corporate insiders such as officers and directors; open- and closed-end mutual funds; broker-dealers; investment advisers; auditing firms; securities exchanges; anyone trading a security
Commodity Futures Trading Commission (“CFTC”)	Commodities futures and options markets and over-the-counter derivatives	Futures commission merchants; floor traders; commodity pool operators; commodity trading advisers; swap dealers; anyone trading a commodities future or option
Federal Consumer Financial Protection Regulator		
Consumer Financial Protection Bureau (“CFPB”)	Offering, sale and providing of consumer financial products like mortgages, credit cards, payday loans, credit scores; truth in lending and savings; debt collection practices; credit reporting practices	Banks; payday lenders; mortgage brokers; credit reporting agencies; prepaid card merchants; debt collectors; credit card companies; commercial companies providing consumer financing
Federal Regulators of Trade Restrictions, Money Laundering, and Terrorist Financing		
Office of Foreign Assets Control (“OFAC”) (part of Treasury)	U.S. trade restrictions and sanctions against persons, firms, and countries	Anyone engaged in commercial activities or transfer of assets with a person, country or company subject to trade restrictions
Financial Crimes Enforcement Network (“FinCEN”) (part of Treasury)	Money laundering and terrorist financing	Banks; broker-dealers; asset managers; any person or business receiving coins or currency of more than \$10,000

COMMITTEE ON CAPITAL MARKETS REGULATION

Enforcement Authority	Examples of the Areas of Law Enforced	Examples of the Types of Individuals and Entities Subject to Enforcement
Federal Banking Regulators		
Office of the Comptroller of the Currency (“OCC”) (part of Treasury with semi-independence)	Organization of nationally chartered banks and savings associations; capital requirements, safety and soundness rules, and self-dealing restrictions applicable to such institutions	Federally chartered banks and savings associations and their officers, directors, employees, and controlling shareholders
Federal Reserve (“Fed”)	Capital requirements of bank holding companies and state-chartered member banks; self-dealing restrictions, laws governing mergers and acquisitions, and safety and soundness rules applicable to such institutions	Bank holding companies (including those with assets greater than \$50 billion, which are subject to enhanced prudential and supervisory standards); state-chartered banks that elect to be member banks of the Federal Reserve System; officers, directors, employees, and controlling shareholders of such institutions
Federal Deposit Insurance Corporation (“FDIC”)	Capital requirements of federally insured depository institutions; safety and soundness rules, self-dealing restrictions, and laws governing mergers and acquisitions applicable to such institutions	Depository institutions with federally insured deposits; officers, directors, and controlling shareholders of such institutions
National Credit Union Administration (“NCUA”)	Organization and governance of federally chartered credit unions; capital requirements; safety and soundness rules, self-dealing restrictions, and laws governing mergers and acquisitions applicable to such institutions	Federally chartered credit unions and credit unions with federally insured deposits; officers, directors, and controlling shareholders of such institutions
Federal Criminal Regulator		
Department of Justice (“DOJ”)	All federal criminal laws, including wire fraud, bank fraud, conspiracy, racketeering, market manipulation, insider trading; civil laws governing false claims to the federal government; civil laws governing misconduct that affects financial institutions	Any person and any entity
State Regulators		
State governments	Consumer protection laws; state banking and insurance laws; anti-fraud and false advertising laws	Any person or entity selling, offering or providing financial consumer products or services; banks; broker-dealers; lenders; mortgage brokers; asset managers; financial planners

As **Table 1.1** demonstrates, there are ten key federal agencies that police the U.S. capital markets and financial system,¹ as well as enforcement authorities from each of the 50 states. The following section sets forth the responsibilities and jurisdictions of these enforcement authorities.

A. Division of Federal Enforcement Powers Among Federal Enforcement Authorities

At the federal level, enforcement jurisdiction is determined based on two factors: (1) whether the case being brought is civil or criminal; and (2) if it is civil, then the enforcement authorities to which Congress has delegated enforcement powers.

The primary differences between criminal enforcement and civil enforcement are that: (1) criminal convictions can lead to imprisonment for individuals;² (2) in criminal cases, prosecutors must meet a higher burden of proof; and (3) criminal statutes often require the government to prove a higher level of intent.

With respect to the burden of proof, in a criminal case, the government must prove its case beyond a reasonable doubt.³ In contrast, civil enforcement actions are subject to a lower burden of proof, usually requiring the government to prove its case only by a preponderance of the evidence (i.e., more likely than not).⁴ Criminal violations also frequently require the government to establish a higher level of *intent* than civil violations. For example, the Securities Exchange Act of 1934, as amended, including by the Sarbanes-Oxley Act (the “**Exchange Act**”), allows the SEC to seek civil monetary penalties for certain violations of its provisions regardless of intent.⁵ By contrast, for criminal penalties to be imposed, the violation of the Exchange Act must be willful.⁶

The DOJ has the sole federal authority to bring criminal actions, as Congress has delegated criminal litigation authority exclusively to the DOJ.⁷ In civil cases, Congress has granted civil enforcement powers to a plethora of enforcement authorities based on the law being enforced. For

¹ Other federal authorities may also be involved in enforcement matters relevant to financial markets on a less regular basis, and are not a focus of this Report, such as the Department of Labor or the Federal Energy Regulatory Commission.

² See generally U.S. SENTENCING GUIDELINES MANUAL (2016), <https://www.ussc.gov/sites/default/files/pdf/guidelines-manual/2016/GLMFull.pdf>.

³ *In re Winship*, 397 U.S. 358, 364 (1970) (“Lest there remain any doubt about the constitutional standard of the reasonable-doubt standard, we explicitly hold that the Due Process Clause protects the accused against conviction except upon proof beyond a reasonable doubt of every fact necessary to constitute the crime with which he is charged.”).

⁴ See, e.g., *Steadman v. SEC*, 350 U.S. 91, 104 (1981) (SEC proceedings subject to preponderance of the evidence standard); *Haltmier v. CFTC*, 554 F.2d 556, 560 (2d Cir. 1977) (CFTC burden of proof is preponderance of the evidence); 12 U.S.C. § 1833a(f) (FIRREA statute explicitly establishing the preponderance of the evidence standard as the burden of proof); 31 U.S.C. § 3731(c) (FCA burden of proof is preponderance of the evidence). Congress can choose to impose a higher burden of proof in civil matters if it so desires.

⁵ 15 U.S.C. § 78u(d).

⁶ *Id.* § 78ff(a).

⁷ 28 U.S.C. §§ 516, 519.

instance, the Securities Act of 1933 (“**Securities Act**”) grants the SEC the sole authority to bring a civil enforcement action to stop potential violations of the Securities Act and impose civil penalties.⁸ For a *criminal* violation of the same statutory provisions, however, it is the DOJ that brings criminal charges.⁹

We proceed by describing the jurisdiction of federal enforcement authorities to bring civil cases in the areas of capital markets, consumer financial protection, banking, and international transactions and money flows. We then discuss the DOJ’s enforcement jurisdiction, including its criminal enforcement authority and two key civil statutes that it enforces.

1. Capital Markets Enforcement Authorities

The SEC and CFTC are the regulators and enforcement authorities responsible for enforcing laws to protect investors and ensure the fair and efficient functioning of capital markets and commodities markets.

i. The SEC

The SEC is an independent agency that was established in 1934, which administers and enforces federal securities laws to “protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.”¹⁰ In the fiscal year ended September 30, 2017, the SEC brought over 750 enforcement actions and obtained orders for civil monetary penalties and disgorgement of ill-gotten gains of more than \$3.7 billion.¹¹ The SEC has an enforcement staff of approximately 1,400.¹² The SEC regulates equity markets with market capitalization of over \$25 trillion,¹³ mutual funds and exchange traded funds with over \$22 trillion in assets under management,¹⁴ and over 3,800 broker-dealer firms and 600,000 of their representatives.¹⁵

The SEC primarily oversees and enforces four different statutory schemes governing the securities markets, as they have been amended over the years. These are the Securities Act of

⁸ 15 U.S.C. §§ 77h, 77t.

⁹ Simultaneous or parallel civil and criminal enforcement actions are not uncommon and have been ruled to be lawful by the U.S. Supreme Court. *See* United States v. Kordel, 397 U.S. 1, 10 (1970). The securities laws only grant the SEC authority to bring a case to seek the civil remedies provided for under the securities laws. *See, e.g.*, 15 U.S.C. § 77t(d) (“Whenever it shall appear to the *Commission* that any person has violated any provision of this subchapter, the rules or regulations thereunder . . . , the *Commission* may bring an action”) (emphasis added).

¹⁰ JOHN C. COFFEE, JR. ET AL., SECURITIES REGULATION: CASES AND MATERIALS 58 (13th ed. 2015).

¹¹ U.S. SEC. & EXCH. COMM’N DIV. OF ENFORCEMENT, ANNUAL REPORT: A LOOK BACK AT FISCAL YEAR 2017 AT 3, <https://www.sec.gov/files/enforcement-annual-report-2017.pdf>.

¹² *Id.* at 3; U.S. SEC. & EXCH. COMM’N, FISCAL YEAR 2019 CONGRESSIONAL BUDGET JUSTIFICATION 15 (2018), <https://www.sec.gov/files/secfy19congbudgjust.pdf>.

¹³ *Largest stock exchange operators worldwide as of April 2017 by market capitalization of listed companies (in trillion U.S. dollars)*, STATISTA, <https://www.statista.com/statistics/270126/largest-stock-exchange-operators-by-market-capitalization-of-listed-companies/> (last visited May 31, 2018).

¹⁴ INV. CO. INST., *Chapter Two: US-Registered Investment Companies*, 2018 INVESTMENT COMPANY FACT BOOK 35, https://www.ici.org/pdf/2018_factbook.pdf.

¹⁵ SIFMA Research Dep’t, 2017 FACT BOOK 7 (2017), <https://www.sifma.org/wp-content/uploads/2016/10/US-Fact-Book-2017-SIFMA.pdf>.

1933,¹⁶ the Exchange Act of 1934,¹⁷ the Investment Company Act of 1940 (“**Investment Company Act**”),¹⁸ and the Investment Advisers Act of 1940 (“**Advisers Act**”).¹⁹

These statutory schemes grant the SEC vast regulatory and enforcement power over the offer and sale of securities,²⁰ the ongoing reporting obligations of publicly held companies,²¹ the registration and activities of broker-dealers,²² the functioning of the securities exchanges,²³ the qualifications and conduct of public company auditing firms,²⁴ the registration, governance and operation of investment companies such as open-end and closed-end mutual funds,²⁵ and the registration, practices and compensation of investment advisers (i.e., money managers, investment consultants and financial planners²⁶), among many other things.²⁷

ii. The CFTC

The CFTC is an independent agency that was established in 1974 and administers the Commodity Exchange Act of 1974, (“**CEA**”) which regulates commodities, futures, options and over-the-counter derivatives.²⁸ The mission of the CFTC is to “foster open, transparent, competitive, and financially sound markets, to avoid systemic risk, and to protect the market users and their funds, consumers, and the public from fraud, manipulation and abusive practices related to derivatives and other products that are subject to the CEA.”²⁹

According to the CFTC, the agency regulates markets of over 40 physical commodities, 3,000 actively traded futures and options contracts, almost \$275 billion in customer funds, nearly 4,000 commodity trading advisors and commodity pool operators, and the over \$350 trillion notional swaps market.³⁰ In fiscal 2017, the CFTC brought 49 enforcement actions and imposed

¹⁶ 15 U.S.C. §§ 77a *et seq.*

¹⁷ *Id.* §§ 78a *et seq.*

¹⁸ *Id.* §§ 80a-1 *et seq.*

¹⁹ *Id.* §§ 80b-1 *et seq.*

²⁰ *See, e.g., id.* §§ 77e, 77g, 77aa, 77j.

²¹ *Id.* § 78l.

²² *See, e.g., id.* § 78o.

²³ *Id.* § 78f.

²⁴ *Id.* § 78j-1(g), (l).

²⁵ *Id.* §§ 80a-1 *et seq.*

²⁶ *Id.* §§ 80b-1 *et seq.*; STAFF OF THE INV. ADVISER REGULATION OFF., DIV. OF INV. MGMT., U.S. SEC. & EXCH. COMM’N, REGULATION OF INVESTMENT ADVISERS BY THE U.S. SECURITIES AND EXCHANGE COMMISSION 1 (Mar. 2013), https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf.

²⁷ *See generally* Coffee, Jr. *et al.*, *supra* note 10.

²⁸ RENA S. MILLER, CONG. RESEARCH SERV., R43117, THE COMMODITY FUTURES TRADING COMMISSION: BACKGROUND AND CURRENT ISSUES 1 (2013); 7 U.S.C. §§ 1 *et seq.*

²⁹ Commodity Futures Trading Comm’n, *Mission & Responsibilities*, <http://www.cftc.gov/About/MissionResponsibilities/index.htm> (last visited Dec. 20, 2016).

³⁰ COMMODITY FUTURES TRADING COMM’N, BUDGET REQUEST FISCAL YEAR 2019 3, 43-47 (Feb 2018).

more than \$430 million in monetary sanctions.³¹ The CFTC has an enforcement staff of approximately 170.³²

The CFTC pursues its mission by administering the CEA through overseeing and enforcing: (a) registration requirements for industry firms such as commission merchants, floor traders, commodity pool operators, swap dealers, and commodity trading advisers;³³ (b) trading requirements;³⁴ (c) anti-fraud and anti-manipulation prohibitions;³⁵ and (d) other rules governing market integrity.³⁶

2. Consumer Financial Protection – The CFPB

The CFPB was created by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“**Dodd-Frank Act**”) as an independent bureau within the Federal Reserve System.³⁷ Its mission is to “implement and . . . enforce Federal consumer financial law,” to protect consumers from “unfair, deceptive, or abusive acts and practices and from discrimination,” and to ensure “that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent and competitive.”³⁸

The CFPB’s enforcement authority applies to two categories of laws: (1) laws created by the Dodd-Frank Act regarding unfair and deceptive practices by those offering, selling or

³¹ Press Release, Commodity Futures Trading Comm’n, CFTC Releases Annual Enforcement Results for Fiscal Year 2017 (Nov. 22, 2017), <https://www.cftc.gov/PressRoom/PressReleases/pr7650-17>.

³² COMMODITY FUTURES TRADING COMM’N, BUDGET REQUEST FISCAL YEAR 2019 at 1 (2018), <https://www.cftc.gov/sites/default/files/idc/groups/public/documents/file/cftcbudget2019.pdf>.

³³ 7 U.S.C. §§ 6d(a), 6e, 6m. A futures commission merchant is an individual or entity that engages in soliciting or accepting orders for the purchase or sale of a commodity future delivery, security future product, a swap, a commodity option and certain other transactions. *Id.* § 1a(28). A floor trader is a person who in or around a trading pit or post, purchases or sells solely for his own account any commodity future delivery, security future product or swap. *Id.* § 1a(23). A commodity pool operator is engaged in the business in the nature of a commodity pool, investment trust or syndicate who, in connection with that business solicits, accepts, or receives from others, funds, securities or property for the purpose of trading in commodity interest. *Id.* § 1a(11). A commodity trading advisor is someone who for compensation engages in the business of advising others as to the value or advisability of trading in, among other things, a contract of sale of a commodity for future delivery, securities future product, or swap, or commodity option. *Id.* § 1a(12).

³⁴ *Id.* § 2(a) (requiring that security futures products be sold on or subject to the rules of a board of trade and that the board of trade meet certain requirements, including that trading in the security futures product not be readily susceptible to manipulation and that the exchange has procedures in place to detect manipulation and insider trading); *Id.* § 7 (requiring that for a board of trade to be designated as a contract market it must meet certain core principles, including: establishing, monitoring and enforcing compliance with rules of the contract market; preventing manipulation, price distortion and disruptions of the delivery of cash-settlement process through market surveillance, compliance and enforcement practices; establishing and enforcing speculative position limits or positions).

³⁵ *See, e.g., id.* §§ 6b(a), (e).

³⁶ *See id.* § 6c (prohibiting, among other things, wash sales, fictitious sales and any transaction that is used to cause any price to be reported that is not a true and bona fide price). *See also* Miller, *supra* note 28, at 1.

³⁷ 12 U.S.C. § 5491.

³⁸ *Id.* § 5511(a), (b)(2). The statute does not define a “consumer financial law”.

providing consumer financial products;³⁹ and (2) existing federal laws governing protection of consumers of financial products and services that Dodd-Frank consolidated under the CFPB’s authority.⁴⁰ For example, the CFPB enforces laws regulating the credit card industry, which has nearly \$1 trillion in balances.⁴¹ The agency also oversees the approximately \$46 billion payday lending industry.⁴² The CFPB has reported that it has provided over \$11 billion in relief to consumers resulting from its enforcement activities.⁴³ The CFPB has an enforcement staff of approximately 750.⁴⁴

3. *Banking and Credit Union Regulators (OCC, Fed, FDIC, and NCUA)*

The OCC, Fed, FDIC, and NCUA (collectively, the “**banking regulators**”) oversee and enforce laws pertaining to the banking operations of depository institutions and their affiliates, such as commercial banks, bank holding companies, savings associations, thrifts and credit unions.

The banking regulators’ primary function is to ensure the safety and soundness of the banking institutions that they oversee. Each banking regulator is therefore empowered to conduct comprehensive examinations, including examination of the financial health of each bank and soundness of operations, its compliance with applicable laws, the security of its infrastructure and

³⁹ The CFPB generally has the authority to regulate individuals and entities that engage in offering or providing a “consumer financial product or service.” *Id.* § 5481(6). The law defines a consumer financial product or service as one “offered or provided for use by consumers primarily for personal, family, or household purposes.” *Id.* § 5481(5). Those financial products and services include, among other things, extending credit and loan services; real estate settlement services and appraisals of real estate and personal property; taking deposits, transmitting or exchanging funds or acting as a custodian of funds; selling or issuing prepaid cards or other payment instruments over which the seller has substantial control; providing check cashing, check collection or check guaranty services; providing payment or financial data processing products or services to a consumer; financial advisory services; consumer credit reporting services; and debt collection related to any consumer financial product or service. *Id.* § 5481(15). With respect to those persons, the CFPB is tasked with enforcing the law that makes it unlawful for them to commit or engage in “an unfair, deceptive, or abusive act or practice.” *Id.* §§ 5531(a), 5536. While Congress provided definitions of what constitute unfair practices and abusive practices, the statute does not define what a deceptive practice is, thus leaving the CFPB with substantial discretion. *Id.* § 5531(c), (d).

⁴⁰ The Dodd-Frank Act consolidated oversight and enforcement of previously existing federal statutes and rules aimed at protecting consumers from an array of federal agencies, including the Fed, the OCC, the FDIC, the Office of Thrift Supervision, the National Credit Union Administration (“**NCUA**”) the Federal Trade Commission (“**FTC**”) and the Department of Housing and Urban Development (“**HUD**”). *Id.* § 5581. The laws consolidated under the CFPB’s jurisdiction included the Truth in Lending Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, the Truth in Savings Act, the Real Estate Settlement Procedures Act, among others. *See id.* §§ 5481(12), 5581.

⁴¹ CONS. FIN. PROT. BUREAU, *THE CONSUMER CREDIT CARD MARKET* 31 (2017).

⁴² Stacy Cowley, *Payday Lending Faces Tough New Restrictions by Consumer Agency*, N.Y. TIMES (Oct. 5, 2017), <https://www.nytimes.com/2017/10/05/business/payday-loans-cfpb.html>.

⁴³ CONS. FIN. PROT. BUREAU, *CONSUMER FINANCIAL PROTECTION BUREAU: BY THE NUMBERS* (2017), https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201707_cfpb_by-the-numbers.pdf.

⁴⁴ CONS. FIN. PROTECTION BUREAU, *CFPB STRATEGIC PLAN, BUDGET, AND PERFORMANCE PLAN AND REPORT 19* (2017), http://files.consumerfinance.gov/f/documents/201705_cfpb_report_strategic-plan-budget-and-performance-plan_FY2017.pdf.

the bank’s risk management system.⁴⁵ They also enforce self-dealing restrictions,⁴⁶ regulate who can serve as a director, officer or influential shareholder of federally insured banks,⁴⁷ and have authority to penalize any federally insured bank or credit union for any violation of law.⁴⁸ While the SEC, CFTC, and CFPB have divisions or offices of enforcement clearly delineated in their organizational structure, the banking regulators do not have stand-alone enforcement divisions.⁴⁹ And unlike the SEC, CFTC, and CFPB, the banking regulators do not publicly disclose the number of staff devoted to enforcement activities.

i. The OCC

A bank or savings association can be organized under the laws of a state or the federal government. The OCC oversees and enforces banking laws and rules governing a bank or savings association that chooses to be chartered at the federal level.⁵⁰ The OCC is the primary regulator of over 1,400 institutions with \$12 trillion in assets.⁵¹

ii. The Fed

The Fed is responsible for enforcing federal law and regulations pertaining to bank holding companies, which are companies that have control over any bank.⁵² Under the Dodd-Frank Act,

⁴⁵ 12 U.S.C. §§ 481 (OCC authority to examine federally chartered banks), 325 (Fed power to examine member banks), 1820 (FDIC authority for examination of federally insured banks). *See also* Luigi De Ghenghi et al., *United States*, in *THE BANKING REG. REV.* 868, 872 (4th ed., 2013) (discussing the contents of a bank examination); Bd. of Governors of the Fed. Res. Sys., *Supervisory Policy and Guidance Topics*, https://www.federalreserve.gov/bankinforeg/topics/exam_n_supervision.htm (discussing Fed’s examination topics).

⁴⁶ *See* 12 U.S.C. §§ 371c, 371c-1, 375a, 375b, 1468(a)–(b), 504, 1828(j), 1828(z).

⁴⁷ *See, e.g., id.* § 1818(e).

⁴⁸ *Id.* §§ 1818(i), 1786.

⁴⁹ *See* Div. of Enforcement, *About the Division*, U.S. SEC. & EXCH. COMM’N, <https://www.sec.gov/enforce> (last modified Apr. 14, 2015); *Division of Enforcement*, COMMODITY FUTURES TRADING COMM’N, <http://www.cftc.gov/lawregulation/enforcement/index.htm> (last visited May 18, 2018); *Supervision, Enforcement & Fair Lending*, CONS. FIN. PROT. BUREAU, <http://www.consumerfinance.gov/about-us/supervision-enforcement-fair-lending/> (last visited May 18, 2018); *See* Office of the Comp. of the Currency, *About the Legal Division*, U.S. DEP’T OF THE TREASURY, <https://www.occ.gov/topics/laws-regulations/about-legal.html> (last visited May 18, 2018); *Organization Directory and Office Contacts*, FED. DEPOSIT INS. CORP., <https://www.fdic.gov/about/contact/directory/> (last updated May 15, 2018); Org. Chart, Bd. of Governors of the Fed. Res. Sys., Legal Division (Jan. 1, 2018), <https://www.federalreserve.gov/aboutthefed/files/LEGAL-org-chart.pdf>. More specifically, the OCC’s Enforcement & Compliance Division is placed within the Chief Counsel’s Office and the Chief Counsel works with the Comptroller of the Currency who heads the OCC. At the FDIC, enforcement falls within the Supervision & Legislation Branch of the Legal Division, which reports to the FDIC Chair (through the General Counsel), one of five board members who run the FDIC, as well as within the Division of Depositor and Consumer Protection, which also reports to the FDIC char. Finally, at the Fed, enforcement offices rest within the Legal Division, the Division of Supervision and Regulation and the Division of Consumer and Community Affairs, with the head of each Division reporting to the seven-member Board of Governors that manages the Fed.

⁵⁰ 12 U.S.C. §§ 1-16, 21-216d (national banks regulated and overseen by the OCC), 1461–70 (federal savings associations regulated and overseen by the OCC).

⁵¹ 2017 OFF. OF THE COMPTROLLER OF THE CURRENCY ANN. REP. 8, <https://www.occ.gov/annual-report/download-the-full-report/2017-annual-report.pdf>.

⁵² 12 U.S.C. §§ 1841–52.

the Fed also has regulatory oversight responsibilities for nonbank systemically important financial institutions.⁵³ The Fed also oversees, regulates, and brings enforcement actions against state chartered banks that elect to become members of the Federal Reserve System.⁵⁴ The Fed is the primary regulator of state chartered member banks with assets of over \$2.5 trillion and bank holding companies with assets of more than \$18 trillion.⁵⁵

iii. The FDIC

The FDIC has oversight and enforcement jurisdiction over banking institutions that have customer deposits insured by the FDIC. If the institution is not already regulated by the OCC or Fed, then the FDIC serves as the sole federal banking regulator of the institution. However, for institutions already subject to OCC or Fed oversight, the OCC and Fed generally enforce the safety and soundness requirements imposed by the depository insurance laws that the FDIC otherwise administers.⁵⁶ The FDIC regulates federally insured institutions with assets of over \$17.5 trillion.⁵⁷

iv. The NCUA

Credit unions are member-owned cooperative associations that take deposits and provide credit.⁵⁸ However, credit unions are not subject to oversight by the OCC, FDIC or Fed, instead they are regulated by the NCUA.

The NCUA can have regulatory authority over a credit union in two ways. First, the NCUA has authority to regulate federally chartered credit unions.⁵⁹ Second, if a credit union has federally insured member deposits, then the NCUA has regulatory authority over the credit union.⁶⁰ The NCUA regulatory regime includes supervision and examination,⁶¹ self-dealing restrictions,⁶² safety and soundness reviews,⁶³ and oversight of credit union officers and directors.⁶⁴ The NCUA regulates over 5,500 credit unions with \$1.4 trillion in assets.⁶⁵

⁵³ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 113(a), 124 Stat. 1398 (2010).

⁵⁴ 12 U.S.C. §§ 321–339a.

⁵⁵ 2016 BD. OF GOVERNORS OF THE FED. RES. SYS. ANN. REP., SUPERVISION AND REGULATION, <https://www.federalreserve.gov/publications/2016-ar-supervision-and-regulation.htm>.

⁵⁶ 12 U.S.C. §§ 1811–35a. Though the FDIC does retain some enforcement powers. For example, the FDIC can terminate the insurance of an institution for engaging in unsafe or unsound practices, and issue a cease-and-desist order for false or misleading advertising about the insured status of an institution. *Id.* §§ 1818(a)(2), (c)(4).

⁵⁷ FED. DEPOSIT INS. CORP., STATISTICS AT A GLANCE (2018), <https://www.fdic.gov/bank/statistical/stats/2018mar/industry.pdf>.

⁵⁸ 12 U.S.C. § 1752; Nat'l Credit Union Admin., *What Is A Credit Union?*, <http://www.mycreditunion.gov/about-credit-unions/Pages/How-is-a-Credit-Union-Different-than-a-Bank.aspx> (last visited Dec. 20, 2016).

⁵⁹ 12 U.S.C. §§ 1752–75.

⁶⁰ *Id.* §§ 1781–90e.

⁶¹ *Id.* § 1756.

⁶² *Id.* § 1757a.

⁶³ *Id.* § 1784.

⁶⁴ *Id.* §§ 1785, 1786.

⁶⁵ NATIONAL CREDIT UNION ADMIN., INDUSTRY AT A GLANCE (2017), <https://www.ncua.gov/analysis/Pages/industry/industry-at-a-glance-december-2017.pdf>.

4. *Trade Restrictions, Money Laundering, and Terrorist Financing – FinCEN and OFAC*

Another important aspect of the U.S. financial system is the regulation of international transactions and the flow of capital across national borders. The Treasury Department has been tasked with implementing, administering and enforcing the U.S. anti-money and counterterrorism financing laws, as well as the laws governing U.S. sanctions, trade restrictions, and embargoes against foreign persons and countries. It does so through two bureaus in the department, FinCEN and OFAC.

i. FinCEN

The Financial Crimes Enforcement Network, commonly referred to as FinCEN, was established in 1990 as a bureau within the Treasury whose Director is appointed by the Secretary of the Treasury.⁶⁶ The Secretary of the Treasury has delegated authority to FinCEN to implement, administer and enforce the Bank Secrecy Act (“BSA”).⁶⁷ The BSA imposes two major sets of requirements on individuals and entities subject to its provisions aimed at preventing and detecting money laundering. First, the BSA imposes reporting requirements related to certain transactions involving the transfer of money, currency or coins across international boundaries.⁶⁸ Second, it requires financial institutions to establish anti-money laundering programs.⁶⁹

FinCEN enforces the BSA’s statutory provisions and rules, which apply to over 100,000 banks, credit unions, money services businesses, insurance companies, securities brokers, mutual funds, precious metal dealers and other financial institutions.⁷⁰ FinCEN has imposed more than \$100 million in aggregate penalties in a calendar year four times since 2010.⁷¹

ii. OFAC

The second office of the Treasury that enforces laws relevant to the capital markets and the financial system is the Office of Assets Control (“OFAC”). OFAC “administers and enforces economic sanctions programs” against countries and groups of individuals, such as terrorists and

⁶⁶ 31 U.S.C. § 310; Fin. Crimes Enf’t Network, *What We Do*, U.S. Dep’t of the Treasury, <https://www.FinCEN.gov/what-we-do> (last visited May 18, 2018).

⁶⁷ U.S. DEP’T OF THE TREASURY, TREASURY ORDER 180-01, FINANCIAL CRIMES ENFORCEMENT NETWORK (July 1, 2014).

⁶⁸ *See, e.g.*, 31 U.S.C. §§ 5313 (requiring U.S. financial institutions involved in a transaction involving the payment of more than \$10,000 to file a report with FinCEN), 5314 (requiring reporting when currency is physically shipped into or out of the United States), 5318 (requiring financial institutions to report suspicious transactions), 5331 (requiring any individual or entity engaged in a trade or business to report receipt of more than \$10,000 in a single or related transactions).

⁶⁹ *See, e.g., id.* § 5318.

⁷⁰ 2010 FIN. CRIMES ENFORCEMENT NETWORK ANN. REP. i.

⁷¹ Kathleen A. Nandan & Kyle R. Bahr, *FinCEN Enforcement Trends: 2015 Year in Review*, REED SMITH LLP (Mar. 28, 2016), <https://www.reedsmith.com/FinCEN-Enforcement-Trends-2015-Year-in-Review-03-28-2016/>.

narcotics traffickers.⁷² OFAC was created in 1950 when President Truman imposed sanctions on Chinese and North Korean assets subject to U.S. jurisdiction.⁷³

OFAC oversees the enforcement of trade restrictions and sanctions related to Russia, Somalia, North Korea, Libya, Iraq, Cuba, Belarus, and other nations.⁷⁴ In addition, it enforces sanctions on groups of individuals involved in terrorism and cyber-related economic and industrial espionage.⁷⁵ OFAC imposes penalties for violations of sanctions, with total penalties in recent years ranging from \$21 million in calendar year 2016 to \$1 billion in calendar year 2014. The calendar 2017 total was approximately \$120 million.⁷⁶

5. DOJ Enforcement

The DOJ is the *only* federal enforcement authority that has criminal enforcement powers. The DOJ also retains civil enforcement authority over laws that have not been delegated to another agency. Two civil statutes that the DOJ enforces are of particular importance in the context of the U.S. financial system: (1) the False Claims Act and (2) the Financial Institutions Reform, Recovery and Enforcement Act of 1989. We first discuss the DOJ's exclusive federal criminal enforcement power and then explore DOJ's civil enforcement authority.

i. DOJ Criminal Enforcement

Participants in the U.S. capital markets and financial system who commit criminal violations of federal law are subject to criminal proceedings that are exclusively brought by the DOJ.⁷⁷ Indeed, the DOJ's website has listed financial fraud as one of its top enforcement priorities.⁷⁸ That includes corporate fraud, such as the falsification of financial information (e.g., false accounting entries or misrepresentation of financial condition) and self-dealing by corporate insiders (e.g., insider trading and misuse of corporate property).⁷⁹ It also includes securities and commodities fraud, including Ponzi and pyramid schemes, embezzlement of clients' money and

⁷² *OFAC FAQs: General Questions*, U.S. DEP'T OF THE TREASURY, https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_general.aspx (last visited May 18, 2018).

⁷³ *Id.*

⁷⁴ *Sanctions Programs and Country Information*, U.S. DEP'T OF THE TREASURY, <https://www.treasury.gov/resource-center/sanctions/Programs/Pages/Programs.aspx> (last visited May 18, 2018).

⁷⁵ *Counter Terrorism Sanctions*, U.S. DEP'T OF THE TREASURY, <https://www.treasury.gov/resource-center/sanctions/Programs/pages/terror.aspx> (last visited May 18, 2018); *Sanctions Related to Significant Malicious Cyber-Enabled Activities*, U.S. DEP'T OF THE TREASURY, <https://www.treasury.gov/resource-center/sanctions/Programs/pages/cyber.aspx> (last visited May 18, 2018); 50 U.S.C. § 1708.

⁷⁶ *Civil Penalties and Enforcement Information: 2017 Enforcement Information*, U.S. DEP'T OF THE TREASURY, <https://www.treasury.gov/resource-center/sanctions/CivPen/Pages/civpen-index2.aspx> (last visited January 29, 2018).

⁷⁷ 28 U.S.C. § 516 (DOJ granted authority to bring criminal cases); U.S. Dep't of Justice, *U.S. Department of Justice Overview*, <https://www.justice.gov/sites/default/files/jmd/legacy/2014/06/21/overview.pdf> (last visited May 18, 2018).

⁷⁸ *Priority Areas*, U.S. DEP'T OF JUSTICE, <https://www.justice.gov/usao/priority-areas> (last visited Dec. 20, 2016).

⁷⁹ *White-Collar Crime*, FED. BUREAU OF INV., <https://www.fbi.gov/investigate/white-collar-crime> (last visited May 18, 2018).

market manipulation.⁸⁰ The table below provides summary statistics about the DOJ’s criminal fraud section.⁸¹

Table 1.2: Summary Statistics on DOJ Criminal Fraud Section

Summary Statistic (2017)	Number
Prosecutors	140
Charges Against Individuals	301
Corporate Criminal Enforcement Actions	10
Criminal Fines Obtained	\$4.6 billion

ii. DOJ Civil Enforcement Powers Under FIRREA and FCA

The DOJ retains exclusive authority to enforce laws where enforcement is not delegated to the other agencies. In the aftermath of the 2007-2008 financial crisis, the DOJ has aggressively enforced two statutes giving rise to civil claims: The False Claims Act (“FCA”)⁸² and the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (“FIRREA”).⁸³ We describe each statute below, then provide information about the DOJ’s FCA and FIRREA enforcement activity.

a. The FCA

The FCA, first adopted during the Civil War in 1863 and known as “Lincoln’s Law,” is the federal government’s primary tool to seek redress for fraud committed against the federal government, its agencies, and their programs.⁸⁴ The FCA creates liability against an individual or entity that, among other things knowingly makes a false or fraudulent claim for payment or approval from the government.⁸⁵ The Attorney General, and thus the DOJ, is authorized by the statute to enforce the FCA’s liability provisions.⁸⁶

b. FIRREA Civil Penalties Provision

FIRREA was passed in the late 1980s in response to the savings and loan crisis.⁸⁷ The purpose of FIRREA was “to reform, recapitalize, and consolidate the Federal deposit insurance

⁸⁰ *Id.*

⁸¹ DOJ FRAUD SEC. YEAR IN REV. 2017 (2017), <https://www.justice.gov/criminal-fraud/file/1026996/download>.

⁸² 31 U.S.C. §§ 3729–33.

⁸³ 12 U.S.C. § 1833a.

⁸⁴ *Financial Institutions in the Crosshairs: The False Claims Act and FIRREA*, GIBSON DUNN (Oct. 2, 2013), <http://www.gibsondunn.com/publications/Documents/FinancialInstitutionsInCrosshairs-webcast-October2013.pdf>.

⁸⁵ 31 U.S.C. § 3729(a).

⁸⁶ *Id.* § 3730(a). The FCA also allows private parties who are aware of false claims having been made against the federal government to bring a suit in the name of the government, which the government may either intervene and proceed with or decline to intervene and allow the private person to conduct the action. *Id.* § 3730(b). Because the focus of the Report is on enforcement actions by the government itself, we do not delve into the details of such private party actions.

⁸⁷ Douglas W. Baruch et al., *FIRREA Enforcement Trends*, 31(12) BANKING & FINANCIAL SERVICES 131 (Dec. 2015), <http://www.lexology.com/library/detail.aspx?g=d3c50eb8-dde6-4b58-ae22-2c8c421628bf>.

system, [and] to enhance the regulatory and enforcement powers of Federal financial institutions regulatory agencies.”⁸⁸ One of Congress’s specific aims was to combat fraud and insider abuse at financial institutions in the wake of the savings and loan crisis.⁸⁹

FIRREA authorizes the DOJ to bring a case in federal court against any individual or entity that violates one or more of 14 enumerated criminal statutes (“**predicate offenses**”).⁹⁰ If the DOJ can prove in court by a preponderance of the evidence that the defendant violated one of those criminal statutes, then civil monetary penalties can be assessed.⁹¹

These offenses include: bribing a bank official;⁹² embezzlement of funds entrusted to a banking institution;⁹³ embezzlement of funds entrusted to an insurance institution;⁹⁴ receiving money from the government through a fraudulent transaction with or by a banking institution⁹⁵ or credit institution;⁹⁶ knowingly making or inviting reliance on a false statement or document to influence the FDIC;⁹⁷ knowingly making false statements on loan applications to influence federal agencies or federal insured financial institutions;⁹⁸ bank fraud;⁹⁹ and knowingly making a false statement to obtain a loan or favorable modification of a loan.¹⁰⁰

Five other predicate offenses can establish civil FIRREA liability but only if they “affect[] a federally insured financial institution.”¹⁰¹ These offenses include: knowingly and willfully making a false claim to the government;¹⁰² knowingly and willfully making a false statement in a matter within the jurisdiction of the federal government;¹⁰³ defrauding financial conservators;¹⁰⁴ mail fraud;¹⁰⁵ and wire fraud.¹⁰⁶

The DOJ has recently taken an expansive view of what it means to “affect[] a federally insured financial institution.”¹⁰⁷ In cases brought during 2013, the DOJ argued that when a

⁸⁸ Pub. L. 101-73, 103 Stat. 183 (1989).

⁸⁹ U.S. CHAMBER INST. FOR LEGAL REFORM, THE FIRREA REVIVAL: DREDGING UP SOLUTIONS TO THE FINANCIAL CRISIS 2 (2014), <http://www.instituteforlegalreform.com/uploads/sites/1/firrea.pdf>. See 12 U.S.C. § 1833a (stating that the DOJ has sole authority to enforce FIRREA).

⁹⁰ 12 U.S.C. § 1833a(c).

⁹¹ *Id.* § 1833a(f).

⁹² 18 U.S.C. § 215.

⁹³ *Id.* § 656.

⁹⁴ *Id.* § 657.

⁹⁵ *Id.* § 1005.

⁹⁶ *Id.* § 1006.

⁹⁷ *Id.* § 1007.

⁹⁸ *Id.* § 1014.

⁹⁹ *Id.* § 1344.

¹⁰⁰ 15 U.S.C. § 645(a).

¹⁰¹ 12 U.S.C. § 1833a(c)(2).

¹⁰² 18 U.S.C. § 287.

¹⁰³ *Id.* § 1001.

¹⁰⁴ *Id.* § 1032.

¹⁰⁵ *Id.* § 1341.

¹⁰⁶ *Id.* § 1343.

¹⁰⁷ 12 U.S.C. § 1833a(c)(2).

financial institution *itself* commits one of the five predicate offenses, it can be held liable under FIRREA. The DOJ takes this position because such conduct does, by definition, “affect” a financial institution. This is known as the “self-affecting” theory. The district courts that have decided the issue have each agreed with the government’s viewpoint and rejected arguments by defendants that a financial institution must be the *victim* of the misconduct.¹⁰⁸ The broad application of FIRREA through the “self-affecting” theory makes FIRREA a powerful and versatile statute.

c. DOJ Enforcement of FCA and FIRREA

The DOJ has aggressively enforced the FCA and FIRREA since the financial crisis.

The DOJ recovered over \$5 billion in FCA claims related to housing and mortgage fraud from 2009 through 2015.¹⁰⁹ FIRREA’s civil penalties provision was rarely used prior to the 2007-2008 financial crisis.¹¹⁰ Indeed, one report found that, between 1989 and 2009, only six court decisions referenced FIRREA’s civil penalties provision.¹¹¹ Since 2009, however, the DOJ used FIRREA as part of a \$7 billion settlement with Citigroup, \$16.65 billion settlement with Bank of America, and a \$13 billion settlement with J.P. Morgan.¹¹² Although the DOJ does not disclose total recovery amounts predicated on FIRREA claims, the FIRREA claims accounted for \$11 billion of the \$36.65 billion total settlement value in those three large cases.¹¹³

In certain high-profile cases, the DOJ has brought claims under both FCA and FIRREA, including the \$25 billion National Mortgage Settlement (summarized in **Appendix B**) with the

¹⁰⁸ *United States v. Wells Fargo Bank*, 972 F. Supp. 2d 593 (S.D.N.Y. 2013); *United States v. Countrywide Fin. Corp.*, 961 F. Supp. 2d 598 (S.D.N.Y. 2013); *United States v. Bank of New York Mellon*, 941 F. Supp. 2d 438 (S.D.N.Y. 2013).

¹⁰⁹ Press Release, U.S. Dep’t of Justice, Justice Department Recovers Over \$3.5 Billion From False Claims Act Cases in Fiscal Year 2015 (Dec. 3, 2015), <https://www.justice.gov/opa/pr/justice-department-recovers-over-35-billion-false-claims-act-cases-fiscal-year-2015>. We have been unable to find similar data for any period before the financial crisis.

¹¹⁰ Antonio F. Dias et al., *FIRREA Civil Money Penalties: The Government’s Newfound Weapon Against Financial Fraud*, JONES DAY (May 2013), <http://www.jonesday.com/firrea-civil-money-penalties-the-governments-newfound-weapon-against-financial-fraud/>.

¹¹¹ U.S. CHAMBER INST. FOR LEGAL REFORM, *supra* note 89, at 13 n.15.

¹¹² See Press Release, U.S. Dep’t of Justice, Federal and State Partners Secure Record \$13 Billion Global Settlement with JPMorgan for Misleading Investors About Securities Containing Toxic Mortgages (Nov. 19, 2013), <https://www.justice.gov/opa/pr/justice-department-federal-and-state-partners-secure-record-13-billion-global-settlement>; Press Release, U.S. Dep’t of Justice, Federal and State Partners Secure Record \$7 Billion Global Settlement with Citibank for Misleading Investors About Securities Containing Toxic Mortgages (Jul. 14, 2014), <https://www.justice.gov/opa/pr/justice-department-federal-and-state-partners-secure-record-7-billion-global-settlement>; Press Release, U.S. Dep’t of Justice, Bank of America to Pay \$16.65 Billion in Historic Justice Department Settlement for Financial Fraud Leading up to and During the Financial Crisis (Aug. 21, 2014), <https://www.justice.gov/opa/pr/bank-america-pay-1665-billion-historic-justice-department-settlement-financial-fraud-leading>.

¹¹³ See sources cited, *supra* note 112.

five largest mortgage service providers.¹¹⁴ The FCA and FIRREA also served as grounds for federal civil claims resolved by the DOJ that were part of a \$16.65 billion mortgage settlement with Bank of America (described in **Appendix B**).¹¹⁵

d. Other Federal Regulators

For completeness, we also must mention that in addition to the aforementioned federal enforcement authorities, other federal enforcement authorities more tangential to the financial markets and financial industry can also play a role in enforcement matters. For example, the Federal Trade Commission could be involved in matters involving anti-competitive behavior, or the Federal Energy Regulatory Commission could be involved in matters involving market activities affecting energy markets. Those agencies' focus is outside the core enforcement authorities for the U.S. financial system, and so are not a further focus of the Report.

B. State Enforcement

The U.S. has a federalist system of government with powers held both by the federal government and state governments. As a result, activities already subject to federal oversight, regulation, and enforcement can also be governed and regulated by state enforcement authorities, particularly state attorneys general.¹¹⁶ The existence of state enforcement authorities further complicates the structure of the U.S. public enforcement system. An exhaustive summary of the authorities of all of the states is beyond the scope of this Report. Instead, we describe the enforcement authorities in New York. We focus on New York because it is at the center of U.S. capital markets and the financial system.¹¹⁷

1. New York Enforcement Regime

The enforcement of New York state laws governing capital markets and the financial system primarily fall within one of two offices – the New York Attorney General's office, and the New York Department of Financial Services.

¹¹⁴ *Recent False Claims Act and FIRREA Suits, Settlements, and Decisions Involving Financial Institutions*, BUCKLEY SANDLER LLP, http://www.buckleysandler.com/uploads/1082/doc/Recent-FIRREA-Cases_BuckleySandler-LLP_v14.pdf.

¹¹⁵ Press Release, U.S. Department of Justice, Bank of America to Pay \$16.65 Billion in Historic Justice Department Settlement for Financial Fraud Leading up to and During the Financial Crisis (Aug. 21, 2014), <https://www.justice.gov/opa/pr/bank-america-pay-1665-billion-historic-justice-department-settlement-financial-fraud-leading>. The FIRREA claims accounted for \$5 billion worth of the settlement. The FCA claims accounted for over \$1 billion of the settlement.

¹¹⁶ *See, e.g.*, N.J. Off. of the Att'y Gen., *About Us*, <http://www.nj.gov/oag/aboutus.htm> (last visited May 18, 2018) (New Jersey attorney general is state's top law enforcement official); Fla. Off. of the Att'y Gen., *The Role and Function of the Attorney General*, <http://myfloridalegal.com/pages.nsf/Main/F06F66DA272F37C885256CCB0051916F> (last visited May 18, 2018) (Florida attorney general is state's chief legal officer and is tasked with protecting consumers from fraud).

¹¹⁷ This is not to suggest that other states have been inactive. Indeed, the opposite is true, as many states have participated in enforcement activities.

i. New York Attorney General

The New York Attorney General has a number of statutory tools to regulate and enforce laws governing financial institutions and participants in the capital markets. The primary sources of enforcement authority are the Martin Act, New York’s Executive Law and New York’s consumer fraud statutes.

a. The Martin Act – Securities and Commodities Transactions

The Martin Act, adopted in 1921,¹¹⁸ provides the Attorney General with the authority to investigate fraud, deception, false promises, or misrepresentation in connection with securities or commodities transactions,¹¹⁹ and to bring civil lawsuits to enforce the Martin Act’s provisions.¹²⁰ It served as the basis for Attorney General Spitzer’s investigation of research analyst practices discussed later in this section.¹²¹

The Attorney General is empowered to enforce the Martin Act through civil lawsuits and criminal actions. The primary civil tool provided by the Martin Act is the ability to obtain a court order enjoining an individual or entity from violating the Martin Act.¹²² In a civil lawsuit, the Attorney General is also authorized to seek a court order requiring a defendant to pay compensation to victims and to return any money or property obtained fraudulently.¹²³

The Attorney General also can pursue criminal charges for violations of the Martin Act.¹²⁴ The major difference between the civil and criminal provisions is that, for felony violations (which can carry a prison term of up to four years),¹²⁵ the defendant must have *intentionally* committed the offense and have *received* property as a result of the intentional fraudulent conduct.¹²⁶ In other words, in criminal cases, the state must prove intent, but it does not need to in civil cases brought under the Martin Act.

¹¹⁸ *Enforcement Proceedings Under New York’s Martin Act*, THOMSON REUTERS (2015), http://www.jonesday.com/files/Publication/cc6cfc9e-1517-4707-958d-8ea80d2042c2/Presentation/PublicationAttachment/9be275fc-e882-499c-9045-9a429519ab82/FebMar15_%20NYSupplement_MartinActFeature.pdf.

¹¹⁹ N.Y. Gen. Bus. Law § 352.

¹²⁰ *Id.* § 353.

¹²¹ See Robert W. Gaffey & Harold K. Gordon, *The Investigative Authority of the New York Attorney General Is Not Without Its Limits*, JONES DAY (Feb. 2016), http://www.jonesday.com/the-investigative-authority-of-the-new-york-attorney-general-is-not-without-its-limits-02-04-2016/#_edn26.

¹²² N.Y. Gen. Bus. Law § 353.

¹²³ *Id.* § 353.

¹²⁴ *Id.* § 358.

¹²⁵ N.Y. Penal Law § 70.00(2)(e).

¹²⁶ N.Y. Gen. Bus. Law § 352c(5), (6).

b. New York Executive Law – Fraud Prevention Through Civil Enforcement Actions

The New York Attorney General is empowered under New York’s Executive Law to investigate and bring enforcement actions against “persistent fraud or illegality in the carrying on, conduct, or transaction of business,”¹²⁷ which is broader than the Martin Act’s focus on securities and commodities transactions. The Attorney General is authorized to bring a civil case to obtain (1) a court-issued injunction to cease unlawful activity and (2) compensation of victims.¹²⁸ The statute does not provide for civil fines.

c. Enforcement of Consumer Protection Laws

New York laws also make it unlawful for any individual or entity to engage in “deceptive acts or practices in the conduct of any business, trade or commerce or in the furnishing of any service” in New York.¹²⁹ The consumer protection laws also make it unlawful to engage in false advertising in conducting business, trade or commerce or providing a service in New York.¹³⁰ The consumer protection laws have been applied to “virtually all economic activity.”¹³¹ The laws are enforceable by the New York Attorney General in civil actions.¹³²

d. Examples of Enforcement Actions by the New York Attorney General

For the last two decades, New York Attorneys General have used their expansive powers to bring significant and well-publicized financial sector enforcement actions. For example, in the early 2000s, New York Attorney General Elliot Spitzer spearheaded investigations into the practices of analysts at Wall Street investment banks. He asserted that they were not providing investors with independent analyses of public company stocks, but instead were issuing favorable ratings and reports, to help their firms generate business from those companies.¹³³

The first settlement Spitzer reached in connection with these investigations was with Merrill Lynch in May 2002.¹³⁴ About one year later, the SEC, Attorney General Spitzer and other state regulators settled claims of “undue influence of investment banking interests on securities research at brokerage firms”¹³⁵ with ten investment banking firms. The ten banks agreed to pay

¹²⁷ N.Y. Exec. Law § 63(12).

¹²⁸ *Id.*

¹²⁹ N.Y. Gen. Bus. Law § 349(a).

¹³⁰ *Id.* § 350.

¹³¹ *Karlin v. IVF Am., Inc.*, 93 N.Y.2d 282, 290 (N.Y. Ct. App. 1999).

¹³² N.Y. Gen. Bus. Law §§ 349, 350-d.

¹³³ *See generally* John Cassidy, *The Investigation: How Eliot Spitzer Humbled Wall Street*, THE NEW YORKER (Apr. 7, 2003), <http://www.newyorker.com/magazine/2003/04/07/the-investigation>.

¹³⁴ *Id.*

¹³⁵ Press Release, U.S. Sec. & Exch. Comm’n, Ten of Nation’s Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking (Apr. 28, 2003), <https://www.sec.gov/news/press/2003-54.htm>.

civil monetary penalties of \$487.5 million and disgorge \$387.5 million in ill-gotten gains.¹³⁶ The settlements also imposed structural reforms regulating the activity of investment banks and their research analysts. Indeed, the Committee noted in its 2006 report that such state enforcement actions can affect practices nationwide.¹³⁷

Former Attorney General Schneiderman was also heavily involved in enforcement actions arising out of the 2007-2008 financial crisis. He served as co-chair of a residential mortgage-backed securities working group organized by the DOJ, which “focused on investigating potential false or misleading statements, deception or other misconduct by market participants in the creation, packaging and sale of mortgage-backed securities.”¹³⁸ The working group reached settlements with five major financial institutions since 2012, imposing monetary sanctions totaling more than \$40 billion.¹³⁹

ii. New York Department of Financial Services

In New York, the Superintendent of the Department of Financial Services (“DFS”) is charged with (1) overseeing and enforcing state banking and insurance laws and (2) protecting consumers of financial products and services.¹⁴⁰ Part of the DFS’s mission is to prevent fraud or intentional, material misrepresentations in connection with the provision of financial products or services.¹⁴¹ In addition, the DFS is authorized to enforce state and federal laws governing debt collection practices and fair lending requirements.¹⁴² The DFS has the authority to bring civil actions to enforce these laws, including by assessing fines.¹⁴³

C. Enforcement by Non-U.S. Government Actors

The focus of this Report is on the U.S. public enforcement system – that is, enforcement by federal and state government entities. However, industry-oriented self-policing organizations are involved in regulating market activities and transactions frequently cross international borders,

¹³⁶ *Id.*

¹³⁷ COMMITTEE ON CAPITAL MARKETS REGULATION, INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION 67-68 (2006), <http://www.capmksreg.org/wp-content/uploads/2016/10/Committees-November-2006-Interim-Report.pdf>.

¹³⁸ Press Release, U.S. Dep’t of Justice, Residential Mortgage-Backed Securities (RMBS) Working Group Announces New Resources to Investigate RMBS Misconduct (May 24, 2012), <https://www.justice.gov/opa/pr/residential-mortgage-backed-securities-rmbs-working-group-announces-new-resources-investigate>.

¹³⁹ Bill Baer, Principal Deputy Ass. Att’y Gen., Remarks at Society of Corporate Compliance and Ethics Conference (Sept. 27, 2016), <https://www.justice.gov/opa/speech/principal-deputy-associate-attorney-general-bill-baer-delivers-remarks-society-corporate>.

¹⁴⁰ N.Y. Fin. Serv. Law § 301. “Financial products and services” is defined broadly to include any financial product or service provided by a person regulated under the banking or insurance laws or that is offered or sold to consumers. N.Y. Fin. Serv. Law § 104. The term “consumer” is not defined by the statute.

¹⁴¹ *Id.* § 408(a).

¹⁴² *Id.*

¹⁴³ *Id.* § 305; *Id.* § 408(a).

we therefore believe that it is important to highlight the role that self-regulatory organizations (“SROs”) and foreign government enforcement authorities play in financial sector enforcement.

1. Self-Regulatory Organizations

SROs are membership-based organizations that develop and enforce rules that regulate market participants within a specific industry, which are recognized and highly regulated by the federal government. Specifically, the existence of these organizations are authorized by Congress through statutes such as the Exchange Act and CEA, and SROs are required to register with the SEC or CFTC.¹⁴⁴ While SROs are formed by private industry participants,¹⁴⁵ and develop their own rules that members of the SRO must follow, the regulatory agency with jurisdiction over it (i.e., the SEC or CFTC) is required to review and approve SROs’ proposed rules to ensure that they meet the statutory requirements.¹⁴⁶ Generally, the authorizing statutes require that the SRO exercise disciplinary power over its members to enforce its rules, and thus engage in self-policing.¹⁴⁷

SROs are especially prevalent in the securities and commodities industries and include organizations such as the Financial Industry Regulatory Authority (“FINRA”); the New York Stock Exchange (“NYSE”); the National Futures Association (“NFA”); boards of trade such as the Chicago Mercantile Exchange (“CME”); and the Municipal Securities Review Board (“MSRB”). SROs can supplement regulation and enforcement by government enforcement authorities due to their familiarity with and proximity to their members and the markets that they police.

i. FINRA – Broker-Dealer SRO

FINRA is an independent non-profit organization authorized by Section 15A of the Exchange Act¹⁴⁸ that regulates the activities of over 3,700 securities firms and 630,000 broker-dealers.¹⁴⁹ FINRA’s mission is to ensure a fair and honest securities industry.¹⁵⁰

FINRA was created in 2007 as an independent entity resulting from the merger of the National Association of Securities Dealers (“NASD”) and the NYSE’s regulatory apparatus that

¹⁴⁴ See, e.g., 15 U.S.C. §§ 78f (national securities exchanges), 78o-3 (registered securities associations), 78q-1 (clearing agency); 7 U.S.C. §§ 7 (boards of trade), 21 (futures associations).

¹⁴⁵ See, e.g., *NFA History*, NAT’L FUTURES ASS’N, <https://www.nfa.futures.org/NFA-about-nfa/who-we-are/NFA-history.HTML> (last visited Nov. 26, 2017) (noting that the NFA was formed when the chairman of the Chicago Mercantile Exchange persuaded other industry leaders to form it as an SRO under the CEA).

¹⁴⁶ See, e.g., 15 U.S.C. § 78s (requiring SEC approval of rules and rule changes for SROs subject to SEC oversight); 7 U.S.C. §§ 7 (requiring boards of trade to apply to CFTC for approval), 21 (requiring futures associations to apply to CFTC for approval).

¹⁴⁷ See, e.g., 7 U.S.C. §§ 21(b)(8), 7(d)(13); 15 U.S.C. §§ 78q-1(b)(3)(G), 78o-3(b)(7), 78f(b)(6). One exception to the above is the MSRB, which was established by law, but which is not allowed to enforce its own rules. 15 U.S.C. § 78o-4.

¹⁴⁸ 15 U.S.C. § 78o-3.

¹⁴⁹ *Statistics*, FIN. INDUS. REGULATORY AUTH., <http://www.finra.org/newsroom/statistics> (last visited May 18, 2018).

¹⁵⁰ *About*, FIN. INDUS. REGULATORY AUTH., <http://www.finra.org/about> (last visited May 18, 2018).

had previously overseen broker-dealers.¹⁵¹ While FINRA consolidated the regulation of broker-dealers under one SRO, the listing exchanges (e.g., NYSE and NASDAQ) retained responsibility for regulating trading on their own markets and issuing and enforcing rules governing listed companies.¹⁵² The exchanges formerly outsourced market surveillance and other functions to FINRA, but the NYSE and NASDAQ have recently moved certain of these functions back in-house.¹⁵³

The Exchange Act requires that FINRA’s rules be designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, facilitate transactions in securities, and protect investors and the public interest, among other things.¹⁵⁴ As a result, FINRA’s rules govern everything from banning manipulative, deceptive and fraudulent schemes by its members in connection with transactions in securities,¹⁵⁵ regulating transactions with broker-dealer customers,¹⁵⁶ and regulating underwriter compensation in securities offerings.¹⁵⁷

FINRA is empowered under the Exchange Act and its rules to enforce the regulations governing its members,¹⁵⁸ including by imposing one or more of the following sanctions on its members: censure, fine, suspension of membership, expulsion of membership, cease-and-desist order, or any other “fitting sanction.”¹⁵⁹ In 2017, FINRA brought 1,369 enforcement actions and imposed over \$130 million in monetary sanctions.¹⁶⁰

ii. *NYSE – Listing Exchange SRO*

Securities listing exchanges, such as the NYSE, are also SROs. Exchanges make and enforce rules governing (1) the listing of company shares on the exchange; and (2) trading and other behavior by broker-dealer members of the exchange.¹⁶¹ The ultimate aim of the NYSE rules

¹⁵¹ Press Release, Fin. Indus. Regulatory Auth., NASD and NYSE Member Regulation Combine to Form the Financial Industry Regulatory Authority (July 30, 2007), <http://www.finra.org/newsroom/2007/nasd-and-nyse-member-regulation-combine-form-financial-industry-regulatory-authority>. The listing exchanges retained regulation over conduct on the exchanges themselves.

¹⁵² Hester Peirce, *The Financial Industry Regulatory Authority: Not Self-Regulation After All* 11–2 (Mercatus Ctr., Working Paper, 2015), <https://www.mercatus.org/system/files/Peirce-FINRA.pdf>.

¹⁵³ See Joe Mont, *NYSE Will Reclaim Market Surveillance, Enforcement From FINRA*, COMPLIANCE WK. (Oct. 7, 2014), <https://www.complianceweek.com/blogs/the-filing-cabinet/nyse-will-reclaim-market-surveillance-enforcement-from-finra#.WJIRroSMA8Y>.

¹⁵⁴ 15 U.S.C. § 78o-3(b).

¹⁵⁵ FINRA, Rule 2020.

¹⁵⁶ FINRA, Rule 2100 *et seq.*

¹⁵⁷ FINRA, Rule 5100 *et seq.*

¹⁵⁸ FINRA, Rule 8300 *et seq.* Technically the Exchange Act requires that FINRA’s rules include enforcement provisions. Exchange Act § 15A(b)(7).

¹⁵⁹ FINRA, Rule 8310(a) (2008).

¹⁶⁰ *Statistics*, FIN. INDUS. REGULATORY AUTH., <https://www.finra.org/newsroom/statistics>.

¹⁶¹ See generally *Listed Company Manual*, N.Y. STOCK EXCH., <http://nysemanual.nyse.com/LCM/Sections/> (last visited May 18, 2018); *NYSE Rules*, N.Y. STOCK EXCH., <http://wallstreet.cch.com/nyse/rules/> (last May 18, 2018).

is to promote just and equitable principles of trade, to encourage free and open markets and to protect investors and the public interest.¹⁶²

NYSE listing rules regulate the companies that choose to list their shares on the exchange. Companies listed on the NYSE, for instance, are subject to corporate governance rules, including board and board committee independence requirements, regulations pertaining to shareholder meetings, and governance requirements (e.g., requirements that listed companies have codes of conduct for their executive officers and conduct annual board self-evaluations), among many other rules.¹⁶³ The companies listed on the NYSE had a market cap of over \$19.6 trillion as of March 2018, the last month for which such data has been disclosed.¹⁶⁴

The NYSE can punish listed companies for violating its listing rules by suspending or terminating the company’s listing on the exchange.¹⁶⁵ This is the NYSE’s sole remedy for non-compliance with its listing rules.¹⁶⁶

The NYSE also issues and enforces rules that regulate broker-dealer member conduct and admission,¹⁶⁷ the operation of the exchange,¹⁶⁸ advertising and communications of broker-dealer members with the public,¹⁶⁹ and dispute resolution between members,¹⁷⁰ among other things.

NYSE’s rules permit it to sanction broker-dealer members and those affiliated with its members for violations of its rules.¹⁷¹ The remedies available to the NYSE include censuring a broker-dealer member, imposing a fine, suspending a member’s membership, expelling a member, suspending or barring a person or entity from associating with a member organization, or imposing “any other fitting sanction.”¹⁷² In 2017, the NYSE brought 65 disciplinary actions and imposed approximately \$8.7 million in fines.¹⁷³

iii. The NFA – Futures Association SRO

The NFA is an industry-wide SRO for the U.S. derivatives industry, which states that its mission is to “safeguard the integrity of derivatives markets, protect investors, and ensure members meet their regulatory responsibilities.”¹⁷⁴ The NFA is the only registered futures association and

¹⁶² *Regulation*, N.Y. STOCK EXCH., <https://www.nyse.com/regulation>.

¹⁶³ N.Y. STOCK EXCH., Rules 300 *et seq.*; 401.00 *et seq.*; 303A.09; 303A.10.

¹⁶⁴ *New York Stock Exchange*, STOCKMARKETCLOCK, <https://www.stockmarketclock.com/exchanges/nyse> (last visited May 31, 2018).

¹⁶⁵ N.Y. Stock Exch., Rules 801–05.

¹⁶⁶ *Id.*

¹⁶⁷ *See generally* N.Y. Stock Exch., Rules 2010–7040; N.Y. Stock Exch., Rules 300–24.

¹⁶⁸ *See generally* N.Y. Stock Exch., Rule 45-299C.

¹⁶⁹ N.Y. Stock Exch., Rules 471–74B.

¹⁷⁰ N.Y. Stock Exch., Rules 600A–39.

¹⁷¹ N.Y. Stock Exch., Rule 8300.

¹⁷² N.Y. Stock Exch., Rule 8310.

¹⁷³ Data was derived from an analysis of disciplinary actions provided on the NYSE’s website. *Disciplinary Actions*, N.Y. STOCK EXCH., <https://www.nyse.com/regulation/disciplinary-actions> (last visited May 31, 2018).

¹⁷⁴ *About NFA*, NAT’L FUTURES ASS’N, <https://www.nfa.futures.org/about/index.html> (last visited May 18, 2018).

performs functions in the derivatives markets similar to those that FINRA performs in the securities markets.¹⁷⁵

Participants in the commodities markets, such as futures commission merchants, introducing brokers, commodity trading advisors, commodity pool operators and contract markets, and swap dealers must all become members of the NFA.¹⁷⁶ The NFA's membership consists of approximately 3,700 firms and 50,000 persons associated with those firms.¹⁷⁷

The NFA establishes admission standards and has adopted rules covering members' business conduct, such as sales practices, recordkeeping, disclosure of fees and minimum capital requirements.¹⁷⁸ The NFA has the authority to take disciplinary actions against firms and individuals that violate its rules.¹⁷⁹ In 2017, it brought 19 disciplinary actions against its members and imposed fines of over \$1.2 million.¹⁸⁰

iv. *The CME – Commodities Contract Market SRO*

The CME is a market for trading derivatives, contracts to buy or sell commodities, and swap contracts. Like securities listing exchanges, contract markets are SROs that make and enforce rules governing trading on the market and conduct of their members. For example, the CME seeks to prevent trade practice violations such as trading ahead of customer orders, disruptive practices, wash trades and prearranged, pre-negotiated and noncompetitive trades.¹⁸¹ The CME also imposes position limits and forbids market manipulation.¹⁸² The CME rules, as required by the CEA, grant the CME authority to discipline its members for rule violations.¹⁸³ In 2017, the CME brought 134 disciplinary actions against its members and imposed monetary sanctions of over \$6.5 million.¹⁸⁴

¹⁷⁵ MELANIE L. FEIN, *SECURITIES ACTIVITIES OF BANKS* 3–103 (4th ed. 2017).

¹⁷⁶ *Id.*; *Swap Dealer Registration*, NAT'L FUTURES ASS'N, <https://www.nfa.futures.org/registration-membership/who-has-to-register/sd-msp.html>.

¹⁷⁷ *Membership and Directories*, NAT'L FUTURES ASS'N, <https://www.nfa.futures.org/registration-membership/membership-and-directories.html> (last visited May 18, 2018).

¹⁷⁸ *How NFA Fights Fraud and Abuse*, NAT'L FUTURES ASS'N, <https://web.archive.org/web/20170228095207/https://www.nfa.futures.org/NFA-about-nfa/who-we-are/how-NFA-fights-fraud-and-abuse.HTML>. See also NFA RULEBOOK, <https://www.nfa.futures.org/nfamanual/NFAManual.aspx>.

¹⁷⁹ Nat'l Futures Assoc., Rule 3-14 (1994).

¹⁸⁰ Data was derived disciplinary actions provided on the NFA's website. *Enforcement and Registration Actions*, NAT'L FUTURES ASS'N, <https://www.nfa.futures.org/news/newsactionslist.asp> (last visited May 31, 2018).

¹⁸¹ *Investigations*, CME GROUP, <http://www.cmegroup.com/market-regulation/investigations.html> (last visited May 18, 2018).

¹⁸² *Market Surveillance*, CME GROUP, <http://www.cmegroup.com/market-regulation/market-surveillance.html> (last visited May 18, 2018).

¹⁸³ 7 U.S.C. § 7(d)(2) (requiring that a board of trade, such as the CME, establish, monitor and enforce compliance with its rules); § 7(d)(13) (requiring an SRO to adopt and enforce disciplinary procedures); CME Rule 402.

¹⁸⁴ Data was derived from disciplinary actions provided on the CME's website. *Notices*, CME GROUP, <http://www.cmegroup.com/tools-information/advisorySearch.html#cat=advisorynotices:Advisory+Notices/Market+Regulation+Advisories&pageNumber=1&subcat=advisorynotices:Advisory+Notices/Market+Regulation+Advisories/Business-Conduct-Committee&searchLocations=/content/cmegroup/> (last visited May 31, 2018).

v. *The MSRB – Municipal Securities SRO*

The MSRB is a member-based SRO that seeks to “protect investors, municipal entities[,] and the public interest by promoting a fair and efficient municipal market, regulating firms that engage in municipal securities and advisory activities, and promoting market transparency.”¹⁸⁵

The MSRB’s mandate is to regulate, through the adoption of rules, the activities of (1) broker-dealers and banks that buy, sell, and underwrite municipal securities and (2) municipal advisors, which are firms that provide advice to state and local governments and other municipalities about the issuance of bonds and other municipal financial products.¹⁸⁶ Each municipal securities broker (i.e., a broker engaged in the business of effecting transactions in municipal securities for the account of others¹⁸⁷), municipal securities dealer (i.e., a person engaged in the business of buying and selling municipal securities for his own account¹⁸⁸), and municipal advisor must register with the MSRB.¹⁸⁹ Over 1,300 broker-dealers and 500 municipal advisors are registered with the MSRB.¹⁹⁰

Unlike other SROs, and for reasons that are unclear, the MSRB does not have the authority to enforce its own rules. Rather, the Exchange Act limits the MSRB’s involvement in enforcement to providing guidance and assistance to regulators that enforce its rules.¹⁹¹ Instead, the SEC enforces the MSRB’s rules, and if the registrant is subject to the enforcement authority of the federal banking regulators, they too can enforce violation of MSRB rules.¹⁹² The SEC does not disclose the number of enforcement actions it brings per year for violations of MSRB rules.

¹⁸⁵ *About MSRB*, MUN. SEC. RULEMAKING BD., <http://www.msrb.org/About-MSRB.aspx>. The MSRB was not only authorized, but was also established by Congress through a 1975 amendment to the Exchange Act at the urging of industry members who believed rigorous industry standards could not be maintained in a rapidly growing marketplace without a formal system of regulation. MUN. SEC. RULEMAKING BD., *THE ROLE AND JURISDICTION OF THE MSRB* (2017) [hereinafter *MSRB ROLE*], <http://www.msrb.org/msrb1/pdfs/Role-and-Jurisdiction-of-MSRB.pdf>; *Creation of the MSRB*, MUN. SEC. RULEMAKING BD., <http://www.msrb.org/About-MSRB/About-the-MSRB/Creation-of-the-MSRB.aspx> (last visited May 18, 2018).

¹⁸⁶ Mun. Sec. Rulemaking Bd., *Creation of the MSRB*, *supra* note 185; *MSRB ROLE*, *supra* note 185. MSRB rules include rules related to the disclosure of material information to customers (MSRB Rule G-47), prohibitions on dishonest and unfair practices (MSRB Rule G-17), and seeking the most favorable terms reasonably available for retail customers’ transactions (MSRB Rule G-18).

¹⁸⁷ 15 U.S.C. § 78c(a)(31).

¹⁸⁸ *Id.* § 78c(a)(30).

¹⁸⁹ MSRB Rule A-12.

¹⁹⁰ *See Broker-Dealers and Bank Dealers Registered with the MSRB*, MUN. SEC. RULEMAKING BD., <http://www.msrb.org/BDRegistrants.aspx> (last visited May 18, 2018); *MSRB-Registered Municipal Advisor Firms with Series-50 Qualified Representatives*, MUN. SEC. RULEMAKING BD., <http://msrb.org/MARRegistrants.aspx> (last visited May 18, 2018).

¹⁹¹ 15 U.S.C § 78o-4(b)(4).

¹⁹² *Id.* § 78o-4 (c).

2. Foreign Governments

Governments outside the U.S. also exercise enforcement powers over U.S. individuals and firms that engage in misconduct subject to the jurisdiction of those countries.

An illustrative example is the United Kingdom (“U.K.”), which is a major hub of financial activity involving U.S. entities. Conduct within the U.K. is governed by the laws and regulatory agencies of the U.K. As a result, a U.S. firm or individual that violates a U.K. law while doing business in the U.K. could be subject to an enforcement action by a U.K. regulator. Similarly, conduct or activities that occur in both the U.S. and U.K. could be subject to enforcement actions in both countries.

The U.K.’s enforcement of laws governing capital markets and the financial system is primarily carried out by two regulators: the Prudential Regulatory Authority (“PRA”) and the Financial Conduct Authority.

The PRA is a subsidiary of the Bank of England that is responsible for the regulation of the safety and soundness all deposit-taking institutions, insurers, and investment banks.¹⁹³ The Financial Conduct Authority is an independent regulatory body that is responsible for the regulation of retail and wholesale financial markets and the infrastructure that supports those markets.¹⁹⁴

The PRA has a number of formal powers it can exercise to enforce the laws and rules it has jurisdiction over. For example, the PRA can object to merger and acquisition activity if a regulated institution is not in compliance with laws, restrict the activities an individual can engage in, suspend or censure an individual or firm, and impose civil fines.¹⁹⁵ The PRA oversees over 1,500 institutions.¹⁹⁶

The Financial Conduct Authority regulates the conduct of the financial markets in the U.K. to ensure that financial markets are “honest, fair and effective.”¹⁹⁷ Its authority includes ensuring market integrity, promoting competition, and protecting consumers.¹⁹⁸ The agency oversees over 58,000 financial services firms.¹⁹⁹ It is the U.K.’s consolidated version of the SEC, CFTC, and

¹⁹³ *Prudential Regulatory Authority*, BANK OF ENGLAND, <http://www.bankofengland.co.uk/pru/Pages/default.aspx> (last visited May 18, 2018).

¹⁹⁴ See Louise Hodges, *UK Financial Regulatory Landscape: A Quick Guide to The New Financial Conduct Authority, Prudential Regulation Authority & Financial Policy Committee*, KINGSLEY NAPLEY LLP (Apr. 2, 2013), <http://www.lexology.com/library/detail.aspx?g=603b0696-94fd-4951-989c-dd291942450e>.

¹⁹⁵ *Regulatory action*, BANK OF ENGLAND, <http://www.bankofengland.co.uk/pru/Pages/supervision/regulatoryaction/default.aspx> (last visited Dec. 1, 2017).

¹⁹⁶ Bank of England, *Prudential Regulatory Authority*, *supra* note 193.

¹⁹⁷ *About the FCA*, FIN. CONDUCT AUTH., <https://www.fca.org.uk/about/the-fca> (last visited May 18, 2018).

¹⁹⁸ *Enhancing market integrity*, FIN. CONDUCT AUTH., <https://www.fca.org.uk/about/enhancing-market-integrity> (last visited Dec. 1, 2017); *Promoting competition*, FIN. CONDUCT AUTH., <https://www.fca.org.uk/about/promoting-competition> (last visited Dec. 1, 2017); *Protecting consumers*, FIN. CONDUCT AUTH., <https://www.fca.org.uk/about/protecting-consumers> (last visited Dec. 1, 2017).

¹⁹⁹ Fin. Conduct Auth., *About the FCA*, *supra* note 197.

CFPB, and DOJ. The Financial Conduct Authority has criminal, civil, and regulatory enforcement authority, and though separate from the Bank of England, it is statutorily required to cooperate with the PRA. Cooperation is mandated because Financial Conduct Authority actions could affect the stability of the U.K. financial system and because entities can be subject to the jurisdiction of both regulators. The Financial Conduct Authority is also responsible for regulating firms that are not regulated by the PRA, such as asset managers.²⁰⁰

The Financial Conduct Authority can bring criminal charges, and impose civil penalties such as suspending or prohibiting a firm or individual from engaging in regulated activities, revoking a firm's authorization, seeking injunctions and compensation of victims, and imposing fines.²⁰¹ In 2014, the Financial Conduct Authority imposed fines of over \$1.8 billion, as well as more than \$1.2 billion in 2015. In 2016, however, total fines were only slightly over \$26 million.²⁰² These are penalties imposed in all of its enforcement actions in those years.

In addition to these two regulatory agencies, the Serious Fraud Office (“SFO”) is a specialist prosecuting authority that works with other government authorities to investigate and prosecute serious and complex fraud, bribery and corruption cases.²⁰³

²⁰⁰ See generally, Fin. Conduct Auth., FCA Mission: Our Approach to Enforcement (2018), <https://www.fca.org.uk/publication/corporate/our-approach-enforcement.pdf>.

²⁰¹ *Enforcement*, FIN. CONDUCT AUTH., <https://www.fca.org.uk/about/enforcement> (last visited May 18, 2018).

²⁰² *2014 fines*, FIN. CONDUCT AUTH., <https://www.fca.org.uk/news/news-stories/2014-fines> (last visited May 18, 2018); *2015 fines*, FIN. CONDUCT AUTH., <https://www.fca.org.uk/news/news-stories/2015-fines> (last visited May 18, 2018); *2016 fines*, FIN. CONDUCT AUTH., <https://www.fca.org.uk/news/news-stories/2016-fines> (last visited May 18, 2018). Dollar amounts represent Pounds converted into U.S. dollars using the exchange rate on December 13, 2017.

²⁰³ *About us*, SERIOUS FRAUD OFFICE, <https://www.sfo.gov.uk/about-us/> (last visited May 18, 2018).

II. Possible Overlapping Enforcement Activities for the Same Misconduct

This complex and fragmented enforcement landscape can create opportunities for one act of misconduct to result in investigations and enforcement actions by multiple enforcement authorities. While the conduct may violate different laws or rules overseen by different enforcement authorities, the enforcement activities of the different authorities “overlap” in that they are, in effect, investigating and penalizing the same underlying conduct or actions.

This Part proceeds in two sections. First, we explain three ways that multiple enforcement authorities could bring overlapping enforcement actions for the same underlying activities by the enforcement target and provide a few examples. Second, we discuss potential problems that may arise when multiple enforcement authorities are involved in overlapping enforcement activity against a target.

A. Ways that Overlapping Enforcement Actions May Occur

There are three types of matters in which enforcement jurisdiction can be exercised simultaneously by U.S. public enforcement authorities: (1) criminal and civil cases; (2) federal and state cases; and (3) federal civil cases enforcing different laws for the same underlying conduct. These are not mutually exclusive and one, all, or any combination of the three can be present in a given case.

1. Overlapping Criminal and Civil Cases

Violations of many statutory provisions are criminal offenses in addition to being subject to civil enforcement. Therefore, the DOJ can bring a criminal action for a violation of the *same provision* for which a regulatory agency may impose a civil penalty. For example, the Securities Act, Exchange Act, Investment Advisers Act and Investment Company Act each provide that a willful violation of any provision of that law can be prosecuted as a criminal violation.²⁰⁴ If someone commits insider trading, for example, he can be subject to both an SEC civil action and a DOJ criminal action. Indeed, in one recent high-profile matter, the SEC and DOJ brought parallel civil and criminal actions relating to trading by the Galleon hedge fund.²⁰⁵

Civil and criminal enforcement actions may also occur together when an act of misconduct violates both a statutory provision enforced by a civil enforcement authority and a *different* substantive criminal provision enforced by the DOJ. For example, a public company executive who made misleading statements in a scheme to deceive investors might face both civil SEC liability under Section 10(b) of the Exchange Act²⁰⁶ and DOJ criminal wire fraud charges.²⁰⁷

²⁰⁴ 15 U.S.C. § 77x (Securities Act); 15 U.S.C. § 78ff(a) (Exchange Act); 15 U.S.C. § 80a-48 (Investment Companies Act); 15 U.S.C. § 80b-17 (Investment Advisers Act).

²⁰⁵ Remarks by Robert Khuzami on *SEC v. Galleon Management, LP* Press Conference (Oct. 16, 2009), <http://www.sec.gov/news/speech/2009/spch101609rk.htm>.

²⁰⁶ 15 U.S.C. § 78f(b).

²⁰⁷ 18 U.S.C. § 1343.

An example of overlapping enforcement actions by both civil and criminal enforcement authorities are the enforcement actions against multiple financial institutions for allegedly manipulating foreign exchange (“FX”) benchmark rates. A series of investigations yielded allegations by the DOJ that Barclays, Citicorp, JP Morgan, RBS, and UBS, had manipulated FX benchmark rates either independently or in collusion, had disclosed confidential customer order information and trading positions, and had altered trading positions at the expense of clients.²⁰⁸ The DOJ imposed criminal fines on these banks of more than \$2.5 billion in May 2015. The financial institutions also faced civil fines by other U.S. enforcement authorities. The table below summarizes the monetary sanctions that these institutions faced from the CFTC, OCC, DOJ and Fed.

Table 1.3: Settlement Payments from FX Benchmark Rigging Cases

Agency	Barclays	Citicorp	JP Morgan	RBS	UBS
CFTC ²⁰⁹	\$400 million	\$310 million	\$310 million	\$290 million	\$290 million
OCC ²¹⁰	-	\$350 million	\$350 million	-	-
DOJ (criminal) ²¹¹	\$650 million	\$925 million	\$550 million	\$395 million	\$203 million
Fed ²¹²	\$342 million	\$342 million	\$342 million	\$274 million	\$342 million
Total	\$1.392 billion	\$1.927 billion	\$1.552 billion	\$959 million	\$835 million

2. *Overlapping Federal and State Cases*

If an act of misconduct violates both federal and state law, then overlapping enforcement actions by both federal and state authorities may result. For example, a depository institution that opens customer accounts without customer knowledge or authorization may violate state consumer protection laws, as well as federal safety and soundness banking laws and federal consumer

²⁰⁸ See Trefis Team, *Five Banks Settle Forex Manipulation Charges For \$3.4 Billion*, FORBES (Nov. 12, 2014), <http://www.forbes.com/sites/greatspeculations/2014/11/12/five-banks-settle-forex-manipulation-charges-for-3-4-billion/#58ac18164567>.

²⁰⁹ Press Release, Commodity Futures Trading Comm’n, Release No. 7815-15 (May 20, 2015), <https://www.cftc.gov/PressRoom/PressReleases/7181-15>.

²¹⁰ Press Release, Office of the Comptroller of the Currency, OCC Fines Three Banks \$950 Million for FX Trading Improprieties (Nov. 12, 2014), <https://www.occ.treas.gov/news-issuances/news-releases/2014/nr-occ-2014-157.html>.

²¹¹ Press Release, Dep’t of Justice, Five Major Banks Agree to Parent-Level Guilty Pleas (May 20, 2015), <https://www.justice.gov/opa/pr/five-major-banks-agree-parent-level-guilty-pleas>.

²¹² Press Release, Board of Governors of the Federal Reserve System, Federal Reserve announces fines totaling more than \$1.8 billion against six major banking organizations for their unsafe and unsound practices in the foreign exchange (FX) markets (May 20, 2015), <https://www.federalreserve.gov/newsevents/press/enforcement/20150520a.htm>.

protection laws,²¹³ which could result in enforcement actions by federal and state enforcement authorities for the same underlying conduct.

There are a few prominent examples of this type of situation. An example is the Barclays LIBOR matter. In that matter, enforcement actions were taken against Barclays in connection with the rigging of two global benchmark interest rates, the London Interbank Offered Rate (“LIBOR”) and the Euro Interbank Offered Rate (“Euribor”) from 2005 through 2009.²¹⁴ Traders in New York and London allegedly worked to submit inaccurate rates to make Barclays’ trading books more profitable.²¹⁵ Barclays settled a civil matter with the CFTC and a criminal matter with the DOJ on June 27, 2012 by agreeing to, among other things, pay penalties of \$200 million and \$160 million to the CFTC and DOJ, respectively.²¹⁶ In addition, 40 states also pursued penalties against Barclays²¹⁷ based on legal claims grounded in the same course of conduct for which Barclays had settled concurrent DOJ and CFTC enforcement actions four years earlier. The states and Barclays reached a joint settlement resulting in the payment of \$100 million to the states in exchange for the states not pursuing any civil claims, including under state antitrust laws, unfair and deceptive practices laws, and state fraud statutes.²¹⁸

3. *Overlapping Federal Civil Cases*

Misconduct can also violate different laws within the jurisdiction of different federal enforcement authorities with civil enforcement powers. For example, if officers at a publicly traded financial institution know about systematic violation of consumer protection laws and fail to disclose that to investors, the company and officers could face enforcement actions by the CFPB for violations of federal consumer protection laws, banking regulators for unsafe and unsound practices, and the SEC for failure to disclose material information to investors.

²¹³ See, e.g., Press Release, Office of the Comptroller of the Currency, OCC Assesses Penalty Against Wells Fargo, Orders Restitution for Unsafe or Unsound Sales Practices (Sept. 8, 2016), <https://www.occ.treas.gov/news-issuances/news-releases/2016/nr-occ-2016-106.html> (noting that the OCC, CFPB and local authorities were sanctioning Wells Fargo for unauthorized opening of customer accounts).

²¹⁴ In re Barclays PLC, et al. (CFTC Docket No. 12-25), <http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfbarcclaysorder062712.pdf>.

²¹⁵ *Id.* at 3.

²¹⁶ *Id.* at 29-30; Press Release, Dep’t of Justice, Barclays Bank PLC Admits Misconduct Related to Submissions for the London Interbank Offered Rate and the Euro Interbank Offered Rate and agrees to Pay \$160 Million Penalty (June 27, 2012), <https://www.justice.gov/opa/pr/barclays-bank-plc-admits-misconduct-related-submissions-london-interbank-offered-rate-and>.

²¹⁷ Participating States included Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Iowa, Kansas, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, Wyoming.

²¹⁸ Settlement Agreement between State Attorneys General and Barclays (Aug. 8, 2016), https://oag.dc.gov/sites/default/files/dc/sites/oag/release_content/attachments/AG_Barclays%20Settlement%20Agreement%20Signed%20Execution%20Copy.pdf.

Examples of federal civil matters by multiple enforcement authorities arising from the same conduct include the 2016 Wells Fargo settlements with the CFPB, OCC, and Fed, which imposed penalties against Wells Fargo in connection with findings that employees had opened unauthorized customer accounts as a result of demanding sales targets and incentives put in place by senior management.²¹⁹

The CFPB fined Wells Fargo \$100 million, which at the time was the CFPB’s largest civil monetary penalty ever assessed.²²⁰ In addition to the fine, the CFPB ordered Wells Fargo to pay full refunds to affected consumers, an estimated \$2.5 million, and to take measures to ensure future compliance.²²¹ The OCC found that Wells Fargo had engaged in unsafe or unsound sales practices arising from the same conduct.²²² The \$35 million civil fine reflected the “bank’s failure to develop and implement an effective enterprise risk management program to detect and prevent the unsafe or unsound sales practices, and the scope and duration of the practices.”²²³ The Fed also investigated Wells Fargo for compliance breakdowns at the bank holding company level that pertained, at least in part, to the unauthorized account opening matter. Over 16 months after the OCC and CFPB actions, the Fed entered a consent order with Wells Fargo requiring the board to implement governance and risk management changes and restricting the bank’s ability to grow until satisfactory changes were adopted, implemented, and verified by a third-party reviewer.²²⁴

B. Potential Concerns with Overlapping Enforcement Actions by Multiple Enforcement Authorities

When underlying misconduct violates laws or rules enforced by different enforcement authorities, each of those authorities may decide to independently investigate the misconduct. As

²¹⁹ Press Release, Office of the Comptroller of the Currency, OCC Assesses Penalty Against Wells Fargo, Orders Restitution for Unsafe or Unsound Sales Practices (Sept. 8, 2016), <https://www.occ.treas.gov/news-issuances/news-releases/2016/nr-occ-2016-106.html> (noting that the OCC, CFPB and local authorities were sanctioning Wells Fargo for unauthorized opening of customer accounts); Press Release, Consumer Fin. Protection Bureau, Consumer Financial Protection Bureau Fines Wells Fargo \$100 Million for Widespread Illegal Practice of Secretly Opening Unauthorized Accounts (Sept. 8, 2016), <https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-fines-wells-fargo-100-million-widespread-illegal-practice-secretly-opening-unauthorized-accounts/>.

²²⁰ Press Release, Cons. Fin. Prot. Bureau, Consumer Financial Protection Bureau Fines Wells Fargo \$100 Million for Widespread Illegal Practice of Secretly Opening Unauthorized Accounts (Sept. 8, 2016), <https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-fines-wells-fargo-100-million-widespread-illegal-practice-secretly-opening-unauthorized-accounts/>.

²²¹ *Id.*

²²² Press Release, Office of the Comptroller of the Currency, OCC Assesses Penalty Against Wells Fargo, Orders Restitution for Unsafe or Unsound Sales Practices (Sept. 8, 2016), <https://www.occ.treas.gov/news-issuances/news-releases/2016/nr-occ-2016-106.html> (noting that the OCC, CFPB and local authorities were sanctioning Wells Fargo for unauthorized opening of customer accounts); Press Release, Consumer Fin. Protection Bureau, Consumer Financial Protection Bureau Fines Wells Fargo \$100 Million for Widespread Illegal Practice of Secretly Opening Unauthorized Accounts (Sept. 8, 2016), <https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-fines-wells-fargo-100-million-widespread-illegal-practice-secretly-opening-unauthorized-accounts/>.

²²³ *Id.*

²²⁴ In the matter of Wells Fargo & Company, Docket No. 18-007-B-HC, <https://www.federalreserve.gov/newsevents/pressreleases/files/enf20180202a1.pdf> (referencing the OCC and CFPB enforcement actions).

a result, a person or firm may be required to respond to multiple requests for the same documents, make employees or other persons available for multiple interviews, and provide access to different enforcement authorities at different times to physical locations or files. Such duplicative activities are inefficient for both government agencies that could otherwise pool resources to streamline the investigative process, and for the targets of the potential enforcement action who must respond to redundant requests. Interviews with industry representatives indicate mixed views about the extent to which enforcement authorities effectively coordinate at the investigative stage. On the one hand, some say they have seen a marked improvement in coordination among enforcement authorities in conducting investigations in the past decade. On the other hand, others say that it is not clear that any one enforcement authority takes the lead on an investigation and production of requested documents and information often runs on parallel tracks.

A second concern is that absent coordination and cooperation, enforcement targets can be subject to great uncertainty when there is a risk of overlapping enforcement actions. From a target's perspective, a source of anxiety is uncertainty surrounding whether enforcement activity pertaining to a specific course of conduct has been completely resolved. In negotiating settlement terms, a target of an enforcement action may make concessions or agree to certain terms, conditions, or payments, on the basis that the settlement will resolve the matter completely. But if the underlying conduct also potentially violates laws under the jurisdiction of other enforcement authorities and the target lacks assurances that future actions by other enforcement authorities may not be taken in the future, then it makes it more difficult for the target to determine acceptable settlement terms for the current matter or to forecast future liability reserves for accounting purposes.

Third, a lack of coordination and cooperation in overlapping enforcement actions could result in penalties that go beyond what is necessary to achieve the policy objectives of deterrence and remediation.²²⁵ This can have counterproductive impacts on activity and the economy and can occur either because enforcement authorities are unwilling to consider what a target has paid to other enforcement authorities. It can also occur if enforcement authorities are in competition with one another to be able to obtain a larger settlement in a matter than other enforcement authorities for political purposes. Thus, penalties could be imposed beyond the amount needed to deter future wrongdoing.

²²⁵ See Deputy Attorney General Rod Rosenstein, Remarks to the New York City White Collar Crime Institute (May 9, 2018), <https://www.justice.gov/opa/speech/deputy-attorney-general-rod-rosenstein-delivers-remarks-new-york-city-bar-white-collar> (explaining new DOJ coordination policy on corporate sanctions as seeking to avoid duplicative penalties and noting that businesses that face oversight from many regulators face a risk of “repeated punishments that may exceed what is necessary to rectify the harm and deter future violations”).

III. Coordination of Enforcement Activities Among U.S. Enforcement Authorities

The U.S. enforcement system's fragmented jurisdictional structure makes coordination among enforcement authorities critical because of the potential issues that can result if coordination is not carried out effectively. However, in the current system there is not a uniform legal mechanism through which investigations or enforcement actions are coordinated. Rather, coordination results from a mixture of sources. Those are: (1) statutory provisions promoting or requiring coordination; (2) coordination by the President of enforcement authorities through the establishment of task forces and working groups; and (3) agency driven coordination through voluntarily adopted policies or ad hoc, case-by-case coordination efforts. We describe the current policies and practices of enforcement authorities and then present recommendations for how a more formal and standardized approach could be implemented.

A. Statutorily Mandated Coordination

In limited instances, Congress has mandated that agencies take steps that promote coordination with each other. However, such directives are the exception rather than the rule and are relatively minor in scope. We review them below.

1. Legal Provisions Intended to Enhance Coordination

A primary example of Congressional efforts to promote enforcement coordination are provisions in Dodd-Frank that require the CFPB to engage with the DOJ on enforcement proceedings. Specifically, the law mandates that the CFPB notify the Attorney General of any suit or proceeding to which it is a party, except for proceedings involving the offering or provision of consumer financial products or services.²²⁶ In addition, the law requires the CFPB and the DOJ to enter into an agreement with each other to ensure that parallel investigations and proceedings involving consumer financial protection laws are conducted in a way that avoids conflicts and does not impede the DOJ's ability to prosecute violations of federal criminal laws.²²⁷

The CFPB and DOJ entered into the statutorily prescribed agreement in January 2012.²²⁸ The Memorandum of Understanding requires the CFPB to notify the DOJ whenever it commences a civil action, including under federal consumer financial laws, or if it is a party to any litigation or proceeding, other than one involving federal consumer financial laws, along with certain other notification requirements.²²⁹

The agreement also parrots the statute by stating that the CFPB and DOJ will consult and coordinate with each other to avoid conflict in parallel investigations and proceedings. It does not elaborate on how this coordination is to be achieved. The lack of detail raises questions about how

²²⁶ 12 U.S.C. § 5564(d)(2)(A).

²²⁷ *Id.* § 5564(d)(2)(B).

²²⁸ See Memorandum of Understanding Between the Consumer Financial Protection Bureau and The United States Department of Justice (Jan. 20, 2012), <http://files.consumerfinance.gov/f/2012/01/CFPB-DOJ-MOU.pdf>.

²²⁹ See *id.*

the agreement is being implemented in practice and whether it is achieving the statute’s aim of coordination. Moreover, it is important to note that a notice requirement like the one applicable to the CFPB and DOJ does not necessarily mean coordination on resolving an enforcement matter or on determining the appropriate aggregate amount of any monetary sanctions imposed.

The Equal Credit Opportunity Act (“**ECOA**”),²³⁰ which prohibits discrimination against credit applicants on the basis of race, color, religion, age, sex or national origin,²³¹ also requires coordination to a limited extent among the CFPB, banking regulators and the DOJ. The ECOA delegates authority to enforce the law to the CFPB as well as to a depository institution’s primary federal banking regulator.²³² Banking regulators and the CFPB are required to refer the suspected violations of the ECOA to the DOJ so the DOJ can decide whether to bring a lawsuit under the DOJ’s statutory purview.²³³

There are a few other notable instances where enforcement coordination is required by law. First, the SEC is required to consult with banking regulators before it takes any enforcement action (or any other action such as issuing a comment letter) regarding the manner in which any insured depository institution or depository institution holding company reports loan loss reserves in its financial statements.²³⁴ Second, before the FDIC can revoke the insurance for deposits at federally insured depository institutions, it must provide at least 30 days’ notice to the bank’s primary federal or state regulator.²³⁵

2. *Narrow Limitations of Statutorily Mandated Coordination*

The current Congressional mandates for coordination are hampered by the narrow and limited nature of the mandatory cooperation and notification requirements. Congress has not adopted any overarching national policy requiring cooperation (including in the determination of sanctions) or established a mechanism or institution through which cooperation can be monitored and enforced.

Another significant limitation of Congressionally-mandated coordination is that it is questionable whether Congress can require *state* authorities to coordinate with the federal government. In a line of constitutional law cases, the Supreme Court has held that Congress can neither pass a law requiring state governments to take specific actions nor can Congress use its control over federal spending to coerce state governments to take specified actions.²³⁶ However, Congress can pass laws to pre-empt state laws and it is possible Congress could condition avoidance by states of pre-emption by requiring approval from federal regulators to proceed. That approval could in practice be subject to some sort of coordination policy. Absent legislation pre-empting state enforcement efforts outright or requiring federal government approval for a state to

²³⁰ 15 U.S.C. §§ 1691 *et seq.*

²³¹ *Id.* § 1691(a).

²³² *Id.* § 1691c(a)(1)-(2), (7), (9).

²³³ *Id.* § 1691e(g)-(h).

²³⁴ Gramm-Leach-Bliley Act, Pub. L. No. 106-102, § 241, 113 Stat. 1338, 1407 (1999).

²³⁵ 12 U.S.C. § 1818(a)(2).

²³⁶ *See* New York v. United States, 505 U.S. 144 (1992); Printz v. United States, 521 U.S. 898, 933 (1997); South Dakota v. Dole, 483 U.S. 203 (1987); NFIB v. Sebelius, 132 S. Ct. 2566 (2012).

undertake enforcement activities, coordination between federal and state enforcement agencies largely has to be based on voluntary arrangements and understandings.

B. Presidential Orders of Coordination

A second mechanism to enhance coordination is a Presidential directive. President George W. Bush issued a directive aimed at enhancing coordination in the wake of the corporate accounting scandals of the early 2000s²³⁷ and President Obama issued one in 2009 that established a task force on financial fraud enforcement.²³⁸ They are both described below.

1. Executive Orders 13271 and 13519

In 2002, amid ongoing accounting scandals at high profile companies like Enron and WorldCom, President Bush signed Executive Order 13271, which established a corporate fraud task force. The task force had two primary objectives. First, it created a working group of DOJ officials to coordinate enforcement activities within the DOJ. Specifically, between the FBI and DOJ's Washington, D.C. office, and various U.S. Attorneys Offices in cases of significant financial crimes. Second, the chairs of the SEC and CFTC, along with the Secretary of the Treasury, Deputy Attorney General, FBI Director, and others, were instructed to make recommendations to the President and Attorney General about how to enhance cooperation among federal and state enforcement authorities.²³⁹ It granted no powers to any agency or official to force, or even simply encourage, cooperation among enforcement authorities.

Upon taking office in 2009, President Obama signed Executive Order 13519, which created a task force led by the DOJ comprised of senior-level officials (selected by the head of the relevant agency or department) from Treasury, the SEC, the CFTC, the Fed, the OCC, the FDIC, FinCEN and the FBI, along with other federal agencies.²⁴⁰ The mission of the task force was to provide advice to the Attorney General in the investigation and prosecution of: bank, mortgage, loan and lending fraud; securities and commodities fraud; FCA violations; mail and wire fraud; money laundering; other financial crimes; and to coordinate law enforcement operations with representatives of state, local and tribal law enforcement.²⁴¹ The task force created a number of enforcement subcommittees, including the residential mortgage-backed securities working group and the securities and commodities fraud working group.

The residential mortgage-backed securities working group is an organization of federal and state authorities that shares resources to investigate wrongdoing in the mortgage-backed securities market prior to the financial crisis.²⁴² The working group, which is still in existence, has recovered

²³⁷ Establishment of the Corporate Fraud Task Force, Exec. Order No. 13,271, 67 Fed. Reg. 46,091 (July 11, 2002).

²³⁸ See Establishment of the Financial Fraud Enforcement Task Force, Exec. Order No. 13,519, 70 Fed. Reg. 60,123 (Nov. 19, 2009), <https://www.gpo.gov/fdsys/pkg/FR-2009-11-19/pdf/E9-28022.pdf>.

²³⁹ *Id.*

²⁴⁰ 70 Fed. Reg. at 60,124.

²⁴¹ *Id.*

²⁴² FINANCIAL FRAUD ENFORCEMENT TASK FORCE, <http://web.archive.org/web/20161203015212/https://www.stopfraud.gov/tfs.html> (last visited May 18, 2018).

over \$40 billion in fines and consumer relief since it was formed in 2012, including in the \$16.65 billion settlement with Bank of America, and major settlements with J.P. Morgan, Goldman Sachs, Citibank and Morgan Stanley.²⁴³

The securities and commodities fraud working group focused on coordination among federal and state authorities to develop and successfully resolve high-priority cases involving securities and commodities fraud (e.g., insider trading, Ponzi schemes, market manipulation).²⁴⁴ The working group was comprised of the U.S. Attorney for the Southern District of New York, the Directors of Enforcement for the SEC and CFTC, and the Assistant Attorney General for the Criminal Division.²⁴⁵ There are not publicly available statistics about the actions taken by this working group, even though it is listed on a government website as an existing task force.²⁴⁶

2. *Limitations of Presidentially-Directed Coordination*

Presidential task forces are helpful in promoting communication and cooperation among agencies, but their ability to directly influence each authority's enforcement activities is limited. Importantly, they lack a mechanism to resolve disputes or force cooperation among the agencies. None of these task forces or working groups has official authority to veto a proposed enforcement action by one agency or to require one enforcement authority to settle a matter. As such, these groups cannot ensure that all enforcement actions pertaining to an underlying act of misconduct are harmonized or resolved simultaneously.

C. *Individual Agency Policies, Procedures and Practice*

Agencies promote coordination and cooperation through internal policies, as well as ad hoc, case-by-case informal coordination with other enforcement authorities on specific enforcement actions. The DOJ and the SEC have the most robust policies concerning coordination with other enforcement authorities. These policies are set forth in the DOJ's U.S. Attorneys' Manual and the SEC's Enforcement Manual.²⁴⁷ This section describes these policies, along with the policies of the banking regulators and the CFPB disclosed in publicly available documents and in public statements.²⁴⁸

²⁴³ Press Release, N.Y. State Att'y Gen., A.G. Schneiderman-Led State & Federal Working Group Announces \$5 Billion Settlement With Goldman Sachs (Apr. 11, 2016), <http://www.ag.ny.gov/press-release/ag-schneiderman-led-state-federal-working-group-announces-5-billion-settlement-goldman>.

²⁴⁴ Bonnie Jonas, *Securities and Commodities Fraud Working Group*, U.S. Att'ys Bulletin, Sept. 2010, at 10, <https://www.justice.gov/sites/default/files/usao/legacy/2010/10/05/usab5805.pdf>.

²⁴⁵ See FIN. FRAUD ENF'T TASK FORCE, FIRST YEAR REPORT (2010), https://www.americanbar.org/content/dam/aba/administrative/litigation/materials/2012_aba_annual/15_1.authcheckdam.pdf.

²⁴⁶ FIN. FRAUD ENF'T TASK FORCE, <https://www.stopfraud.gov/sf> (last visited Jan. 3, 2018).

²⁴⁷ See generally U.S. ATTORNEYS' MANUAL, <https://www.justice.gov/usam/united-states-attorneys-manual> (last visited May 18, 2018); U.S. SEC. & EXCH. COMM'N, DIV. OF ENF'T, ENFORCEMENT MANUAL (2017), <https://www.sec.gov/divisions/enforce/enforcementmanual.pdf>.

²⁴⁸ We have been unable to locate any publicly available policies or guidelines at the CFTC regarding coordination of enforcement activities with other enforcement authorities.

I. Agency Policies Promoting Coordination

i. The DOJ

The DOJ’s internal policy handbook, the U.S. Attorneys’ Manual, provides that DOJ attorneys should coordinate with other enforcement authorities throughout the enforcement process. The Manual is a reference for U.S. Attorneys, Assistant U.S. Attorneys and attorneys at the DOJ’s Washington, D.C. office that contain general policies and procedures relevant to the work that they conduct.²⁴⁹

The Manual indicates that the DOJ places priority on the coordination of enforcement actions with other agencies. In 2012, for example, the Attorney General issued a memorandum to all DOJ attorneys that was incorporated into the U.S. Attorneys’ Manual that instructed that the DOJ’s policy is that “criminal prosecutors and [DOJ] civil trial counsel should timely communicate, coordinate, and cooperate with one another and agency attorneys to the fullest extent appropriate to the case and permissible by law,” whenever an alleged violation of federal law could give rise to multiple proceedings.²⁵⁰

The Attorney General’s memorandum sets forth policies that DOJ attorneys should follow at three stages of the enforcement process. First, when the DOJ is in the early evaluation stage of a case, DOJ attorneys should consider all potential civil, administrative and criminal remedies and explore those remedies with other government personnel.²⁵¹

Second, during the investigative stage, DOJ attorneys should consider strategies to maximize the government’s ability to share information among criminal, civil and administrative teams. For example, grand jury information cannot be shared with civil and administrative teams absent a court order, so criminal prosecutors aware of civil or administrative actions should consider obtaining information outside the grand jury process, so they can share it with the team leading the civil or administrative actions.²⁵²

Third, DOJ attorneys should consider the effect that resolution of their case will have on other enforcement proceedings, and should effectively and timely communicate with representatives of other agencies so that those agencies can pursue available remedies that may exist because of the resolution of the DOJ action (e.g., suspension of a registered entity or individual).²⁵³

²⁴⁹ U.S. ATTORNEYS’ MANUAL §1-1.100, <https://www.justice.gov/usam/usam-1-1000-introduction> (last visited May 18, 2018). It serves as internal guidance and does not provide rights to any third party.

²⁵⁰ Memorandum from the Attorney General on Coordination of Parallel Criminal, Civil, Regulatory, and Administrative Proceedings (Jan. 30, 2012), <https://www.justice.gov/usam/organization-and-functions-manual-27-parallel-proceedings>; U.S. ATTORNEYS’ MANUAL § 1-12.000, <https://www.justice.gov/usam/usam-1-12000-coordination-parallel-criminal-civil-regulatory-and-administrative-proceedings> (last visited May 18, 2018).

²⁵¹ Memorandum from the Attorney General, *supra* note 250.

²⁵² *Id.*

²⁵³ *Id.* For the inclusion of the policies in the U.S. Attorneys’ Manual, see U.S. ATTORNEYS’ MANUAL § 1-12.000.

The U.S. Attorneys’ Manual further specifies that criminal attorneys should confer with civil attorneys within the DOJ in the event a criminal case is not brought, so they can assess whether a civil enforcement action is appropriate.²⁵⁴ That guidance, however, does not clearly require the DOJ to communicate a decision not to prosecute to outside agency attorneys.

The Manual also provides that, in deciding whether to bring a criminal case, DOJ attorneys should consider the fact that civil remedies might be imposed for the same misconduct by the DOJ or other enforcement authorities. Specifically, the Principles of Federal Prosecution contained in the U.S. Attorneys’ Manual states that one consideration prosecutors must weigh is whether there is an adequate non-criminal alternative to prosecution.²⁵⁵ In making that judgment, prosecutors are instructed to consider all relevant factors, including the sanctions available under the alternative, the likelihood that those sanctions will be imposed and the effect of a non-criminal disposition of the matter on federal law enforcement interests.²⁵⁶

Moreover, on May 9, 2018, Deputy Attorney General Rod Rosenstein announced a new DOJ anti-“piling on” policy pertaining to coordination of penalties against corporations when proceedings or investigations by multiple enforcement authorities arise from the same misconduct. This new policy has been reflected in the U.S. Attorneys’ Manual, which was revised to instruct DOJ attorneys that they should consider the sanctions imposed or that will be imposed by other enforcement authorities to achieve an equitable outcome.²⁵⁷ It also instructs DOJ attorneys to coordinate with those other enforcement authorities “as appropriate.”²⁵⁸ We commend the DOJ for undertaking efforts to increase coordination in enforcement matters.

ii. The SEC

The SEC’s Enforcement Manual, a reference source for SEC attorneys containing SEC policies and procedures, also emphasizes cooperation and coordination with other enforcement authorities, primarily with criminal law enforcement authorities. First, the SEC policies provide that SEC attorneys should share information related to an investigation or enforcement action with federal, state, local and foreign government authorities, SROs and certain other entities upon request, and at the SEC’s discretion.²⁵⁹

Additionally, the SEC provides its staff with guidance on cooperating with the DOJ and states in criminal enforcement matters. The SEC’s Enforcement Manual states that, in certain circumstances, it is appropriate for the DOJ to ask the SEC to refrain from taking certain actions

²⁵⁴ U.S. ATTORNEYS’ MANUAL § 1-12.000.

²⁵⁵ *Id.*

²⁵⁶ *Id.* § 9-27.250, <https://www.justice.gov/usam/usam-9-27000-principles-federal-prosecution#9-27.250> (last visited May 18, 2018).

²⁵⁷ *Id.* § 1.-12.100.

²⁵⁸ *Id.*

²⁵⁹ 17 CFR § 240.24c-1; SEC ENFORCEMENT MANUAL, *supra* note 247, § 5.

that could harm a criminal investigation, and vice versa.²⁶⁰ The Enforcement Manual does not provide additional detail beyond this generic guidance, stating that each case is unique and instructing staff to discuss specific facts and considerations with their supervisors.²⁶¹ The guidance also provides that, while the SEC can cooperate with criminal authorities, the SEC should maintain its independence from the criminal matter.²⁶²

Finally, the SEC’s Enforcement Manual provides its staff guidance on when it is appropriate to refer a matter to the DOJ or to state or foreign criminal law enforcement authorities. Specifically, the SEC staff is instructed to take into account, among other things, “the egregiousness of the conduct, whether recidivism is a factor, and whether involvement of criminal authorities will provide additional meaningful protection to investors,” in deciding whether to refer a case to criminal enforcement authorities.²⁶³

iii. FFIEC Efforts at Coordination

The Fed, FDIC, and OCC also have adopted formal, publicly available policies that encourage cooperation and coordination, albeit only among the banking regulators themselves. The Fed, FDIC and OCC are subject to a policy published in 1997 by the Federal Financial Institutions Examination Council (“FFIEC”), a statutorily created interagency body empowered to prescribe uniform principles and standards related to the examination of financial institutions.²⁶⁴ Under the FFIEC policy, “[a]ny federal banking regulatory agency that proposes to take a formal enforcement action against any federal regulated financial institution or any institution-affiliated party” is *required* to “notify in writing the other federal banking regulatory agencies and, where appropriate, a state supervisory authority prior to or at the initiation of such action.”²⁶⁵

The FFIEC policy also requires federal banking regulators to coordinate enforcement matters if two or more of such agencies are involved in an enforcement action.²⁶⁶ For example, if the OCC were pursuing an action against a federally chartered bank and the Fed were pursuing an action against its parent holding company, the OCC and the Fed would be expected to coordinate.

However, the FFIEC policy does not provide any mechanism to ensure that the agencies act consistently with one another or take one-another’s actions, including sanctions, into account. In the end, each agency is responsible for its own jurisdictional turf and for making its own enforcement decisions, including whether to bring an action, whether to settle, and for how much to settle. The policy actually makes that fact explicitly clear, stating “[t]hese procedures are not intended to preclude or forestall any federal banking regulatory agency from initiating an

²⁶⁰ SEC ENFORCEMENT MANUAL, *supra* note 247, § 5.2.

²⁶¹ *Id.*

²⁶² *Id.*

²⁶³ *Id.* § 5.6.1.

²⁶⁴ 12 U.S.C. § 3301; FED. FIN. INST. EXAMINATION COUNCIL, <https://www.ffiec.gov/about.htm> (last visited May 18, 2018).

²⁶⁵ Interagency Coordination of Formal Corrective Action by the Federal Bank Regulatory Agencies, 62 Fed. Reg. 7,782, 7,783 (Feb. 20, 1997).

²⁶⁶ *Id.*

enforcement action alone and on a timely basis against an institution or institution-affiliated party for which it has primary supervisory jurisdiction.”²⁶⁷

iv. The CFPB

Agencies may also have informal practices or policies that encourage cooperation and coordination that are not necessarily documented, at least in any publicly available documents. For example, the CFPB does not have a formal, documented, publicly available coordination policy with banking regulators regarding its enforcement of federal consumer financial laws. However, an Inspector General report has noted that CFPB officials informally coordinate with banking regulators. The CFPB and banking regulators told the Inspector General that they believed it was best to handle enforcement issues on a case-by-case basis.²⁶⁸

2. Limitations of Agency Policies on Coordination

Currently, there is no uniform standard or mandate that has been imposed on enforcement authorities to create standardized and transparent coordination policies. In principle, voluntarily adopted agency policies that promote or require coordination can help to mitigate the inefficiencies that can result from a fragmented enforcement system. Even ad hoc case-by-case coordination among teams at different enforcement authorities can help to avoid the potential pitfalls that may arise when multiple enforcement authorities are targeting a person or firm for the same underlying misconduct. However, because enforcement investigations and negotiations are conducted behind the scenes and little meaningful disclosure is made about how enforcement authorities coordinate in specific matters, it is difficult to evaluate the extent to which enforcement authorities make efforts under their voluntarily adopted policies or ad hoc approaches to coordinate, and to evaluate the effectiveness of any such efforts.

Nevertheless, several limitations to the reliance on internal policies and ad hoc coordination exist. First, because agency policies are generally adopted internally (without public participation) and at the agencies’ discretion, the agencies retain wide latitude with respect to their implementation and potential revision.

When policies are independently adopted by each enforcement authority or coordination is done on a case-by-case basis, there is also not standardization between enforcement authorities. Policies adopted at an agency level may also vary widely from agency to agency, which directly undermines their effectiveness. Coordination is a two-way street: for example, efforts by the SEC to coordinate with the CFPB on a particular matter will be unsuccessful if the CFPB lacks the capacity or will to fully engage with the SEC in a cooperative fashion. Similarly, while we commend the DOJ’s May 2018 announcement of additional policies aimed at improving

²⁶⁷ *Id.*

²⁶⁸ See JAMES W. HAGEN, INSPECTOR GEN., NAT’L CREDIT UNION ADMIN., COORDINATION OF RESPONSIBILITIES AMONG THE CONSUMER FINANCIAL PROTECTION BUREAU AND THE PRUDENTIAL REGULATORS—LIMITED SCOPE REVIEW (Jun. 1, 2015), <https://www.ncua.gov/About/leadership/CO/OIG/Documents/OIG20150604CoordinationofResponsibilities.pdf>.

coordination in resolving enforcement matters against corporations, such efforts will not be maximally effective if other enforcement authorities do not reciprocate.

Second, the informal nature of coordination and lack of information about its effectiveness also means that agencies' accountability to the public and to elected officials regarding these policies and their execution of them is limited. That can result in a public perception that enforcement authorities are not effectively cooperating and coordinating even if they are doing so behind the scenes.

D. Recommendations to Formalize and Standardize Coordination

The fragmented structure of the U.S. enforcement system creates potential policy concerns about the fairness of the system. These concerns include inefficient uses of government and private resources; uncertainty for enforcement targets; and the possibility of duplicative sanctions. The Committee Staff, therefore, proposes several recommendations aimed at formalizing and standardizing the coordination process to ameliorate the issues that have the potential to arise from the fragmented enforcement structure.

- **Recommendation 1:** Each enforcement authority should develop formal, written policies, subject to public notice and comment, that detail how the enforcement authority will coordinate with other enforcement authorities in conducting investigations, requesting access to documents and witnesses, and negotiating settlements.

Public policies regarding coordination among agencies would inspire public confidence that enforcement authorities are making serious efforts to coordinate activities. The adoption of such a requirement would also increase the saliency within agencies about the importance of coordination and cooperation. Congress could even impose certain parameters for such policies and thus encourage the standardization of coordination and cooperation policies among enforcement authorities. Indeed, the Financial CHOICE Act of 2017, proposed legislation that has passed the U.S. House of Representatives, would require coordination of enforcement efforts.²⁶⁹ We specifically recommend that the development of these policies be done through a public comment and notice process.

- **Recommendation 2:** Federal enforcement authorities should collaborate with one another on the development of their coordination policies.

Coordination policies will only be maximally effective if the policies are compatible with those at other enforcement authorities. Therefore, during the process of developing policies, the enforcement authorities should be discussing ideas with each other and working to ensure that the individual enforcement authority policies will work together to ensure effective coordination.

²⁶⁹ Specifically, if enacted, Section 391 of the Financial CHOICE Act of 2017 would require the CFPB, CFTC, FDIC, Fed, OCC, SEC, and NCUA to each implement policies and procedures to minimize duplication of efforts, establish joint investigations, and appoint a lead agency in joint investigations. Financial CHOICE Act of 2017, H.R. 10, 115th Cong. § 391 (2017).

- **Recommendation 3:** Enforcement authorities should consider the sanctions that other enforcement authorities, including foreign enforcement authorities, have imposed or are about to impose when setting sanctions in their own enforcement actions. Enforcement authorities should explain how they have taken such other sanctions into consideration.

As part of a coordination program, enforcement authorities should require that agencies consider sanctions that other agencies, as well as foreign enforcement authorities, have imposed or will be imposing when setting sanctions in their own enforcement actions. Agencies are now *permitted* to weigh the sanctions already imposed by other enforcement authorities but are not legally *required* to do so. Such a requirement could encourage officials to develop legitimate rationales for the imposition of additional penalties if the underlying misconduct has already been sanctioned. In November 2017, Deputy Attorney General Rod Rosenstein stated that the DOJ is “considering proposals to improve coordination . . . to help avoid duplicative and unwarranted [penalties],”²⁷⁰ and, as noted, in May 2018 the DOJ adopted the anti-“piling on” policy to coordinate the setting of sanctions against corporations. We commend the DOJ for recognizing the importance of this issue. It is critical that other agencies do so as well because enforcement authorities are often not well positioned to litigate enforcement actions. Litigation is often not a practical option because financial institutions seek to avoid antagonistic relationships with their day-to-day regulatory supervisors and reputational harm that could result from prolonged litigation. Thus, settlements are common and because settlements lack meaningful judicial review, it is possible that settlements will fail to consider the penalties imposed by other enforcement agencies that are not a party to the settlement. It is therefore critical that enforcement authorities work together to determine the total penalty amount for the underlying misconduct and then allocate that amount among the various enforcement authorities with jurisdiction over the matter. That would avoid duplicative penalties for the same underlying misconduct, which, as discussed in chapter 2, is a principle adopted by the U.S. Sentencing Guidelines.

²⁷⁰ Rod Rosenstein, Deputy Attorney General, U.S. Dep’t of Justice, Remarks at the Clearing House’s 2017 Annual Conference (Nov. 8, 2017), <https://www.justice.gov/opa/speech/deputy-attorney-general-rosenstein-delivers-remarks-clearing-house-s-2017-annual>.

IV. Forum Selection and Procedural Fairness

Part IV describes the vast discretion that certain enforcement authorities, particularly the SEC, CFTC, and CFPB, have in deciding whether to litigate an enforcement action in federal court or in an administrative proceeding. To address concerns about procedural fairness, we conclude this Part by recommending that the enforcement authorities' unilateral forum selection discretion be circumscribed.

A. SEC, CFTC, and CFPB Power to Choose a Forum

When an agency seeks to enforce a law over which it has jurisdiction, it may be statutorily required to bring an action in a particular forum – exclusively in federal court or exclusively in an administrative proceeding under the agency's own purview. At other times, the agency may be able to choose the forum it would like to use. The DOJ is limited to bringing cases in federal court;²⁷¹ the banking regulators, OFAC and FinCEN are generally limited to using administrative processes;²⁷² and the SEC, CFTC and CFPB generally have the discretion to bring a case in federal court or in an administrative proceeding.²⁷³

Of the three agencies that have discretion to choose the forum for litigation, only the SEC truly utilizes administrative proceedings.²⁷⁴ The last time the CFTC litigated a case in an administrative proceeding was in 2001.²⁷⁵ Historically the CFTC has used the administrative forum purely to document pre-arranged settlement agreements. The CFPB has only litigated one case in an administrative proceeding. Like the CFTC, the CFPB has almost exclusively used the administrative forum to document pre-arranged settlement agreements.

²⁷¹ See, e.g., 31 U.S.C. § 3730(a) (FCA), 18 U.S.C. § 1833a(c) (FIRREA); U.S. CONST. amend. VI (right to jury trial in criminal cases).

²⁷² See 31 U.S.C. § 5321 (FinCEN authorized to seek monetary penalties only through administrative action); 50 U.S.C. § 1705(a) (OFAC authorized to seek monetary penalties only through administrative action); 12 U.S.C. § 93(a)-(b) (same OCC); *Id.* § 1847(b) (same Fed); *Id.* § 1818(i)(E) (FDIC, OCC and Fed allowed to assess monetary penalty through written notice but not civil suit). FinCEN can bring cases in federal court to seek court orders to stop ongoing violations of law, but does not have a choice of forum to obtain that relief. 31 U.S.C. § 5320.

²⁷³ See 15 U.S.C. § 77h-1(f) (Securities Act authorizing SEC to bring enforcement action in administrative forum); *id.* § 77t(b), (d) (Securities Act authorizing SEC to bring enforcement action in federal court); *Id.* § 78u-3(f) (Exchange Act authorizing SEC to bring administrative action); *id.* § 78u(d) (Exchange Act authorizing SEC to bring civil lawsuit to enforce law); *Id.* § 80a-9 (Investment Company Act authorizing SEC to bring administrative action); *Id.* § 80a-41 (Investment Company Act authorizing SEC to bring civil lawsuit to seek sanctions); *Id.* § 80b-9 (Advisers Act authorizing SEC to bring administrative action to seek sanctions); *id.* § 80b-3(e), (f) (Advisers Act authorizing SEC to bring civil lawsuit to seek sanctions); 7 U.S.C. § 13a (authorizing CFTC to seek sanctions against registered entities in administrative proceedings); *Id.* § 13a-1 (authorizing CFTC to seek sanctions through civil lawsuit); 12 U.S.C. §§ 5564–66 (authorizing CFPB to bring enforcement action in either forum).

²⁷⁴ *Despite 1st Administrative Appeal CFPB Seeks Out Courts*, REEDSMITH (June 24, 2015), <https://www.reedsmith.com/en-US/Despite-1st-Administrative-Appeal-CFPB-Seeks-Out-Courts-06-24-2015/>.

²⁷⁵ *Recent developments in CFTC enforcement*, GIBSON DUNN (Apr. 13, 2016), <http://www.gibsondunn.com/publications/documents/Recent-Developments-in-CFTC-Enforcement.pdf>. The CFTC will issue administrative orders when it reaches a settlement agreement before formally bringing a case, but historically it has not used the administrative forum to litigate cases.

Data the Committee Staff has collected on enforcement actions filed by the SEC, CFTC, and CFPB from 2000 through 2016 shows that the proportion of enforcement actions brought by the SEC in the administrative forum has steadily increased. **Figure 1.1**, below, shows the SEC increasing the percentage of filed enforcement actions in the administrative forum from roughly 55% in calendar year 2010 to over 75% in calendar year 2016. It is important to note that the Dodd-Frank Act, passed in 2010, expanded the scope of the SEC's authority to bring cases seeking monetary penalties against individuals and firms not registered with the SEC in the administrative forum.²⁷⁶ While we do not have data for 2000-2016 on what proportion of the cases filed in the administrative forum are pre-arranged settlements, the SEC acknowledged in 2015 that it had shifted practices to file most pre-settled cases in the administrative forum.²⁷⁷ Moreover, because of the constitutional challenges to SEC administrative law judges discussed later in this chapter, practitioners have stated that in recent years the vast majority of litigated cases have been filed in federal court.²⁷⁸ Thus, some, if not all, of the increase in the use of the administrative forum could be attributable to a shifting of where cases with pre-arranged settlements are being filed.

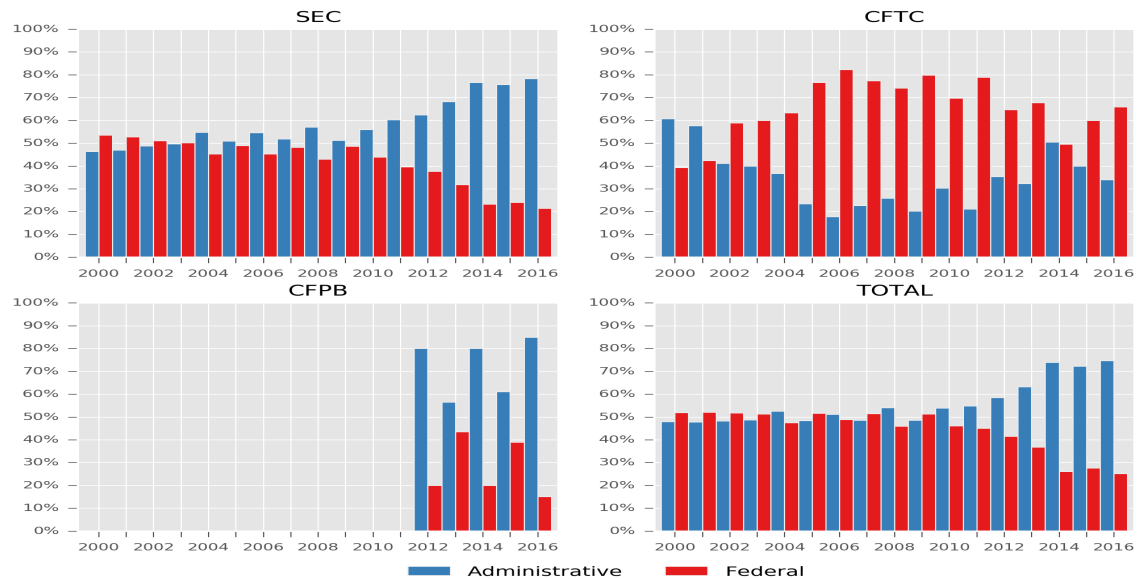
There are no clear trends in the CFPB's and CFTC's use of the administrative forum or federal court forum. The CFTC has usually filed between 20% and 40% of its cases in the administrative forum, reflecting negotiated settlements put into place before an action was formally filed. The percent of cases filed by the CFPB in the administrative forum has ranged from approximately 60% to 80%, virtually all of which were pre-arranged settlements.

²⁷⁶ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 929P, 124 Stat. 1398, 1862 (2010).

²⁷⁷ See Andrew Ceresney, Keynote Speech and New York City Bar 4th Annual White Collar Institute (May 12, 2015), <http://www.sec.gov/news/speech/ceresney-nyc-bar-4th-white-collar-key-note.html>.

²⁷⁸ Matthew Solomon, et al., CLEARY GOTTLIEB, *Supreme Court Grants Certiorari on the Constitutionality of SEC ALJ Appointments – What this Means for the Securities Industry* (Jan. 16, 2018), <https://www.clearyenforcementwatch.com/2018/01/supreme-court-grants-certiorari-constitutionality-sec-alj-appointments-means-securities-industry/>.

Figure 1.1: Percentage of Enforcement Actions Filed in Federal Court or Administrative Forum



B. Differences Between a Federal Court Case and Administrative Proceeding

When an agency brings a lawsuit in federal court, the case is presided over by a federal judge who is independent of the agency.²⁷⁹ The case is governed by the Federal Rules of Civil Procedure and the Federal Rules of Evidence. In essence, the agency is like any other party to a lawsuit and must make its best case. By contrast, when an agency seeks to assess a penalty administratively, the matter is usually brought before an administrative law judge (“ALJ”) who presides over the case and makes an initial decision.²⁸⁰ OFAC and FinCEN are exceptions to this rule. Rather than a hearing before an ALJ, those agencies simply allow a target to provide information in writing to the agency before a final penalty is assessed by the director of the respective agency.²⁸¹ We do not address the OFAC and FinCEN approach, but note that it raises serious due process concerns.

²⁷⁹ U.S. CONST. art. II, § 2 (appointment by President with advice and consent of Senate); U.S. CONST. art. III (providing that federal judges have lifetime tenure).

²⁸⁰ See 17 C.F.R. § 201.110 (SEC administrative actions heard by ALJ); *Id.* § 10.8 (CFTC administrative cases heard by ALJs); 12 C.F.R. § 1081.104 (CFPB administrative cases to be heard by an ALJ); *Id.* § 308.5 (FDIC administrative actions heard by ALJ); *Id.* § 263.5 (Fed administrative actions heard by ALJ); *Id.* § 19.5 (OCC administrative actions heard by ALJ).

²⁸¹ See James H. Freis, Jr., Director, Fin. Crimes Enf’t Network, U.S. Dep’t of the Treasury, *The Objectives and Conduct of Bank Secrecy Act Enforcement*, Remarks Delivered at the ABA/ABA Money Laundering Enforcement Conference (Oct. 20, 2008), https://www.ffiec.gov/bsa_aml_infobase/documents/new_11_08/FinCEN_Objectives_Conduct%20.pdf; 31 C.F.R. § 538.702 (Sudanese Sanctions Regulations); 31 C.F.R. § 542.702 (Syrian Sanctions Regulations).

1. *Use and Selection of ALJs*

ALJs who preside over administrative hearings are agency employees paid by the agency bringing the matter, who are supposed to function as independent, impartial triers of fact.²⁸² Given the inherent tension between being an agency employee and an impartial adjudicator, certain procedural protections exist to make ALJs more independent from the agency than a normal employee. First, ALJs are selected through a merit selection process administered by a separate executive agency called the Office of Personnel Management (“**OPM**”) that involves competitive examinations.²⁸³ When an agency needs to hire an ALJ, it selects one from the top three available candidates as determined by the OPM.²⁸⁴ Second, ALJs cannot be rated by the agency on their job performance or receive monetary or honorary awards or incentives from an agency.²⁸⁵ Third, ALJs are protected from being fired by an agency; they can only be removed for “good cause” by the independent Merit Systems Protection Board.²⁸⁶

2. *Different Procedural Rules*

When an ALJ presides over an administrative action, the ALJ applies procedural rules developed by the relevant agency.²⁸⁷ These rules can differ from those that would apply in federal court, such as the Federal Rules of Civil Procedure and the Federal Rules of Evidence.

For example, the SEC’s rules require an ALJ to commence a hearing on the merits within 10 months of the SEC bringing the action²⁸⁸ and to render a decision within 120 days after the conclusion of the hearing.²⁸⁹ This contrasts with the Federal Rules of Civil Procedure applicable in federal court, which do not impose any such time constraints on federal judges.²⁹⁰ Similarly, the SEC rules impose greater restrictions on a respondent’s ability to depose witnesses and obtain other discovery in advance of a hearing than do the Federal Rules of Civil Procedure.²⁹¹ However, it is important to note that the SEC’s Rules of Practice require the SEC to provide the defendant access to SEC files, documents, and information that the Federal Rules of Civil Procedure do not require. Specifically, SEC rules require the agency to turn over its case file to a defendant, including any exculpatory information in its possession, within seven days of serving notice on the defendant of the initiation of proceedings.²⁹² A corresponding rule does not exist in federal court. In addition, the SEC’s rules generally allow hearsay evidence, while the Federal Rules of

²⁸² VANESSA K. BURROWS, CONG. RESEARCH SERV., RL34607, ADMINISTRATIVE LAW JUDGES: AN OVERVIEW (2010).

²⁸³ *Id.* at 2.

²⁸⁴ *Id.* at 2–3.

²⁸⁵ 5 C.F.R. § 930.206.

²⁸⁶ 5 U.S.C. § 7521; 5 C.F.R. § 930.211.

²⁸⁷ *See, e.g.*, 17 C.F.R. §§ 201.100 *et seq.* (SEC Rules of Procedure and Practice).

²⁸⁸ *Id.* § 201.360(a)(2)(ii).

²⁸⁹ *Id.* § 201.360.

²⁹⁰ In some instances, a more expedited process might be desirable for the defendant. However, in matters where a defendant needs to conduct extensive discovery, the faster process could potentially hinder a defendant.

²⁹¹ *Compare* 17 C.F.R. § 201.233; *with* Fed. R. Civ. P. 30.

²⁹² 17 C.F.R. § 201.230.

Evidence generally bar it.²⁹³ In some matters, the administrative forum procedural rules can make it more difficult for defendants to uncover evidence that might be exculpatory and permit the government to build cases using evidence that would not be admissible in federal court.²⁹⁴

3. *Appeal of ALJ Decisions*

Once an ALJ has heard the evidence and made an initial decision, the decision can be appealed to the agency head, commissioners, or board members of the agency.²⁹⁵ These agency leaders then make the ultimate determination about whether the law was violated and the appropriate sanction to impose.²⁹⁶ The decision can also be reviewed by the agency on its own accord, even absent a request for an appeal.²⁹⁷ An agency's final decision to impose a sanction is subject to judicial review if the respondent chooses to bring a case in federal court.²⁹⁸

While the agency decision in an administrative proceeding is reviewable, federal courts review the agency's statutory interpretation of the law under a very deferential standard. So long as the agency's interpretation of the statute is reasonable, then the agency's interpretation is upheld.²⁹⁹ For example, when the SEC brings an enforcement action in the administrative forum, unresolved questions of statutory interpretation are typically decided by the SEC's own ALJs. An adverse ruling must then be appealed to the Commissioners before the target of the enforcement action can appeal the agency decision to a federal court.³⁰⁰ Thus, if the case is appealed to the federal courts, the SEC Commissioners will have had the first chance to interpret the statute and the courts will uphold that interpretation, so long as it is reasonable. The use of the administrative forum can therefore be used as a way for the agency to influence how a law is interpreted and applied. It thus represents a potential substantive legal advantage to an enforcement authority that has the authority to select the litigation forum.

C. *Constitutional Challenges to the SEC's Administrative Proceedings*

In recent years, the SEC's general use of administrative proceedings has been challenged on constitutional grounds. These challenges originated from fairness concerns that arise out of the

²⁹³ Compare 17 C.F.R. § 201.320 with Fed. R. Evid. 801-807.

²⁹⁴ In some matters, a defendant could benefit from the ability to use hearsay evidence in the administrative forum and thus the different rules of admissibility do not necessarily disadvantage a defendant.

²⁹⁵ 17 C.F.R. §§ 201.410–411 (SEC), 10.102–105 (CFTC); 12 C.F.R. §§ 1081.400–407 (CFPB), 308.40 (FDIC), 263.40 (Fed), 19.40 (OCC).

²⁹⁶ See sources cited, *supra* note 295.

²⁹⁷ See sources cited, *supra* note 295.

²⁹⁸ 5 U.S.C. §§ 702, 704 (Administrative Procedure Act providing that a party aggrieved by an agency action can seek judicial review of agency action). See, e.g., 12 U.S.C. § 5563(b)(4) (providing that CFPB administrative action can be appealed to appropriate U.S. Court of Appeals).

²⁹⁹ See *Chevron U.S.A. v. Natural Resources Def. Council*, 467 U.S. 837 (1984). Recently appointed Justice Gorsuch believes the Chevron doctrine is unconstitutional, and so observers should watch closely to see if the Supreme Court reverses its precedent in coming years. See Alison Frankel, *Chevron Deference Landmine Lurks in New Brief in SCOTUS Whistleblower Case*, REUTERS (Nov. 9, 2017), <https://www.reuters.com/article/legal-us-otc-chevron/chevron-deference-landmine-lurks-in-new-brief-in-scotus-whistleblower-case-idUSKBN1D92YZ>.

³⁰⁰ 12 C.F.R. § 201.410; 5 U.S.C. § 704.

use of the administrative forum by the SEC. The primary constitutional challenge is that the SEC’s appointment of ALJs violates the Appointments Clause of the Constitution because ALJs are “inferior officers.” The Appointments Clause requires that “inferior officers” be appointed by the President, a court of law, or the heads of departments.³⁰¹ However, the SEC’s ALJs are not appointed by President or a court, nor are they appointed by the SEC Commissioners.³⁰² Instead, ALJs are hired by the Office of Human Resources within the SEC.³⁰³ The SEC asserts that the Appointments Clause does not apply because ALJs are not “inferior officers” but are simply employees of the SEC.³⁰⁴ Two appeals courts have recently reached opposing conclusions on this constitutional question.

A three-judge panel of the D.C. Circuit Court of Appeals rejected the Appointments Clause challenge. The court held that ALJs are not “inferior officers” who are subject to the requirements of the Appointment Clause, but are instead merely government employees.³⁰⁵ The D.C. Court held this classification was appropriate because the SEC ALJs do not have full decision-making powers—the SEC Commissioners review their decisions, and only the SEC Commissioners can issue final administrative orders. The full D.C. Circuit then decided to hear the case and split evenly on the issues, leaving the three-judge panel’s decision in place.³⁰⁶

In a different case, the Tenth Circuit Court of Appeals held that the SEC has violated the Appointments Clause in its ALJ hiring process and therefore decisions rendered by ALJs are invalid. The Tenth Circuit found that that the ALJs are “inferior officers” because they exercise significant discretion in performing important functions and therefore should be appointed by the SEC Commissioners or the President.³⁰⁷

The challenger in the D.C Circuit case has petitioned the Supreme Court to hear its constitutional challenge to the appointment of ALJs.³⁰⁸ On November 29, 2017, the DOJ filed a brief with the Supreme Court agreeing that the ALJs are not appointed in a constitutional manner.³⁰⁹ In January 2018, the Supreme Court accepted the case, which was argued in April 2018, and the Supreme Court is expected to decide on the constitutionality of the appointment process

³⁰¹ U.S. CONST. art. II, § 2.

³⁰² *Bandimere v. SEC*, 844 F.3d 1168, 1177 (10th Cir. 2016).

³⁰³ *Id.*

³⁰⁴ *Id.* at 1182.

³⁰⁵ *Lucia v. SEC*, 832 F.3d 277, 282–89 (D.C. Cir. 2016).

³⁰⁶ *Lucia*, 832 F.3d at 277; *Securities Litigation Update: After Full D.C. Circuit Deadlocks, Circuit Court Split Over the Constitutionality of SEC Administrative Law Judges Likely Bound for Supreme Court*, DAVIS POLK & WARDWELL, LLP (June 28, 2017), https://www.davispolk.com/files/2017-06-28_after_full_d_c_circuit_deadlocks_circuit_court_split_over_constitutionality_sec_aljs_likely_bound_supreme_court.pdf.

³⁰⁷ *See generally* *Bandimere*, 844 F.3d at 1184–99.

³⁰⁸ *Petition for Writ of Certiorari, Raymond J. Lucia Companies, Inc. v. SEC*, 2017 U.S. App. LEXIS 11298 (2017) (No. 15-1345).

³⁰⁹ Dave Michaels & Brent Kendall, *Trump Administration Questions Validity of SEC Judges*, WALL ST. J. (Nov. 29, 2017), <https://www.wsj.com/articles/trump-administration-questions-validity-of-sec-judges-1511998721>.

of SEC ALJs by the end of June 2018.³¹⁰ As of the date this Report went to press, the Supreme Court had not issued a decision.

These legal challenges created uncertainty about the validity of actions taken by SEC ALJs. Thus, on November 30, 2017, the Commissioners of the SEC ratified the appointment of the agency's ALJs and ordered that all ongoing cases be reconsidered by the ALJs.³¹¹ The ratification likely resolves the Appointments Clause issue prospectively, but it does not resolve the petition pending before the Supreme Court about whether cases that already have been decided were done so by constitutionally appointed ALJs.

D. Policy Concerns and Recommendation

Having an agency act as prosecutor, judge and jury, together with procedural rules that favor the agency, creates concerns that agencies like the SEC could choose administrative proceedings in an attempt to increase their success rates. In fact, a 2015 analysis by the Wall Street Journal found that the SEC wins roughly 90% of litigated cases in its own courts compared to 69% in federal courts.³¹² And Professors Pritchard and Choi have found evidence that the SEC has used forum selection to resolve marginal (i.e., weaker and/or lower priority) cases through administrative rather than civil action.³¹³

However, a balanced analysis must acknowledge that the SEC is not necessarily guaranteed greater success by bringing cases in the administrative forum. In 2015, for example, the SEC had a 100%-win rate in the six cases that went to trial in federal court.³¹⁴ In addition, an analysis by Professor Joseph Grundfest at Stanford Law School found that over a 30-month period during fiscal years 2014-2016 there was no statistically significant difference in win rates between enforcement actions brought in federal court or before ALJs.³¹⁵ Furthermore, a few recent, high-profile enforcement actions in the administrative forum demonstrate that ALJs do find contrary to the SEC. The first case involved an enforcement action against a private equity fund manager, Lynn Tilton, for violations of disclosure requirements. The ALJ found that the SEC had no

³¹⁰ Andrew Chung, *U.S. Supreme Court Takes Up Challenge to SEC In-House Judges*, REUTERS (Jan. 12, 2018), <https://www.reuters.com/article/us-usa-court-sec/u-s-supreme-court-takes-up-challenge-to-sec-in-house-judges-idUSKBN1F12JC>.

³¹¹ U.S. SEC. & EXCH. COMM'N, RELEASE NO. 33-10440, IN RE: PENDING ADMINISTRATIVE PROCEEDINGS ORDER (Nov. 30, 2017), <https://www.sec.gov/litigation/opinions/2017/33-10440.pdf>.

³¹² See Jean Eaglesham, *SEC Wins with In-House Judges*, WALL ST. J. (May 6, 2015), <https://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803>. But see Urska Velikonja, *Are the SEC's Administrative Law Judges Biased?*, 92 WASH. L. REV. 315, 349 (2017) (finding roughly equivalent success rates in either forum).

³¹³ Adam C. Pritchard & Stephen Choi, *The SEC's Shift to Administrative Proceedings: An Empirical Assessment* (U. Mich. Law Sch., Working Paper No. 119, 2016), http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1233&context=law_econ_current at 36.

³¹⁴ Gideon Mark, *SEC and CFTC Administrative Proceedings*, 19 U. PA. J. CONST. L. 45 (2016).

³¹⁵ Joseph A. Grundfest, *Fair or Foul? SEC Administrative Proceedings and Prospects for Reform Through Removal Legislation*, 85 FORD. L. REV. 1143, 1175-84 (2016).

evidence of intent or reckless conduct to prove its allegations and dismissed the proceeding in September 2017.³¹⁶

The SEC also lost an administrative insider trading case against a Wells Fargo research analyst and a Wells Fargo trader, Gregory Bolan and Joseph Ruggieri. The SEC alleged that Bolan provided tips to Ruggieri in exchange for a personal benefit, in the form of personal and professional support. The ALJ ruled in September 2015 that the SEC had not established that Bolan received such benefits in direct connection to the tips.³¹⁷ In April 2017, the ALJ found that the SEC failed to show that Ruggieri had actually made trades based on insider tips.³¹⁸

The SEC issued guidance in 2015 about how it should choose a litigation forum, but the SEC's selection guidance does not alleviate concerns about the fairness of the administrative forum or the potential for the SEC to engage in forum shopping. The SEC's guidance is a vague and flexible set of factors for its enforcement division to consider, many of which suggest the SEC should choose the forum most favorable to it.³¹⁹ The guidance thus provides no real constraint on the SEC's discretion. For example, the guidance instructs staff to consider which forum provides the SEC with desired claims, legal theories and forms of relief; indicates that in-house courts are more resource- and time-effective; and implies that unresolved securities law questions should be brought before the SEC's own ALJs to further the development of the law.³²⁰ Even if most litigated cases are currently filed in federal court,³²¹ a potential for misuse of the SEC's discretion remains.

- **Recommendation 4:** When enforcement authorities have lawful discretion to choose to bring a case in federal court or an administrative proceeding, like the SEC, CFTC, and CFPB do, defendants should have the right to remove a case filed in an administrative forum to federal court in non-settled matters.³²²

³¹⁶ *In re Lynn Tilton et al.*, Initial Decision, U.S. Sec. & Exch. Comm'n (Sept. 27, 2017), <https://www.sec.gov/alj/aljdec/2017/id1182cff.pdf> at 2, 56.

³¹⁷ Nate Raymond, *Ex-Wells Fargo trader wins appeal in SEC insider trading case*, REUTERS (July 15, 2017), <https://www.reuters.com/article/us-usa-insidertrading-wells-fargo/ex-wells-fargo-trader-wins-appeal-in-sec-insider-trading-case-idUSKBN1A00T4>.

³¹⁸ Jonathan Stempel, *SEC suffers rare in-house loss in insider trading case*, REUTERS (Apr. 18, 2017), <https://www.reuters.com/article/us-usa-stocks-sec/sec-suffers-rare-in-house-loss-in-insider-trading-case-idUSKBN17K2FC>.

³¹⁹ See *SEC Enforcement Division Issues Guidance on Venue Selection*, LATHAM & WATKINS (May 18, 2015), <https://www.law.com/thoughtLeadership/lw-sec-guidance-choice-of-venue> (stating that the guidance provides no "meaningful limitations" on the SEC's discretion).

³²⁰ U.S. SEC. & EXCH. COMM'N, DIVISION OF ENFORCEMENT APPROACH TO FORUM SELECTION, [https://files.drinkerbiddle.com/Templates/media/files/pdfs/SEC-Guidance\(1\).pdf](https://files.drinkerbiddle.com/Templates/media/files/pdfs/SEC-Guidance(1).pdf).

³²¹ Matthew Solomon, et al., CLEARY GOTTlieb, *Supreme Court Grants Certiorari on the Constitutionality of SEC ALJ Appointments – What this Means for the Securities Industry* (Jan. 16, 2018), <https://www.clearyenforcementwatch.com/2018/01/supreme-court-grants-certiorari-constitutionality-sec-alj-appointments-means-securities-industry/>.

³²² The proposal largely mirrors one already made in existing proposed legislation. See The Financial CHOICE Act of 2017, H.R. 10, 115th Cong. §§ 714, 823 (2017). We emphasize that the right of removal only applies when the enforcement authority brings claims in the administrative forum that it could have brought in federal court. Thus, if the claims brought can only be done so in an administrative forum, then the right of removal would not apply. For example, the SEC can only bring a case to suspend or terminate the registration of a public company in the administrative forum. 15 U.S.C. § 781(j). See also *id.* § 780(b)(4) (limiting proceedings to bar persons or entities from the securities industry to the administrative forum).

The federal courts represent a gold standard in terms of impartiality, the legal ability of adjudicators, and the procedural rights of defendants. The proposal would ensure that targets of federal government enforcement actions would have the same access to the federal courts that the government agency would have itself. It would instill more confidence in the justice and fairness of litigated enforcement actions, and it would prevent enforcement authorities from steering cases involving novel or unique legal theories to the agency's own forum, and instead allow impartial and independent federal judges to interpret the law. Agencies would not be disadvantaged, just required to participate in the forum that most other litigants in the U.S. legal system must use.

Chapter 2: Rationalizing the Setting of Sanctions

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A critical aspect of any enforcement regime is the sanctions that are imposed on wrongdoers. Effective sanctions can deter future misconduct, punish wrongdoing, and signal the egregiousness of an act to the public. This chapter’s focus is primarily on monetary sanctions, which play an especially important role in the enforcement of the laws and rules governing the financial system and capital markets. Chapter 2 is organized into three parts.

Part I describes the remedies that enforcement authorities have at their disposal to sanction, punish, and remediate misconduct. It includes a taxonomy of both the monetary and non-monetary sanctions that agencies can use.

Part II examines the inconsistent approaches that regulators take to determining monetary sanction amounts. It shows that many regulators, particularly the SEC, CFTC, and CFPB lack meaningful public policies, guidelines, or matrices to help determine penalty amounts. It explains how the absence of formal policies that standardize penalty setting practices creates the risk of disproportionate and arbitrary penalties. Other enforcement authorities like the Fed, OCC and FDIC have adopted sanction setting policies that are applied on a case-by-case basis, but the policies are not binding, are not applied in all matters, and their application requires significant interpretation that renders them largely meaningless. With regard to criminal matters, the U.S. Sentencing Guidelines do not apply when the DOJ negotiates nonprosecution and deferred prosecution agreements. The unbounded discretion enforcement authorities have in setting penalty amounts is particularly troubling because financial institutions face great pressure to settle enforcement actions. Part II concludes by offering policy recommendations that seek to implement a rational, principles-based, and transparent approach to penalty setting through the use of guideposts.

Part III also presents the Committee Staff’s data analysis of the monetary sanctions imposed in enforcement actions by an array of authorities over a roughly 17-year period. The Committee Staff’s data show clear upward trends in the total aggregate monetary sanctions imposed in enforcement actions and the size of the mean and median monetary sanctions imposed on enforcement targets during the period. However, due to the lack of public, formal policies and procedures for the setting of monetary penalties, the drivers of the increase in monetary sanctions is unclear. Part III also sets forth the general shortcomings in publicly available information regarding U.S. enforcement actions and their outcomes. Specifically, major enforcement authorities like the SEC and CFTC do not have publicly accessible databases that allow the public, academics, or others to readily identify and analyze the sanctions imposed against defendants in specific cases. To improve the public’s access to information about the outcomes in specific enforcement actions, we recommend that each enforcement authority should establish an easily accessible, searchable, centralized database of all of its ongoing and completed enforcement actions.

I. Remedies Available to Enforcement Authorities

Enforcement authorities have numerous remedial tools available to them to punish and remediate misconduct. These tools fall into two broad categories: (1) monetary sanctions; and (2) non-monetary sanctions. This Part provides further classifications of those broad categories below, describes the purposes of each type of remedy and explains which regulators have such remedies in their enforcement toolkits.

A. Monetary Sanctions

Remedies that result in the payment of monies to the government, victims, or third parties can be classified as “monetary sanctions,” and includes: (1) civil and criminal monetary penalties; (2) disgorgement and restitution; and (3) consumer relief payments.

1. Civil and Criminal Monetary Penalties

A civil monetary penalty is a punitive fine imposed by a court or assessed by an agency for a violation of law.¹ All of the federal enforcement agencies addressed in this Report have been granted authority by Congress to impose civil monetary penalties.² Civil penalties serve to punish wrongdoing and deter others from committing legal violations. In criminal cases, the DOJ can seek criminal fines that serve a similar purpose.³

2. Disgorgement and Restitution

i. Disgorgement

Disgorgement is a type of monetary remedy that requires a party who profits from illegal or wrongful acts to give up his or her ill-gotten gains.⁴ Disgorgement has two key purposes: (1) to prevent unjust enrichment and (2) to punish and deter misconduct. Disgorgement can prevent

¹ See BLACK’S LAW DICTIONARY 1247 (9th ed. 2009).

² The SEC’s general authority to seek civil monetary penalties for securities law violations is found in the following statutes: 15 U.S.C. §§ 77h-1(g), 77t(d), 78u(d), 78u-3(f), 80a-9(d), 80a-41, 80b-9, 80b-3. The CFTC’s authority can be found at: 7 U.S.C. §§ 13a, 13a-1. The CFPB’s authority can be found at 12 U.S.C. § 5565. FinCEN’s authority is at 31 U.S.C. § 5321. OFAC’s authority is found within the rules of each sanctions regime, for example at 31 CFR §§ 701-705 (Sudan sanctions penalties). The banking regulators can assess civil monetary penalties under numerous laws, including the National Bank Act, 12 U.S.C. § 93, laws governing savings associations, 12 U.S.C. § 504, laws governing state-member banks of the Fed, 12 U.S.C. §§ 504, 505, laws governing bank holding companies, 12 U.S.C. § 1847(b), and the Federal Deposit Insurance Act, 12 U.S.C. § 1818(i). While the FCA compensates the government for losses incurred because of a misstatement and could be viewed as a form of restitution, the remedy is more analogous to a penalty due to its punitive nature because the government obtains triple damages.

³ See, e.g., 15 U.S.C. § 77x (Securities Act providing for a fine of up to \$10,000 and prison time of no more than five years for willful violation of the Securities Act); 15 U.S.C. § 78ff (Exchange Act authorizing criminal fines and prison time for willful violations of the law); 15 U.S.C. § 80a-48 (Investment Companies Act providing for criminal fines and prison time for violations of the law); 15 U.S.C. § 80b-17 (Advisers Act providing for criminal fines and prison time for violations of the law); 7 U.S.C. § 13 (CEA providing for criminal fines and prison time for violations of the law); 18 U.S.C. § 1343 (providing for criminal fine or prison time for violation wire fraud law).

⁴ *Disgorgement*, LEGAL INFO. INST., <https://www.law.cornell.edu/wex/disgorgement> (last visited Nov. 3, 2017).

unjust enrichment by prohibiting a culpable party from profiting from his or her wrongdoing. Disgorgement can also serve a punitive purpose, thus acting as a penalty.⁵

The SEC,⁶ CFTC,⁷ CFPB⁸ and banking regulators⁹ have the authority to obtain disgorgement in enforcement actions. The DOJ has the authority to seek criminal and civil forfeiture of criminal proceeds and contraband for certain crimes, but this authority does not extend to FCA and FIRREA actions.¹⁰ OFAC and FinCEN do not have authority to obtain disgorgement.

ii. Restitution

Restitution is a type of monetary remedy that compensates victims for loss resulting from wrongful or unlawful conduct.¹¹ Its objective is to remediate harm by making a victim of wrongdoing whole. Restitution thus requires a determination of the monetary value of the injury incurred by victims of the misconduct.

The CFPB, CFTC and banking regulators are able to seek restitution as a form of relief.¹² OFAC, FinCEN, and the SEC, however, are not expressly authorized to seek restitution. It is not clear why those enforcement authorities do not have the express power to seek restitution, but there are some potential rationales. For example, violations of anti-money laundering and sanctions laws overseen by OFAC and FinCEN do not naturally have third-party victims who would benefit from restitution. And the SEC has access to a wide range of other remedies. For example, while the SEC is not authorized to seek restitution, it is authorized in certain circumstances to compensate investors using monetary amounts collected through civil monetary penalties and/or disgorgement.¹³ This is known as the “Fair Funds” authority, which is discussed in detail in

⁵ *Kokesh v. SEC*, 137 S. Ct. 1635 (2017).

⁶ 15 U.S.C. § 78u-3; 15 U.S.C. § 80a-9; 15 U.S.C. § 80b-3; Russell G. Ryan, *The Equity Façade of SEC Disgorgement*, 4 HARV. BUS. L. REV. Online (Nov. 15, 2013), http://www.hblr.org/wp-content/uploads/2013/11/Ryan_The-Equity-Façade-of-SEC-Disgorgement.pdf; Francesco A. DeLuca, *Sheathing Restitution’s Dagger under the Securities Acts*, 33 REV. BANKING & FIN. L. 899, 901 (2013-2014), https://www.bu.edu/rbfl/files/2014/03/RBFL-Vol-33.2_DeLuca.pdf. In the recent Supreme Court case of *Kokesh v. SEC*, the Supreme Court opinion’s footnote raised questions about whether the SEC has statutory authority to obtain disgorgement in federal court cases. 137 S. Ct. 1635, 1642 n.3 (2017).

⁷ 7 U.S.C. § 13a-1(d)(3).

⁸ 12 U.S.C. § 5565.

⁹ 12 U.S.C. § 1818(b)(6).

¹⁰ Though, it is worth noting that if the underlying misconduct also constitutes wire, mail, or bank fraud, for example, the DOJ can seek forfeiture of property that constitutes or is derived from proceeds obtained from the violation, which is often the same as disgorgement. *See, e.g.*, 18 U.S.C. §§ 981 (civil forfeiture statute), 982 (criminal forfeiture statute). Generally, forfeiture, a complex area of law that has frequently been used as a tool in the war on drugs, is beyond the scope of this Report. *See, e.g.*, Annemarie Bridy, *Carpe Omnia: Civil Forfeiture in the War on Drugs and the War on Piracy*, 46 ARIZ. ST. L.J. 683, 694–700 (2014).

¹¹ Law.com, *Restitution*, LEXISNEXIS, <http://dictionary.law.com/Default.aspx?selected=1831> (last visited Nov. 3, 2017). *See SEC v. Huffman*, 966 F.2d 800, 802 (1993) (noting the difference between disgorgement and restitution).

¹² 12 U.S.C. § 5565 (CFPB); 7 U.S.C. § 13a-1(d) (CFTC); 12 U.S.C. § 1818(b)(6) (authorizing banking regulators to seek restitution in conjunction with a cease-and-desist order where either (a) the depository institution or affiliated party was unjustly enriched in connection with the violation or (b) the violation or practice involved a reckless disregard for the law).

¹³ 15 U.S.C. §§ 78u-2(e), 78u-3(e), 7246.

Chapter 3. While similar to restitution in that victims are compensated, the distribution of disgorgement funds may not fully compensate the victims for harm incurred because the amount disgorged is determined based on the gain obtained by the defendant from wrongdoing rather than the harm to victims.

3. Consumer Relief/Extraordinary Restitution

In recent years, certain authorities, particularly the DOJ, have included “consumer relief” amounts in settlement agreements (which is also referred to as extraordinary restitution). Consumer relief or extraordinary restitution payments are payments made or benefits provided to individual consumers, communities, or third-party organizations that were not necessarily victims of misconduct. Examples of consumer relief include forgiveness of principal on loans, donations to community redevelopment organizations or legal aid groups, or funding of affordable housing projects. In Chapter 3, we provide more information about consumer relief and extraordinary restitution payments, including data on the use of these provisions in certain large settlements with financial institutions and policy concerns about their use.

4. Each Type of Monetary Relief Plays a Significant Role

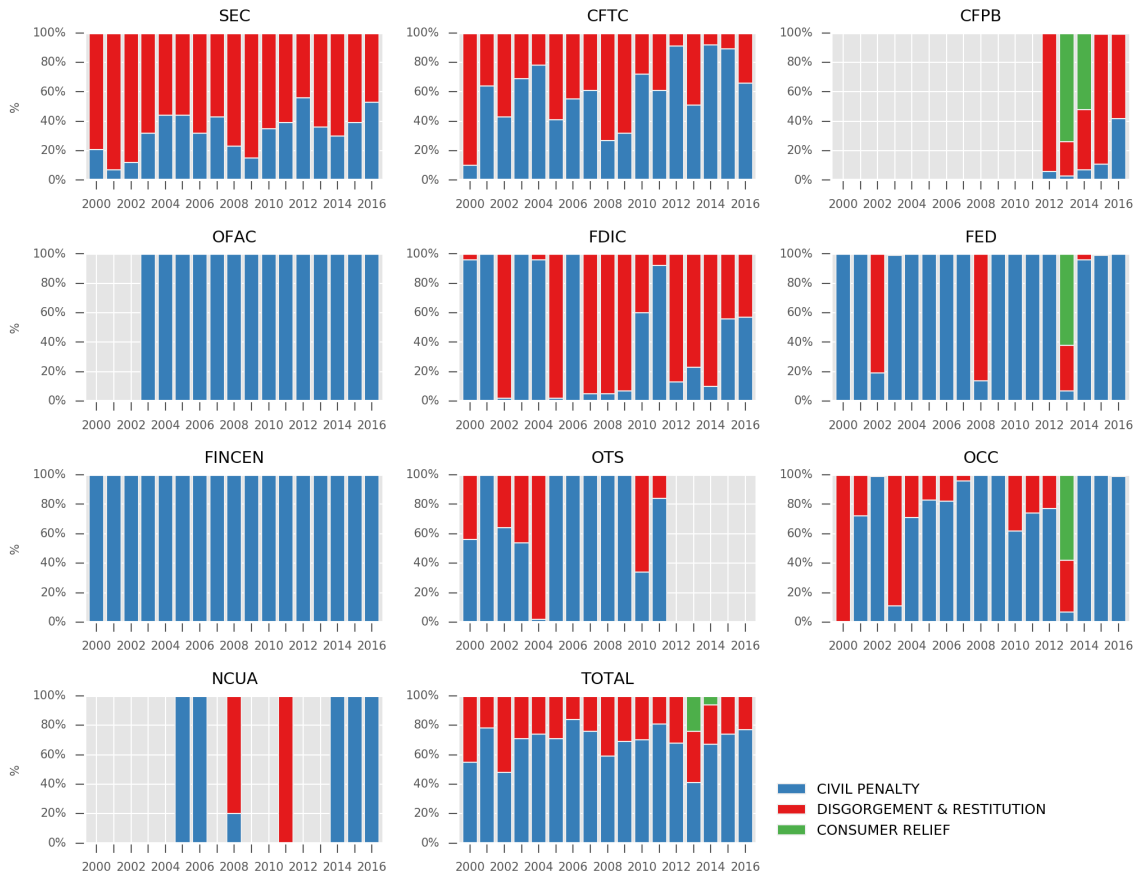
Figure 2.1, below, presents the Committee Staff’s data analysis of the proportion of total monetary sanctions for each of the three types of monetary sanctions obtained by the SEC, CFTC, CFPB, OFAC, FDIC, Fed, FinCEN, the Office of Thrift Supervision (“**OTS**”),¹⁴ OCC, and NCUA for calendar years 2000 through 2016. Because restitution and disgorgement are similar, **Figure 2.1** combines them into one category of “disgorgement and restitution”.

Figure 2.1 shows that the SEC and CFTC both obtain civil monetary penalties and disgorgement/restitution as major types of relief. In contrast, OFAC and FinCEN order only civil monetary penalties. The Fed and OCC primarily rely on civil monetary penalties as their form of monetary sanction, though in 2013 over half of the monetary sanctions they recovered consisted of consumer relief and restitution, which was attributable to the over \$8.5 billion Independent Foreclosure Review settlement.¹⁵

¹⁴ The Office of Thrift Supervision was a bureau of the Department of the Treasury that regulated certain depository institutions. The OTS merged with the OCC in 2011. <https://www.occ.treas.gov/about/who-we-are/occ-for-you/bankers/ots-integration.html>; <https://www.treasury.gov/about/history/Pages/ots.aspx>. Consumer relief could be negotiated by any regulator as part of a negotiated settlement and all regulators included in the graphs other than OFAC and FinCEN can seek to obtain disgorgement or restitution.

¹⁵ The Independent Foreclosure Review settlement was reached in January 2013 and resolved enforcement actions by the Fed and OCC with ten mortgage servicing companies for deficient practices in mortgage loan servicing and foreclosure processing. Press Release, Bd. of Governors of the Fed. Reserve Sys. & Office of the Comptroller of the Currency (Jan. 7, 2013), <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20130107a.htm>.

Figure 2.1: Proportion of Monetary Sanctions by Sanction Type



B. Non-Monetary Sanctions

Enforcement authorities also have a wide range of *non*-monetary remedial tools at their disposal, which they can use to punish and deter misconduct without requiring any monetary payments. For example, certain non-monetary sanctions can stop a wrongdoer from continuing to engage in misconduct; others may prevent a culpable party from conducting business in a particular industry or field. These can be effective tools to both punish and remediate wrongdoing, especially when monetary sanctions are insufficient to punish or deter wrongdoing, or where an enforcement target does not have the means to pay monetary sanctions.

1. Cease-and-Desist Orders and Injunctions

To ensure that misconduct is promptly terminated once it has been identified, certain authorities are empowered to issue an order that unlawful conduct stop or to seek a similar order from a federal court.

i. Cease-and-Desist Orders

Agencies can issue a cease-and-desist order, an order handed down by a government agency that directs a person or firm to stop doing something immediately.¹⁶ Importantly, a cease-and-desist order does not require the approval of a court, though such administrative actions can be subject to court challenge.¹⁷

The banking regulators are authorized to issue cease-and-desist orders against institutions and individuals if they violate any law, rule, regulation or agreement with the agency.¹⁸ The SEC,¹⁹ CFTC,²⁰ and CFPB²¹ are also authorized to issue cease-and-desist orders in response to violations of the statutes and rules they enforce.

By contrast, the DOJ,²² FinCEN²³ and OFAC²⁴ cannot issue cease-and-desist orders, as in civil matters they are limited to seeking monetary sanctions or court orders. FinCEN and OFAC may lack cease-and-desist powers because once informed of a violation of sanctions or anti-money laundering laws, persons and entities are likely to voluntarily cease the violation because they otherwise risk criminal prosecution.²⁵

ii. Injunctions

Enforcement authorities can also seek an injunction, which is a court order compelling a person or firm to refrain from doing or to stop doing something immediately.²⁶ The SEC,²⁷ CFTC,²⁸ CFPB,²⁹ and FinCEN³⁰ are authorized to seek court-issued injunctions. Banking regulators' and OFAC's enforcement actions are required to be brought as administrative proceedings and thus they cannot seek court-issued injunctions in an original enforcement

¹⁶ BLACK'S LAW DICTIONARY 253 (9th ed. 2009).

¹⁷ *Id.*

¹⁸ 12 U.S.C. § 1818(b).

¹⁹ 15 U.S.C. §§ 77h-1(a) (cease-and-desist order to enforce the Securities Act), 78u-3(cease-and-desist to enforce Exchange Act), 80a-9(f) (cease-and-desist order to enforce Investment Company Act), § 80b-3 (cease-and-desist order to enforce Investment Advisers Act).

²⁰ 7 U.S.C. § 13a.

²¹ 12 U.S.C. § 5565.

²² Here we are referring to the DOJ's civil powers under FIRREA and the FCA. 31 U.S.C. § 3729(a); 12 U.S.C. § 1833a(c).

²³ 12 U.S.C. § 5320.

²⁴ 50 U.S.C. § 1705(b).

²⁵ *See, e.g.*, 50 U.S.C. § 1705(c) (maximum 20-year prison sentence for willful violation of sanctions).

²⁶ Black's Law Dictionary 855 (9th ed. 2009).

²⁷ 15 U.S.C. §§ 77t(b) (Securities Act), 78u(d) (Exchange Act), 80a-41 (Investment Company Act), 80b-9 (Advisers Act).

²⁸ 7 U.S.C. § 13a-1.

²⁹ 12 U.S.C. § 5565.

³⁰ 31 U.S.C. § 5320.

proceeding. The DOJ also cannot seek injunctions under the FCA or FIRREA, which are solely designed to allow the government to recover monetary relief for certain injuries.³¹

2. Bars, Suspensions and Removals

To protect depositors, investors, and other participants in the capital markets and financial system, the laws also authorize certain agencies to prohibit bad actors from engaging in certain lines of businesses or associating with certain types of firms. The agencies with this authority are the SEC, CFTC, the Fed, FDIC, NCUA, and OCC.

For example, the SEC has the ability to: (a) bar persons from serving as officers or directors of public companies; (b) suspend the registration of persons or firms, such as broker-dealers, that must register with the SEC; and (c) restrict who can serve as an employee, director, or advisory board member of a registered investment company.³² The CFTC can also suspend the registration of persons or firms registered with the CFTC.³³ Finally, the banking regulators can remove or suspend a person from being an employee, officer, director or controlling shareholder of an insured financial institution for certain types of misconduct.³⁴

Banking regulators routinely remove individuals affiliated with banks from positions or prohibit them from holding positions, as evidenced by the fact that in 2017, the Fed issued 12 orders under its removal/prohibition authority and the FDIC issued 64 such orders.³⁵ These removals typically result from self-dealing or financial impropriety involving the individual. We are not aware of comprehensive publicly available guidelines (beyond applicable statutory provisions) that detail how enforcement authorities should exercise prosecutorial discretion to decide when it is appropriate for enforcement authorities to seek or impose such sanctions.³⁶

³¹ See, e.g., Antonio F. Dias et al., *FIRREA Civil Money Penalties: The Government's Newfound Weapon Against Financial Fraud*, JONES DAY (May 2013), <http://www.jonesday.com/firrea-civil-money-penalties-the-governments-newfound-weapon-against-financial-fraud/> (noting that FIRREA ultimately protects U.S. taxpayers from bearing cost of fraud against insured depository institutions).

³² 15 U.S.C. §§ 77h-1(f), 77t(e), 78u-3(f), 78u(d), 78o, 80a-9(b).

³³ 7 U.S.C. § 13(b).

³⁴ 12 U.S.C. §§ 1829(a), 1818(e).

³⁵ *Enforcement Actions*, BD. OF GOVERNORS OF THE FED. RESERVE SYS., [https://www.federalreserve.gov/apps/enforcementactions/search.aspx_\(search 2017 for "prohibition from banking" orders\)](https://www.federalreserve.gov/apps/enforcementactions/search.aspx_(search%202017%20for%20%22prohibition%20from%20banking%22orders)); *FDIC Enforcement Decisions and Orders*, FED. DEPOSIT INS. CORP., [https://www5.fdic.gov/EDO/DataPresentation.html_\(search 2017 for "removal/prohibition order"\)](https://www5.fdic.gov/EDO/DataPresentation.html_(search%202017%20for%20%22removal%20prohibition%20order%22)).

³⁶ For example, while the FDIC Manual of Examination Policies explains the statutory requirements that must be met to pursue specific types of non-monetary sanctions, it does not set forth agencies policies about how to exercise discretion about whether to seek or impose such sanctions if the statutory criteria are met or provide gloss on the meaning of the statutory criteria. FDIC, DSC Risk Management Manual of Examination Policies, § 15.1, https://www.fdic.gov/regulations/safety/manual/manual_examinations_full.pdf (last visited May 18, 2018). In addition, while the OCC Policies and Procedures Manual (PPM 5310-3) provides guidance about when a formal enforcement actions should be taken against a bank, the guidance does not cover enforcement actions against individuals. OCC, Policies and Procedures Manual (PPM 5310-3), <https://www.occ.treas.gov/news-issuances/bulletins/2017/ppm-5310-3.pdf> (last visited May 18, 2018).

It is also worth noting that a criminal conviction obtained by the DOJ can result in individuals or entities being automatically statutorily barred from certain activities. For instance, under the banking laws, individuals convicted of money laundering or crimes involving breach of trust or honesty are prohibited from participating in the affairs of an insured depository institution.³⁷ Similarly, a conviction can result in a business losing government contracts or licenses in some situations.³⁸

3. *Undertakings and Directives*

To punish violations and prevent them from recurring, enforcement authorities may also require an enforcement target to perform certain undertakings (i.e., take certain affirmative actions) as part of the relief in an enforcement proceeding or settlement. Banking regulators can require insured depository institutions to restrict the growth of the institution, dispose of loans or assets, rescind agreements or contracts, and take any other action the regulator deems appropriate, when the regulator uncovers a violation of law by the institution.³⁹ Other federal regulators, including the SEC, CFTC, CFPB, OFAC, FinCEN and the DOJ can also impose undertakings to resolve enforcement proceedings, which may include, for example, requiring a firm to adopt a compliance system or improve weaknesses in internal reporting processes.

4. *Revocations of Registration, Charter or Insurance*

Enforcement authorities can also revoke or suspend registrations, charters, or insurance in response to misconduct. This is a powerful form of sanction because many individuals and firms rely on such registrations, charters, and insurance to conduct business. For example, broker-dealers and investment advisers must register with the SEC to engage in business, and commodity dealers must register with the CFTC. Nationally chartered banks must receive a charter from the OCC. And many depository institutions benefit from FDIC insurance in their efforts to attract depositors. The SEC,⁴⁰ CFTC⁴¹ and the bank regulators can impose this type of sanction.⁴² OFAC, FinCEN, the CFPB and DOJ do not have these types of available relief, because persons and entities are not required to register with them to conduct business.

5. *Other Types of Relief*

Authorities can also impose other types of non-monetary relief, such as emergency remedies. For example, the DOJ and CFPB, CFTC, and SEC can obtain emergency type relief in

³⁷ See, e.g., 12 U.S.C. § 1829.

³⁸ Wulf A. Kaal & Timothy A. Lacine, *The Effect of Deferred and Non-Prosecution Agreements on Corporate Governance: Evidence from 1993-2013*, 70(1) THE BUSINESS LAWYER 61, 71 (2014).

³⁹ 12 U.S.C. § 1818(b)(6).

⁴⁰ E.g., 15 U.S.C. §§ 77h(d) (suspension of registration statement), 78o (revoke registration of broker-dealers).

⁴¹ 7 U.S.C. §§ 7b, 13 (allowing revocation of registration for violations of CEA).

⁴² 12 U.S.C. § 1818(a)(2) (authorizing revocation of federal depository insurance if the institution, its directors or trustees have engaged or are engaging in an unsafe or unsound practice or have violated applicable law, regulation or written agreement with a banking regulator).

federal court.⁴³ Such relief, that each of those enforcement authorities can seek, includes temporary restraining orders and asset freezes to prevent the movement of assets while a matter is litigated. Asset freezes ensure that money to pay fines or disgorgement or restitution is available in the event the enforcement authority settles or wins the case.

Agencies can also negotiate to require that defendants admit facts or even liability as part of settlement agreements. This condition of settlement is in theory available to any enforcement authority. The SEC, in particular, emphasized this tool under former Chair White. In 2013, the SEC announced that admissions might be required to settle cases “where there [was] a special need for public accountability and acceptance of responsibility.”⁴⁴ However, it was rarely used (in less than 2% of cases from fiscal 2014 through fiscal 2017,) and in October 2017 the co-head of the SEC’s Division of Enforcement, Steven Peikin, made statements casting doubt on how extensively the SEC will use this tool prospectively.⁴⁵

Finally, it is worth noting that the CFPB is unique among enforcement authorities in that it has the authority to seek or impose *any* legal or equitable relief (i.e., judicially created remedy) for a violation of federal consumer financial law. Thus, in addition to the types of relief discussed above, the CFPB can order rescission (i.e., undoing of a contract) or reformation of a contract.⁴⁶ The CFPB is also unique among agencies in that the CFPB can recover the cost of bringing an enforcement action in the event that it is the prevailing party.⁴⁷

C. Automatic Disqualifications

In some matters, an enforcement action will automatically result in a firm losing certain privileges (“**automatic disqualifications**”), such as the ability to engage in certain lines of business or use certain registration exemptions in securities offerings. These automatic disqualifications occur because of statutory provisions or agency rules. And they can be problematic because they can be triggered when there is no nexus between the misconduct underlying the enforcement action and the privileges that are revoked. While an automatic disqualification can be waived by the relevant regulator, the burden of applying for the waiver and obtaining the necessary votes for such a waiver falls on the affected firm. These automatic disqualifications can arise under SEC, CFTC, and Department of Labor laws and regulations,⁴⁸

⁴³ OFAC, FinCEN, the Fed, OCC, FDIC, and NCUA are limited to administrative proceedings as discussed in Chapter I. Thus, they cannot seek emergency relief in federal court.

⁴⁴ Mary Jo White, Chair, U.S. Sec. & Exch. Comm’n, Speech at the Council of Institutional Investors Fall Conference: Deploying the Full Enforcement Arsenal (Sept. 26, 2013) (transcript available at <https://www.sec.gov/news/speech/spch092613mjw>).

⁴⁵ David Rosenfeld, *Admissions in SEC Enforcement Cases: The Revolution That Wasn’t*, 103 IOWA L. REV. 113, 131 (2017); Dave Michaels, *SEC Signals Pullback from Prosecutorial Approach to Enforcement*, WALL ST. J. (Oct. 25, 2017), <https://www.wsj.com/articles/sec-signals-pullback-from-prosecutorial-approach-to-enforcement-1509055200>.

⁴⁶ 12 U.S.C. § 5565.

⁴⁷ *Id.* § 5565(b).

⁴⁸ Richard A. Rosen & David S. Huntington, *Waivers from Securities Law Disqualifications*, 29 INSIGHTS No. 8, pp. 2-16 (Aug. 2015).

but we focus our discussion on SEC automatic disqualifications, which have been a focus of public attention in recent years.⁴⁹

Securities laws and regulations impose automatic disqualifications both statutorily and through SEC rules. Statutory automatic disqualifications include the 1940 Act’s prohibition on a person serving as an investment adviser or principal underwriter of registered investment companies. They also include exclusion of an issuer from safe harbor provisions under the Securities Act and Exchange Act designed to protect issuers making certain forward-looking statements.⁵⁰ Automatic disqualifications under SEC rules include loss of the ability of an issuer to rely on exemptions from registration requirements in securities offerings if the “bad actor” provisions in Regulation A and Regulation D are triggered, and the loss of status as a well-known seasoned issuer, a status that allows certain issuers to more efficiently conduct follow-on offerings.⁵¹

However, the automatic disqualifications are not tailored to require a connection between the wrongdoing and the disqualification. Instead, the statutes and rules are drafted so broadly that a nexus between the underlying wrongdoing that triggers the disqualification can be extremely attenuated from the activity banned or prohibited. The nexus can be attenuated in two important ways.

First, the conduct that resulted in a criminal or civil enforcement actions that triggers an automatic disqualification can be remote from securities activities that the securities laws are concerned about. For example, an issuer can lose the safe harbor exemption applicable to forward-looking statements if the issuer is found guilty (by trial or plea) of a crime that merely arises out of the business of a bank or insurance company or involves bribery.⁵² As a result, a bank pleading guilty to money laundering, or an issuer who pleads guilty to a criminal Foreign Corrupt Practices Act violation, would become ineligible from being a well-known seasoned issuer. That is despite the fact that those underlying criminal violations might have no bearing on the issuer’s propensity or ability to make accurate and full disclosures in offering documents.

Second, a firm can be subject to an automatic disqualification provision because of misconduct by a related or affiliated entity. For example, automatic disqualification from having well-known seasoned issuer status can be triggered if a remote subsidiary of the issuer is barred

⁴⁹ Automatic disqualifications also exist in other contexts. One example is the Department of Labor’s Qualified Professional Asset Manager exemption from Section 406 of ERISA, which investment advisers and managers use to conduct business on behalf of an ERISA plan with fewer restrictions. This exemption, however, is not available when the asset manager or any affiliate has been subject to certain enforcement actions within a ten year look back period. 75 Fed. Reg. 38,837.

⁵⁰ 15 U.S.C. §§ 80a-9(a), 77z-2(b), 78u-5(b).

⁵¹ 17 C.F.R. §§ 230.262, 230.504, 230.506, 230.405. There are also a couple other automatic disqualifications worth noting. These include loss of the registration exemption under Rule 602 of Regulation E for certain small business investment companies and business development companies and Rule 206(4)-3 of the Advisers Act, which restricts the payment of fees by investment advisers to “solicitors” if certain triggering conditions are met. *Id.* §§ 230.602, 275.203(4)-3.

⁵² 15 U.S.C. §§ 77z-2(b), 78u-5(b), 78o(b)(4)(B)(i)-(iv). The text only provides some examples. Numerous crimes are listed in § 78o(b)(4)(i)-(iv).

by a state or federal banking regulator from engaging in banking.⁵³ Thus, a financial conglomerate could be prevented from using certain offering privileges if a small bank subsidiary was banned by a state banking regulator from banking for any reason. That could be despite the fact that the subsidiary’s conduct may not have involved any of the issuer’s employees, officers, or directors responsible for ensuring accurate disclosure in the issuer’s filings. The 1940 Act’s Section 9(a) automatic disqualification can also be triggered by an affiliate’s wrongdoing. Section 9(a) bars an entity and affiliates from serving as an investment adviser or depositor. It is triggered for a firm if any company affiliated with the firm is convicted of a felony or misdemeanor involving misconduct in investment capacities.⁵⁴

The automatic disqualifications are burdensome on businesses and complicate the resolution of enforcement actions. That is because to avoid being shut out of certain areas of businesses, firms have to apply for waivers from the automatic disqualifications.⁵⁵ Because the SEC does not disclose the number of waiver applications it receives or waiver requests that it denies, no one has been able to calculate the success rate of waiver applications.⁵⁶ However, the SEC discloses the grant of waivers, and a review of waivers from July 2003 to December 2014 by Professor Urska Velikonja has found that the SEC granted 201 waivers during that period, or a little less than 20 per year.⁵⁷

Waivers also present issues with coordination across enforcement agencies, as enforcement targets often have to simultaneously negotiate the settlement for the underlying enforcement action with a different enforcement authority while also working with the SEC to grant a waiver.⁵⁸ In addition, the automatic disqualifications undermine enforcement targets that may want to litigate an enforcement action rather than settle, because if the defendant loses, then the resolution of the enforcement action and the waiver application may not be coordinated.

Thus, we find the automatic nature of the disqualifications, combined with the possibility that an automatic disqualification can be triggered for conduct that lacks any clear nexus to the protection of investors in securities markets to be problematic. We therefore recommend a change to the automatic disqualification process.

- **Recommendation 5:** Automatic disqualifications (whether statutory or otherwise) prohibit a firm from engaging in certain activities when the firm or an affiliate has resolved certain

⁵³ 17 C.F.R. § 230.506(d)(1)(iii).

⁵⁴ 15 U.S.C. § 80a-9(a).

⁵⁵ See, e.g., 15 U.S.C. § 80-9(c) (allowing the SEC to grant a waiver if the applicant shows the prohibitions are “unduly or disproportionately severe” and a waiver is not “against the public interest” or protection of investors”); 17 C.F.R. § 230.405 (allowing SEC to grant a waiver if the applicant establishes “good cause”).

⁵⁶ See Urska Velikonja, *Waiving Disqualification: When Do Securities Violators Receive a Reprieve?*, 103 CAL. L. REV. 1081, 1112-13, 1125-26 (2015). Even if data on waiver applications or waiver denials were disclosed, meaningful success rates would be difficult to calculate because firms and their lawyers likely engage in informal conversations with SEC staff before submitting any waiver request. Thus, if it is communicated that a waiver request is unlikely to be granted, then a firm may not bother to apply for a waiver. *Id.* at 1113.

⁵⁷ *Id.* at 1115. Velikonja analyzed waivers granted under Regulation A and D, as well as for well-known seasoned issuers under Securities Act Rule 405.

⁵⁸ Rosen & Huntington, *supra* note 48, at 13 (“All of this requires careful and constant coordination with the client, the SEC and any other regulators or co-counsel involved in the settlement.”).

criminal or civil enforcement matters. These disqualifications should only be triggered when there is a clear nexus between the conduct underlying the triggering enforcement action and the disqualification itself. Where a clear nexus does not exist, disqualifications should have to be affirmatively imposed by the relevant regulator using appropriate due process protections.

II. Laws, Rules, and Guidelines Governing Setting of Monetary Sanctions

Part II of this Chapter examines how enforcement authorities determine the amount of monetary sanctions that they obtain in civil and criminal enforcement actions either through administrative or judicial orders or settlement agreements.

First, we discuss the law governing the determination of restitution and disgorgement. We also explain that there appear to be no formal policies or procedures for how consumer relief amounts are determined in settlement agreements. Then, we detail the approaches taken by enforcement authorities to setting civil and criminal monetary penalties. We begin by discussing civil enforcement authorities and then turn to the DOJ and criminal penalties.

We show that *all* enforcement authorities effectively retain unbridled discretion in setting penalty amounts. Such unbridled discretion is concerning because there is a risk that enforcement authorities can act arbitrarily (and unfairly) and impose disproportionate penalties that could chill otherwise lawful and productive financial activities. In particular, enforcement authorities' discretion is relatively unconstrained in matters against financial institutions, which for practical reasons face pressure to settle rather than litigate potential enforcement proceedings. We conclude Part II by recommending that enforcement authorities adopt “guideposts” or key principles to act as guardrails in the penalty setting process.

A. Restitution, Disgorgement, and Consumer Relief

As noted in Part I, restitution is a remedy that compensates victims for loss resulting from wrongful or unlawful conduct. Disgorgement, on the other hand, involves a defendant giving up a monetary amount wrongfully gained. Disgorgement funds are sometimes (but not always) distributed to persons affected by the defendant's unlawful conduct.⁵⁹ Thus, while restitution and disgorgement are related types of monetary relief, they are distinct remedies. Below we provide an overview of judicially-developed law about the calculation of restitution and disgorgement. The overview focuses on SEC and CFTC enforcement actions, which have the most developed case law.⁶⁰ It is important to note that enforcement actions are frequently resolved through negotiated settlements, rather than being litigated in court and this limits the relevant case law on point.

⁵⁹ See *Kokesh v. SEC*, 137 S. Ct. 1635, 1644 (2017).

⁶⁰ For example, we do not address the scope of restitution and disgorgement under the CFPB's authority because the law is not yet fully developed. Indeed, only one federal circuit has directly addressed how these remedies should be applied. See *Consumer Fin. Prot. Bureau v. Gordon*, 819 F.3d 1179, 1196 (9th Cir. 2016), cert. denied, 137 S. Ct. 2291 (2017). See also *Short-Term Lender to Pay \$38M in Restitution and \$13M in Penalties*, Fed. Bank. L. Rep. ¶ 154-585. We also do not address the calculation of disgorgement or restitution payments ordered by the Fed, FDIC, or OCC because the limited existing case law deals more with challenges to the authority of bank regulators to order those payments rather than the method by which any amounts ordered to be paid should be calculated. See, e.g., *Simpson v. Office of Thrift Supervision*, 29 F.3d 1418, 1421 (9th Cir. 1994); *Hoffman v. Fed. Deposit Ins. Corp.*, 912 F.2d 1172, 1174 (9th Cir. 1990); *Spiegel v. Ryan*, 946 F.2d 1435, 1437 (9th Cir. 1991); *Akin v. Office of Thrift Supervision Dep't of Treasury*, 950 F.2d 1180, 1182 (5th Cir. 1992); *Cavallari v. Office of Comptroller of Currency*, 57 F.3d 137, 141 (2d Cir. 1995).

I. SEC

As discussed in Part I, the SEC can use disgorgement as a tool for protecting the investing public and deterring future violations.⁶¹ It is commonly used in the context of insider trading cases⁶² as well as for other violations of the securities laws.⁶³ Although the governing securities laws do not define how the appropriate disgorgement amount should be calculated, case law establishes certain parameters. Notably, there must be a *causal connection* between the violation and the improper gains to be disgorged.⁶⁴ The SEC must also establish a reasonable approximation of the gains attributable to the illegal transaction.⁶⁵

While the amount to be disgorged in an SEC case is based on the amount gained by the defendant, the specific approach used to calculate the amount of the gain depends on the type of case. For example, in an insider trading case, the disgorgement amount is generally the difference between (a) the value of the shares when the insider purchased them while in possession of the material, nonpublic information, and (b) their market value a short time after public dissemination of the inside information.⁶⁶ In the case of sales based on inside information, the amount of disgorgement can also be based on the amount of loss avoided.⁶⁷

Outside the insider trading context, the disgorgement amount can be equal to compensation received as a result of a fraudulent scheme.⁶⁸ In cases where individuals make false and misleading statements in connection with the offering and sale of securities, disgorgement has been calculated to be the entire amount of the funds raised (offset against any amount returned to investors).⁶⁹

More generally, in determining the total amount of gain to be disgorged in any specific case, courts typically deduct any amounts returned to defrauded investors⁷⁰ or the amount paid

⁶¹ *Kokesh*, 137 S. Ct. at 1640.

⁶² See THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 16:18.

⁶³ See, e.g., *SEC v. Wolfson*, 249 Fed. Appx. 701 (10th Cir. 2007) (upholding disgorgement award in a pump and dump scheme); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1475 (2d Cir. 1996) (upholding disgorgement in securities fraud case involving selling securities with excessive markups failing to disclose the nature of the market and the defendant's control of it) and *SEC v. Bilzerian*, 29 F.3d 689, 697 (D.C. Cir. 1994) (upholding disgorgement for disclosure failures and misrepresentations in SEC filings in connection with takeover scheme).

⁶⁴ *SEC v. Patel*, 61 F.3d 137, 139 (2d Cir. 1995); *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989).

⁶⁵ See *SEC v. Bilzerian*, 29 F.3d 689, 697 (D.C. Cir. 1994); *SEC v. Warde*, 151 F.3d 42, 50 (2d Cir. 1998); *SEC v. Calvo*, 378 F.3d 1211, 1217 (11th Cir. 2004).

⁶⁶ See, e.g., *SEC v. Patel*, 61 F.3d 137, 139 (2d Cir. 1995); *SEC v. MacDonald*, 699 F.2d 47, 54–5 (1st Cir. 1983).

⁶⁷ See, e.g., *SEC v. Happ*, 392 F.3d 12, 31 (1st Cir. 2004). See also, e.g., *SEC v. Patel*, 61 F.3d 137, 139 (2d Cir. 1995).

⁶⁸ *SEC v. Drexel Burnham Lambert, Inc.*, 956 F. Supp. 503, 505 (S.D.N.Y. 1997), *aff'd sub nom. SEC v. Fischbach Corp.*, 133 F.3d 170 (2d Cir. 1997).

⁶⁹ *SEC v. United Energy Partners, Inc.*, 88 F. App'x 744, 746 (5th Cir. 2004).

⁷⁰ See, e.g., *Opulentica, LLC*, 479 F. Supp. 2d 319, 330 (S.D.N.Y. 2007); *SEC v. United Energy Partners, Inc.*, 88 F. App'x 744, 747 (5th Cir. 2004); *SEC v. Kenton Capital, Ltd.*, 69 F. Supp. 2d 1, 15 (D.D.C. 1998).

under a settlement with defrauded customers.⁷¹ However, most courts tend not to allow offsets for general business expenses,⁷² meaning that the “gain” to be disgorged can at times be larger than the actual net profits from the illicit conduct. Despite granular differences in how to calculate disgorgement, there is a generally accepted approach that is consistently applied given the common understanding of what disgorgement is – the taking away of ill-gotten gains. That relative consistency contrasts with monetary penalties, which as discussed later in this chapter, are set in inconsistent and difficult to discern ways.

2. CFTC

As noted in Part I, the CEA authorizes the CFTC to seek both restitution and disgorgement.⁷³ It provides that the CFTC may seek and the courts may impose both “disgorgement of gains received in connection with [violations]” and “restitution to persons who have sustained losses proximately caused by [violations] (in the amount of such losses).”

i. Disgorgement

The law surrounding disgorgement for CFTC enforcement actions is similar to that used for SEC actions.⁷⁴ The CFTC must establish that the amount of the disgorgement being sought reasonably approximates the defendant’s unjust enrichment.⁷⁵ Much like in SEC actions, courts have declined to offset business expenses from the amount of disgorgement,⁷⁶ sometimes resulting in disgorgement amounts greater than the defendant’s actual net profit.

ii. Restitution

The amount of restitution ordered in CFTC cases is generally based on the monetary damages sustained by the victims of the defendant’s violation(s),⁷⁷ offset by amounts paid to victims pursuant to awards for criminal restitution.⁷⁸ Consistent with this approach, some CFTC consent orders transparently calculate the restitution amount based on net customer losses attributable to the defendant’s unlawful actions.⁷⁹

⁷¹ See James Tyler Kirk, *Deranged Disgorgement*, 8 J. BUS. ENTREPRENEURSHIP & L. 131, 144 (2014) [hereinafter *Deranged Disgorgement*]. See, e.g., *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1475 (2d Cir. 1996).

⁷² See *Deranged Disgorgement*, *supra* note 71, at 136–41 (reviewing cases on treatment of business expenses).

⁷³ 7 U.S.C. 13a-1(d)(3).

⁷⁴ See Verity Winship, *Public Agencies and Investor Compensation: Examples from the SEC and CFTC*, 61 ADMIN. L. REV. 137, 152 (2009).

⁷⁵ *U.S. CFTC v. Wuensch*, Comm. Fut. L. Rep. ¶ 27,661.

⁷⁶ See, e.g., *CFTC v. John David Stroud, et al.*, Comm. Fut. L. Rep. ¶ 33,686.

⁷⁷ *U.S. CFTC v. PMC Strategy, LLC*, 903 F. Supp. 2d 368, 382 (W.D.N.C. 2012); *U.S. CFTC v. Driver*, 877 F. Supp. 2d 968, 981 (C.D. Cal. 2012); *In the Matter of Walters*, 2001 WL 1734770, at *1. See also *CFTC v. Miklovich*, 687 F. App’x 449, 453 (6th Cir. 2017). *But see U.S. CFTC v. Wilshire Inv. Mgmt. Corp.*, 531 F.3d 1339, 1345 (11th Cir. 2008) (concluding district court abused its discretion in awarding customers’ losses).

⁷⁸ *In the Matter of Walters*, 2001 WL 1734770, at *1.

⁷⁹ See, e.g., *U.S. CFTC v. Samaru*, 27 F. App’x 885, 886 (9th Cir. 2001).

3. *Consumer Relief/Extraordinary Restitution*

There appear to be no publicly-available agency guidelines or policies outlining how consumer relief amounts are set in settlement agreements. The lack of such guidelines is troubling, especially given that billions of dollars of consumer relief have been granted in recent years.⁸⁰ In Chapter 3, we provide additional detail on consumer relief payments and related policy concerns.

B. Civil and Criminal Monetary Penalties

The imposition of monetary penalties in addition to disgorgement or restitution is to ensure that a wrongdoer makes payments that exceed his or her profit from wrongdoing. This is critical for deterrence. However, determining the appropriate size of monetary penalties is much more complicated than disgorgement or restitution. In this section, we describe the numerous factors that are considered in determining the size of a civil or criminal monetary penalty. These factors include any relevant statutory minimum and maximum amounts, express statutory factors, case law requiring that penalties be in line with an agency's prior penalty decisions, and agency guidelines or matrices, to the extent an agency has adopted such policies or guidance.

This section proceeds in three stages. First, we explain that the SEC, CFTC, CFPB, DOJ Civil Division, and FinCEN appear to set penalties in a largely unstructured, informal, and non-transparent manner. Second, we explain that the banking regulators (the Fed, FDIC, OCC) and OFAC have policy statements and penalty matrices, but that these policies are subject to interpretation rendering them largely meaningless. Finally, we explain the setting of penalties in DOJ criminal matters.

Before proceeding, however, it is important to note that the Federal Civil Penalties Inflation Adjustment Act of 1990 requires agencies to adopt annual rules to adjust the statutory maximum civil monetary penalty amounts for inflation.⁸¹ Throughout the rest of this section, the reader will be provided with the statutory amounts.

1. Regulatory Authorities Without Public Policies or Guidelines

The SEC, CFTC, CFPB, the DOJ's civil enforcement division, and FinCEN take an approach to penalty setting that is not guided by comprehensive public agency policies, guidelines, or penalty matrices. While the enforcement authorities are constrained by statutory maximums and

⁸⁰ Recent settlement agreements providing for extensive consumer relief amounts, such as those with Bank of America, J.P. Morgan, Goldman Sachs, and Deutsche Bank, are described in detail in Chapter 3.

⁸¹ The maximum amounts are adjusted annually by inflation under the Federal Civil Penalties Inflation Adjustment Act of 1990, Pub. L. 101-410, 104 Stat. 890-892 (1990), *amended by* the Federal Civil Penalties Adjustment Act Improvements Act of 2015, Pub. L. 114-74, 129 Stat. 599-601 (2015) (codified at 28 U.S.C. § 2461 note). The adjustments are exempt from public notice and comment and must be published by January 15 of each year. Office of Mgmt. & Budget, Exec. Office of the President, Memorandum for the Heads of Executive Departments and Agencies (Feb. 24, 2016), <https://web.archive.org/web/20161207001447/https://www.whitehouse.gov/sites/default/files/omb/memoranda/2016/m-16-06.pdf>. The adjustments are made by the agency that enforces the underlying statutory provisions, using a multiplier provided to them by the Office of Management and Budget. The multiplier is based on changes to the Consumer Price Index. *Id.*

certain mandatory statutory factors, these enforcement authorities do not have publicly available, formal policies and procedures in place for setting the appropriate civil monetary penalty to be imposed in enforcement actions. That is particularly problematic because the statutory penalty maximums apply on a “per violation” basis meaning that even those restrictions are largely meaningless because enforcement authorities have vast discretion in how to count the number of violations that have occurred. We describe the problems inherent in the “per violation” approach in Section II.B.1.iii.

i. Statutory and Case Law Constraints

Table 2.1, on the next page, illustrates how each of the enforcement authorities listed is subject to statutory caps on the size of the civil monetary penalty that may be imposed. The table shows the generally applicable statutory maximum civil penalty amount. It is important to note that some statutes provide more guidance than others. For example, SEC and CFPB violations must be categorized into one of three tiers, with more egregious conduct subject to increasing maximum penalty amounts. By contrast, the laws applicable to the CFTC do not contain different tiers.

Table 2.1: Civil Monetary Penalty Statutory Maximums

Enforcement Authority	Violation Type	Maximum Amount
SEC ⁸²	Tier 1: Any violation of the applicable statute	\$5,000/\$7,500 ⁸³ (individual) per violation; \$50,000/\$75,000 (entity) per violation
	Tier 2: Violation involving fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement	\$50,000/\$75,000 (individual) per violation; \$250,000/\$375,000 (entity) per violation
	Tier 3: A Tier 2 violation AND it resulted in, or created significant risk of substantial losses to others or resulted in a substantial pecuniary gain to the violator	\$100,000/\$150,000 (individual) per violation; \$500,000/\$725,000 (entity) per violation
CFTC	False or Misleading Statements ⁸⁴	Greater of: (a) \$140,000; or (b) triple the defendant's monetary gain per violation
	Manipulation ⁸⁵	Greater of: (a) \$1,000,000; (b) or triple defendant's gain per violation
CFPB ⁸⁶	Tier 1: Any violation consumer financial law	\$5,000 per day per violation
	Tier 2: Reckless engagement in violation of federal consumer financial law	\$25,000 per day per violation
	Tier 3: Knowing violation of federal consumer financial law	\$1,000,000 per day per violation
DOJ	FIRREA ⁸⁷	\$1,000,000 per violation
	FCA ⁸⁸	\$5,000 to \$10,000 per violation PLUS three times the damages sustained by the government from the false statement
FinCEN ⁸⁹	Bank Secrecy Act (BSA)	(1) the amount involved in the transaction that violates the BSA (not to exceed \$100,000); or (2) \$25,000, whichever is greater

⁸² See 15 U.S.C. § 78u-2(b); 15 U.S.C. § 77h-1(g); 15 U.S.C. § 80a-9(d); 15 U.S.C. § 80b-3(i). There are also some other provisions that impose different penalties for specific types of misconduct. For example, in an insider trading case, the SEC can seek civil monetary penalties up to three times the profit gained or loss avoided as a result of the insider trade. 15 U.S.C. § 78u-1(a)(2). The inflation adjusted maximums are presented and are published in the Federal Register. See Adjustments to Civil Monetary Penalty Amounts, 83 Fed. Reg. 1,397 (Jan. 11, 2018).

⁸³ The amount on the left is the maximum under the Exchange Act, the Investment Advisers Act and the Investment Companies Act. The amount on the right is the maximum amount under the Securities Act. This holds for all the SEC amounts listed in the table. If the SEC brings a case in federal court, the maximum amount can be up to the gross amount of the pecuniary gain to the defendant if it exceeds the noted maximum. 15 U.S.C. §§ 77t(d), 78u(d), 80a-41(e), 80b-9(e).

⁸⁴ 7 U.S.C. § 9(10). See also Adjustment of Civil Monetary Penalties for Inflation, 83 Fed. Reg. 9,426 (Mar. 6, 2018), <https://www.gpo.gov/fdsys/pkg/FR-2018-03-06/pdf/2018-04480.pdf>. The CFTC has argued that gain should be determined based on the gross receipts received by the defendant, but a number of appeals courts have held that “gain” should be calculated as the defendant’s net profit. See, e.g., CFTC v. Vartulli, 228 F.3d 94, 113 (2d Cir. 2000); R&W Tech. Servs. Ltd. v. CFTC, 205 F.3d 165, 178 (5th Cir. 2000).

⁸⁵ 7 U.S.C. §§ 13a, 13a-1(d). See also Adjustment of Civil Monetary Penalties for Inflation, 83 Fed. Reg. 9,426 (Mar. 6, 2018).

⁸⁶ 12 U.S.C. § 5565(c). See also Civil Penalty Inflation Adjustments, 83 Fed. Reg. 1,526 (Jan. 12, 2018).

⁸⁷ 12 U.S.C. § 1833a(b). See also Civil Monetary Penalties Inflation Adjustment, 83 Fed. Reg. 3,944 (Jan. 29, 2018). For a continuing violation, the statutory maximum it is the lesser of \$1 million per day of the violation or \$5 million.

⁸⁸ 31 U.S.C. § 3729(a)(1). See also Civil Monetary Penalties Inflation Adjustment for 2017, 83 Fed. Reg. 3,944 (Jan. 29, 2018).

⁸⁹ 31 U.S.C. § 5321(a)(1). See also Inflation Adjustment of Civil Monetary Penalties, 83 Fed. Reg. 11,876 (Mar. 19, 2018), <https://www.gpo.gov/fdsys/pkg/FR-2018-03-19/pdf/2018-05550.pdf>.

In addition to the maximum dollar amounts imposed under the relevant statutes, some of the statutory provisions delineate specific factors that must be considered. For example, the statutes applicable to the SEC and CFPB require consideration of certain qualitative factors in setting penalty amounts.

Under the SEC-applicable statutes, the SEC must determine that a civil monetary penalty is in the public interest. However, the SEC only needs to make such a determination in matters brought in the administrative forum.⁹⁰ Importantly, the statute does not provide the SEC any guidance about how to determine either when a penalty is in the public interest or an appropriate penalty amount within the statutory maximum cap once the SEC has determined that a penalty is in the public interest.

The CFPB's governing statute requires that the CFPB consider specified factors in setting a penalty size. The CFPB is to take into account: (1) the size of the financial resources and good faith of the person charged; (2) the gravity of the violation; (3) the severity of the risks to or losses of the consumer; (4) the history of previous violations; and (5) other factors that justice may require.⁹¹ It does not explain how those factors should affect a penalty amount.

It is important to note that in cases where an enforcement authority sets a penalty amount, federal courts have stated that the penalty should not be “out of line” with the agency’s decisions in other cases.⁹² Consequently, the decisions in prior matters, in addition to the applicable statutory provisions, should, in theory, also act as a constraint on agency discretion, at least in cases where the agency must seek court approval of the penalty. However, financial institutions are highly unlikely to be able to obtain judicial review of penalty amounts because, due to practical considerations, financial institutions virtually always settle potential enforcement matters.

ii. Absence of Public, Formal Agency Policies

The SEC, CFTC, CFPB, the DOJ’s civil enforcement division, and FinCEN have not established comprehensive public guidelines on how civil penalty amounts are determined. That provides a great deal of discretion to those agencies when negotiating settlement agreements and can make it difficult for ALJs or federal court judges to calculate penalty amounts when a case is litigated and not settled.

This makes the penalty setting process unpredictable and can infuse the process with arbitrariness. For example, the CFPB has been criticized for its lack of transparency surrounding

⁹⁰ Compare 15 U.S.C. §§ 78u-2(c), 77h-1(g), 80a-9(d), 80b-3(i) with *id.* §§ 77t(d), 78u(d), 80a-41(e), 80b-9(e). In making that determination, the SEC is statutorily required to consider six factors: (1) whether the misconduct involved fraud, deceit or manipulation; (2) the harm to other persons resulting from the misconduct; (3) the extent to which any person was unjustly enriched; (4) whether the enforcement target is a repeat offender; (5) the need to deter future violations; and (6) any other factors justice may require.

⁹¹ 12 U.S.C. § 5565(c)(3).

⁹² *Collins v. SEC*, 736 F.3d 521, 526 (D.C. Cir. 2013).

how it determines penalty sizes.⁹³ Indeed, one partner of the law firm Ballard Spahr stated that he had studied CFPB settlements to create a guide for clients facing CFPB investigations about the penalties that they might face and was unable to develop any rule from his review.⁹⁴ Instead, he says he has to rely on his “gut” in advising clients about the amount they may eventually have to pay out.⁹⁵ In addition, a former enforcement chief at the OCC, Robert Serino, has stated that FinCEN’s publicly available orders assessing penalties are so lacking in information that one cannot even reach a conclusion about the general approach or factors that FinCEN takes into account.⁹⁶

Furthermore, a former SEC lawyer in the Office of General Counsel analyzed 28 SEC litigated administrative proceedings and found that different ALJs take different approaches to determining penalty sizes.⁹⁷ That could undermine the legality of ALJ penalty determinations because federal courts have held that penalties imposed in one case cannot be out of line with decisions in other cases before that agency.⁹⁸

Enforcement authorities without formal guidelines and/or matrices likely consider non-statutory factors on an informal basis when determining penalties. For example, Anthony Alexis, an enforcement official at the CFPB noted that the CFPB looks to non-statutory factors in determining the appropriate penalty amount. For example, whether the violator has worked to independently ferret out violations, reported problems to the CFPB and begun to fix them, and voluntarily provided restitution to consumers.⁹⁹

We note that the CFTC has decades old public policy statements that have not been revoked, which list certain qualitative factors the agency should consider in setting penalty amounts. These include: (1) the gravity of the offense; (2) the financial condition of the target; (3) other considerations;¹⁰⁰ and (4) the target’s cooperation with the CFTC.¹⁰¹ Similarly, the SEC issued a policy statement in 2006 that lists factors to consider in penalizing corporations, which include: (1) the presence or absence of a benefit to the corporation from the violation; (2) the degree to which a penalty will compensate victims or injure innocent shareholders; (3) the need to

⁹³ See Evan Weinberger, *CFPB Enforcement Chief Defends Money Penalty Process*, LAW360 (Apr. 4, 2016), <http://www.law360.com/articles/779896/cfpb-enforcement-chief-defends-money-penalty-process>.

⁹⁴ See *id.*

⁹⁵ See *id.*

⁹⁶ See Robert B. Serino, *FinCEN’s Lack of Policies and Procedures for Assessing Civil Money Penalties In Need of Reform*, AM. BAR ASS’N (July 2016), http://www.americanbar.org/publications/blt/2016/07/07_serino.html.

⁹⁷ See Jonathan N. Eisenberg, *Calculating SEC Civil Money Penalties*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 24, 2016), <https://corpgov.law.harvard.edu/2016/01/24/calculating-sec-civil-money-penalties/>.

⁹⁸ See *Collins v. SEC*, 736 F.3d 521, 525 (D.C. Cir. 2013).

⁹⁹ Evan Weinberger, *CFPB Enforcement Chief Defends Money Penalty Process*, LAW360 (Apr. 4, 2016), <http://www.law360.com/articles/779896/cfpb-enforcement-chief-defends-money-penalty-process>.

¹⁰⁰ The first 3 factors are provided for in a 1994 policy statement. See U.S. GEN. ACCT. OFFICE, *MONEY PENALTIES: SECURITIES AND FUTURES REGULATORS COLLECT MANY FINES BUT NEED TO BETTER USE INDUSTRY WIDE DATA 20* (1998), <http://www.gao.gov/assets/230/226534.pdf>.

¹⁰¹ See U.S. COMMODITY FUTURES TRADING COMM’N, *ENFORCEMENT ADVISORY: COOPERATION FACTORS IN ENFORCEMENT DIVISION SANCTION RECOMMENDATIONS 1* (2004), <http://www.cftc.gov/files/enf/enfcooperation-advisory.pdf>.

deter the particular type of offenses; (4) the extent of injury to innocent parties; (5) the pervasiveness of the conduct within the corporation; (6) the level of intent of the perpetrators; (7) the degree of difficulty of detecting the wrongdoing; (8) the remedial steps taken by the corporation; and (9) the extent of cooperation with the SEC and other enforcement authorities.¹⁰² A corresponding policy does not appear to exist for penalties against individuals. It is also unclear how stringently either of the agencies apply those factors.¹⁰³

iii. *Application of “Per Violation” Penalty Maximums*

The lack of formal policies and guidelines is particularly important because the statutory maximum amounts detailed in the previous table are all on a “*per violation*” basis. Misconduct can be characterized in such a manner that a wide range of penalty sizes are possible, which essentially gives unbridled discretion to enforcement authorities in many instances. An example can be helpful. If a defendant is charged with distributing a materially misleading prospectus in violation of the SEC’s Rule 10b-5, then the SEC might characterize the conduct as a single violation. Alternatively, it might determine that there are as many violations as there are paragraphs in the prospectus containing misstatements. Or, the SEC could determine that there are as many violations as there are investors who received the prospectus.¹⁰⁴ The SEC, CFTC, CFPB, and DOJ have not disclosed policies about how to make such determinations.

In litigated matters, ALJs and federal court judges have had to make those judgment calls, but have acted in an inconsistent manner. For example, in the SEC context, an analysis by a former SEC lawyer found that one administrative law judge often combined related acts of misconduct into a “course of conduct” that equaled only one violation.¹⁰⁵ Another judge took a different approach by counting a large number of violations.¹⁰⁶ The lawyer also found that the judges’ explanations of how they reached the number of violations to determine penalty amounts were somewhat cryptic, taking up only one or two sentences in decisions that could exceed 100 pages.¹⁰⁷

Similarly, federal court judges have wrestled with the issue. In the FCA context, for example, some judges have been willing to treat individual false claims as distinct violations even if part of a larger scheme or course of conduct. For example, in a recent Fourth Circuit decision, the appeals court held that a defendant had committed over 9,000 violations because it had submitted over 9,000 different invoices to the government, each of which, according to the court, was a separate false claim.¹⁰⁸

¹⁰² U.S. Sec. & Exch. Comm’n, *Statement of the Securities and Exchange Commission Concerning Financial Penalties* (Jan. 4, 2006), <https://www.sec.gov/news/press/2006-4.htm>.

¹⁰³ See, e.g., Michael S. Piwowar, Commissioner, U.S. Sec. & Exch. Comm’n, Remarks to the Securities Enforcement Forum 2014 (Oct. 14, 2014), https://www.sec.gov/news/speech/2014-spch101414msp#_ftnref16 (raising concerns about number of staff recommendations not accompanied by an analysis of the factors in the 2006 policy statement and stating that it is important to have a “clear analytical framework” for determining penalties).

¹⁰⁴ See Jonathan N. Eisenberg, *Calculating SEC Civil Money Penalties*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 24, 2016), <https://corpgov.law.harvard.edu/2016/01/24/calculating-sec-civil-money-penalties/>.

¹⁰⁵ See *id.*

¹⁰⁶ See *id.*

¹⁰⁷ See *id.*

¹⁰⁸ *United States ex rel. Bunk v. Gosselin World Wide Moving, N.V.*, 741 F.3d 390, 407–08 (4th Cir. 2013).

It is important to note that later in this chapter, we discuss how in criminal cases the U.S. Sentencing Guidelines provide instructions to federal judges about how to avoid multiple punishments for the same underlying conduct. Civil cases could benefit from a similar approach.

iv. Concerns with Agencies' Lack of Penalty-Setting Guidance

Our primary concern is that the absence of comprehensive public, formal policies coupled with the malleable nature of the statutory penalty limits, gives enforcement authorities effectively unbridled discretion in setting penalties and thus creates the risk of arbitrary and disproportionate penalties.

Importantly, enforcement targets generally cannot use courts to check agencies' unbounded discretion, because financial institutions face significant pressures to settle matters outside of court. Contested enforcement proceedings create uncertainty among shareholders. They also divert management attention from business operations. In addition, the decision to litigate could have negative effects on employees, customers, suppliers, and communities. In criminal matters, in particular, we are unaware of any large financial institution that has survived a contested criminal case that has resulted in a conviction. Furthermore, in civil matters, firms are very reluctant to litigate potential enforcement proceedings because of the adverse effect that doing so could have on their relationship with their regulatory supervisors. Regulators provide firms with feedback, request data, have onsite examiners, and engage in reviews of firms' policies, procedures and operations. Thus, a collaborative relationship is often in a firm's best interest and litigating a case could upset that dynamic.

Disproportionate and arbitrary penalties are undesirable for several reasons.

First, they serve no additional deterrent or remedial purpose. As a result, such penalties threaten to undermine the aims of the Eighth Amendment to the U.S. Constitution, which expressly forbids the government from imposing penalties that are disproportionate to the gravity of the offense.¹⁰⁹ The Supreme Court has held that the Eighth Amendment applies to both civil and criminal penalties.¹¹⁰

Second, the law in many areas is necessarily subject to uncertainty and case-by-case interpretations such that the boundaries of the law are not well defined.¹¹¹ Well-intentioned actors may therefore avoid lawful and productive financial activities out of fear of being wrongly targeted by enforcement authorities and subject to arbitrary and disproportionate penalties. For example, the concepts of materiality in disclosing information to buyers of a security, or unfair and deceptive practices in the context of providing financial products or services to consumers are necessarily case-specific. Therefore, uncertainty about specific mandatory disclosures or unfair practices

¹⁰⁹ U.S. CONST. amend. VIII (“Excessive bail shall not be required, nor excessive fines imposed, nor cruel or unusual punishment inflicted.”); *United States v. Bajakajian*, 524 U.S. 321, 334 (1998).

¹¹⁰ *Austin v. United States*, 509 U.S. 602 (1993).

¹¹¹ *Cf.* Matt Levine, *The CFPB Approach to Regulation Has It Backward*, BLOOMBERG (Jan. 30, 2018), <https://www.bloomberg.com/view/articles/2018-01-30/the-cfpb-approach-to-regulation-has-it-backward>.

coupled with the risk of disproportionate penalties could result in a broker-dealer choosing to forgo engaging in the offering or marketing of valuable securities or products.¹¹²

The risk that disproportionate penalties will chill lawful and productive activities is especially true because, as behavioral economists have noted, individuals are typically loss averse – they dislike losses more than equivalent gains.¹¹³ If lawful and productive activities of individuals and firms are chilled, then economic growth, financial innovation, access of investors and consumers to products and services, and entrepreneurs access to capital will be constrained. Thus, the problem of disproportionate and arbitrary penalties is felt by investors, consumers, and innovators. In effect, disproportionate penalties act as a tax on lawful activity and produce deadweight loss.

Fear of arbitrary and disproportionate penalties may not only deter financial market participants from engaging in lawful and productive activities, but it can also limit the amount of capital that firms can allocate to loans and investments. Firms instead must devote capital to fund unexpected liabilities arising from disproportionate enforcement actions. Any such funds cannot be used for productive purposes, establishing another mechanism by which unrestrained agency discretion could hinder economic growth.

Third, arbitrary and disproportionate penalties can undermine the basic goals of the enforcement system – ensuring respect for and compliance with the law. According to Professor Christopher Hodges at Oxford University,¹¹⁴ if the legitimacy of penalties is doubted, then respect for the law could decline and reduce overall compliance rates. Equally as important, disproportionate and arbitrary penalties could result in an excessively adversarial relationship between regulators and those that they regulate. This could be a problem, because a more collaborative approach between enforcement authorities and firms and individuals may best achieve compliance. According to Professor Hodges, individuals improve their behavior when they receive feedback,¹¹⁵ and feedback requires open lines of communications and mutual respect between the parties.

Aside from the risk of arbitrary and disproportionate penalties, the unbridled discretion afforded by an ad hoc approach to penalty setting also fosters the potential for unequal treatment of enforcement targets through the imposition of inconsistent penalties. A hallmark of the American justice system is equality under the law and thus unequal treatment of similar defendants would violate a core American-legal value. Similarly situated defendants who have committed similar violations of similar size, scope and egregiousness might be penalized materially different amounts, particularly in settlement agreements, for several reasons.

First, enforcement targets may not have all the facts about similar misconduct by others. Even though settlement agreements are frequently publicly available, the statement of facts in a

¹¹² The uncertainty of the law itself can deter otherwise lawful conduct. However, the risk of arbitrary and disproportionate penalties being imposed provides a secondary or supplemental deterrent effect on lawful activities.

¹¹³ CHRISTOPHER HODGES, *LAW AND CORPORATE BEHAVIOR* 20 (2015).

¹¹⁴ *Id.* at 28.

¹¹⁵ *Id.* at 21.

settlement agreement is limited and, therefore, certain facts may be omitted. Thus, facts disclosed in other settlement agreements may not be useful precedent. As a result, the target cannot point to prior cases as grounds for an appropriate penalty amount because the government could always assert that other non-disclosed facts were considered. Absent penalty guidelines, the enforcement target lacks a credible source to use to justify its bargaining position.

Second, absent policies or core principles, it is more difficult for an enforcement target to engage in a substantive back and forth with enforcement authorities about the appropriate penalty. The absence of a common starting point about the relevant considerations, how to weigh them, and how to calculate the number of violations that occurred, means that the parties can have widely divergent views of the appropriate penalty amount. That can result in inefficient negotiations because every case requires coming to an understanding about those considerations. That process can also result in materially disparate penalties in otherwise similar cases.

Of course, in the event of an extraordinarily high settlement demand, an enforcement target could force the government to litigate the case. However, that would be costly in terms of the resources that would be needed to try a case, could distract management, and could result in unwanted publicity. Furthermore, as discussed earlier, the possibility of litigating with a supervisory regulator that has day-to-day authority over many aspects of a firm's business is particularly unappealing. As a result, enforcement targets may have strong incentives to settle even if they believe a particular settlement amount is arbitrary or disproportionate. And a target with fewer resources to litigate an enforcement action may feel even more pressure to settle than a defendant with greater resources, even if their conduct was the same.

2. Enforcement Authorities with Penalty Setting Policies – the Banking Regulators and OFAC

The banking regulators (specifically the Fed, OCC, and FDIC), and OFAC have policies for assessing civil monetary penalties. The following discussion focuses first on the approach used by the banking regulators and then describes the OFAC approach. While we applaud efforts to implement publicly disclosed policies, the application of these policies requires significant interpretation that can render them meaningless. These policies also do not always apply in the cases with the largest penalties – the stated rationale is that matrices work best in routine matters that involve fewer judgment calls.¹¹⁶ In effect, the matrices and guidelines can provide a veneer of restraining agency discretion, but in practice they leave enforcement authorities with effectively unbridled discretion in setting penalties.

i. FDIC, Fed, and OCC Penalty Setting Approach

The size of the penalties assessed by banking regulators is governed in three ways. First, the statutes provide maximum penalty amounts. Second, the banking regulators have adopted an

¹¹⁶ See, e.g., Letter from Richard Spillenkothen, Director Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System to the Officer in Charge of Supervision at Each Federal Reserve Bank (Mar. 24, 1997), <https://www.federalreserve.gov/boarddocs/srletters/1997/SR9706.HTM> (stating that civil monetary penalty matrix is to be used for routine matters where no special circumstances apply).

interagency policy on the assessment of civil monetary penalties that identifies 13 factors the agencies should consider in setting penalty sizes. Third, the banking regulators have adopted penalty matrices that use a points system to calculate penalty amounts.

The primary statutory provision governing the assessment of civil monetary penalties by the FDIC, OCC and Fed is 12 U.S.C. § 1818(i). This provision authorizes the assessment of civil monetary penalties by a bank’s primary regulator and provides three different tiers of maximum penalties based on the nature of the misconduct.¹¹⁷ A table summarizing the three tiers and the applicable penalties is provided below.

Table 2.3: FDIC, Fed, and OCC Penalty Maximums

Tier	Type of Violation	Maximum Civil Penalty
Tier 1 ¹¹⁸	Insured depository institution or affiliate: violates any law or regulation; violates any condition imposed in writing by the banking regulator in connection with any action on any application, notice, or other request made by the banking institution; violates any written agreement between the banking institution and the banking regulator	\$5,000 per day of the violation
Tier 2 ¹¹⁹	A Tier 1 violation that involves reckless engagement in an unsafe or unsound practice or breach of a fiduciary duty that either (a) is part of a pattern of misconduct; (b) causes or is likely to cause more than a minimal loss to the banking institution (i.e., harm); or (c) results in pecuniary gain to the violator (i.e., profit).	\$25,000 per day of the violation
Tier 3 ¹²⁰	Knowingly committing a Tier 1 violation or knowingly engaging in an unsafe or unsound practice or knowingly breaching a fiduciary duty AND in committing such violation, practice or breach the violator knowingly or recklessly causes substantial loss to the banking institution (i.e., causes harm) or obtains a substantial pecuniary gain (i.e., profits).	Insured depository institution: Lesser of \$1,000,000 or 1% of the institution’s total assets per day of the violation. Any other enforcement target: \$1,000,000 per day of the violation.

The FDIC, Fed, and OCC are also required by statute to consider four “mitigating factors” in determining the size of the penalty to impose. Specifically, the statute provides that the agencies must consider: (1) the size of financial resources and good faith of the institution or person charged; (2) the gravity of the violation; (3) the history of previous violations; and (4) other matters as justice may require.¹²¹

¹¹⁷ See 12 U.S.C. § 1818(i).

¹¹⁸ *Id.* § 1818(i)(2)(A). See also Rules of Practice for Hearings, 83 Fed. Reg. 1,182 (Jan. 10, 2018) (inflation adjusted amounts).

¹¹⁹ 12 U.S.C. § 1818(i)(2)(B). See also Rules of Practice for Hearings, 83 Fed. Reg. 1,182 (Jan. 10, 2018) (inflation adjusted amounts).

¹²⁰ 12 U.S.C. § 1818(i)(2)(C)-(D). See also Rules of Practice for Hearings, 83 Fed. Reg. 1,182 (Jan. 10, 2018) (inflation adjusted amounts).

¹²¹ 12 U.S.C. § 1818(i)(2)(G).

In addition to the statutory factors, the FDIC, Fed, and OCC are party to a policy released in 1998 by the FFIEC, the interagency coordinating body for federal banking regulators first referenced in Chapter 1. The FFIEC policy sought to “provide guidance on the appropriateness of a civil money penalty” for violations of the laws governing banking institutions.¹²² The *non-binding policy* identified 13 relevant, non-exhaustive factors for the agencies to weigh in setting penalty sizes. These include:

1. Whether the violation was intentional or committed with disregard of the law or of the consequences to the institution;
2. The duration and frequency of the violations;
3. Whether the violations continued or ceased after the target was notified of the violations;
4. Whether the target cooperated with the agency to allow an early resolution of the problem;
5. Whether there was concealment of the violation;
6. Threat of loss, actual loss or other harm to the institution and degree of the harm;
7. Whether the target or the target’s associates received a financial gain or other benefit as a result of the violation;
8. Whether the target paid restitution of losses resulting from the violation;
9. Prior history of violations;
10. Previous criticism of the target for similar actions;
11. Presence or absence of compliance programs;
12. Tendency to engage in violations of law, unsafe or unsound banking practices or breaches of fiduciary duty;
13. Existence of any agreements, commitments, order or conditions in writing intended to prevent the violation.¹²³

Each of the FDIC, Fed, and OCC have adopted and made publicly available civil monetary penalty matrices that incorporate the FFIEC factors.¹²⁴ Each of the agency’s matrices or accompanying guidance provides that the agency retains discretion to deviate from the relevant matrix, and thus they are *non-binding*.

¹²² Assessment of Civil Money Penalties, 63 Fed. Reg. 30,226 (Jun. 3, 1998).

¹²³ *Id.*

¹²⁴ FED. DEPOSIT INS. CO., COMPLIANCE EXAMINATIONS—ENFORCEMENT ACTIONS (Mar. 2016) [hereinafter FDIC], <https://www.fdic.gov/regulations/compliance/manual/2/II-9.1.pdf>; OFFICE OF COMPTROLLER OF THE CURRENCY, PPM 5000-7 (REV), POLICIES AND PROCEDURES MANUAL (Feb. 26, 2016) [hereinafter OCC], <https://www.occ.gov/news-issuances/bulletins/2016/bulletin-2016-5a.pdf>; BD. OF GOVERNORS OF FED. RESERVE SYS., SR 91-13 (FIS), CIVIL MONEY PENALTIES AND THE USE OF THE CIVIL MONEY PENALTY ASSESSMENT MATRIX (June 3, 1991) [hereinafter Fed], <https://www.federalreserve.gov/boarddocs/srletters/1991/sr9113.htm#Footref4>. The NCUA has not publicized a generally applicable matrix showing how it calculates penalty amounts.

COMMITTEE ON CAPITAL MARKETS REGULATION

The FDIC and OCC each have one matrix that applies to institutions and one that applies to institutional affiliates (e.g., officers, directors, controlling shareholders).¹²⁵ The Fed, by contrast, has one matrix that applies to both individuals and institutions.¹²⁶

The agency matrices operate in similar fashions. The matrices use a point system to reach a penalty amount. The total number of points assigned to a violator is determined by specified substantive factors (based on the statutory factors and the 13 FFIEC factors), each of which are then assigned a score of zero to four based on the conduct in the specific case. Each factor's score is then multiplied by a "weight factor" pre-assigned by the matrix. The points are then summed to reach an aggregate number of points. Finally, the point value is compared to a schedule of point values that provide the suggested civil monetary assessment amount. An illustrative example of the OCC's matrix applicable to financial institutions is presented in **Appendix C**.

The matrix shows that the OCC uses eleven factors like intent, harm to others, gain to the enforcement target from the wrongdoing, and concealment to calculate a total point value. The OCC assigns a point value of between 0 to 4 to each substantive factor listed in the matrix. The matrix also contains mitigating factors like good faith and cooperation to offset the aggravating factors to obtain a final total point value.

The matrix also specifies the weight that the OCC assigns to each factor. The OCC gives the greatest weight to intent and concealment and the least weight to the mitigating factors such as cooperation and payment of restitution.

The matrix illustrates that agencies can consider factors not specifically enumerated in statutes or FFIEC policy. For example, the OCC considers the good faith of the institution before it was informed about the violation, though that is not required under the statute or the interagency policy.

Once the agency assigns point values to each factor, multiplies each factor by the specified weighting, and adds up the point values to get a total point value, then an OCC-developed table describes the maximum civil monetary penalty that should be imposed given the total point score and the size of the institution. As we discuss later, application of the matrix requires interpretation in a manner that does not cabin agency discretion.

¹²⁵ See FDIC, *supra* note 124; OCC, *supra* note 124.

¹²⁶ See Fed, *supra* note 124. The scope of the applicability of the matrices differs by agency. The Fed, for example, has stated that its matrix only applies to tier 1 penalties (the least severe type of violations described in the previous table). BD. OF GOVERNORS OF FED. RESERVE SYS., SR 97-6 (ENF), CIVIL MONEY PENALTY ASSESSMENT PROCEDURES (Mar. 24, 1997). The OCC's matrices apply to tier 1 and tier 2 violations (the lowest and intermediate types of violations described in the previous table). See OCC, *supra* note 124, at 4. The FDIC's guidance accompanying its matrices does not state that the matrices are inapplicable with respect to any tier of violations. See FDIC, *supra* note 124.

ii. *OFAC Penalty Matrix Approach*

The statutes OFAC enforces provide statutory *maximums* for the civil penalties that the Secretary of the Treasury is authorized to impose for violations of trade sanction laws. For example, the International Emergency Economic Powers Act caps the civil monetary penalty that can be imposed for a violation of trade restrictions to the greater of: (1) \$250,000¹²⁷; or (2) twice the amount of the value of the transaction that violated the law.¹²⁸ The statute provides discretion to OFAC so long as the penalty imposed falls below the statutory maximum.

OFAC has developed and published a system that it uses to determine the appropriate penalty size within the statutory cap. It is outlined in a 2009 set of enforcement guidelines that is applicable to firms and individuals.¹²⁹ In those guidelines, OFAC explains that it will place actions into one of four categories based on two variables: (1) whether the violation was egregious; and (2) whether the violation was self-disclosed to OFAC. Determining whether a violation was egregious requires the application of agency discretion.

OFAC's guidance also lists the factors it will consider in determining if the case is egregious or not. It weighs the following factors: (1) whether the violation was a willful or reckless violation of law;¹³⁰ (2) the violator's awareness of the conduct at issue; (3) the actual or potential harm to the sanctions program caused by the conduct; (4) the size, commercial sophistication and sanctions history of the violator; (5) the existence, nature and adequacy of the violator's risk-based OFAC compliance program; (6) the violator's remedial response to the violation; (7) the violator's cooperation with OFAC; (8) other enforcement actions taken by other agencies for the same or similar misconduct; and (9) the effect the case will have on future compliance and deterrence.¹³¹ OFAC gives substantial weight to the first four factors with particular emphasis on the first two.¹³² A case will be deemed egregious if an analysis of the factors "indicates that the case represents a particularly serious violation of the law calling for a strong enforcement message."¹³³

Once OFAC categorizes a case as egregious or not and determines whether the violator voluntarily disclosed the violation to OFAC, then OFAC applies its four-quadrant matrix to set the penalty size. The matrix is produced on the next page.

¹²⁷ For inflation adjusted amount, see Inflation Adjustment of Civil Monetary Penalties, 83 Fed. Reg. 11,876 (Mar. 19, 2018), <https://www.gpo.gov/fdsys/pkg/FR-2018-03-19/pdf/2018-05550.pdf>.

¹²⁸ 50 U.S.C. § 1705(b).

¹²⁹ See Economic Sanctions Enforcement Guidelines, 74 Fed. Reg. 57,593 (Nov. 9, 2009), https://www.treasury.gov/resource-center/sanctions/Documents/fr74_57593.pdf.

¹³⁰ Willful being worse than reckless as a willful violation involves a decision to take an action knowing that it will violate U.S. law. Economic Sanctions Enforcement Guidelines, 74 Fed. Reg. 57,593, 57,602 (Nov. 9, 2009), https://www.treasury.gov/resource-center/sanctions/Documents/fr74_57593.pdf.

¹³¹ *Id.* at 57,602–03.

¹³² *Id.* at 57,605.

¹³³ *Id.*

Table 2.4: OFAC Civil Monetary Penalty Maximum Amount Matrix

	Egregious	Not Egregious
Voluntary Disclosure	One-half statutory maximum	One-half of transaction value (capped at one-half statutory maximum) ¹³⁴
No Voluntary Disclosure	Statutory maximum	Applicable schedule amount (capped at statutory maximum) ¹³⁵

iii. Limitations of Penalty Matrices

Penalty matrices have potential advantages over an ad hoc, case-by-case approach to setting monetary penalties. The use of such a formalized process has the potential to increase consistency in penalty amounts to better ensure equal treatment of similarly situated defendants. It also means that the enforcement authority has given considerable thought to the factors that should be considered in each case and the weight those factors should be given. That contemplative process has the potential to decrease the risk that irrational penalties are imposed. The use of matrices also should increase the efficiency in the penalty-setting process because it pre-establishes the premise for any settlement negotiations.

However, the banking regulators’ matrices do not apply in all cases. For example, the Fed only requires that its staff apply its matrix to the least severe violations (i.e., tier 1 violations). The stated rationale is that matrices work best in routine matters that involve fewer judgment calls.¹³⁶ But consistency in penalties and mitigating the risk of arbitrary and disproportionate penalties is just as important, if not more important, in the largest cases. And constraints on discretion may be more appropriate in larger cases given that there are fewer similar cases to establish that the enforcement authority’s penalty is arbitrary.

An enforcement agency can also reach an extraordinarily wide range of penalty outcomes even when they apply their matrices or guidelines. The decision about how many points to assign to a particular factor requires subjective judgments. Take the OCC matrix for example. If the total points assigned to the misconduct falls within the range of 101-130 points, a large bank can face a fine of up to \$60 million. That amount increases to \$150 million, a \$90 million difference, if the point value instead falls within the range of 131-160. If the point value is going to be near the cutoff of 131 points for a higher penalty, then enforcement authorities could categorize certain factors in a way to obtain a higher point value and thus higher penalty. For example, the matrix’s factor of “intent” can be given a score of 3 if the bank disregarded red flags or a 4 if the bank clearly disregarded the law. Under a particular fact pattern, one could imagine a judgment call

¹³⁴ For the inflation adjusted maximum, see Inflation Adjustment of Civil Monetary Penalties, 83 Fed. Reg. 11,876 (Mar. 19, 2018), <https://www.gpo.gov/fdsys/pkg/FR-2018-03-19/pdf/2018-05550.pdf>.

¹³⁵ The statutory provision sets a cap of \$250,000 per violation. *Id.*

¹³⁶ *See, e.g.*, Letter from Richard Spillenkothen, Director Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System to the Officer in Charge of Supervision at Each Federal Reserve Bank (Mar. 24, 1997), <https://www.federalreserve.gov/boarddocs/srletters/1997/SR9706.HTM> (stating that civil monetary penalty matrix is to be used for routine matters where no special circumstances apply).

having to be made. Because the “intent” score is multiplied by a factor of 7, that decision can increase or decrease the total points by 7 points. Undoubtedly in some cases that judgment call will be critical.

In addition, the presence of matrices does not eliminate the “per violation” issue we raised in the discussion of SEC, CFTC, and CFPB penalties in section II.B.1.iii. An enforcement authority with a matrix could aggregate conduct into one violation or divide wrongdoing into multiple violations. If the enforcement authority took the former approach, then the matrix would be applied one time to derive one penalty amount. If the latter approach were used, then the matrix would be applied for each violation and the total penalties would be the sum of each analysis, which could result in higher penalties.

3. DOJ’s Criminal Monetary Penalties

The process behind the determination of criminal penalties for the DOJ is unique because it depends on whether the case results in a conviction entered by a court or whether the target negotiates a settlement with the DOJ out of court.

i. Court Imposed Criminal Penalties in Criminal Convictions

When the DOJ brings a criminal action, the defendant – whether an individual or entity – can be subject to monetary penalties (as well as prison time for an individual).¹³⁷ In the event a defendant is convicted, judges must consider sentencing guidelines that have been developed by the U.S. Sentencing Commission (the “**Commission**”).¹³⁸ The Commission is an independent agency in the judicial branch that consists of seven voting and two non-voting members, whose purpose is to establish sentencing policies and practices for the federal criminal justice system.¹³⁹ The Commission is authorized and empowered to fulfill its duties by federal statute.¹⁴⁰

To achieve its mission, the Commission has published a Sentencing Guidelines Manual that is over 600 pages long.¹⁴¹ The manual provides the method by which a court is to determine the appropriate advisory sentencing range and fines for defendants. Specifically, the sentence is determined using a grid with ranges based on an “offense level” (on a range of 1 to 43) and “criminal history” (on a range of I to VI).¹⁴² For example, if the calculated offense level is 30 and the criminal history is a III, then the guidelines recommend a sentence of 121 to 151 months in

¹³⁷ See, e.g., 15 U.S.C. § 77x (Securities Act providing for a fine of up to \$10,000 and prison time of no more than five years for willful violation of the Securities Act); 15 U.S.C. § 78ff (Exchange Act authorizing criminal fines and prison time for willful violations of the law); 15 U.S.C. § 80a-48 (Investment Companies Act providing for criminal fines and prison time for violations of the law); 15 U.S.C. § 80b-17 (Advisers Act providing for criminal fines and prison time for violations of the law); 7 U.S.C. § 13 (CEA providing for criminal fines and prison time for violations of the law); 18 U.S.C. § 1343 (providing for criminal fine or prison time for violation wire fraud law).

¹³⁸ See generally U.S. SENTENCING GUIDELINES MANUAL [hereinafter USSG], <http://www.ussc.gov/sites/default/files/pdf/guidelines-manual/2016/GLMFull.pdf>.

¹³⁹ *Id.* Ch.1, Pt.A, intro. comment.

¹⁴⁰ 28 U.S.C. § 994(a).

¹⁴¹ See generally USSG, *supra* note 138.

¹⁴² See USSG, *supra* note 138, Ch.5, Pt.A, sentencing table.

prison for a defendant that is a natural person.¹⁴³ Importantly, the Sentencing Guidelines Manual contains detailed instructions on how judges should apply the guidelines when defendants are convicted on multiple different counts, but involve the same underlying misconduct and the same harm.¹⁴⁴ The guidelines are designed to “prevent multiple punishment for substantially identical offense conduct.”¹⁴⁵ This would minimize concerns regarding the “per violation” problem described in the prior section.

Criminal fines for *natural persons* are based on the “offense level” obtained after proceeding through the analysis required by the Sentencing Guidelines Manual. These fines range from as low as \$500 to as high as \$500,000.

The Sentencing Guidelines Manual also provides a multistep process for determining the appropriate criminal fine to impose on an *organizational* defendant.¹⁴⁶ The following describes the process at a high level.

The guidelines first require the calculation of a base criminal fine, which is based on the offense level assigned to the underlying crime.¹⁴⁷ The base fines range from \$8,500 to \$150 million.¹⁴⁸ The sentencing guidelines also provide that the fine should at least be equal to the pecuniary gain to the organization from the offense, or the pecuniary loss from the offense caused by the organization if the violation was intentional, knowing, or reckless.¹⁴⁹

The base fine is then multiplied by a “culpability score” based on factors such as the level at which the unlawful conduct took place in the organization, the organization’s prior criminal history, whether the organization has an effective compliance and ethics program and whether the organization self-reported the crime or cooperated with the criminal investigation.¹⁵⁰ The court then imposes a criminal fine after considering the recommended amount calculated through this process.

ii. Alternative Resolution Agreements with Prosecutors

However, prosecutors can enter into settlement agreements called non-prosecution agreements (“**NPA**s”) and deferred prosecution agreements (“**DPA**s”) for which the DOJ is not legally bound to consider the Sentencing Guidelines. Of course, the Sentencing Guidelines are still a factor in negotiations because a defendant is likely to calculate whether the terms of an NPA or DPA offer a better deal than what the defendant could face under the Sentencing Guidelines if convicted after a trial.

¹⁴³ *See id.*

¹⁴⁴ *Id.* Ch.3, Pt.D.

¹⁴⁵ *Id.* Ch.3, Pt.D, intro. comment.

¹⁴⁶ *Id.* Ch.8, intro. comment.

¹⁴⁷ *Id.* § 8C2.4.

¹⁴⁸ *Id.*

¹⁴⁹ *Id.*

¹⁵⁰ *Id.* § 8C2.5. The multiplier can be less than 1, which reduces the fine, or as great as 4, which quadruples the base fine amount.

a. Role of NPAs and DPAs

NPAs and DPAs are privately negotiated agreements between prosecutors and a target of a criminal investigation in which the government agrees to close an investigation or dismiss outstanding charges in exchange for the target’s acceptance and fulfillment of certain conditions.¹⁵¹ As a former U.S. Attorney testified before Congress, “[NPAs and DPAs] occupy an important middle ground in the resolution of corporate crimes cases” between seeking a criminal conviction and declining to pursue prosecution.¹⁵² The agreements “typically require the payment of restitution to victims, and/or fines and penalties.”¹⁵³ They also contain provisions to root out illegal conduct and prevent recidivism by requiring the target to adopt or improve internal controls and ethics and compliance programs.¹⁵⁴

NPAs and DPAs differ from plea agreements because in plea agreements, the defendant is *convicted* of a crime and a *judge* imposes a sentence.¹⁵⁵ The judge must accept that the plea bargain was entered voluntarily and inform the defendant of the charges it is facing and the rights it is waiving by entering a plea.¹⁵⁶

Data on DOJ criminal actions against financial institutions from the University of Virginia Corporate Prosecution Registry illustrates the central role NPAs and DPAs play. In most years from 2000 through 2016, NPAs and DPAs constituted most criminal matters resolved by the DOJ against financial institutions and in multiple years they represented *all* such resolved criminal matters. As **Figure 2.2** shows on the next page, NPAs and DPAs are used more often than plea agreements.

¹⁵¹ See Paul J. Larkin, Jr., *Funding Favored Sons and Daughters: Nonprosecution Agreements and “Extraordinary Restitution” in Environmental Criminal Cases*, 47 LOY. L.A. L. REV. 1, 4-5 (2014).

¹⁵² *Concerning Corporate Settlement Agreements: Hearing Before the H. Judiciary Subcomm. on Commercial and Admin. Law* (March 11, 2008) (statement of David E. Nahmias, U.S. Att’y for the N. Dist. of Ga., Dep’t of Justice).

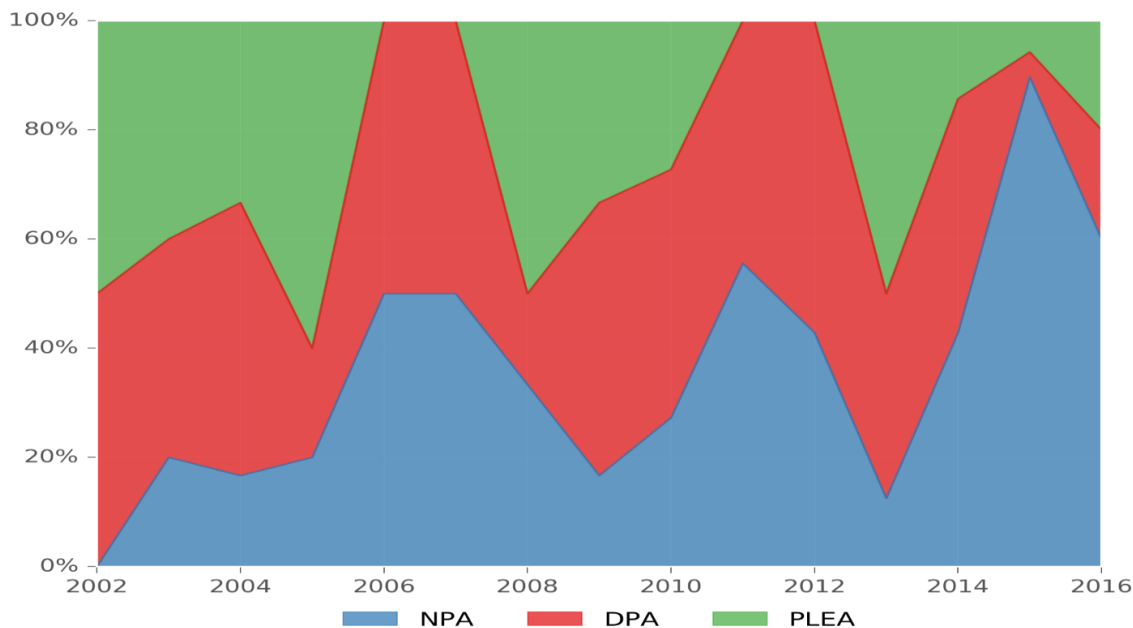
¹⁵³ *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ See Larkin, *supra* note 151, at 25–26.

¹⁵⁶ See *id.* at 23.

Figure 2.2: Method of Resolution of Financial Institution DOJ Criminal Matters



b. Differences Between NPAs and DPAs

NPAs and DPAs “differ in form rather than substance.”¹⁵⁷ The difference between the two is that an NPA is entered into before criminal charges are ever filed against a person or firm, whereas a DPA is entered into upon the filing of criminal charges.¹⁵⁸

NPAs are entered into before criminal charges are filed in court and the agreement is therefore only maintained by the parties and not filed in court.¹⁵⁹ NPAs are *not* reviewed by courts before they are finalized¹⁶⁰ because they are entered into before any charges are filed in court.¹⁶¹ Thus, there is no judicial oversight of NPAs. By contrast, DPAs are entered into after formal criminal charges have been filed in court. As a result, the agreement is typically filed with the court to seek the court’s leave to stay the case while the defendant takes the necessary steps to meet the

¹⁵⁷ James R. Copland & Rafael A. Mangual, *Justice Out of The Shadows: Federal Deferred Prosecution Agreements and The Political Order*, MANHATTAN INST., Jun. 2016, at 4, <https://www.manhattan-institute.org/sites/default/files/R-JC-0616.pdf>.

¹⁵⁸ The difference in timing can have reputational implications because a defendant who enters into a DPA is an indicted criminal defendant, while one who enters into an NPA is not.

¹⁵⁹ Memorandum from Craig S. Morford, Acting Deputy Attorney General, DOJ 1 n.2 (Mar. 7, 2008), <https://www.justice.gov/sites/default/files/dag/legacy/2008/03/20/morford-useofmonitorsmemo-03072008.pdf>.

¹⁶⁰ See Cindy R. Alexander & Mark A. Cohen, *The Evolution of Corporate Criminal Settlements: An Empirical Perspective on Non-Prosecution, Deferred Prosecution, and Plea Agreements*, 52 AM. CRIM. L. REV. 537, 556–57 (2015), <http://www.americancriminallawreview.com/files/5714/3311/7862/52-3-Summer-Alexander-Cohen.PDF>

¹⁶¹ See Copland & Mangual, *supra* note 157, at 4.

terms of the agreement, at which point the case is dismissed.¹⁶² However, DPAs are subject to limited judicial review.¹⁶³ According to the D.C. Circuit Court of Appeals, one of the few federal appeals court to have decided a case on the scope of judicial review applied to DPAs, the courts are not to substantively review the terms of such an agreement or second guess the government’s decision to enter into one.¹⁶⁴

c. Prosecutorial Discretion to Enter into NPAs and DPAs

DOJ prosecutors have enormous discretion in negotiating and implementing NPAs and DPAs in three key ways.

First, the DOJ does not have a formal policy that directly governs when it is appropriate for prosecutors to enter into such agreements. Instead, they are entered into on an ad hoc, case-by-case basis. According to a GAO study that examined the government’s use of DPAs and NPAs, prosecutors stated that they base their decisions about whether to enter these agreements based on an analysis involving the Principles of Federal Prosecution of Business Organizations (the “**Principles**”) contained in the U.S. Attorneys’ Manual.¹⁶⁵ The Principles list a number of factors to be considered in deciding whether to decline prosecution or to seek a conviction. The prosecutors view the analysis as existing along a continuum in which the use of NPAs and DPAs lies in the middle of the decision to decline prosecution or seek a conviction.¹⁶⁶

Second, prosecutors have great discretion in negotiating the specific terms of NPAs and DPAs, including the amount of criminal monetary fines imposed under these agreements. In 2016, the DOJ recovered more than \$4 billion in fines under these types of agreements.¹⁶⁷ Indeed, the desire to avoid a criminal conviction may cause some potential criminal defendants to accept penalties outside the scope of the Sentencing Guidelines to avoid the reputational costs that may arise from an indictment or ultimate criminal conviction. Moreover, no statute or DOJ policy or guidance regulates terms in these agreements, such as governance changes that prosecutors may require.

Third, prosecutors frequently have unilateral discretion about whether to terminate an agreement and bring criminal charges. A study of NPAs and DPAs by Professor Garrett at the University of Virginia found that 83% of such agreements provide that prosecutors can unilaterally

¹⁶² *See id.*

¹⁶³ *See id.*

¹⁶⁴ *See generally* United States v. Fokker Services B.V., 818 F.3d 733 (D.C. Cir. 2016).

¹⁶⁵ U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-09-636T, CORPORATE CRIME: PRELIMINARY OBSERVATIONS ON DOJ’S USE AND OVERSIGHT OF DEFERRED PROSECUTION AND NON-PROSECUTION AGREEMENTS 4 (2009), <http://www.gao.gov/assets/130/122853.pdf>.

¹⁶⁶ *Id.*

¹⁶⁷ *See 2016 Year-End Update On Corporate Non-Prosecution Agreements (NPAs) and Deferred Prosecution Agreements (DPAs)*, GIBSON DUNN (Jan. 4, 2017), <http://www.gibsondunn.com/publications/documents/2015-Year-End-Update-Corporate-Non-Prosecution-Agreements-and-Deferred-Prosecution-Agreements.pdf>.

terminate them.¹⁶⁸ In the event of a dispute about compliance with the terms of the agreement, there is significant uncertainty as to whether a venue exists to resolve the dispute.

d. Recent Changes to DOJ Practices Involving NPAs and DPAs

In recent years, the DOJ has taken initial steps to provide guidance about NPAs and DPAs. First, in some recent NPAs, prosecutors have listed factors that they have taken into account and referred to the sentencing guidelines in explaining how fines were determined.¹⁶⁹ More importantly, in April 2016, the DOJ announced a one-year pilot program, specifically regarding cases involving the Foreign Corrupt Practices Act, a law that aims to prevent U.S. persons and businesses from engaging in bribery and corruption in foreign dealings (“**FCPA Pilot Program**”).¹⁷⁰ In particular, the FCPA pilot program provided that in such cases prosecutors could agree to criminal fines as low as (1) 25% below the sentencing guideline range if the target fully cooperated with the DOJ and timely and appropriately remediated the problem; or (2) 50% below the range if the prior conditions are met and the target voluntarily disclosed the violation.¹⁷¹

The FCPA Pilot Program explicitly used the Sentencing Guidelines as the starting point for reaching the settlement amount in the NPA or DPA and adjusted the penalty downward if certain conditions about disclosure, cooperation, and remediation are met. In November 2017, the DOJ permanently adopted an FCPA Corporate Enforcement Policy that, in most significant respects, adopts the FCPA Pilot Program approach.¹⁷² It also creates a presumption that if a company voluntarily discloses a violation, fully cooperates with the DOJ, and timely and appropriately remediates the violation, then the DOJ will not prosecute the company. In March 2018, officials in the DOJ’s Criminal Division announced that the policy will be applied as nonbinding guidance in other criminal matters outside the FCPA context.¹⁷³

C. Rationalizing the Determination of Penalties with Guideposts

As we have shown, there is wide disparity in the policies, procedures, and approaches governing the determination of sanctions in enforcement actions. However, in practice, agencies have unbridled discretion to set penalty amounts. We believe that enforcement authorities should adopt core principles or “guideposts” that will appropriately cabin agency discretion and serve as

¹⁶⁸ See Brandon L. Garrett, *Structural Reform Prosecution*, 93 VA. L. REV. 853, 894 (Table 1) (2007).

¹⁶⁹ See, e.g., Deferred Prosecution Agreement at 3–4, *United States v. Embraer S.A.*, No. 16-60294-cr-COHN (Oct. 24, 2016) (listing nine factors leading to a penalty 20% below the low end of the Sentencing Guidelines range); Deferred Prosecution Agreement at 3–5, *United States v. Rolls-Royce PLC*, No. 16-cr-247 (Dec. 20, 2016) (listing 10 factors leading to a penalty 25% below the low end of the Sentencing Guidelines range).

¹⁷⁰ See DOJ CRIMINAL DIV., THE FRAUD SECTION’S FOREIGN CORRUPT PRACTICES ACT ENFORCEMENT PLAN AND GUIDANCE 2 (2016), <https://www.justice.gov/archives/opa/blog-entry/file/838386/download>; Richard L. Cassin, *DOJ will keep Pilot Program after April expiry during evaluation*, RECATHLON LLC (Mar. 10, 2017, 11:28 AM), <http://www.fcpablog.com/blog/2017/3/10/doj-will-keep-pilot-program-after-april-expiry-during-evalua.html>.

¹⁷¹ See DOJ CRIMINAL DIV., THE FRAUD SECTION’S FOREIGN CORRUPT PRACTICES ACT ENFORCEMENT PLAN AND GUIDANCE 8 (2016), <https://www.justice.gov/archives/opa/blog-entry/file/838386/download>

¹⁷² U.S. ATTORNEYS’ MANUAL, § 9-47.120.

¹⁷³ Jonathan S. Kolodner, et al., *DOJ Announces Expansion of Approach Encouraging Self-Reporting and Cooperation*, CLEARY GOTTlieb (Mar. 5, 2018), <https://www.clearyenforcementwatch.com/2018/03/doj-announces-expansion-approach-encouraging-self-reporting-cooperation/>.

guardrails to prevent enforcement authorities from straying off the road and imposing arbitrary and irrational monetary penalties.

The Committee Staff makes separate recommendations with respect to non-DOJ enforcement authorities and the DOJ. This is largely for two reasons. First, in criminal matters before federal judges, the U.S. Sentencing Guidelines apply and we wish to make clear that our recommendations do not apply to such matters. Second, for the non-DOJ enforcement authorities, we recommend involving the Financial Stability Oversight Council (“FSOC”) in the development of principles. Given the historical importance of DOJ’s independence from outside influences, and the fact that the DOJ is not otherwise involved in FSOC, we believe the DOJ should take similar steps, but act independently of FSOC.

1. Development of Guideposts for Non-DOJ Federal Agencies

We believe that FSOC should develop core principles for enforcement authorities to apply in enforcement matters when setting monetary penalties. FSOC was created as part of Dodd-Frank and is comprised of the Secretary of the Treasury and includes, among others, representatives from the Fed, OCC, CFPB, FDIC, SEC, CFTC, NCUA, all of which are important enforcement authorities.¹⁷⁴ Given the perspective of all of these different members, we believe FSOC is well-positioned to craft a set of thoughtful and balanced principles.

The principles designed by FSOC and adopted and implemented by the enforcement authorities should constrain agency discretion, ensure that penalties achieve their deterrent and remedial aims without suppressing lawful economic activity, avoid duplicative penalties, promote consistency in penalties across similarly situated enforcement targets, and seek transparency in the penalty setting process. We believe there are four principles or guideposts that can achieve those aims.

The first guidepost should be that the penalties must be proportionate. More specifically, penalties should be proportionate to the harm caused by the misconduct, as well as the gravity or intentionality of the misconduct. Where the harm that resulted from wrongdoing is large, a higher penalty may be more justified than when an unlawful act did not harm investors or consumers. In addition, penalties should not be determined on a “per violation” basis. The problem with such an approach is that it can result in penalties that are disproportionate. For example, if a defendant mails out 1,000 copies of a disclosure document at one time that contain the exact same misstatement, such a violation could presently be treated as 1,000 violations. In general, we believe that focusing on the harm caused rather than the number of violations would result in more rational and proportionate penalties. In addition, enforcement authorities should consider the gravity or intentionality of the misconduct. Holding all other factors constant, misconduct that is intentional and brazen deserves to be penalized more than misconduct that results from carelessness.

A second guidepost should be that enforcement authorities must take into account the enforcement target’s efforts to remedy the misconduct. Individuals and firms that seek to redress

¹⁷⁴ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 111, 124 Stat. 1376, 1392 (2010).

the wrong committed should be provided with recognition of such efforts through a reduced penalty. Likewise, steps taken to quickly end wrongdoing upon its discovery should be accounted for, as should efforts to assist government investigators in identifying and prosecuting culpable individuals. These mitigating factors should play a part in penalty setting because doing so creates incentives for firms to voluntarily compensate harmed investors or consumers and quickly stop wrongdoing before the government is even involved or aware of a matter.

Third, enforcement authorities should have to conclude that the penalties being imposed are not unnecessarily duplicative in light of other penalties that the enforcement target has incurred or is about to incur from other enforcement authorities for the same underlying misconduct. This analysis helps ensure that the overall penalties faced by a target are proportionate to its misconduct. A penalty that appears proportionate in isolation could be disproportionate when viewed in light of other punishment that has already been assessed.

Fourth, enforcement authorities should have to consult and rely upon outcomes in other enforcement actions involving similar wrongdoing and conclude that the penalties being imposed are consistent with those imposed in similar matters. More specifically, the enforcement authority should identify cases involving similar misconduct, evaluate how the facts of the current matter are similar to or different from those cases, and then determine that the penalties being imposed in the current case are justified by the penalties imposed in the prior cases. This guidepost should help ensure consistency across cases over time and across defendants. However, we believe that past enforcement actions should not be relied upon for this analysis unless imposed by a federal court in a contested matter, because the lack of existing standardized policies for determining penalties could result in enforcement agencies relying upon past actions that imposed arbitrary and disproportionate penalties. Thus, with respect to reliance on past settled matters, this approach should only apply to new enforcement actions that have had penalties determined in accordance with our other recommendations. Moreover, we believe that more weight should be given to non-settled matters where penalties were set by federal judges because a more fully developed factual record exists for comparison purposes and the matter benefited from the involvement of the judge as an independent third-party adjudicator.

To allow the public to hold enforcement authorities accountable and have confidence that the guideposts are being utilized, enforcement authorities must be transparent. Transparency should be accomplished in two ways. First, enforcement authorities should publish the guideposts that they adopt. Second, in every enforcement action, the enforcement authority should explain how the guideposts were applied.

- **Recommendation 6:** Enforcement authorities should adopt publicly available core principles or guideposts setting forth the key considerations to be made in setting monetary penalties. FSOC should establish these principles or guideposts and they should include: (1) ensuring that the penalties are proportionate; (2) accounting for the enforcement target's remedial efforts; (3) avoiding duplicative penalties for the same underlying misconduct; and (4) relying on historical precedents for consistency. Enforcement authorities should explain how the guideposts were applied in each enforcement action.

2. *Establishment of DOJ Guidelines*

The DOJ lacks public policies for the determination of penalties in: (1) the settlement of civil cases under FIRREA and the FCA; and (2) the resolution of criminal matters through NPAs and DPAs. The potential benefits of DOJ guideposts in FIRREA, FCA, NPA and DPA matters are the same as those outlined above. The DOJ should also take into account lessons it has learned from the FCPA Pilot Program and the adoption of its new FCPA Corporate Enforcement Policy in developing its guideposts.

- **Recommendation 7:** The DOJ should establish similar publicly available guideposts for the setting of sanctions imposed in both DOJ civil matters under FIRREA and the FCA, as well as in criminal matters, including those resolved through NPAs and DPAs.

III. Data on Monetary Sanctions

In this part, we first describe our data collection process and the general shortcomings in publicly available information regarding U.S. enforcement actions. We then present our analysis of the data that we collected, covering a roughly 17-year period. Our data show clear upward trends in the total aggregate monetary sanctions imposed in enforcement actions and the size of the mean and median monetary sanctions imposed on enforcement targets during the period. However, due to the lack of principles or guideposts for the setting of monetary penalties, the drivers of the increase in monetary sanctions remain unclear. That illustrates another potential benefit of principles or guideposts. Policies or guideposts could provide confidence to the public that increases in the sanctions imposed in the typical (median) or average (mean) case are actually driven by changes in behavior, including more egregious conduct or harm to investors, rather than a simple ratcheting up of sanctions for similar acts. Such transparency would enable policymakers to better respond to such trends with reforms that would enhance deterrence.

A. Data Collection Process and Limitations of Available Data

1. Data Collection Process

The Committee Staff gathered data on enforcement actions from the following agencies: (1) SEC (2) CFTC; (3) CFPB; (4) Fed; (5) FDIC; (6) OCC; (7) OTS; (8) NCUA; (9) OFAC; (10) FinCEN; (11) DOJ civil and criminal cases (against financial institutions only in each instance); and (12) New York Department of Financial Services (“NY DFS”).

Data collection sources and methods differed depending on the specific enforcement authority. The data collection methods are described in **Appendix D**. Our data analysis generally spans from 2000 to 2016, except where otherwise indicated in individual figures, charts, or graphs. We intend to update this data annually.

2. Limitations of Publicly-Available Enforcement Data and Recommendations to Improve Access to Enforcement Data

We found numerous flaws in the presentation, disclosure, and accessibility of enforcement authorities’ case-level data. Therefore, the data analyses use only the case-level data that could be gathered and analyzed using our reasonable best efforts.

One major complication was that SEC and DOJ enforcement action information and documents are not located on one centralized webpage. For example, SEC enforcement action documents are located in at least four different pages on its website.¹⁷⁵ In addition, it is not clear

¹⁷⁵ The four different webpages are: (1) “Litigation Releases” for matters brought in federal court; (2) “Administrative Proceedings” for cases initiated and/or settled in the administrative forum; (3) “ALJ Initial Decisions” for cases litigated before administrative law judges; and (4) “Commission Opinions and Adjudicatory Orders” for administrative cases appealed to the commissioners. See *Litigation Releases*, U.S. SEC. & EXCH.

that all relevant information about enforcement matters is posted on agency websites.¹⁷⁶ Another complication is that most of the enforcement authorities do not provide summary information in tabular or spreadsheet form about the outcomes and sanctions imposed in specific enforcement actions.¹⁷⁷

It is important to note, however, that the Fed, OCC, and FDIC provide relatively robust public disclosures regarding enforcement actions. These banking regulators present enforcement information on their websites in tabular form or downloadable spreadsheets that identify enforcement actions, the defendants, and sanctions imposed in each action. We commend the Fed, OCC, and FDIC for their efforts to enhance transparency in this regard.

Data deficiencies appear to extend to agencies' internal resources as well. Indeed, one staffer at the CFTC told us that when CFTC attorneys research the sanctions imposed in past cases, they refer to the enforcement releases posted on the CFTC's public website. The CFTC does not have an internal searchable database.¹⁷⁸

The current arrangement and disclosure of enforcement actions makes it extremely difficult for the public to effectively monitor enforcement activity and creates dependency on the use of annual aggregated statistics released by the agencies. Furthermore, the aggregated data does not allow policymakers, the public, academics, or others to conduct analyses on important trends, such as the median and mean monetary sanctions being imposed, the types of defendants (i.e., individuals versus firms), or the extent to which the cases with the largest monetary sanctions drive aggregate sanction amounts.

- **Recommendation 8:** Each enforcement authority should establish an easily accessible, searchable, centralized database of all of its enforcement actions.

The databases should include, in a downloadable format, information on: (1) the defendants' identities (including an identification number for firms that allows for the consistent identification of firms across agencies and for the identification of the corporate parent of any subsidiaries); (2) whether the defendant was a natural person or a corporate entity; (3) the date the enforcement action was filed; (4) the date the enforcement action was resolved; (5) a breakdown of the types of monetary and non-monetary sanctions imposed on each defendant; (6) the amount of civil monetary penalties, disgorgement, restitution, and/or consumer relief imposed on each

COMM'N, <https://www.sec.gov/litigation/litreleases.shtml>; *Administrative Proceedings*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/litigation/admin.shtml>; *ALJ Initial Decisions: Administrative Law Judges*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/alj/aljdec.shtml>; *Commission Opinions and Adjudicatory Orders*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/litigation/opinions.shtml>.

¹⁷⁶ For example, it appears that the SEC does not post a litigation release for every case resolved or settled in federal court. Because Lexis Nexis Securities Mosaic does not review individual case dockets in federal court, the SEC data reported herein may be missing monetary sanction amounts from civil cases that the SEC does not publish press releases for and thus would underestimate the total amount of monetary sanctions imposed by the SEC.

¹⁷⁷ To collect data on CFPB, NCUA, OFAC, FinCEN, and NY DFS enforcement actions, research assistants had to review the relevant order, opinion, or press release in each action. Had a third-party vendor not already hand collected data from SEC and CFTC enforcement actions, a similar hand review of individual SEC and CFTC orders would have also been necessary.

¹⁷⁸ Telephone Interview with CFTC Staffer (March 21, 2017).

defendant (broken out by category of monetary relief); and (7) the aggregate amount of each type of monetary sanction imposed against all defendants in the enforcement action. In addition, if the government’s case is dismissed or the government loses a non-settled matter, the database should clearly and prominently indicate the resolution of the matter and that the defendant incurred no sanctions.

The public deserves the ability to evaluate if authorities are operating in a fair, impartial, and just manner, and to analyze outcomes in enforcement actions. Making data on specific enforcement cases more easily accessible would advance that interest. In turn, this increased transparency should increase the accountability of enforcement authorities to the public. Implementing these databases should not be a significant burden on enforcement authorities. Many of them already have some internal capacity to analyze the outcomes of enforcement actions. Others, like the OCC, FDIC, and Fed, already engage in efforts to disclose the results of specific enforcement actions

B. Data Findings on Enforcement Activity and Monetary Sanctions

Our collection of case-level enforcement data permits us to conduct analyses of enforcement trends during a 17-year period and across many different U.S. enforcement authorities. This section presents data on: enforcement activity, as measured by the number of enforcement actions per year and the total monetary sanctions ordered to be paid per year, and median and mean monetary sanctions ordered to be paid by enforcement action defendants.

1. Enforcement Activity

We measure: (a) the annual amount of enforcement activity in the United States as measured by the number of enforcement actions and (b) the total monetary sanctions imposed each year.

i. Number of Enforcement Actions

Figure 2.3, on the next page, illustrates the number of enforcement actions brought each year from 2000 through 2016. Each vertical bar shows the combined actions brought by all of the agencies indicated in the legend.¹⁷⁹

¹⁷⁹ OFAC was excluded from this analysis because in the early 2000’s, OFAC brought a significant number of cases involving minimal financial penalties against individuals for activities such as travelling illegally to Cuba, which are outside the scope of the Report’s focus on capital markets and the financial system. We also excluded notices from banking regulators to banks that certain individuals were automatically barred by statute from being affiliated with the bank because of legal problems. Data for the DOJ consists only of actions against financial institutions. For all other enforcement authorities, the number of enforcement actions includes all enforcement actions brought by the enforcement authority.

Figure 2.3: Number of Enforcement Actions Per Year

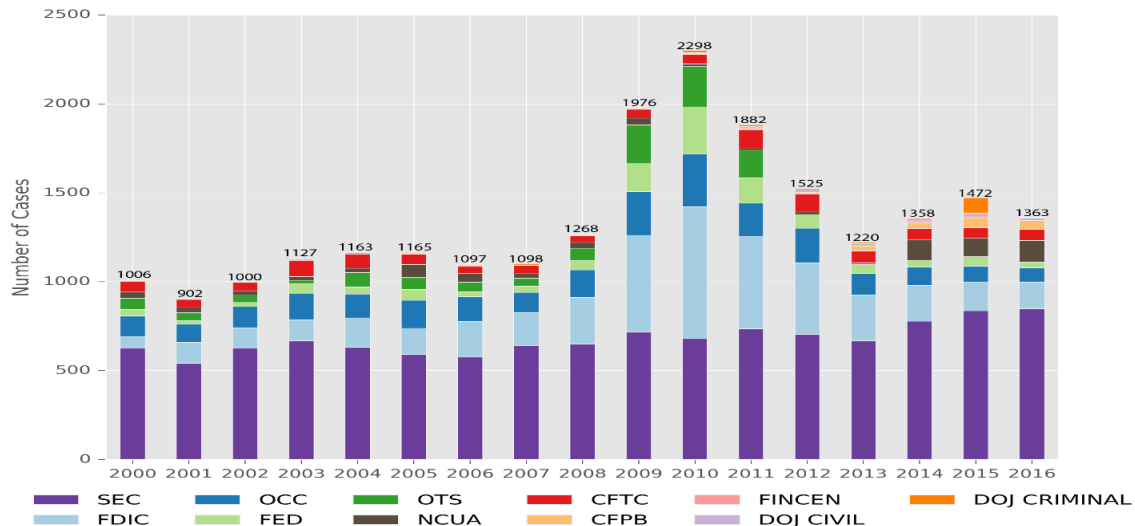


Figure 2.3 shows that the SEC is the most active enforcement authority, as measured by the number of actions brought each year. Such actions have generally risen from just above 500 cases in 2001 to about 850 cases in 2016. In all years except 2009-2012, the SEC brought a majority of the enforcement actions. The only other enforcement authorities that have brought more than 100 enforcement actions in a year are the FDIC, Fed, OCC, OTS, and NCUA

There was a noticeable sharp increase in overall enforcement activity beginning in 2009, in the aftermath of the 2008 financial crisis. The trend was driven primarily by an increase in enforcement actions by the FDIC, Fed, OCC, and OTS. In 2010, enforcement actions by those enforcement authorities peaked at 742, 266, 296, and 226, respectively, and accounted for about two-thirds of enforcement activity. The activity of those agencies has declined since then, to just over 260 cases in total in 2016.

The CFTC, CFPB, and FinCEN bring comparatively fewer actions than other enforcement authorities. The CFTC has brought between about 40 to 100 cases per year, while the CFPB ramped up from its inception to around 55 cases in 2015. FinCEN typically brings fewer than 10 cases per year. In addition, DOJ criminal cases against financial institutions¹⁸⁰ typically number fewer than 10 per year, with the exception being 2015 in which 87 criminal matters were brought, mostly in connection with its investigation of Swiss tax shelters.

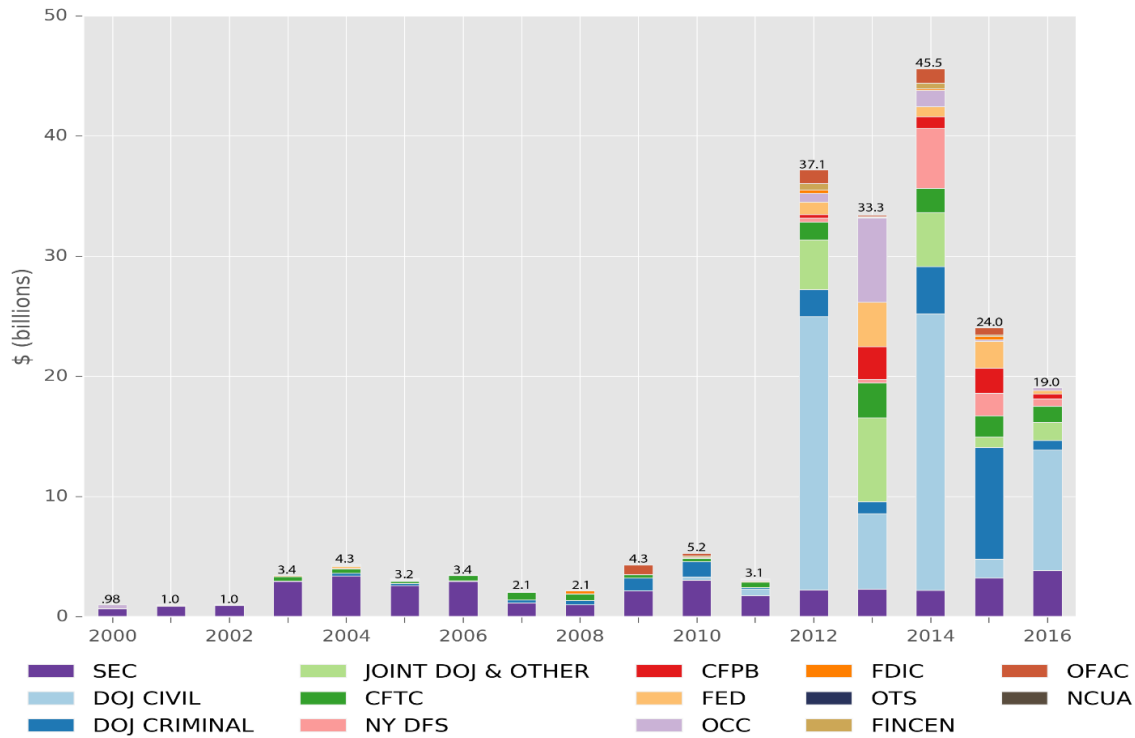
ii. Total Monetary Sanctions

A separate measure of enforcement activity is the total amount of monetary sanctions imposed in enforcement actions. **Figure 2.4**, on the next page, shows the aggregate amount of

¹⁸⁰ DOJ criminal cases include cases brought by U.S. Attorney’s offices and DOJ headquarters.

monetary sanctions ordered to be paid in actions brought by enforcement authorities, plus those imposed by the NY DFS, OFAC, and penalties obtained by states and others in joint actions with the DOJ.¹⁸¹

Figure 2.4: Total Monetary Sanctions



In most years, the SEC and CFTC are the enforcement authorities that impose the most monetary sanctions. While the SEC typically has imposed aggregate sanctions of between \$1 billion to \$4 billion per year (including in the most recent year), the CFTC increased from roughly \$450 million in 2006 to approximately \$2.9 billion in 2013. However, since 2012, the DOJ has been the leader, imposing monetary sanctions of over \$25 billion in each of 2012 and 2014 (on roughly 20 cases per year) and over \$10 billion in each of 2015 and 2016.

Figure 2.4 shows a very large spike in the total monetary sanction amounts awarded after the 2008 financial crisis. The spike in monetary sanction begins in 2012, going from about \$3 billion in 2011 to over \$37 billion in 2012. The amounts peaked in 2014 at around \$45 billion. The

¹⁸¹ The “Joint DOJ & Other” amounts are comprised of amounts awarded to states or to agencies like the FDIC, NCUA or FHA as receivers for failed institutions in actions settled or brought together with the DOJ action. The amounts awarded to receivers of failed institutions are not included in the individual agency amounts as they are not included in the enforcement actions on those agencies’ websites because rather than acting as regulatory authorities in those instances, the agency is standing in the shoes of the failed institution asserting private legal claims.

increase is driven by very large cases that settled matters arising from the financial crisis. For example, the \$25 billion National Mortgage Settlement, discussed in **Appendix B**, occurred in 2012 and accounts for about 67% of the total in the Committee Staff’s data for that year. Similarly, the \$16.65 billion Bank of America referenced in Chapter 1 and described in **Appendix B** accounts for more than 33% of the monetary sanctions in 2014.

The spike in monetary sanctions in 2012-2016 was primarily driven by the DOJ civil and criminal actions against financial institutions. Given the relatively small number of DOJ cases shown in **Figure 2.3**, a very small number of cases drove the exponential growth in penalty amounts following the crisis.¹⁸² **Figure 2.4** also shows large increases in the amounts imposed by banking regulators such as the OCC and Fed from 2012-2015. For example, in 2012-2015, Fed monetary sanctions ranged from around \$850 million to over \$3.6 billion, compared to only \$85 million in 2011 and less than \$1 million in 2010. During the 2012-2015 period, the Fed resolved a number of large matters, including the Independent Foreclosure Review, foreign exchange rigging, and LIBOR rigging cases.

Overall monetary sanctions in the past few years have been in a downtrend. Recent SEC and CFTC reports for fiscal 2017 indicate that trend may be continuing, as CFTC monetary sanctions fell 67% from fiscal 2016 to fiscal 2017 and SEC monetary sanctions declined over 7% in the same period.¹⁸³ The downtrend could be a result of large cases arising from the financial crisis being resolved.

2. Monetary Sanctions Attributable to the Largest Actions

The Committee Staff’s data analysis shows that the top 10% of cases with monetary sanctions typically account for more than 90% of all monetary sanctions imposed each year.¹⁸⁴ This is important because if enforcement authorities are motivated in part by a desire to publish impressive statistics on overall penalties each year, then they can influence those numbers by ratcheting up sanctions in a relatively small number of cases.

3. Median and Mean Monetary Sanctions

Trends in the median and mean size of financial sanctions ordered against particular defendants in enforcement actions can be analyzed using case-level data. The median and mean size of monetary sanctions are particularly useful to observe differences in the approach taken by

¹⁸² Over 76% of the penalties from 2000-2016 are accounted for by the top 1% of cases and 97% by the top 10%. A figure in Appendix E shows the proportion of total monetary sanctions comprised of the top 1% and top 10% of cases with monetary sanctions for each of the non-DOJ enforcement authorities. This shows that across regulators, the largest cases make up the vast proportion of total monetary sanctions.

¹⁸³ Gabriel Rubin, *CFTC Reports Steep Drop in Enforcement Actions and Fines*, WALL ST. J. (Nov. 22, 2017), <https://www.wsj.com/articles/cftc-reports-steep-drop-in-enforcement-actions-and-fines-1511384084>; Urska Velikonja, *Behind the Annual SEC Enforcement Report: 2017 and Beyond, Part I*, N.Y.U. PROGRAM ON CORP. COMPLIANCE & ENFORCEMENT (Nov. 22, 2017) https://wp.nyu.edu/compliance_enforcement/2017/11/22/behind-the-annual-sec-enforcement-report-2017-and-beyond-part-i/.

¹⁸⁴ Related figures can be found in Appendix E.

distinct types of regulators in “typical” cases. Median penalty amounts are determined by ranking penalty amounts from smallest to largest and taking the amount that falls in the middle of that ranked list. A mean penalty is the average penalty and is calculated by adding up all penalties and dividing by the number of defendants. Of course, mean penalties are impacted more directly by a few very large penalties than median penalties. Differences in median and mean amounts could demonstrate changes in the role of monetary sanctions to accomplishing enforcement’s aims of deterrence and remediation.¹⁸⁵

i. Median Monetary Sanctions by Enforcement Authority Category

Figure 2.5, below, shows the median monetary sanction against defendants in cases brought by capital markets regulators, banking regulators, and the DOJ in which a financial sanction was imposed.¹⁸⁶ It is useful to analyze median sanction amounts because while outlier cases with large monetary sanctions can affect the mean or average, the median amount reflects penalty amounts in an ordinary case.

Figure 2.5: Median Monetary Sanctions

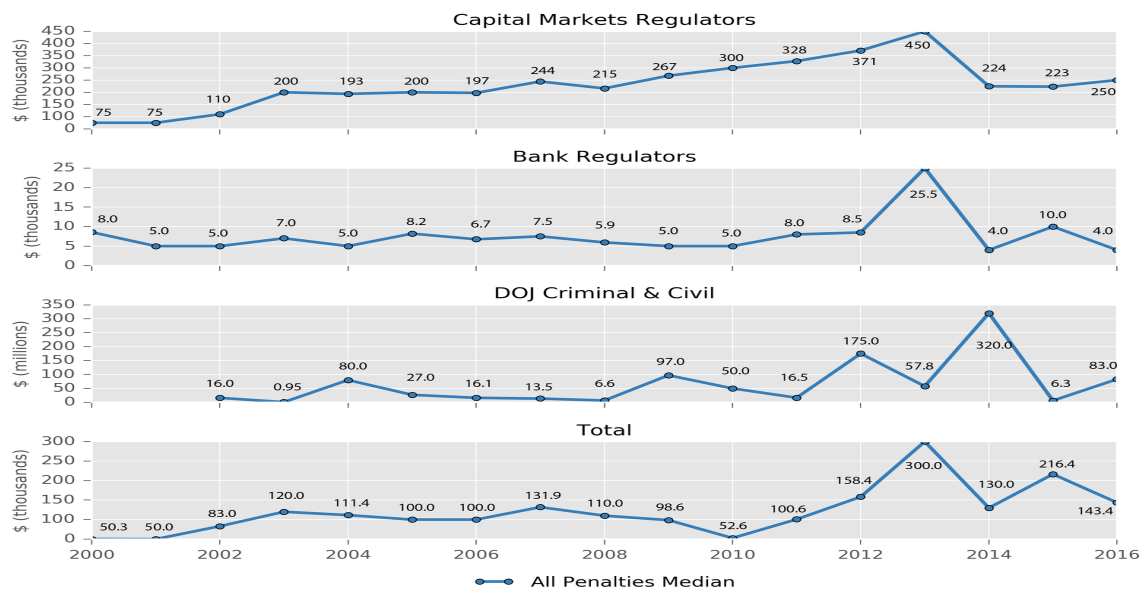


Figure 2.5 shows that the median monetary sanction imposed by capital markets regulators has increased over three-fold from 2000 to 2016 and six-fold from 2000 to 2013. The figure also shows that the median monetary sanction is usually very small in cases brought by banking

¹⁸⁵ Differences could also result, among many reasons, because the enforcement authorities are bringing enforcement actions that are different in nature. One agency could be bringing cases against more egregious types of misconduct. Our data does not allow us to control for that possibility or others.

¹⁸⁶ Data on capital markets regulators and bank regulators includes all enforcement actions against institutions and individuals. DOJ data is comprised only of actions against financial institutions as outlined in Appendix D.

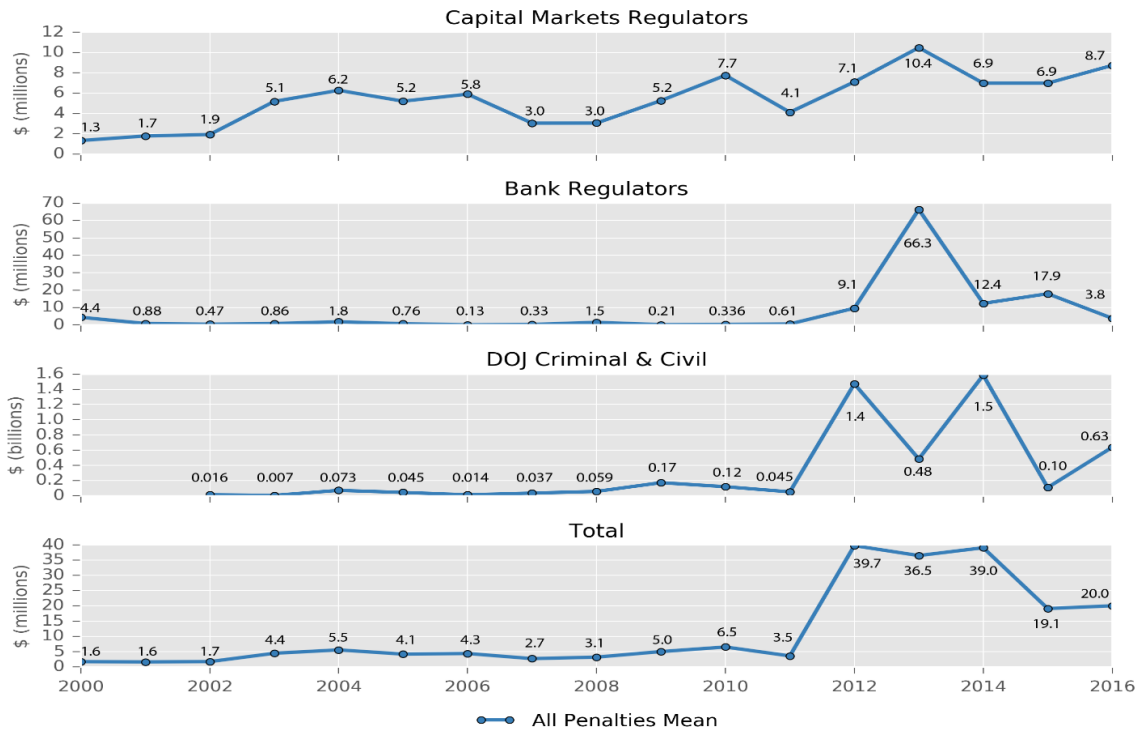
regulators (less than \$10,000 prior to 2012). However, in 2013, the median financial sanction for bank regulators jumped to over \$25,000. A breakdown by agency is presented in **Appendix E**.

This data shows that increases in overall monetary sanctions appear to be driven, in part, by higher monetary sanctions at the defendant-level, and not solely by an increase in the number of cases. Increasing median monetary sanctions could be a result of enforcement authorities increasing the amounts imposed over time in similar cases. Unfortunately, the lack of a standardized process to determine penalties does not allow us to evaluate this possibility.

ii. Mean Monetary Sanctions by Enforcement Authority Category

Figure 2.6, below, presents the mean financial sanction against defendants in cases involving monetary sanctions brought by capital markets regulators, banking regulators, and the DOJ in financial system-related matters.¹⁸⁷ The mean monetary sanctions against defendants has also increased from 2000-2016.

Figure 2.6: Mean Monetary Sanctions



Capital markets regulators have seen an increase in mean monetary sanction amounts from around \$1 million in 2000 to \$9 million in 2016. The banking regulators had mean monetary

¹⁸⁷ Data on capital markets regulators and bank regulators includes all enforcement actions against institutions and individuals. DOJ data is comprised only of actions against financial institutions as outlined in Appendix D.

sanctions below \$1 million prior to 2011 before jumping to \$9 million in 2012 and over \$66 million in 2013. The mean amount from 2012-2015 was particularly high, because the OCC and Fed reached agreements with multiple banks in several large settlements. These settlements included: a \$500 million settlement with HSBC for money laundering in 2012, the Independent Foreclosure Review, which resulted in over \$8.5 billion in financial sanctions, including direct payments to consumers and consumer relief in 2013, and foreign exchange and LIBOR rigging in 2014.

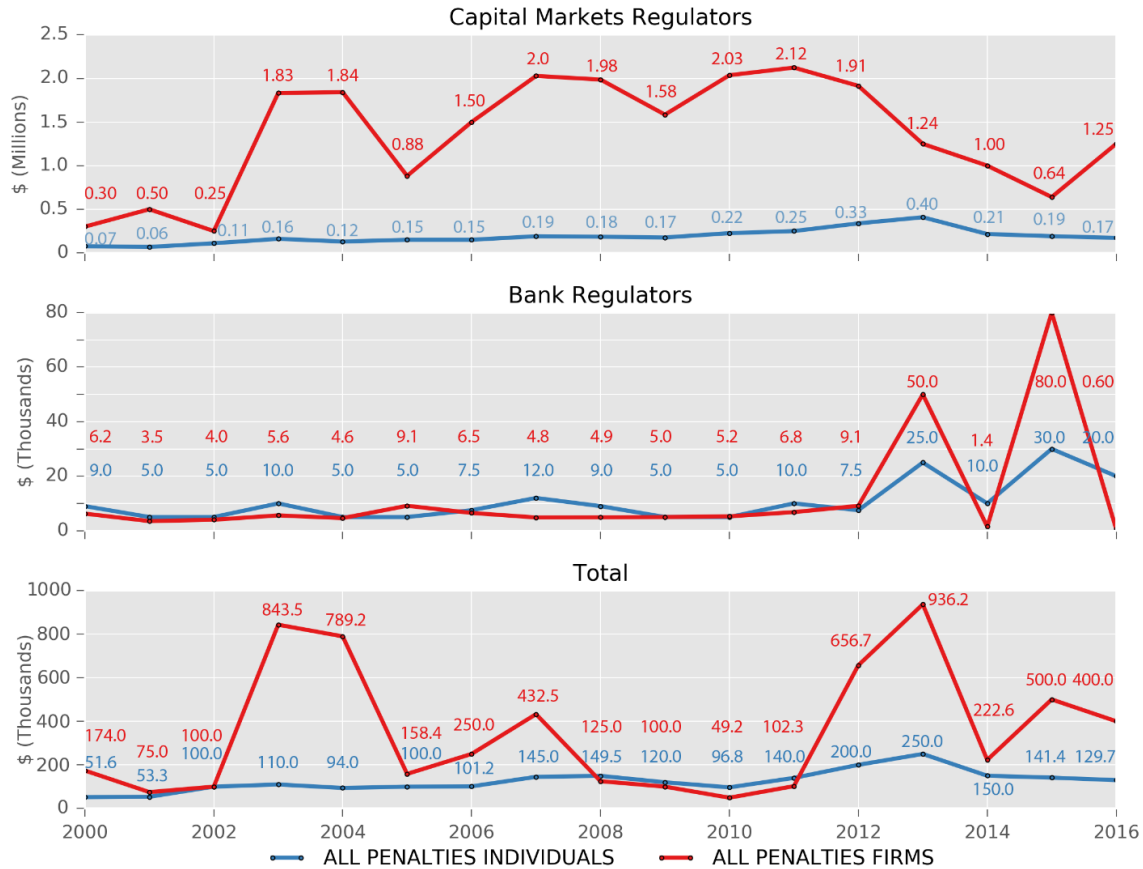
Figure 2.6 also shows a spike in the mean DOJ sanctions in 2012 and 2014 associated with the \$25 billion National Mortgage Settlement (2012) and the \$16.65 billion Bank of America settlement (2014). Beginning in 2012, there was also an increase in the mean sanctions collectively imposed by capital markets regulators, banking regulators, and the DOJ (shown in the bottom panel). A breakdown of the amounts by agency can be found in **Appendix E**.

iii. Median Monetary Sanctions: Individual vs. Firm Defendants by Agency Category

Case-level data also permits an analysis of the median monetary sanctions imposed on individuals and firms and to observe trends for both types of defendants. **Figure 2.7**, on the next page, shows the median monetary sanction against an individual defendant and a firm defendant in cases brought by capital markets regulators and bank regulators in which monetary sanctions were imposed.¹⁸⁸

¹⁸⁸ DOJ is excluded because the case-level data we have is only with respect to firms.

Figure 2.7: Median Individual and Firm Monetary Sanctions



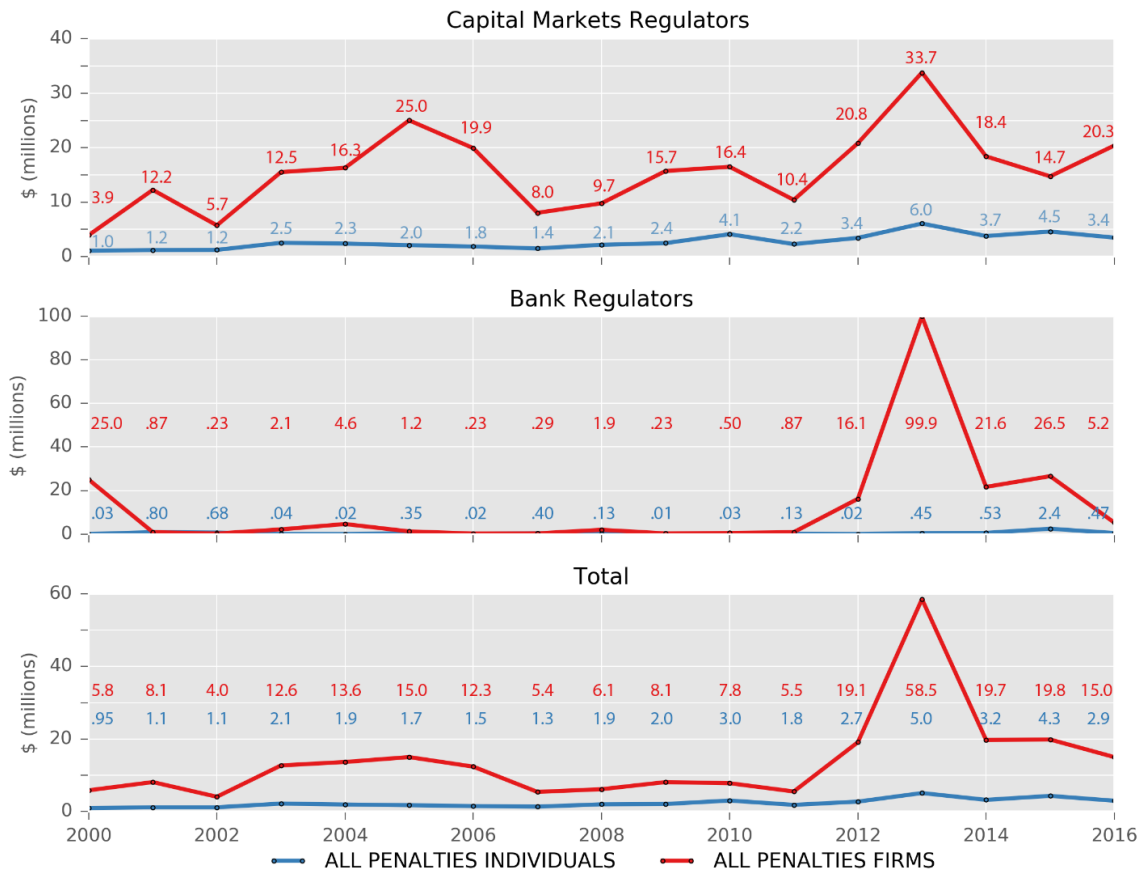
The median penalty amount has increased for both individuals and firm defendants. Overall, median individual monetary sanctions increased from about \$50,000 in 2000 to \$130,000 in 2016 (a 160% increase) and firms saw an increase from around \$175,000 in 2000 to \$400,000 in 2016 (an approximately 130% increase). Similar trends are seen among capital markets regulators and banking regulators. A breakdown by agency can be found in **Appendix E**.¹⁸⁹

¹⁸⁹ The volatility in the median amount imposed on firms in the banking regulator category in 2014 and 2016 can be attributed to a large number of small dollar cases brought by the NCUA against credit unions for filing late reports. If one truncates the data from 2000 to 2013, banking regulators imposed a median fine against individuals of \$9,000 in 2000 and \$25,000 in 2013 (approximately a 175% increase) and \$6,250 in 2000 and \$50,000 in 2013 against firms (a roughly 700% increase).

iv. Mean Monetary Sanctions: Individual Vs. Firm Defendant by Agency Category

Our data also allows for an analysis of the mean monetary sanctions imposed on individual and firm defendants. **Figure 2.8** shows that mean monetary sanctions against individuals increased over three-fold from \$950,000 in 2000 to \$2.9 million in 2016, and that mean firm monetary sanctions increased from \$5.8 million to \$15 million. The mean monetary sanction by capital markets regulators against individual defendants increased from \$1 million to \$3.4 million and against firm defendants increased from \$3.9 million to \$20.3 million. A further breakdown of the results by agency can be found in **Appendix E**.

Figure 2.8: Mean Individual and Firm Monetary Sanctions



C. Conclusion

Our 17-year data analysis shows increasing enforcement activity, significant growth in the aggregate amount of monetary sanctions being assessed, and increases in the median and mean monetary sanctions imposed on both individual and firm defendants facing monetary sanctions across different types of regulators. These trends warrant further study, discussion, and debate. They also highlight the importance of guideposts for determining penalties, so enforcement trends can be understood and policy can be adapted to respond. For example, has there been an increase in the frequency and severity of illicit behavior or simply an increase in the prioritization of enforcement actions and the size of monetary penalties for the same behavior? It is not possible to reach a conclusion as to the drivers of these enforcement trends because of the lack of guideposts to ensure that monetary penalties are set in a consistent manner for similar acts and over time.

**Chapter 3: Ensuring Appropriate Use of Monetary
Sanctions**

Chapter 3: Ensuring Appropriate Use of Monetary Sanctions

Monetary sanctions should be used to advance the public interest, including to remediate harm caused to victims. In Chapter 3, we examine the existing policies and procedures for the use of monetary sanctions.

Part I describes the core constitutional and statutory framework governing the allocation of monetary penalties recovered by federal enforcement authorities. These laws provide that monetary penalties paid to the federal government should generally be deposited with the U.S. Treasury for Congress to appropriate with other sources of government revenue, such as tax revenue.¹ We also explain that enforcement authorities often do not recover the monetary sanctions owed to them and that this undercuts the deterrent and remedial effect of the imposed sanctions. We therefore recommend that enforcement authorities provide an annual accounting that discloses the amount of such monetary sanctions actually collected.

Part II explores instances where Congress has used its appropriations authority to earmark penalties collected by certain agencies for specific uses. In these cases, the funds are used as directed and never deposited with Treasury. These programs include: (a) investor and consumer relief funds, such as the SEC “Fair Funds” and the CFPB Civil Penalty Fund; (b) the SEC’s and CFTC’s whistleblower programs; and (c) the DOJ’s Three Percent Fund. We conclude Part II with several recommendations to enhance the transparency of certain of these programs.

Part III examines how enforcement authorities, particularly the DOJ, can structure settlement agreements to direct funds to consumers and certain pre-approved third parties who were not necessarily victims. This practice is often referred to as “extraordinary” restitution and these allocations are made without subjecting these funds to Congress’ appropriation authority. We set forth two recommendations that would allow for the continued use of extraordinary restitution while imposing some restrictions to prevent abuse and enhancing transparency about how extraordinary restitution is spent.

Part IV describes the discretion state attorneys general have in spending settlement funds. In some states, attorneys general have broad legal authority to disperse settlement funds and in others, where the law is unclear, attorneys general have attempted to structure settlement agreements to delineate how the funds will be spent. The ultimate use of settlement funds by states is very opaque. To address these concerns, we recommend that the states should adopt legislation: (1) requiring an annual accounting from state officials of how state settlement funds are spent; and (2) prohibiting third parties that receive state settlement funds, from using those funds to engage in political activities.

¹ The states have differing practices. Some states require through constitutional or statutory provisions that collected penalties must be deposited into the state’s general fund to be appropriated by the state legislature. *See* U.S. CHAMBER OF COMMERCE, ENFORCEMENT SLUSH FUNDS: FUNDING FEDERAL AND STATE AGENCIES WITH ENFORCEMENT PROCEEDS 34-41 (2015), http://www.instituteforlegalreform.com/uploads/sites/1/Enforcement_Slush_Funds_web.pdf. Other states, however, allow the state attorney general to determine how to disperse penalties or to use penalties to fund other enforcement activities.

I. Constitutional and Statutory Provisions Requiring Collected Monies be Deposited with Treasury

A. The Constitution's Appropriations Clause

The U.S. Constitution vests the spending powers of the federal government in the hands of Congress.² Indeed, the Appropriations Clause establishes that money may not be withdrawn from the U.S. Treasury or spent without express Congressional authorization.³ The framers granted Congress the power of the purse because they determined that it is the branch of government that is most representative of the people and therefore best positioned to allocate the nation's resources.⁴ The courts have stated the Congress' appropriations power is "a bulwark of the Constitution's separation of powers."⁵ Many state constitutions likewise vest such authority exclusively in the legislative branch.⁶ Critically, for our purposes, federal enforcement authorities are **not** constitutionally permitted to spend money that they have collected from penalty assessments unless expressly authorized to do so by Congress.⁷

B. Statutory Provisions that Supplement the Appropriations Clause

Congress has fortified its constitutionally prescribed spending powers by adopting two laws limiting the ability of agencies to spend monies received from sources other than Congress, such as monies received from enforcement penalties.

First, the Anti-Deficiency Act of 1982 prohibits government agencies from "mak[ing] or authoriz[ing] an expenditure or obligation exceeding . . . an appropriation."⁸ In other words, an agency cannot spend government money that Congress has not expressly authorized.⁹ Second, the 1982 Miscellaneous Receipts Act¹⁰ requires that "an official or agency of the Government receiving money for the Government from any source shall deposit the money in the Treasury as soon as practicable."¹¹ The statutory provision closed a potential loophole in the Appropriations Clause and the Anti-Deficiency Act because an argument existed that those provisions only applied to funds that were actually deposited in the Treasury.¹² Under such an interpretation, an agency could receive money and spend it before depositing it in the Treasury. The Miscellaneous Receipts Act precludes that possibility.

² U.S. CONST. art. I, § 9, cl. 7.

³ Todd David Peterson, *Protecting the Appropriations Power: Why Congress Should Care about Settlements at the Department of Justice*, 2009 BYU L. REV. 327, 336 (2009).

⁴ Gerald E. Frug, *The Judicial Power of the Purse*, 126 U. PA. L. REV. 715, 740 (1978).

⁵ Dep't of Navy v. FLRA, 665 F.3d 1339, 1347 (D.C. Cir. 2012).

⁶ U.S. CHAMBER OF COMMERCE, *supra* note 1.

⁷ U.S. CONST. art. I, § 9, cl. 7.

⁸ 31 U.S.C. § 1341(a)(1)(A).

⁹ Peterson, *supra* note 3, at 329.

¹⁰ 31 U.S.C. § 3302.

¹¹ *Id.* § 3302(b).

¹² Peterson, *supra* note 3, at 331, 340.

As a consequence of Congress' constitutional and statutory spending powers, monies received by an agency are generally deposited with the Treasury and pooled with other government revenue, such as tax revenue, which are then used to fund the government's expenditures.

We believe that in most circumstances the best policy is for Congress to control how monetary sanctions are spent, especially those that are not distributed to victims of wrongdoing. Members of Congress are directly accountable to the public through the ballot box. Therefore, if the public disapproves of how money being collected by the government is spent, then the public has a direct outlet to voice that frustration. In addition, the amount appropriated by Congress to different programs is publicly disclosed and thus there is some transparency about how money is being spent.

C. Issue of Collecting Monies to be Deposited into the Treasury

Enforcement authorities can only deposit money into the Treasury if they have successfully collected money owed from an enforcement action. In practice, defendants can fail to pay their debts to the government for several reasons, but the most common reason is that defendants simply do not have the ability to pay.¹³

Collection of monetary sanctions has been a historical problem for the SEC. For fiscal year 2015, for example, the SEC collected only \$2.4 billion of the \$4.2 billion it says it was ordered to be paid, or 57%,¹⁴ and in the three most recent fiscal years that ended on September 30, 2017, the SEC also collected approximately 57% of the money it was entitled to.¹⁵ Similarly over a decade long-period, the CFTC only was able to collect roughly 50% of the civil monetary fines ordered against its enforcement targets.¹⁶

Congress has been cognizant of the difficulty and importance of collecting on unpaid debts owed to the government. As such, the DOJ is authorized to collect debts that are referred to it by other agencies, such as the SEC or CFTC, through legal actions.¹⁷ For example, in fiscal 2016, the CFTC referred over 30 matters to the DOJ for unpaid debts of over \$160 million.¹⁸

The DOJ is required to provide an annual report to Congress accounting for the referrals it received and its success at recovering funds owed under those referrals.¹⁹ For example, in fiscal year 2016, the DOJ disclosed that it had received referrals to collect on over \$17 billion of money

¹³ Michael Rothfeld & Brad Reagan, *Prosecutors Are Still Chasing Billions in Uncollected Debts*, WALL ST. J. (Sept. 17, 2014), <https://www.wsj.com/articles/prosecutors-are-still-chasing-97-billion-in-uncollected-debts-1410984264>.

¹⁴ U.S. SEC. & EXCH. COMM'N, FISCAL YEAR 2017 ANNUAL PERFORMANCE REPORT AND 2019 CONGRESSIONAL BUDGET JUSTIFICATION ANNUAL PERFORMANCE PLAN 113 (2018), <https://www.sec.gov/files/secfy19congbudgjust.pdf>.

¹⁵ *Id.*

¹⁶ Rothfeld & Reagan, *supra* note 13

¹⁷ See DOJ ANN. REP.: DEBT COLLECTION RECOVERY ACTIVITIES OF THE DEPARTMENT OF JUSTICE FOR CIVIL DEBTS REFERRED FOR COLLECTION 1 (Feb. 2016) [hereinafter 2016 Debt Collection Annual Report].

¹⁸ *Id.* at 12.

¹⁹ 2016 Debt Collection Annual Report, *supra* note 17.

owed to the government and collected over \$12 billion during the same period.²⁰ However, the SEC, CFTC, and other enforcement authorities are not required to disclose their success rates for collecting monetary sanctions owed to them. It is important for the public to understand what percentage of monies owed to the government are being collected because uncollected funds undermine the deterrent effect of the sanctions and hinder the ability of the government to remediate harm caused by the wrongdoing. Transparency also will increase accountability of enforcement authorities and incentivize greater efforts to collect unpaid sanctions.

- **Recommendation 9:** Enforcement authorities should provide an annual accounting that discloses the amount of monetary sanctions assessed through orders, judgments, and settlements, and the amount of such monetary sanctions actually collected.

²⁰ *Id.* at 3.

II. Congressionally Approved Statutory Programs for the Use of Penalties

In certain instances, Congress has authorized agencies to distribute or spend money received on specific schemes or programs operated by the relevant agency. In these situations, money is not deposited into the Treasury, but into another specified fund, and is therefore not subject to Congress’ typical appropriations process. Part II explains three such programs: (1) investor and consumer compensation funds, including SEC “Fair Funds” and the CFPB’s Civil Penalty Fund; (2) the SEC and CFTC’s whistleblower programs; and (3) the DOJ “self-funding” system, the Three Percent Fund.

A. Increasing Transparency on the Use of Monetary Sanctions

Before delving into the specifics of the Congressionally approved programs, we first want to highlight more generally the lack of transparency that surrounds the amount of money used in such programs. For example, the DOJ is not required to and the DOJ does not regularly disclose to the public the amount of sanctions allocated to the Three Percent Fund as compared to the funds deposited with the Treasury. Similarly, the SEC is not required to provide an annual accounting of the amount of funds dispersed in the aggregate through the Fair Funds program, and what amounts are sent to the Treasury. The public’s understanding of and confidence in how monetary sanctions are used could be greatly improved if enforcement authorities were required to provide an annual accounting. Such an accounting would allow for a more effective evaluation of individual programs that Congress has authorized. It would also facilitate efforts to analyze the enforcement system at a macro level to understand what proportion of monetary sanctions are being used to achieve remedial aims, or are deposited with Treasury to be appropriated by Congress.

- **Recommendation 10:** Each federal enforcement authority should provide an annual accounting of how monetary sanctions imposed in their enforcement actions are used. The accounting should include: (1) the amount of monetary sanctions that the enforcement authority collected and deposited with the Treasury; and (2) the amount of monetary sanctions that the enforcement authority directed to Congressionally authorized programs (itemized by program).

B. Investor and Consumer Compensation Funds

A key goal of enforcement is to remediate the harm caused to victims of wrongdoing. That can be achieved by compensating victims with monetary sanctions that are obtained and collected by enforcement authorities. The SEC “Fair Funds” and CFPB Civil Penalty Fund exist to do just that.

1. SEC Fair Funds

i. SEC Fair Funds Statutory Authority and the Agency’s Implementation

The SEC’s “Fair Funds” authority has expanded and evolved in three stages.

It was created in 1990 when Congress gave the SEC discretion to collect disgorged ill-gotten gains in enforcement actions and to pay them to investors.²¹ Then in 2002, the Sarbanes-Oxley Act granted the SEC the authority to distribute civil monetary penalties (i.e., fines for illicit conduct) to investors as compensation for harm suffered from the unlawful conduct.²² However, a distribution of civil monetary penalties could only be made when the SEC also disgorged ill-gotten gains from the same defendant for distribution to victims. Finally, in 2010, Section 929B of Dodd-Frank further empowered the SEC to create a distribution fund (i.e., “fair fund”) to distribute civil penalties to injured investors, even in the absence of any collection of disgorgement amounts.²³

The SEC retains the discretion to determine whether to establish a fair fund in a specific matter.²⁴ Under the SEC’s rules, the SEC does not need to pay out any monetary sanctions collected to victims of wrongdoing and instead could choose to deposit money it collects in the Treasury.²⁵ Although the SEC’s Rules of Practice and Enforcement Manual do not provide guidance about the circumstances in which it is appropriate to create a fair fund, the SEC’s Assistant Director of the Office of Distributions has said that the SEC considers: (1) whether there is an identifiable class of investors that suffered identifiable harm; and (2) whether the amount of money likely to be collected is large enough to justify a distribution given the number of victims.²⁶

If a fair fund is created, a proposed fund plan detailing procedures and eligible fund beneficiaries is drafted. It is then submitted for public notice-and-comment, and ultimately approved or disapproved by the SEC Commissioners.²⁷

ii. The SEC’s Use of its Fair Funds Authority

The SEC has actively and regularly used its Fair Funds authority. The most comprehensive study of the SEC’s use of its Fair Funds powers was conducted by Professor Urska Velikonja of

²¹ 15 U.S.C. § 78u-2(e) (“In any proceeding in which the Commission or the appropriate regulatory agency may impose a penalty under this section, the Commission or the appropriate regulatory agency may enter an order requiring accounting and disgorgement, including reasonable interest. The Commission is authorized to adopt rules, regulations, and orders concerning payments to investors, rates of interest, periods of accrual, and such other matters as it deems appropriate to implement this subsection.”).

²² Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 308, 116 Stat. 746, 784 (2002) (codified at 15 U.S.C. § 7246), *amended by* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929B, 124 Stat. 1376, 1852 (2010).

²³ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929B, 124 Stat. 1376, 1852 (2010) (“If . . . the Commission obtains a civil penalty against any person for a violation of [the securities] laws . . . the amount of such civil penalty shall . . . be added to and become part of a disgorgement fund *or other fund* established for the benefit of the victims of such violation.”).

²⁴ In an administrative proceeding, the SEC can order the creation of a fair fund. In a federal court proceeding, the SEC can move for the court to order the creation of a fair fund.

²⁵ U.S. Sec. & Exch. Comm’n, *Rules of Practice and Rules on Fair Fund and Disgorgement Plans*, Sept. 2016, Rule 1100, <https://www.sec.gov/about/rules-of-practice-2016.pdf> [hereinafter SEC Rules of Practice].

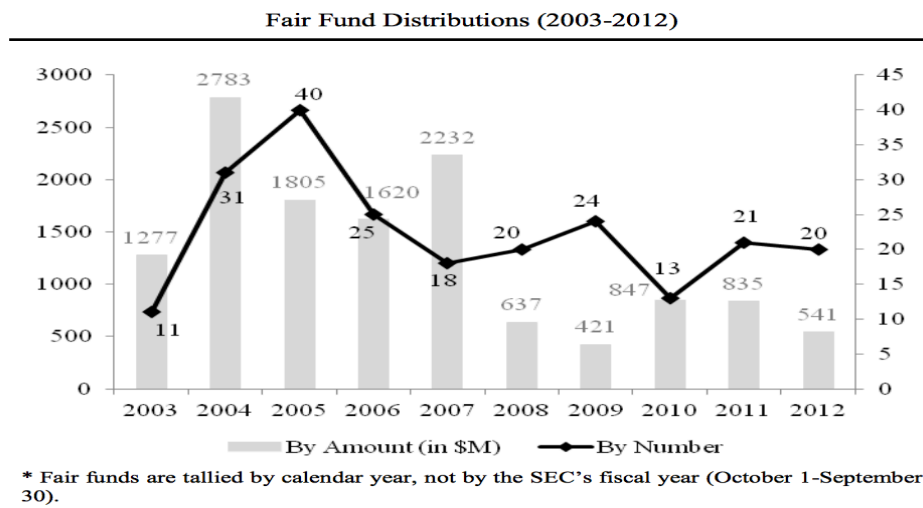
²⁶ See Urska Velikonja, *Public Compensation for Private Harm: Evidence from the SEC’s Fair Funds Distributions*, 67 STAN. L. REV. 331, 342 (2015).

²⁷ SEC Rules of Practice, *supra* note 25, Rule 1101, 1103–04.

Georgetown University Law Center in a *Stanford Law Review* article.²⁸ Professor Velikonja examined all SEC distribution funds created from July 25, 2002 (the date the Sarbanes-Oxley provision took effect) until December 31, 2013. She found that during that time, the SEC ordered \$14.46 billion to be distributed to harmed investors,²⁹ which accounted for about 75% of the monetary sanctions the SEC collected.³⁰ The size of the total distributions from particular fair funds has ranged from \$24,959 to \$816.5 million.³¹

The figure, below, from Professor Velikonja’s paper, shows that the SEC has distributed hundreds of millions of dollars a year to victims. From 2003 through 2012, the study found that the SEC distributed nearly \$13 billion from fair funds. In the last five years of the data period (2008-2012), the SEC distributed money from about 20 funds per year. Unfortunately, more recent data is not available as the SEC does not regularly collect and release such data on an annual basis.³²

Figure 3.1: SEC Fair Funds Activity



²⁸ See Velikonja, *supra* note 26.

²⁹ *Id.* at 350.

³⁰ *Id.* at 334.

³¹ *Id.*

³² Though for fiscal 2017, the SEC commendably did disclose that in fiscal 2017, it dispersed almost \$1.06 billion out of fair funds. U.S. SEC. & EXCH. COMM’N, DIVISION OF ENFORCEMENT ANNUAL REPORT 11 (FY 2017), <https://www.sec.gov/files/enforcement-annual-report-2017.pdf>.

2. *CFPB Civil Penalty Fund*

i. *CFPB Consumer Protection Fund Statutory Authority and the Agency's Implementation*

Unlike the SEC, Section 1017 of the Dodd-Frank Act *requires* the CFPB to deposit all civil monetary penalties into the Consumer Financial Civil Penalty Fund (“**Civil Penalty Fund**”).³³ The Civil Penalty Fund is used as a pool of cash to compensate victims injured by activities for which civil penalties were imposed.³⁴

Victims eligible to receive compensation out of the Civil Penalty Fund are persons that: (1) have suffered harm from misconduct for which a civil monetary penalty has been imposed through a final court or CFPB order,³⁵ (2) suffered uncompensated harm (i.e., the victim must not have been fully compensated and is not reasonably expected to be fully compensated through other legal actions),³⁶ and (3) to whom it would be practicable to make a payment (i.e., harm is reasonably calculable and it is administratively feasible to make a payment to them).³⁷

Section 1017 and CFPB rules provide that all the civil monetary penalties collected by the CFPB be *pooled together* in the Civil Penalty Fund for victim compensation.³⁸ Thus, the penalties collected from one defendant can be used to compensate the victims of another defendant's misconduct. This is another key difference between the CFPB Civil Penalty Fund and SEC Fair Funds, which are each set up with respect to a specific case.

CFPB rules provide that the Civil Penalty Fund is run by a Fund Administrator.³⁹ Every six months, the Fund Administrator determines the amount of money to allocate to various classes of victims out of the Civil Penalty Fund.⁴⁰ If the amount of uncompensated harm among all classes of victims exceeds the amount of money in the Civil Penalty Fund, priority is given to classes of victims who suffered harm from the most recent enforcement actions closed during that period.⁴¹

Unused funds can remain in the Civil Penalty Fund for distribution to victims in subsequent periods⁴² or be allocated as grants to consumer education and financial literacy programs.⁴³ Funds used on consumer education and financial literacy programs can be spent for the benefit of consumers who were not victims of any wrongdoing. Rather, they are more preventative in nature, as the hope is that more informed, educated, and financially literate consumers may avoid schemes, scams, or deceptive practices.

³³ 12 U.S.C. § 5497(d)(1). The CFPB can order restitution. Restitution is not placed into the Civil Penalty Fund but paid to the victims.

³⁴ *Id.* § 5497(d)(1)-(2).

³⁵ 12 C.F.R. § 1075.103 (2013).

³⁶ *Id.* § 1075.104(a)-(b).

³⁷ Consumer Financial Civil Penalty Fund, 78 Fed. Reg. 26,491, 26,493-94 (May 7, 2013).

³⁸ 12 U.S.C. § 5497(d); 12 C.F.R. § 1075.100-.110.

³⁹ 12 C.F.R. § 1075.102.

⁴⁰ *Id.* § 1075.105(b).

⁴¹ *Id.* § 1075.106(b).

⁴² Consumer Financial Civil Penalty Fund, 78 Fed. Reg. 26,491 (May 7, 2013) (codified at 12 C.F.R. pt. 1075).

⁴³ 12 U.S.C. § 5497(d)(1)-(2).

ii. *The CFPB's Use of the Civil Penalty Fund*

Since its creation, the CFPB has deposited \$560 million into the Civil Penalty Fund and paid out over \$480 million in victim compensation and distributed over \$25 million in consumer education and literacy program allocations. The individual recipients of distributions from the Civil Penalty Fund are not publicized. The annual data through the close of the fiscal year ended September 30, 2017 (the most recently available data as of February 8, 2018) is produced in the table below.

Table 3.1: Accounting of CFPB Civil Penalty Fund

Activity	Amount	Amount
Cash Collections:		
FY 2012	\$32,000,000	
FY 2013	\$49,520,001	
FY 2014	\$77,502,001	
FY 2015	\$183,120,079	
FY 2016	\$182,138,760	
FY 2017	<u>\$42,488,801</u>	
Total Cash Collections		\$566,769,642
Less Allocations:		
Victim Compensation		
FY 2013	\$10,488,815	
FY 2014	\$20,803,560	
FY 2015	\$158,827,932	
FY 2016	\$130,696,406	
FY 2017	<u>\$161,415,457</u>	
Total Allocations to Victim Compensation		\$482,232,170
Consumer Education and Financial Literacy Programs		
FY 2013	\$13,380,000	
FY 2014	\$0	
FY 2015	\$0	
FY 2016	\$15,432,809	
FY 2017	<u>\$0</u>	
Total Allocations to Consumer Education and Financial Literacy Programs		\$28,812,809
Total Allocations		\$511,044,979
Less Administrative Set-aside⁴⁴		
FY 2013	\$1,573,322	
FY 2015	\$500,000	
FY 2016	\$2,500,000	
FY 2017	\$1,000,000	
Total Available for Future Allocation		\$54,283,486

⁴⁴ The CFPB Financial Report for FY 2015 excludes a line item for FY 2014 set-aside administrative expenses. See CONS. FIN. PROT. BUREAU, FINANCIAL REPORT OF THE CONSUMER FINANCIAL PROTECTION BUREAU (Nov. 16, 2015), http://files.consumerfinance.gov/f/201511_cfpb_report_fiscal-year-2015.pdf.

3. *Policy Considerations for the SEC and CFPB Investor and Consumer Compensation Funds*

The rationale behind the SEC Fair Funds and CFPB Civil Penalty Fund – the compensation of harmed investors and consumers – is consistent with one of the core aims of enforcement systems, remediation. In addition, attempting to ensure that victims are made whole for their losses may help instill public confidence in the overall enforcement system. We therefore believe these programs serve a valuable function.

However, the transparency of the SEC’s use of its fair funds authority could be improved. Specifically, the SEC is not required to disclose the total amount of distributions made per year under its fair fund authority and what percentage of the monies it collects each year are spent on fair funds distributions. To obtain annual data for her paper, Professor Velikonja had to review individual fair funds orders. Annual data about fair funds distributions could help the public evaluate the effectiveness of the SEC’s fair funds authority.

- **Recommendation 11:** The SEC should publicly disclose annually the amount of funds distributed through its Fair Funds authority and the amount of money in fair funds that remains available for distribution (on both an aggregate and individual fund basis).

The CFPB Civil Penalty Fund also has a few issues that warrant attention. First, the CFPB is not limited in how much money it can hold in the Civil Penalty Fund at one time or how much it can use on financial education and literacy programs. While CFPB rules provide that compensation should be paid out to victims to whom it is practical to make payments,⁴⁵ the CFPB may not be properly incentivized to ensure it is effectively and efficiently identifying or locating victims to use the funds to provide compensation.

Second, while the CFPB is required to provide annual reports on how much money has been deposited into the Civil Penalty Fund and how much money has been paid out, there do not appear to be current efforts by Congress, the GAO, or others to evaluate the effectiveness of the program, which is only in its early stages.

- **Recommendation 12:** The CFPB should conduct a retrospective analysis of the Civil Penalty Fund that evaluates whether: (1) the Civil Penalty Fund is effectively compensating injured consumers; (2) victims are being adequately identified; and (3) there should be a cap on the total amount of money that can remain in the Civil Penalty Fund (with the balance distributed to the Treasury) to encourage efficient distribution of funds to injured consumers.

C. SEC and CFTC Whistleblower Programs

As part of the Dodd-Frank Act, Congress required the SEC and CFTC to establish “whistleblower” programs. The term “whistleblower” generally refers to an employee of an

⁴⁵ 12 C.F.R. § 1075.106.

organization who becomes aware of illicit conduct at the organization and reports this misconduct to authorities.

The SEC and CFTC whistleblower programs require those agencies to provide bounties to whistleblowers who report information to the agencies that allow them to levy monetary sanctions for violations of the laws they enforce.⁴⁶ Whistleblower bounties create incentives for individuals with relevant information of wrongdoing to disclose that information, which may help uncover misconduct that could otherwise go undetected and enable the SEC and CFTC to more efficiently use investigative and enforcement resources.⁴⁷ Thus, the whistleblower programs serve a deterrence function.

1. Authority for Whistleblower Programs and Agency Implementation

Sections 922 and 748 of the Dodd-Frank Act established whistleblower funds at the SEC and the CFTC, respectively.⁴⁸ The SEC and CFTC are *required* to deposit money into their respective whistleblower funds from monetary sanctions that they collect that are not paid out to victims, if the balance of the funds fall below specified thresholds. The thresholds are \$300 million for the SEC’s Investor Protection Fund and \$100 million for the CFTC’s Customer Protection Fund.⁴⁹

The statute and rules governing distributions from the SEC and CFTC whistleblower funds are very similar. The key provisions of the SEC whistleblower program are summarized to illustrate the statutory scheme.

Exchange Act Section 21F, established by Section 922 of the Dodd-Frank Act, requires the SEC to pay an award to a whistleblower if the whistleblower *voluntarily*⁵⁰ provides *original information*⁵¹ to the SEC that leads to the SEC *obtaining monetary sanctions exceeding \$1 million*.⁵² The *amount* that the SEC must pay to someone who qualifies as a whistleblower must not be less than 10% and not more than 30%, of the total monetary penalties that have been collected in the case.⁵³ In addition, the SEC rules provide that a whistleblower must be an individual and that the individual must provide the SEC with information that relates to a possible violation of securities laws.⁵⁴

⁴⁶ See 15 U.S.C. § 78u-6; 7 U.S.C. § 26.

⁴⁷ *Office of the Whistleblower*, U.S. SEC. & EXCH. COMM’N, <https://www.sec.gov/whistleblower>.

⁴⁸ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, §§ 748, 922, 124 Stat. 1376, 1739, 1841 (2010).

⁴⁹ 15 U.S.C. § 78u-6(g); 7 U.S.C. § 26.

⁵⁰ The statute leaves the meaning of “voluntary” undefined. The SEC’s rules define the term broadly such that a person is deemed to have voluntarily provided information as long as the SEC or other regulatory authorities did not directly ask the individual for information. 17 C.F.R. § 240.21F-4(a).

⁵¹ SEC rules require that original information be derived from the whistleblowers own “independent knowledge” or “independent analysis” and not from publicly available sources. § 240.21F-4(b). The whistleblower must be the “original source” of the information as well. *Id.*

⁵² 15 U.S.C. § 78u-6(b). Monetary sanctions include penalties, disgorgement and interest.

⁵³ 15 U.S.C. § 78u-6(b).

⁵⁴ 17 C.F.R. § 240.21F-2(a).

The statute explicitly provides the SEC with discretion to determine the size of the appropriate award (within the statutory range) for an individual whistleblower.⁵⁵ However, in determining the size of an award the SEC is statutorily required to take into account: (a) the significance of the information provided by the whistleblower to the success of the enforcement action; (b) the degree of assistance the whistleblower provided; (c) the SEC’s interest in deterring violations of securities laws by making awards to whistleblowers; and (d) any other factors the SEC deems relevant in its rules and regulations.⁵⁶ The size of the award granted by the SEC is not appealable.⁵⁷

The statutory provisions governing the SEC and CFTC whistleblower programs do not provide for much transparency about individual awards. In fact, the statute prohibits the agencies from disclosing information that could reasonably lead to the identification of the whistleblower.⁵⁸ This provision was intended to protect whistleblowers from retaliation.

2. *Use of the SEC and CFTC Whistleblower Programs*

Since their implementation, the whistleblower programs have become important sources of enforcement information for the agencies, particularly for the SEC. Indeed, former SEC Chair White stated that the SEC has received high-quality tips through the program and that whistleblowers have provided the SEC with highly technical analyses of evolving fraud schemes, identified additional witnesses for enforcement actions, and explained documents to the SEC to enhance its understanding of cases.⁵⁹

Scholarly work supports Chair White’s observation. For example, Professors Dyck, Morse and Zingales found that employees can play a key role in fraud detection.⁶⁰ In studying over 200 cases of alleged fraud at U.S. companies from 1996 to 2004, the authors found that employees revealed the same percentage of alleged frauds as the SEC and company auditors combined.⁶¹ They also found that individuals who have access to inside information, like employees, are more likely to detect and expose fraud, particularly in smaller cases.⁶² Finally, they found that monetary incentives motivate people with information to come forward and divulge their knowledge.⁶³

The most recent annual SEC Whistleblower Report states that the SEC has received over 18,000 tips under this program and has awarded more than \$160 million in awards to 46

⁵⁵ 15 U.S.C. § 78u-6(c).

⁵⁶ *Id.*

⁵⁷ *Id.* § 78u-6(f).

⁵⁸ *Id.* § 78u-6(h)(2); 7 U.S.C. § 26(h)(2).

⁵⁹ Mary Jo White, Chair, U.S. Sec. & Exch. Comm’n, *The SEC as the Whistleblower’s Advocate* (Apr. 30, 2015), <https://www.sec.gov/oig/reportspubs/511.pdf>.

⁶⁰ Alexander Dyck et al., *Who Blows the Whistle on Corporate Fraud?*, LXXV(6) J. FIN. 2213, 2213 (Dec. 2010).

⁶¹ *Id.* at 2214.

⁶² *Id.* at 2214–15.

⁶³ *Id.*

whistleblowers.⁶⁴ The number of tips has increased each year, and \$49 million of the awards granted were awarded in fiscal year 2017.⁶⁵ The table below shows the amount of whistleblower awards granted in each fiscal year since 2012. We also note that on March 19, 2018, the SEC announced its highest ever whistleblower awards.⁶⁶ In a single matter, the SEC awarded over \$80 million to three whistleblowers.⁶⁷

Table 3.2: SEC Whistleblower Program Payments by Fiscal Year

Fiscal Year	2012	2013	2014	2015	2016	2017
Amount of Whistleblower Awards	\$0.2 million	~\$15 million	~\$31.5 million	\$37 million	\$57 million	\$49 million

In addition, during the life of the CFTC program, the CFTC has received over 1,300 tips and awarded more than \$10.5 million to four whistleblowers. A single award of more than \$10 million granted in March 2016 accounts for most of the total award money to date.⁶⁸ There is very little publicly-available information about the circumstances that gave rise to this reward.⁶⁹

D. DOJ Three Percent Fund

Congress has authorized the DOJ to allocate three percent of certain civil monetary penalties collected into a fund known as the “Three Percent Fund” that the DOJ may then use internally. This section explains the DOJ’s Three Percent Fund and how it has evolved over time. We then attempt to provide insight as to the size of the Three Percent Fund and how such funds have been spent. We highlight the lack of transparency surrounding the collection and use of Three Percent Fund money. And how it has expanded in size and scope. We conclude by making a recommendation to limit the scope of the Three Percent Fund.

1. DOJ Authority to Take Three Percent of Civil Monetary Penalties

The DOJ is responsible for collecting debts arising from its own enforcement actions and for collecting unpaid debts that are referred to it by other federal agencies.⁷⁰ In 1993, Congress

⁶⁴ U.S. SEC. & EXCH. COMM’N, 2017 ANN. REP. TO CONG. ON THE DODD-FRANK WHISTLEBLOWER PROGRAM 1 (Nov. 15, 2017).

⁶⁵ *Id.* at 1, 23.

⁶⁶ Press Release, U.S. Sec. & Exch. Comm’n, SEC Announces Its Largest-Ever Whistleblower Awards (Mar. 19, 2018), <https://www.sec.gov/news/press-release/2018-44>.

⁶⁷ *Id.*

⁶⁸ COMMODITY FUTURES TRADING COMM’N, ANN. REP. ON THE WHISTLEBLOWER PROGRAM AND CUSTOMER EDUCATION INITIATIVES 5 (2018); *Whistleblower Program*, COMMODITY FUTURES TRADING COMM’N, <https://www.whistleblower.gov/orders/>.

⁶⁹ Commodity Futures Trading Comm’n, No. 16-WB-06, CFTC Whistleblower Award Determination (Mar. 28, 2016), <https://www.whistleblower.gov/files/Final%20Orders/16-WB-06.pdf>; Press Release, Commodity Futures Trading Comm’n, CFTC Announces Whistleblower Award of More than \$10 Million (Apr. 4, 2016).

⁷⁰ See 2016 Debt Collection Annual Report, *supra* note 17, at 1. However, the DOJ generally only acts as collector (including through filing suit and obtaining and enforcing judgments) once a federal department or agency has failed

authorized the Three Percent Fund to help fund the DOJ’s debt-collection activities⁷¹ by authorizing the DOJ to retain three percent of “all amounts collected pursuant to [its] civil debt collection litigation activities.”⁷² This legislation followed a DOJ estimate that hundreds of millions of dollars of additional debt could be recovered each year if the DOJ were provided with more resources.⁷³

In determining what cases it can take three percent of the proceeds from, the DOJ has interpreted the phrase “civil debt litigation activities” liberally, to include: (1) the DOJ’s debt collection litigation, where it sues on behalf of a federal agency to collect an unpaid debt;⁷⁴ (2) administrative activities like tracking unpaid debts and issuing notices for payments due;⁷⁵ and, (3) most importantly, DOJ-initiated civil enforcement actions, including judgments and settlements.⁷⁶ This means that the DOJ can obtain funds not only in instances in which it is seeking to collect penalties that have already been imposed by a prior judgment, but can also collect three percent of monetary sanctions in any case it originates even when the monetary sanctions are paid immediately and no debt collection activities are necessary.⁷⁷

i. The Size of the DOJ Three Percent Fund

The DOJ does not publicly disclose total annual contributions to the Three Percent Fund or the current size of the fund. However, according to a 2016 Majority Staff Report of the Senate Committee on Homeland Security and Governmental Affairs (the “**2016 Majority Staff Report**”), the DOJ deposited more than \$1.5 billion into the Three Percent Fund from 2009 to 2015, and the fund had a remaining balance of over \$325 million at the end of the 2015 fiscal year.⁷⁸ Indeed,

to persuade a debtor to pay what is owed. See GOV’T ACCOUNTABILITY OFFICE, GAO-15-48, DEP’T OF JUSTICE: ALT. SOURCES OF FUNDING ARE A KEY SOURCE OF BUDGETARY RESOURCES AND COULD BE BETTER MANAGED 16, n.37 (Feb. 2015) [hereinafter 2015 GAO Report].

⁷¹ See 139 Cong. Rec. H7968-01 at 24,548 (Oct. 14, 1993); see also Maj. Staff Rep. of the S. Comm. on Homeland Security and Governmental Aff., The Justice Department’s Housing Settlements: Millions of Consumer Relief Funds Disbursed with No Guarantees of Helping Homeowners 30, 33 (May 18, 2016) [hereinafter Housing Staff Report].

⁷² Pub. L. 103-121, § 108, 107 Stat. 1153, 1164 (1993). Thus, the three percent cannot be applied to criminal debts or monetary penalties from criminal judgments. However, Loretta Lynch, the former Attorney General, stated in 2015 that it can be applied to “penalties associated with certain financial recoveries, including through non-prosecution and deferred prosecution agreements”. *Responses to Questions from the S. Comm. on the Judiciary* 21 (Feb. 9, 2015) (Loretta Lynch, Att’y Gen., Dep’t of Justice).

⁷³ See 139 Cong. Rec. H7968-01 at 24,548 (Oct. 14, 1993).

⁷⁴ See, e.g., U.S. v. Konczak, Civil Action No. 14-cv-0673-CBS (D. Colorado 2015).

⁷⁵ 2015 GAO Report, *supra* note 70, at 66. Such administrative activities also include payment processing; according to a recent GAO report, “[i]f . . . a civil settlement results in [a payment] for the government, DOJ generally manages the transactions from the debtor to the government entity receiving the funds” and, as a result, receives a three percent cut of the funds dispersed. See *id.* at 16. See also Housing Staff Report, *supra* note 71, at 31.

⁷⁶ 2015 GAO Report, *supra* note 70, at 17, n.38.

⁷⁷ However, the DOJ may only exercise its right to retain three percent of civil penalties *after* payment has been collected by the DOJ, and it cannot retain three percent from criminal fines or penalties or from asset forfeitures. 2015 GAO Report, *supra* note 70, at 16–17, n.36, 38; *Id.* at 66; see also Pub. L. No. 107-273, § 11013, 116 Stat. 1758, 1823 (2002).

⁷⁸ Housing Staff Report, *supra* note 71, at 31. Collections for the Three Percent Fund in 2015 were \$393.6 million. The DOJ’s total budgetary resources in that year were \$46.4 billion.

according to the 2016 Majority Staff Report, the DOJ retained approximately \$449.5 million from the 2013 JP Morgan Chase and 2014 Bank of America settlements alone.⁷⁹

The table below, shows the amount and percentage of civil debt collections that were deposited into the Three Percent Fund from 2012 to 2015, based on data provided in the 2016 Majority Staff Report. Fiscal years 2014 and 2015 show a substantial increase in the monies deposited into the Three Percent Fund. The increase in deposits in those years was due to several large settlements with financial institutions.⁸⁰

Table 3.3: Data on DOJ Three Percent Fund Deposits

Fiscal Year	Total Amount of Civil Debts Collected by DOJ⁸¹	Amount Deposited into the Three Percent Fund⁸²	Amounts Added as a Percentage of Civil Debt Collections
2012	\$11 billion	\$161.1 million	1.5%
2013	\$7.1 billion	\$158.3 million	2.2%
2014	\$20.6 billion	\$526.0 million	2.5%
2015	\$18.1 billion	\$393.6 million	2.2%
Total	\$56.8 billion	\$1.239 billion	2.2%

The amount deposited into the Three Percent Fund for 2016 is not available as of the date of publication of this Report. However, the DOJ collected \$12.1 billion worth of civil debts in fiscal year 2016,⁸³ and three percent of those debts would be another \$360 million for the Three Percent Fund.

2. DOJ Uses of Monies Deposited in the Three Percent Fund

Unlike the SEC’s Fair Funds, the SEC and CFTC’s whistleblower programs, and the CFPB’s Consumer Protection Fund, once the DOJ deposits monies into the Three Percent Fund, the funds can be used by the DOJ *internally*.⁸⁴

⁷⁹ See Letter from Hon. Peter J. Kadzik, Assistant Att’y Gen., DOJ, to Hon. Ron Johnson, Chairman, S. Comm. on Homeland Sec. & Governmental Affairs (Aug. 24, 2015) [hereinafter Kadzik Letter]. Approximately \$238 million was retained by the DOJ for the 2013 JP Morgan Chase settlement and roughly \$211.5 million was retained for the 2014 Bank of America settlement. As a part of the settlements, approximately \$16.1 billion was paid to federal entities and Fannie Mae and Freddie Mac. Of this, \$7.9 billion came from the JP Morgan settlement and \$8.2 came from the Bank of America settlement. *Id.*

⁸⁰ Letter from Lee J. Loftus, Assistant Attorney General for Administration, DOJ, to David Maurer, Director, Homeland Security and Justice Issues, GAO (February 9, 2015) [hereinafter DOJ-GAO Letter].

⁸¹ See 2016 Debt Collection Annual Report, *supra* note 17, at 9.

⁸² Housing Staff Report, *supra* note 71, at 32. Amount listed are rounded to the nearest one hundred thousand dollars.

⁸³ See 2016 Debt Collection Annual Report, *supra* note 17, at 9.

⁸⁴ See Pub. L. No. 107-273, § 11013, 116 Stat. 1758, 1823 (2002) (stating that “[s]uch amounts in the Working Capital Fund shall remain available until expended”). See also 2015 GAO Report, *supra* note 70, at 67. Monies do not need to be spent in the year that they are collected.

The specifics about *how* the funds can be used internally have evolved over time. Under the original 1993 statutory language, the amounts in the Three Percent Fund were to be used “for paying the costs of processing and tracking [civil debt collection] litigation.”⁸⁵ In 2002, however, Congress amended the statute to expand the allowable uses: under the current law they must be used “first, for paying the costs of processing and tracking civil and criminal debt-collection litigation, and, thereafter, for financial systems and for debt-collection-related personnel, administrative, and litigation expenses.”⁸⁶

The DOJ takes the view that the language in the 2002 amendment allows the DOJ to allocate Three Percent Fund amounts to activities related to affirmative civil and criminal investigations and cases that *could* produce any sort of debt to the government (i.e., funds can be used on cases seeking an initial order of penalties where the DOJ might lose).⁸⁷ Costs for those enforcement-related actions may include administrative and labor costs for court cases and investigations.⁸⁸ Thus, in the DOJ’s view, the Three Percent Fund can be used to fund core civil and criminal enforcement functions.

i. DOJ Internal Procedures for Dispersing Three Percent Fund

The DOJ’s Collection Resources Allocation Board (“**CRAB**”) decides how monies in the Three Percent Fund are dispersed.⁸⁹ The CRAB, which was established in 1994, is composed of the DOJ Controller, the Director of the DCM and the Chief Financial Officer of the U.S. Marshals Service.⁹⁰

The CRAB reviews requests for funds from different areas within the DOJ based on proposed uses and determines how they will be allocated. All CRAB decisions are briefed to and reviewed by the Deputy Attorney General.⁹¹ The DOJ stated that the CRAB follows the statutory guidance in allocating the Three Percent Fund.⁹² Additional statements from the DOJ on how the CRAB prioritizes Three Percent Fund allocations are unavailable. However, according to a 2015 GAO report, the CRAB has recently emphasized allocating Three Percent Fund monies to:⁹³

1. Costs to manage debt collection activities, including funding the DCM and the computer system infrastructure.
2. Debt collection activities, such as tracking debtors’ funds and conducting administrative activities (e.g., sending demand letters to debtors).

⁸⁵ Pub. L. No. 103-121, § 108, 107 Stat. 1153, 1164 (1993).

⁸⁶ Pub. L. No. 107-273, § 11013, 116 Stat. 1758 1823 (2002).

⁸⁷ See 2015 GAO Report, *supra* note 70, at 17 n.39.

⁸⁸ See *id.*

⁸⁹ See *id.* at 17, 18, 67.

⁹⁰ See Kadzik Letter, *supra* note 79; See also 2015 GAO Report, *supra* note 70, at 18. The Chief Financial Officer of the U.S. Marshals Service is a nonpermanent member of the CRAB.

⁹¹ Kadzik Letter, *supra* note 79, at 2.

⁹² See *id.* at 3.

⁹³ 2015 GAO Report, *supra* note 70, at 68–9.

3. Costs of conducting civil litigation and investigations where collections are presumed to be obtained. Three Percent Fund monies are used to pay the personnel, court costs, and administrative activities that support such litigation.
4. Costs of conducting criminal litigation or investigations where collections are presumed to be obtained from the defendant.

Beyond these broad priorities, the CRAB also considers the long-term viability of the DOJ Three Percent Fund when making funding decisions. Importantly, grants to DOJ activities or programs that have the potential to bring in additional monies to the Three Percent Fund may be prioritized over other DOJ activities that bring in less funding.⁹⁴ Once funds are allocated by the CRAB, it does not involve itself in any litigation or settlement activities.⁹⁵

ii. Data on the How Three Percent Funds Have Been Allocated

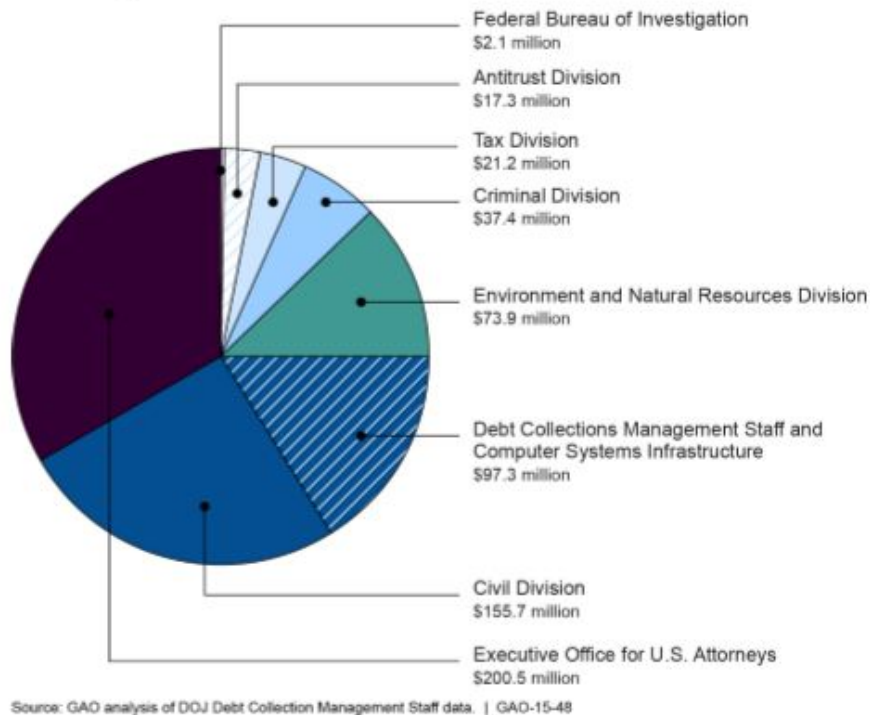
While some information can be gleaned from the exhibits to DOJ divisions' budget submissions,⁹⁶ the DOJ is not required to publish Three Percent Fund allocations. And there is no public comprehensive information on where the monies from the Three Percent Fund are deployed. However, the 2015 GAO report gives some insight into recent allocations. On the next page is a chart from the GAO report showing how monies from the Three Percent Fund were allocated during fiscal years 2009-2013.

⁹⁴ *Id.* at 18–19.

⁹⁵ See DOJ-GAO Letter, *supra* note 80, at 2.

⁹⁶ See, e.g., Exhibit H: Summary of Reimbursable Resources, U.S. Attorneys FY 2018 Congressional Budget Submission.

Figure 3.2: Expenditure of DOJ Three Percent Fund Amounts



Of the approximately \$600 million allocated from 2009 to 2013, the largest allocations from the Three Percent Fund were to the Executive Office for U.S. Attorneys (\$200.5 million),⁹⁷ the Civil Division (\$155.7 million), the Debt Collections Management staff and computer systems infrastructure (\$97.3 million) and the Environment and Natural Resources Division (\$73.9 million).⁹⁸ Based on the publicly available information, it is not possible to determine what proportion of these allocations are devoted to debt collection activities and what are devoted to funding investigations and enforcement litigation activities.

3. Potential Problems with the Three Percent Fund

We have two major concerns with the Three Percent Fund. First, the DOJ provides little to no transparency on the amount of money deposited into the Three Percent Fund and how such funds are used. The public deserves to know the amount of money flowing into the Three Percent Fund each year and how such funds are being spent.

⁹⁷ The Executive Office for U.S. Attorneys provides management oversight and administrative support for United States Attorneys throughout the country and acts as a liaison between the DOJ and U.S. Attorneys. *See generally* OFFICE OF THE INSPECTOR GEN., REVIEW OF DEBT COLLECTION PROGRAMS OF THE UNITED STATES ATTORNEYS’ OFFICES at 3, 5-6 (June 2015).

⁹⁸ 2015 GAO Report, *supra* note 70, at 69–70.

It is important to note that other enforcement authorities also lack transparency for how they use monies from enforcement actions that have been allocated to a fund for internal use. FINRA, a self-regulatory organization that we described in Chapter 1, collects fines from actions it takes against its members and places them into a segregated account that it uses internally for capital expenditure and regulatory projects.⁹⁹ Historically, FINRA has not disclosed in its annual reports exactly how that money is spent.¹⁰⁰ However, going forward, FINRA has announced that it will disclose an itemized list of how all fines are spent on an annual basis starting with fines collected in 2018.¹⁰¹ We commend FINRA for this step and note that the DOJ should follow FINRA’s lead.

Our second concern is that the size and purpose of the Three Percent Fund have grown beyond what were contemplated at its inception. As the 2016 Majority Staff Report noted, the current intake into the Three Percent Fund far exceeds what Congress originally considered.¹⁰² In 1993, Congress estimated that the DOJ’s civil debt collection activities would recover approximately \$918 million, meaning Congress considered the possibility of up to \$27 million going into the coffers of the DOJ annually.¹⁰³ By contrast, in fiscal 2015, \$393.6 million was deposited into to the Three Percent Fund, nearly 15-times more than Congress’ original estimate. While part of this increase is due to natural growth in the size and volume of traditional debts referred to the DOJ for collection, a significant portion has resulted from the DOJ’s broad view of what constitutes “civil debt litigation activities” for which it can impose its three-percent collection.

The scope of how the funds may be *used* has also expanded. For example, the DOJ allocates Three Percent Fund monies to affirmative civil and criminal investigations and cases that *could* produce a debt to the government.¹⁰⁴ The 2016 Majority Staff Report noted that by allowing funds to be allocated to any investigation or case that could theoretically result in a civil debt to the government, “the DOJ is operating in a gray area” because it is not limiting use of funds to cases where a debt already exists. We believe the DOJ can serve a vital role in collecting debts owed to enforcement authorities and the government. However, we are concerned that the self-funding of enforcement actions could go beyond the intended uses of Three Percent Fund monies, which potentially raises separation of powers problems between the DOJ and Congress’ constitutional appropriations powers.

- **Recommendation 13:** The DOJ Three Percent Fund should be reformed so that: (1) the DOJ can only use money from the Three Percent Fund as Congress intended – i.e., on activities to collect delinquent debts; and (2) the DOJ provides a public annual accounting of the amount of money deposited into the Three Percent Fund, the amount of money

⁹⁹ FINRA, *Fines Policy*, <http://www.finra.org/industry/fines-policy> (last visited May 18, 2018).

¹⁰⁰ See, e.g., FINRA, FINRA ANNUAL FINANCIAL REPORT (2017), https://www.finra.org/sites/default/files/2016_AFR.pdf.

¹⁰¹ FINRA, FINRA 2018 ANNUAL BUDGET SUMMARY 2, https://www.finra.org/sites/default/files/2018_Annual_Budget_Summary.pdf.

¹⁰² Housing Staff Report, *supra* note 71, at 33.

¹⁰³ 139 Cong. Rec. H7968-01 (Oct. 14, 1993) at 24,548.

¹⁰⁴ 2015 GAO Report, *supra* note 70, at 17 n.39.



COMMITTEE ON CAPITAL MARKETS REGULATION



distributed from the Three Percent Fund, and how money distributed out of the Three Percent Fund was spent.

III. Extraordinary Restitution

Enforcement authorities can negotiate settlements with enforcement targets that direct monies to provide relief or benefits to consumers or to fund third-party organizations or groups. Such arrangements are referred to as extraordinary restitution,¹⁰⁵ as they are payments made by the enforcement target to third parties who were not necessarily injured by the target’s alleged misconduct.¹⁰⁶ The amount and potential recipients of the funds are negotiated between the enforcement authority and target.

In Part III of this Chapter we describe the legal basis under which enforcement authorities can include extraordinary restitution payment provisions in settlement agreements given that settlement funds are usually subject to Congressional appropriations. In addition, we provide more detailed data about the extent to which extraordinary restitution payments were included as part of settlements with large financial institutions following the financial crisis, and use a case study to analyze how such extraordinary restitution payments were spent. Finally, we identify policy concerns relevant to the use of extraordinary restitution and make a recommendation to address those concerns and increase transparency. We primarily focus on extraordinary restitution by the DOJ in large settlement agreements, because the DOJ has used this tool most extensively, though it is a tool that other enforcement authorities could use as well.¹⁰⁷

A. *The Legal Basis for the DOJ’s Use of Extraordinary Restitution*

The DOJ is able to include extraordinary restitution in settlement agreements because it has great discretion in carrying out litigation on behalf of the United States. Congress has statutorily delegated to the DOJ the power to conduct litigation¹⁰⁸ and, inherent in the power to litigate, is the authority to *settle* litigation.¹⁰⁹ The Supreme Court has stated that the DOJ’s authority to conduct litigation may only be limited by direct legislative statements to the contrary.¹¹⁰ Similar logic would apply to settlements entered into by other agencies that have been granted litigation authority.

¹⁰⁵ See generally Paul J. Larkin, *Funding Favored Sons and Daughters: Nonprosecution Agreements and “Extraordinary Restitution in Environmental Criminal Cases*, 47 LOY. L.A. L. REV. 1 (2013); Peterson, *supra* note 3, at 327.

¹⁰⁶ See Larkin, *supra* note 105, at 8 (describing extraordinary restitution as “the government compell[ing] a party to contribute to an organization of the government’s choosing.”)

¹⁰⁷ As noted in Chapter 2, the Fed and OCC used the tool in one high-profile instance when resolving the “independent foreclosure review,” which provided for over \$5 billion in relief to consumers who were not necessarily victims of wrongdoing. Press Release, Bd. of Governors of the Fed. Reserve Sys. & Office of the Comptroller of the Currency, Independent foreclosure review to provide \$3.3 billion in payments, \$5.2 billion in mortgage assistance (Jan. 7, 2013). As we show later in this chapter, DOJ settlement agreements with 10 financial institutions included more than \$40 billion worth of extraordinary restitution provisions.

¹⁰⁸ 5 U.S.C. §§ 515–16, 3106.

¹⁰⁹ Peterson, *supra* note 3, at 342 (citing Op. Att’y Gen. 98, 102 (1934)).

¹¹⁰ *Kern River Co. v. United States*, 257 U.S. 147, 155 (1921).

In addition, the Miscellaneous Receipts Act, which, as described earlier, requires monies received by government agencies to be deposited in the U.S. Treasury, does not directly limit an enforcement authorities' power to negotiate settlement payments to third parties. This is because the government itself never receives any money in these settlements. Rather, the DOJ takes the position that such arrangements avoid the Miscellaneous Receipts Act restrictions so long as two conditions are met: (1) the settlement is executed prior to an admission or finding of wrongdoing; and (2) the government does not have post-settlement control over the funds (*i.e.*, the funds remain in the hands of the enforcement target or some other non-government party to distribute).¹¹¹

Moreover, the courts have limited power to review or reject extraordinary restitution arrangements. For example, when the government enters into a civil settlement agreement, or an NPA (as defined in Chapter 2) in a criminal case, before a matter has been filed in court, there is no court involvement or review of the agreement.¹¹² In those instances, the agreement is merely a contract between two parties and no rule, regulation, or law defines what elements are out of bounds.¹¹³

Even when a civil or criminal case has been filed in court, the federal courts take a hands-off approach to reviewing the contents of the agreements. In civil cases, the Second Circuit, which has the most developed case law on point, has held that it will only review a settlement agreement to verify it does not violate the law, that the terms are clear, that it resolves the claims of the complaint, and is not tainted by collusion or corruption.¹¹⁴ In criminal cases, the D.C. Circuit has held that when the DOJ enters into a DPA, courts should not second-guess the DOJ's decision to dismiss criminal charges in exchange for monetary payments or other undertakings. Such decisions are within the province of the executive branch under the constitutional separation of powers.¹¹⁵

The DOJ can enforce compliance with the extraordinary restitution payment requirements by monitoring the other party's performance and terminating the settlement agreement and pursuing the underlying legal claims in an enforcement action if the other party does not comply with the terms of the agreement.

B. Examples of Extraordinary Restitution in DOJ Settlements

The DOJ included extraordinary restitution provisions in some of the largest settlements in the post-financial crisis era. For example, the DOJ used such arrangements in the settlement of mortgage fraud cases with the largest banks. These settlement agreements included consumer relief provisions that required financial institutions to provide principal forgiveness or other relief to borrowers and payments to third-party community organizations or charities that were not directly

¹¹¹ David K. Min, *Settling the Question: Did Bank Settlement Agreements Subvert Congressional Appropriations Powers?: Written Testimony Before the Subcomm. On Oversight and Investigations of the H. Comm. On Fin. Services*, 114th Cong. (May 19, 2016). This logic should apply to any government agency, not just the DOJ.

¹¹² Larkin, *supra* note 105, at 29.

¹¹³ *Id.*

¹¹⁴ SEC v. Citigroup Global Markets, Inc., 752 F.3d 285, 295 (2d Cir. 2014).

¹¹⁵ United States v. Fokker Services B.V., 818 F.3d 733, 741–48 (D.C. Cir. 2016).

harmful by the alleged misconduct underlying the claims being resolved. The DOJ's use of extraordinary restitution is examined below.

1. The DOJ's Use of Extraordinary Restitution

In the \$25 billion National Mortgage Settlement with Ally, Bank of America, Citigroup, J.P. Morgan, and Wells Fargo over foreclosure practices, the settlement agreements with the DOJ required that the banks provide "consumer relief" to borrowers who were not necessarily directly harmed by the banks' alleged misconduct.¹¹⁶ The same is true for separate settlements with Citigroup (\$7 billion), Bank of America (\$16.65 billion), J.P. Morgan (\$13 billion), Deutsche Bank (\$7.2 billion), Credit Suisse (\$5.3 billion), and Goldman Sachs (\$5.06 billion) over mortgage underwriting and securitization practices.¹¹⁷

Consumer relief in these cases included:

- modification to first lien mortgage loans,
- write-downs of second lien mortgage loans,
- incentive payments for owners to participate in short sales,
- forbearance for unemployed borrowers,
- anti-blight activities, and
- refinancing programs.¹¹⁸

¹¹⁶ Press Release, Dep't of Justice, \$25 Billion Mortgage Servicing Agreement Filed in Federal Court (Mar. 12, 2012), <https://d9klfgibkcquc.cloudfront.net/Settlement-USDOJ-FILING-news-release.pdf>

¹¹⁷ See, e.g., Consent Judgment, *United States v. Bank of Am. Corp.*, No. 12-cv-00361-RMC (D.D.C. Apr. 4, 2012); Press Release, Dep't of Justice, Justice Department, Federal and State Partners Secure Record \$7 Billion Global Settlement with Citigroup for Misleading Investors About Securities Containing Toxic Mortgages (July 14, 2014), <https://www.justice.gov/opa/pr/justice-department-federal-and-state-partners-secure-record-7-billion-global-settlement>; Press Release, Dep't of Justice, Bank of America to Pay \$16.65 Billion in Historic Justice Department Settlement for Financial Fraud Leading up to and During the Financial Crisis (Aug. 21, 2014), <https://www.justice.gov/opa/pr/bank-america-pay-1665-billion-historic-justice-department-settlement-financial-fraud-leading>; Press Release, Dep't of Justice, Justice Department, Federal and State Partners Secure Record \$13 Billion Global Settlement with JPMorgan for Misleading Investors About Securities Containing Toxic Mortgages (Nov. 19, 2013), <https://www.justice.gov/opa/pr/justice-department-federal-and-state-partners-secure-record-13-billion-global-settlement>; Press Release, Dep't of Justice, Deutsche Bank Agrees to Pay \$7.2 Billion for Misleading Investors in its Sale of Residential Mortgage-Backed Securities (Jan. 17, 2017), <https://www.justice.gov/opa/pr/deutsche-bank-agrees-pay-72-billion-misleading-investors-its-sale-residential-mortgage-backed>; Press Release, Dep't of Justice, Credit Suisse Agrees to Pay \$5.28 Billion in Connection with its Sale of Residential Mortgage-Backed Securities (Jan. 18, 2017), <https://www.justice.gov/opa/pr/credit-suisse-agrees-pay-528-billion-connection-its-sale-residential-mortgage-backed>; Press Release, Dep't of Justice, Goldman Sachs Agrees to Pay More than \$5 Billion in Connection with Its Sale of Residential Mortgage Backed Securities (Apr. 11, 2016), <https://www.justice.gov/opa/pr/goldman-sachs-agrees-pay-more-5-billion-connection-its-sale-residential-mortgage-backed>.

¹¹⁸ See sources cited *supra* note 117.

Table 3.4, below,¹¹⁹ illustrates how the “consumer relief” provisions constituted *more than 50%* of the \$85 billion total settlement amount in ten of the largest settlement agreements involving the DOJ and financial institutions pertaining to foreclosure, mortgage-lending and securitization practices. Although the DOJ does not maintain a publicly accessible centralized repository of all of its settlement agreements, these agreements were widely reported in the press and could be found in the public domain.

Table 3.4: Consumer Relief in Major Post Financial Crisis DOJ Settlements

Bank	Total Settlement Amount	Amount of Consumer Relief	% of Settlement as Consumer Relief
JPMorgan Chase	\$13 billion	\$4 billion	30.8%
Citigroup	\$7 billion	\$2.5 billion	35.7%
Deutsche Bank	\$7.2 billion	\$4.1 billion	56.9%
Credit Suisse	\$5.3 billion	\$2.8 billion	52.8%
Morgan Stanley	\$3.2 billion	\$400 million	12.5%
National Mortgage Settlement	\$24.1 billion	\$19.1 billion	79.3%
Bank of America	\$16.65 billion	\$7.49 billion	44.5%
Standard & Poor’s	\$1.375 billion	\$0	0%
Wells Fargo	\$1.2 billion	\$0	0%
Goldman Sachs	\$5.06 billion	\$1.8 billion	35.6%
Total	\$85.085 billion	\$42.19 billion	50.18%

The percentage of the settlement amounts in these cases allocated to consumer relief is similar to the findings of the Boston Consulting Group’s 2017 study of enforcement actions against E.U. and U.S. banks from 2009 through 2016. The study found that 38% (\$123 billion of \$321 billion) of the total dollar amount of enforcement actions against the 50 largest European and U.S. banks went to consumers.¹²⁰ It should be noted that in 2017 a memo from Attorney General Sessions barred the use of extraordinary restitution, and thus consumer relief payments, in DOJ settlement agreements. We discuss this ban in more detail later.

¹¹⁹ See Dealbook, *Where Does the Mortgage Settlement Money Go?*, N.Y. TIMES (Dec. 23, 2016), https://www.nytimes.com/2016/12/23/business/dealbook/24mortgagelist.html?_r=0; Michael Patrick Wilt, *Evaluating ‘Consumer Relief’ Payments in Recent Bank Settlement Agreements*, 17 J. BUS. & SECS. LAW 255, 263, (2017), https://papers.ssrn.com/sol3/papers2.cfm?abstract_id=2916436. The table excludes the \$2 billion settlement with Barclays in March 2018 and the \$4.9 billion settlement with RBS in April 2018, each of which were entered into after Attorney General Sessions issued a memo largely prohibiting the practice of including consumer relief in settlements. That memo is discussed in more detail later in this chapter.

¹²⁰ BOS. CONSULTING GRP., GLOBAL RISK 2017: STAYING THE COURSE IN BANKING 16 (2017), http://image-src.bcg.com/BCG_COM/BCG-Staying-the-Course-in-Banking-Mar-2017_tcm9-146794.pdf. The BCG study used data from penalties, fines, and settlements that exceeded \$50 million.

2. *Bank of America Settlement Agreement Case Study on Consumer Relief Provisions*

There is no legal requirement that the distribution of consumer relief funds be disclosed to the public. However, the independent monitor for Bank of America’s 2014 residential mortgage-backed securities settlement with the DOJ and six states has made his reports publicly available online with specific details about the dispersion of funds. Given the level of detail provided in these monitor reports, we have chosen the Bank of America settlement as an illustrative case study.

As discussed in **Appendix B**, in 2014, Bank of America settled FCA, FIRREA, and securities fraud claims with the DOJ, as well as state law claims with six states, for a total settlement amount of \$16.65 billion. Of that amount, \$7 billion was designated as consumer relief, and \$490 million was designated to cover taxes that recipients of the relief were expected to incur (which was to be allocated to third-party organizations if the tax relief was not needed).¹²¹ The settlement agreement included a “menu” of the specified types of consumer relief that Bank of America could provide. The agreement required that minimum amounts of certain types of consumer relief be provided and capped the amounts of other types of consumer relief. **Table 3.5** sets forth the types of consumer relief and relevant minimums and maximums.¹²²

¹²¹ See generally, Bank of America Settlement Agreement, <http://bankofamerica.mortgagesettlementmonitor.com/Settlement-Agreement-Documents/US-DOJ-Bank-of-America-Settlement-Agreement.pdf>.

¹²² See Annex 2 to the Bank of America Settlement Agreement, <http://bankofamerica.mortgagesettlementmonitor.com/Settlement-Agreement-Documents/Settlement-Agreement-Bank-of-America-Consumer-Relief-Annex-2.pdf>.

Table 3.5: Types of Consumer Relief in Bank of America Settlement Agreement

Menu Number	Type of Consumer Relief	Minimum or Maximum Amount
1.A	First Lien Principal Forgiveness (i.e., reducing unpaid principal balance)	\$2.15 billion minimum
1.B	Principal Forgiveness Forbearance (i.e., reducing any principal whose payment had been delayed)	N/A
1.C	First Lien – Forbearance (delaying repayment of principal)	N/A
1.D	Second Lien Extinguishment (i.e., forgive full balance of second lien mortgage)	Combined with 1.E, \$2.5 billion maximum
1.E	Junior Liens – Unsecured Principal Forgiveness/Extinguishment	Combined with 1.E, \$2.5 billion maximum
2	Low- to Moderate Income Lending and Other Loans ¹²³	N/A
3.A	Principal Extinguishment (i.e., forgive entire first lien principal balance,	Combined maximum limit with items 1.D and 1.E is \$3 billion
3.B	Costs Paid for Demolition and Property Remediation of Abandoned and Uninhabitable Residential Properties as Part of Comprehensive Local Strategy to Stabilize Neighborhoods	N/A
3.C	Donations of Mortgages and Real-Estate Owned Properties to Municipalities, Land Banks, Non-Profit Organizations and Service Members with Disabilities	N/A
3.D	Donations to Non-Profit Organizations to Facilitate Reduction, Rehabilitation or Maintenance of Abandoned and Uninhabitable Residential Properties it has Donated	N/A
3.E	Donations to Community Development Financial Institutions	\$50 million minimum
3.F	Donations to Legal Assistance Organizations	\$30 million minimum
3.G	Donations to Housing Counseling Agencies	\$20 million minimum
4	Making Subordinated Loans at a Loss for Affordable Rental Housing	\$100 million minimum

Under the settlement agreement, certain types of consumer relief are given different amounts of “credit” toward the required amount of total consumer relief and the minimums and maximums. For example, a \$1 donation to a housing counseling agency is generally counted as \$2 worth of credit. The independent monitor published his final report on Bank of America’s progress on March 17, 2017. It showed that Bank of America has fulfilled its consumer relief obligations.

Table 3.6, on the next page, summarizes the monitor’s findings. The table divides up the payments into two categories, (1) relief to consumers, and (2) payments to third-party organizations. For each of those categories, it shows: (a) the actual dollar figure of consumer relief provided; (b) the dollar value of *credit* received by Bank of America for that relief; and (c) the percentages of the total relief and credit that these amounts represent.

¹²³ Bank of America could make purchase-money loans to creditworthy borrowers who (a) are located in certain geographic areas, (b) lost their primary residences to foreclosure or short sale, or (c) are first-time homebuyers from low- and moderate-income households.

Notably, a vast majority of the relief (97.4% of the actual dollar amount and 95.5% of the credited amount) was provided in the form of consumer relief payments such as principal forgiveness on first lien mortgages and unsecured loans. These payments helped homeowners suffering as a result of the housing crash and financial crisis, and demonstrate that extraordinary restitution devoted to consumer relief can provide valuable public assistance.

Table 3.6: Allocation of Consumer Relief Amounts in Bank of America Settlement

Relief Category	Actual \$ Amount	% of Actual \$ Amount	Credit \$ Amount	% of Credit \$ Amount
Consumer Relief	\$6.2 billion	97.4%	\$6.55 billion	95.5%
Payments to Third-Party Organizations	\$166.6 million	2.6%	\$308 million	4.5%

3. Potential Benefits of and Problems Arising from Extraordinary Restitution

One potential benefit of extraordinary restitution is that it allows for payment of general compensation to society. This is helpful when it is difficult to identify specific victims, or harm is widely dispersed through a community and it could be logistically challenging to calculate the harm to each member. Second, misconduct can indirectly harm a community through negative externalities of the wrongdoing and extraordinary restitution can help mitigate those costs.

However, extraordinary restitution can present opportunities for political or personal cronyism. This is of particular concern when the funds are directed to third-party organizations,¹²⁴ especially if the funds are used for political activities like issue advocacy ads, electioneering, or lobbying. Indeed, enforcement officials making settlement decisions may direct funds to their political or ideological allies, to advance their own political views or ambitions. Critics of the DOJ have pointed out that the Bank of America settlement resulted in payments to liberal activist organizations like La Raza,¹²⁵ which by its nature is a political organization.

C. Recent DOJ Reforms and Committee Staff Recommendations

In the criminal context, the DOJ barred payments to non-victims beginning in 2008.¹²⁶ The bar was implemented after certain extraordinary restitution payments attracted public scrutiny.

¹²⁴ *Settling the Question: Did Bank Settlement Agreements Subvert Congressional Appropriations Powers?: Testimony Before the Subcomm. On Oversight and Investigations of the H. Comm. On Fin. Services*, 114th Cong. (May 19, 2016) (statement of Paul J. Larkin, Jr., Senior Legal Research Fellow, The Heritage Foundation).

¹²⁵ Kimberly A. Strassel, *Justice’s Liberal Slush Fund*, WALL ST. J. (Dec. 3, 2015), <https://www.wsj.com/articles/justices-liberal-slush-fund-1449188273>.

¹²⁶ U.S. ATTORNEYS’ MANUAL § 9-16.325 (“Plea agreements, deferred prosecution agreements and non-prosecution agreements should not include terms requiring the defendants to pay funds to a charitable, educational, community, or other organization or individual that is not a victim of the criminal activity or is not providing services to redress the harm caused by the defendant’s criminal conduct.”). Memorandum from Mark Filip to Holders of the United

Specifically, they were implemented after public criticism that resulted from a settlement in which a U.S. Attorney allegedly directed a corporate criminal defendant to endow a \$5 million chair at his law school alma mater.¹²⁷

In June 2017, the DOJ also imposed a severe restriction on extraordinary restitution in civil matters. Attorney General Sessions distributed a memo to DOJ lawyers that stated that the DOJ would “no longer engage in [the] practice” of including “payments to various non-governmental, third-party organizations as a condition of settlement with the United States,” and that the DOJ would not enter into agreements that direct or provide for payments to “any non-governmental person or entity that is not a party to a dispute.”¹²⁸ Had this restriction been in place in 2014, the Bank of America settlement would not have been permitted. We think the restriction is overly broad given the benefits extraordinary restitution payments can provide.

Attorney General Sessions’ memo provided only three limited exceptions for: (1) payments that provide restitution to victims or directly remedy the harm being redressed, including, for example, harm to the environment; (2) payments for legal or professional services rendered in connection with the matter; and (3) payments authorized by statute.¹²⁹ Thus, the memo appears to prohibit both types of extraordinary restitution previously identified: (1) payments to consumers who were not direct victims; and (2) payments to charities, non-profits, and other third-party organizations that were not direct victims. However, the memo only represents the policy of the current DOJ and could be revised or repealed by a subsequent Attorney General or presidential administration. In addition, the memo only applies to the DOJ and so does not restrict the availability of this remedy in settlements with other enforcement authorities.

We do not think the blanket prohibition is necessary because extraordinary restitution payments, as previously discussed, can serve a valuable function. Instead, we believe it would be better if restrictions on extraordinary restitution were more narrowly tailored to directly address the major concerns about cronyism and the appearance of cronyism.

- **Recommendation 14:** Third parties that receive settlement funds from extraordinary restitution should be prohibited from using those funds to engage in political activities. Federal enforcement authorities should adopt policies and guidelines to effectively implement the ban.

Such legislation would make the adopted policy binding on the DOJ and all other enforcement authorities, and bar the most concerning and egregious use of settlement funds – the potential direction of funds to political allies and cronies for political purposes. At the same time,

States Attorneys’ Manual (May 14, 2008),

http://amlawdaily.typepad.com/amlawdaily/files/extraordinary_restitution_attach.pdf.

¹²⁷ See, e.g., David Kocieniewski, *In Testy Exchange in Congress, Christie Defends His Record as A Prosecutor*, N.Y. TIMES (June 26, 2009), <http://www.nytimes.com/2009/06/26/nyregion/26christie.html> (noting criticism of case where a law professor chair was endowed at the U.S. attorney’s alma mater as part of a deferred prosecution agreement).

¹²⁸ Memorandum from Jeff Sessions, Att’y Gen., *Prohibition on Settlement Payments to Third Parties* (June 5, 2017), <https://www.justice.gov/opa/press-release/file/971826/download>.

¹²⁹ *Id.*

this approach would allow the government to structure settlement agreements to provide consumer relief or payments to community organizations to mitigate the negative externalities or effects of an enforcement target's misconduct. Obviously, Congress will either need to define the meaning of "political activity" in any legislation it adopts, or agencies will have to define such activities in their own rules. While we leave the details to Congress and the enforcement authorities, we believe that political activities should include activities like running issue advocacy ads, electioneering, and lobbying.

In our view, implementing this prohibition on the use of settlement funds for political purposes should not represent an onerous burden. Enforcement authorities could, for example, require a documentation, signed under penalty of perjury, from the recipient certifying that the funds would not be not used for political activities.

Relatedly, opaqueness about the existence of extraordinary restitution provisions and the distribution of extraordinary restitution amounts also opens the door up to misconduct or at least the appearance of misconduct. Specifically, opaqueness may breed suspicions that settlements funds are being directed to the pet causes, projects, or allies of officials instead of for the public benefit. As a result, we believe enforcement authorities should increase the transparency about when extraordinary restitution provisions are utilized and the amount of settlement funds paid out as extraordinary restitution.

- **Recommendation 15:** Each federal enforcement authority should provide an annual accounting of the amount of settlement funds paid out as extraordinary restitution.

Such an accounting should be on both an aggregate and individual case level. This additional transparency would allow for a more effective evaluation of in what circumstances and matters extraordinary restitution provisions are being included and how much money is being devoted to extraordinary restitution. This disclosure would also provide Congress and members of the public the ability to attempt to track how such funds are being distributed. The added transparency may also result in enforcement officials giving extra thought when determining whether a particular settlement warrants the inclusion of an extraordinary restitution provision.

IV. States' Use of Monetary Sanctions

A. Power of Attorneys General to Allocate Settlement Funds

Unlike federal agencies, certain state attorneys general are not legally constrained in how they can use settlement funds. In such circumstances, extraordinary restitution is not necessary, as there is no requirement that the attorney general deposit settlement money in the state's treasury or general fund.

One prominent example is the Massachusetts Attorney General, who is only required to "account to the state treasurer for all fees, bills of costs and money received by [her] by virtue of [her] office."¹³⁰ The discretion of the Massachusetts Attorney General was evident in a 2010 settlement agreement between Massachusetts and Morgan Stanley, which required that Morgan Stanley pay \$2 million of the \$102 million settlement funds to state non-profit groups.¹³¹

Another example is the 2008 settlement between Michigan and Countrywide Financial for alleged predatory lending practices. The settlement agreement required that almost \$10 million be spent on borrower education programs and neighborhood rehabilitation efforts.¹³² In 2009, the Michigan Attorney General allocated \$50,000 of the settlement amount to two local parks.¹³³

In other instances, the ability of a state attorney general to decide how settlement funds are allocated has been contested. For example, when the State of Florida settled the National Mortgage Settlement (described in detail below) for \$334 million, the Florida Attorney General negotiated the agreement so that \$74 million would be transferred to the state general fund as a civil penalty and \$260 million would be disbursed at her direction.¹³⁴ However, state legislators claimed that all spending decisions required legislative approval.¹³⁵ In the end, a compromise was reached, allowing the legislature to appropriate \$200 million and spend \$55 million on the legislature's budget commission, and permitting the Attorney General to disburse \$5 million.¹³⁶

¹³⁰ Mass Gen. Laws ch. 12, § 29.

¹³¹ Press Release, Office of Att'y Gen. of Mass., Morgan Stanley to Pay \$102 Million for Role in Massachusetts Subprime Mortgage Meltdown Under Settlement with AG Coakley's Office (June 24, 2010), <http://www.mass.gov/ago/news-and-updates/press-releases/2010/attorney-general-martha-coakley-reaches-102.html>.

¹³² Jay Greene, *Countrywide to renegotiate mortgages with 10,000 in Michigan*, CRAIN'S DETROIT BUS. (Oct. 6, 2008), <http://www.craindetroit.com/article/20081006/FREE/810060271/countrywide-to-renegotiate-mortgages-with-10000-in-michigan>.

¹³³ Jim Harger, *State, local legislators call for reevaluation of Countrywide mortgage settlement funds after surprise parks money*, MICH. LIVE (Mar. 19, 2009), http://www.mlive.com/news/grand-rapids/index.ssf/2009/03/state_local_legislators_call_f.html.

¹³⁴ National Mortgage Settlement consent judgment, B2-5 (April 2012), https://d9klfgibkcqec.cloudfront.net/Consent_Judgment_BoA-4-11-12.pdf.

¹³⁵ Gary Fineout, *Fla. Attorney General not budging on settlement*, ASSOCIATED PRESS (Oct. 17, 2012), <https://www.yahoo.com/news/fla-attorney-general-not-budging-203524697.html>.

¹³⁶ Press Release, Fla. Senate, Florida Senate Passes Bill Outlining National Mortgage Settlement Funds (Apr. 26, 2013), <http://www.flsenate.gov/Media/PressRelease/Show/1497>.

Similarly, in California, where settlement amounts in the same National Mortgage Settlement were supposed to be used “for the benefit of California homeowners affected by the mortgage crisis,”¹³⁷ based on the terms of the settlement agreement, the Governor and state legislature used over \$330 million to the state’s general fund to pay down the state’s debt.¹³⁸ That decision resulted in litigation in which a state lower court judge ordered the state to place the funds back into an account designated for use to assist homeowners.¹³⁹

B. 2012 National Mortgage Settlement Case Study

The 2012 National Mortgage Settlement offers a useful case study of how states have allocated settlement funds.¹⁴⁰ The National Mortgage Settlement referenced above, was a settlement reached with the five largest mortgage servicers (Citi, J.P. Morgan, Bank of America, Ally Financial, and Wells Fargo) in 2012, in which the servicers agreed to pay approximately \$25 billion to settle allegations arising from mortgage loan servicing and foreclosure practices.¹⁴¹ Forty-nine states participated in the settlement and divided \$2.5 billion amongst themselves. In addition, \$20 billion in consumer relief was paid directly to consumers and roughly \$1 billion was sent to the U.S. Treasury.¹⁴²

The National Conference of State Legislatures (“NCSL”), an independent group that studies issues relevant to state legislatures, has attempted to track how the 49 states spent the \$2.5 billion that they received under the National Mortgage Settlement. The NCSL has been able to at least partially track the settlement funds for 41 states.¹⁴³

The NCSL data shows that eight of the ten states with the largest settlement amounts from the National Mortgage Settlement directed significant amounts of these funds to third-party groups or earmarked the funds for specific government offices or programs. These range from payments to legal aid organizations, to housing charities like Habitat for Humanity, to tuition scholarships, and to funding for state court systems. **Table 3.7**, on the next page, provides examples of the available information on the amounts provided to these states and how those amounts were spent.

¹³⁷ Shaila Dewan, *Needy States Use Housing Aid Cash to Plug Budgets*, N.Y. TIMES (May 15, 2012), <http://www.nytimes.com/2012/05/16/business/states-diverting-mortgage-settlement-money-to-other-uses.html>.

¹³⁸ Gretchen Morgenson, *California Has to Repay \$331 Million to Homeowners Fund, Court Rules*, N.Y. TIMES (June 15, 2015), https://www.nytimes.com/2015/06/16/business/california-has-to-repay-331-million-to-homeowners-fund-court-rules.html?_r=0.

¹³⁹ *Id.*

¹⁴⁰ The settlement terms often directed that the funds would be used in the discretion of the state attorney general. For example, the settlement with Citi specified that the amounts owed to each state were to be used as directed by the attorney general of the state in accordance with purposes set forth in an exhibit to the agreement. *See* Consent Judgment, *United States v. Bank of Am. Corp.*, No. 12-cv-00361-RMC (D.D.C. Apr. 4, 2012), https://d9k1fgibkcquc.cloudfront.net/Consent_Judgment_Citibank-4-11-12.pdf.

¹⁴¹ Heather Morton, *National Mortgage Settlement Summary - NY*, NAT’L CONF. ST. LEGIS. (last visited Nov. 19, 2017), <http://www.ncsl.org/research/financial-services-and-commerce/national-mortgage-settlement-summary.aspx#NY>.

¹⁴² *Id.*

¹⁴³ Our conversations with staff at the NCSL indicate that their data was derived from press releases and public records, and from interviews and conversations with various state officials.

Table 3.7: Expenditure of State Settlement Amounts

State	Settlement Amount Received	Tracked Expenditures of Settlement Amount
California	\$410.6 million	<ul style="list-style-type: none"> - \$41.6 million – Unfair Competition Law Fund - < \$11 million – housing and legal aid groups
Florida	\$334.1 million	<ul style="list-style-type: none"> - \$35 million – down payment assistance - \$10 million – housing counseling - \$15 million – legal aid programs - \$9.1 million – Florida tuition scholarship program - \$36 million – state courts system - \$10 million – Department of Children and Families - \$20 million – Habitat for Humanity - \$50 million – reduced rents on new and existing rental units - \$10 million – fund construction or rehabilitation of rental units - \$40 million – State Housing Initiative Program - \$10 million – grant program for housing homeless persons - \$10 million – grant for housing persons with developmental disabilities - \$5 million to state attorney general’s office for costs - \$74 million – general fund
Texas	\$134.6 million	<ul style="list-style-type: none"> - \$10 million – Judicial Fund - \$124.6 million – General Fund
Illinois	\$105.8 million	<ul style="list-style-type: none"> - \$20 million – legal aid organizations - \$5 million – foreclosure mediation programs - \$4.36 million – Habitat for Humanity - \$10.5 million – State and County Housing and Land Authorities - \$18.2 million – other third-parties
Georgia	\$99.4 million	<ul style="list-style-type: none"> - \$99.4 million – economic development
Arizona	\$97.8 million	<ul style="list-style-type: none"> - \$50 million – state general fund - \$41 million – assistance to keep consumers in homes and consumer restitution - \$5 million – enforcement and monitoring - \$5 million – housing counseling - \$4 million – legal services - \$2 million – outreach, marketing and education
Michigan	\$97.2 million	<ul style="list-style-type: none"> - \$7.5 million – restitution - \$5 million – mortgage and foreclosure assistance to veterans - \$6 million to attorney general to investigate and prosecute mortgage-related crimes - \$25 million – blight elimination - \$20 million – foreclosure counseling - \$3.7 million – housing and community development programs - \$5 million – homeowner refinancing grants - \$15 million – homeowner purchasing assistance - \$10 million – education funding for lowest performing schools
Ohio	\$92.8 million	<ul style="list-style-type: none"> - \$75 million – grant program for abandoned/vacant property demolition - \$20 million – foreclosure assistance - \$2 million – Economic Crimes division of attorney general office
New Jersey	\$72.1 million	<ul style="list-style-type: none"> - \$72.1 million – General Fund

C. Concerns with States' Use of Settlement Funds

As with many other aspects of the enforcement system, the use of settlement funds by state authorities is not very transparent. Only thanks to the NCSL's independent work is there any centralized data on how the states' portion of the National Mortgage Settlement was spent. Despite those efforts, funds could not be tracked at all by the NCSL for eight states, and for many of the others, it is unclear how significant percentages of the settlement funds were used.

This lack of transparency is troubling. It undercuts accountability to the public. Accountability is especially important when settlement funds are not allocated through a legislative process and are used in ways that do not directly remedy misconduct or compensate its victims. If the public cannot easily and readily understand how settlement funds are used, then they are unable to evaluate whether this money is being spent in the public interest. Citizens may reasonably expect that monies received by states will be used to remediate problems caused by the alleged unlawful acts underlying the settlement. Without adequate transparency, citizens do not know if that is the case. Even when settlement amounts exceed the amount required to fully compensate consumers or communities, the public has a right to know whether any excess funds are being used to fund beneficial programs or whether they are being used as slush funds for attorneys general or state legislatures to fund politically active organizations, groups, or other political allies.

- **Recommendation 16:** The states should adopt legislation: (1) requiring an annual accounting from state officials of how state settlement funds are spent; and (2) prohibiting third parties that receive state settlement funds from using those funds to engage in political activities.

Chapter 4: Promoting Individual Accountability

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This chapter focuses on the topic of individual accountability, which many, including the SEC co-heads of enforcement, have said is the most effective way to deter misconduct.¹ Individual accountability is particularly effective because culpable individuals are forced to directly bear and internalize the cost of punishment, whereas when firms are penalized, the costs are largely borne by shareholders who played no part in the wrongdoing. At the outset, it is critical to understand that enforcement actions against firms do not prevent enforcement agencies from also targeting individuals. Chapter 4 proceeds in four parts.

Part I outlines why it is important to hold both individuals and firms accountable under U.S. law and the relationship between individual and firm liability. We also explain important distinctions between individual and firm liability and note that firms can potentially be liable for a legal violation even if no specific individual at that firm has violated U.S. law.

Part II examines the investigative tools and powers that enforcement authorities have to identify and pursue suspected wrongdoers. We generally find that enforcement authorities can identify bad actors and punish them whether they are individuals or firms, but that there are certain unique challenges to pursuing individuals.

Part III describes the policies and public statements of government authorities regarding individual liability showing that enforcement authorities appear to understand the importance of individual accountability and have recently placed an added priority on it. This is important given the legal and non-legal factors that may make firm-level cases more attractive to enforcement authorities than cases against individuals.

Part IV discusses various legal reforms that the government could adopt in an effort to more readily identify culpable individuals and hold them accountable. First, we consider broadly lowering the legal standard for liability from intentional wrongdoing to negligence. Indeed, the U.K. Senior Manager's regime recently imposed a negligence standard on high-level officers and directors. Second, we explore the possibility of a strict liability standard, as imposed by government rules requiring clawbacks of executive compensation. We believe that both approaches would encourage excessive government intrusion on business decisions and would impede the recruitment of qualified officers and directors. Instead, we present recommendations that focus on better incentivizing firms and enforcement authorities to work together to identify and prevent individual misconduct.

¹ DIV. OF ENFORCEMENT, U.S. SEC. & EXCH. COMM'N, ANNUAL REPORT 2 (2017), <https://www.sec.gov/files/enforcement-annual-report-2017.pdf>.

I. The Importance and Establishment of Individual and Firm Accountability

It is important that both culpable individuals and firms be held accountable for wrongdoing. The importance of individual accountability has been highlighted by the press,² politicians³ and even enforcement agencies themselves. Firm accountability is also important because it can incentivize firms to take steps to prevent, identify, and punish wrongdoing by employees. Firms may sometimes also be in the best position to compensate injured consumers or investors. We discuss the rationales for individual and firm liability and then explain how individuals and firms can be held liable for the acts of others.

A. Importance of Individual Accountability

Individual accountability is critical to a successful enforcement system for at least three reasons: (1) deterrence; (2) public confidence; and (3) less collateral damage to innocent third parties.

1. Deterrent Effect of Individual Accountability

Personal liability forces a firm manager or employee to internalize the costs of wrongdoing.⁴ Imposing costs on the culpable individuals can offset the personal benefits that motivated an individual to engage in unlawful conduct, such as the prospect of greater compensation, making the misconduct costlier for them than beneficial.⁵ By contrast, when a firm is penalized with a fine, shareholders who were uninvolved in wrongdoing often bear the cost of the punishment. This creates a disconnect between the perpetrators and those bearing the costs.

² See, e.g., James B. Stewart, *In Corporate Crimes, Individual Accountability is Elusive*, N.Y. TIMES (Feb. 19, 2015), https://www.nytimes.com/2015/02/20/business/in-corporate-crimes-individual-accountability-is-elusive.html?_r=0; William Cohan, *Justice Dept. Shift on White-Collar Crime Is Long Overdue*, N.Y. TIMES (Sept. 11, 2015), <https://www.nytimes.com/2015/09/12/business/dealbook/justice-dept-shift-on-white-collar-crime-is-long-overdue.html>; David Browdin, *The Big Wells Fargo Picture: Can We Discourage White-Collar Crime Without Jailing the Criminals?*, U.S. NEWS AND WORLD REP. (Nov. 2, 2016), <https://www.usnews.com/opinion/economic-intelligence/articles/2016-11-02/what-the-wells-fargo-scandal-teaches-us-about-detering-white-collar-crime>.

³ See, e.g., *Sen. Warren slams 'shockingly weak' punishments for corporate crime*, REUTERS (Jan. 29, 2016), <https://www.reuters.com/article/us-usa-companies-warren/sen-warren-slams-shockingly-weak-punishments-for-corporate-crime-idUSKCN0V71WU>; Matthew Daly, *Senators Call for Criminal Investigation of Wells Fargo*, ASSOCIATED PRESS (Oct. 6, 2016), <https://apnews.com/c6e4cc507d7944ccad055ef5478b5e62/senate-democrats-call-criminal-probe-wells-fargo> (reporting that fourteen senators called for criminal investigations of bank executives when company opened unauthorized customer accounts).

⁴ See e.g., Steven L. Schwarz, *Excessive Corporate Risk-Taking and the Decline of Personal Blame*, 65 EMORY L.J. 533, 536 (2015); Claire A. Hill & Richard W. Painter, *Why S.E.C. Settlements Should Hold Senior Executives Liable*, N.Y. TIMES (May 29, 2012) (stating that when only a firm is penalized, the individuals responsible for the conduct have little incentive to modify their conduct).

⁵ Jennifer Arlen & Marcel Kahan, *Corporate Governance Regulation Through Nonprosecution*, 84 U. CHI. L. REV. 323, 345 (2017).

Similarly, the criminal penalty of incarceration and the threat of imprisonment – which can only be levied against individuals – can be more a more effective deterrent than fines on a firm.⁶

2. Public Confidence

Successfully holding culpable individuals accountable for unlawful conduct can also inspire public confidence in the enforcement regime. Commentators, including Peter Henning, a professor at Wayne State University Law School and former trial attorney with the DOJ’s Criminal Division, have noted that when firms are frequently the only target in enforcement actions and they typically settle cases by paying fines, then the public may view such settlements as simply a cost of doing business.⁷ On the other hand, holding individuals accountable demonstrates a commitment to the public to root out wrongdoing and communicates that those who engage in wrongdoing face consequences.

3. Reduced Harm to Innocent Parties

When enforcement authorities hold an individual accountable, there are likely to be fewer costs imposed on innocent third parties. Firm-level sanctions and fines, unlike penalties imposed on culpable individuals, typically fall primarily on innocent third parties, such as stockholders and creditors, rather than on the individuals responsible for the misconduct.⁸ Indeed, the prosecution and conviction of a firm, can lead to its collapse, eliminating shareholder value, harming creditors, and costing employees their jobs. That is why the DOJ’s Principles of Prosecution of Business Organizations instruct DOJ prosecutors to consider the consequences of a conviction or indictment in deciding whether to charge a corporation with a crime.⁹

⁶ See e.g., John Collins Coffee, Jr., *Corporate Crime and Punishment: A Non-Chicago View of the Economics of Criminal Sanctions*, 17 AM. CRIM. L. REV. 419, 463 (1980) (arguing that among other factors, the risk of incarceration faced by individuals makes the deterrent effect of prosecuting individuals greater than prosecuting firms).

⁷ Peter J. Henning, *Guilty Pleas and Heavy Fines Seem to be the Cost of Doing Business for Wall St.*, N.Y. TIMES (May 20, 2015), <https://www.nytimes.com/2015/05/21/business/dealbook/guilty-pleas-and-heavy-fines-seem-to-be-cost-of-business-for-wall-st.html> (“Banks appear willing to plead guilty as long as the collateral costs are not too heavy. Thus, the potency of a criminal conviction as a deterrent seems to have been dissipated, perhaps to the point that it is just a business expense. In a sense, they have become pleas without the baggage that comes with the acknowledgment of guilt when all that is involved is the payment of fines, something that can be done as well in a civil proceeding.”).

⁸ See e.g., John Hasnas, *The Centenary of a Mistake: One Hundred Years of Corporate Criminal Liability*, 46 AM. CRIM. L. REV. 1329, 1339–40 (2009) (stating that when a company gets fined “it is the owners of the corporation, the shareholders, who incur the penalty” who “have no direct control or knowledge of the behavior of corporate employees who commit criminal offenses”); Albert W. Alschuler, *Two Ways to Think about the Punishment of Corporations*, 46 AM. CRIM. L. REV. 1359, 1367–69 (2009) (stating that “[i]nnocent shareholders pay the fines, and innocent employees, creditors, customers, and communities sometimes feel the pinch too”); John C. Coffee, Jr., *No Soul to Damn: No Body to Kick*, 79 MICH. L. REV. 386, 408–09 (1981) (noting that large corporate fines can injure creditors, shareholders, employees and communities).

⁹ U.S. ATTORNEYS’ MANUAL, § 9-28.1100.

The failure of Arthur Andersen, the accounting firm that acted as Enron’s auditor, is a prominent example of the damage such suits can cause.¹⁰ Arthur Andersen was convicted on a single federal criminal count for which it was indicted in the aftermath of Enron’s collapse, and as a result, the international firm and employer of 85,000 collapsed, even though its conviction was ultimately overturned on appeal.¹¹ As a public accounting firm, Arthur Andersen was particularly vulnerable to the reputational stain that a criminal conviction imparted. Indeed, a study by Professors Karpoff and Lott found that 93.5% of the lost market cap value suffered by firms subject to government investigations or convictions for fraud were attributable to *reputational* damage rather than legal costs or fines.¹²

B. Importance of Firm Liability

Liability at the corporate entity level dates back to 1909 in the United States, when the Supreme Court decided that if the unlawful actions of employees taken in the course of their employment also benefit the corporation, then the corporate entity can also be held both criminally and civilly liable under the theory of *respondeat superior*.¹³ This means that firms are held *strictly liable* (regardless of the firm’s intent) for unlawful activities by its employees or agents committed in the course of employment to benefit the corporation.

Indeed, if a firm benefits from illegal conduct, it makes sense to recoup those benefits through fines and disgorgement and to incentivize the firm to develop policies and systems to prevent such wrongdoing. Furthermore, in cases where the harm caused to consumers or investors is very large and cannot be remediated by the culpable individuals, a deep pocketed firm will be in a better position to compensate harmed parties.

Finally, the threat of firm liability “usefully enlists the firm in interdicting and deterring its wayward agents.”¹⁴ In other words, to avoid liability, firms will be incentivized to take steps to prevent employee wrongdoing, monitor employees’ compliance with the law, and adopt internal accountability mechanisms to punish wrongdoing. Thus, the firm can be used to supplement efforts by the government to prevent wrongdoing and to identify and punish it when it does occur.

¹⁰ See, e.g., James Copland, “Regulation by Prosecution: The Problems with Treating Corporations as Criminals,” Civil Justice Report, No. 13 (Dec. 2010), http://www.manhattan-institute.org/html/cjr_13.htm.

¹¹ *Id.*

¹² Jonathan M. Karpoff & John R. Lott, Jr., *The Reputational Penalty Firms Bear from Committing Criminal Fraud*, 36 J.L. & ECON., 757, 759, 784 (1993).

¹³ *New York Central & Hudson River Railroad Co. v. United States*, 212 U.S. 481, 495–96 (1909). See also Pamela H. Bucy, *Corporate Ethos: A Standard for Imposing Corporate Criminal Liability*, 75 MINN. L. REV. 1095, 1095 (1991). The threat of corporate-level punishment could also incentivize firms to enact compliance policies and proactively discourage misconduct through *ex ante* monitoring and *ex post* sanctions of employees. See Jennifer Arlen, *Corporate Criminal Liability: Theory and Evidence*, in RESEARCH HANDBOOK ON THE ECONOMICS OF CRIMINAL LAW 144, 145 (Keith Hylton and Alon Harel, eds., Edward Elgar Publishing, 2012).

¹⁴ Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687, 689 (1997).

C. The Relationship Between Individual and Firm Liability

As an initial matter, *firms* are vicariously liable for the unlawful acts of their employees and agents taken in the course of their employment and for the benefit of their employer. Thus, firm liability is, by definition, related to a particular individual’s liability because the firm’s liability is derived from an individual’s conduct. They are inexorably linked. In most instances, statutory provisions do not impose liability on an individual or firm for merely failing to act (i.e., a negligence-type standard) or by attributing the actions of others to an individual.¹⁵ However, there are a few important exceptions in which liability can be imposed on an individual or firm because of an act committed by others that the individual or firm failed to prevent. We review these exceptions below. In addition, in the context of firm liability the government can potentially rely on a legal theory of *aggregation* in which the government combines the acts, knowledge, and intent of a firm’s employees to claim wrongdoing by a firm. We also review this theory as it applies to the relationship between firm and individual liability.

1. Individual Liability for Failure to Stop Wrongdoing by Others

A number of laws impose liability on *individuals* in connection with the acts of others.

For example, the SEC may bring actions against an individual for a failure to reasonably supervise employees. The securities laws permit the SEC to bring these cases against registered investment advisers or broker-dealers.¹⁶ In 2016, the SEC settled with the financier Steven A. Cohen for failure to supervise a subordinate, when his hedge fund was involved in the Martoma insider trading matter detailed in Part III of this chapter.¹⁷

The SEC also has the power under Section 15(a) of the Securities Act and Section 20(a) of the Exchange Act to hold an individual liable for the securities law violations of any person that they control, which is known as control person liability.¹⁸ The scope of this type of vicarious

¹⁵ We use the term “intentional” broadly to refer to a requirement that the person affirmatively engaged in an act or conduct and/or the person had a required mental state when engaged in the conduct. Examples of laws requiring “intentional” acts as we use the term include 15 U.S.C. §§ 77x (criminal conviction under Securities Act requires “willful” violation), 78u-2 (civil penalties in SEC administrative actions generally require “willful” violation), 78ff (criminal conviction under Exchange Act requires “willful” violation); 31 U.S.C. § 3729 (requiring “knowing” acts to violate False Claims Act); 12 U.S.C. § 1833a(c) (FIRREA predicate violations require the defendant to have engaged in the predicate offense and have had some sort of intent); 12 U.S.C. § 1818(i) (requiring the defendant to itself have violated the law, and for larger penalties, imposing intent requirements); 7 U.S.C. §§ 13 (criminal convictions for violations of Commodity Exchange Act require knowing or willful violations of the law), 13a-1 (requiring CFTC civil actions be brought against those who have engaged in, are engaging in, or are about to engage in an act or practice violation the Commodity Exchange Act).

¹⁶ 15 U.S.C. §§ 78o(b)(4)(E); 80b-3(e)(6).

¹⁷ See Press Release, U.S. Sec. & Exch. Comm’n, Steven A. Cohen Barred from Supervisory Hedge Fund Role (Jan. 8, 2016), <https://www.sec.gov/news/pressrelease/2016-3.html>.

¹⁸ 15 U.S.C. §§ 77o(a), 78t(a). The SEC defines “control” in Rule 405 as the “possession, direct or indirect, of the power to direct or cause the direction of the management or policies of a person, whether through the ownership of voting securities, by contract, or otherwise.”

liability is fairly constrained however. For example, some circuit courts of appeal have read a “culpable participant” requirement into the statute, which means that the SEC has to prove that the defendant actually participated in the violation.¹⁹ Furthermore, defendants subject to a control person liability action can avoid liability by establishing that they acted in good faith and did not induce the legal violation.²⁰

In addition, as part of the Sarbanes-Oxley Act of 2002 (“SOX”), Congress adopted a statutory provision that imposed strict liability on the CEO and CFO public companies in the event that the company had to restate its financial statements due to misconduct by an employee of the company. Specifically, the SEC is authorized to disgorge (i.e., clawback) any “bonus” or “other incentive-based or equity-based compensation” received by an issuer’s CEO or CFO.²¹ SOX was passed after a series of high-profile public company accounting scandals and in response to President Bush’s 10-point plan to protect shareholders, which included a statement that “CEOs or other officers should not be allowed to profit from erroneous financial statements.”²² The law applies to accounting misconduct resulting in a restatement of financial statements and does not permit clawbacks for other types of violations.

Finally, banking regulators can remove a director or officer from his or her position if the individual’s failure to act constituted a breach of the duty of care or duty of loyalty that is owed to the corporation, causes loss to the corporation, and demonstrates disregard by the officer or director of the safety and soundness of the bank.²³ Thus, even if the officer or director did not intentionally participate in a legal violation, he or she can still be penalized.

2. Firm Liability Resulting from the Conduct of Employees and the Aggregation of Conduct by Multiple Employees

While individuals can generally only be held liable for their own actions, knowledge, and intent (with a few exceptions described above), firms can potentially be held liable for the totality of the actions, knowledge, and intent of all its employees.

As discussed earlier, it is black-letter law that a firm can be held criminally and civilly vicariously liable for the actions of an individual employee done in the course of employment for the benefit of the employer under the doctrine of *respondeat superior*. It provides incentives for firms to monitor and regulate the conduct of employees. It also allows injured parties the ability to obtain compensation and remediation where such damages may not be obtainable from an individual with limited resources.

¹⁹ See PAUL VIZCARRONDO, JR., LIABILITIES UNDER THE FEDERAL SECURITIES LAWS 129–130 (2013), <http://www.wlrk.com/docs/OutlineofSecuritiesLawLiabilities2013.pdf> (noting that the Second and Third Circuits follow the test).

²⁰ 15 U.S.C. § 78t(a).

²¹ 15 U.S.C. § 7243.

²² *The President’s 10-Point Plan: Improving Corporate Responsibility and Protecting America’s Shareholders*, WALL ST. J. (Mar. 6, 2002), <https://www.wsj.com/articles/SB1015460971646141720>.

²³ 12 U.S.C. § 1818(e).

More importantly and troubling, under an unsettled legal theory, not only can a firm be held vicariously liable when a specific employee commits a legal violation, but the *aggregated* (or collective) actions, knowledge, and intent of all of its employees can also be imputed to it. This theory is sometimes referred to as “collective scienter”.

The First Circuit Court of Appeals, which endorsed the collective scienter theory, has stated that, “the acts of a corporation are . . . simply the acts of all of its employees operating within the scope of their employment”²⁴ and thus, “[i]t is irrelevant whether employees administering one component of an operation know the specific activities of employees administering another aspect of the operation.”²⁵ In practice, this means that a firm can be held liable for a legal violation resulting from the collective activities of its employees even when no single employee has violated the law.

An illustrative example is useful to understand the concept. Under the aggregation theory, a firm could be held liable for violating disclosure requirements in connection with the sale of securities even if there is no single individual at that firm that directly violated such standards. All that is required for firm liability is that there are individuals that *collectively* violated the standard. Thus, if one individual at a firm knows that the disclosure materials for a security are untrue and another individual at that firm actually markets and sells the security (without such knowledge), then enforcement authorities would aggregate the one individual’s knowledge with the others act of marketing and selling the security. The enforcement authority would then take the position that the *firm* was in violation of securities law. This is true even though neither individual is in violation of securities law.

The government appears to have relied on the aggregation theory in many of the largest mortgage-related settlement cases that arose out of the financial crisis. We reviewed the settlements listed in **Table 3.4** in Chapter 3, which imposed sanctions of more than \$85 billion. Each of the settlement agreements was accompanied by a statement of facts. In those statements, the government did not identify specific employees that were culpable. Instead, the government often did not attribute actions to a specific or identifiable employee, and failed to establish a clear nexus between the knowledge of a particular employee and the subsequent actions of individuals at the firm (i.e., that those engaged in selling the securities knew of the inaccurate information in the disclosures).²⁶

²⁴ United States v. Bank of New England, 821 F.2d 844, 856 (1st Cir. 1987) (citing cases from the Eighth and Tenth Circuit Courts of Appeal for the proposition that corporations can be liable for the collective acts of its employees).

²⁵ *Id.*

²⁶ One commentator said about the J.P. Morgan settlement that it was “anodyne,” “glossed over many details,” and did not name any bankers. William D. Cohan, *How Wall Street’s Bankers Stayed Out of Jail*, THE ATLANTIC (September 2015), <https://www.theatlantic.com/magazine/archive/2015/09/how-wall-streets-bankers-stayed-out-of-jail/399368/>. It should be noted, however, that in the Wells Fargo settlement, a specific employee was identified as having engaged in wrongdoing and he simultaneously settled claims with the government. <https://www.justice.gov/opa/file/839796/download>. It is also important to note that the government could still decide to prosecute individuals in the cases that we reviewed, which could place facts into the public record that would indicate that a firm was vicariously liable for the illicit conduct by a particular individual or group of individuals. In addition, the statements of fact in settlement agreement are heavily negotiated and may not contain all pertinent information to allow a complete analysis of the government’s legal theory of liability.

It is critical to note, however, that the concept of aggregate or collective scienter stands on shaky legal ground. For example, it runs contrary to traditional principles of agency law. As the Restatement (Third) of Agency makes clear, a principal (in this case a firm) cannot be held liable for fraud if an agent makes a false statement the agent believes to be true simply because a different agent knows different facts that make the statement false.²⁷ An example is helpful. Assume a car dealership has two employees, A and B. Employee A knows that a certain used car has a mechanical issue that causes the car to breakdown in bad weather. Employee B is unaware of that fact, sells the car to a customer, and in doing so states that the car has no known problems and is in working order. The car dealership is not liable for fraud under normal agency law principles. But under an aggregation theory, the car dealership could be held liable.

Furthermore, decisions by many federal circuit courts of appeals in different circumstances reject or undercut an aggregation theory.²⁸ For example, the D.C. Circuit Court of Appeals held in a False Claims Act case that it would be improper to apply a collective intent theory and noted that in other cases, “we have expressed a good deal of skepticism about corporate intent theories that rely on aggregating the states of mind of multiple individuals.”²⁹ Moreover, in the securities litigation context, the Third Circuit has stated that if liability could not be established against a particular individual, then the company could not itself be liable.³⁰ That is an express rejection of a collective intent theory.

From a practical perspective, the value of such a liability theory is questionable because a firm may not be in a position to track the knowledge of every single employee, and facing the threat of such a liability theory, firms might focus more resources than appropriate on monitoring employees at the expense of other critical corporate functions.³¹ For reasons discussed in II.B.2 in this chapter, firms have many reasons to settle and resolve a matter rather than contest it, and as a consequence, the government can still use unsettled legal theories such as collective scienter as a legal basis for enforcement matters. Given the uncertain legal soundness of aggregate or collective scienter, the Committee Staff encourages enforcement authorities to abstain from using it as a basis for imposing liability.

²⁷ Restatement (Third) of Agency § 5.03, Comment d(2) (2006) (“[A] principal may not be subject to liability for fraud if one agent makes a statement, believing it to be true, while another agent knows facts that falsify the other agent’s statement. Although notice is imputed to the principal of the facts known by the knowledgeable agent, the agent who made the false statement did not do so intending to defraud the person to whom the statement was made.”).

²⁸ See, e.g., *U.S. v. Sci. Applications Int’l Corp.*, 626 F.3d 1257, 1274 (D.C. Cir. 2010) (holding that under the False Claims Act, collective knowledge is inappropriate to establish requisite scienter); *In re Apple Computer*, 127 F. App’x 296, 303 (9th Cir. 2005) (“A corporation is deemed to have the requisite scienter for fraud only if the individual corporate officer making the statement has the requisite level of scienter at the time that he or she makes the statement.”); *Aetos Corp. v. Tysons Food, Inc.* (In re Tysons Foods, Inc. Sec. Litig.), 155 F. App’x 53, 57 (3d Cir. 2005) (“Having concluded that there is no primary liability on the part of any of the individual officers, the District Court properly held that Tyson Foods could not itself be primarily liable under the facts of this case.”).

²⁹ *Sci. Applications Int’l Corp.*, 626 F.3d at 1274.

³⁰ *Aetos Corp.*, 155 F. App’x at 57.

³¹ Bradley J. Bondi, *Dangerous Liaisons: Collective Scienter in SEC Enforcement Actions*, 6(1) NYU J. OF L. & BUSINESS 1, 6 (2009).

II. The Government’s Tools and the Challenges of Holding Individuals Accountable

In this section, we examine the tools that the government has to identify misconduct and punish bad actors, whether they are individuals or firms. We find that there are certain unique challenges to pursuing individuals.

A. Investigative Powers and Tools

U.S. enforcement authorities have extraordinary powers to obtain information necessary to establish criminal and civil cases against individuals suspected of violating the law. Critically, the tools available to investigators are the same regardless of whether the investigative target is an individual or a firm. We describe some of the key tools in criminal and civil matters. While the tools in both types of matters allow the government to compel the production of information and materials, the particular tools differ based on whether the matter is criminal or civil.

In criminal investigations, the DOJ can establish grand juries to compel witnesses to provide testimony to the grand jury or to produce documents.³² Moreover, the DOJ can seek a search warrant from a federal magistrate judge based on probable cause that a crime has been committed. This enables investigators to obtain documents, records, property, electronically stored information and other evidence of a crime.³³

In fact, the government has shown a willingness to use all of its evidence gathering capabilities, as illustrated by its expanded use of wiretaps in criminal insider trading matters. In the investigation and 2011 trial of insider trading activities of Raj Rajaratnam and his hedge fund, Galleon, the DOJ used wiretaps in an insider trading case for the first time.³⁴ Rajaratnam, his hedge fund, and his associates were suspected of having traded on material non-public information from insiders at companies including IBM, Intel, and McKinsey & Co.³⁵ According to one study, the wiretaps captured 550 individual callers, over 18,000 phone calls and led not only to Rajaratnam’s conviction, but also to the indictment of twenty other individuals.³⁶

Civil enforcement authorities like the SEC, CFTC, CFPB and banking regulators also have powerful tools, albeit slightly different, to compel the production of information and materials in investigations. Specifically, civil enforcement authorities are authorized by statute to issue subpoenas to obtain relevant information in civil investigations,³⁷ which they can enforce by a

³² CHARLES DOYLE, CONG. RESEARCH SERV., RS 20214, FEDERAL GRAND JURIES: THE LAW IN A NUTSHELL, (2015), <https://fas.org/sgp/crs/misc/RS20214.pdf>.

³³ Fed. R. Crim. P. 41.

³⁴ Peter Lattman, *Rajaratnam Conviction Upheld by Appeals Court*, N.Y. TIMES (June 24, 2013), https://dealbook.nytimes.com/2013/06/24/rajaratnam-conviction-upheld-by-appeals-court/?_r=0 (“For the first time in an insider trading case inquiry, and most prominently in the Rajaratnam case, the authorities used wiretaps – a method typically reserved for drug trafficking and organized crime cases – to record the conversations of traders.”).

³⁵ HOWARD J. KAPLAN ET AL., THE HISTORY AND LAW OF WIRETAPPING 1 (2012), https://www.americanbar.org/content/dam/aba/administrative/litigation/materials/sac_2012/29-1_history_and_law_of_wiretapping.authcheckdam.pdf.

³⁶ *Id.* at 2, 5.

³⁷ *See, e.g.*, 15 U.S.C. §§ 77s(c), 78u(b), 80a-41(b), 80b-9(b); 12 U.S.C. § 1818(n); 12 U.S.C. §§ 5562-65.

court order if necessary. As a result of their legal powers, both criminal and civil investigators can obtain incriminating emails, text messages, and voicemails, and also obtain statements and testimony from witnesses that can help them build cases.

In addition to legal powers to compel the production of facts and evidence, the DOJ and civil enforcement authorities can pressure companies to provide information on culpable individuals by taking into account a company's cooperation in an investigation when determining whether to sanction the company and what sanctions to impose.

B. Remedies

As detailed in Chapter 2, U.S. enforcement authorities have a vast array of remedies available to them to craft the appropriate punishment given the unique facts of each case. These remedies are available against both individual and firm defendants and include monetary sanctions like civil monetary penalties,³⁸ disgorgement,³⁹ and restitution.⁴⁰ They also include non-monetary sanctions such as cease-and-desist orders,⁴¹ and industry bars.⁴²

³⁸ The SEC's general authority to seek civil monetary penalties for securities law violations is found in the following statutes: 15 U.S.C. §§ 77h-1(g), 77t(d), 78u(d), 78u-3(f), 80a-9(d), 80a-41, 80b-9, 80b-3. The CFTC's authority can be found at: 7 U.S.C. §§ 13a, 13a-1. The CFPB's authority can be found at 12 U.S.C. § 5565. FinCEN's authority is at 31 U.S.C. § 5321. OFAC's authority is found within the rules of each sanctions regime, for example at 31 CFR §§ 701-705 (Sudan sanctions penalties). The banking regulators can assess civil monetary penalties under numerous laws, including the National Bank Act, 12 U.S.C. § 93, laws governing savings associations, 12 U.S.C. § 504, laws governing state-member banks of the Fed, 12 U.S.C. §§ 504, 505, laws governing bank holding companies, 12 U.S.C. § 1847(b), and the Federal Deposit Insurance Act, 12 U.S.C. § 1818(i).

³⁹ 15 U.S.C. §§ 78u-3, 80a-9, 80b-3; Russell G. Ryan, *The Equity Façade of SEC Disgorgement*, HARV. BUS. L. REV., http://www.hblr.org/wp-content/uploads/2013/11/Ryan_The-Equity-Façade-of-SEC-Disgorgement.pdf; Francesco A. DeLuca, *Sheathing Restitution's Dagger under the Securities Acts*, 33 REV. BANKING & FIN. L. 899, 901 (2013-2014), https://www.bu.edu/rbfl/files/2014/03/RBFL-Vol-33.2_DeLuca.pdf; 7 U.S.C. § 13a-1; 12 U.S.C. §§ 5565, 1818(b)(6).

⁴⁰ 12 U.S.C. § 5565 (CFPB); 7 U.S.C. § 13a-1(d) (CFTC); 12 U.S.C. § 1818(b)(6) (authorizing banking regulators to seek restitution in conjunction with a cease-and-desist order where either (a) the depository institution or affiliated party was unjustly enriched in connection with the violation or (b) the violation or practice involved a reckless disregard for the law).

⁴¹ 12 U.S.C. § 1818(b) (banking regulators); 15 U.S.C. §§ 77h-1(a) (SEC cease-and-desist order to enforce the Securities Act), 78u-3 (SEC cease-and-desist to enforce Exchange Act), 80a-9(f) (SEC cease-and-desist order to enforce Investment Company Act), 80b-3 (SEC cease-and-desist order to enforce Investment Advisers Act); 7 U.S.C. § 13a (CFTC); 12 U.S.C. § 5565 (CFPB).

⁴² 15 U.S.C. §§ 77h-1(f), 77t(e), 78u-3(f), 78u(d), 78o, 80a-9(b); 7 U.S.C. § 13(b). In some instances, some remedies may actually only be available against individuals. For example, banking regulators have the power to remove individuals from officer or director positions at banks. 12 U.S.C. §§ 1829(a), 1818(e). Specifically, the FDIC, Fed, and OCC can remove an officer or director of a bank if that individual broke a law, engaged in or participated in an unsafe or unsound practice, or breached his or her fiduciary duties, if the bank suffers or is likely to suffer a financial loss and the conduct involved personal dishonesty or demonstrated willful or continuing disregard for the safety and soundness of the bank.

C. Challenges of Making Cases Against Individuals

There are factors that can make it challenging to bring a case against an individual even when an enforcement action has been resolved against a firm. Indeed, in the aftermath of the financial crisis, enforcement agencies reached settlements worth billions of dollars against large financial institutions, but generally did not bring corresponding cases against individuals. That is not because the settlements with institutions barred actions against individuals – they explicitly did not⁴³ – but rather because there are two practical difficulties enforcement authorities face when bringing cases against individuals. First, it can be more difficult to prove that an individual violated the law, as compared to a firm. Second, there are non-legal resource and political considerations that may drive enforcement authorities to seek settlements with firms in lieu of pursuing cases against individuals.

1. Difficulties in Proving an Individual’s Liability

It can be challenging to impose liability on individuals when knowledge or intent is an element of the offense. This is an especially difficult hurdle to meet in criminal cases. For example, to prove a fraud charge against high-level executives, prosecutors must be able to prove both that the individual knew of the fraudulent activity and, more so, that the individual had fraudulent intent (or *scienter*).⁴⁴

Knowledge and intent can be hard to prove against a particular individual because senior executives in an organization often do not know the details of decisions made by employees. Additionally, senior executives must often make decisions with limited facts and thus intent is often unclear even when senior executives are making decisions related to wrongful acts committed by the firm. For example, a disclosure document could be misleading, but the senior executive signing off on it may not have known the relevant facts making the disclosure misleading. As Deputy Attorney General Yates has stated, “[i]n large corporations, where responsibility can be diffuse and decisions are made at various levels, it can be difficult to determine if someone possessed the knowledge and . . . intent necessary to establish their guilt.”⁴⁵

One method that has been used to try to establish knowledge is the use of certifications. For example, in the aftermath of the Enron and WorldCom accounting scandals, Congress passed

⁴³ Press Release, U.S. Dep’t of Justice, Bank of America to Pay \$16.65 Billion in Historic Justice Department Settlement (Aug. 21, 2014), <https://www.justice.gov/opa/pr/bank-america-pay-1665-billion-historic-justice-department-settlement-financial-fraud-leading> (“The settlement does not release individuals from civil charges, nor does it absolve Bank of America, its current or former subsidiaries and affiliates or any individuals from potential criminal prosecution.”).

⁴⁴ See, e.g., 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/articles/2014/01/09/financial-crisis-why-no-executive-prosecutions/>. Intent is also required for establishing criminal liability under the securities laws. 15 U.S.C. §§ 77x, 78ff, 80a-48, 80b-17 (each of the Securities Act, Securities Exchange Act, Investment Company Act and Investment Advisers Act requiring a “willful[]” violation of the law).

⁴⁵ Sally Quillian Yates, Individual Accountability for Corporate Wrongdoing (Sept. 9, 2015), <https://www.justice.gov/archives/dag/file/769036/download>.

the Sarbanes-Oxley Act of 2002,⁴⁶ which includes requirements that the CEO and CFO of a public company certify the accuracy and completeness of periodic reports.⁴⁷ However, even violations of these provisions condition the certification on the officers' knowledge.⁴⁸

The diffusion of knowledge and information across a firm does not present the same challenge for establishing liability for the firm because of the aggregation theory previously discussed.⁴⁹ Under the aggregation or collective liability theory described earlier, a firm's intent can arguably be inferred when one person has knowledge attributable to the firm and another person engages in an act attributable to the firm, as in the car dealership example provided earlier in this chapter. This purported ability to aggregate conduct and knowledge could explain why large financial institutions would agree to large settlements but no individuals would be held accountable. As we discussed earlier, this theory of firm liability stands on questionable legal footing.

2. *Non-Legal Considerations*

Beyond factors grounded in the law, enforcement officials must make decisions about how to utilize their limited pool of resources and satisfy political pressure to demonstrate results. As a result, enforcement officials may be reluctant to bring anything but the most airtight cases in contested proceedings. And for the reasons described above, cases against individuals will generally be more difficult to prove and more often contested.

As a practical matter, enforcement agency resources are finite. Indeed, in the immediate aftermath of the financial crisis, Congress authorized \$70 million for the Department of Justice to spend on pursuing financial fraud cases in 2010 and 2011, but only ended up appropriating \$9.3 million in 2010 and \$0 in 2011.⁵⁰ In fiscal 2016, the SEC had an enforcement budget of \$528 million.⁵¹

The reality of finite resources forces enforcement agencies to choose how to allocate their budgets and staff to maximum effect. And cases against firms tend to be less resource-intensive than actions against individuals.⁵² First, the government can exert pressure on firms to conduct internal investigations to demonstrate cooperation with the government to receive better settlement terms, which can save the government money, time, and manpower.⁵³

⁴⁶ Pub L. 107-204, 116 Stat. 745.

⁴⁷ 15 U.S.C. § 7241; 18 U.S.C. § 1350.

⁴⁸ 15 U.S.C. § 7241(a)(2) (certification as to the completeness of the disclosure and fair presentation of financial information is "based on such officer's knowledge"); 18 U.S.C. § 1350 (imposing criminal penalties for an officer certifying that a periodic report fully complies with the Exchange Act only if the officer signs the certification "knowing" that the report does not comport with the requirements).

⁴⁹ *United States v. Bank of New England*, 821 F.2d 844, 856 (1st Cir. 1987).

⁵⁰ Daniel C. Richman, *Corporate Headhunting*, 8 HARV. L. & POL'Y REV. 265, 274 (2014).

⁵¹ U.S. SEC. & EXCH. COMM'N, FISCAL YEAR 2018 CONGRESSIONAL BUDGET JUSTIFICATION ANNUAL PERFORMANCE PLAN (2017), <https://www.sec.gov/files/secfy18congbudjust.pdf>.

⁵² Daniel C. Richman, *Corporate Headhunting*, 8 HARV. L. & POL'Y REV. 265, 273-74 (2014).

⁵³ *Id.* at 273.

Second, corporations are likely to settle enforcement cases quickly to avoid the loss of investor confidence and business disruption associated with prolonged government investigations and the possibility of prosecution.⁵⁴ As we noted earlier, over 90% of lost market value to firms from government enforcement actions can be attributable to reputational harm. A quick settlement that announces charges and simultaneously settles a matter minimizes the number of days the alleged wrongdoing receives attention. Furthermore, if firms were to contest a case, management would likely be distracted for a significant period of time because of the need to formulate a case strategy, continually consult with legal counsel, reassure clients, and prepare to testify at trial. In addition, firms that litigate enforcement actions face great uncertainty risk in the event they lose. For example, as we discussed in Chapter 2, there are frequently few guideposts for determining monetary sanction amounts and a firm could risk an exorbitant penalty were it to lose a litigated case. As well, a loss in a litigated case can have collateral consequences through mechanisms like automatic disqualifications that are easier to resolve through a structured and organized settlement process.

Third, as we detailed earlier, firms are pressured to settle criminal matters to prevent failure of the business and are pressured to settle civil matters to avoid the untenable position of antagonizing supervisory regulators.

Finally, enforcement officials also face political pressure from Congress and the public to produce results that can justify the funding that they receive,⁵⁵ which can influence enforcement priorities. For example, charging an individual defendant that is willing to go to trial can be politically risky because juries often desire a compelling narrative and blatant evidence of culpability.⁵⁶ Moreover, in certain instances when lower-level employees engage in clear wrongdoing, politics and optics could motivate agencies to target the firm rather than middle-class Americans.

⁵⁴ See Steven L. Schwarcz, *Excessive Corporate Risk-Taking and the Decline of Personal Blame*, 65 EMORY L.J. 533, 549 (2015) (describing how firms are more likely to settle “as a cost of doing business”); John C. Coffee, Jr., “No Soul to Damn: No Body to Kick”, 79 MICH. L. REV. 386, 403 (1981) (noting that “the accused corporation often cannot afford the time interval necessary to establish its innocence”).

⁵⁵ Margaret H. Lemos & Max Minzer, *For Profit Public Enforcement*, 127 HARV. L. REV. 853, 875-82 (2014); John C. Coffee, Jr., *SEC Enforcement: What Has Gone Wrong?*, THE CLS BLUE SKY BLOG (Jan. 2, 2013) (stating that the SEC needs to use metrics to justify its budget); Jonathan R. Macey, *The Distorting Incentives Facing the U.S. Securities and Exchange Commission*, 33 HARV. J. L. PUB. POL’Y 639, 643–45 (2010) (noting that the SEC is largely evaluated on the performance of the Enforcement Division, which focuses the agency on its enforcement statistics).

⁵⁶ Daniel C. Richman, *Corporate Headhunting*, 8 HARV. L. & POL’Y REV. 265, 270 (2014).

III. U.S. Enforcement Authorities' Emphasis on Individual Accountability

Although there are real challenges that enforcement officials face in identifying and penalizing illicit conduct by individuals, U.S. enforcement authorities have recognized the importance of individual accountability as is evident in the emphasis that they have placed on this issue in formal policies and public statements.

In this section, we first discuss the evolution of the DOJ's efforts to leverage the threat and risk of firm liability to build cases against culpable individuals and to emphasize individual accountability. We then explain the SEC's policy on prioritizing individual accountability. Next, we note recent statements and actions by the CFPB, OCC, and FinCEN emphasizing the importance of individual accountability in enforcement actions. Finally, we present data showing that enforcement actions against individuals constitutes a significant portion of overall enforcement actions.

A. The DOJ's Internal Policies Target Individuals

The DOJ has used its internal policies on the prosecution of corporations to develop ways to leverage the liability exposure of firms to gather evidence against individuals. Over time, DOJ internal policies have evolved to include explicit instructions to DOJ attorneys that in every case they should be seeking to develop a case against individual defendants. As the following discussion will show, the DOJ has always recognized the importance of prosecuting individuals, has revised its policies over time to enhance the ability of prosecutors to build cases against culpable individuals, and in 2015 made it expressly clear that individual accountability is its primary goal. We then provide a couple of prominent recent examples – foreign exchange and LIBOR rigging matters – in which the DOJ appears to have made an effort to prosecute individuals where misconduct occurred within financial institutions.

The first pertinent DOJ guidance was issued in 1999 by then-Deputy Attorney General Eric Holder (the “**Holder Memo**”).⁵⁷ It emphasized to DOJ lawyers the value of holding corporations accountable for wrongdoing, but also made clear that corporate prosecutions would *not* take the place of individual prosecutions. Specifically, the memo stated that while “[c]orporations should not be treated leniently,” prosecution of a corporation is not a “substitute” for the prosecution of criminally culpable individuals.

The Holder Memo sought to have DOJ lawyers use the threat of corporate liability to obtain information that could implicate culpable individuals. The Holder Memo detailed eight factors that prosecutors were to consider in deciding whether to charge a corporation: (1) the nature and seriousness of the offense; (2) the pervasiveness of wrongdoing within the corporation; (3) the corporation's history of similar conduct; (4) the corporation's timely and voluntary disclosure of

⁵⁷ Memorandum from Eric Holder, Deputy Att'y General, U.S. Dep't of Justice, to Heads of Dep't Components and U.S. Attorneys (June 16, 1999), <https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2010/04/11/charging-corps.PDF>.

wrongdoing and its willingness to cooperate in the investigation; (5) the existence and adequacy of the corporation’s compliance program; (6) the corporation’s remedial actions; (7) the collateral consequences of criminal charges; and (8) the adequacy of non-criminal remedies against the corporation.⁵⁸

Two of the above factors could be used to incentivize a corporation to help the DOJ build cases against culpable individuals. First, to determine the extent of a corporation’s cooperation in the fourth factor, the Holder Memo stated that prosecutors should take into account whether the corporation willingly identified the individual wrongdoers and disclosed the results of any internal investigation, including whether the corporation waived attorney-client and work product privileges in doing so.⁵⁹ The DOJ would also consider whether the corporation appeared to protect culpable employees by, among other things, advancing attorneys’ fees or providing them information through a joint defense agreement.⁶⁰ Thus, the DOJ could exert pressure on corporations to assist the DOJ in uncovering culpable individuals and building a case against those individuals. Second, in the remediation (sixth) factor, corporations could be given credit for internally disciplining wrongdoers because “[e]ffective internal discipline can be a powerful deterrent against improper behavior by a corporation’s employees.”⁶¹ This factor demonstrates that the DOJ focused not only on public retribution and punishment of individuals, but also accountability within the corporation.

In 2003, the Bush Administration issued a memo to replace the Holder Memo, which is referred to as the Thompson Memo, and put an even greater emphasis on individual accountability.⁶² For example, while the Thompson Memo reiterated the view that corporate prosecutions were appropriate, it directed that only “rarely should provable individual culpability not be pursued,” even when a corporation is held accountable.⁶³ In addition, the Thompson Memo added a ninth factor to consider in deciding whether to criminally charge a corporation – “the adequacy of the prosecution of individuals responsible for the corporation’s malfeasance” – though it did not elaborate any further on that factor.⁶⁴ This additional factor, however, implied that individual prosecutions could be sufficient and obviate a need for a corporate prosecution.

As discussed in the Committee’s 2006 report on improving U.S. capital markets, the Holder and Thompson Memos were criticized for putting pressure on corporations to waive attorney-client and work product privileges and for interfering with the ability of employees to receive legal defense funding from their employers.⁶⁵ The Thompson memo was therefore revised by two

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² Memorandum from Larry D. Thompson, Deputy Att’y General, U.S. Dep’t of Justice, to Heads of Dep’t Components and U.S. Attorneys (Jan. 20, 2003).

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ Memorandum from Paul J. McNulty, Deputy Att’y General, U.S. Dep’t of Justice, to Heads of Dep’t Components and U.S. Attorneys [hereinafter the McNulty Memo]; COMMITTEE ON CAPITAL MARKETS REGULATION, INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION 84-86 (2006), <http://www.capmksreg.org/wp-content/uploads/2016/10/Committees-November-2006-Interim-Report.pdf>; John Power, *Note – Show Me the*

memos issued in quick succession in 2006 and 2008 that rightly sought to address those concerns while still allowing prosecutors to pressure corporations to help identify culpable individuals.

The 2006 memo, referred to as the McNulty Memo, primarily revised guidance on how prosecutors should weigh a corporation's cooperation in an investigation. It limited the ability of prosecutors to request that attorney-client and work product privileges be waived by the corporation to instances where a "legitimate need" exists and required approval from the U.S. Attorney or the Deputy Attorney General to do so.⁶⁶ It also forbade prosecutors from taking into account whether the corporation advanced attorneys' fees to employees when assessing the firm's cooperation.⁶⁷

The 2008 memo, known as the Filip Memo, made further revisions in the same areas. Specifically, the memo provided that the DOJ's evaluation of a firm's cooperation would not consider whether the firm waived privilege or not, but would instead focus solely on whether the firm provided relevant information and evidence and identified culpable individuals.⁶⁸ As a result, These were balanced changes that continued DOJ efforts to leverage corporate liability to build cases against individuals while protecting attorney-client and work product privileges.

The DOJ issued its most recent guidance in a 2015 memorandum by Deputy Attorney General Sally Yates, which for the first time squarely instructed DOJ attorneys to make individual accountability the department's top priority. The Yates Memo instructed its attorneys: (1) to focus investigations on individuals from their inception; (2) to establish plans for resolving cases against individuals *before* a case against a corporate defendant is resolved; and (3) in civil cases, to look beyond an individual's ability to pay when deciding whether to bring a case to seek civil penalties.⁶⁹ The U.S. Attorney Manual guidelines were revised in November 2015 to reflect the contents of the Yates Memo and now require investigations to "focus on wrongdoing by individuals from the very beginning of the investigation" and to consider whether "charges against the individuals responsible for the corporation's malfeasance" will satisfy prosecutorial objectives before bringing charges against a corporation.⁷⁰ This policy has been left in place by the current administration.

There are two prominent examples, the foreign exchange and LIBOR rigging matters, that demonstrate that the DOJ is indeed prioritizing individual accountability in addition to firm liability.

Money: The Thompson Memo, Stein, and an Employee's Right to the Advancement of Legal Fees Under the McNulty Memo, 64 WASH. & LEE L. REV. 1205, 1207 (2007) (noting the controversy created by the Thompson Memo's position that the advancement of legal fees could be a factor in charging a corporation).

⁶⁶ McNulty Memo, *supra* note 65, at 9–11.

⁶⁷ *Id.* at 11.

⁶⁸ Memorandum from Mark Filip, U.S. Dep't of Justice, to Heads of Dep't Components and U.S. Attorneys, 7-11 (Aug. 28, 2008).

⁶⁹ Sally Quillian Yates, Deputy Att'y General, U.S. Dep't of Justice, to Heads of Dep't Components and U.S. Attorneys (Sept. 9, 2015), <https://www.justice.gov/archives/dag/file/769036/download>.

⁷⁰ U.S. ATTORNEYS' MANUAL §§ 9-28.010, 9-28.1300.

In May 2015, the DOJ obtained guilty pleas from five large financial institutions for conspiring to manipulate the price of the U.S. dollars and euros exchanged in the foreign currency exchange spot market resulting in criminal fines of more than \$2.5 billion.⁷¹ The banks acted in concert by using an electronic chat room and coded language.⁷² They manipulated the market in at least two ways. First, they coordinated trading efforts to manipulate the benchmark rates set at 1:15pm and 4:00pm that are used to price orders for many large customers.⁷³ Second, they would agree at certain times not to buy or sell, to avoid moving prices in a direction adverse to the other conspirators.⁷⁴ In addition to guilty pleas from the five institutions, the DOJ has also obtained guilty pleas from two former traders from Citigroup and Barclays,⁷⁵ and has indicted three traders, one each from JP Morgan, Citigroup and Barclays whose cases are pending.⁷⁶ Those three traders were also fined over \$11 million by the Federal Reserve and Office of the Comptroller of the Currency.⁷⁷ A sixth trader from UBS has been assisting prosecutors to build their cases.⁷⁸

The DOJ has also pursued criminal charges against individuals in the LIBOR rigging matter. LIBOR is a benchmark rate that reflects the rates at which banks make unsecured loans to each other.⁷⁹ It is used as a base rate for setting interest rates that consumers and businesses pay on term loans, auto loans, and mortgages.⁸⁰ LIBOR is set by a panel of global banks that submit their cost of borrowing to Thompson Reuters data collection service at 11:00am each morning.⁸¹ In the LIBOR rigging matter, the rate was manipulated by the submission of false borrowing costs to the data collection service.⁸² Global fines by regulators around the world against banks have totaled \$9 billion, and the DOJ has indicted at least 16 individuals.⁸³

B. The SEC's Emphasis on Individuals

In 2006, the SEC adopted guidelines stating that penalizing the responsible individuals as opposed to the company is preferable where penalizing the company will not increase the deterrent

⁷¹ Press Release, U.S. Dep't of Justice, Five Major Banks Agree to Parent-Level Guilty Pleas (May 20, 2015), <https://www.justice.gov/opa/pr/five-major-banks-agree-parent-level-guilty-pleas>.

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.* The traders referred to themselves as "The Cartel."

⁷⁵ Suzi Ring & David McLaughlin, *FX 'Cartel' Traders Said to Inch Closer Toward Deal to Face U.S. Trial*, BLOOMBERG (June 1, 2017), <https://www.bloomberg.com/news/articles/2017-06-01/fx-cartel-traders-said-to-inch-toward-deal-to-face-u-s-trial>.

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ James McBride, *Understanding the Libor Scandal*, COUNCIL ON FOREIGN RELATIONS (Oct. 12, 2016), <https://www.cfr.org/backgrounder/understanding-libor-scandal>.

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.* The DOJ's conviction of two traders, Anthony Allen and Anthony Conti, was recently overturned by the Second Circuit Court of Appeals because the conviction hinged, to a large measure, on testimony by a witness who had been exposed to coerced statements made by the defendants in the United Kingdom. The appeals court held that on the facts of the case, the defendants' Fifth Amendment right against self-incrimination was violated. *See United States v. Allen*, No. 16-898, slip. op. (2nd Cir. July 19, 2017).

effect of the enforcement action.⁸⁴ Such a prioritization is consistent with a statement that then-Chair White made in a 2016 speech that individual accountability is a “core pillar” of an enforcement system and is a priority of the agency.⁸⁵

Like the DOJ, there are prominent examples of the SEC pursuing charges against individuals where it has also targeted a firm. One such example is the SAC Capital case, which the SEC dubbed as potentially the largest insider trading scheme ever pursued. In that matter, the SEC alleged that a professor at the University of Michigan Medical School, who was a consultant for an expert network, tipped off a hedge fund run by CR Intrinsic Investors (an affiliate of Steven A. Cohen’s SAC Capital) ahead of negative news about a drug trial.⁸⁶

The SEC sued the hedge fund, the professor, and Mathew Martoma, a portfolio manager at the hedge fund.⁸⁷ The SEC settled with both the professor (the tipper) and CR Intrinsic Investors, including a civil penalty of \$601.7 million against the hedge fund. Its civil litigation against Martoma is still underway.⁸⁸ The SEC also settled with Steven A. Cohen by prohibiting him from managing money other than his own for approximately two years.⁸⁹ Martoma was also criminally indicted by the DOJ in 2012, was convicted by a jury in 2014 and was sentenced to nine years in prison.⁹⁰ Martoma appealed his conviction, which was upheld by a Second Circuit panel in 2017.⁹¹

C. Data Shows that the Government Does Target Individuals

Data trends analyzed by the Committee Staff show that enforcement authorities take individual accountability seriously, although it is not possible to make normative conclusions from the data about whether enforcement authorities are optimally prioritizing cases against individuals.

1. Independent Data Analysis of Civil Regulator Enforcement Actions

Our collection and analysis of case-level enforcement action data from 2000 until 2016 demonstrates that regulators have brought a significant portion of their cases against individuals and there appears to be a trend in the past seven to eight years of an increasing percentage of cases being brought against individuals.

⁸⁴ Statement of the U.S. Sec. & Exch. Comm’n, *Concerning Financial Penalties* (Jan. 4, 2006), <https://www.sec.gov/news/press/2006-4.htm>.

⁸⁵ Mary Jo White, Chair, U.S. Sec. & Exch. Comm’n, *A New Model for SEC Enforcement: Producing Bold and Unrelenting Results* (Nov. 18, 2016), <https://www.sec.gov/news/speech/chair-white-speech-new-york-university-111816.html>.

⁸⁶ Steve Goldstein, *SEC Alleges Largest-Ever Insider-Trading Scheme*, MARKETWATCH (Nov. 20, 2012), <http://www.marketwatch.com/story/sec-alleges-largest-ever-insider-trading-scheme-2012-11-20>.

⁸⁷ U.S. Sec. & Exch. Comm’n, Litigation Release 23133 (Nov. 14, 2014), <https://www.sec.gov/litigation/litreleases/2014/lr23133.htm>.

⁸⁸ *Id.*

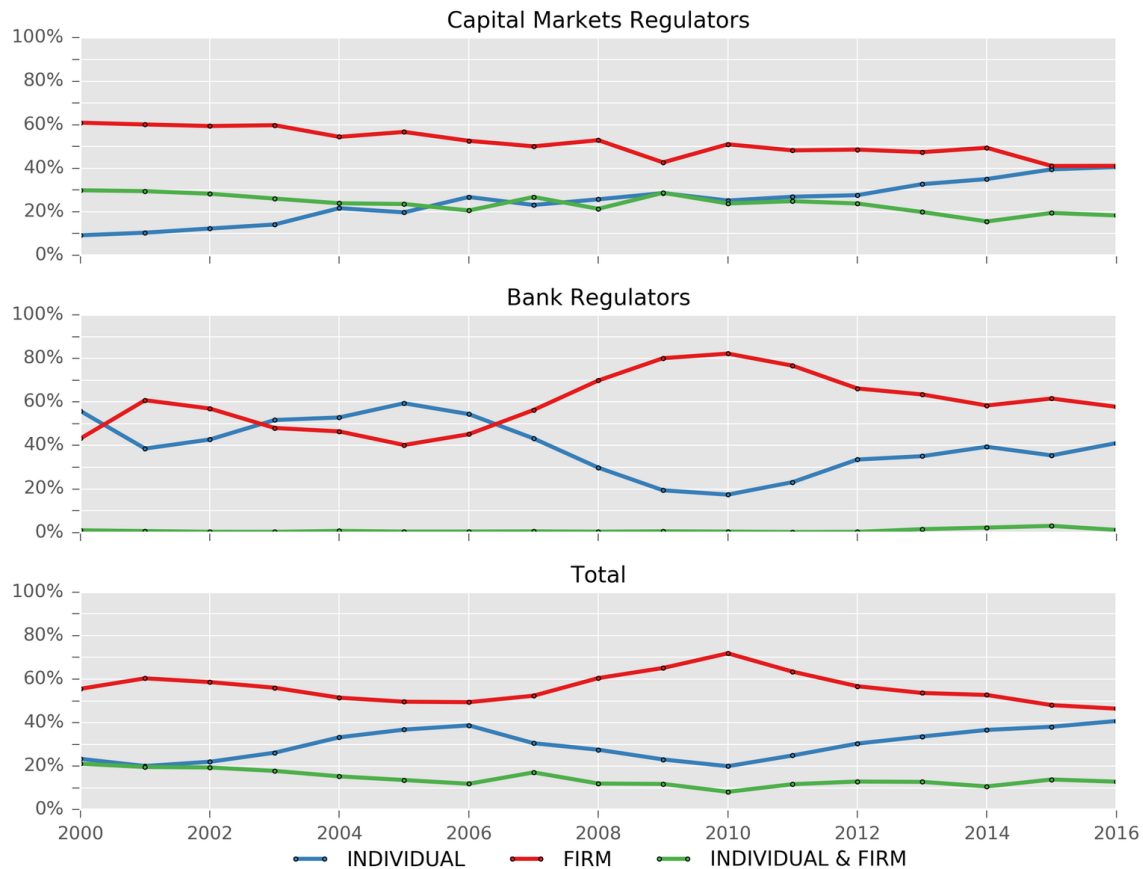
⁸⁹ Press Release, U.S. Sec. & Exch. Comm’n, Stephen A. Cohen Barred from Supervisory Hedge Fund Role (Jan. 8, 2016), <https://www.sec.gov/news/pressrelease/2016-3.html>.

⁹⁰ Matthew Goldstein, *Martoma Starts Serving 9-Year Sentence for Insider Trading*, N.Y. TIMES (Nov. 21, 2014), https://dealbook.nytimes.com/2014/11/21/martoma-starts-serving-9-year-sentence-for-insider-trading/?_r=0.

⁹¹ Alexandra Stevenson, *Mathew Martoma’s Insider Trading Conviction is Upheld*, N.Y. TIMES (Aug. 23, 2017), <https://www.nytimes.com/2017/08/23/business/dealbook/mathew-martoma-insider-trading-conviction-upheld.html>

As **Figure 4.1** shows, the percentage of enforcement actions brought by both capital markets (SEC and CFTC) and banking regulators (FDIC, OCC, Fed, and CFPB) against individuals has markedly increased in recent years. Indeed, the percentage of actions that capital markets and banking regulators have *collectively* brought against individuals has steadily increased since 2010 and is now at its highest point for our data period. **Figure 4.1** also shows that the percentage of enforcement actions that capital markets regulators have brought against individuals, not firms, has steadily increased throughout our data period and was at its highest point as of 2016. Similarly, the percentage of enforcement actions by bank regulators against individuals has also significantly risen in recent years, approximately doubling from 20% of cases in 2010 to 40% of cases in 2016.

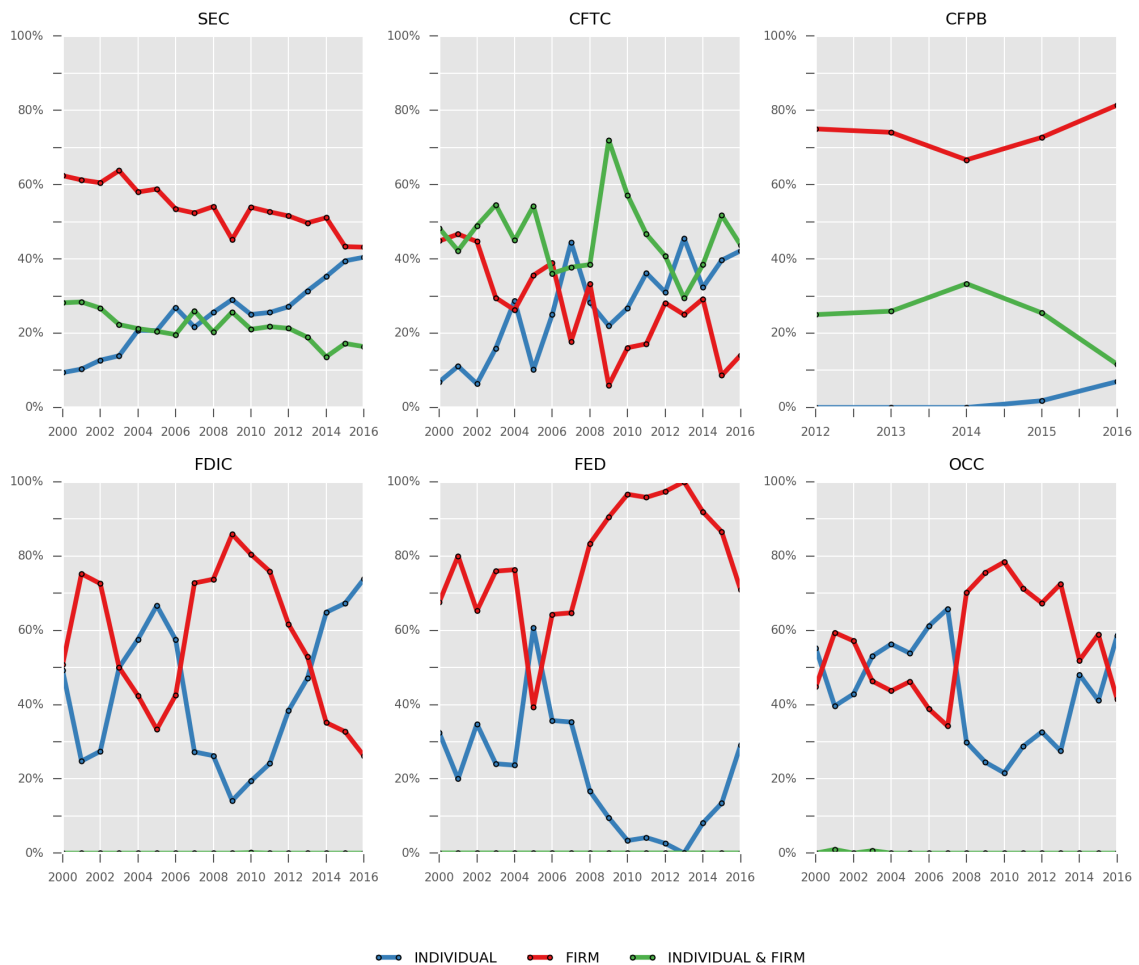
Figure 4.1: Percentage of Enforcement Actions Initiated Per Year by Defendant Type



Breaking out the case-level data even further on an agency-by-agency basis further illustrates this trend as shown on the next page in **Figure 4.2**. For example, the percentages of SEC cases involving individual defendants has steadily risen from roughly 40% in 2002 to approximately 60% in 2016. Likewise, in 2016, the FDIC brought over 70% of its formal enforcement actions against individuals, the highest percentage from 2001 through 2016 and a

significant increase from a low of around 15% in 2009. The proportion of OCC enforcement actions against individuals has also increased in recent years: these actions constituted about 20% of cases in 2010 and rose to almost 60% in 2016.

Figure 4.2: Percentage of Enforcement Actions Initiated Per Year by Defendant Type



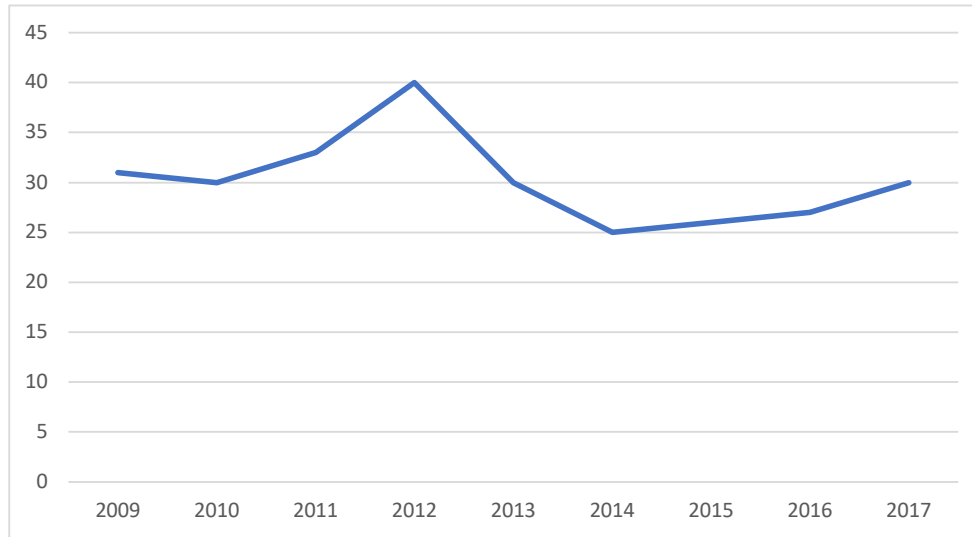
2. Additional Data on DOJ Enforcement

Although the DOJ does not produce annual statistics on the proportion of criminal or civil cases it brings against individuals or firms in the areas of the law relevant to this Report, a review of insider trading enforcement activity shows that the crime, which almost always involves the prosecution of individual defendants,⁹² has remained a focus of the DOJ over time.

⁹² Indeed, in the Committee Staff’s review of DOJ press releases of insider trading cases from 2009 through 2017 found only two cases involving firm defendants rather than individual defendants.

We searched DOJ and U.S. Attorney press releases archived online and developed a data set on insider trading from 2009 to the present.⁹³ **Figure 4.3** below shows that in the aftermath of the financial crisis, the DOJ steadily brought more insider trading cases (all against individuals) from 2009 through 2012.

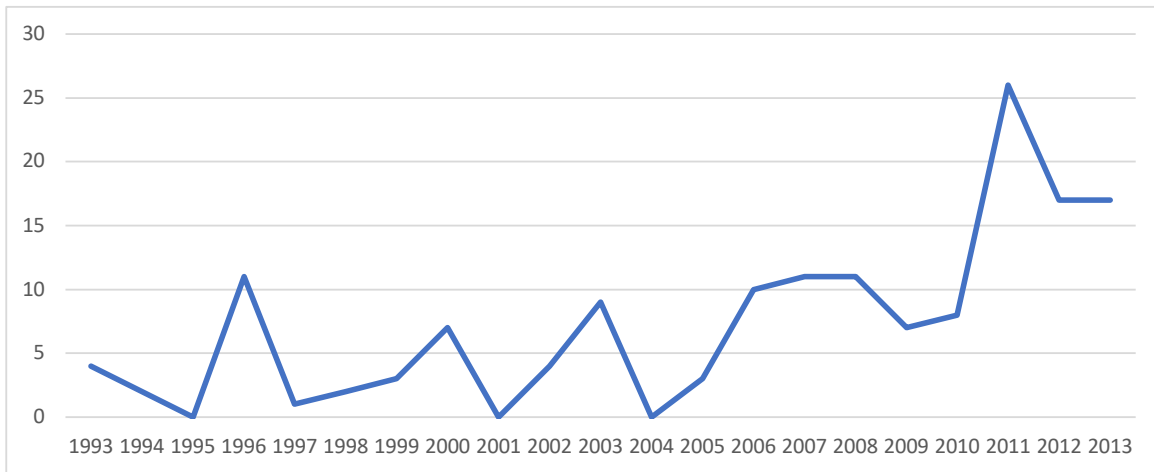
Figure 4.3: Number of Insider Trading Indictments Per Year



Data gathered by the *Wall Street Journal* from 1993 to 2013 on the number of insider trading case sentences in the Eastern and Southern Districts of New York is also illustrative. **Figure 4.4** shows a sharp spike in sentences of guilty defendants after 2009.

⁹³ Prior to 2009, DOJ and U.S. Attorneys’ Offices do not appear to reliably issue or post press releases online.

Figure 4.4: Number of Insider Trading Sentences Per Year



To allow the public to better understand the extent to which the DOJ prosecutes individuals for crimes pertinent to the capital markets and financial system, the DOJ should provide more useful information to the public. Current annual reports released by the Executive Office of the U.S. Attorneys provide an annual number of “white collar” cases brought, but that is comprised of numerous sub-categories of crimes such as “bankruptcy fraud,” “insurance fraud,” “securities fraud,” and “tax fraud” that could have been committed by an ordinary person, a high-level executive, or even a corporation. No distinction is made between cases brought against financial professionals or high-ranking business officials and “Joe Smith’s” fraudulent tax return filing or cases brought against firms.

- **Recommendation 17:** The DOJ should publish annual statistics analyzing trends of criminal actions against financial professionals. Useful data would disclose the annual number of cases brought and average and median penalties imposed in categories of white-collar crimes committed by officers and directors of firms and gatekeepers such as lawyers and accountants.

IV. Promoting Individual Accountability through Effective Compliance Programs

We believe that it is appropriate to consider if there are ways to allow the government to better prevent individual misconduct and to bring more effective cases against culpable individuals. Indeed, we agree with former SEC Chair White’s suggestion that “we have to think outside the box of our current laws.”⁹⁴

First, we consider proposals to lower the standard of liability. Specifically, we explore a possible expansion of liability for executives and directors mirrored on the U.K. Senior Manager’s Regime, which imposes personal liability on high-level officers and directors who act negligently in ensuring legal compliance within their firms. We also explore the possibility of subjecting executive compensation to forfeiture for corporate wrongdoing such that executives would directly bear some costs when their firms pay penalties. We identify concerns that those proposals would result in excessive government intrusion on business decisions.

Instead, we propose that enforcement authorities adopt an affirmative compliance defense for firms that adopt adequate compliance programs, fully disclose individual wrongdoing, and cooperate with government investigations of individuals. We believe such a policy should help prevent misconduct and increase the probability of the government being able to build a strong case against culpable individuals and conserve limited enforcement resources.

A. Expanded Liability Mirrored on the U.K. Senior Managers Regime

Former SEC Chair White, has said that the U.S. should carefully study the U.K.’s recently implemented regime known as the Senior Managers Regime.⁹⁵ We agree. The U.K. Senior Managers Regime is notable because it imposes a *negligence*-based standard for culpability, which means that it considers whether an individual has acted *reasonably*. Other than some exceptions that we detailed earlier in the chapter, U.S. law generally applies an intent standard for individual culpability.⁹⁶

The Senior Managers Regime currently governs the U.K. operations of U.K. banks and covers the U.K. operations of all U.K. domiciled financial services companies, including U.K. subsidiaries of U.S. or E.U. bank holding companies.⁹⁷ The Regime is civil in nature⁹⁸ and

⁹⁴ Mary Jo White, Chair, U.S. Sec. & Exch. Comm’n, *A New Model for SEC Enforcement: Producing Bold and Unrelenting Results* (Nov. 18, 2016), <https://www.sec.gov/news/speech/chair-white-speech-new-york-university-111816.html> (stating that the U.S. should “at a minimum” closely monitor the U.K.’s new Senior Manager Regime).

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ One exception is in the event of a failure of a financial institution. If a financial institution fails, senior executives could be criminally prosecuted if the executive is aware that he made a decision that could cause the institution to fail where the executive’s conduct falls “far below what could reasonably be expected” of a person in his position, and the implementation of the decision did cause the institution to fail. HOGAN LOVELLS, *CRIMINAL LIABILITY FOR BANK DIRECTORS? A LOOK AT THE UNITED KINGDOM AND SOUTH AFRICA* (2015),

violation of the law can result in financial penalties, as well as public censure and suspension of an individual from the industry.⁹⁹ The Senior Manager Regime has three key components.

First, the U.K. law identifies those individuals who are “senior managers,” including a firm’s chief executive officer, chief risk officer, and chief financial officer, as well as certain board members, such as the lead independent director and chairman of the board.¹⁰⁰ Second, the law identifies certain responsibilities that the firm must assign to one of the senior managers of the firm.¹⁰¹ These include responsibilities such as the management and allocation of the firm’s capital, the firm’s treasury management function, and the production and integrity of the firm’s financial information.¹⁰² Third, the senior manager who is assigned to a particular responsibility must take “reasonable steps” to prevent regulatory breaches in the area or areas of responsibility that they have been assigned.¹⁰³ If they do not take reasonable steps (a standard that is not yet well-defined), and a regulatory breach occurs in a senior manager’s area of responsibility, he or she is subject to civil liability.

The Committee Staff is concerned about the consequences of following the path the U.K. has adopted.

One concern is that adoption of the U.K. approach would place government officials in the role of second-guessing business decisions about the appropriate investment of time or resources by a senior manager to supervise a particular function of the firm. In other words, the government would be able to impose liability for simply disagreeing with a manager’s considered judgment.¹⁰⁴ That would run contrary to the historical U.S. approach, to defer to corporate boards and officers. In the corporate law context, for example, the business judgment rule usually governs, which provides that a court presumes directors and officers act on an informed basis and in good faith. So long as the presumption is not rebutted, a director or officer is insulated from liability to the corporation for a business decision if the decision had a rational business purpose.¹⁰⁵

The U.K.’s negligence standard, by contrast, imposes liability even if the manager acted in an informed manner and in good faith, but did not act *reasonably*. This would give officials with

<https://www.hoganlovells.com/en/publications/criminal-liability-for-bank-directors-a-look-at-the-united-kingdom-and-south-africa>.

⁹⁹ See FIN. CONDUCT AUTH., DECISION PROCEDURE AND PENALTIES MANUAL, §§ 6.1–6.7, 6A.1–6A.4, (Aug. 2017), <https://www.handbook.fca.org.uk/handbook/DEPP.pdf>.

¹⁰⁰ See SHEARMAN & STERLING LLP, IMPLEMENTATION ISSUES ARISING FROM THE REVISED UK SENIOR MANAGER AND CERTIFICATION REGIME 2, 10 (2015).

¹⁰¹ *Id.*

¹⁰² *Id.* at 8.

¹⁰³ *Id.*

¹⁰⁴ A more extreme expansion of liability risk for top executives has been proposed by the Special Inspector General for the Troubled Asset Relief Program to require certain executives to certify that no criminal or civil misconduct has been committed or is ongoing in their organizations. See SIGTARP, A Proposal from the Special Inspector General for TARP to Counter the Ongoing and Evolving Threat of Financial Institution Fraud, n.2, <https://www.sig tarp.gov/Pages/Proposal.aspx>.

¹⁰⁵ See *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984); *Am. Soc’y for Testing & Materials v. Corpro Cos.*, 478 F.3d 557, 572 (3d Cir. 2007).

vast prosecutorial discretion the ability to second-guess business decisions. Managers might feel compelled to extensively document the rationale for their business decisions or to seek opinion of legal counsel in connection with ordinary business matters, to stave off possible future second guessing by government authorities. Either could negatively impact business decision-making.

Another concern is that imposing broader negligence-like liability would also likely make it difficult for companies to find qualified individuals to serve as officers and directors.¹⁰⁶ Moreover, U.S. shareholders have repeatedly expressed a desire not to expand liability of directors and officers, as they have consistently voted to amend corporation's constituent documents to eliminate director liability.¹⁰⁷

B. Subjecting Executive Compensation to Clawbacks

Another possible approach to increasing individual accountability is to require that executives and directors directly bear the cost of misconduct within their firms by subjecting their compensation to forfeiture in the event the firm pays a penalty for wrongdoing within the firm. This could be accomplished by mandating that companies clawback executive or director compensation in light of a triggering event, such as the payment of a penalty by the firm. In effect, doing so would impose a form of strict liability on the executives or directors covered by a clawback policy because they could be forced to pay back compensation even if they were not in any way involved with the legal violation.

As discussed earlier in this chapter, the SEC is authorized to clawback incentive compensation of CEOs and CFOs if a public company restates financial results because of a material error in the financial statements resulting from misconduct by someone within the company. Furthermore, under the Dodd-Frank Act, the SEC has been instructed to adopt rules requiring companies to develop policies about when the company itself would seek to clawback compensation from its executive officers in the event of a financial restatement.¹⁰⁸ However, the SEC has not finalized a rule and doing so is not on its rulemaking agenda.¹⁰⁹ Of course, this policy could be expanded beyond financial restatements to any wrongdoing within a firm. Indeed, studies

¹⁰⁶ See, e.g., Assaf Hamdani & Reinier Kraakman, *Rewarding Outside Directors* 15 (John M. Olin Ctr. For Law, Econ., and Bus., Discussion Paper No. 578, 2007), http://www.law.harvard.edu/programs/olin_center/papers/pdf/Kraakman_Hamdani_578.pdf.

¹⁰⁷ See Lawrence Hamermesh, *Why I Do Not Teach Van Gorkom*, 34 GA. L. REV. 477, 490 (2000) (finding that when surveying 100 Fortune 500 companies, 98% incorporated in jurisdictions allowing for exculpatory provisions in the corporation's charter adopted such provisions).

¹⁰⁸ Pub. L. No. 111-203, § 954, 124 Stat. 1376, 1904 (2010).

¹⁰⁹ See Jay Clayton, Chair, U.S. Sec. & Exch. Comm'n, Opening Remarks at the Securities Regulation Institute (Jan. 22, 2018), <https://www.sec.gov/news/speech/speech-clayton-012218> (noting that some companies have voluntarily adopted clawback policies that go beyond the requirements of the Dodd-Frank Act and that SEC rulemaking priorities should reflect such developments); Office of Info. & Reg. Affairs, U.S. Sec. & Exch. Comm'n Agency Rule List – Spring 2018, https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCd=3235&Image58.x=58&Image58.y=9 (last visited May 18, 2018).

have shown that clawback policies may reduce the incidence of accounting restatements and may be value enhancing for shareholders.¹¹⁰

Although public companies are not currently required to have clawback policies, they have increasingly adopted them and expanded their scope beyond accounting issues. For example, a 2016 report by Meridian Compensation Partners found that of 250 large publicly traded companies surveyed, 93% disclosed a clawback policy in 2016 compared to 75% in 2011.¹¹¹

A related concept to a clawback is the requirement that executives and directors post part of their compensation as a bond that would be subject to forfeiture to pay for penalties incurred by their institution. William Dudley, for example, suggested that a component of executive compensation should be deferred for around a decade and be used as a type of “performance bond” that could be drawn upon to pay portions of monetary sanctions imposed in enforcement actions for unlawful activity at the firm.¹¹²

We agree that clawbacks or forfeiture of compensation can play a valuable role in deterrence by incentivizing executives and directors to prioritize compliance within the firm. To a limited extent, it could also help reduce the cost of any wrongdoing to innocent shareholders by requiring executives or directors to bear some of the cost of the penalty themselves. However, we do not believe the government should be granted additional powers to require the clawback or forfeiture of compensation more broadly at this time.

First, doing so would pose the same problems identified with the U.K. Senior Managers Regime. The government could be involved in second guessing business decisions. For example, a government mandate that companies adopt clawback policies might include provisions that the government could penalize a company or its board if the clawback policy was not appropriately implemented. Given that the decision about whether to seek to clawback compensation in a particular situation would involve an exercise of discretion and judgment by the board, the government could second guess a board decision not to pursue a clawback. In addition, qualified individuals may be more reluctant to take positions as officers or directors at firms that are mandated to clawback compensation.

Second, clawback policies are inherently complex and the government is not well positioned to dictate specific terms of clawback arrangements. Clawback issues include: what

¹¹⁰ Lilian H. Chan, et al., *The Effects of Firm-Initiated Clawback Provisions on Earnings Quality and Audit Behavior*, 54 J. ACCOUNTING & ECONOMICS 180, 180-96 (2012). *But see* Diane K. Denis, *Mandatory Clawback Provisions, Information Disclosure, and the Regulation of Securities Markets*, 54 J. ACCOUNTING & ECONOMICS 197, 197-200 (2012) (noting that restatements may fall if executives are reluctant to find that a restatement is required); Tor Erik Bakke, et al., *Do Clawbacks Have Claws? The Value Implications of Mandatory Clawback Provisions* (2017), https://wpcarey.asu.edu/sites/default/files/aazam_virani_seminar_march_31_2017.pdf.

¹¹¹ MERIDIAN COMPENSATION PARTNERS, LLC, 2016 CORPORATE GOVERNANCE & INCENTIVE DESIGN SURVEY 21 (Fall 2016).

¹¹² William C. Dudley, President and Chief Executive Officer, Fed. Reserve Bank of N.Y., *Enhancing Financial Stability by Improving Culture in the Financial Services Industry* (Oct. 20, 2014), <https://www.newyorkfed.org/newsevents/speeches/2014/dud141020a.html>.

compensation should be subject to clawback; what actions might trigger a clawback; exactly which officers and directors should be subject to a clawback in specific scenarios; and what discretion the board should have to waive its right to seek a clawback. Given the numerous details that must be worked out in each instance, the extent to which executive compensation should be subject to clawback is a matter most appropriately left to shareholders, directors, and management. Indeed, there is already a movement underway at public companies to adopt clawback policies and these clawback policies have been exercised effectively in recent cases.¹¹³ Leaving the issue of clawbacks to boards, management, and shareholders would allow for a diversity of approaches across firms and experimentation rather than a top-down, one-size fits all approach. Thus, we believe the marketplace should dictate how clawback policies are adopted, implemented, and enforced.

C. Promoting Individual Accountability Through an Affirmative Defense

The Committee Staff believes that individual accountability can be promoted by encouraging and incentivizing firms to develop robust compliance programs that seek to prevent, identify, disclose and punish individual wrongdoing. We believe that this would help the government identify culpable individuals and build cases against them, while allowing the government to conserve and more efficiently use the finite enforcement resources at its disposal.

- **Recommendation 18:** An affirmative compliance and cooperation defense should be established in the United States to further promote effective compliance programs and harness their strengths to help identify and prevent individual misconduct. A successful application of the defense should require that the firm establish that the compliance procedures meet a baseline of reasonableness; and the firm promptly, transparently, and wholly disclosed known violations and all non-privileged relevant information uncovered during an internal investigation or review.

This section will: (1) explain that such a policy arises naturally out of the government’s focus on compliance and voluntary disclosure; (2) discuss why compliance and disclosure programs can help hold individuals accountable; and (3) lay out some of the key attributes of the affirmative defense.

1. The Proposal Flows Naturally Out of the Government’s Emphasis on Compliance Programs and Voluntary Disclosure

Effective compliance programs and firm cooperation with regulators already play a critical role in the U.S. public enforcement regime and in determining the legal consequences that a firm will face due to an employee’s misconduct.

¹¹³ Press Release, Wells Fargo Board Releases Findings of Independent Investigation of Retail Banking Sales Practices and Related Matters (Apr. 10, 2017), <https://newsroom.wf.com/press-release/community-banking-and-small-business/wells-fargo-board-releases-findings-independent> (noting that Wells Fargo had clawed back more than \$130 million in compensation from two executives).

The “presence or absence of compliance programs” is one of the thirteen factors that the OCC, FDIC, Fed, and NCUA are expected to consider when evaluating the appropriateness of civil monetary penalties.¹¹⁴ This factor is also incorporated into certain of these agencies’ penalty matrices, so that it is expressly taken into account in calculating the penalty that is assessed in a given situation.¹¹⁵

Similarly, several of the “factors to be considered” by prosecutors in determining whether to charge a corporate defendant under the DOJ’s Principles of Federal Prosecution of Business Organizations relate to the adequacy of a firm’s compliance program. These include: (1) “the pervasiveness of wrongdoing within the corporation, including the complicity in, or the condoning of, the wrongdoing by corporate management”; (2) “the existence and effectiveness of the corporation’s pre-existing compliance program”; and (3) “the corporation’s remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one....”¹¹⁶

A firm’s cooperation with investigators and voluntary disclosure of wrongdoing are also factors that some authorities consider in determining whether to bring a case or the appropriate penalty to impose if a case is brought. The FFIEC policy statement, for example, identified as relevant factors both “[t]he failure to cooperate with the agency in effecting early resolution of the problem” and “voluntary disclosure” of the violation.¹¹⁷

As discussed in detail in Part I, the DOJ considers the extent of a firm’s cooperation in deciding whether to bring charges in criminal matters. Under the Principles of Federal Prosecution of Business Organizations, the DOJ may decline to bring a case against a corporation if the corporation provides the DOJ with “all relevant facts” with respect to culpable individuals,¹¹⁸ thus leveraging corporate resources to assist in prosecuting the persons responsible for unlawful acts.

Additionally, just this past September, the CFTC’s Division of Enforcement released an Enforcement Advisory¹¹⁹ on voluntary disclosures of wrongdoing and the “substantial credit companies and individuals can expect from the Division if they voluntarily disclose misconduct

¹¹⁴ See Chapter 2, II.B.3, *supra*.

¹¹⁵ See, e.g., *id*.

¹¹⁶ U.S. ATTORNEYS’ MANUAL § 9-28.300.

¹¹⁷ FFIEC, Assessment of Civil Monetary Penalties, 63 Fed. Reg. 30,226 (June 3, 1998), <https://www.gpo.gov/fdsys/pkg/FR-1998-06-03/pdf/98-14611.pdf>.

¹¹⁸ U.S. ATTORNEYS’ MANUAL § 9.28-700.

¹¹⁹ U.S. COMMODITY FUTURES TRADING COMM’N, COOPERATION FACTORS IN ENFORCEMENT DIVISION SANCTION RECOMMENDATIONS FOR COMPANIES (last accessed Oct. 27, 2017), <http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfadvisorycompanies011917.pdf>; U.S. COMMODITY FUTURES TRADING COMM’N, COOPERATION FACTORS IN ENFORCEMENT DIVISION SANCTION RECOMMENDATIONS FOR INDIVIDUALS (last accessed Oct. 27, 2017), <http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfadvisoryindividuals011917.pdf>.

and fully cooperate with the Division’s investigation.”¹²⁰ The CFTC believes that the Updated Advisory promotes two objectives: (1) increasing voluntary compliance with laws by encouraging detection, reporting, and remediation of misconduct; and (2) enhancing the Enforcement Division’s ability to prosecute wrongdoers.¹²¹

According to the CFTC’s Advisory, a business organization must satisfy three key requirements for self-reporting and cooperation: (1) “voluntary disclosure” of the violation to the Enforcement Division; (2) “full cooperation”; and (3) “timely and appropriate remediation of flaws in compliance and control programs.”¹²² If a company fulfills each of these three requirements, the Division will recommend a “substantial reduction in the civil monetary penalty that would otherwise be.”¹²³

In addition, the SEC took a narrow but important step in February 2018 when it announced its Share Class Selection Disclosure Initiative. Under the initiative, certain investment advisers that effectively charge clients excessive fees can avoid civil monetary penalties if they voluntarily self-report the violation and pay the client any ill-gotten gains received from the client.¹²⁴ The SEC also has a 2001 policy that set forth factors it would consider in giving credit to companies potentially subject to enforcement proceedings, which include the company’s compliance procedures and voluntary disclosure and remediation of the wrongdoing.¹²⁵

Finally, the DOJ has already taken its own steps to implement a compliance and cooperation defense that it can apply in Foreign Corrupt Practices Act (“FCPA”) cases. As described in Chapter 2, the DOJ initiated a FCPA trial program in 2016, that gave DOJ lawyers the discretion to refuse to bring a prosecution or to seek lower penalties, when a corporation: (a) voluntarily self-reports a violation; (b) fully cooperates with a DOJ investigation; (c) remediates deficiencies in its policies, procedures, and internal controls; and (d) disgorges profits resulting from the bribery violations.¹²⁶ In November 2017, the DOJ officially adopted an FCPA Corporate Enforcement Policy derived from the trial program that establishes a presumption that the DOJ will not prosecute a company for an FCPA violation if the company voluntarily discloses the violation, fully cooperates with the DOJ, and timely and appropriately remediates the problem.¹²⁷

¹²⁰ U.S. COMMODITY FUTURES TRADING COMM’N, UPDATED ADVISORY ON SELF REPORTING AND FULL COOPERATION 1 (last accessed Oct. 27, 2017) at 1.

¹²¹ *Id.* at 2.

¹²² *Id.* at 2–3. Voluntary cooperation consists of several elements: (a) disclosure prior to an imminent threat of the wrongdoing otherwise being exposed; (b) disclosure within a reasonably prompt time of one becoming aware of misconduct; and (c) disclosure of all known relevant facts.

¹²³ *Id.* at 3.

¹²⁴ Press Release, U.S. Securities & Exchange Comm’n, SEC Launches Share Class Selection Disclosure Initiative to Encourage Self-Reporting and the Prompt Return of Funds to Investors (Feb. 12, 2018), <https://www.sec.gov/news/press-release/2018-15>.

¹²⁵ U.S. Sec. & Exch. Comm’n, Exchange Act Release No. 44969 (Oct. 23, 2001), <https://www.sec.gov/litigation/investreport/34-44969.htm>.

¹²⁶ U.S. DEP’T OF JUSTICE CRIMINAL DIV., THE FRAUD SECTION’S FOREIGN CORRUPT PRACTICES ACT ENFORCEMENT PLAN AND GUIDANCE 2 (2016), <https://www.justice.gov/archives/opa/blog-entry/file/838386/download>.

¹²⁷ U.S. ATTORNEYS’ MANUAL § 9-47.120. Even if a company is not prosecuted, as part of its remediation efforts, it must forfeit any gains from the misconduct and compensate victims for harm resulting from the misconduct.

As noted earlier, this policy was expanded in March 2018 to apply in a nonbinding fashion to all corporate criminal matters.

2. Compliance Programs, Voluntary Disclosure and Cooperation, and an Affirmative Compliance Defense Can Promote Individual Accountability

Effective corporate compliance programs, including cooperation with regulatory investigations, can play a vital role in preventing and holding culpable individuals accountable for wrongdoing. These programs can educate employees on rules and regulations, establish ethical norms that drive employee behavior, and ensure that management and directors remain engaged on compliance matters. Effective compliance programs also include oversight mechanisms that enable firms to promptly detect, cease, report, and remediate individual misconduct.

Indeed, an effective compliance system allows aberrant acts of individual noncompliance to be uncovered and addressed by both the firm and government. For example, an act of noncompliance may be addressed with direct intervention by the employee's supervisor, who can take disciplinary action against or terminate the employee. With effective compliance programs, firms can promptly uncover and remediate, as well as report, wrongdoing. That also increases the probability that culpable individuals will be held accountable for misconduct. A robust compliance program could allow a firm to promptly document which employees were involved in wrongdoing, and what employees had particular information that could help the government establish knowledge and intent.

Moreover, an effective compliance program that is coupled with reporting of misconduct to enforcement authorities and ongoing cooperation with any official investigation can increase the overall efficiency of the public enforcement system. Enforcement authorities can spend fewer resources on particular investigations or cases. More efficient use of enforcement resources can allow enforcement authorities to use remaining resources to pursue more matters or devote resources to more complicated and sophisticated cases.

Currently, a firm could be subject to liability even if it operated a reasonable compliance program and cooperated with investigators. For example, an asset manager could have a sophisticated insider trading compliance program in place. The system could include the review of emails and message apps, the supervision of calls by compliance officers, regular training, audits of trading activity, and processes for reporting suspected insider trading and termination of culpable employees. However, even with such a system, a portfolio manager could decide to engage in insider trading and go to great lengths to avoid detection for a time. Because the employee committed insider trading, the company could be vicariously liable and subject to enforcement actions. While the SEC could consider the firm's compliance program and any disclosure to and cooperation with the SEC in making a decision about whether to pursue a case, it would be left to the SEC's discretion about whether to bring a case. The unpredictability about the benefit the company will receive from adopting and implementing a compliance program and cooperating with the government in any investigation or proceeding is problematic because it underincentivizes investments in costly compliance programs and procedures.

3. *Operation of the Compliance and Cooperation Affirmative Defense*

An affirmative defense would require the firm to bear the burden of proof and persuasion that it has an effective compliance program. Specifically, firms must notify an enforcement agency that the firm will assert such a defense and detail the evidence it would present at a trial or administrative hearing. The agency should then determine whether the corporation has sufficient evidence to establish the defense. If the firm’s evidence is sufficient and cannot be rebutted, agency policies should prohibit the filing of an enforcement action. If an enforcement authority decides to file an enforcement action, the firm should be able to assert and argue its defense before a court or administrative law judge in an effort to avoid liability.

We defer to Congress on the particular details about what internal policies and conduct would be sufficient to establish a compliance and cooperation defense, as well as the specific violations for which the defense should apply. However, we believe that there are certain key features that the defense should include.

First, as an *affirmative* defense, the burden should be on the company to prove that it had an adequate system in place, and the defense should be available even when a violation of law by an employee has been found. A successful application of the defense should also require that: (1) the compliance procedures meet a baseline of reasonableness; and (2) the corporation promptly, transparently, and wholly discloses known violations and all non-privileged relevant information uncovered during an internal investigation or review. Thus, a court or administrative law judge considering the defense would analyze the adequacy or reasonableness of the firm’s policies and procedures.

The reasonableness inquiry into a firm’s policies and procedures differs from the U.K. Senior Manager Regime’s reasonableness standard described earlier. Under the affirmative compliance defense, the court would decide if the firm acted reasonably such that the firm should be *shielded from liability* it would otherwise incur. That is much different than the U.K. “reasonableness” analysis, which second guesses the actions of particular senior managers to determine if *liability should be imposed* on the senior manager where none previously existed. It makes sense for the government to carefully scrutinize the activities of a firm seeking the benefit of an affirmative compliance defense when the firm would otherwise be vicariously liable for the actions of its employees. In that circumstance, the government is not creating uncertainty for business decisions nor discouraging qualified individuals from pursuing a particular job or career. By contrast, the U.K. reasonableness inquiry creates uncertainty by increasing the threat of liability through government second-guessing of decisions.

Congress and other policymakers should be cognizant of potential issues in creating an affirmative defense. Certain legal violations might result in harm to consumers, investors, market participants, or others, and only the potential corporate defendant may have the resources to provide remedial compensation through restitution payments. Therefore, lawmakers should consider the extent to which an adequate compliance program should provide for the remediation of harm caused to consumers, investors, and other victims of illicit conduct. Second, repeat violations of the same or related legal provisions by different employees may be evidence of an ineffective compliance program.

D. Promoting Individual Accountability by Enhancing Transparency Surrounding Criminal and Civil Violations and Implementing Industry Wide Bans

As discussed in Chapter 1, the U.S. public enforcement system is highly decentralized. One negative consequence of this fragmented enforcement structure is the incompleteness and disorganization of information about enforcement action outcomes. Access to comprehensive, publicly-available, case-level data on *all* enforcement actions brought against companies and individuals is critical for policymakers and the public to monitor and analyze the enforcement system and its effectiveness and should be made available in a centralized, searchable database as detailed earlier. However, presently, a single database with the names and details of individuals that have been held liable for criminal or civil sanctions for financial wrongdoing does not exist.¹²⁸

Instead, investors must navigate disparate online resources maintained by different organizations to find this critical information about the professionals that they hire.¹²⁹ Given the complex landscape of U.S. enforcement authorities, their research may involve separately searching criminal records at the state and federal levels, databases of enforcement actions brought by federal agencies like the SEC and CFTC, and SRO disciplinary records. Considering the number of state and federal enforcement authorities, it is easy to see how an investor seeking comprehensive information regarding civil or criminal judgments against a particular individual could fail to accomplish their goal.

The absence of a centralized database of this information¹³⁰ directly undermines individual accountability for wrongdoing as bad actors may evade reputational or professional consequences of their actions. Yet it is appropriate, and necessary for investor protection.

- **Recommendation 19:** Enforcement authorities should coordinate to compile a single, publicly-available resource that aggregates information on final judgments or orders imposing criminal or civil sanctions against financial professionals and present it in a user-friendly format.

¹²⁸ We are aware that those formally charged or convicted of a crime have a “rap sheet” that can be accessed as part of a background check. However, a “rap sheet” does not include civil enforcement matters. Moreover, a public database would make access to such information easier for those, like consumers, who may not run a formal background check on someone.

¹²⁹ See, e.g., U.S. DEP’T OF TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: CAPITAL MARKETS 45 (Oct. 2017), <https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf>. We note that the U.S. Treasury made a similar recommendation as recommendation 19 in this Report.

¹³⁰ We note that this recommendation would not require firms or the industry to compile a database or publish names of bad actors. Rather, the database would be based on government enforcement actions and compiled by the enforcement authorities themselves.

Report Appendices

Appendix A: List of Report Recommendations

Chapter 1: The Structure of the U.S. Enforcement System – Improving Coordination and Procedural Fairness

1. Each enforcement authority should develop formal, written policies, subject to public notice and comment, that detail how the enforcement authority will coordinate with other enforcement authorities in conducting investigations, requesting access to documents and witnesses, and negotiating settlements.
2. Federal enforcement authorities should collaborate with one another on the development of their coordination policies.
3. Enforcement authorities should consider the sanctions that other enforcement authorities, including foreign enforcement authorities, have imposed or are about to impose when setting sanctions in their own enforcement actions. Enforcement authorities should explain how they have taken such other sanctions into consideration.
4. When enforcement authorities have lawful discretion to choose to bring a case in federal court or an administrative proceeding, like the SEC, CFTC, and CFPB do, defendants should have the right to remove a case filed in an administrative forum to federal court in non-settled matters.

Chapter 2: Rationalizing the Setting of Sanctions

5. Automatic disqualifications (whether statutory or otherwise) prohibit a firm from engaging in certain activities when the firm or an affiliate has resolved certain criminal or civil enforcement matters. These disqualifications should only be triggered when there is a clear nexus between the conduct underlying the triggering enforcement action and the disqualification itself. Where a clear nexus does not exist, disqualifications should have to be affirmatively imposed by the relevant regulator using appropriate due process protections.
6. Enforcement authorities should adopt publicly available core principles or guideposts setting forth the key considerations to be made in setting monetary penalties. FSOC should establish these principles or guideposts and they should include: (1) ensuring that the penalties are proportionate; (2) accounting for the enforcement target's remedial efforts; (3) avoiding duplicative penalties for the same underlying misconduct; and (4) relying on historical precedents for consistency. Enforcement authorities should explain how the guideposts were applied in each enforcement action.
7. The DOJ should establish similar publicly available guideposts for the setting of sanctions imposed in both DOJ civil matters under FIRREA and the FCA, as well as in criminal matters, including those resolved through NPAs and DPAs.

8. Each enforcement authority should establish an easily accessible, searchable, centralized database of all of its enforcement actions.

Chapter 3: Ensuring Appropriate Use of Monetary Sanctions

9. Enforcement authorities should provide an annual accounting that discloses the amount of monetary sanctions assessed through orders, judgments, and settlements, and the amount of such monetary sanctions actually collected.
10. Each federal enforcement authority should provide an annual accounting of how monetary sanctions imposed in their enforcement actions are used. The accounting should include: (1) the amount of monetary sanctions that the enforcement authority collected and deposited with the Treasury; and (2) the amount of monetary sanctions that the enforcement authority directed to Congressionally authorized programs (itemized by program)
11. The SEC should publicly disclose annually the amount of funds distributed through its Fair Funds authority and the amount of money in Fair Funds that remains available for distribution (on both an aggregate and individual fund basis).
12. The CFPB should conduct a retrospective analysis of the Civil Penalty Fund that evaluates whether: (1) the Civil Penalty Fund is effectively compensating injured consumers; (2) victims are being adequately identified; and (3) there should be a cap on the total amount of money that can remain in the Civil Penalty Fund (with the balance distributed to the Treasury) to encourage efficient distribution of funds to injured consumers.
13. The DOJ Three Percent Fund should be reformed so that: (1) the DOJ can only use money from the Three Percent Fund as Congress intended – i.e., on activities to collect delinquent debts; and (2) the DOJ provides a public annual accounting of the amount of money deposited into the Three Percent Fund, the amount of money distributed from the Three Percent Fund, and how money distributed out of the Three Percent Fund was spent.
14. Third parties that receive settlement funds from extraordinary restitution should be prohibited from using those funds to engage in political activities. Federal enforcement authorities should adopt policies and guidelines to effectively implement the ban.
15. Each federal enforcement authority should provide an annual accounting of the amount of settlement funds paid out as extraordinary restitution.
16. The states should adopt legislation: (1) requiring an annual accounting from state officials of how state settlement funds are spent; and (2) prohibiting third parties that receive state settlement funds from using those funds to engage in political activities.

Chapter 4: Promoting Individual Accountability

17. The DOJ should publish annual statistics analyzing trends of criminal actions against financial professionals. Useful data would disclose the annual number of cases brought and average and median penalties imposed in categories of white-collar crimes committed by officers and directors of firms and gatekeepers such as lawyers and accountants.
18. An affirmative compliance and cooperation defense should be established in the United States to further promote effective compliance programs and harness their strengths to help identify and prevent individual misconduct. A successful application of the defense should require that the firm establish that the compliance procedures meet a baseline of reasonableness; and the firm promptly, transparently, and wholly disclosed known violations and all non-privileged relevant information uncovered during an internal investigation or review.
19. Enforcement authorities should coordinate to compile a single, publicly-available resource that aggregates information on final judgments or orders imposing criminal or civil sanctions against financial professionals and present it in a user-friendly format.¹

¹ This recommendation differs from recommendation number 8 because the Committee Staff is recommending that enforcement actions against financial professionals that impose civil or criminal sanctions be provided by all the enforcement authorities in one accessible location as part of a comprehensive database. In recommendation 8, the Committee Staff is recommending that each enforcement agency develop its own searchable database of all enforcement action outcomes against any type of defendant.

Appendix B: Summaries of National Mortgage Settlement and Bank of America Settlement Referenced in Chapter 1

1. 2012 National Mortgage Settlement

The 2012 National Mortgage Settlement resolved claims of unlawful and abusive mortgage servicing and foreclosure practices and imposed \$25 billion in total sanctions, and involved over 50 state and federal enforcement authorities.

Enforcement authorities began investigations into the widespread use of “robo-signed” affidavits in foreclosure proceedings in October 2010. Robo-signing refers to the practice of allowing bank employees to sign affidavits in support of foreclosure despite not actually reviewing the supporting documents. As a result, a bank could foreclose on homes that were not actually in default or that the bank does not in fact own.

These investigations into robo-signing practices were conducted by the DOJ, including the U.S. Attorney’s Offices for the Eastern and Southern Districts of New York, the District of Colorado, the Western District of North Carolina, and the District of South Carolina, as well as state attorneys general and/or state banking regulators from 49 states, with assistance from the CFPB, OCC, Fed, and other federal regulators.² The investigations targeted five leading mortgage servicers: Bank of America, JPMorgan Chase, Wells Fargo, Citibank and Ally Financial.

The multiple investigations by state and federal regulators resulted in one global settlement agreement that required the five mortgage servicers to collectively provide \$20 billion in financial relief for consumers and to pay \$5 billion to various federal and state authorities.³ Of that \$5 billion, \$4.25 billion was divided among the 49 states, and \$750 million was paid to the DOJ to resolve potential civil claims under FIRREA.⁴

2. 2014 Bank of America Settlement (Residential Mortgage-Backed Securities)

A \$16.65 billion settlement between Bank of America, the DOJ, SEC, FDIC, and six states related to practices involving the underwriting and securitization of residential mortgage-backed securities represents one of the largest single settlements in history.⁵ In this case, the DOJ, SEC,

² Press Release, U.S. Dep’t of Justice, Federal Government and State Attorneys General Reach \$25 Billion Agreement with Five Largest Mortgage Servicers to Address Mortgage Loan Servicing and Foreclosure Abuses (Feb. 9, 2012), <http://www.justice.gov/opa/pr/federal-government-and-state-attorneys-general-reach-25-billion-agreement-five-largest>.

³ Press Release, Nat’l Ass’n of Attorneys General, State Attorneys General, Feds Reach \$25 Billion Settlement with Five Largest Mortgage Servicers on Foreclosure Wrongs, <http://www.naag.org/naag/media/naag-news/state-attorneys-general-feds-reach-25-billion-settlement-with-five-largest-mortgage-servicers-on-foreclosure-wrongs.php>.

⁴ *Id.*

⁵ See Settlement Agreement Between Bank of America and U.S. Dep’t of Justice (Aug. 20, 2014), <https://www.justice.gov/iso/opa/resources/3392014829141150385241.pdf>.

FDIC and six states alleged that Bank of America sold billions of dollars of residential mortgage-backed securities without disclosing key facts about the quality of the securitized loans to investors. The enforcement authorities also alleged that Bank of America made misrepresentations about the quality of those loans to Fannie Mae and Freddie Mac, two quasi-government agencies.⁶

A multitude of federal and state authorities investigated Bank of America’s residential mortgage-backed securities practices. These included members of the residential mortgage-backed securities working group, such as the DOJ, 10 U.S. Attorneys’ Offices, the FBI, the SEC, HUD, HUD’s Office of Inspector General, the Federal Housing Finance Agency, the Office of the Special Inspector General for the Troubled Asset Relief Program, the Fed, the Recovery Accountability and Transparency Board, FinCEN, and more than 10 state attorneys general.⁷

Bank of America’s settlement agreements arising from the investigations resulted in penalties of \$16.65 billion to be paid to three different federal agencies (DOJ, SEC and FDIC) and six states, including New York and California.⁸ The breakdown of the payments is provided in the table, below.⁹

Table: Bank of America Settlement Payment Amounts

Recipient of Relief	Dollar Amount
DOJ	\$5 billion
SEC	\$135 million
FDIC (private securities fraud claims on behalf of failed banks as receiver)	\$2.83 billion
California	\$300 million
Delaware	\$45 million
Kentucky	\$23 million
Maryland	\$75 million
New York	\$300 million
Illinois	\$200 million
Consumer Relief overseen by Monitor	\$7 billion

⁶ Press Release, U.S. Dep’t of Justice, Bank of America to Pay \$16.65 Billion in Historic Justice Department Settlement for Financial Fraud Leading up to and During the Financial Crisis (Aug. 21, 2014), <https://www.justice.gov/opa/pr/bank-america-pay-1665-billion-historic-justice-department-settlement-financial-fraud-leading>.

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

COMMITTEE ON CAPITAL MARKETS REGULATION

Appendix C: OCC Civil Monetary Penalty Matrix

Factors	0	1	2	3	4	Factor Weight
Intent(1) ¹⁰	None		Should have known	Disregarded red flags or other warnings	Clear intent or clearly disregarded the law or consequences to the bank	7
Continuation after notification(3)	Violation ceased before notification	Violation ceased immediately upon notification	Bank took timely steps to correct violation, but violation continued after notification	No timely corrective action; violation continued for short period of time after notification	Violation still continuing or continued for long period of time after notification	5
Concealment(5)	None, or self-disclosure of violation	Disclosure of relevant facts upon request	Incomplete disclosure of relevant facts or materials	Purposely complicated transaction to make it difficult to uncover	Actively took steps to conceal misconduct or relevant facts	6
Financial gain or other benefit as a result of violation (7)	None	Minimal indirect gain or benefit to bank or related interest	Indirect gain or benefit to bank or related interest	Direct gain or benefit to bank or related interest	Substantial direct benefit to bank or related interest	4
Loss or risk of loss to the bank(6)	No loss and no risk of loss	Minimal actual loss or minimal risk of loss	Moderate risk of loss	Moderate actual loss or substantial risk of loss	Substantial actual loss	4
Impact or harm other than financial loss to the bank(6)	No impact or harm to bank	Minimal impact or minimal harm to bank	Some impact or some harm to bank	Moderate impact or moderate harm to bank	Substantial impact or substantial harm to bank	4
Loss or harm to consumers or the public (consumer law or BSA violations)	No loss and no harm	Minimal loss or minimal harm	Moderate loss or harm to moderate number of consumers or portion of the public	Moderate loss or harm to substantial number of consumers or portion of the public	Substantial loss or harm to substantial number of consumers or portion of the public	5
Previous concern or administrative action for similar violation (10)(13)	None	Concern in any matters requiring attention (MRA) for related	Repeat or past due concern in an MRA for related	Concern in an informal enforcement action intended to	Concern in a formal enforcement action intended to prevent the violation	5

¹⁰ Parenthetical numbers refer to the numbered interagency factors listed in the FFIEC’s “Interagency Policy Regarding the Assessment of Civil Money Penalties by the Federal Financial Institutions Regulatory Agencies,” 63 Fed. Reg. 30,227 (June 3, 1998).

COMMITTEE ON CAPITAL MARKETS REGULATION

Factors	0	1	2	3	4	Factor Weight
		deficiency or violation	deficiency or violation	prevent the violation		
History of violations and tendency to engage in violations(9)(12)	No prior similar violations or minimal history of unrelated violations	Prior unrelated violations	At least one prior similar violation	Prior unrelated repeat or recurring violations	Prior similar repeat or recurring violations	3
Duration and frequency of violations before notification(2)	Isolated violation	Violation continued for up to 6 months	Several violations, or violation continued for up to 1 year	Frequent violations, or violation continued for 1-2 years	Pattern or practice, or violation outstanding for more than 2 years	3
Effectiveness of internal controls (IC) and compliance program (CP)(11)	Strong ICs and CP	Generally effective ICs and C with relevant weaknesses	ICs and CP have moderate weaknesses	Minimal, ineffective ICs and CP	ICs and CP are substantially lacking	4
Subtotal 1						
Good faith before notification	Complete lack of good faith		Some evidence of good faith		Good faith shown throughout	2
Full cooperation after notification(4)	None		Limited disclosure and cooperation after notification		Full disclosure and cooperation after notification	2
Restitution, if applicable(8)	No restitution	Partial restitution	Complete restitution under compulsion	Complete restitution timely after notification	Complete restitution voluntarily before notification	1
Subtotal 2						

Total Matrix Score (subtract subtotal 2 from subtotal 1)

Suggested Action Based on Total Matrix Score and Total Assets of Bank

Total Matrix Score	Total assets up to \$50 million	Total assets \$50 million+ to \$250 million	Total assets \$250 million+ to \$1 billion	Total assets \$1 billion+ to \$5 billion	Total assets \$5 billion+ to \$25 billion	Total assets \$25 billion+ to \$100 billion	Total assets over \$100 billion
0-40	No Civil Monetary Penalty (“CMP”)	No CMP	No CMP	No CMP	No CMP	No CMP	No CMP
41-70	Up to \$10,000	Up to \$20,000	Up to \$100,000	Up to \$300,000	Up to \$1.5 million	Up to \$5 million	Up to \$15 million
71-100	Up to \$25,000	Up to \$50,000	Up to \$250,000	Up to \$1 million	Up to \$5 million	Up to \$15 million	Up to \$30 million
101-130	Up to \$50,000	Up to \$100,000	Up to \$500,000	Up to \$2 million	Up to \$10 million	Up to \$30 million	Up to \$60 million
131-160	Up to \$100,000	Up to \$200,000	Up to \$1 million	Up to \$4 million	Up to \$20 million	Up to \$75 million	Up to \$150 million
161+	Up to \$100,000+ but less than 1 percent of total assets	Up to \$200,000+ but less than 1 percent of total assets	Up to \$1 million+ but less than 1 percent of total assets	Up to \$4 million+ but less than 1 percent of total assets	Up to \$20 million+ but less than 1 percent of total assets	Up to \$75 million+ but less than 1 percent of total assets	Up to \$150 million+ but less than 1 percent of total assets

Appendix D: Data Collection Efforts

In Chapter 2, data gathered by the Committee Staff on monetary sanctions and trends over time with respect to enforcement actions and monetary sanctions are presented. Data on the number of enforcement actions, aggregate monetary sanctions, and mean and median defendant-level monetary sanctions are derived from the case-level collected of data. So too is data presented in the Report on the proportion of monetary sanctions comprised of civil monetary penalties, disgorgement and restitution, and consumer relief; the percent of SEC, CFTC, and CFPB cases brought in federal court and administrative proceedings; and the proportion of DOJ criminal matters against financial institutions resolved through NPAs, DPAs, or plea agreements. The following describes how the data used in those analyses was obtained.

1. *Case-Specific Enforcement Action Data Gathered from Agency Spreadsheets and Tables*

The Fed, FDIC, OCC, and OTS provide downloadable spreadsheets or tabular information on their websites, which provide detailed information on specific enforcement actions. For those agencies, we pulled the data from the relevant agency website for the period from January 1, 2000 through December 31, 2016.¹¹

2. *Case-Specific Enforcement Action Data Gathered by Hand from Individual Orders*

The NCUA, OFAC, FinCEN, CFPB, and NY DFS post all their enforcement action orders in one central and accessible portion of their websites. For those agencies, each enforcement order was downloaded and hand reviewed to collect data. These actions date as far back as January 2000 and through December 31, 2016.¹²

3. *Case-Specific Enforcement Action Data Gathered from Third-Party Databases*

Data on DOJ civil and criminal actions against financial institutions was gathered using two distinct methods. Data on *criminal* actions against institutions was gathered through the University of Virginia Corporate Prosecutions Project database, which provides monetary sanction information and the method of resolution for each case in spreadsheet form. Information on DOJ *civil* cases was gathered by downloading all press releases from the DOJ's website and each of the 93 U.S. Attorneys' Office websites. Press releases were searched for the names of the 50 largest financial institutions and then hand reviewed to determine if they were relevant and to gather pertinent information on monetary sanctions. We also searched for any references to FIRREA and included those matters in the data if the matter was against a financial institution.

¹¹ We excluded voluntary terminations of deposit insurance from our data, as well as notices from banking regulators to banks that they had become aware that certain individuals were no longer permitted to be affiliated with the bank unless approved by the regulator.

¹² OFAC cases are available only back to 2003 and NY DFS back to 2001. The CFPB was established in 2011 and so it does not have any enforcement actions until 2011. The OTS was merged into the OCC in 2011, so OTS data is through 2011.

COMMITTEE ON CAPITAL MARKETS REGULATION

Finally, SEC and CFTC data was gathered primarily using a Lexis Securities Mosaic database on sanctions imposed on defendants in specific actions. The database is derived from agency press releases and administrative orders provided on the agencies' websites. Case-specific data was supplemented and revised by reviewing SEC and CFTC annual reports, press releases regarding annual enforcement results, and case-specific enforcement orders or press releases. This approach was used in an attempt to identify cases potentially missing from the Lexis Securities Mosaic database and to control for collective liability imposed on multiple defendants, in calculating aggregate monetary sanction values.

Appendix E: Supplemental Enforcement Data

Figure E.1: Percent of Monetary Sanctions Comprised of the Top 1% and 10% of Matters Imposing Monetary Sanctions

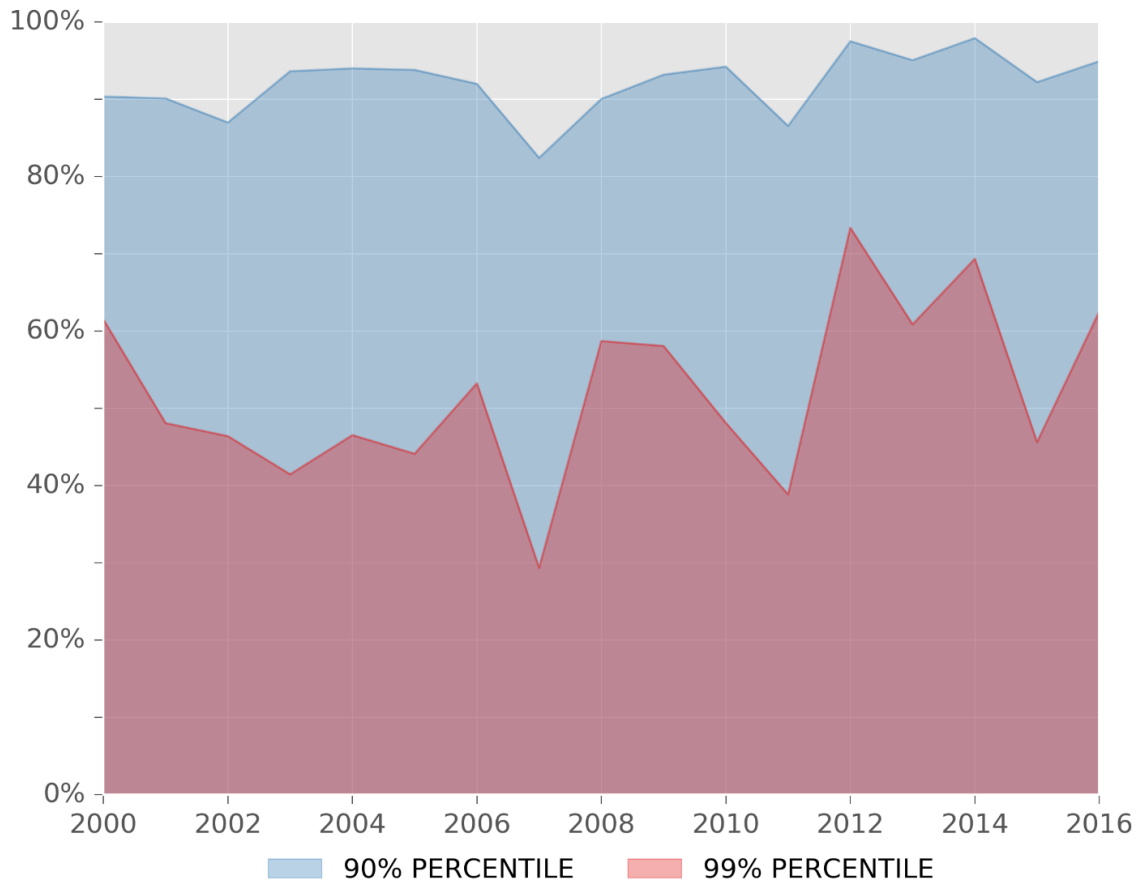


Figure E.2: Percent of Monetary Sanctions Comprised of the Top 1% and 10% of Matters Imposing Monetary Sanctions by Agency

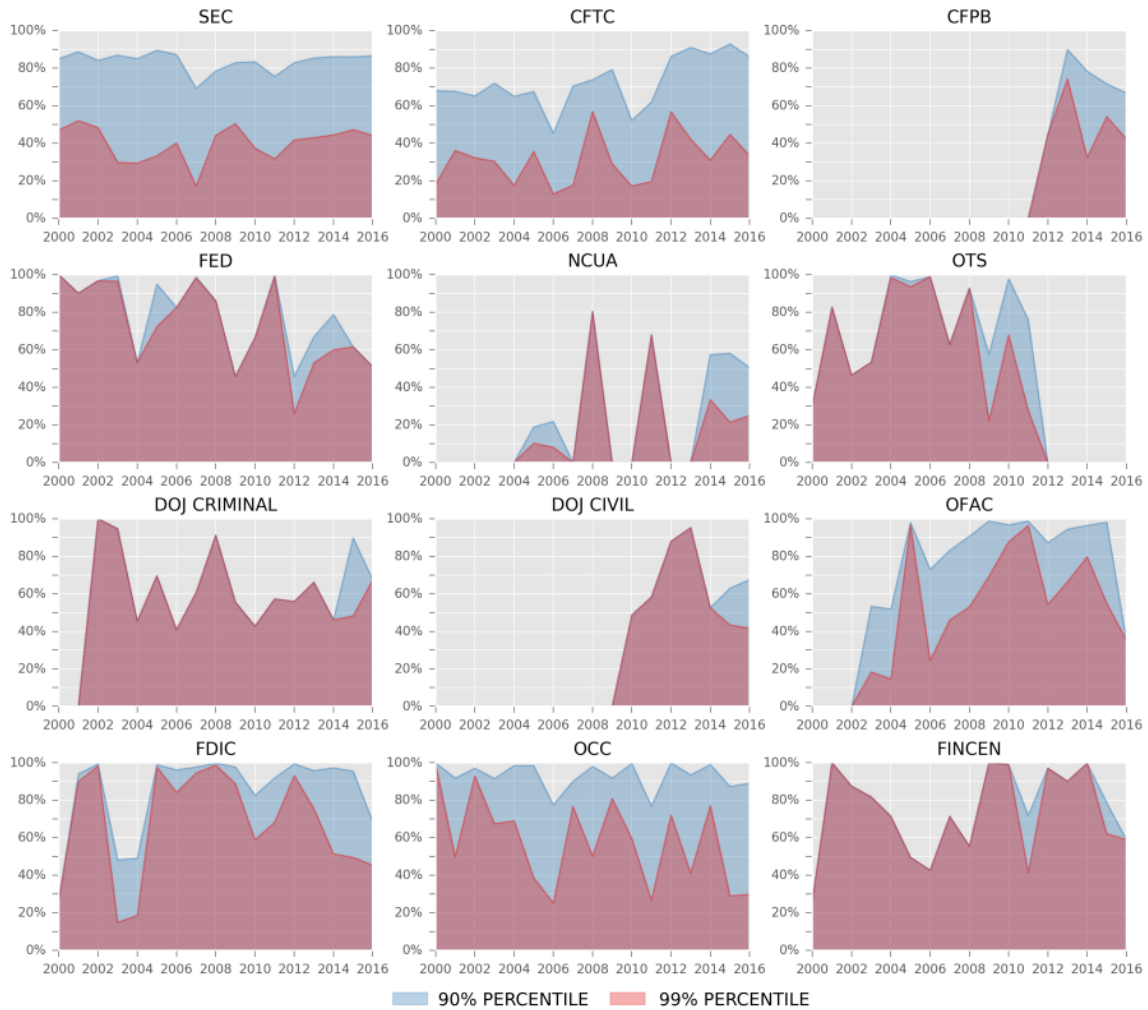


Figure E.3: Median Monetary Sanctions by Agency

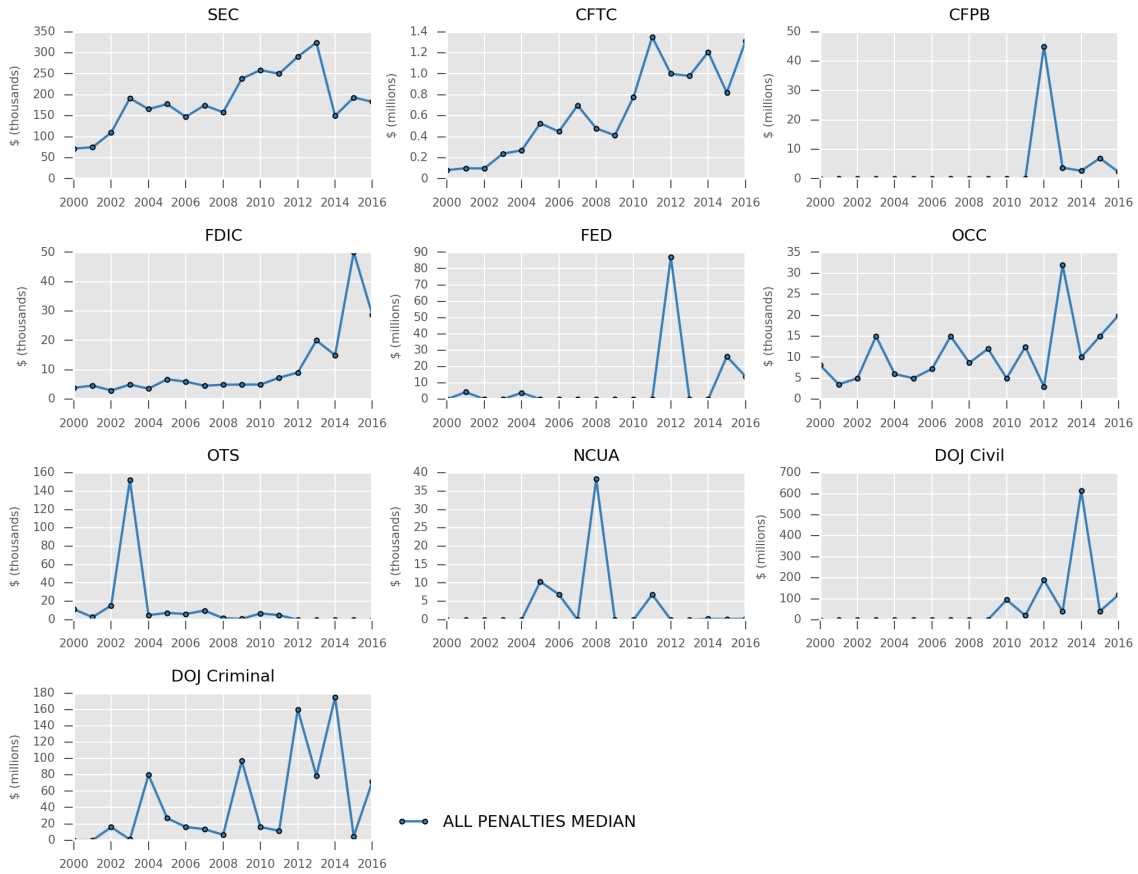


Figure E.4: Mean Monetary Sanctions by Agency

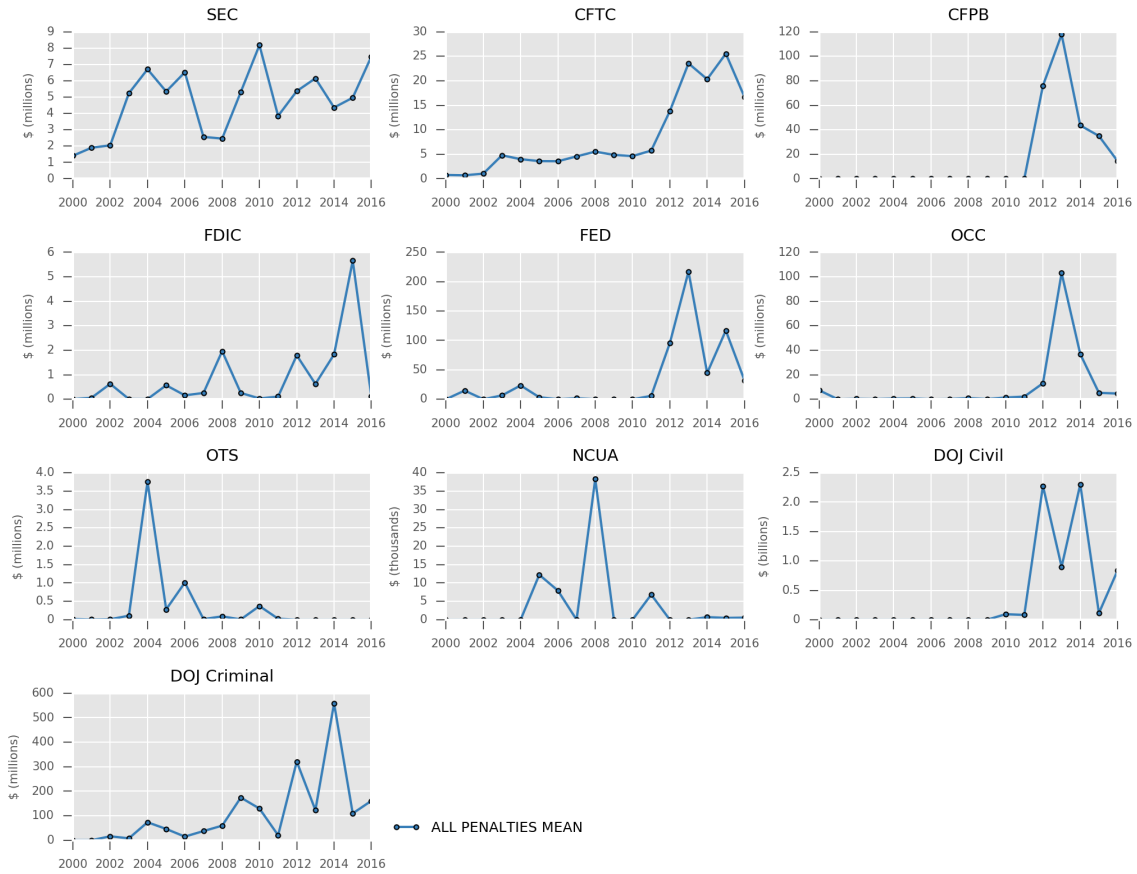


Figure E.5: Median Monetary Sanctions: Individual v. Firm Defendants by Agency

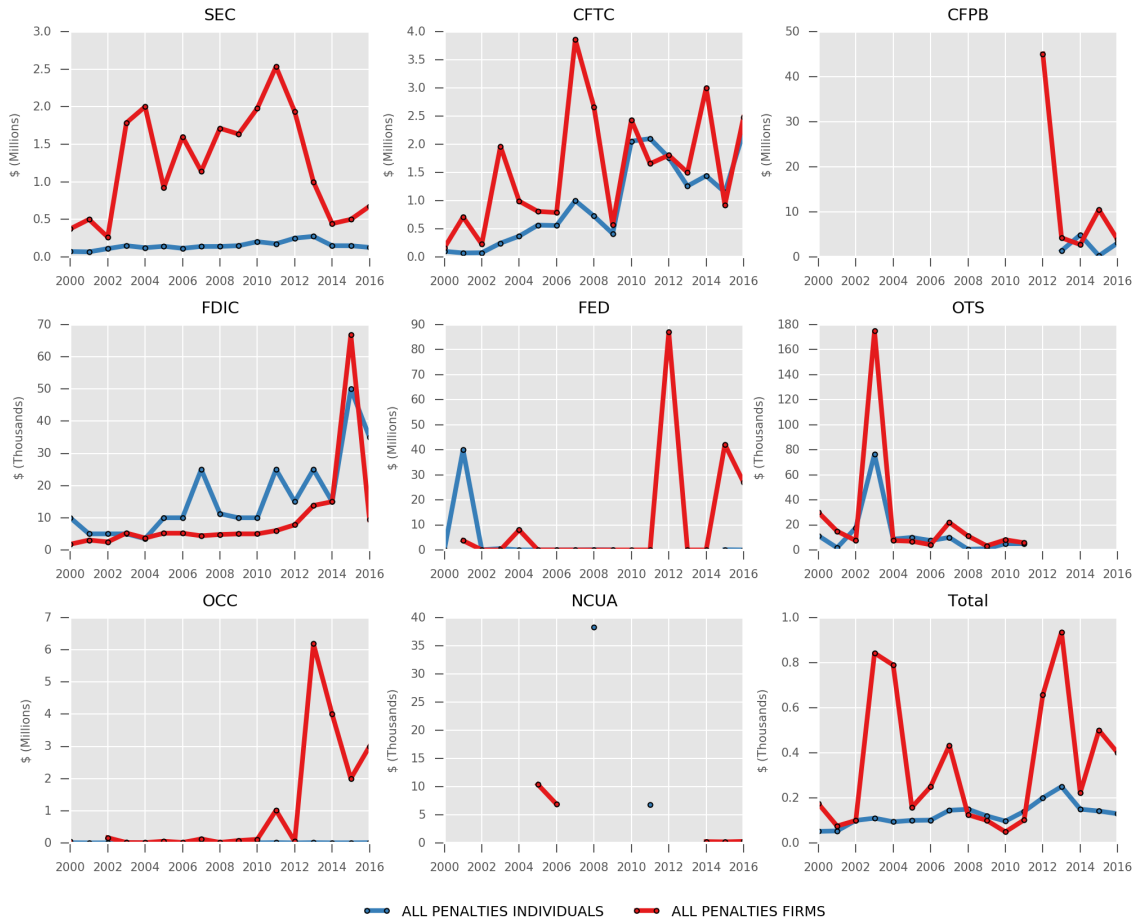
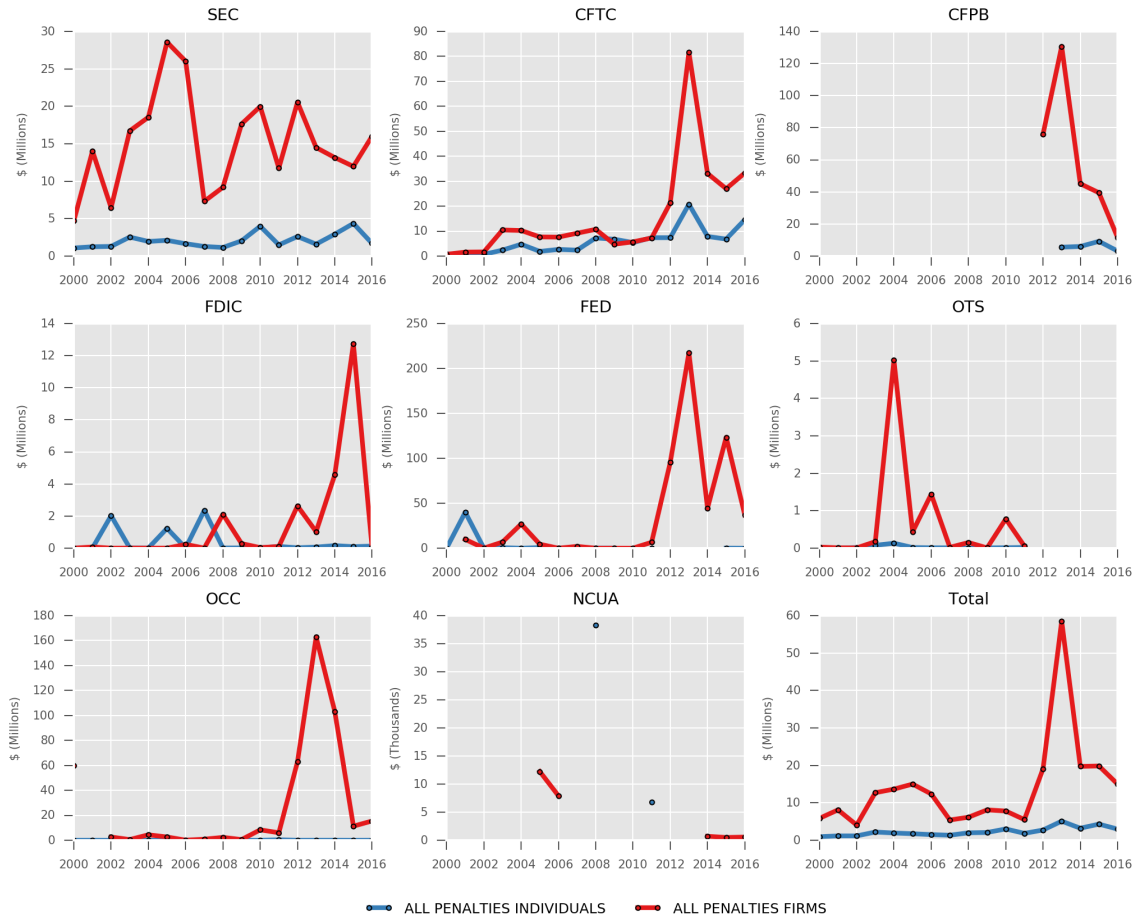


Figure E.6: Mean Monetary Sanctions: Individual v. Firm Defendants by Agency



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