Enforcement Actions in the Banking Industry

Trends and lessons learned

“The enforcement actions we are issuing today make clear that the OCC will take forceful action, not only when the institutions we supervise engage in wrongdoing, but when management fails to exercise the oversight necessary to ensure that employees follow laws and regulations intended to protect customers and maintain the integrity of markets.”

— Thomas J. Curry, Comptroller of the Currency, November 2014

What can banks learn from an analysis of enforcement actions?

Banking regulators routinely issue Enforcement Actions (“EA’s”) against institutions and individuals for a number of reasons, including “violations of laws, rules, or regulations, unsafe or unsound banking practices, breaches of fiduciary duty, and violations of final orders, conditions imposed in writing or written agreements.”

EAs offer some of the most concrete evidence of risk management and compliance issues in the banking industry. In spite of being ex post measures, they offer a clear view into the problems banking supervisors find in their bank examinations. Many of these issues are likely to be specific to particular institutions, where problems occur due to reasons unique to those entities; however, in some instances, the number and types of EAs reflect market conditions and/or supervisory focus at a specific point in time.

In almost all instances, EAs are costly to the institutions involved, and often also to individuals at those institutions. Not only do affected entities have to spend money and resources correcting the problems identified by the EA, but they must also sometimes pay restitution to the aggrieved parties and/or pay fines. There is also the reputational cost of being the target of an EA, which, of course, varies by the type and severity of EA. Since most formal EAs are public, there is also the potential reputational risk.

Our Focus

1. How do recent trends in EAs in the banking industry compare with historical norms?
2. How does the composition of EAs differ by banking supervisor?
3. How has the mix of EAs changed for institutions of different sizes?
4. What issues led to the issuance of EAs, especially the more severe ones?

Type of Enforcement Action	Formal EAs released in the public domain
Regulators	Federal Deposit Insurance Corporation (“FDIC”), Office of the Comptroller of the Currency (“OCC”) (and Office of Thrift Supervision), Federal Reserve System, National Credit Union Administration (“NCUA”), and Consumer Financial Protection Bureau (“CFPB”)
Institutions Covered	Banks, bank holding companies (BHCs), thrifts and thrift holding companies, and credit unions
Analysis Period	January 1, 2000–August 27, 2015

Question 1. How do recent trends in enforcement actions in the banking industry compare with historical norms?

Finding: The number and severity of enforcement actions are stabilizing at historic levels—but the associated fines have increased markedly since 2010.

Trend 1: The overall number of EAs is returning to normal levels.

- In the pre-2008 period, on average, 683 formal EAs were issued each year.
- The spike in the number of EAs in 2005 (when 1,073 EAs were issued) was largely driven by an increase in Sanctions against Personnel ("SAPs").
- As one would expect, banks witnessed a sharp upturn in EAs in 2008 and 2009. Due to banks' deteriorating capital, liquidity, and earnings performance during this time period, as well as the lag generally observed in the issuance of EAs, 2010—with 1,795 EAs issued—had the highest number of EAs within the analysis period.
- Since 2011, the number of EAs has been on a steady decline. In 2014, for instance, only 583 EAs were issued—well below the average during 2000–2007.

Trend 2: The broader mix of enforcement action types is beginning to return to its pre-2008 composition.

- Of the 15 formal EA types tracked, three—Cease and Desist Orders ("C&Ds") or Consent Orders ("COs"), Formal Agreements, and Prompt Corrective Actions ("PCAs")—are classified as "severe" due to their impact on and significance for institutions.
- In all years from 2000 through August 27, 2015, less severe actions outnumbered severe actions, except in 2009 and 2010.
- Since 2011, the proportion of severe actions has been on a steady decline, reaching less than 20 percent in 2014.
- In the less severe category, SAPs were the most common EA type issued in the analysis period, comprising about 43% of all EAs, on average, between 2000 and 2014.

Question 2. How does the composition of enforcement actions differ by banking supervisor?

Finding: The composition of enforcement actions reflects differences in supervisory mandates. The FDIC's supervisory style is more direct than that of other regulators.

Each federal banking regulator has a specific focus for its supervision:

- the Federal Reserve System supervises state member banks, BHCs, and savings and loan holding companies;
- the FDIC is the primary supervisory body for state-chartered banks and savings institutions that are not members of the Federal Reserve System;
- the OCC's supervision authority extends to all national banks and federal savings associations;
- the NCUA regulates credit unions; and
- the CFPB's consumer protection agenda applies to banks with assets over $10 billion and other non-banking institutions.

Although each regulator has a different mission, two fundamental elements are common to their supervisory agenda: **safety and soundness, and consumer protection**. As a result, there is a fair amount of collaboration among banking supervisors in the initiation of EAs.

Question 2. How does the composition of enforcement actions differ by banking supervisor?

Finding: The composition of enforcement actions reflects differences in supervisory mandates. The FDIC's supervisory style is more direct than that of other regulators.

- In terms of composition of EAs, the FDIC has mainly issued C&Ds, which represent 43% of its total actions (excluding SAPs) between 2000 and 2014. This is followed by Other Fines, that is, Civil Money Penalties ("CMPs") against institutions, which represent 23% of its actions over the last 15 years. This pattern of injunction-type sanctions suggests that the FDIC takes a more direct approach against institutions.
- On the other hand, the Federal Reserve System has mostly issued Formal Agreements, which make up about 74% of its total EAs (excluding SAPs). It has made minimal use of C&Ds, suggesting a less direct approach.
- The OCC has used a mix of severe actions (30% Formal Agreements and 23% C&Ds). In addition, the OCC has also been active in issuing fines against individuals and institution-affiliated parties ("IAPs"), as evidenced by the 23% of its total EAs being Fines Levied against a Person. The OCC issued the highest number of Fines against a Person—623 between 2000 and 2014, compared to 366 by the FDIC and 12 from the Federal Reserve System.
- 55% of the NCUA's EAs (excluding SAPs) were Other Fines, that is, fines or CMPs against institutions. However, in absolute numbers, the NCUA issued just 50 orders of CMPs/Other Fines over the last 15 years, less than 10% of the 766 such orders issued by the FDIC.
- As of August 2015, the CFPB had issued a total of 70 EAs against all types of entities. Of these, 20 were against banks/BHCs and credit card companies. Nearly 50% of the EAs issued against banks and credit card companies were for deceptive marketing and enrollment, unfair billing, illegal debt collection, and discriminatory pricing practices in credit cards. The next most significant type of EA was actions related to mortgages.

Question 3. How has the mix of enforcement actions changed for institutions of different sizes?

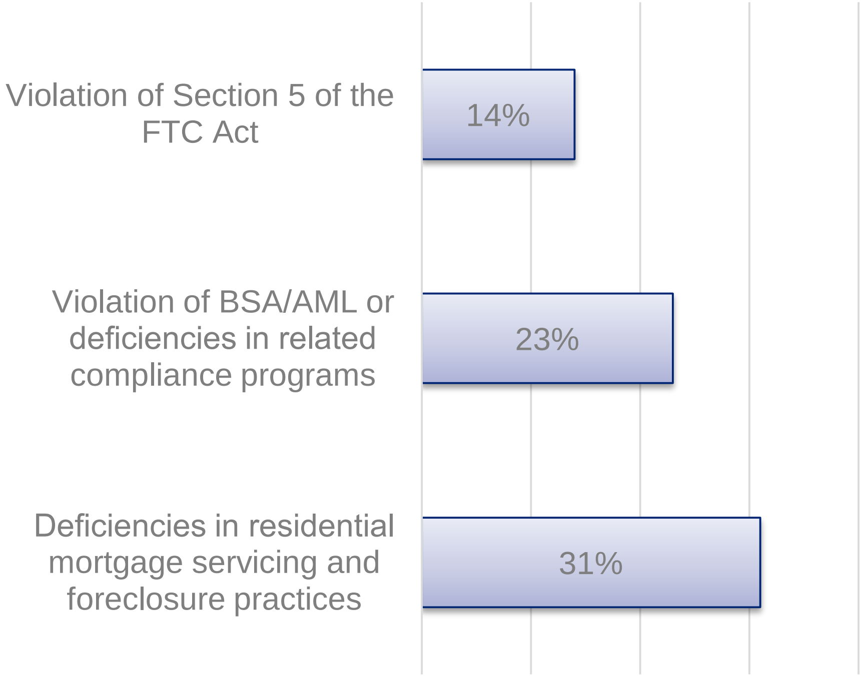
Finding: While the number of enforcement actions has declined since 2010, their composition differs from the years before 2008 for all institution sizes.

1. **Large institutions (assets greater than $50 billion):** Of all the EAs in the study sample, nearly 17% were against large institutions, and their employees/IAPs.
   - SAPs have comprised 89% of the total number of EAs against large banks since 2000. However, this EA type has been declining since 2010, resulting in fewer total sanctions for large institutions since then.
   - Another recent trend is the increase in EAs against institutions; since 2011, severe and less severe EAs against institutions combined have ranged between 15% and 29% of total EAs in any given year. However, in prior years, these sanctions were no more than 9% of total EAs in any given year. This upward trend in sanctions against institutions in recent years is a meaningful change in the supervisors' focus.
2. **Mid-sized institutions (assets between $10 billion and $50 billion)**: In total, mid-sized banks and their employees/IAPs have received only 5% of all EAs issued since 2000.
   - Similar to the trend among large institutions, about 77% of total EAs against mid-sized banks were SAPs.
   - Severe EAs against mid-sized institutions have remained reasonably low through the analysis period, except in 2009 and 2010, when they rose marginally to 12 and 10, respectively.
3. **Small institutions (assets less than $10 billion):** Small institutions, in aggregate, received a higher number of EAs than their larger counterparts. More than 5,500 individual institutions have received an EA since 2000.
   - The total number of EAs is returning to pre-2008 levels, largely due to the declining incidence of severe EAs (C&Ds and Formal Agreements) since 2011. On a relative basis, however, SAPs remain common, unlike the trend among large and mid-sized banks.
   - Small institutions were the only bank category to receive Prompt Corrective Action orders in the last 15 years, largely for "undercapitalization" issues. Not surprisingly, about 83% of PCAs were issued during 2009–2012.

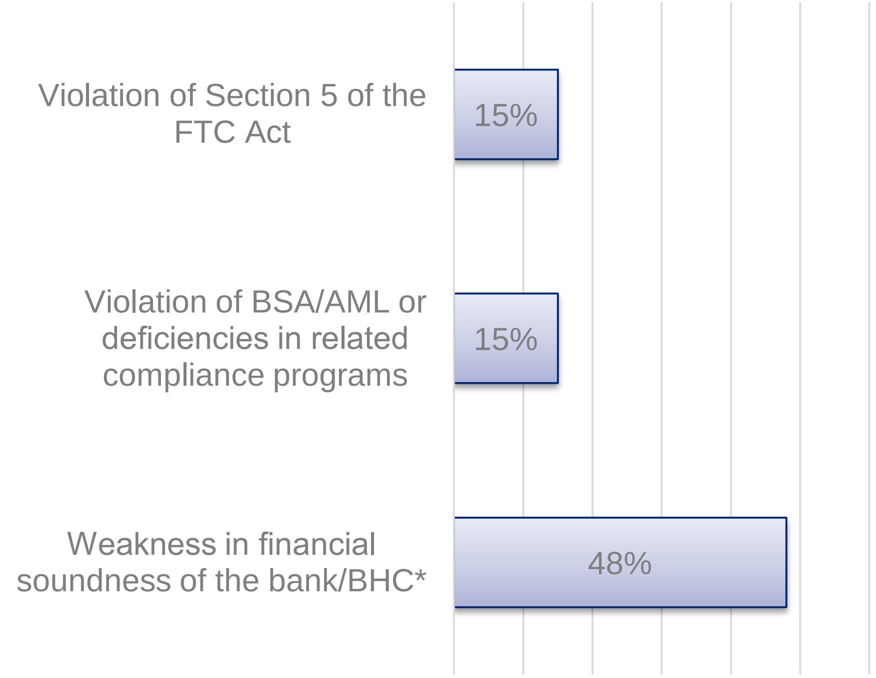
Question 4. What issues led to the issuance of enforcement actions, especially the more severe ones, since 2008?

Finding: Deficiencies in mortgage servicing practices and Bank Secrecy Act (BSA) compliance triggered many severe EAs for large institutions. On the other hand, EAs against mid-sized institutions were typically driven by concerns regarding financial safety and soundness of the institution/BHC.

Top reasons for severe EAs against large institutions since 2008



Top reasons for severe EAs against mid-sized institutions since 2008



*Section 5 of the Federal Trade Commission Act – Unfair or Deceptive Acts or Practices

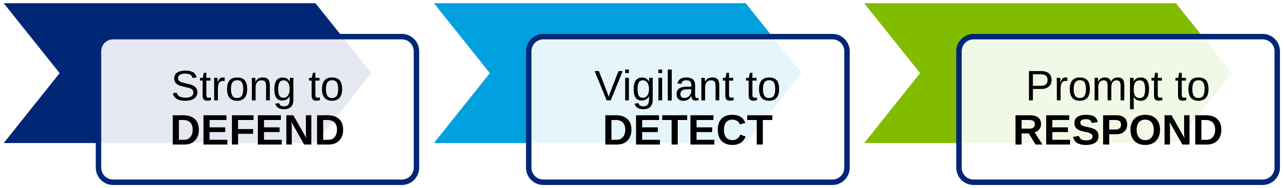
What is the outlook for the future?

Although the number of enforcement actions has declined in recent years, one may expect banking supervisors to remain aggressive in their penalties...and to expand the types of issues they will proactively monitor.

- The decline in the total number of EAs since 2011, especially the severe ones, is certainly a positive development for the banking industry. 2014 saw the least number of severe actions issued against banks since 2008. This trend signals that, overall, banks have made meaningful improvements in their financial soundness, including higher capital and liquidity levels, and better asset quality.
- If recent EAs against some large banks provide any indication, supervisors are not reluctant to promptly enforce banking rules and regulations where there appear to be lapses. Expect this trend to continue in the near future, especially in areas such as risk management and compliance management, where supervisors are increasingly relying on forward-looking data and tools rather than lagging indicators, as was the norm in the past.
- With safety and soundness, and consumer protection as top priorities, regulators may continue to issue sanctions for violation of BSA/AML laws and unfair/deceptive consumer practices. In addition, an analysis of regulators' strategic plans suggests that cyber security, credit risk, and interest rate risk may also be among the key focus areas over the next few years.
- Although the scope of the study focuses on EAs by four federal banking regulators and the CFPB, other agencies—including the Securities and Exchange Commission (SEC), the Department of Justice (DoJ), and the US Commodity Futures Trading Commission (CFTC)—also keep a close watch on banks' activities.

How can banks better anticipate and respond to future enforcement actions?

A robust risk management and compliance framework demonstrating resilience, vigilance, and responsiveness could help prepare banks for future enforcement actions.



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