Shaming by Bank Regulators – Methods and Applications

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ABSTRACT

In recent years, regulatory shaming has been increasingly used by regulators in many countries, in various fields. This chapter examines whether regulatory shaming should serve as an enforcement tool in the banking field as well.

As is well known, it is of paramount importance to maintain the stability of the banking system and to strengthen public confidence in it. But regulatory shaming may possibly to lead to the opposite result: Loss of public confidence in the "shamed" bank, withdrawal of deposits from the bank, and damage to the bank's economic situation.

Notwithstanding the above, the chapter recommends using regulatory shaming in the banking context under certain limitations, and outlines the recommended practice thereof.

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A. INTRODUCTION

In recent years, regulators around the world have made increasing use of shaming strategies. Thus, for example, the American Occupational Safety and Health Administration (OSHA) publishes the names of employers who have been fined for safety violations.[1] In Australia, the NSW Food Authority publishes lists of food businesses that have violated food safety laws.[2] The UK government publishes a list of businesses that fail to pay the national minimum wage to their

[1] United States Department of Labor: OSHA News Releases–Enforcement, available at https://www.osha.gov/news/newsreleases/enforcement.

[2] NSW Government - Food Authority: Name and Shame, available at https://www.foodauthority.nsw.gov.au/offences

employees.[3] In China, the Ministry of Environmental Protection publishes the names of enterprises that have violated environmental rules;[4] the list is long.

Methods of regulatory shaming are varied, but all have in common the publication of negative information about the supervised body made by the regulator or pursuant to his instruction, reflecting the regulator's condemnation or denunciation of the supervised body.[5] Regulatory shaming routinely includes information not only about the offending behavior or violation, but also about the regulator's response, such as enforcement and punitive procedures, warnings to the public to refrain from engaging with the supervised body and even calls for the public to file lawsuits where appropriate.[6] Comparative tables, ratings, or scores which indicate censure, are also considered methods of shaming ("soft shaming").[7]

Regulatory shaming has several important goals. First, it may motivate the offending body to correct its ways and desist from the improper behavior.[8] Second, it may serve as a deterrent to prevent similar behavior on the part of other entities.[9] As a result, shaming may lead to the correction of market failures and increase market efficiency.[10] Third, the negative publicity provides the public with information, enabling it to make informed decisions on the basis of the details published,[11] and alerting it against the infringing party.[12] Finally, negative publicity may be considered a means of punishment.[13] It is important to emphasize that regulatory shaming is not intended to demean or humiliate the supervised body but to promote a public interest such as safety at work, protection of public health, protection of the environment and the like.[14]

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[3] HMRC – Department for Business, Energy & Industrial Strategy: Press Release: Naming Employers who Fail to Pay Minimum Wage to be Resumed Under Revamped Rules (11.2.20), available at https://www.gov.uk/government/news/naming-employers-who-fail-to-pay-minimum-wage-to-be-resumed-under-revamped-rules.

[4] David Stanway, "China's Name and Shame Campaign Fails to Deter Polluters", Reuters (23.12.16), available at https://www.reuters.com/article/us-china-pollution-shaming/chinas-name-and-shame-campaign-fails-to-deter-polluters-idUSKBN14C095.

[5] Sharon Yadin, "Regulatory Shaming", 49 Envtl. L. J. 101, 113-114, 124 (2019).

[6] See, for example, the campaign launched by the British financial regulator when it was discovered that banks had illegally sold payment protection insurance to customers: Financial Conduct Authority: PPI Campaign, available at www.fca.org.uk/ppi/.

[7] Yadin, *supra* note 5, at p. 120.

[8] Nathan Cortez, "Regulation by Database", 89 U. Colo. L. Rev. 1, 4 (2018).

[9] Yadin, *supra* note 5, at p. 135. Cortez, *supra* note 8, at p. 4, 23, 92.

[10] Yadin, *supra* note 5, at p. 114. Cortez, *supra* note 8, at p. 22.

[11] Cortez, *supra* note 8, at p. 22. This was, for example, the goal behind the establishment of the American Financial Consumer Protection Bureau database on customer complaints. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1021.

[12] This is the approach of the Dutch financial legislation. See: Juliette J.W. Pfaeltzer, "Naming and Shaming in Financial Market Regulations: A Violation of the Presumption of Innocence?", 10 Utrecht L. Rev. 134 (2014).

[13] Yadin, *supra* note 5, at p. 107-109. See also Pfaeltzer, *supra* note 12, at p. 147. Cortez Nathan Cortez, "Agency Publicity in the Internet Era", 2011 Byu L. Rev. 1371, 1427-1428 (2011).

[14] Yadin, *supra* note 5, at p. 141.

Regulatory shaming has several benefits. It diversifies the enforcement mechanisms available to the regulator; its implementation is simple and inexpensive;[15] and experience in a number of fields has shown that the efficacy of the enforcement strategy is enhanced.[16]

On the other hand, regulatory shaming also has its drawbacks. Concern has been voiced that regulators might employ it to exact revenge against a supervised entity or to achieve extraneous objectives.[17] In addition, it is feared that as regulatory shaming becomes more ubiquitous, it will be used as a substitute for traditional enforcement and punitive measures, ultimately undermining the effectiveness of enforcement. Further, shaming can cause considerable economic damage to the supervised body.[18]

This chapter examines whether it is appropriate for the banking regulator to employ shaming as an enforcement mechanism in light of the special characteristics of the banking sector. Banks depend on public trust and the public's deposit of funds. Shaming can undermine public confidence, causing customers to abandon the targeted bank and make massive withdrawals. It has the potential to destabilize the bank and in extreme cases cause its collapse. Due to the banking sector's central role in the economy, a bank collapse could harm the economy as a whole. Consequently, caution must be exercised in choosing the appropriate enforcement and punishment strategies, including shaming, when dealing with banks.

The chapter will be structured as follows: Section B will describe the unique characteristics of the banking system that mandate the exercise of caution when choosing enforcement measures, including shaming, to be taken against banks. Section C will detail the considerations that actually favor regulatory shaming in the banking sector. A review of the activities of banking regulators around the world reveals that many regulators already apply shaming tactics against banks which are subject to their supervision. Section D will analyze these tactics with reference to four modes of shaming: publishing enforcement decisions issued by the regulator against infringing banks; publishing customers' complaints and the outcome of handling procedures; publishing comparative data concerning banks; and publishing audit reports produced by the regulator. Finally, Section E will present a model for regulatory shaming in the banking field, and call on banking regulators to implement the model as part of their enforcement strategy.

B. THE UNIQUE CHARACTERISTICS OF THE BANKING SYSTEM

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15 Yadin, *ibid*, at p. 129-131.

16 See, for example, a study that found that shaming by the American Occupational Safety and Health Administration also reduced regulatory violations in other workplaces: Matthew S. Johnson, "Regulation by Shaming: Deterrence Effects of Publicizing Violations of Workplace Safety and Health Laws", 110 American Economic Review 1866 (2020). On regulatory publicity as increasing compliance, see: Judith van Erp, "Naming and Shaming in Regulatory Enforcement", in Christine Parker and Vibeke Lehmann Nielsen (eds), *Explaining Compliance – Business Responses to Regulation* 322 (2011).

17 Cortez, *supra* note 13, at p. 1450.

18 For examples, see *infra,* note 58. This is especially true in the internet era due to the scope and magnitude of the transfer of information. See Cortez, *supra* note 13, at p. 1374, 1398 (2011).

The banking system has a number of special characteristics that should be taken into account when considering whether to name and shame a bank.[19]

1. THE CENTRAL ROLE OF BANKS IN THE ECONOMY

The first issue that should be born in mind is the dominant role of banks in our economy. The banks are central players in the provision and distribution of liquidity to the market.[20] The credit provided by the banks finances broad segments of business and private activities in the country.[21] The banks manage the payment system and are responsible for the transfer of money.[22] In addition, the banking industry is the key transmission channel for monetary policy, since it acts as a pipeline for the transfer of governmental loans, and serves as the counterpart for the central bank's operations.[23]

Due to the pivotal role of the banks, the collapse of a bank—and in particular a major bank—could materially injure the essential services and economic activity of the market.[24] Therefore, caution must be exercised in taking enforcement proceedings against the banks, certainly when these may undermine the stability of a bank.

2. SENSITIVITY TO SHOCKWAVES

Banks, more than other companies in the economy, are particularly sensitive to shockwaves that could endanger their stability.

Banks are financial intermediaries that receive funds from customer-depositors and make them available for the use of customer-borrowers.[25] Although other financial intermediaries are increasingly entering the field of banking activities, the banks are still the only financial intermediaries engaged in deposit receiving and credit provision at the same time.

This special type of financial intermediation is not dependent on the size of the bank's equity. This means that the bank's main activity does not require a broad capital base and therefore the bank can operate with reduced equity.[26] Because of this unique situation, a shockwave, with which a corporation with a broader capital base is capable of coping, may have a negative impact on the bank and lead it to quickly deteriorate into a state of insolvency. Hence the need to exercise extra caution in the use of various enforcement measures against the banks.

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19 Ruth Plato-Shinar, *Banking Regulation in Israel: Prudential Regulation versus Consumer Protection* 4-9 (2016).

20 Philip E. Strahan, "Liquidity Production in Twenty-First-Century Banking", in Allen N. Berger, Philip Molyneux, John O.S. Wilson (eds), *The Oxford Handbook of Banking* 112 (2010). John Armour et al, *Principles of Financial Regulation* 277 (2016).

21 Armour, *ibid*, at p. 278.

22 *Ibid*, at p. 281-283.

23 Tommaso Padoa-Schioppa, *Regulating Finance: Balancing Freedom and Risk* 46 (2004) .

24 Jonathan R. Macey and Geoffrey P. Miller, "Bank Failures, Risk Monitoring, and the Market for Bank Control", 88 Columbia Law Rev. 1153, 1154 (1988).

25 Mathias Dewatripont and Jean Tirole, *The Prudential Regulation of Banks* 13-14 (1993). Armour, *supra* note 19, at p. 28.

26 Anat Admati, Martin Hellwig, *The Bankers' New Clothes: What's Wrong with Banking and What to Do about It* (2013).

3. THE RISK OF CONTAGION

Another reason for the special sensitivity of banks to shockwaves is the exposure of the banks to contagion, namely, the possibility that failure of one bank will affect other banks in the system.[27]

Contagion may occur through two main channels. The first is the "real" or "exposure" channel, which relates to the potential for a "domino effect" through real, direct exposures. Such susceptibility ensues from the interconnectedness among the banks in the inter-bank market (borrowing from, and lending to, each other) and from the linkages between banks in the settlement and payment systems.[28]

The second channel is the "information channel".[29] It relates to contagious depositor withdrawals, which are caused by imperfect information about a perceived failure of a bank. When depositors in one bank see depositors in another bank rush to withdraw their funds, and particularly if they see the other bank closing its doors rather than paying out, they might conclude that their own bank is vulnerable to the same sort of experience, and immediately initiate a run on their bank, which will put the latter at risk as well.[30]

Thus, even in the case of one bank, there is a need to exercise extra caution when it comes to implementing enforcement measures.

4. DEPENDENCE ON PUBLIC CONFIDENCE

Another idiosyncrasy of the banking system is its dependence on public confidence.

Banks are dependent on customer deposits because these are the main source of money lent to other customers. However, a large portion of customer funds can be withdrawn on demand or after a short period of time.[31]

Rumors concerning a worsening of the bank's financial condition can lead to panic withdrawals with which the bank is unable to cope. Moreover, panic by depositors can cause the collapse of a bank even if that panic is based on false rumors.[32] Depositors prefer to withdraw their funds in the absence of clarity in regard to the bank's financial situation, thereby triggering the rapid depletion of the bank's liquidity reserves.[33] The phenomenon of a run on a bank can cause its collapse even if the bank is solvent, because the immediate need to repay the funds deposited may force the bank to dispose of its assets at a price below their real value.[34]

The existence of a safety net, such as a deposit insurance scheme, may mitigate the damage to depositors but cannot prevent a run on the bank, due to its limited scope and the fact that it

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[27] Richard J. Herring & Robert E. Litan, "Financial Regulation in the Global Economy" 50 (Washington D.C., Brookings Institution Press, 1995). Xavier Friexas et al, "Lender of Last Resort: A Review of the Literature", Financial Stability Review 151, 154 (1999).

[28] Frixas, *ibid*, at p. 155-156. Olivier de Bandt, Philipp Hartmann, Jose Luis Peydro, "Systemic Risk in Banking – an Update", in Allen N. Berger, Philip Molyneux, John O.S. Wilson (eds), *Oxford Handbook of Banking* 633, 643-650 (2010).

[29] Larisa Dragomir, *European Prudential Regulation and Supervision* 30 (2010).

[30] Macey & Miller, *supra* note 24, at p. 1156. Douglas W. Diamond and Philip H. Dybvig, "Bank Runs, Deposit Insurance, and Liquidity", 91 Journal of Political Economy 401(1983).

[31] Macey & Miller, *supra* note 24, at p. 1156.

[32] Herring and Litan, *supra* note 27 at p. 150.

[33] Diamond and Dybvig, *supra* note 30. See also Macey and Miller, *supra* note 24, at p. 1157.

[34] David T. Llewellyn, *Regulation and Supervision of Financial Institutions* 4 (1986).

does not fully cover the amounts deposited.[35] Needless to say, in countries where a deposit insurance scheme does not exist, the likelihood of a run on a bank is particularly high.

In view of the above, it is of paramount importance to maintain the stability of the banking system and strengthen public confidence in it. However, shaming may lead to precisely the opposite result: loss of trust in the bank may cause customers to abandon the "shamed" bank, withdraw deposits and undermine the bank's financial stability. Moreover, studies show that shaming has spillover effects that can also affect other banks, peers of the shamed body.[36] In light of this, one may ask whether shaming is an appropriate strategy in the banking context.

C. REGULATORY SHAMING IN THE BANKING SECTOR – *LEX FERENDA*

Countering the above considerations, which mandate the exercise of particular caution when publishing negative information about banks, are a number of factors that militate in favor of employing a shaming strategy against infringing banks.

1. THE SPECIAL IMPORTANCE OF DISCLOSURE IN THE BANKING SECTOR

In the previous section, I described the special status of banks in the economy. As central players in the capital and money markets, it is vital to ensure that banks operate legally and fairly and that effective measures are taken to deter them from violating relevant statutory provisions. The critical importance of this goal is evident from the numerous scandals that have affected banks globally in recent years.[37] Sunlight is the best disinfectant, and publicly exposing shortcomings in the conduct of banks may reduce the recurrence of similar failings in the future.

Following the global financial crisis of 2008, there has been a growing call for the banking system to become more transparent to the public.[38] Proponents of this approach argue that increasing transparency through the disclosure of detailed, up-to-date information about the banks, their financial condition, business models, transactional risk levels, corporate governance, and the like may actually enhance the stability of the system.[39] Maximum disclosure allows market players to assess more accurately the risks in transacting with the bank and consequently

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35 Plato-Shinar, *supra* note 19, at p. 120-124.

36 Kishanthi Parella, "Reputational Regulation", 67 Duke L.J. 907, 914, 937-939 (2018).

37 Ruth Plato-Shinar, "Law and Ethics: The Bank's Fiduciary Duty towards Retail Customers", in Costanza Russo, Rosa Lastra and William Blair (eds), *Research Handbook on Law and Ethics in Banking and Finance* 214, 214 (2019). The misbehavior of banks is reflected in their increasing conduct costs. See Ruth Plato-Shinar and Keren Borenstein-Nativ, "Misconduct Costs of Banks – The Meaning behind the Figures", 32 BFLR 495 (2017).

38 See, for example: Iris H-Y Chiu, "Transparency Regulation in Financial Markets – Moving into the Surveillance Age?" 2 European Journal of Risk Regulation 305 (2011).

39 Tito Cordella and Eduardo LavyYeyati, "Public Disclosure and Bank Failures", 45 International Monetary Fund Staff Papers 110 (1998), available at https://www.imf.org/external/Pubs/FT/staffp/1998/03-98/pdf/cordella.pdf. Solomon A. Tadesse, "The Economic Value of Regulated Disclosure: Evidence from the Banking Sector", 25 Journal of Accounting and Public Policy 32 (2006). Erlend Nier, "Banking Crises and Transparency" (2004), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=567052.

better protect themselves ("market discipline").[40] Concomitantly, maximum disclosure creates an incentive for banks to act responsibly, out of concern that any failures will be publicized. Regulatory shaming meshes with this trend as a mechanism that increases the transparency of the banking system.

As explained in Section A above, one of the concerns unique to the banking system is the fear of a run on a bank, potentially leading to its collapse and a negative impact on the entire economic system. However, not all adverse publicity creates the risk of a run on a bank. Publicity concerning a bank's financial difficulties may result in a panicked withdrawal of deposits, but other publicity may not necessarily produce the same effect. Indeed, a review of negative publications made by financial regulators around the world that do not refer to a bank's financial distress, teaches that these publications have not produced the harsh outcome of a run on the bank concerned.[41]

It seems, therefore, that the fear that regulatory shaming will undermine the shamed bank's stability is not always well-founded. While adverse publications that could cause a run on the bank or fracture its stability should be avoided, there are other types of negative publications that are best allowed.

2. REGULATORY SHAMING AS A BASIS FOR CIVIL ENFORCEMENT AGAINST BANKS

Government authorities—including the financial regulatory authorities—are not immune to phenomena such as regulatory captivity,[42] passivity in the exercise of authority and under-enforcement.[43] As a result, the authorities do not always pursue the requisite enforcement and punitive measures against the infringing bodies. In these cases, civil enforcement in the form of lawsuits—including class actions—against the banks is of great importance.[44] Such claims may be instituted by customers, investors, consumer organizations and various associations, in order to exhaust remedies against the infringing bank.

Civil enforcement is another tool for law enforcement, creating deterrence, and allowing injured members of the public to obtain relief. However, a precondition for establishing and succeeding in these claims is obtaining well-founded and reliable information about the infringing conduct. Due to the high level of trustworthiness of the regulator, the information

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[40] Robert Bartlett, "Making Banks Transparent", 65 Vand. L. Rev. 293, 303 (2012).

[41] See *infra* Part D.

[42] Regulatory capture refers to situations in which regulators serve the industry's private interests instead of the public interest. See, e.g., Daniel Carpenter & David A. Moss (eds.), *Preventing Regulatory Capture: Special Interest Influence in Regulation and How to Limit It* (2014).

[43] Cortez, *supra* note 8, at p. 25. For an illustration of these phenomena in respect of bank fees, see: Ruth Plato-Shinar, *The Bank Fees Regime in Israel – A Political Economy Perspective*, *in* Emilios Avgouleas & David C. Donald (eds), *The Political Economy of Financial Regulation* 189 (2019).

[44] On private enforcement see: Matthew C. Stephenson, "Public Regulation of Private Enforcement: The Case for Expanding the Role of Administrative Agencies", 91 Va. L. Rev. 93 (2005). On shaming by private enforcers, see: David A. Jr. Skeel, "Shaming in Corporate Law", 149 University of Pennsylvania Law Review 1811, 1824–25, 1844–45 (2001).

published by it is considered reliable and may serve as a basis for civil enforcement proceedings.[45]

The information published by the regulator may be used for additional civil measures against the infringing banks. Third parties such as consulting firms that publish findings and recommendations, bloggers influencing public opinion, civil society organizations promoting public campaigns, and even other law enforcement agencies, may also rely on the information published by the banking regulator based on the latter's reliability and trustworthiness.[46]

In this context, it is worth mentioning the role of the media in monitoring the banking system, and the importance of investigative journalism leading to broad public exposure. The reliability of media reports depends on obtaining credible material from an authorized source, and publications issued by the regulator can fulfill this role.[47]

In addition to pursuing civil enforcement measures against infringing banks, importance attaches to exerting public pressure on policy makers in order to motivate them to act to change the status quo. A variety of banking reforms are the result of public pressure and censure. Here, too, information plays a key role. The information is essential for the formation[48] of public opinion, shaping the public agenda and spurring public involvement. Regulatory shaming makes reliable information available to the public and enables the public interest to be promoted through public censure and pressure.

3. INCREASING THE TRANSPARENCY OF THE BANKING REGULATORY AUTHORITY

For years, confidentiality was considered an inevitable aspect of financial supervision, so that publishing information about decisions and measures taken by financial regulators was treated with circumspection.[49] In recent years, however, attitudes have changed, and calls have increased for greater transparency on the part of financial regulatory authorities.[50]

The transparency of government institutions is an essential condition for the proper functioning of the public system.[51] It enables the existence of effective control mechanisms on the administrative echelon, and supervision of the appropriateness of the authority's operations. Transparency is the basis for the authority's accountability.[52] In addition, transparency may motivate the authority itself to improve its operation, knowing that it is constantly exposed to the

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45 Yadin, *supra* note 5, at p. 110-112. But compare Cortez, who questions this assumption, *supra* note 8, at p. 71-72

46 Cortez, *ibid*, at p. 26.

47 On media enforcement see: Skeel, *supra* note 44, at 1841-1844.

48 See, for example: Lisa Kastner, "Much Ado About Nothing? Transnational Civil Society, Consumer Protection and Financial Regulatory Reform", 21 Review of International Political Economy 1313 (2014). In Israel, public pressure led to supervision over bank fees. See, Plato-Shinar, *supra* note 44

49 Rene Smits and Nikolai Badenhoop, "Towards a Single Standard of Professional Secrecy for Supervisory Authorities – A reform proposal", 44 European Law Review 295, 299.

50 See, for example: Christine Kaufmann and Rolf Weber, "The Role of Transparency in Financial Regulation", 13 Journal of International Economic Law 779 (2010). Smits and Badenhoop, *supra* note 49.

51 Cortez, *supra* note 8, at p. 27-28.

52 Smits and Badenhoop, *supra* note 49, at p. 296. Mark Fenster, "The Opacity of Transparency", 91 Iowa L. Rev. 885, 894-899 (2006). Jennifer Shkabatur, "Transparency With(out) Accountability: Open Government in the United States", 31 Yale L. & Pol'y Rev. 79, 83, (2012).

critical eye of the public.[53] Information transparency also has the effect of increasing public trust in the authorities.[54]

Regulatory shaming is a means of increasing the transparency of the regulators themselves as it provides information about their supervisory and enforcement activities. An effective system of banking supervision, characterized by a high level of transparency, may strengthen the status of banking supervision in the eyes of the public, and at the same time heighten public confidence in the banking system itself.

So far I have listed the considerations in favor of regulatory shaming of banks. However, alongside the benefits of regulatory shaming, it is important to examine the implications of such a measure on the bank being shamed.

Regulatory shaming harms the bank's good name and reputation.[55] Such an injury is not a theoretical matter. The embarrassment can cause the bank real economic damage, including abandonment by customers, withdrawal of deposits, loss of transactions and loss of profits.[56] An example is the case of Wells Fargo Bank, which for years opened millions of fictitious accounts for its customers without their knowledge and consent. When this was discovered, the Consumer Financial Protection Bureau (CFPB) fined the bank USD 185 million, but that figure was only a small portion of the loss that the bank suffered as a result of its tainted reputation. One study predicted that, as consumers switched to other banks in the wake of the scandal, Wells Fargo stood to lose almost USD 100 billion in deposits plus another USD 4 billion in revenue over the next two years.[57]

Despite the considerable damage that can be caused to a bank being shamed, I believe that such cases should not prevent bank regulators from engaging in shaming measures. This approach is based on the fact that, as explained, shaming is a means of achieving a public interest.[58] In balancing the need to promote the public interest against protection of the bank's private interest, the former must be preferred even at the cost of some harm to the latter. This conclusion is strengthened in light of the fact that the bank being shamed by the regulator has

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53 Cortez, *supra* note 8, at p. 25.

54 See: Roman Horvath and Dominika Katuscakova, "Transparency and Trust: The Case of the European Central Bank", 48 Applied Economics 5625 (2016).

55 For a discussion on whether a corporation is entitled to a right to reputation see, for example: David J. Acheson, "Corporate Reputation under the European Convention on Human Rights", 10 Journal of Media Law 49 (2018). Gary KY Chan, "Corporate Defamation: Reputation, Rights and Remedies", 33 Legal Studies 264 (2013). Konstantin Tretyakov, "Corporate Identity and Group Dignity", 8 Wash. U. Jur. Rev. 171, 205, 213 (2016).

56 See Cortez, *supra* note 8, at p. 29. Parella, *supra* note 36, at p. 910–911. Jonathan M. Karpoff, "Does Reputation Work to discipline Corporate Misconduct?" in Timothy G. Pollock and Michael L. Barnett (eds), *Oxford Handbook of Corporate Reputation* 361 (2012). In the banking field, one study found that the publication of customers complaints by the Financial Consumer Protection Bureau, led to a greater reduction in mortgage applications to banks that received more mortgage complaints. See: Yiwei Dou and Yongoh Roh, "Public Disclosure and Consumer Financial Protection" (2020), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3647491.

57 CG42, Wells Fargo Mini-Study 3 (2016), available at http://cg42.com/wp-content/uploads/2016/12/cg42-Wells-Fargo-Mini-Study-102016vF.pdf. See also: Evan Ramstad, "U.S. Bancorp's Richard Davis Says Banks Are Still Fighting for Their Reputation", STAR TRIB. (Oct. 19, 2016, 9:09 PM), available at https://www.startribune.com/u-s-bancorp-profit-continues-steady-march/397576481/.

58 Yadin, *supra* note 5, at p. 142.

(presumably) contravened the provisions of the law and acted in a manner completely contrary to the public interest. As long as the regulator applies the shaming measures properly and proportionately, and the publication does not undermine the stability of the bank, it seems that the benefits inherent in this strategy outweigh the difficulties it produces for the banks themselves.

D. TECHNIQUES FOR REGULATORY SHAMING IN THE BANKING SECTOR

A review of the conduct of banking regulators in different countries reveals that, despite the sensitive characteristics of the banking system outlined in Chapter B above, banking regulators do make use of shaming as a regulatory device. Four principal channels are utilized: publication of enforcement decisions, publication of customers' complaints, publication of comparative data and ratings, and publication of audit reports issued by the regulator. Each of these channels is discussed below.

1. PUBLICATION OF ENFORCEMENT DECISIONS

The most powerful means of shaming available to the banking regulator is the open publication of the regulator's decision regarding a violation or offense committed by a bank as well as the sanction imposed on the bank in respect thereof (hereinafter – "enforcement decision"). A survey of various jurisdictions indicates that this is the most common way of shaming. The publication is usually made pursuant to explicit statutory powers. In some cases, the regulator is vested with discretionary power to publish, while in other cases the statutory power is mandatory and must be exercised.

A duty to publish enforcement decisions can be found in various European directives that apply to banks operating throughout the EU. One example is the Capital Requirements Directive that deals with the capital required of these institutions.[59] The Directive requires from Member States to ensure that the financial regulators publish on their official website any administrative penalties against which there is no appeal, and which are imposed for breach of the national provisions that implement the Directive, including information on the type and nature of the breach and the identity of the natural or legal person on whom the penalty is imposed, without undue delay after that person is informed of those penalties. Where Member States permit publication of penalties against which there is an appeal, the financial regulators shall, without undue delay, also publish on their official websites information on the appeal status and outcome thereof.[60]

Notwithstanding the foregoing, the financial regulators shall publish the penalties on an anonymous basis in any of the following circumstances: (a) where the penalty is imposed on a natural person and, following an obligatory prior assessment, publication of personal data is

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59 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176/338. Another example is Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, OJ L 173/349 , Article 71.

60 *Ibid*, Art. 68(1).

found to be disproportionate; (b) where publication would jeopardize the stability of financial markets or an ongoing criminal investigation; (c) where publication would cause disproportionate damage to the institutions or natural persons involved.[61] The regulators shall ensure that information remains on their official website at least five years. Personal data shall be retained on the official website of the competent authority only for the period necessary, in accordance with the applicable data protection rules.[62]

In addition to implementing the provisions of the EU Directives in their national law, various European countries have enacted rules in respect of the publication of enforcement decisions.

In the UK, for example, the Financial Services and Markets Act 2000 refers to the publication of three types of notices, as follows:[63]

1. Publication of a supervisory notice, a decision notice or a final notice. Such a publication is mandatory. However, the regulator may not publish the information if, in its opinion, publication of the information would be unfair to the person with respect to whom the action is taken; prejudicial to the interests of consumers (where the regulator is the Financial Conduct Authority); prejudicial to the safety and soundness of a supervised bank (where the regulator is the Prudential Regulation Authority); or detrimental to the stability of the UK financial system.

2. A notice of discontinuance: Such a notice may be published only if the persons to whom the notice is given or copied, consents.

3. The publication of a warning notice: Such a publication is forbidden, as is any information relating to it. However, in respect to certain warning notices that are detailed in the Act, the regulator may, after consulting the persons to whom the notice is given or copied, publish information about the matter as it considers appropriate.[64]

The Financial Services and Markets Act 2000, provides the UK financial regulators with another avenue of publication. The Act empowers regulators, to censure a bank publicly by way of a disciplinary measure. The Act states that, if the regulator considers that a bank has contravened a requirement imposed on it, the regulator may publish a statement to that effect.[65] This provision is accompanied by sections that allow the regulator to impose financial penalties, suspend permission or impose a restriction in relation to the carrying on of a regulated activity; a structure that clarifies that the adverse publication *per se* is a disciplinary penalty.[66]

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[61] *Ibid*, Art. 68(2).

[62] *Ibid*, Art. 68(3).

[63] Financial Services and Markets Act 2000, Section 391. See also Financial Conduct Authority Enforcement Guide, Chapter 6, available at https://www.handbook.fca.org.uk/handbook/document/EG_Full_20140401.pdf.

[64] On the publication of warning notices, see: Shail Patel and Ian Weinstein, "Five Years of Warning Notice Statements: Balancing Transparent Regulation Against Procedural Fairness" 4 NewSquare (26.3.2019), available at https://www.4newsquare.com/five-years-of-warning-notice-statements-balancing-transparent-regulation-against-procedural-fairness/.

[65] Financial Services and Markets Act, 2000, c. 8, Section 205. The Financial Conduct Authority (FCA) publishes the information in its website, in a dedicated webpage: https://tinyurl.com/y2k83tdt. However, the Prudential Regulation Authority (PRA) includes the date in the Enforcement Decision Making Committee Report, See: https://www.bankofengland.co.uk/prudential-regulation/publication/2020/enforcement-decision-making-committee-2019-20-report.

[66] Financial Services and Markets Act, 2000, Part XIV Disciplinary Measures.

The Act further determines that if a regulator *proposes* to publish a statement, it must give the bank a warning notice which will set out the terms of the statement.[67] If the regulator *decides* to publish a statement, it must without delay give the bank a warning notice which will set out the terms of the statement.[68] The bank may refer a decision notice to a special tribunal established pursuant to the Act.[69] After a statement is published, the regulator must send a copy of it to the bank.[70]

In the Netherlands too, one may find detailed legislation on the publication of enforcement decisions by the financial regulator. The Dutch Financial Supervision Act refers to three types of publications:

1. Publication of a public warning in respect of a violation—prior to the imposition of a penalty;
2. Publication of an imposed administrative fine;
3. Publication of an imposed incremental penalty payment—for a continuing violation.

Whereas a publication in the first category is at the discretion of the regulator, the regulator is under a duty to publish the latter two categories of penalties. Dutch law prescribes detailed procedures regarding the manner, date and content of the publication, the right of the financial institution to refer to the courts against publication, and more.[71]

In the United States, enforcement decisions are subject to a statutory disclosure obligation, even if they are the product of inspection and audit reports, which are considered confidential as is explained below.[72] These decisions are regularly published on the financial regulators' websites, which also include advanced search engines. Decisions are published in detail, and regulators are prohibited from merely setting out extracts or summaries of them.[73]

Apart from enforcement decisions, there are regulators that publish a register which provides information about people and organizations that the regulator has disqualified or banned from practicing in the financial services, including the details of the violation committed by them.[74]

Nonetheless, there are countries where the publication of enforcement decisions is less commonplace. An example of this is Israel. A review of enforcement decisions published by the Supervisor of Banks shows that the Supervisor customarily confines the publication of

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[67] *Ibid*, Section 207. As to the confidentiality of the warning notice, see Section 391.

[68] *Ibid*, Section 208.

[69] *Ibid*.

[70] *Ibid*, Section 209.

[71] Financial Supervision Act (Wft), Articles 1:94-1:101. For elaboration, see: Pfaeltzer, *supra* note 12.

[72] See, for example, in respect of the Federal Reserve Board :12 U.S.C. §1818(u), and the definition of the term "confidential supervisory information" in 12 C.F.R. § 261.2(c)(1)(A) which excludes final orders and agreements.

[73] See, for example, the website of the Federal Reserve Board: www.federalreserve.gov/apps/enforcementactions/search.aspx.

[74] See, for example: Australian Securities and Investments Commission (ASIC): Banned and Disqualified, available at https://asic.gov.au/online-services/search-asics-registers/banned-and-disqualified/.

enforcement decisions to one area—the prohibition of money laundering.[75] Apart from this, only a handful of enforcement decisions have been published in other areas over the years.[76] There is no statutory provision in Israeli law that authorizes the Supervisor of Banks to publish enforcement decisions. However, the authority to publish decisions may derive from the general statutory provision vesting the Supervisor with the power to supervise and audit banking corporations.[77] The absence of a clause mandating publication, or at least authorizing the Supervisor of Banks to do so, may explain the conservative approach and scarcity of publications on the subject.[78]

2. PUBLICATION OF CUSTOMER COMPLAINTS

Another regulatory shaming measure involves the publication of information about justified complaints filed by customers against the various banks.

In the United Kingdom, for example, the FCA publishes information every six months on complaints filed against banks.[79] The publication includes information about the particular banks and specifies their names, however it only includes data on banks that have reported 500 or more complaints in a six month period, or 1,000 or more in a year. The publication contains the number of opened, closed and upheld complaints per bank, the type of product the complaint was about, the reason for the complaint, and the amount of redress paid. The FCA publishes the data in a dedicated web-page, in a user-friendly manner, including search engines that facilitate finding the information.

Information on customer complaints filed against banks is also published in the United States. For example, the FCPB publishes a Consumer Complaint Database that includes complaints that were submitted to the FCPB about consumer financial products and services.[80] The complaints are published after the bank responds, confirming a commercial relationship with the consumer, or after 15 days, whichever comes first. The database includes broad statistical and individual information, as well as sophisticated search engines. The database is generally updated daily. The published data includes not only the bank's name but also its response (if any), and whether the response was timely or further disputed by the customer.[81]

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75 See: Bank of Israel: Sanctions Committee, available at https://www.boi.org.il/en/BankingSupervision/AntiMoneyLaunderingAndTerrorFundingProhibition/Pages/SanctionsCommittee.aspx.

76 Ruth Plato-Shinar, "Regulatory Shaming: Should it Serve as an Enforcement Tool in Banking Regulation?", 23 Law & Business 1, 23-24 (2019, in Hebrew).

77 Banking Ordinance 1941, Section 5(a).

78 Another explanation for the scarcity of publications could be a paucity of enforcement decisions.

79 FCA Complaints Data, available at www.fca.org.uk/firms/complaints-data

80 FCPB Consumer Complaint Database, available at https://www.consumerfinance.gov/data-research/consumer-complaints/.

81 For analyses of this database, see: Dou & Roh, *supra* note 56. Cortez, *supra* note 8, at p. 47-52. lan Ayres et al., "Skeletons in the Database: An Early Analysis of the CFPB's Consumer Complaints", 19 Fordham J. Corp. & Fin. L. 343 (2014).

In other countries, information about customer complaints is published in a less accessible way. For example, in Israel, the Supervisor of Banks does not maintain a public database of customer complaints. Instead, the Supervisor publishes an annual report reviewing his department's activities concerning complaints in the foregoing year, from which data can be extracted.[82]

The first part of the report provides comparative quantitative data between the various banks.

The second part includes a ranking of the five largest banks and scores for each of these banks based on the following criteria: (a) the rate of complaints found to be justified by the Supervisor of Banks; (b) the ratio of each bank's share of complaints to its share in the system; (c) the rate of complaints which the bank handled appropriately out of the total number of complaints in respect of which the Supervisor of Banks approached the bank; (d) the rate of cases in which the bank acted for the benefit of the customer even though the complaint was not found to be justified.

The third part of the report reviews examples of specific complaints found to be justified by the Banking Supervision Department. In this context, however, the information is usually provided on an anonymous basis, without specifying the name of the bank.[83]

3. PUBLICATION OF COMPARISONS AND RATINGS OF THE SUPERVISED ENTITIES

Another shaming technique involves the publication of comparative data between the banks regarding the manner of their conduct, while assigning a score to each bank. This technique clearly has the effect of embarrassing the bodies that receive low scores.

For example, in Israel, in 2018 the Supervisor of Banks began publishing an annual survey that examines customer satisfaction with the quality of service received. The survey examines the level of satisfaction with the bank in general, the specific branch, the waiting time at the branch, the waiting time for a telephone response, the use of electronic service stations, and the bank's digital services.[84] The numerical results enable an easy comparison between the various banks, and have an embarrassing effect on banks that have earned a low result.

4. PUBLICATION OF AUDIT REPORTS

Another possible channel for regulatory shaming is the publication of a bank's audit report. An audit report is one of the most effective instruments for dealing with deficiencies discovered during the course of a bank audit. The report describes in detail the deficiencies discovered, and prescribes the procedures required to correct them. Some audit reports include harsh and incisive criticism, and are written—in terms of content and style—in the knowledge that they will only be

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[82] See, for example: Bank of Israel – Banking Supervision Department, Review of Public Enquiries and Measures to Protect Banking Customers, 2018 (25.9.2019), available at https://www.boi.org.il/en/NewsAndPublications/PressReleases/Pages/29-3-19.aspx.

[83] For a critical analysis of these reports, see: Plato-Shinar, *supra* note 76, at p. 19. Plato-Shinar and Borenstein-Nativ, *supra* note 37, at p. 513.

[84] See, for example: Bank of Israel – Banking Supervision Department: Press Release: The Banking Supervision Department publishes the findings of the second annual survey on customers' satisfaction with the service they receive from the banks (2.12.2019), available at https://www.boi.org.il/en/NewsAndPublications/PressReleases/Pages/2-12-19.aspx.

seen by the audited bank. Therefore, the publication of audit reports is a particularly sensitive action which the regulator generally refrains from performing.

In Israel, the Supreme Court has ruled that audit reports will be kept secret and not made public.[85] This ruling is based on a statutory provision which imposes a duty of confidentiality on all information and documents submitted to the Supervisor of Banks.[86] The court interpreted the section widely so that the duty of confidentiality established by the section applies not only to the "raw materials" submitted by the bank for supervision, but also to the product obtained after these materials have been processed by the regulator, and therefore the court prohibits the publication of the ensuing audit reports.

The Supreme Court upheld the Supervisor of Banks' argument that the banks cooperate with the Supervisor in reliance on the fact that the findings are confidential and that the Bank of Israel will not disclose them to a third party. Removing the confidentiality of the reports would lower the level of cooperation on the part of the bank, thereby impairing the effectiveness of the reports ("chilling effect"). In addition, the court accepted the argument that the relationship between the Supervisor and the banks is an "intimate" one that also includes informal consultations based on the understanding that the information remains confidential. The court ruled that by virtue of their nature, inspection and audit activities should remain confidential, and that in the field of banking, this conclusion has even greater validity due to the sensitive nature of the information.[87]

Other countries follow a slightly more flexible approach.

In the United States, the banking regulators' audit reports are defined as "confidential supervisory information",[88] and enjoy statutory confidentiality.[89] The courts have explained that this special arrangement was born out of the practical need for full transparency in the relationship between the regulators and the regulated entities, a transparency that is necessary for effective supervision and the integrity of the supervisory process.[90] Confidentiality applies broadly to all audit, inspection and review reports of any kind, and encompasses all information related to or included in them.[91]

However, under US law, the regulator—and only he—is allowed to decide on the disclosure of the information.[92] Anyone interested in obtaining such confidential information is required to make an appropriate application to the regulator in accordance with the procedure set out in the regulations, and the regulator has discretion as to whether to grant the request or not.[93] The

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85 APA 5089/16 The Movement for Quality Government in Israel v. Bank of Israel (2018). See also: ACA 6546/94 Israel Union Bank Ltd. v. Azulay, PD 49(4) 54 (1995).

86 Banking Ordinance 1941, Section 15A. Similar sections exist in other jurisdictions as well. See, for example, in the UK: Financial Services and Markets Act, 2000, Section 348.

87 APA 5089/16, *supra* note 85, at paras. 21-22.

88 See, for example, 12 C.F.R. § 261.2 (the Federal Reserve Board).

89 See, for example: 12 C.F.R. §§ 261.22(a) (the Federal Reserve Board). 12 C.F.R. § 4.36(b) (Office of the Comptroller of the Currency ;12 C.F.R. § 309.6 (Federal Deposit Insurance Corporation) ; 12 C.F.R. §§ 1070.41 (Consumer Financial Protection Bureau).

90 *In re* Subpoena Served upon Comptroller of Currency, 967 F.2d 630 (D.C. Cir. 1992) .Wultz v. Bank of China Ltd., 61 F. Supp. 3d 272 (S.D.N.Y. 2013).

91 12 C.F.R. § 261.2.

92 12 C.F.R. § 261.20(g).

93 12 C.F.R. § 261.22.

premise is that the information is confidential, and that its disclosure will be permitted, if at all, in only a few exceptional cases.[94]

Similarly, in the UK, audit reports are considered "confidential information".[95] As such, they must not be publicly disclosed by the regulators, without the consent of the bank from whom the regulator obtained the information and the persons to whom they relate.[96]

However, the Act further determines that information is not confidential if: (a) it has been made available to the public by virtue of being disclosed in any circumstances in which, or for any purposes for which, disclosure is not precluded by the Act; or (b) it is in the form of a summary or collection of information so framed that it is not possible to ascertain from it information relating to any particular person.[97]

E. SUMMARY – THE PROPOSED MODEL FOR REGULATORY SHAMING IN THE BANKING SECTOR

In Section B we saw the special characteristics of banks that require extra care to be taken when publishing negative information about banks. Banks rely on public trust and on public deposits. Shaming can undermine that public trust, lead customers to abandon the bank concerned and make massive withdrawals of deposits. This may lead to damage to the bank's stability and—due to the contagion effect—damage to the banking system as a whole.

On the other hand, in Section C we listed a number of considerations that justify the disclosure of negative information about the banks. Among other things, we saw that not every negative publication will lead to customer abandonment and financial damage to the banks. In addition, we saw that banking transparency may improve bank conduct, increase public confidence in banks, and therefore strengthen the banking system. It should also be reiterated that the purpose of shaming is not to demean or humiliate the bank, but to motivate it to correct its procedures, deter other banks from committing similar violations, bring about improved market behavior, and achieve public interests. In various cases these goals are indeed reached.[98]

Given all this, it seems that shaming is an appropriate enforcement measure in the banking context. However, due to the sensitivity of this field, I propose the adoption of a **banking regulatory shaming model**, as described below.

1. ENACTING AN EXPLICIT EMPOWERMENT CLAUSE

From the above discussion it can be noticed that the approach of the law to regulatory shaming in the banking field differs between jurisdictions. In some countries the issue is regulated statutorily, while in other jurisdictions the law is silent. In those jurisdictions where the legislature has explicitly addressed the issue and conferred authority upon the regulator, the

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94 12 C.F.R. § 261.22(a).

95 Financial Services and Markets Act, 2000, Sections 348(2) and (3). See also: Financial Conduct Authority: FCA Mission: Approach to Supervision 23-24 (April 2019), available at

96 Ibid, Section 348(1). https://www.fca.org.uk/publication/corporate/our-approach-supervision-final-report-feedback-statement.pdf.

97 Ibid, Section 348(4).

98 See *supra* note 16.

power can be either mandatory—compelling the regulator to publish information in certain cases, or discretionary—letting him decide upon the matter. In countries where the law is silent, confidentiality clauses—and their interpretation by the courts—play an important role in determining the scope of information that may be disclosed.

As a starting point for the proposed model, I am of the opinion that one should not be satisfied with general provisions vesting supervisory and enforcement powers on the banking regulator. Rather, the power to censure should be anchored in explicit legislation, by establishing an empowerment clause that would allow the banking regulator (and in some cases even compel it) to publicize the required information. Such an empowerment clause would not only remove the fear of unauthorized publication, but would also reflect the legislature's expectation that the regulator will exercise its authority, thereby encouraging such activity.

2. SCOPE OF DISCLOSURE PURSUANT TO THE PROPOSED EMPOWERMENT CLAUSE

The proposed empowerment clause will vest the regulator with discretion as to the nature and scope of the information to be published, thus ensuring flexibility and enabling the shaming tactic to be adapted to the circumstances of the case in question. However, a number of basic principles can be applied when deciding upon the content of the publication:

- No information will be published that could, in the opinion of the regulator, impair the stability of the bank or cause a run on the bank.
- No information will be published that infringes the privacy or banking confidentiality of the bank's customers.
- No information will be published that infringes the bank's trade secrets.
- Information that has already been published by another competent local or foreign authority can be published. Such information has in any case lost its mantle of confidentiality, and therefore there can be no reason to preclude its publication by the banking regulator.
- Similarly, there is no impediment to republication of information that has already been published by the supervised bank itself—for example, within the framework of disclosure under securities law.
- Needless to say, no information will be published that must be kept confidential by virtue of any law.

3. DUTY TO PUBLISH ENFORCEMENT DECISIONS AND CUSTOMER COMPLAINTS

As may be recalled, enforcement decisions are the regulator's decisions regarding a violation or offense committed by a bank and the sanction imposed on the bank in respect thereof. Unlike reviews, inspection and audit reports which are conducted as part of the supervisory process vis-à-vis the bank, enforcement decisions are made after the process has been completed. They do not undermine cooperation between the bank and the regulator, and considerable importance attaches to disclosing them to the general public. In addition, the publication of an enforcement decision should not undermine the stability of the shamed bank, as it can be assumed that this risk had already been examined and factored in at the earlier stage when the sanction was imposed on the bank. If there was no initial fear that the imposition of the sanction would harm

the stability of the bank, we may safely assume that no such fear will arise as a result of its publication.

In light of this, insofar as concerns enforcement decisions, the regulator must be placed under a statutory duty to publish enforcement decisions, rather than enjoy a mere discretionary power to publish. Enforcement decisions should be published subject to being final and unappealable, and subject to the restrictions on publication set out in section E2 above.

Similar rules will govern the publication of customer complaints that are found to be justified. Such publication has an additional consumer purpose. Exposing the complaints and their handling process to customers who have experienced similar problems, will make it easier for the latter to file complaints and receive the remedies to which they are entitled.

4. RESTRICTING THE PUBLICATION OF AUDIT REPORTS

Different rules will govern inspection and audit reports. As mentioned, audit reports are one of the most effective instruments for dealing with deficiencies discovered in banking activity. The reports may include harsh criticism. They are written—in terms of their content and style—in the knowledge that they will only be seen by the audited bank. Data collection is dependent on the supervised bank's cooperation, and such cooperation is founded on the bank's understanding that the reports will not be disclosed to others. In light of this, the said reports and the information related to them should enjoy strict confidentiality.

Nevertheless, according to the model proposed here, the banking regulator will be given discretion to publish the above information in exceptional cases: where the public interest in disclosure of the information outweighs the interest in maintaining its secrecy; when disclosing the information does not pose a risk of harming the supervisory procedure; and subject to the considerations specified in section E2 above.

Within the scope of his discretion, the banking regulator will be able to decide whether to publish an outline or summary of the broad conclusions arising from the report, as opposed to the full and original report. The regulator will also be able to decide on the date of publication. Conceivably, he may choose to delay publication due to the sensitivity of a particular topic, to a time when it would have a weaker impact. As a general rule, the information will be kept confidential; its disclosure made possible in only exceptional cases at the discretion of the regulator.

5. OTHER PUBLICATIONS – DISCRETIONARY POWER

Insofar as concerns other publications such as comparison tables, indices and surveys, the regulator will be vested with discretion to publish data and information as it sees fit, subject to the criteria outlined in Section E2 above.

In conclusion, I believe that regulatory shaming based on the **banking regulatory shaming model** proposed in this chapter, can serve as an enforcement mechanism in the banking field. Its operation in accordance with the principles outlined above may lead to more effective banking supervision and improved conduct within the banking system.