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BREAKING BAD? TOO-BIG-TO-FAIL BANKS NOT GUILTY AS NOT CHARGED

NIZAN GESLEVICH PACKIN*

Since the 2008 financial crisis, rating agencies,1 regulators,2 global organizations,3 and academics4 have argued that large banks receive significant competitive advantages because the market still perceives them as likely to be saved in a future financial crisis.5 Therefore, not only do the largest banks enjoy the economic safety benefits of being large and diversified, but they also receive implicit as well as explicit and direct government subsidies.6 The most significant subsidy, an implicit one,

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4. See, e.g., Who is Too Big to Fail: Does Title II of the Dodd-Frank Act Enshrine Taxpayer-Funded Bailouts?: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Fin. Svcs., 113th Cong. 69 (2013) (written testimony of David A. Skeel, Jr., Professor of Corporate Law at the Univ. of Pa. Law Sch.), available at http://financialservices.house.gov/uploadfiles/hrbg-113-ba09-wstate-dskeel-20130515.pdf (large banks, “[a]mong other benefits . . . borrow money much more cheaply than other financial institutions, because their cost of credit is artificially reduced by the Too Big to Fail subsidy.”).


6. Put simply, subsidies are a method of financial support given to those in need without any pay-back obligation on the receiving end. See MERRIAM-WEBSTER’S COLLEGIATE DICTIONARY 1174 (10th ed. 1996). Subsidies can take various forms and can be granted using different types of policies, which include direct transfers of funds and support or indirect assistance. Doug Koplow, Case Studies of Subsidy Reform and Sustainable Development: Energy, in ORG. FOR ECON. CO-OPERATION & DEV.,
stems from market perception that the government will not allow the largest banks to fail—i.e., that they are “too-big-to-fail” (“TBTF”)—enabling them to borrow at lower interest rates. Focusing on these subsidies, recent media reports sent shockwaves across financial markets by estimating the value of the financial advantages for the six largest U.S. banks since the start of 2009 at $102 billion. On November 14, 2013, the Government Accounting Office (“GAO”) issued the first of two reports on the benefits large banks receive because of their size. A less obvious yet highly-related issue is large banks’ exemptions from criminal statutes. This issue was not mentioned in the 2013 report, but should be included in the 2014 report that will examine the economic advantages the largest banks receive because of implied government support. Specifically, in this Commentary, I argue that this exemption contributes to the subsidies’ economic value while also creating incentives for unethical and even criminal activity.

Before analyzing the elements of such exemptions, it is critical to first understand large banks’ subsidies framework in which such a benefit exists. The 2013 report was the result of a highly controversial debate on


A subsidy involves the direct transfer of public monies to the subsidized enterprise and uses resources exacted from taxpayers as a whole. An exemption, on the other hand, involves no such transfer. It assists the exempted enterprise only passively, by relieving a privately funded venture of the burden of paying taxes.

Walz v. Tax Comm’n of New York, 397 U.S. 664, 690 (1970) (footnote omitted). He explained that direct subsidies involve government “forcibly” diverting the income of taxpayers to the recipient, whereas exemption involves government “merely refrain[ing] from diverting to its own uses income independently generated . . . through voluntary contributions.” Id. at 691 (citing from Donald A. Giannella, Religious Liberty, Nonestablishment, and Doctrinal Development—Part II. The Nonestablishment Principle, 81 HARV. L. REV. 513, 553 (1968)).

7. See Robert Johnson, Introduction to ROOSEVELT INST., MAKE MARKETS BE MARKETS 9 (Robert Johnson & Erica Payne eds.) (2010), available at http://www.makemarketsbemarkets.org/report/MakeMarketsBeMarkets.pdf (“The structure of our current financial markets . . . has not been subject to the most important principle of all—the opportunity for market participants to fail.”).


the existence and nature of such subsidies, especially following the enactment of the Dodd-Frank Act,11 but there is still disagreement as to whether large banks actually receive any subsidies.12 Certain commentators argue that large banks deserve different treatment because they create benefits for businesses that would not be available elsewhere;13 the banking field facilitates substantial scale economies,14 which make

11. Despite the big banks’ attempts to prove that the Dodd-Frank Act would render their advantages insignificant, they have only been able to point to one independent academic research team that has found that the megabanks’ market advantages diminished because of the Dodd-Frank rules (concluding that the Act “has been effective in reducing” the subsidy). Bhanu Balasubramnian & Ken B. Cyree, Has Market Discipline on Banks Improved After the Dodd-Frank Act? 2 (Working Paper, Nov. 2, 2013), available at http://ssrn.com/abstract=2349042.


large banks a source of gains for society\textsuperscript{15} that justify Congress’s support. Therefore, they essentially argued that the largest banks are unique and worth protecting because they leverage revenue and cost synergies through economies of scale, and as a result create benefits, that pass on to their customers and investors and lower the costs of finance for the entire society.\textsuperscript{16}

One of the benefits large banks receive is a non-monetary semi-exemption from criminal statutes that contributes to their subsidies value. Indeed, the Department of Justice (“DOJ”) allows for “deferred prosecution” and advances settlements instead of criminal charges for large financial institutions when they violate criminal laws such as money laundering and drug trafficking.\textsuperscript{17} This semi-immunity policy, nicknamed “too-big-to-jail,”\textsuperscript{18} also translates into an additional economic advantage that only the largest banks enjoy.\textsuperscript{19}

\textbf{TOO-BIG-TO-JAIL}

In the years following the financial crisis, the media reported on large-scaled scandals in which the biggest banks were illegally involved. Nevertheless, even after it had learned about these scandals, the U.S. government only fined rather than prosecuted the relevant banks. This approach, which was nicknamed too-big-to-jail, caused a great deal of


\textsuperscript{16} Id.

\textsuperscript{17} Jessica Silver-Greenberg, \textit{HSBC to Pay Record Fine to Settle Money-Laundering Charges}, \textsc{N.Y. Times}, Dec. 12, 2012, at B3, available at http://dealbook.nytimes.com/2012/12/11/hsbc-to-pay-record-fine-to-settle-money-laundering-charges/?_r=0 (“Federal and state authorities secured a record $1.92 billion payment from HSBC . . . to settle charges that the banking giant transferred billions of dollars for nations under United States sanctions, enabled Mexican drug cartels to launder tainted money through the American financial system, and worked closely with Saudi Arabian banks linked to terrorist organizations.”).


anger and frustration.\textsuperscript{20} Trying to justify this policy, Attorney General Holder explained that the DOJ cannot indict big financial institutions because doing so might harm the economy. Holder, testifying before the Senate Judiciary Committee, said that he is “concerned that the size of some of these institutions becomes so large that it does become difficult for us to prosecute them when we are hit with indications that if we do prosecute—if we do bring a criminal charge—it will have a negative impact on the national economy, perhaps even the world economy.”\textsuperscript{21} Some have argued that this declaration is unsurprising given that in 1999, as Deputy Attorney General, Holder instructed prosecutors to consider “collateral consequences” when determining whether or not to prosecute corporations.\textsuperscript{22}

This statement also makes sense given the current reality, in which the U.S. government preferred, instead of prosecution,\textsuperscript{23} a $13 billion settlement in November 2013 with JPMorgan for its role in creating the 2008 crisis.\textsuperscript{24} One of the reasons for doing so is that whatever acts JPMorgan had allegedly done were of such magnitude that prosecution through the judicial system would have prolonged the proceedings not just over years, but possibly over generations. Thus, prosecuting JPMorgan appears to have been unrealistic and out of the question. JPMorgan was allowed to become too-big-to-jail, and now it is out of the reach of any


government, even if such benefits offend the public’s sense of justice. And while the DOJ declared that it “does not release individuals from civil charges, nor does it release JPMorgan or any individuals from potential criminal prosecution,”25 this statement does not mean much. According to certain studies, major banks normally do not get prosecuted, and banks that do typically receive deferred or non-prosecution agreements, which are settlements that avoid indictment or convictions.26 Similarly, individuals are also rarely prosecuted, and that helps the firm avoid criminal convictions as well.27 They believe that this is the result of the government not wanting the major banks to lose their banking licenses, or to hurt their reputation and consequently innocent shareholders.28

**IF YOU BUILD IT, THEY WILL COME**

Letting JPMorgan and other large banks dodge criminal liability has several negative effects. First, it “effectively vitiates the law as written by Congress,”29 as Congress had no intentions to declare that violations of money laundering, terrorist financing, or fraud would only constitute civil violations.

Second, giving the large banks *de facto* special treatment conflicts with the basic constitutional provision of equality under the law,30 as it essentially requires applying the law in such a way that discriminates in favor of the largest banks. Thus, it contradicts one of the most fundamental American legal principles,31 reinforced by the Supreme

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Court’s equal protection jurisprudence. Accordingly, reflecting upon this practice, a federal judge in New York noted that for judges who take an oath to apply the law equally, the ‘too-big-to-jail’ excuse is troubling, and disregards the principle of equality under the law.

Third, while the troubling too-big-to-jail policy refers to the prosecution of financial institutions, rather than their senior executives, it appears that the DOJ is also uninterested in prosecuting the individuals who worked at those banks and led their negative behavior. In fact, the DOJ has not pursued any of the large banks’ executives that were personally involved in the scandals that took place in the last few years despite the fact that several government agencies clearly stated in reports that in their opinion, fraud and unethical behavior both caused and exacerbated the financial crisis. For example, the Financial Crisis Inquiry Commission, in its final report, “uses variants of the word ‘fraud’ no fewer than 157 times in describing what led to the crisis, concluding that there was a ‘systemic breakdown,’ not just in accountability, but also in ethical behavior... [T]he crisis was in material respects the product of intentional fraud.”

Finally, making TBTF banks pay large fines in lieu of being prosecuted for their illegal actions is also problematic because it creates negative incentives for large banks in the contexts of (i) desired ethical standards

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32. Although many have assumed, including the Supreme Court in historic cases such as Palmer v. Thompson, 403 U.S. 217, 224–25 (1971) (motive irrelevant where swimming pool closings affect races equally) and Griffin v. Cnty. Sch. Bd. of Prince Edward Cnty., 377 U.S. 218 (1964) (shutting down all public schools in wake of desegregation order without intent evaluation), that action that carries the effect of discrimination violates principles of equality, the Court later narrowed the Constitution’s guarantee of equality under the law, ruling that intent was the standard. See Brando Simeo Starkey, A Failure of the Fourth Amendment & Equal Protection’s Promise: How the Equal Protection Clause Can Change Discriminatory Stop and Frisk Policies, 18 Mich. J. Race & L. 131 (2012). The intent doctrine took full shape in Washington v. Davis, 426 U.S. 229 (1976) and Vill. of Arlington Heights v. Metro. Hous. Dev. Corp., 429 U.S. 252 (1977). Accordingly, courts examine purposefulness and intent to discriminate rather than merely disproportionate impact upon a certain group. And intent is most easily proven where discrimination takes the form of a classification on the face of a statute or rule. However, the intent doctrine may not apply here, nor should it narrow equal protection principles, because Attorney General Holder’s comments make clear that the government’s failure to prosecute the biggest banks is intentional, purposeful, and applicable only to a subset of financial institutions.


34. “[N]ot a single high-level executive has been successfully prosecuted in connection with the recent financial crisis, and given the fact that most of the relevant criminal provisions are governed by a five-year statute of limitations, it appears likely that none will be.” Id.

35. Id.
and business-doing norms in the financial markets; (ii) encouraging
criminal behavior by guaranteeing a “carrot”—it is worth the banks’ while
to engage in criminal behavior because even if a fine is higher than the
criminally-obtained profit, which is usually not the case, the fine can be
paid for from the fruits of additional crimes committed in the future; and (iii)
encouraging criminal behavior by eliminating any potential “stick”—
ensuring large banks that the only thing they have to lose is money.

WHAT’S NEXT?

Concerned with this too-big-to-jail policy, legislatures have recently
attempted to introduce bills that would bolster U.S. anti-money laundering
laws, close loopholes, support the flow of information, and if nothing else,
give financial regulators greater civil powers to hold senior executives at
large banks accountable for misconduct happening on their watch.

In addition, as suggested by a U.S. district judge, the government can
and should criminally charge executives in TBTF banks because, despite
Attorney General Holder’s concern about the economic reverberations of
prosecuting TBTF banks, those banks would not collapse if one or more of
their high level executives were prosecuted, as opposed to the institutions
themselves. For example, concerns were raised in the U.S. over whether
criminally prosecuting HSBC, the London-based bank that was involved
in money laundering, would lead to its collapse and damage the financial
system. Independently of how the government treats HSBC as an
institution, it can and should charge its senior executives that made
culpable decisions regarding the money laundering. Moreover, liability
should stand on the well-established “willful blindness” or “conscious

36. John Titus, How Obama Surrendered Sovereignty to The Criminal Banking Cartel, DAILY
BAIL (Apr. 24, 2013, 5:33 PM), http://dailybail.com/home/how-obama-surrendered-sovereignty-to-
the-criminal-banking-ca.html (“[Deferred prosecution] looks very much like a green light for big
banks to commit crimes with wild abandon while pretending that fines levied in lieu of prosecution
(a) are something other than a small tax paid by the banks doing business as criminal enterprises,
(b) cannot simply be paid for from the fruit of additional crimes in the future, and thus (c) do not
guarantee more crime.”).

37. “When prosecutors choose not to prosecute to the full extent of the law in a case as egregious
as this, the law itself is diminished. The deterrence that comes from the threat of criminal prosecution
is weakened, if not lost,” Editorial, Too Big to Indict, Dec. 12, 2012, N.Y. TIMES, at A38, available at

38. See, e.g., Press Release, Comm. on Fin. Svs.—Democrats, Leading House Democrats
Introduce Bills to Deter Money Laundering And Hold Executives Responsible (Oct. 24, 2013),

39. Rakoff, supra note 33.
40. Titus, supra note 36.

http://openscholarship.wustl.edu/law_lawreview/vol91/iss4/7
disregard” doctrine, which has been used to infer that top executives had knowledge of the dubious nature of the activities that their institutions were involved in. The Supreme Court has weighed in on this idea, and has recently concluded that

[t]he doctrine of willful blindness is well established in criminal law. Many criminal statutes require proof that a defendant acted knowingly or willfully, and courts applying the doctrine of willful blindness hold that defendants cannot escape the reach of these statutes by deliberately shielding themselves from clear evidence of critical facts that are strongly suggested by the circumstances.

If the DOJ refuses to prosecute large financial institutions, it can still prosecute their executives, and must if the federal government is serious about preventing another financial crisis. The ambiguous threat of economic harm resulting from prosecution is not applicable to prosecuting individuals, and the prospect of protracted litigation is no justification for failure to protect consumers from shouldering the banking industry’s criminal activity.

41. Id.