



BANK OF ENGLAND

**THE SCOTTISH AND NORTHERN IRELAND
BANKNOTE STATEMENT OF PENALTY
POLICY**

This Statement of Penalty Policy applies in respect
of breaches from 3 April 2017

Introduction

- 1 This document is a statement of the policy of the Bank of England (“the Bank”) in relation to the failure by an authorised bank to comply with any of the Scottish and Northern Ireland Banknote Regulations 2009 or any other regulations made under Section 215 Banking Act 2009 (the “Regulations”) or the Scottish and Northern Ireland Banknote Rules 2017 or any other Rules made under Paragraph 3 of the Regulations (“the Rules”), henceforth referred to as a ‘compliance failure’.
- 2 Expressions or defined terms used in Part 6 of the Banking Act 2009, the Regulations or the Rules have, unless the contrary intention appears, the same meaning in this Statement of Penalty Policy.
- 3 This document sets out the process used to both assess the categorisation and apply the appropriate enforcement power to any such compliance failure. In doing so, it meets the requirement of Schedule 3, paragraph 5 of the Regulations that the Bank must publish a statement of policy in respect of the process it will follow when it imposes a financial penalty under section 222 of the Banking Act 2009 and the Regulations and the amount of any such penalty.
- 4 The Bank updates its statement of penalty policy from time to time. This statement applies in respect of a compliance failure which occurs or continues on or after 3 April 2017. The statement published on the date in the first column of Table 1 applies in respect of any compliance failure which occurred or continued on or after that date but wholly before the relevant date in the second column.

Table 1 – Versions of the SPP and the dates to which they apply

| Statement of penalty policy (SPP) | Applies to compliance failures occurring or continuing on or after the date of the SPP and wholly before: |
|-----------------------------------|---|
| 23 November 2009 | 1 April 2010 |
| 1 April 2010 | 21 May 2010 |
| 21 May 2010 | 24 June 2011 |
| 24 June 2011 | 5 June 2015 |
| 5 June 2015 | 3 April 2017 |
| 3 April 2017 | |

Overview of the Compliance Failure Assessment Process

- 5 As part of the assessment process the Bank will assess:
 - (i) the type and therefore the seriousness of the compliance failure that has occurred; and
 - (ii) the outcome of the compliance failure, including whether a financial penalty is proposed and, if so, what amount.
- 6 Upon the discovery of a compliance failure, the Bank will give formal written notice to an authorised bank that it judges a compliance failure to have taken place and that the compliance failure assessment process has begun.
- 7 A compliance failure resulting from any act or omission by an agent of an authorised bank will be treated as a compliance failure by that authorised bank.
- 8 Initially, the Bank will conduct an information gathering exercise in respect of the compliance failure, in particular seeking to understand the causes of the compliance failure and any remedial control enhancements implemented by the authorised bank.
- 9 The authorised bank will be expected to co-operate with the Bank in the provision of sufficient relevant, high quality information, in a timely manner to enable the Bank to undertake a proper assessment of the compliance failure.
- 10 The authorised bank will be given the opportunity to make representations to the Bank during this process.
- 11 The Bank's Scottish & Northern Ireland Banknote Team ("S&NI Team") will consider which category the compliance failure should fall under (see Compliance Failure Category section), after assessing the compliance failure against the factors set out in Table 1 and any other factors the Bank in its sole discretion considers relevant to the compliance failure.
- 12 Where repeated compliance failures have a single underlying cause, the Bank may treat those compliance failures as a combined single compliance failure when determining the appropriate category.
- 13 The compliance failure categorisation and outcome will be assessed by the Decision Making Body ("DMB") relevant to that category of compliance failure (see Compliance Failure Outcome and Compliance Failure Category sections).
- 14 The compliance failure outcome will be formally communicated to the authorised bank.
- 15 The Bank reserves the right to re-open any incident if new information emerges.

Compliance Failure Categories

- 16 The Bank has four categories of compliance failure:
 - i. Underbacking;
 - ii. Serious;
 - iii. Notable; and
 - iv. Minor.
- 17 Table 2 contains a non-exhaustive list of factors the Bank will consider when assessing the appropriate compliance failure categorisation.

Underbacking

- 18 An Underbacking compliance failure is a compliance failure which results in the total value of the authorised bank's backing assets falling below the total value of notes required to be backed at the relevant time, unless this deficit of backing assets is caused by a compliance failure that results in notes ceasing to be Excluded Notes under Rule 3.1 (in which case the compliance failure will be given the appropriate classification under one of the other three categories).
- 19 Underbacking is the most severe category of compliance failure reflecting the particular importance to noteholder protection of the requirement that all Scottish and Northern Ireland banknotes except Excluded Notes must be fully backed with ring-fenced assets at all times.

Serious

- 20 A Serious compliance failure is a compliance failure where the Bank assesses that there is serious risk, or the potential for serious risk, to noteholder protection, or the total value of the authorised bank's backing assets held in the form of Bank of England notes or UK coin falls below 60% of the value of its Notes In Circulation at the relevant time.

Notable

- 21 A Notable compliance failure is where the Bank assesses that there is risk to noteholder protection or there is potential of risk to noteholder protection, but the Bank does not assess that risk to be material enough to categorise it as a Serious compliance failure.

Minor

- 22 A Minor compliance failure is where the Bank assesses that there is no risk or negligible or minor risk to noteholder protection or the potential of negligible or minor risk to noteholder protection.
- 23 The Bank's expectation is that a failure to comply with Rule 7.1 (the NIPS Code of Connection), would typically fall into this category.

Decision Making Body

- 24 The choice of which DMB will take a decision is determined by the category of compliance failure. In summary, the more significant the compliance failure, the more senior the composition of the DMB:
- (i) All Underbacking or Serious compliance failures will be assessed by the Bank's Assessment Committee and Review Committee.
 - (ii) Notable compliance failures will be assessed by the Head of Division, Notes Operations.
 - (iii) Minor compliance failures will be assessed by the Notes senior manager with responsibility for the Scottish and Northern Ireland Banknote Regime.
- 25 First, as part of the relevant DMB's assessment, it will assess whether the compliance failure categorisation by the S&NI Team adequately reflects the severity of the compliance failure. The DMB will be able to re-categorise a compliance failure so that it can be submitted to another level of DMB if appropriate. Second, the DMB will decide the outcome of the compliance failure.

Compliance failure outcomes

26 There are three compliance failure outcomes, Financial Penalty, Laid-on-File and Private Warning. In determining the compliance failure outcome, the Bank will, in its sole discretion, take into account what it considers to be all relevant factors, a non-exhaustive list of which are contained in Table 2.

Table 2 – Compliance categories, key factors taken into account and compliance failure outcomes

| Category of Compliance Failure | A non-exhaustive list of factors to be considered when determining the compliance failure outcome | Compliance Failure Outcomes |
|---|--|---|
| <p>CATEGORY: UNDERBACKING¹ Where the compliance failure results in underbacking.</p> | <ul style="list-style-type: none"> How promptly and effectively was the compliance failure brought to the Bank's attention? The duration of the compliance failure. | <p>Financial Penalty Expectation for Underbacking or Serious compliance failures</p> |
| <p>CATEGORY: SERIOUS Where there is serious risk or the potential for serious risk to noteholder protection, or the percentage of backing assets held in BoE notes or UK coin falls below 60%.</p> | <ul style="list-style-type: none"> Was the compliance failure deliberate (as defined in paragraph 38)? Did the authorised bank act with due skill, care and diligence? What was the value of any lost seigniorage? Were relevant controls in line with common industry practice? | |
| <p>CATEGORY: NOTABLE Where there is risk to noteholder protection or there is potential of risk to noteholder protection.</p> | <ul style="list-style-type: none"> How have similar compliance failures been dealt with by the authorised bank in the past (with most emphasis on the past 2 years)? The number and nature of any compliance failures that have occurred (with most emphasis on the past 2 years) in respect of the relevant authorised bank, with particular regard to similar compliance failures. | <p>Laid-on-File Expectation for Notable compliance failures (may be applied on exceptional basis for Underbacking, or Serious compliance failures)</p> |
| <p>CATEGORY: MINOR Where there is no risk or negligible or minor risk to noteholder protection or the potential of negligible or minor risk to noteholder protection</p> | <ul style="list-style-type: none"> Was there a compliance failure of the NIPS Code of Connection? | <p>Private Warning Expectation for Minor compliance failures (may be applied on exceptional basis for Notable compliance failures)</p> |

Financial Penalty

27 The Bank's expectation is that a financial penalty will be the appropriate outcome for the compliance failures in the Underbacking and Serious categories, but each

¹ As detailed in paragraph 18, this does not include underbacking resulting from notes ceasing to be Excluded Notes under Rule 3.1.

case will be judged on its individual facts. Notable or Minor compliance failures will not incur a financial penalty.

- 28 When assessment of a compliance failure results in the Bank deciding to propose imposing a penalty, the Bank will follow the provisions in Schedule 3 to the Regulations (imposition of penalties) and, where applicable, the appeals process relating to penalties (see Appeals Process section).
- 29 Penalty amounts will be a multiple of £100.
- 30 The Bank may impose a financial penalty subject to the limit set by the Regulations, which is based on the value of 10% of the average mean value of the authorised bank's Notes In Circulation in the previous calendar year.
- 31 Subject to that limit, the Bank has discretion on whether to impose a penalty for a compliance failure and, if so, the amount of that penalty, and it will exercise its discretion taking account of, as appropriate, the principles set out in this policy and all relevant circumstances of which it is aware.
- 32 In accordance with Regulation 16, the Bank will reference details of any financial penalties imposed in the previous financial year in the Bank's Scottish and Northern Ireland Banknote Issuance Annual Report. Furthermore, details of any financial penalties in the previous financial year will be formally communicated to each authorised bank's Chief Risk Officer on an annual basis. However, the Bank will not publish details of any actions taken before the end of a 3 month period starting from when the Bank has completed the process set out in this Statement of Penalty Policy.

Underbacking

- 33 Subject to paragraph 30, the maximum financial penalty in respect of an Underbacking compliance failure is the difference between the total value of the authorised bank's backing assets and the total value of its notes required to be backed at the relevant time;
- 34 Where a compliance failure has occurred or persisted on more than one calendar day, the Bank may calculate the maximum penalty on the basis of the value on any one calendar day during which the compliance failure persisted.
- 35 Whilst maintaining the discretion set out in paragraph 31, the Bank would normally expect to impose a minimum penalty for an Underbacking compliance failure of £20,000.

Serious

- 36 Whilst maintaining the discretion set out in paragraph 31, the Bank would normally expect to impose a maximum penalty for a Serious compliance failure of £20,000.
- 37 Whilst maintaining the discretion set out in paragraph 31, the Bank would normally expect to impose the financial penalties set out in Table 3. This is

subject to any seigniorage lost² not being greater than that amount. In the event that seigniorage lost is greater than the amount set out in Table 3, the proposed financial penalty will be increased to equal the amount of seigniorage lost, rounded up to the nearest multiple of £100.

Table 3 – Penalty amounts for Serious compliance failures

| Nature of the compliance failure | Reporting | |
|--|--|---|
| | Compliance failure proactively disclosed by the authorised bank once it is aware of the compliance failure | Compliance failure <u>not</u> proactively disclosed by the authorised bank once it is aware of the compliance failure |
| Deliberate | £20,000 | £20,000 |
| Not deliberate but lacking due skill, care and diligence | £10,000 (if discovered by authorised bank) £15,000 (if discovered by third party) | £20,000 |
| Not deliberate and not lacking due skill, care and diligence | £5,000 (if discovered by authorised bank) £7,500 (if discovered by third party) | £20,000 |

- 38 A deliberate compliance failure is when the Bank determines that a compliance failure was a consequence of, or was facilitated by, a wilful and intentional act(s) or omission(s) by an authorised bank’s management (individually or as a group) in contravention of the Rules or Regulations.
- 39 Where the authorised bank does not proactively disclose a Serious compliance failure to the Bank as soon as it is aware of it, subject to the Bank’s discretion as described in paragraph 31, the expectation will be for that compliance failure to attract the maximum penalty, as shown in Table 3.
- 40 In exceptional circumstances, the Bank may make further reductions to the penalty amounts outlined in Table 3 above, but would not reduce the penalty to below a sum representing:
- (i) any reduction in the UK government’s seigniorage which may have resulted from the compliance failure; and
 - (ii) any financial or other benefit enjoyed by the authorised bank by virtue of the compliance failure.
- 41 Factors that the Bank is minded to take into account in the exercise of the Bank’s discretion will be included in the notice of proposed penalty it gives in each case under schedule 3, paragraph 1 of the Regulations.

² The Bank does not consider compliance failures that result in notes ceasing to be Excluded Notes under Rule 3.1 to constitute a loss of seigniorage.

Laid On File

- 42 Where the outcome of a compliance failure is that it is Laid On File, the authorised bank will be informed by letter, which will also state that no financial penalty will be imposed.
- 43 The compliance failure will be taken into account when assessing future compliance failures during the subsequent 2 year period from the outcome being notified to the authorised bank, particularly if there was a pattern of similar compliance failures which could indicate problems with an authorised bank's systems and controls.
- 44 The Bank's expectation is that the outcome for compliance failures categorised as Notable will be that they are Laid On File.
- 45 In accordance with Regulation 16, the number of compliance failures Laid On File in the previous financial year will be referenced in the Bank's Scottish and Northern Ireland Banknote Issuance Annual Report. However the Bank will not publish the name of the relevant authorised bank when referencing these types of compliance failures in this Annual Report. Details of any compliance failures Laid On File in the previous financial year will also be formally communicated to each authorised bank's Chief Risk Officer on an annual basis.

Private Warning

- 46 Where the outcome of a compliance failure is a Private Warning, the authorised bank will be informed in a Private Warning letter sent to the relevant operational contact, which will also state that no financial penalty will be imposed.
- 47 The number of compliance failures resulting in Private Warnings will not be included in the Bank's Scottish and Northern Ireland Banknote Issuance Annual Report nor communicated directly by the Bank to the authorised bank's Chief Risk Officer. Only if a pattern of such compliance failures occurred would the Bank expect to take them into account when assessing future compliance failures that have a similar cause or outcome.

Appeals Process

- 48 This appeals process applies where an authorised bank has received notice under:
- a. paragraph 1 of Schedule 3 of the Regulations (notice of proposal); or
 - b. paragraph 2 of that Schedule (variation of proposal).
- 49 Where the Bank gives notice under paragraph 3 of that Schedule (decision notice), it must also specify in the decision notice:
- a. that the authorised bank may, in writing, apply to the Bank for the matter to be considered by an Appeal Panel ("an appeal");
 - b. the period in which the application can be made (which must be a period of not less than 14 days from the date the notice is received by the authorised bank); and
 - c. that if the authorised bank applies for an appeal the decision notice is suspended.
- 50 Where the authorised bank applies in writing for an appeal within the period specified in the decision notice:

- a. the Bank shall arrange for the matter to be considered by an Appeal Panel; and
- b. the decision notice is suspended until:
 - i. the Appeal Panel makes a finding, at which point the decision notice ceases to have effect (the Bank may issue a further decision notice if the finding allows); or
 - ii. the authorised bank confirms that it is no longer pursuing the appeal.

51 An Appeal Panel shall comprise three persons:

- a. a member of Court or officer or servant of the Bank, who must be a person who has not been involved in a decision to which the decision notice relates (including any decision relating to a notice which preceded the decision notice) (“the Bank member”);
- b. two persons who are not members of Court or officers or servants of the Bank (“the external members”).

52 The Bank member shall chair the Appeal Panel.

53 At least one of the external members shall be a person whom the Bank considers to have relevant experience of banking or the regulation of financial institutions.

54 Parties may attend and be represented by legal advisors at hearings before the Appeal Panel. The Appeal Panel may deliberate matters in the absence of the parties.

55 At any hearing before the Appeal Panel, the chair of the Panel may:

- a. give such directions as he or she considers appropriate for the fair determination of the issues; and
- b. as appropriate, appoint times and places for further hearings before the Appeal Panel.

56 The Appeal Panel may give directions without a hearing.

57 Directions may include (but are not limited to) the following:

- a. the production of reports or other material to assist the Appeal Panel to reach a decision;
- b. the making of written representations;
- c. the making of oral representations at a hearing or hearings;
- d. the attendance of witnesses at a hearing or hearings and their examination and/or cross-examination (on oath or otherwise).

58 A finding of the Appeal Panel may include that the penalty should remain the same, be reduced, be increased or that a penalty should not be imposed in respect of the subject matter of the appeal.

59 The Bank shall take steps in accordance with the finding of the Appeal Panel, which may include, as appropriate issuing a variation of proposal under paragraph 2 of Schedule 3 to the Regulations or a decision notice under paragraph 3 of that schedule.

60 The requirements of paragraph 49 do not apply to decision notices given following the appeal process (including a decision notice which follows a variation of proposal).