

Opinion of the European Economic and Social Committee on the 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on Reinforcing sanctioning regimes in the financial services sector'

COM(2010) 716 final

(2011/C 248/18)

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On 8 December 2010 the Commission decided to consult the European Economic and Social Committee, under Article 304 of the Treaty on the Functioning of the European Union, on the

Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on Reinforcing sanctioning regimes in the financial services sector

COM(2010) 716 final.

The Section for the Single Market, Production and Consumption, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 26 May 2011.

At its 472nd plenary session, held on 15 and 16 June 2011 (meeting of 16 June), the European Economic and Social Committee adopted the following opinion by 105 votes to 2 with 4 abstentions.

1. Conclusions and recommendations

1.1 The EESC welcomes the creation of a supranational system of sanctions that are truly effective, dissuasive and proportionate. It supports the approach taken by the Commission communication to provide common criteria that Member States should meet as a minimum requirement when establishing administrative sanctions for the infringement of financial services legislation.

1.2 The regulatory framework aims to facilitate the implementation of legal principles which have already been applied successfully by the EU such as the 'polluter pays' principle which is used here to impose proportionate penalties for the damage caused and to set an example in the case of financial violations, or the 'leniency' policy which is used in procedures for investigating and curbing anti-competitive practices. These are particularly relevant here, given the unique role that staff working at financial institutions can play in reporting violations.

1.3 The EESC agrees with the Commission's approach on referring to 'sanctions' as a broad notion which encompasses tax-related administrative measures, restoration of legality, confiscation, the disqualification of managers, withdrawing privileges (such as the withdrawal of licences), pecuniary sanctions, fines which act as a deterrent, and other similar measures.

1.4 The EESC calls on the Commission to investigate ways of preventing fraudulent financial operations that originate in or are directed towards tax havens and financial havens and that involve capital movements which have an impact on the internal market.

1.5 The confiscation of unlawful profits and punitive damages should be used in addition to the sanction imposed.

The EESC has already suggested ⁽¹⁾ that the proceeds should be paid into a 'support fund for collective action' to make it easier for consumers' associations to take collective action seeking compensation or redress. The EESC ⁽²⁾ therefore reminds the Commission that it has already expressed its views on several occasions regarding the need to adopt a supranational regulatory framework to harmonise collective action.

1.6 The EESC calls on the Commission to take into consideration the need for the EU to sign international agreements with third countries in order to reinforce the extra-territorial impact of current legislation on financial sanctions, ensuring that it is able to deal effectively and dissuasively with infringements of financial services legislation.

2. Introduction

2.1 The financial crisis has put into doubt whether financial market rules are always respected and applied as they should be across the Union. Lack of enforcement of the rules in one Member State may have significant implications for the stability and functioning of the financial system in another Member State.

2.2 The ECOFIN Council asked the Commission and the three Committees of Supervisors (Committee of European Banking Supervisors - CEBS, Committee of European Insurance and Occupational Pensions Supervisors - CEIOPS and Committee of European Securities Regulators - CESR) to conduct a cross-sectoral stocktaking exercise of the coherence, equivalence and actual use of sanctioning powers in the Member States.

⁽¹⁾ OJ C 162, 25.6.2008, pp.1-19 and OJ C 175, 28.7.2009, pp.20-25.

⁽²⁾ OJ C 324, 30.12.2006, p.1.

2.3 At international level, strengthening sanctioning regimes is one of the elements required for the reform of the financial sector, as agreed by G20 leaders at the summit held in Washington on 15 November 2008. The Dodd-Frank Wall Street Reform and Consumer Protection Act (July 2010) provides a comprehensive reform of the American financial system.

3. The Commission Communication

3.1 This Communication is based on the studies of the Committees of Supervisors and discussions with Member States. The document presents areas for potential improvement, and suggests possible EU actions to achieve greater convergence and efficiency of national sanctioning regimes. In the financial sector, efficient sanctioning regimes are a key element of a supervisory regime which should ensure sound and stable financial markets and the protection of consumers and investors.

3.2 In order to ensure full application of EU law, sanctions must be effective, proportionate and dissuasive. Sanctions can be considered effective when they are capable of ensuring compliance with EU law, proportionate when they adequately reflect the gravity of the offence and do not go beyond what is necessary for the objectives pursued, and dissuasive when they are sufficiently serious to deter the authors of violations from repeating the same offence, and put off other potential offenders.

3.3 Under the existing legal framework, Member States enjoy considerable autonomy in terms of choice and application of national sanctions. However, this autonomy should be balanced with the need for effective and consistent application of European law.

3.4 The European directives and regulations currently in place in the area of financial services contain four groups of provisions on sanctions:

- coordination of the power to impose sanctions between several Member States;
- obligation for Member States to provide for the application of appropriate administrative sanctions and measures and to ensure that they are effective, proportionate and dissuasive. Most existing Directives do not differentiate between investigative, preventive and punitive measures;
- another group concerns sanctions for specific infringements;
- a fourth group makes provision for the authorities to publish the measures and sanctions under certain circumstances.

3.5 The review of sanctioning regimes shows divergences across Member States which may stem from many factors including differences in national legal systems, constitutional requirements, the functioning of national administrations and the role of courts (administrative or criminal).

3.6 The Commission has found the following divergences and weaknesses in national sanctioning regimes:

- some competent authorities do not have at their disposal important types of sanctioning powers for certain violations;
- the levels of administrative pecuniary sanctions (fines) vary widely across Member States and are too low in some Member States;
- divergence exists in the nature (administrative or criminal) of sanctions provided for in national legislation;
- the level of application of sanctions varies across Member States.

3.7 According to the Commission, the fact that national sanctioning regimes diverge on key aspects can result in the following: lack of compliance with EU financial services rules; risk of undermining consumer protection and market integrity; distortions of competition in the internal market; a negative impact on financial supervision; risk of undermining confidence in the financial sector.

3.8 The Commission considers that further convergence and reinforcement of sanctioning regimes is essential to prevent risk of improper functioning of financial markets. It therefore suggests that a minimum common standard could be set to ensure a minimum approximation of national sanctioning regimes. This approximation should address the following key issues:

- appropriate types of administrative sanctions for the violation of key provisions;
- publication of sanctions;
- a sufficiently high level of administrative fines;
- sanctions provided for both individuals and financial institutions;
- appropriate criteria to be taken into account when applying sanctions;
- possible introduction of criminal sanctions for the most serious violations;
- appropriate mechanisms supporting effective application of sanctions.

4. General comments

4.1 The EESC's view

4.1.1 The Committee takes a very positive view of the Commission Communication. As part of the process of re-defining international rules on capital markets, the Communication proposes developing a more efficient supranational regulatory framework to crack down on violations carried out by financial institutions and operators.

4.1.2 In fact, the Communication embodies the spirit of political positions which were consolidated at the G-20 summits, particularly at those held in Washington (2008), London (2009) and Seoul (2010), together with the EU's own positions which were agreed at the highest level (e.g. the establishment of Financial Supervisory Authorities, the reform of the Markets in Financial Instruments Directive, the agreement on high-risk investment funds such as hedge funds, etc.).

4.2 *Subsidiarity principle*

4.2.1 The Communication is clearly in line with the subsidiarity principle. The document underlines the fact that the national authorities have primary responsibility to ensure that a coordinated, integrated approach is taken to consistently applying both the existing legal framework and the future framework of sanctions for violations in the financial services sector. In fact, the scope of the Communication is limited to the sanctions which are imposed by the competent authorities of Member States.

4.2.2 However, if 'intra-European' violations are committed – where the authors of the violation act in different Member States and have an impact on the whole of the single market – the following action should be taken:

- ensure that it is clear who is responsible for starting up the sanctions procedure. This should prevent forum shopping, where potential infringers shop around to decide which national authorities are most lenient in applying the sanctions legislation;
- consider delegating the roles and responsibilities of the competent authorities under certain conditions;
- occasionally, under exceptional circumstances, give the European Supervisory Authorities responsibility for such cases, depending on the nature of the issue involved.

4.2.3 Supranational action is justified by the need to ensure convergence of national sanctioning regimes (administrative or criminal). Currently, these regimes either have serious weaknesses or shortcomings which mean they cannot be harmonised, or they operate using completely different criteria. Each Member State would have to choose whether the route taken was administrative or criminal, while ensuring that the principles of equivalence and effectiveness were met, in line with ECJ case law.

4.2.4 The regulatory framework under discussion is in keeping with the principle of sharing responsibilities between different authorities and legal systems. The framework aims to facilitate the implementation of legal principles which the EU has already applied successfully, such as the 'polluter pays' principle which is used here to impose proportionate penalties for the damage caused and to set an example in the case of financial violations, or the 'leniency' policy which is used in procedures for investigating and curbing anti-competitive practices. These are particularly relevant here, given the unique role that staff working at financial institutions can play in reporting violations.

4.2.5 The sanctions and penalties that are applied to offenders must of course be severe in order to deter people from committing offences which cannot be tolerated in a democratic society. However, people who cooperate in the detection of offences should be treated more leniently, and have their sanctions or penalties substantially lowered or withdrawn.

4.2.6 The EESC considers that encouraging people to report violations – as set out in the Dodd Frank Act in the USA – could be a good way of cleaning up the internal market for financial services and improving the way it operates. This could be achieved by setting up a system providing financial and other incentives for people who report infringements of the legislation regulating these financial services to the Financial Supervisory Authorities.

4.2.7 In some Member States, it is not possible to report infringements due to legislative barriers which are still in place because of the supposed need to protect business secrets. These barriers therefore need to be removed, as do other confidentiality barriers that could act against the people who report infringements. In any case, employees need to be protected through programmes protecting their interests.

4.2.8 The existing Directive on money laundering already provides for favourable treatment for people who are employed by financial institutions and report suspicious operations, and ensures that they are protected from victimisation in the workplace or elsewhere.

4.3 *Shortcomings in the Communication*

4.3.1 It is clear that when the Commission Communication refers to violations, it is generally referring to the behaviour of individuals – natural or legal persons who can be pursued via administrative or criminal proceedings. The Communication does not therefore tackle fraud or reporting oversights carried out by state authorities, and notably those responsible for regulating and monitoring the financial markets: if these authorities are not operating as they should, there could be serious consequences for the internal market and the interests of consumers.

4.3.2 This is the case, for example, in the need to remove the 'invisible barriers' which are still insuperable obstacles to the exercise of fundamental economic freedoms (e.g. the abuse of discretionary powers when determining the suitability of directors of a credit institution⁽³⁾, or insurance institution; or the decision on the incompatibility of shareholders who have a 'qualifying holding' in the capital of a financial institution⁽⁴⁾, etc.).

4.3.3 All Member States should ensure that they have domestic measures in place to highlight the accountability of the directors of those financial institutions which, because of their systemic character, could potentially cause incalculable damage to the stability of the financial markets, and to consumers, if they are managed imprudently or fraudulently.

⁽³⁾ Article 11 of Directive 2006/48/CE of the European Parliament and of the Council of 14.6.2006, OJ L 117, 30.6.2006, p.1.

⁽⁴⁾ Article 12 of Directive 2007/44/CE of the European Parliament and of the Council of 5.9.2007, OJ L 247, 21.9.2007, p.1.

4.3.4 Currently, anyone employed by a financial institution (even one which is too small to have an impact on the market) can be prosecuted if they commit a crime of corruption, fraud, or money laundering, while – as happens in some Member States – the managers of the institutions, who are responsible for the damage caused by violations, could potentially avoid administrative or criminal sanctions. This situation cannot be justified. One may conclude that there have been serious shortcomings in corporate governance.

4.4 Reciprocity

4.4.1 The Communication's perspective on the matter is too EU-focused. The Communication concentrates on intra-European scenarios, and fails to examine the actions of financial institutions in third countries, which could also have an impact on the internal market, given the opening of capital markets and the fact that it is relatively easy for these financial institutions to operate by way of freedom of establishment, through accepted techniques such as 'joint ventures' or 'leap-frogging'.

4.4.2 Given that there is no common regime which would facilitate a policy of reciprocity with third states on financial services, it is all the more necessary for national authorities to provide supervisory and sanctioning mechanisms that are just as tough and effective for financial institutions from third countries.

4.4.3 The EESC calls on the Commission to investigate ways of preventing fraudulent financial operations that originate in or are directed towards tax havens and financial havens and that involve capital movements which have an impact on the internal market.

4.4.4 The EESC expresses concern at the Commission's failure to properly address aspects regarding the follow-up of actions penalised for non-compliance with financial legislation when these are perpetrated in third countries or when natural or legal persons residing in third countries are directly or indirectly responsible for them.

4.5 The following technical issues also need to be pointed out:

4.5.1 The EESC agrees with the Commission's approach on referring to 'sanctions' as a broad notion which encompasses tax-related administrative measures, restoration of legality, confiscation, the disqualification of managers, withdrawing privileges (such as the withdrawal of licences), pecuniary sanctions, fines which act as a deterrent, and other similar measures.

4.5.2 All of the procedures for sanctions should be based, as a minimum, on the principles of legality, criminality, establishing guilt, ensuring sanctions do not have a retroactive effect, *reformatio in peius*, presuming someone is innocent until

proven guilty, proportionality, the application of the principle of double jeopardy, time-barring and time limits, possibility of a provisional halt to proceedings, and the right to appeal in order to secure the right to an effective remedy before a court of law.

4.5.3 It would also make sense to improve publicity and raise awareness on the sanctions imposed on the authors of violations. This information will naturally be published in domestic official journals, but depending on the seriousness of the offence, details could also be published in the *Official Journal of the European Union*, in print media, and on the Internet for example. The infringer should cover the costs of circulating the information.

4.6 Issues regarding the legislative instrument

4.6.1 The EESC considers that it would be helpful to clarify the type of legislative instrument that the Commission is proposing to adopt. This should help to ensure that the objective is achieved: creating a sanctioning regime which acts as a deterrent and is based on the principles of effectiveness and proportionality.

4.6.2 Whilst the best solution would be a Regulation, there should be no margin of discretion in its application and it might not be the most suitable instrument to use at this stage in the evolution of Union law.

4.6.3 The EESC considers that it would be more appropriate to choose a framework Directive, even though the Commission considers that a minimum level of harmonisation needs to be achieved. If a framework Directive is used, the rules need to be sufficiently clear, with the precise, unconditional instructions required to ensure direct effect, in line with ECJ case law. The Directive should contain very detailed provisions in order to meet the general interest objectives being pursued.

4.6.4 At all events, the process of imposing financial sanctions must ensure that the infringer cannot obtain any benefit whatsoever from committing the infringement. Common methods should be established to calculate the drawback of any profit unlawfully acquired, in addition to the fine imposed.

4.6.5 The confiscation of unlawful profits and punitive damages should be used in addition to the sanction imposed. The EESC has already suggested⁽⁵⁾ that the proceeds should be paid into a 'support fund for collective action', in accordance with the priorities of each Member State, to make it easier for consumers' associations and other organisations with a legitimate interest to take collective action seeking compensation. The EESC⁽⁶⁾ therefore reminds the Commission of the need to adopt a supranational regulatory framework to harmonise collective action to ensure that there is a high level of protection for consumers' economic interests.

⁽⁵⁾ See footnote 1.

⁽⁶⁾ See footnote 2.

4.6.6 The following circumstances should also be taken into account when sanctions are imposed: the personal circumstances of the author of the violation, the seriousness of the infringement, the financial strength of the infringer, the cooperative behaviour of the author of the violation, the duration of the infringement, the effect of the infringement on the rights and legitimate interests of users and consumers and on other economic operators.

4.7 *Lisbon Treaty and consumers*

4.7.1 The Communication certainly does take into account the position of the consumers of financial services. The document mentions various options, including mainstreaming the procedures for collective redress. The EESC has already supported this proposal in a number of opinions. However, the Communication only takes a passive approach to the situation of consumers, based on consumer protection and punishing improper or criminal practices.

4.7.2 In the context of application of the Lisbon Treaty, which establishes participatory democracy as a key principle in the democratic life of the Union, it is necessary to involve consumers and their most representative associations.

4.7.3 The proposed sanctioning regime should establish measures to ensure that consumers' associations working in this area are strengthened. Permanent channels of communication should also be set up between the European Parliament, the Commission, the EESC and consumers' associations. Public

funding should also be secured in order to ensure there is a more effective system in place for flagging up situations which could put the stability of financial markets at risk, and for ensuring that rules keep pace with changes in products and market practices, while also taking account of the impact which imposing penalties on financial institutions would have on clients.

4.7.4 Coupled with the focus on consumer protection and curbing the damage caused by infringements of sector rules, these measures would ensure a preventative approach is taken to the problem, which could prove far more effective.

4.7.5 The EESC considers that a European Agency for Consumer Financial Protection should be set up and repeats ⁽⁷⁾ the need to examine the possibility of providing an authority under European Law similar to that introduced by the Dodd-Frank Act (the Bureau of Consumer Financial Protection) in the United States.

4.7.6 The EESC therefore proposes that the Commission should use the time allotted for preparing the future proposal to conduct or review studies on European best practice with regard to protecting consumers of financial services, which can be used as a platform for designing legal instruments which will ensure a high level of protection for all users of financial services. Under the Charter of Fundamental Rights, all EU institutions are responsible for ensuring a high level of protection for users of financial services.

Brussels, 16 June 2011.

The President
of the European Economic and Social Committee
Staffan NILSSON

⁽⁷⁾ OJ C 107, 6.4.2011, p. 21.