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**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL
COMMITTEE AND THE COMMITTEE OF THE REGIONS**

Reinforcing sanctioning regimes in the financial services sector

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1. INTRODUCTION

The European Union's work on constructing the single market for financial services has made progress towards a harmonised framework of prudential rules and rules of conduct for financial institutions, which should ensure safety, stability and integrity of financial markets.

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 EU rules in one Member State may have significant implications for the stability and functioning of the financial system in another Member State. It is therefore essential to ensure a consistent and effective application of EU rules in all Member States.

The Commission has been working on a comprehensive reform of the financial sector aiming at ensuring the soundness and stability of the financial system. In particular, the recent reform of the supervisory architecture will allow better monitoring of financial markets and better safeguard of market stability, security and integrity.

Efficient and sufficiently convergent sanctioning regimes are the necessary corollary to the new supervisory system. As recognised in the de Larosière report: *"Supervision cannot be effective with weak, highly variant sanctioning regimes. It is essential that within the EU and elsewhere, all supervisors are able to deploy sanctioning regimes that are sufficiently convergent, strict, resulting in deterrence"*¹.

Ensuring proper application of EU rules is first and foremost the task of national authorities, who have the responsibility to prevent financial institutions from violating EU rules, and to sanction violations within their jurisdiction. But national authorities need to act in a coordinated and integrated way. The new European Supervisory Authorities (ESAs) will bring about improvements in the coordination of national authorities' enforcement activities².

¹ Report of the High-level Group on Financial supervision in the EU chaired by Jacques de Larosière, 25.2.2009, par. 201.

² In November 2010, the European Parliament and the Council adopted legislative acts establishing a new supervisory framework for financial regulation in Europe, including the creation of the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA), and the Occupational Pensions Authority (EIOPA), see COM(2009) 499, COM(2009) 501 and COM(2009) 502. These Authorities will have powers to carry out peer reviews of national authorities including sanctioning powers, and will receive information about sanctions applied by national authorities. Those powers can be used to monitor national legislation and to promote exchange of information and best practices between Member States. They have also the power to settle disagreements between national authorities, in some areas that require cooperation, coordination or joint decision-making by different supervisory authorities. In its Proposal on amending Regulation (EC) No 1060/2009 on credit rating agencies - COM(2010) 289 -, the Commission also proposes to entrust the European Securities and Markets Authority with the power to take appropriate supervisory measures in case of infringements of

Moreover, a proper enforcement of EU legislation requires that all national authorities have at their disposal appropriate sanctioning powers.

In this context, 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, in order to help determining whether sanctioning regimes are sufficiently equivalent³. The studies carried out by the Committees of Supervisors cover the sanctions applied by the Member States for violations of national rules transposing some of the most important EU directives applicable in the banking, insurance and securities sectors⁴. Following this exercise⁵, the Commission's Communications of 4 March 2009 and of 2 June 2010⁶ announced a Communication on sanctions in the financial services sector to promote convergence of sanctions across the range of the supervisory activities.

At the international level, strengthening sanctioning regimes is one of the elements of the financial sector reform. In the summit held in Washington on 15 November 2008, G20 leaders agreed on the implementation of an Action plan for Reform of financial markets including actions aimed at protecting markets and investors against illicit conduct and ensuring that appropriate sanctioning regimes are in place.⁷ Increasing regulatory enforcement and remedies is also one of the objectives of the recent US financial regulation reform⁸.

the Regulation and to ask the Commission to impose on a credit rating agency a fine in some specific cases.

³ The European Council, in its "Stockholm Programme – an open and secure Europe serving and protecting citizens" of 2.12.2009, emphasised the need to regulate financial markets and prevent abuse and invited the Member States and the Commission to improve the detection of market abuse and the misappropriation of funds. The JHA Council conclusions on economic crisis prevention and support for economic activity, stressed that consideration could be given to whether it is possible or, as the case may be, appropriate to harmonise criminal laws regarding the handling of serious stock market price manipulations and other misconduct relating to securities markets. See Doc. 8920/10 of 22.4.2010 and 7881/10 of 29.3.2010.

⁴ Capital Requirements Directive 2006/48/EC (OJ L 302, 17.11.2009); Markets in financial instruments Directive 2004/39/EC (OJ L 145, 30.4.2004); Market Abuse Directive 2003/6/EC (OJ L 96, 12.4.2003); Solvency II Directive 2009/138/EC (OJ L 335, 17.12.2009); Prospectus Directive 2003/71/EC (OJ L 345, 31.12.2003); Insurance Mediation Directive 2002/92/EC (OJ L 9, 15.1.2003); Anti-Money Laundering Directive 2005/60/EC OJ L 309, 25.11.2005); UCITS Directive 2009/65/EC (OJ L 302 17.11.2009).

⁵ CEBS: "Mapping of supervisory objectives, including early intervention measures and sanctioning powers", March 2009/47, CESR: "Report on administrative measures and sanctions as well as criminal sanctions available in Member States under the Market Abuse Directive", 17.10.2007; "Report on the mapping of supervisory powers, supervisory practices, administrative and criminal sanctioning regimes of MS in relation to the MiFID Directive; 16.2.2009, 08/220, "Report on CESR members' powers under the Prospectus Directive and its implementing measures" June 2007, 07-384; CEIOPS: "Report to the European Commission on EU supervisory powers, objectives, sanctioning powers and regimes", 29.5.2009, 21/09. This Communication is based on the information provided in those reports and the contributions subsequently received from Member States.

⁶ COM(2010) 301.

⁷ Subsequent G20-meetings called for the need to strengthen financial supervision and regulation to promote, among others, market integrity and support market discipline (London, April 2009) and for actions to protect consumers, depositors and investors against abusive market practices (Pittsburgh, September 2009)

⁸ The Dodd-Frank Wall Street Reform and Consumer Protection Act, (July 2010) provides a comprehensive reform of the American financial system. Its practical implementation is subject to a

Based on the above studies of the Committees of Supervisors and the discussions with Member States, this Communication presents areas for potential improvement identified in the review of national sanctioning regimes, suggests possible EU actions to achieve greater convergence and efficiency of these regimes, and invites all stakeholders concerned to comment on the actions proposed.

On the basis of the feedback received, which will feed the debate on the role of sanctioning regimes in relation to further legislation, and following a thorough impact assessment of the relevant sanctions related issues, the Commission will consider which proposals would be required to amend legislative acts in the financial services area⁹.

2. SANCTIONING REGIMES IN THE FINANCIAL SECTOR

2.1. Key notions

This Communication refers to sanctioning regimes as the legal framework covering sanctions provided for in national legislation for the violations of EU financial services rules (including the national rules transposing EU directives) by financial institutions and other market participants, and actual enforcement of sanctions.

Sanctions are an important part of any regulatory system. They provide a deterrent and act as a catalyst to ensure that EU legislation is complied with. In the financial sector, efficient sanctioning regimes are a key element of a supervisory regime which should ensure sound and stable financial markets and ultimately, the protection of consumers and investors. The scope of this Communication is limited to sanctions imposed and applied by the competent authorities of Member States including courts in the field of financial services. Further incentives to ensure compliance with EU legislation can be provided by ensuring that consumers have the means to obtain redress from the authors of a violation wherever they have suffered harm. The Commission will launch a public consultation on collective redress¹⁰, where it will also take into account issues related to consumer redress in the financial services sector.

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 violation 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 other potential offenders from committing such violations.

Whether sanctions meet these requirements, depends on a number of factors, such as the nature and level of the sanctions provided for by law, the institutional and procedural settings governing their application, the effective detection of infringements and the actual application

substantive amount of rules being developed by the responsible US regulatory agencies in order to give effect to the high-level provisions of the Act. The reform envisages, for instance, the creation of financial incentives for whistleblowers to report to the SEC violations of securities laws, the strengthening of the SEC's authority to pursue actions for aiding and abetting any person who violated the federal securities laws, and a lower standard of proof on this.

⁹ A review of the supervisory powers available to national banking supervisors is carried out for example in the ongoing work on crisis management.

¹⁰ See Commission work program 2011, par. 2.6 - COM(2010) 623.

of the sanctions provided for by law. These factors are part of sanctioning regimes as referred to in this Communication.

EU financial services rules often refer to both "administrative sanctions" and "administrative measures". The distinction between measures and sanctions is not clear-cut: some administrative actions – such as the withdrawal of authorisation may be considered to be an administrative sanction in some Member States and an administrative measure in others. This communication refers to "sanctions" as a broad notion covering the whole spectrum of actions applied after a violation is committed, and intended to prevent the offender as well as the general public from committing further infringements.

2.2. EU legal framework

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. In particular, the European directives and regulations currently in place in the area of financial services essentially contain four groups of provisions on sanctions:

- The first group concerns the coordination of the power to impose sanctions between several Member States which may be affected by an infringement – a key issue in the context of the "passport" and the exercise of freedom to provide services and freedom of establishment in the internal market¹¹.
- A second group sets out an obligation for Member States to provide for the application of appropriate administrative sanctions and measures where EU rules are infringed, and to ensure that they are effective, proportionate, and dissuasive¹². Most existing Directives provide for a list of powers to be made available to national authorities, but without differentiating between investigative, preventive and repressive measures and without specifying in which cases those powers should be used¹³.

¹¹ Market Abuse Directive, Article 16. Solvency II, Article 250(1)(b); CRD, Article 132(1)(d). Solvency II, Articles 155(3), 158(2); CRD, Article 30(3); MiFID, Article 62(2); UCITS, Articles 21(5) and 108(5); Prospectus Directive, Article 23. MiFID, Articles 32(7) and 62(2); UCITS, Article 108(1)), (UCITS, Article 109(2); MiFID, Article 62(2).)

¹² Article 51(1) of MiFID Directive stipulates, for example, that: "Without prejudice to the procedures for the withdrawal of authorisation or to the right of Member States to impose criminal sanctions, Member States shall ensure, in conformity with their national law, that the appropriate administrative measures can be taken or administrative sanctions be imposed against the persons responsible where the provisions adopted in the implementation of this Directive have not been complied with. Member States shall ensure that these measures are effective, proportionate and dissuasive". See also Article 25 of the Prospectus Directive 2003/71/EC, Article 14 of the Market Abuse Directive 2003/6/EC (interpreted by the Court in the case C-45/08, Spector Photo Group and Van Raemdonck/CBFA, judgment of 23.12.2009, para 65-77), and Article 28 of Directive 2004/109/EC on transparency requirements, Article 99(1) of UCITS Directive 2009/65/EC, Article 54 of Directive 2006/48/EC on credit institutions, or Article 34 of Solvency II Directive 2009/138/EC -, Article 39(2) of the Directive on money laundering, providing also for sanctions against natural persons. Recital 38 of the Market Abuse Directive specifies that "sanctions should be sufficiently dissuasive and proportionate to the gravity of the infringement and to the gains realised".

¹³ See MiFID Article 50, CRD Article 136, UCITS Article 98, Solvency II Article 34, Prospectus Article 21.

- A third group concerns sanctions for specific infringements¹⁴. Certain acts indicate one or more particular sanctions, such as the withdrawal of authorisation, that competent authorities may impose under certain specific circumstances¹⁵, and in some cases also in which circumstances competent authorities are under an obligation to impose that sanction¹⁶.
- A fourth group makes provision for the authorities to publish the measures and sanctions under certain circumstances¹⁷.

The existing EU legislation is restricted to administrative sanctions and measures. Member States may choose to apply criminal sanctions.

3. SHORTCOMINGS OF EXISTING SANCTIONING REGIMES

The review of sanctioning regimes carried out by the Commission in cooperation with the Committees of Supervisors shows divergences across Member States. Such divergences may stem from many factors including differences in the national legal systems of Member States, constitutional requirements, the functioning of national administrations and the role of courts (administrative or criminal).

The way sanctions are designed in some Member States raises the question whether sanctions are fully effective, proportionate and dissuasive. Furthermore, divergences exist as to the level of enforcement. In some Member States no sanctions were applied for more than two years. The Commission considers that this could be symptomatic of a weak enforcement of EU rules.

3.1. Divergences and weaknesses in national sanctioning regimes

While their nature and degree differs to some extent across sectors and EU legislative acts, certain divergences and weaknesses have been identified on the following issues¹⁸.

Some competent authorities do not have at their disposal important types of sanctioning powers for certain violations

The types of sanctions vary widely across Member States, including for the same type of infringement. In general, competent authorities will only be able to impose a sanction that is optimal in terms of effectiveness, proportionality and dissuasiveness, if they have a wide range of different sanctioning powers.

¹⁴ See Articles 62, 258(2) of Directive 2009/138/EC - Solvency II; Article 99(2) UCITS; Article 8(1)-(3) of Directive 2002/92/EC on insurance mediation.

¹⁵ This concerns mainly the withdrawal of an authorisation, see e.g. Directive 2009/138/EC (Solvency II), Article 144(1); Directive 2006/48/EC (CRD), Article 17.

¹⁶ See e.g. Directive 2009/138/EC (Solvency II), Article 131 and 144(2).

¹⁷ For example Article 51(3) of Directive 2004/39/EC - MiFID, Article 25(2) of the Prospectus Directive 2003/71/EC, Article 28(2) of Directive 2004/109/EC on transparency requirements, Article 14(4) of Market Abuse Directive 2003/6/EC, Article 99(3) of Directive 2009/65/EC – UCITS.

¹⁸ The examples provided in this section do not mention the Member States concerned, as their purpose is only to better illustrate the general problems identified. More information can be found in the reports of the Committees of Supervisors on which this Communication is based.

National legislations do not always provide for certain sanctioning powers, such as withdrawal of licenses and disqualification/dismissal of managers, which seem to be particularly appropriate to ensure deterrence in the financial sector.

For example, in 6 Member States there is no possibility to withdraw the authorisation in case of violations of the Market Abuse Directive. 15 Member States do not provide for the disqualification/dismissal of the management and/or supervisory body in cases involving market manipulation under this Directive. Those powers may be useful to effectively sanction violations, and therefore prevent market abuse.

Public warnings and publication of sanctions are not foreseen in all national legislations even though they may make a significant contribution to general prevention, since they act as reminders of the sanctions applicable to certain types of behaviour and show that there is a real danger that such behaviour will be discovered and punished by the authorities. For example, under the MiFID, 5 Member States do not provide for public reprimands/warnings and 7 Member States do not provide for the publication of sanctions. In the insurance sector, only 14 supervisory authorities consistently publish sanctions.

The levels of administrative pecuniary sanctions (fines) vary widely across Member States and are too low in some Member States

Important divergences exist as to the minimum and maximum level of pecuniary sanctions provided for in national legislations and sometimes the maximum level is so low that the sanctions are unlikely to be sufficiently dissuasive.

For example, in the banking sector the maximum amount of fines provided for in case of a violation is unlimited or variable in 6 Member States, more than 1 million euros in 9 Member States, less than 150 000 euros in 7 Member States.

In the securities sector among the 18 Member States providing for administrative fines for violations of the prohibition of insider dealing, 4 Member States provide for maximum fines of 200 000 euros or less, while only 12 Member States provide for fines of 1 million euros or higher. In the case of violations of the minimum conditions for authorisation of investment firms, 17 Member States provide for maximum fines of less than 1 million and in 6 of them the maximum amount is 100 000 euros or less. In the insurance sector, fines are unlimited or can reach 1 million euros or more in 10 Member States, they are between 100 000 and 1 million euros in 7 Member States, and less than 100 000 euros in 6 Member States.

Violations of financial services legislation can lead to gains of several million euros, in excess of the maximum levels of fines provided for in some Member States¹⁹. A fine that is lower than the gains that can be expected from the violation is unlikely to have much of a deterrent effect. Moreover, a potential offender may always hope that the infringement will remain undetected by the authorities. To ensure that a fine has a sufficiently deterrent effect on a rational market operator, the possibility that an infringement will remain undetected must be offset by imposing fines which are significantly higher than the potential benefit deriving from a breach of the financial services legislation. In the financial sector, where a large number of potential offenders are cross-border financial institutions with very considerable turnovers, sanctions of a few thousand euros cannot be considered sufficiently dissuasive.

¹⁹ See for example FSA press release No FSA/PN/098/2003 of 25/09/2003.

Some competent authorities cannot address administrative sanctions to both natural and legal persons

In certain Member States, sanctions are imposed solely on natural persons or solely on legal persons: they will therefore be treated in different ways as regards a specific offence, depending on the Member State where the offence is committed.

For instance, some Member States do not provide for the application of sanctions to natural persons in the insurance sector.

In this situation, a natural person (e.g. the manager of a bank) who is essentially responsible for an infringement might not be discouraged from committing infringements if he runs no risk of being sanctioned for his illicit conduct because sanctions are applied to legal persons (e.g. the bank) only. On the other hand, when an individual has committed a violation to the benefit of a financial institution, sanctions applicable to the individual only might not have a sufficient deterrent effect on the financial institution. In addition, when an infringement is the responsibility of a legal person (e.g. a financial institution as a whole), sanctioning the natural persons (e.g. the employees involved in the infringement) only might be insufficient to encourage such financial institution to take the organisational measures and provide the staff training necessary to prevent infringements.

Competent authorities do not take into account the same criteria in the application of sanctions

In most sectors, divergences exist on the factors to be taken into account by competent authorities when deciding the type of administrative sanction and/or calculating the amount of the administrative pecuniary sanctions to be applied in a specific case. Certain factors, such as the benefit resulting from the violation (if calculable) as well as the financial strength and the possible cooperative behaviour of the author of a violation, are not always taken into account, while they would help ensuring effectiveness, proportionality and dissuasiveness of the sanctions actually applied.

For example, for the violation of insider dealing under the Market Abuse Directive, only 12 Member States provide for sanctions corresponding at least to the benefit derived from the violation. However, a fine that is not considerably higher than the benefit that may be gained from a violation will have only a limited dissuasive effect.

In the banking sector, only 17 Member States take into account the financial strength of a financial institution when determining the level of a fine imposed on it. Only 5 Member States take into account that factor in the application of fines for violations of the UCITS Directive²⁰. However, any penalty imposed needs to have an equivalent effect on all financial services undertakings: a fine of a small level, while being clearly dissuasive for certain smaller financial institutions, will have only a very limited dissuasive effect for large financial institutions.

Finally, the level of co-operation of the offender is not taken into account in all Member States, while this would encourage offenders to cooperate with the competent authorities,

²⁰ Sources: information provided by CESR members on sanctions envisaged in national rules transposing the UCITS Directive.

which is important to increase their investigatory capacity. For example, in the insurance sector, the cooperation with the authorities is taken into account in 18 Member States only.

Divergence exists in the nature (administrative or criminal) of sanctions provided for in national legislation

The range of violations for which administrative or criminal sanctions are envisaged in national legislation diverges across the EU.

For example, while all Member States provide for administrative sanctions in the case of violations of the MiFID Directive, only 13 Member States also provide for criminal sanctions.

Subject to a detailed case-by-case analysis, criminal sanctions applicable to the most serious violation of EU financial services rules send out a strong message of disapproval to individual offenders and could therefore have an important dissuasive effect, if they are appropriately applied by the criminal justice system.

The level of application of sanctions varies across Member States

In addition to the provision for appropriate sanctions in national legislation, it is key for the effectiveness of sanctioning regimes to ensure that sanctions are actually applied when a violation is found or proven to have occurred.

Although there is no simple indicator that would be able to measure and compare the level of application of sanctions in different Member States, some evidence can be derived from input factors, such as the resources dedicated by a country to application of sanctions, or output factors such as the number and level of sanctions applied. For example, the number of sanctions applied in different Member States in 2007 ranges from 0 to more than 100, and divergences also exist in Member States having financial banking sectors of similar size. Some Member States have not applied any sanction for more than two years²¹.

This could be explained by a number of factors including the absence of infringements, but it appears very likely that violations this could be due, in part to violations not being detected. This appears even more likely when considering that some of these Member States have a financial sector of a certain importance and that other Member States having financial markets of similar size applied several sanctions in the period of two years mentioned above.

3.2. Consequences of divergent and weak sanctioning regimes

The sanctions provided for by national law in the case of violations of EU financial services rules, diverge in key aspects of sanctioning regimes. Those divergences have led to a situation in which sanctions do not seem always optimal in terms of effectiveness, proportionality, and dissuasiveness.

Indeed, when sanctions applied across the Union are not sufficiently strict or their level is particularly low even for the most serious infringements, there is a high risk that they will not have a sufficiently dissuasive effect, as the perceived reward from the illegal behaviour will far outweigh the real risk. Moreover, as the effectiveness and dissuasive effect of sanctions

²¹ E.g.: in the banking sector, some Member States did not impose any sanction in 2006-2007-first quarter 2008.

depend at least partly on them being seen to be applied by the competent authorities, providing for appropriate sanctions would be insufficient if violations are not detected and therefore sanctions are not applied.

Lack of dissuasiveness and ineffective application of sanctions can result in a **lack of compliance with EU financial services rules** (such as prudential rules, conduct of business obligations, transparency obligations, etc.), which can increase the risk of market manipulation and lack of transparency, and may lead financial institutions to take excessive risks in their activity.

This situation risks seriously **undermining consumer protection and market integrity**. Violations of the EU financial services rules may cause serious economic damages to a broad range of users of financial services and to financial market safety and integrity, which have in turn serious negative repercussions on the whole economy.

Furthermore, divergences in sanctioning regimes may create **distortions of competition in the Internal Market**. If sanctions applied in different Member States for similar infringements are considerably different, financial institutions could be tempted to engage in regulatory arbitrage when deciding on their place of establishment or the location of branches; in order to benefit from the least stringent sanctioning regimes. This can prevent the development of a level playing field within the Internal Market.

The shortcomings identified in national sanctioning regimes can also have **a negative impact on financial supervision**. A new European supervisory architecture has been set up to ensure effective supervision of financial firms, which requires cooperation, coordination and trust between national supervisors. However, a supervisory authority could be unwilling to delegate powers²² to an authority in another Member States in which the sanctioning regime is considerably weaker. If national supervisors are not equipped with equivalent and consistent powers, including sanctioning powers, there is a risk that the decisions agreed within a college will not be applied in a consistent way by the supervisors concerned.

Finally, this situation risks **undermining confidence in the financial sector**, where stakeholders, and particularly consumers note that illegal behaviour is not met with appropriate sanctions which are capable of discouraging further infringements.

4. SUGGESTED POLICY ACTIONS

In view of those shortcomings, the Commission holds the view that further convergence and reinforcement of sanctioning regimes is necessary to prevent risk of improper functioning of financial markets and will provide important benefits. The Commission considers that these objectives can be better achieved through EU action rather than by different national initiatives, which would not be sufficient to achieve sufficient convergence.

The Commission therefore suggests that a minimum common standard could be set at European level on the key issues of sanctioning regimes in the financial services sector where shortcomings have been identified.

²² A competent authority may delegate tasks and responsibilities to other competent authorities under certain conditions, to ensure effective cross-border supervision.

4.1. Minimum approximation of national sanctioning regimes

The Commission considers that an EU legislative initiative to promote convergence and reinforcement of national sanctioning regimes in the financial services sector could be necessary. These objectives cannot be sufficiently achieved by the Member States alone: in the absence of a common EU framework, national initiatives cannot ensure consistency in the reinforcement of sanctioning regimes. EU action seems therefore necessary to achieve sufficient convergence.

The Commission holds the view that a legislative initiative is warranted to set some minimum common standards that Member States should respect in designing administrative sanctions for violations of financial services rules and when applying sanctions in this field. Such standards would be developed in the framework of basic principles common to all specific sectors, which would guarantee the overall coherence of any EU action in this field, but be adapted to the specifics of the different sectors and EU legislative acts in the financial services area.

Moreover, the introduction of criminal sanctions for the most serious violations of financial services legislation could be envisaged if and where this would prove essential to ensure the effective implementation of such legislation.

The envisaged legislative approach would be sector-specific and strictly limited to certain elements of the sanctioning regime²³. Some key elements are identified in the following section.

4.2. Key Issues for the approximation

Depending on the specificities of each sector and legislative act in the financial services field, the Commission believes that approximation should address at least the following issues.

- ***Appropriate types of administrative sanctions for the violation of key provisions***

In the Commission's view, for violations of each key provision of an EU legislative act, compliance with which is essential for the practical effectiveness of the act and therefore for the well-functioning of financial markets, a core set of administrative sanctions should be provided in all Member States. Such sanctions should be of a nature so as to allow the competent authorities to impose, in each specific case, a sanction that is likely to be optimal in terms of effectiveness, proportionality, and dissuasiveness.

²³

The legal bases for EU action in this field would be the Treaty's internal market provisions concerning the approximation of laws (Article 114 TFEU), the coordination of rules on taking up and pursuing activities as self-employed persons and freedom to provide services (Articles 53(1) and 62 TFEU). They provide the EU legislature with the possibility of adopting measures for the approximation of national laws, with the purpose to improve the conditions for the establishment and functioning of the internal market. This may include legislative measures relating to sanctions if they are necessary in order to ensure that EU rules are fully effective. The introduction of such measures in the EU financial services legislation would be based on the same legal basis as the sectoral legislative acts concerned. Article 83 TFEU also provides a legal basis for the establishment of minimum rules concerning the definition of criminal offences and sanctions, when the approximation of criminal laws proves essential to ensure the effective implementation of a Union policy in an area which has been subject to harmonisation measures.

For example, cease and desist orders and court or administrative injunctions may be useful if there is a risk of certain types of violation being continued or repeated. In addition to that, imposing an appropriate fine may have a considerable deterrent effect because it imposes a cost on the author of the breach. Withdrawal of authorisations may be appropriate in case of recurrent violation of key provisions of the EU legislative acts. Replacement of the managers of a financial institution is a sanction to be applied in the case of serious wrongdoings in the management.

Moreover, public warning and the publication of sanctions may make a significant contribution to general prevention of violations. Sanctioning regimes will better prevent other potential offenders from future violations, if those are aware that the sanctions provided for by law are actively applied and enforced and there is a real risk that violations will be detected and sanctioned by the authorities.

The Commission suggests that coherent provisions are introduced in each legislative act, indicating for each of the key provisions one or more types of administrative sanctions that must be available to the competent authorities in all Member States in case of violations of that provision. National legislation would have to ensure that those types of sanctions can be imposed against the persons responsible for such a violation. The Commission will also consider possible measures to ensure an appropriate interplay between such administrative sanctions and any criminal sanctions imposed by Member States.

- ***Publication of sanctions***

The Commission believes that competent authorities should be required to disclose to the public sanctions imposed as a rule. The Commission therefore is considering whether a general obligation in this sense should be introduced and the exceptions from that obligation further limited, for example by providing that where disclosure would seriously jeopardise the financial markets, the competent authority would be required to publish the sanction in an anonymous way.

- ***A sufficiently high level of administrative fines***

In view of the large gains that could be obtained from violations of financial services legislation, the level of any fines provided for by national law should be sufficiently high to allow national authorities to impose effective, proportionate, and dissuasive fines. In order to dissuade a rational market operator from breaching the law, the possibility that a violation would remain undetected should be offset by a fine that could reasonably be considered to exceed the potential financial benefits that could be gained from a violation, even where those benefits are not capable of calculation. This would be on the assumption that a rational market operator would take into account the likelihood of detection in deciding whether to commit an offence, and that not all infringements would be actually detected.

Moreover, given that, depending on the circumstances of each specific case, the actual level of sanctions imposed is often much lower than the maximum foreseen by the legislation, and the permitted range of sanctions is not always fully exercised, it is all the more important for the thresholds to be sufficiently high so as to ensure deterrence from all types of infringements.

The Commission therefore will assess whether there is a need to establish, for each category of administrative fines, minimum levels which Member States would need to respect when

laying down the range of the fines foreseen in national legislations. This level could be determined by taking into account the types of violations and the benefits that could be expected to be gained from a violation, for it to significantly exceed such potential benefits.

- ***Sanctions provided for both individuals and financial institutions***

Sanctions should be imposed on the individuals responsible for a violation and/or on the financial institution to the benefit of which those individuals are acting when committing a breach. Sanctioning the individuals responsible for a violation may be more appropriate where a violation is exclusively their responsibility. On the other hand, where that individual is part of a financial institution, fining the financial institution is frequently appropriate if the person responsible acted to the benefit of a financial institution. It could also encourage financial institutions to take the organisational measures and provide the staff training necessary to prevent violations.

The Commission considers that subject to the specificities of each legislative act administrative sanctions should be available against the individuals responsible and the financial institutions to the benefit of which the individual acted.

The Commission is considering introducing appropriate provisions specifying that administrative sanctions should be applicable to all the persons responsible for an infringement²⁴. This should include the individual responsible for a violation and/or, where that individual is part of a financial institution, the financial institution to the benefit of which he acted when carrying out the violation.

- ***Appropriate criteria to be taken into account when applying sanctions***

The effectiveness, proportionality and dissuasiveness of sanctions depend also on the factors, including aggravating or mitigating circumstances, taken into account by the competent authorities when deciding the sanctions to be applied to the author of a specific violation. This holds particularly true for determining the actual amount of fines, where national legislation usually provides for a range of minimum and maximum amounts.

These factors should be framed in such a way as to allow competent authorities to adapt type and level of sanctions imposed to the nature and the impact of the violation as well as to the personal conditions of the offenders, which would help ensuring optimal proportionality and dissuasiveness of the sanctions actually imposed.

In the Commission's view, in addition to the seriousness of the violation which is already foreseen in almost all national legislations, the factors to be taken into account should include at least:

- the financial benefits for the author of the infringement derived from the violation (if calculable), in order to better reflect the impact of the violation and discourage further violations.

²⁴ Most Directives provides that sanctions can be imposed on the persons responsible for the infringement, but without clarifying whether this includes natural and legal persons. There are some exceptions, eg Solvency II Directive 2009/138/EC, Article 34 ("The supervisory authorities shall have the power to take any necessary measures, including where appropriate, those of an administrative or financial nature, with regard to insurance or reinsurance undertakings, and the members of their administrative, management or supervisory body").

- the financial strength of the author of the violation, as indicated by elements such as the annual turnover of a financial institution or the annual income of a person responsible for the violation, which would help in ensuring that sanctions are sufficiently dissuasive even for large financial institutions.
- the cooperative behaviour of the author of the violation, which can contribute to encourage infringers to cooperate and in so doing increase the investigatory capacity of the authorities and therefore effectiveness of sanctions.
- the duration of the violation.

The Commission therefore is considering proposals to introduce provisions requiring Member States to ensure that competent authorities, when determining the sanction to be imposed for a violation of financial services legislation, take into account, as a minimum, certain common key criteria.

- ***Possible introduction of criminal sanctions for the most serious violations***

Criminal sanctions, in particular imprisonment, are generally considered to send a strong message of disapproval that could increase the dissuasiveness of sanctions, provided that they are appropriately applied by the criminal justice system.

However, criminal sanctions may not be appropriate for all types of violations and in all cases. Imprisonment can only be imposed against natural persons, whilst in some Member States criminal fines can be imposed on legal persons. Not all types of violations occurring in the financial services area may be considered sufficiently serious so as to warrant criminal sanctions.

The existing EU financial services law is without prejudice to the right of Member States to impose criminal sanctions. In fact, several Member States have criminal sanctions in place for certain offences in the financial services sector, particularly in case of market abuse or insider dealing. In the case of market manipulation prohibited under the Market Abuse Directive, only 2 Member States do not provide for criminal sanctions. In other areas criminal sanctions are provided for in far fewer Member States. For example, violations of the initial conditions of authorisation of an investment firm under the MiFID Directive are punishable by imprisonment in only seven Member States.

In the light of the above considerations and in line with the conclusions of the JHA Council of 22 April 2010 on economic crisis prevention and support for economic activity and the Stockholm Programme²⁵, the Commission will assess whether and in which areas the introduction of criminal sanctions, and the establishment of minimum rules on the definition of criminal offences and sanctions may prove to be essential in order to ensure the effective implementation of EU financial services legislation. Any proposals in the field of criminal law should aim at ensuring appropriate coherence and consistency across different sectors, in particular when considering the type and level of criminal sanctions included in EU directives.

- ***Appropriate mechanisms supporting effective application of sanctions***

²⁵ See footnote 3.

In order to ensure an effective, proportionate and dissuasive sanctioning regime, it is essential that the sanctions provided for by the law are effectively applied, that violations are detected, that investigations and sanctioning procedures are carried out expediently and that appropriate sanctions are imposed where this is warranted.

The application of sanctions for violations of EU financial services legislation is mainly the responsibility of national authorities. In order to enable competent authorities to effectively enforce EU law, the legal and institutional framework should be as conducive as possible to the detection of violations and the imposition of appropriate sanctions.

The Commission recalls Member States' obligation to ensure, without prejudice to the independence of the judiciary, that competent authorities apply the sanctions provided for in national legislation in an effective way. That should include, inter alia, sufficient human and financial resources devoted to the application of sanctions, appropriate training and specialised knowledge of persons and institutions carrying out investigations and sanctioning procedures. The Commission considers that these issues could be better addressed at national level.

Nevertheless, the Commission believes that EU can take action to improve the legal framework in which competent authorities operate, and particularly to ensure that all national authorities have the necessary key powers and investigatory tools, they cooperate and coordinate their action appropriately.

While the degree of convergence in relation to most key powers and investigatory tools on the basis of existing legislation is already relatively high, no such convergence has yet been reached concerning, in particular, mechanisms encouraging persons who are aware of potential violations to report those violations within a financial institution or to the competent authorities, and at encouraging persons who are responsible of potential violations, to report those violations to the competent authorities.

In the Commission's view, it could be useful to explore whether common provisions could be introduced on mechanisms that Member States should put in place to better detect violations of EU law, particularly those aiming at protecting persons (e.g. employees of financial institutions) who denounce potential violations committed by other persons ("whistleblowing") or at providing for reduction of sanctions applicable to the persons who confess their involvement in a violation, under certain strict and clearly defined conditions (leniency programmes)²⁶. By allowing competent authorities to uncover violations that would have probably been remained undetected, or to gather additional evidence about a violation, such mechanisms can contribute to more effective application of EU law, to the benefit of all players in financial market.

As to the cooperation between competent authorities, the existing EU legislation already provides an obligation on Member States to take the necessary measures to ensure that competent authorities cooperate with each other whenever necessary for the purpose of detecting violations and imposing sanctions. In particular, competent authorities shall exchange information and cooperate where a violation has effects in more than one Member State.

²⁶ See programmes established by OFT and SEC to reward whistleblowers.

The Commission believes that the new ESAs will further facilitate the existing cooperation between competent authorities, which will help in ensuring more consistent application of sanctions and more efficient supervisory activities. To this end, the ESAs should use their powers to carry out peer reviews, and include sanctioning powers as a priority area for those reviews. They should also make full use of their powers to collect information on sanctions, in order to monitor national legislation and to promote exchange of information and best practices between Member States. Moreover, the ESAs have the possibility of settling disagreements between national authorities, in some areas that require cooperation, coordination or joint decision making by supervisory authorities from more than one Member State.

Finally, the Commission will consider whether further convergence on other specific issues, such as the rules on the burden of proof, would be necessary to ensure sanctions provided for by law are effectively applied.

5. CONCLUSION

The financial crisis has shown that financial market rules are not always respected and applied as they should be. This has seriously undermined confidence in the financial sector. While recognising that stricter sanctioning regimes cannot remedy all problems related to the application of EU financial services rules, the Commission believes that greater convergence and reinforcement of existing national regimes can significantly help to prevent risk of improper functioning of financial markets and assist the development of a level playing field within the Internal Market.

The Commission welcomes comments from Member States and other stakeholders on the analysis of the shortcomings identified and the policy proposals suggested in this Communication. Stakeholders are in particular invited to indicate whether there is any issue they do not consider appropriate for further approximation and whether there are areas in which the Commission should consider additional actions.

The Commission invites all interested parties to send their contributions to: markt-sanctions-consultation@ec.europa.eu, by 19 February 2011.

The responses received will be available in the Commission website unless confidentiality is specifically requested, and the Commission will publish a summary of the results of the consultation.

The Commission will take into account the comments received, should it decide to make appropriate proposals on how to reinforce national sanctioning regimes in a consistent manner. Any future legislative initiative in this field would be accompanied by an impact assessment of the relevant sanctions related issues.