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IMPACT ASSESSMENT

Accompanying document to the

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

{COM(2010) 716 final}
{SEC(2010) 1497 final}

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1. INTRODUCTION

The financial crisis has unveiled a number of regulatory and supervisory failures which should be tackled in order to repair and strengthen the financial sector. Effective sanctions and sanctioning powers are a key element of a supervisory regime which should ensure sound and stable financial markets and, ultimately, the protection of consumers and investors. As such they have attracted significant political attention over the last years.

The Ecofin Council of 4 December 2007, when reviewing the functioning of the Lamfalussy process, invited the Commission to "study the differences in supervisory powers and objectives between national supervisors, to conduct a cross-sectoral stock-taking exercise of the coherence, equivalence and actual use of sanctioning powers among Member States and the variance of sanctioning regimes and where necessary to define an adequate set of powers".

The Larosière report on supervision recognized the important role of sanctioning regimes: "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 sanctions regimes that are sufficiently convergent, strict, resulting in deterrence. This is far from being the case now." The corresponding measure proposed is: "in the first stage, EU should also develop a more harmonised set of financial regulations, supervisory powers and sanctioning regimes" (Recommendation 20). The recommendations of the Larosière report were broadly endorsed by the Commission's Communication "Driving European recovery" of 4 March 2009. One of its five key objectives is indeed: "To ensure more effective sanctions against market wrongdoing". – To this end, the Commission announced its intention to come forward with proposals on how sanctions could be strengthened in a harmonised manner and better enforced.

In its conclusions of 19-20 March 2009, the European Council called for better regulation of financial markets, in particular as regards "rigorous enforcement of financial regulation and transparency, backed by effective, proportionate and dissuasive sanctions, in order to promote integrity in financial markets."

In its Communication "Regulating Financial Services for sustainable growth" of 2 June 2010, the Commission committed itself to carry out a revision of existing sanctioning powers and their practical application and announced a Communication on sanctions in the financial services sector aiming at promoting convergence of sanctions across the range of supervisory activities.

At the international level, strengthening sanctioning regimes is a priority 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. Increasing regulatory enforcement and remedies is also one of the objectives of the recent US financial regulation reform[1].

This impact assessment defines the problem and explains the need for and the objectives of EU level action in the field of sanctioning regimes. It also provides an analysis of the rationale, the alternatives and the impact of the Commission proposals on how sanctioning regimes may be approximated at EU level, which are presented in the Communication on sanctions in the

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, <http://financialservices.house.gov/singlepages.aspx?NewsID=3&RBID=775> (21 July 2010).

financial sector. It will be followed by a more comprehensive and detailed impact assessment for the envisaged proposals.

KEY CONCEPTS:

Sanctioning regimes: legal framework covering sanctions provided for in national legislation for the violations of EU financial services rules - including: type (administrative and criminal, pecuniary and non-pecuniary) and level of sanctions, addressees of sanctions, factors to be taken into account in the application of sanctions - and actual enforcement of sanctions.

Effectiveness, proportionality and dissuasiveness of sanctions: to be effective, sanctions must achieve the aim of the legislative act, to be proportionate, they must adequately reflect the gravity, nature and extent of the loss and/or harm and must not go beyond what is necessary for the objectives pursued; and to be dissuasive, sanctions must deter future infringements.

2. PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES

2.1. Consultation of interested parties and procedural issues

Following the above-mentioned request from the ECOFIN Council, in 2008, the European Commission invited the European Committees of Banking Supervisors (CEBS), of Securities Regulators (CESR) and of Insurance and Occupational Pensions Supervisors (CEIOPS) to provide assistance in conducting a review of supervisory powers and sanctioning regimes across Europe in the financial services sector. The main purpose was to ascertain whether such sanctioning regimes are sufficiently equivalent / convergent in their effect.

The above mentioned Committees of Supervisors carried out studies in each of the three main sectors concerned (banking, insurance, securities, hereinafter referred to as "the CEBS/CEIOPS/CESR reports"[2]). Their reports provide information as regards administrative sanctions (both pecuniary and non-pecuniary) and criminal sanctions (in the securities field). CEBS and CEIOPS reports also provide some information on the actual use of sanctions since 2005.

The Commission services carried out a first internal analysis of the type of sanctions envisaged in national legislation, the maximum level of those sanctions, the factors taken into account in determining the level of sanctions and finally, the effectiveness of their application. Those issues have also been discussed with Member States and the comments received have been taken into account in this impact assessment. Overall, they agreed on the need to promote further convergence of national sanctioning regimes while underlying the need to be respectful of the different national legal frameworks and judicial systems. A number of Member States stressed that the objective should not be to have full uniformity, but rather a minimum set of powers as well as an attempt to reduce divergences.

An Impact Assessment Steering group was set up to steer the preparation of this Impact Assessment, comprising representatives from DGs: MARKT, ECFIN, SG, SJ, ENTR, EMPL, COMP, SANCO, JUST. The Steering group met on 5 July, on 19 July and on 17 September

[2] Available on <http://www.c-ebs.org/home.aspx>, <http://www.cesr-eu.org/>, and <https://www.ceiops.eu/> (20 September 2010). Information contained in these reports have been subsequently updated on the basis of the contributions received from member States.

2010.This impact assessment takes into account the comments made by the members of the group.

This Report was sent to the Impact Assessment Board on 27 September. The Board discussed the report in its hearing on 22 October 2010. The Board discussed the report on its hearing on 20 October 2010. The following changes have been implemented following the Board's opinion: comparative data have been included on size of the banking markets and number of sanctions imposed; an additional option has been added for issue 1 and the scope of the action envisaged for pecuniary sanctions has been broadened; the reasons why changes in national legislations seem necessary have been better explained; the impact of the selected options on third countries and particularly US has been addressed

3. POLICY CONTEXT, PROBLEM DEFINITION AND SUBSIDIARITY

3.1. Background and context

Completing the single market in financial services is recognised as one of the key areas for EU's future growth and jobs, essential for EU's global competitiveness and thus a crucial part of the economic reform process: the more integrated financial markets are, the more efficient the allocation of economic resources and long-run economic performance will be. However, only when rules are enforced effectively, can companies and citizens benefit from access to safe European markets.

3.1.1. Nature and size of the market concerned

The EU is one of the key players in global financial services: its contribution to world financial services accounts for 25% to 50% in key segments of financial markets[3] (Chart 1 in Annex II gives an overview of the size of European financial markets.

The wholesale financial sector, which is concerned by many of the sanctions discussed in this Impact Assessment, is of decisive importance for the EU economy and plays a key role in ensuring that the entire economy can make the investments necessary for sustainable growth. Indeed, the sector's output was worth an estimated €219bn in 2008, while it employs almost 1.4 million people, and exports of wholesale financial services by EU countries account for a significant proportion of world trade in services [4] The role of the wholesale financial sector is also significant in terms of value added in the economy and of employment. For instance, financial intermediation and insurance and pension funding, which respectively accounted for 4,7% and 1% of EU-25 total value added (2007), have been identified as some of the most important sectors for the EU economy[5]. The European financial market is becoming more and more integrated, particularly in the wholesale financial sector, and there are a growing number of large financial groups and infrastructures operating on a pan-European basis. Although the financial crisis led to increased market segmentation, the level of financial integration remains high.

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3 See European Financial Integration report 2009 (EFIR 2009), <http://ec.europa.eu/internal_market/finances/fim/index_en.htm>

4 London Economics, report "The importance of wholesale financial services to the EU economy 2009", September 2009

5 See Commission staff working document "'Implementing the new methodology for product market and sector monitoring: Results of a first sector screening' accompanying the Commission Communication of 2007 "A single market for 21st century Europe", COM(007)274 final.

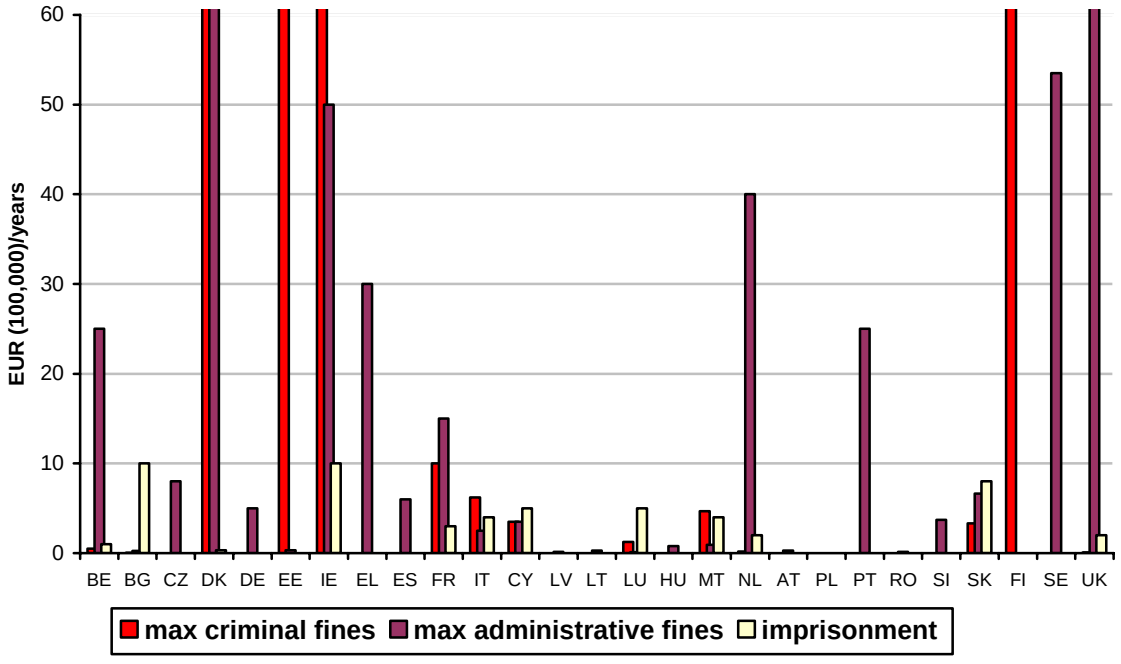
The banking and insurance markets are dominated by pan-European groups active in several Member States, whose risk management functions are centralised in the group's headquarters. Currently around 70% of EU banking assets is in the hands of some 40 banking groups with substantial cross-border activities. Especially in the EU-12, banking markets are dominated by foreign (mostly Western European) financial groups (see Chart 2 in Annex II). In these countries, on average 65% of banking assets are in foreign-owned banks. In countries like Estonia, the Czech Republic and Slovakia over 92% of banking assets are in foreign-owned banks.

3.1.2. Number of infringements/ order of magnitude of sanctions

It is by definition impossible to obtain reliable estimates about the number and importance of undetected violations of the law in any area. Nevertheless, the number of sanctions actually imposed by Member States provides an indication of the number and importance of detected violations of financial services legislation. Information provided in competent authorities' annual reports, and other information in the possession of the Commission, provide some data on the number of sanctioned violations in the reference periods for violations of banking legislation and of market abuse rules. The number of actual violations is likely to be much higher.

Regarding the range of sanctions available on the statute book, Chart 3 and 4, covering most Member States gives a guide to the sanctions available for violations of MiFID and MAD. It can be immediately seen that there is a wide range, particularly as regards fines (administrative and criminal).

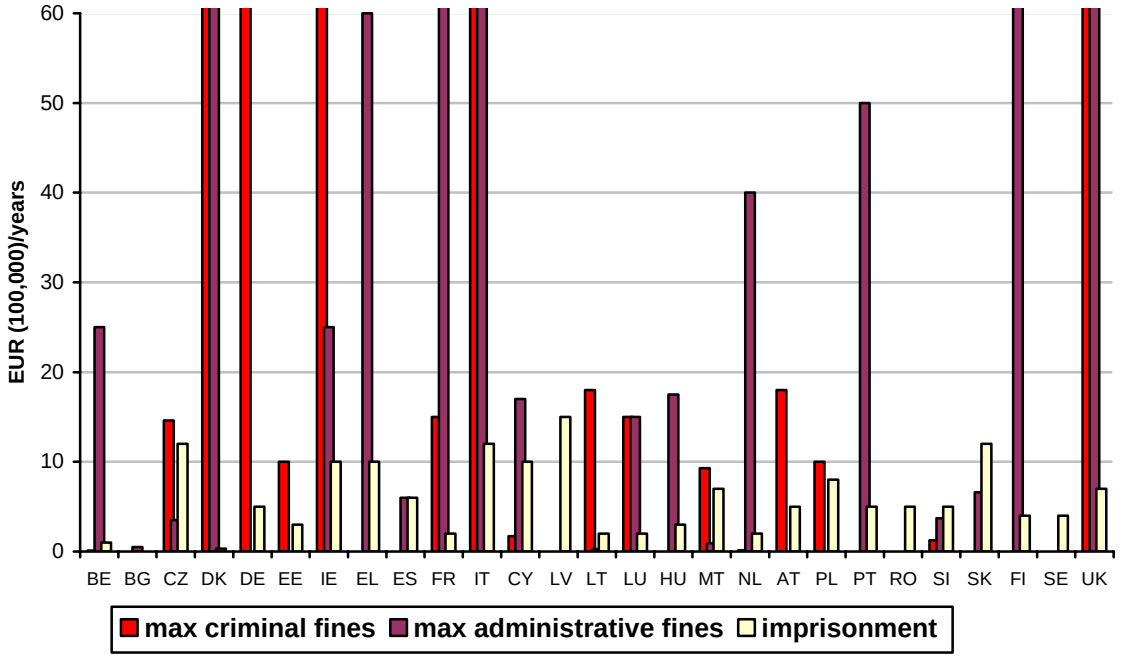
Chart 3 – Range of financial sanctions (administrative and criminal) (legal persons) and terms of imprisonment for natural persons (MiFID).



Comments: administrative fines are unlimited in DK and UK; criminal fines are unlimited in FI and DK. However, in DK the level of fines is limited by case law currently at a level of DKK 5000 - 25000 (approximately € 670 – 3355). Maximum fines are: FR: EUR 1.5 million or ten times the unlawful gains. EL: EUR 3 million or twice the unlawful gains. In ES, maximum fine is up to the highest of the following amounts: 5x gross profit obtained as a result of the acts or omissions comprising the infringement; 5% of the infringing firm's own funds; 5% of the total funds involved in the infringement or EUR 600 000. No information for PL.

Source: CESR report, p. 182-184 and contributions from MS

Chart 4 – Range of administrative and criminal fines and terms of imprisonment for insider dealing (Art. 2 MAD).

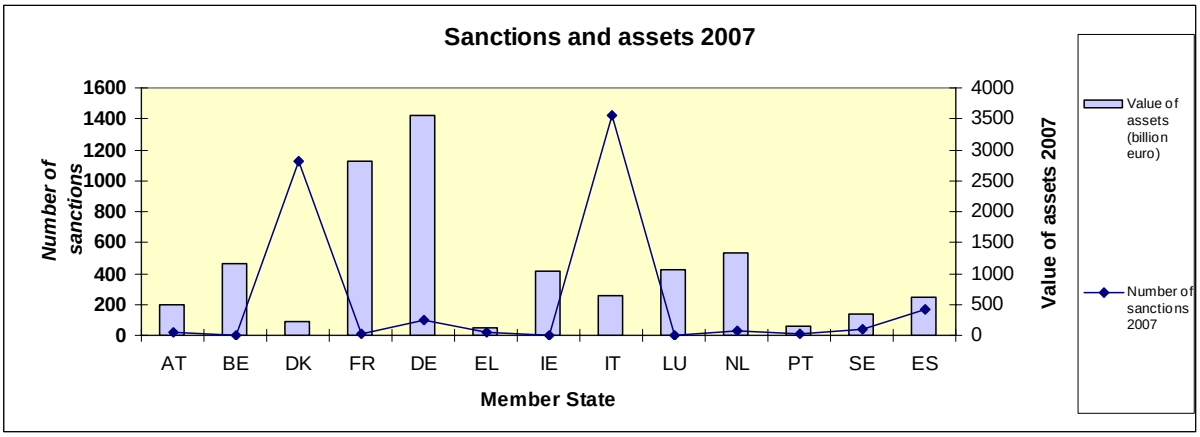


Comments: UK and DK: unlimited criminal fines. However, in DK the level of fines is limited by case law currently at a level of DKK 5000 - 25000 (approximately € 670 – 3355). In nine other Member States, if the gains from an infringement are quantifiable and exceed the maximum amount of the relevant sanction, the set amount of the fine can be exceeded. (BE, DE, ES, FR, IT, LT, LU, NL, RO, UK). In ES, maximum fine is up to the highest of the following amounts: 5x gross profit obtained as a result of the acts or omissions comprising the infringement; 5% of the infringing firm's own funds; 5% of the total funds involved in the infringement or EUR 600 000.

Source: CESR report, summary of February 2008, p. 15-17 and contributions from MS

The information available to the Commission about sanctions actually imposed concerns mainly the banking sector, and (for certain Member States only) the securities sector. The difficulty of gathering this information is illustrative itself of the lack of transparency regarding sanctions. In the banking sector, some Member States imposed no sanctions whatever during that period, and others imposed less than 25 sanctions per year, including some Member States with very large financial markets. Chart 5 shows that the number of sanctions applied differs considerably even between Member States with banking sectors of a similar size, as approximately estimated on the basis of the value of the banks' assets.

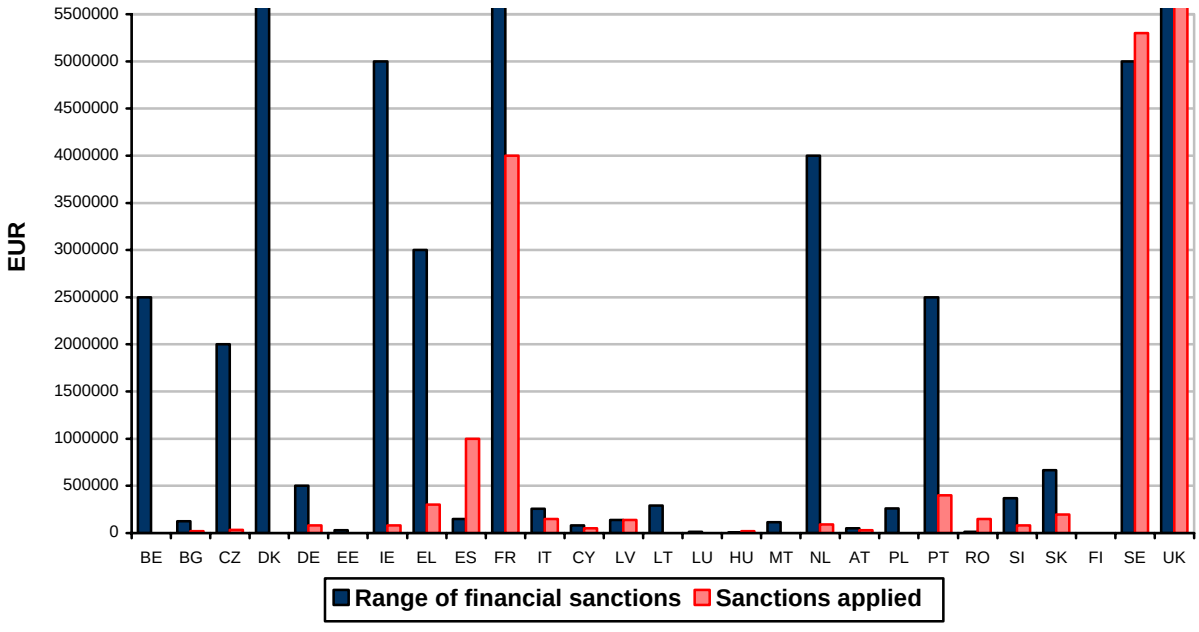
Chart 5: Number of sanctions imposed in 2007 and value of banks' assets in some Member States



Source: CEBS report, page 55, BIS statistics and contributions from MS

Chart6, compiled from input from Member States, gives an overview of the amount of administrative financial sanctions imposed in the banking sector (compared with the range of sanctions, that is the minimum and maximum levels provided for in the legislation). From this table it can be seen that the majority of Member States, imposed little or no sanctions during that period. It also shows that in most cases where a wide range of sanctions are allowed in the statute book, including very high sanctions, that range of sanctions is not effectively imposed. Only in three Member States was a significant amount of sanctions, totalling over one million euro, actually imposed in the banking sector during that period.

Chart 6 – Range of (financial) administrative sanctions against legal persons, and sanctions applied from 2005 to 2007 (in Euros)

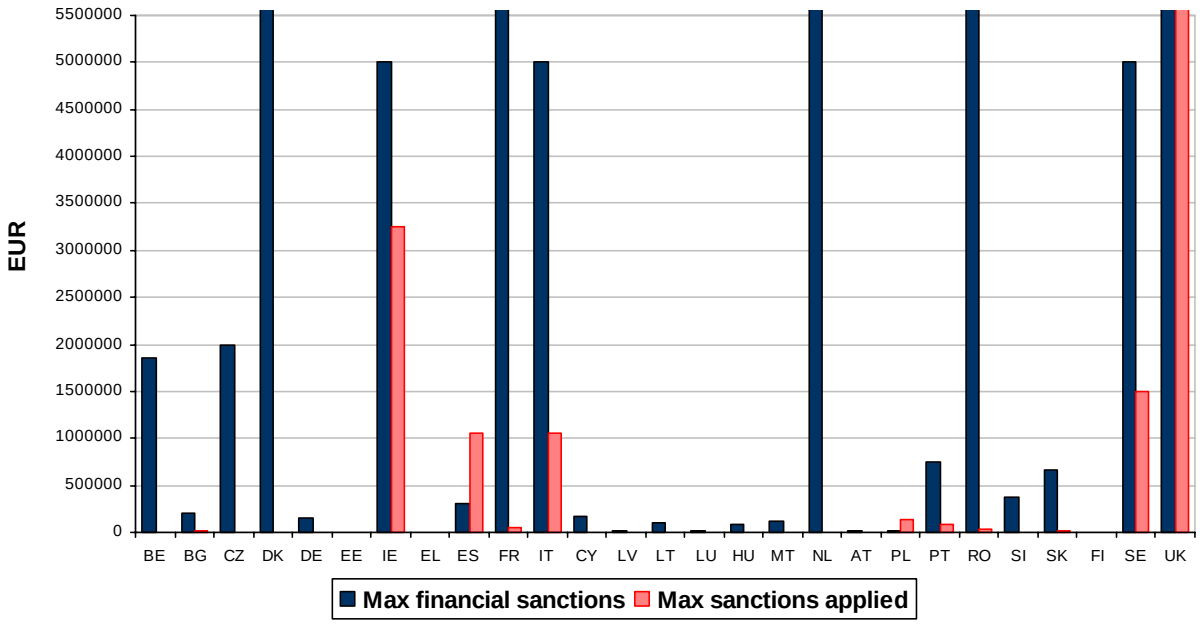


Comments: Fines unlimited in DK and UK. Maximum fines are linked to equity capital (RO, ES), turnover (HU, LT), or an alternative maximum figure, as indicated in the table. FR: max fines EUR 50 million. FI: fines not applicable to credit institutions. IT – fines can be cumulatively applied to natural persons and can exceed that amount in case of repeated violations.

Source: CEBS report, p. 50-52 and contributions from national authorities.

Chart 7 gives an overview of the maximum fines against legal persons foreseen in national legislations in the insurance sector and the amounts of administrative financial sanctions actually imposed. It shows important differences in the maximum fines foreseen in national legislations. In eight member States no fine was imposed during the period 2005 to 2007.

Chart 7 – Range of (financial) administrative sanctions against legal persons (available in 2005-2007), and sanctions applied from 2005 to 2007 (in Euros)



Comments: DK, NL and UK – fines are unlimited. However, in DK the level of fines is limited by case law currently at a level of DKK 5000 - 25000 (which approximately is € 670 – 3355). RO: the amounts of fines are linked to turnover or capital. PL: the amount of fines is linked to gross written premium, FR: maximum fines EUR 50 million. No fines available in FI. No information available for EL.

Source: CEIOPS report, pg. 119-123 contributions from national authorities

For the securities sector (specifically for market abuse), chart 8 shows the number of financial sanctions imposed annually in certain years, for those Member States for which the Commission has information.

Chart 8: Number of financial sanctions imposed in some Member States[6]

Member State	**Financial sanctions imposed – number (year)**
DE	16 (2008), 7 (2007), 20 (2006) – criminal financial sanctions imposed by the judicial authorities[7]
FR	48 (2008), 48 (2007), 31 (2006)[8]
UK	6 (2008), 1(2007),[9] 6(2006) – does not include criminal fines imposed

6 Sources: Annual Reports 2006, 2007 and 2008, http://www.cbfa.be/fr/sanc/sanc.asp (29 July 2010).

7 Source: Annual Report 2008, p. 158; Report 2007, p. 162. Also to be taken into account are cases in which proceedings were terminated following a payment – 17 in 2006, 14 in 2007 and 12 in 2008. additional information by DE authorities.

8 Source: Annual report 2008, p. 197; Annual report 2007, p. 197; Annual Report 2006, p. 227; additional information by FR authorities

IT	6 (2008); 17 (2007) (no information for 2006) [10]
ES	11 (2008), 14 (2007) – number of sanctions imposed "mainly concerning market abuse"[11]
NL	4 (2008), 2 (2007), 1 (2006) – financial sanctions [12]
BE	1 (2008), 2 (2007), 1 (2006) [13] – does not include criminal fines imposed by the judicial authorities
LU	0 (2006), 0 (2007), 0 (2008) [14]
AU	21 (2008)[15] – does not include criminal fines imposed
CY	6(2008)
PL	8(2008), 11 (2007), 4 (2006) – only criminal sanctions imposed by the courts

3.1.3. Overview of legislative framework

This initiative concerns sanctioning regimes for the legislative acts adopted by Council and Parliament in the field of financial services, together with the Commission measures based on those acts, and in particular legislation addressed by the Level 3 Committees in their respective studies. The main Directives concerned are listed in Annex 1.

Those acts put in place (in case of regulations) or oblige Member States to put in place (in the case of directives) certain rules for the conduct of business by market participants or for the taking up and conduct of certain businesses of financial institutions. For example, those acts require Member States to prohibit certain conducts (see e.g. the Market Abuse Directive), or to ensure that financial activities are not carried out without appropriate authorisation and that financial institutions authorised under a directive comply with certain requirements at all times (see e.g. the Solvency II Directive). In each of those cases, the question of appropriate sanctioning arises if a market participant or financial institution does not comply with an EU regulation or with the national provisions enacted by Member States to transpose an EU directive.

The existing legal framework leaves it for the national authorities to detect such violations and to apply appropriate sanctions[16]. At present, EU legislation deals with neither the type and level of sanctions to be applied nor their enforcement. Therefore, Member States enjoy considerable autonomy in terms of choice and application of national sanctions. However, this autonomy should be balanced with the need for uniform application of European law. Where EU legislation does not specifically provide any penalty for an infringement or refers for that purpose to national law, regulations and administrative provisions, the principle of sincere cooperation

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9 Source: Annual report 2008/2009, p. 33; Annual Report 07/08 P. 23Press releases

10 Source: Annual report 2008, p. 241

11 Source: Annual Report 2008, p 210-211

12 Source: Annual Report 2007, p. 38; Annual Report 2008, p. 40.

13 Source: http://www.cbfa.be/fr/sanc/sanc.asp (29 July 2010).

14 Source: Annual Report 2008, p. 145; Annual Report 2007, p. 133; Annual Report 20006, p. 137.

15 Source: Annual Report 2008, p. 118); additional information by AU authorities

16 In its Proposal on amending Regulation (EC) No 1060/2009 on credit rating agencies (COM(2010) 289 final), the Commission proposes to entrust the European Securities and Markets Authority (ESMA) with the power to take appropriare supervisory measures where a credit rating agency (CRA) has committed a breach of the Regulation, and to request the Commission to impose on a CRA a fine, in some particular cases.

requires that Member States "take any appropriate measure to ensure fulfilment of the obligations arising out of the Treaty or resulting from the acts of the Institution of the Union" (Article 4.3 TEU). The European Court of Justice has gradually specified that this principle obliges Member States to ensure the application of "effective, proportionate and dissuasive" sanctions in case of infringement of European rules[17]. For that purpose, whilst the choice of penalties remains within Member States' discretion, Member States' must ensure that infringements of EU law are penalised under conditions, both procedural and substantive, which are analogous to those applicable to infringements of national law of a similar nature and importance and which, in any event, make the penalty, effective, proportionate and dissuasive.

As to the interpretation of this requirement, in general terms, in the light of the case law of the Court of Justice of the European Union, sanctions can be considered effective when they are capable of ensuring compliance and consequently effective application of EU law. Sanctions would be proportionate when they do not go beyond what is necessary for the objectives pursued and adequately reflect the gravity of the infringement[18]. Finally, sanctions can be considered dissuasive when they prevent authors of potential violations from committing or from repeating those violations. Beyond these broad principles, which stem in any event from the case law, it is hardly possible to formulate generally applicable criteria for judging the requirements of effectiveness, proportionality and dissuasiveness. This has to be assessed in the light of the nature of different infringements and the specifics of the sectors concerned.

In order to ensure that Member States comply with their obligations in the area of financial services, the Directives applicable in the financial sector contain standard clauses requiring Member States to provide that appropriate administrative measures can be taken or administrative sanctions be imposed against the persons responsible where the provisions adopted in the implementation of the Directives have not been complied with. In addition, some Directives contain rules on: - cooperation between national authorities in charge of the detection of infringements and/or the application of sanctions; - powers to be conferred to the competent authorities; - administrative sanctions/measures applicable in some specific cases; - possibility to publish the sanctions/measures applied in specific cases.

3.2. Problem definition

In spite of the rules described in the previous subsection, sanctioning regimes provided for by Member States for violations of national laws transposing the legislative acts adopted by Council and Parliament in the field of financial services legislation, are divergent and fragmented. The information provided in the CESR, CEIOPS and CEBS reports show a certain divergence across national sanctioning regimes which are designed in a way that does not always ensure sanctions are sufficiently effective, proportionate and dissuasive. Furthermore, the information received shows a divergence in the level of enforcement: the fact that in some Member States no sanctions were applied in a given period could be symptomatic of a weak enforcement of EU rules.

While the nature and degree of the problems identified differ to some extent across sectors and Directives, the main problem drivers behind this phenomenon may be summarised as follows.

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[17] Judgment of 21 September 1989, Case C-68/88, Commission vs Greece; Judgement of 13 September 2005, Case C-176/03, Commission vs Council, par 48; Judgement of 5 July 2007, Case 430/05, Ntionik et Pikoulas, par 53.

[18] See ECJ judgement of 5 July 2007, Ntionik et Pikoulas, C-430/05, par 53; ECJ judgement of 6 July 2000, . Molkereigenossenschaft Wiedergeltingen, C-356/97, par. 35-36.

Problem drivers

Divergences and weaknesses in sanctioning regimes

The levels of administrative pecuniary sanctions (fines) vary widely across Member States and seem too small in some Member States, including for the same type of infringement.

For instance, as regards the level of administrative pecuniary sanctions, the maximum levels provided for in national legislation diverge very widely:

– Banking sector:[19] the maximum amount of fines provided for in case of a violation is unlimited or variable in 5 Member States, more than 1 million euros in 9 Member States, less than 150.000 euros in 7 Member States.

– 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 11 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, 15 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.

– Insurance sector:[20] 6 Member States provide for maximum fines of 100 000 euros or less[21].

The fines applied in certain Member States may appear to be rather small, for several reasons. [22] First, 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 States.[23] However, a fine that is lower than the gains that can be expected from the violation for which the fine is imposed is unlikely to have much of a dissuasive effect. Second a potential offender may always hope that the infringement will remain undetected by the authorities. To ensure that a fine has a sufficiently dissuasive effect on a rational market operator, the possibility that an infringement will remain undetected must be offset by imposing fines which are higher than the benefit that the undertaking gained from breaching the financial services legislation in question. In the financial sector, where a large number of potential offenders are cross-border financial

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19 This concerns the range of fines available for violations of banking legislation in general, and does not relate to a specific violation.

20 This concerns the range of fines available for violations of insurance legislation in general, and does not relate to a specific violation.

21 See CEBS report, p. 50-52; CEIOPS report, p. 119-123; CESR report on MAD, excerpts from the replies of national authorities; CESR report on Mifid, p. 182.

22 Research on the level of fines and its relation to the level of enforcement, as well as on the optimal level of fines includes the following: John C. Coffee, Law and the Market: The Impact of Enforcement, Columbia Law and Economics Working Paper No. 304, 2007, p. 13 ssq < http://finance.wharton.upenn.edu/weiss/wpapers/07-3.pdf> (20 September 2010); Uldis Cerpsa Greg Mathersb and Anete Pajustec: Securities Laws Enforcement in Transition Economies, p. 12 ssq., < http://www.cerge-ei.cz/pdf/gdn/R CV_100_paper_01.pdf> (20 September 2010); Rafael La Porta, florencio Lopez-de-Silvanes, Andrei Shleifer: What Works in Securities Laws?, the Journal of Finance, Vol. LXI, No. 1, February 2006; with a specific focus on another area (antitrust) see Wouter Wils, Optimal Antitrust fines – theory and practice, World Competition 2006, p. 183, 199 ssq; Peik Granlund: Regulatory choices in global financial markets – restoring the role of aggregate utility in the shaping of market supervision, Bank of Finland Research Discussion Papers 1, 2008, p. 13 ssq; CRA International/City of London: Assessing the Effectiveness of Enforcement and Regulation, London, April 2009..

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

institutions with very considerable turnovers, sanctions of a few thousand euro do not seem to be sufficiently dissuasive.

Some Member States do not have at their disposal important types of sanctioning powers for certain infringements.

– 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 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. Furthermore, public warnings and publication of sanctions are not foreseen in all national legislations.

– 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. However, the publication of sanctions 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. [24]

Divergences also exist as to the type of persons who may be sanctioned. In some Member States sanctions are not applicable to natural persons (e.g. Insurance) or to legal persons (e.g. MAD pecuniary sanctions).

– For example, in the banking sector, in one Member States sanctions are limited to natural persons and in two other Member States to legal persons.[25]

– In the insurance sector, three competent authorities do not have the power to apply sanctions to natural persons, five authorities are able to apply only financial sanctions to natural persons, and two authorities are able to apply only non-financial sanctions.[26]

Therefore, legal persons and natural persons will most probably be treated in different ways as regards a specific violation, depending on the Member States where the violation is committed. Similarly, the integrity of financial markets will be protected to different degrees across Member States. However, competent authorities will be better able to choose a sanction that is optimal in terms of effectiveness, proportionality and dissuasiveness if sanctions are applicable to natural and legal persons. [27] A natural person (e.g. the manager of a bank) who is essentially responsible for an infringement would probably not be discouraged from committing infringements if he doesn't risk to be sanctioned for his illicit conduct because sanctions are applied to legal persons (e.g. the bank) only. On the other hand, 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 would probably not encourage such financial institution to take the organisational measures and provide the staff training necessary to prevent infringements.

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24 See references quoted above (Footnote 22).
25 Source: CEBS report, p. 58 and excerpts from replies of national authorities.
26 Source: CEIOPS report, p. 108-110.
27 See references quoted above (Footnote 22), in particular Granlund, p. 18.

The criteria taken into account to determine the level of the fines vary substantially (e.g. undertaking's own funds, profit derived from the offence, loss incurred by third parties etc.).

– 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 offence.[28] Of the 4 Member States with the lowest maximum administrative pecuniary sanctions (200 000 euros or less) only 1 provides for sanctions related to the illegal profit obtained. A fine that is not considerably higher than the benefit that may be gained from a violation could have a limited dissuasive effect. [29]

– For example, in the banking sector, only 17 Member States take into account the financial strength[30] of a financial institution when determining the level of a fine imposed on it. 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, may have only a very limited dissuasive effect for large financial institutions.

Moreover, divergences exist on the nature (administrative or criminal) of sanctions provided for in national legislations. For example, while all Member States provide for administrative sanctions in case of violations of the Mifid Directive, only 13 Member States provide for criminal sanctions, including criminal fines and/or custodial penalties. Criminal sanctions send out a strong message of disapproval to individual offenders and could therefore have an important dissuasive effect.

Finally, even where appropriate sanctions (both pecuniary and non-pecuniary) are in place, a certain divergence exists in the level of application of sanctions in different Member States.

The effectiveness, proportionality and dissuasiveness of sanctioning regimes depend not only on the sanctions provided for by law but also on their application. 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 occur.

There is no clear indicator that would be able to measure and compare the level of application of sanctions in different Member States. Research therefore derives some initial evidence on the level of application of sanctions in different country 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.[31] In this regard, the data available concerning the number and level of sanctions applied gives some evidence of a certain divergence:[32]

– 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 banking and insurance sectors of similar size.

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28 Source: CESR MAD Report, p. 31 and excerpts from replies of national authorities.

29 See references quoted above (Footnote 22)..

30 Source: CEBS report, p. 53 and excerpts from replies of national authorities. The financial strength of an undertaking may be indicated for example by the level of its own funds, its turnover, or its total assets; when an individual is responsible for the violation, his financial strength may be indicated by his annual income. Pls note that for the banking sector, the data available concerns does not relate to certain specific types of sanctions.

31 See references quoted above (Footnote 22), in particular Coffee, p. 13 ssq; CRA International, p. 27-32.

32 Source: CEBS report, p. 55; CEIOPS report, p. 26, 127; see also Chart in section 2.1.1 above.

– Some Member States have not applied any sanction for more than two years.

Numbers of applied sanctions can be low either because there have not been any violations, or because violations are not detected, or cannot be proven. While the total absence of violations in some Member States cannot be ruled out as a possibility, it appears more likely that violations are not detected, 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 same reference period. In an integrated financial market, economic and cultural differences alone cannot explain such divergences.

As the effectiveness and dissuasive effect of sanctions depend at least partly on them being seen to be applied by the competent authorities, providing for appropriate types and levels of sanctions would be insufficient if violations are not detected and therefore sanctions are not applied. Deficiencies in detection of violations can lead to the same problems of lack of compliance with EU law, undermined protection of consumers and market integrity, and lack of confidence in the financial sector described above.

While the application of sanctions for violations of EU financial services legislation is the responsibility of national authorities, an insufficient application is an integral part of the problem addressed and should therefore be taken into consideration, with full regard to the limited scope for EU action on this matter.[33]

Consequences of the problem drivers / Specific problems

The divergences between sanctioning regimes and the weaknesses of the sanctioning regimes described in the previous section may render the sanctions for breaches of EU financial services legislation **insufficiently effective, proportionate and dissuasive**. These divergences and weaknesses may also create **distortions of competition in the Internal Market**, which may be detrimental to the protection of investors and consumers of financial services products alike. Unequal treatment of violations in different Member States may result in different costs for the undertakings engaged in financial services activities, which risks creating competitive disadvantages for undertakings from certain Member States and prevents the development of a level playing field within the Internal Market. In extreme circumstances, undertakings seeking to circumvent financial services legislation might seek to establish their operations in those Member States with the least stringent sanctioning regimes. This could result in relaxed business practices which may undermine market integrity and consumers protection. Further, financial institutions with cross-border operations could seek to exploit the differences between the legislation in force in different Member States. This is particularly relevant in view of the integrated nature of EU financial markets, many of which are dominated by cross-border groups (see section 3.1.1 above).

For example: An investment company based in Member State A under the MiFID regime is subject to fines of no more than EUR 12 500 for breaches of that regime, whereas a subsidiary of the same company based in Member State B under the same regime may be subject to fines exceeding EUR 1 500 000.

[33] See section 5.1 below.

Those divergences and weaknesses of sanctioning regimes can also have a **negative impact on the trust between national supervisors and hence on cross border financial supervision**.

The crisis exposed, in particular, serious failings in the cooperation, coordination, consistency and trust among national supervisors. In today's European financial markets, in which many financial firms operate on a cross-border basis, the effectiveness of cross-border supervision must be ensured. This requires cooperation, coordination and trust between national supervisors, something that cannot be realised where there are varying sanctioning regimes. To this end, a new European supervisory architecture has been set up, to upgrade the quality and the consistency of national supervision and strengthen the oversight of cross border groups through the setting up of supervisory colleges. However, a supervisory authority could be unwilling to delegate powers 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. This is particularly relevant in view of the importance of cross-border groups in EU financial markets (see section 3.1.1 above).

For example: If, in a college of supervisors[34], the authorities of Member States A, B and C agreed to replace the managers of a bank at central and subsidiary level because of failures at both levels, the authority of Member State A would apply the measure without difficulty, the authority of Member State B would need the cooperation of other national authorities and the authority of Member State C would be unable to do anything, because it lacks the necessary power.

Where supervision is faced with divergent standards in both the level and type of sanctions available, loopholes can appear through which infringing parties may manage to avoid appropriate penalties for illegal behaviour.

General problems

The specific problems identified in the previous section can result in a **lack of compliance with EU financial services rules**, such as prudential rules, conduct of business obligations, transparency obligations, etc.

For example, when the maximum amount of the pecuniary sanctions is very low, even for the most serious infringements, there is a high risk that sanctions will not have a sufficiently dissuasive effect, as the perceived reward from such behaviour will far outweigh the real risk.

For example: in the banking sector, when an infringement of banking law and money laundering occurs in some Member States, the competent authorities will apply fines of less than EUR 150.000, which are very unlikely to have a dissuasive effect on the large banking groups operating in these Member States.

Similarly, when the level of sanctions does not depend on the benefit resulting from the offence, it is very likely that they will not discourage further offences. Furthermore, even where sanctions are linked to the benefit from the offence, this can be very difficult to quantify or calculate

[34] The college of supervisors is the forum in which all national authorities supervising a specific cross-border financial institution coordinate their activities

accurately. Thus the risk remains that sanctions will not consistently respect the seriousness of some violations.

For example: in some Member States the fines for insider dealing are limited to EUR 200 000, while the profits derived from such violations have in some recent cases amounted to several millions of Euros.

Divergences and weaknesses of sanctioning regimes may therefore deprive EU financial services rules of their effectiveness: it can increase the risk of market manipulation and lack of transparency and may lead financial institutions to take excessive risks in their activity, and can ultimately be detrimental to the proper functioning of financial markets.

This situation risks seriously **undermining consumer protection and market integrity**. But improper functioning of financial markets deriving from lack of compliance with EU financial services rules can also negatively affect the whole economy. Violations of these rules may indeed 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.

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

For example: if consumers have the impression that financial institutions violating the laws protecting them against unsuitable investment advice or against improper use of money invested in funds do not have to fear deterrent sanctions, their reluctance to make efficient use of financial market opportunities – already severely hit by the financial crisis - may be further exacerbated. If consumers will be reluctant to shop around Europe if they feel that the level of protection of consumers and market integrity is significantly different in different Member States.

3.2.1. Affected stakeholders

EU action aiming at approximating and reinforcing sanctioning regimes in the financial sector will affect all market players:

– financial institutions, including their stakeholders (the extent to which financial institutions of different nature and size would be affected would depend on the specific violations for which sanctions are applied);

– users of financial services, including depositors, investors, policy-holders, pensioners and non financial companies;

– public authorities, including central banks, supervisors and other national authorities in charge of the application of sanctions.

3.2.2. Baseline scenario

The baseline scenario would be one in which no action is taken in this field by the Commission at this point. The EU would continue to build on the existing legal framework and continue to rely on the national sanctioning regimes, which are divergent both in substance and application, and are sometimes not sufficiently dissuasive.

General clauses on sanctions already contained in sectoral Directives would be maintained and similar clauses would be included in future legislative proposals put forward by the Commission in the financial services sector. The Commission proposal for a regulation on over-the-counter (OTC) derivatives, central counterparties and trade repositories[35] envisages also the introduction of a provision requiring that sanctions shall include at least administrative fines.

Member States would be therefore obliged to ensure that sanctions are effective, proportionate and dissuasive, but they would be free to decide how to achieve this result. As "guardian of the Treaties", the Commission would verify that Member States implement correctly the rules on sanctions already contained in the sectoral Directive. In case it believes national sanctioning regimes to be incompatible with these general rules, the Commission would have the possibility of commencing infringement proceedings against Member States under Article 258 of the TFEU[36], asking them to take the measures necessary to ensure correct application of the EU law. However, the existing EU rules on sanctions being very general[37], those rules leave a certain margin of discretion to Member States, and infringement proceedings would probably only be successful in cases such as those where Member States do not provide any sanctions at all for certain violations. In other cases, it would be very difficult for the Commission to gather the evidence necessary to prove that national regimes are not effective, proportionate and dissuasive. Indeed, in the context of such an action, it is for the Commission to provide the Court of Justice with all the evidence needed to enable it to establish that a Member State fails to fulfil the obligations deriving from EU law, and in so doing the Commission may not rely on any presumption. Within this scenario, national authorities in different Member States would continue to have different sanctioning powers and the same infringements to European rules would be dealt with in a different way across the EU. Member States with strong sanctioning regimes could be reluctant to fully trust those with weaker sanctioning regimes, making it difficult to ensure effective cross border supervision. The Commission would continuously monitor the functioning of sanctioning regimes and would assess the need for policy action at later stage.

The baseline scenario takes into account that the existing coordination work of the Level 3 committees will be further enhanced with the creation of the new European Supervisory Authorities. Already today, CESR has established a Standing Committee (CESR-Pol) which has responsibility for CESR work related to co-operation and coordination of surveillance and enforcement activities between national supervisors. Once created, the new Authorities would continue such work and could play an important role in increasing the coherence and monitoring the application of sanctions. The new Authorities will have powers to play an active role in building a common supervisory culture. In particular, they can 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 in order to monitor national legislation and to promote exchange of information and best practices between Member States. Moreover, they have the power to settle disagreements between national authorities, in some areas that require

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35 COM(2010) 484.

36 Article 258 provides that the Commission may take action against a Member State for failing to fulfil an obligation under the Treaties. In particular, the Commission may formally request the Member State to bring the infringement of EU law to an end, and if the MS does not take appropriate correct measures necessary, it can refer the case to the European Court of Justice.

37 The standard clauses contained in the sectoral Directives require Member States: - to provide that appropriate administrative measures can be taken or administrative sanctions be imposed against the persons responsible where the provisions adopted in the implementation of the Directives have not been complied with, and – to ensure that these measures are effective, proportionate and dissuasive.

cooperation, coordination or joint decision-making by supervisory authorities from more than one Member State. Those possibilities will exist regardless of any additional policy action by the EU.

The European Securities and Markets Authority (ESMA) would probably be empowered to adopt supervisory measures where a credit rating agency has committed a breach of the Regulation, as envisaged in the proposal tabled by the Commission for the revision of the regulation on credit rating agencies (CRA Regulation)[38].

In the baseline scenario no clear and consistent guidance is provided to Member States on the type and the level of sanctions to be applied to certain violations. Therefore, it is very likely that national sanctioning regimes would not reach a degree of approximation ensuring that sanctions are always dissuasive and effectively enforced.

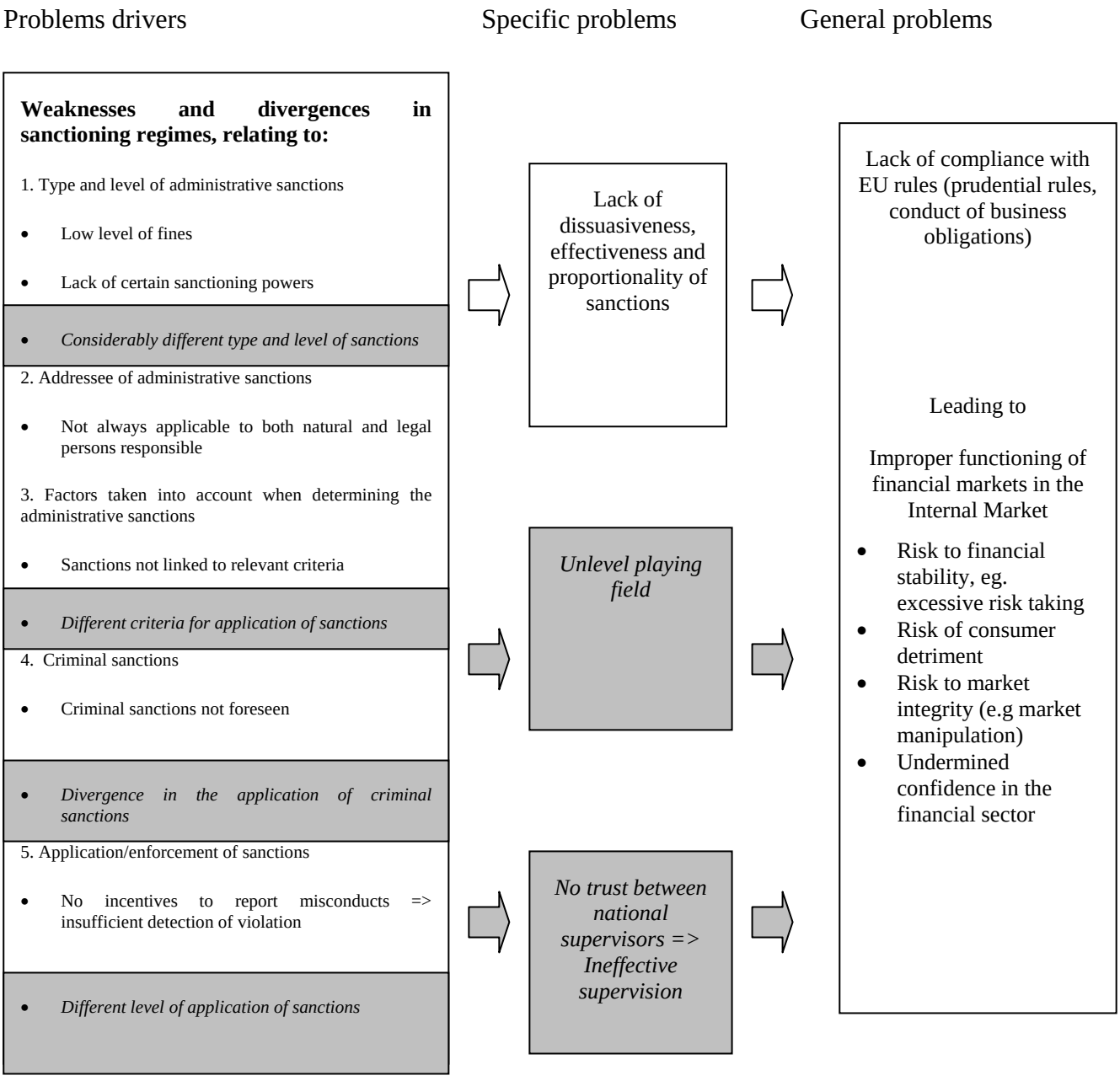
In the baseline scenario, financial institutions will also be subject to reputational damage linked to a violation that becomes public. This supposes that the public is aware of the sanctions imposed, which is not the case where information about violations or sanctions is not published. Moreover, the reputational damage depends also on the level of fines imposed: very low fines may be associated to minor violations which are unlikely to seriously undermine the reputation of their perpetrator.

In the baseline scenario, financial institutions will also be subject to civil liability for violations in accordance with national law. However, its deterrent effect is limited as it does not cover all possible violations of EU financial services rules: civil action cannot be always taken against the perpetrator/s of the violation and/or the damages caused by the violation can often not be quantified (e.g. a violation of capital adequacy or reporting requirements by a financial institution – a severe violation of the relevant directives – does not always lead to any actual damage until an institution finds itself in severe difficulties as a result). In any case, the purpose of civil actions is to compensate damages incurred by third parties, which would probably not be deterrent in cases where the profit derived from the violation is higher than the damages to be compensated.

At the international level, the EU would continue to push for rigorous enforcement of financial regulations in order to get more effective, proportionate and dissuasive sanctions, but the lack of common standards at EU level would make it difficult to propose concrete measures to be adopted at international level. Lack of European common standards would weaken the EU credibility at international level.

[38] See footnote 16.

Problem tree *



* The grey parts of the problem tree refer to problems mainly relating to divergences in sanctioning regimes while the white parts refer those mainly relating to weaknesses

3.3. The EU's right to act and justification

EU legislation on financial services is based on the Treaty provisions on the establishment of the Internal Market, particularly those aiming at ensuring the freedom of establishment (article 49 TFEU) which enables an economic operator to carry on an economic activity in a stable and continuous way in one or more Member States, and the freedom to provide services (article 56), which enables an economic operator providing services in one Member State to offer services on a temporary basis in another Member State.

The overall objective of the financial services legislation is to create integrated, open, competitive, and economically efficient European financial market, where financial services can circulate freely at the lowest possible cost throughout the EU, with adequate and effective levels of prudential control, financial stability and a high level of consumer protection.

The corollary of an integrated financial services market is that the same unlawful conduct incurs similar sanctions wherever the infringement is committed in the European Union. Such sanctions should be sufficiently dissuasive in order to discourage future wrongdoings. In this way, the EU would put out a strong message that certain conducts are unacceptable and punishable on an equivalent basis, which would increase confidence in the financial sector. This requires some convergence in sanctioning regimes across the EU.

The legal bases for EU level action in this specific field are: Articles 53, para. 1 and 62 TFUE, which provide the EU legislature with the possibility of adopting directives for the coordination of the provisions concerning the taking-up and pursuit of activities as self-employed persons and the provision of services in the Internal Market, and Article 114 TFEU on the approximation of laws, according to which the European legislator can adopt "measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and the functioning of the Internal Market." The object of measures adopted on the basis of Article 114 TFEU must genuinely be to improve the conditions for the establishment and functioning of the internal market.[39]

The European legislature therefore has discretion as to the method of approximation which is the most appropriate in order to improve the conditions for the establishment and proper functioning of the Internal Market[40]. This may include the approximation of national laws concerning the type and level of administrative sanctions to be imposed.

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.

3.3.1. Subsidiarity principle

Convergence of national sanctioning regimes seems necessary to promote dissuasiveness thereby ensuring a level playing field, a uniform application of EU financial services legislation, and full cooperation and mutual trust between national supervisors across the EU. These objectives cannot be sufficiently achieved by the Member States alone.

Better application of the existing sanctioning powers by competent authorities at national level could increase the effectiveness of sanctioning regimes but such an improvement of the application would not be sufficient to approximate the sanctioning powers provided for in national legislation, which seems necessary to ensure that all national authorities have at their disposal comparable sanctioning powers.

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39 Case C-58/08 Vodafone and Others v. Secretary of State for Business, Enterprise and Regulatory Reform Judgment of the Court 8 June 2010.

40 In *United Kingdom v Parliament and Council*, that by using the expression 'measures for the approximation' in Article 95 EC (now Article 114 TFEU) the authors of the Treaty intended to confer on the EU legislature a discretion as regards the method of approximation most appropriate for achieving the desired result, in particular in fields with complex technical features. Case C-217/04 *United Kingdom v Parliament and Council* [2006] ECR I-3771

In order to ensure that violations of financial services legislation are adequately sanctioned across the EU, and supervisors can develop mutual trust that each of their counterparts has appropriate sanctioning powers at its disposal, it must be ensured that sanctioning powers available in every single Member State adhere to a common minimum standard. That can only be achieved by EU action.

EU action is therefore needed to achieve sufficient convergence. The objectives of the Communication can therefore be better achieved through EU action rather than by different national initiatives.

The communication will put forward proposals to approximate the Member States' legislations on sanctions in the financial sector, based on common principles to be applied consistently across the European Union. This appears particularly important when considering that EU financial markets are increasingly integrated, especially at the wholesale level[41].

Any future legislative initiative in this field will be accompanied by new impact assessments analysing the need for the measures proposed and their impacts.

3.3.2. Proportionality

Actions proposed in the communication will not go beyond what is necessary to achieve the objective of reducing divergences in national sanctioning regimes and reinforcing sanctions to the extent this is necessary to ensure effective application of EU legislation.

The existing divergences between sanctioning regimes partly reflect the specificities of the different national legal systems and traditions, At the same time, the objective of a sufficiently effective, proportionate, and dissuasive sanctioning regimes, as established by the EU legislative acts in the field of financial services, is shared by all Member States. Such specificities do not justify a significantly different treatment of violations of EU financial services rules in different parts of the Internal Market.

The measures suggested in the communication will promote further convergence while ensuring respect for different national legal systems and traditions. Changes in national legislation will be necessary only where the existing rules do not comply with some basic standards of an efficient sanctioning regime. Similarly, Member States will be obliged to put in place new administrative procedures only to the extent these basic standards so require.As to the regional and local dimension of the action envisaged, it is worth noting that the issues relating to sanctions in the area of financial services are in most cases enshrined in national legislation and applied by competent authorities at national level. At this stage, no specific implications of the envisaged actions for certain regions or localities can be identified.

3.3.3. Fundamental Rights

Possible **impacts on relevant fundamental rights** will have to be considered in any proposals to approximate Member States' legislation on sanctioning regimes in the financial sector.

The following fundamental rights of the Charter of Fundamental Rights are of particular relevance:

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[41] See EFIR 2009, footnote 3 above.

- Equality before the law (Art. 20)

- Non-discrimination (Art. 21)

- The fundamental rights provided for in Title VI Justice: right to an effective remedy and to a fair trial (Art. 47); presumption of innocence and right of defence (Art.48), principles of legality and proportionality of criminal offences and penalties (Art. 49), right not to be tried or punished twice for the same offence (Art.50)

Greater convergence achieved through the approximation of sanctioning regimes will ensure non discrimination and equal treatment of the authors of the violations as between Member States. In particular, the measures proposed in this respect will better ensure that comparable violations are not dealt with differently and different violations are not dealt with alike, unless such differences are objectively justified. When dealing with the reinforcement of sanctions particular attention will be paid to proportionality issues. More severe sanctions will be proposed only to the extent the existing ones are not appropriate to attain the objective pursued by the rules which have been breached.

4. OBJECTIVES

EU action on the approximation and reinforcement of sanctioning regimes could satisfy several mutually complementary objectives. It could benefit supervisors and other national authorities in charge of the application of sanctions: they would have more appropriate instruments to deal with the infringements, which would help in preventing future breaches of EU law. More convergent sanctioning regimes could also raise mutual trust between supervisors and ease the implementation of their decisions. More effective supervision and better prevention of infringements would be beneficial to the whole financial system, in terms of consumer protection and safety, stability and integrity of financial markets.

The general policy objectives of this exercise are the following:

- Restored confidence in the financial sector

- Better protection of users of financial services.

- Safety, stability and integrity of financial markets

- Compliance with EU financial rules contributing to a proper functioning of financial markets

To achieve these general objectives, the following specific objectives must also be ensured:

- The effectiveness, proportionality and dissuasiveness of sanctions;

- The development of a level playing field which reduces the opportunities for regulatory arbitrage;

- The effective supervision of financial services providers.

The specific objectives listed above require the attainment of the following operational objectives:

- Reinforcement of sanctioning regimes
- Approximation of sanctioning regimes

5. POLICY OPTIONS, IMPACT ANALYSIS AND COMPARISON

For the purposes of this impact assessment, the analysis is at this stage limited to a general assessment of the possible options, aimed at approximating and reinforcing national sanctioning regimes. Policy options considered do not deal with specific measures needed in the three main sectors concerned (banking, insurance, securities), which will be assessed at the later stage when the Commission makes firm proposals. Policy options have been identified on the basis of both the content (issues covered) and the nature (legally binding or not) of the measures proposed. The latter aspect is relevant in the context of this analysis, given that the legal nature of the measures proposed is likely to have a significant impact on the degree to which the objectives of approximating and reinforcing national regimes can be achieved, but also because it will be perceived by Member States - key stakeholders in the context of this initiative – as determining to a large extent the impact any measure proposed is likely to have on them. The analysis covers the main policy issues identified on the basis of the available information, which does not exclude that additional issues could be identified following the consultation of stakeholders launched with the Communication, and addressed in the future Commission's proposals.

In order to assess and compare the policy options, an analysis of their main impacts has been carried out against criteria deriving from the problems identified in the current situation and the operational objectives of this proposal. The analysis takes also into account the different impact on the stakeholders concerned and the issues relating to proportionality, subsidiary and the impact on fundamental rights of each option. The options are compared with regard to the criteria of effectiveness and efficiency according to the following definitions:

Effectiveness: the extent to which options achieve the objectives of the proposal;

Efficiency: the extent to which objectives can be achieved for a given level of resources/at least cost.

The following schema is used to compare the contribution of the different options to the achievement of the objectives: √√ (strong positive) √ (positive), 0 (neutral).

In view of the limits of the data available and the nature of the subject-matter, no attempt has been made to quantify the impacts of each option. By definition, it is very difficult to estimate the number of undetected violations and therefore quantify their potential impact. The analysis is therefore of qualitative nature.

5.1. Policy options relating to the content of the measures

This section explains the main issues to be addressed in order to achieve the objectives of approximating and reinforcing national sanctioning regimes. In view of the problem as defined in section 3.2 above, we have identified the following issues for potential EU action:

– EU action concerning the type of administrative sanction and level of pecuniary administrative sanctions;

– EU action concerning the addressees of administrative sanctions;

– EU action concerning the factors taken into account when determining the sanctions;

– EU action concerning criminal sanctions;

– EU action to support effective application of sanctions.

For each issue, different policy options have been analysed as to the content of the measures that may be taken to this purpose. Finally, those options have been compared and a set of preferred policy options identified.

ISSUE 1: Type of administrative sanction and level of pecuniary administrative sanctions

This issue addresses the type of administrative sanctions applicable in the different Member States for violations of EU financial services rules, including the publication of sanctions, which can be considered itself a (complementary) sanction. As to the pecuniary sanctions in particular, this issue concerns the minimum and maximum level of such sanctions foreseen in national legislations.

Options	**Description**
1: no EU action	Member States are obliged only to ensure that their legislation on type of administrative sanctions and level of pecuniary sanctions complies with the general obligation to guarantee "effectiveness, proportionality and dissuasiveness of sanctions" already contained in sectoral Directives. Member States maintain their legislation unchanged insofar they consider type and level of sanctions envisaged are sufficiently effective, proportionate and dissuasive.
2: minimum common provisions on type of administrative sanctions and level of pecuniary sanctions for key violations	Some common provisions on the type of sanctions that should be available to the competent authorities in all Member States for certain key violations. (For instance, common provision that withdrawal of authorisations should be available in case of recurrent violation of key provisions of the EU Directives, that the publication of sanctions should be always envisaged, that cease and desist orders could be issued to stop unauthorised activities, that dismissal/disqualification of managers should be available in case of serious wrongdoings in the management) Common minimum provisions to ensure that level of pecuniary sanctions for certain key violations or categories violations is sufficiently high to ensure dissuasiveness (e.g. that the maximum level significantly exceeds the benefit derived from the infringement, if this can be calculated or estimated, and that a minimum level is provided for very serious violations which reflects the seriousness of the violation). Member States could set those levels at the level determined by the EU or higher, or could provide for an unlimited maximum level. Would lead to an increased convergence of sanctioning regimes while preserving some Member States discretion on the type and level of sanctions applicable to violations of EU financial services legislation.
3: uniform type of administrative sanctions and level of pecuniary sanctions for key	Key violations would be treated in a uniform way across Europe The same type of sanctions and level (minimum and maximum) of pecuniary sanctions would be provided for in all national legislations for violations of key provisions of the EU Directives. Member States would not be allowed to stipulate different types of sanctions or

violations	different levels of fines applicable to those violations while they would maintain their discretion in deciding sanctions applicable to other violations.
4: uniform type of administrative sanctions and level of pecuniary sanctions across EU for all violations	All Member States provide for the same type of sanctions and level of pecuniary sanctions in their national legislations. Each violation of EU financial services would be dealt with in a uniform way wherever it was committed. Uniform provisions would regulate the types of administrative sanctions applicable for violation of each specific rule of the financial services Directives. For pecuniary sanctions, fixed minimum and maximum level..

- **Policy option 1: no EU action**

In the absence of any action at EU level, Member States would hardly be willing to compare type of sanctions and level of pecuniary sanctions they envisage with those envisaged in other Member States, and to question the effectiveness of their own regime. This implies that type and level of sanctions would probably remain divergent and not always optimal in terms of dissuasiveness. The Commission could verify whether national provisions on type and level of sanctions comply with the general clause contained in the sectoral Directives which requires that sanctions are effective, proportionate and dissuasive. However, it would be extremely difficult for the Commission to initiate infringement procedures against Member States on that basis, given that the infringement of such general clauses would be very difficult to prove.

The new ESAs would also monitor the functioning of national sanctioning regimes and would have the possibility to address breaches of EU law. They could actively promote further convergence by guidelines and recommendations.

- **Policy option 2: minimum common provisions on type of administrative sanctions and level of pecuniary administrative sanctions**

As regards option 2, applying minimum common criteria would help in ensuring that violations of financial services legislation are dealt with in a similar way in all Member States. This reinforces the development of a level playing field in European financial services markets, as undertakings would risk incurring similar – even if not identical - sanctions and therefore bear similar costs[42] wherever they breach financial services legislation. Knowing that the response to violations of financial services rules is broadly equivalent throughout the EU would also increase consumer confidence and may lead to more cross border selling of financial services products, reducing the fragmentation of the single market along national lines. Further, the application of minimum common criteria will help improve cross-border supervision, by ensuring that all competent national authorities have equivalent minimum sanctioning powers, at least for key breaches of financial services legislation.

This option would increase the dissuasive effect of sanctions at least in all Member States which currently have levels of sanctions which are too low. Ensuring that the level of fines envisaged in national legislations cannot be lower than the level determined by the EU would allow for the imposition of fines that are optimal in terms of dissuasiveness and proportionality and consequently reduce risks of violations of EU legislation.[43] A higher level of sanctions signals in

[42] This term would be broadly defined as to include all potential negative consequences.

[43] See references above (Footnote 22).

fact to any potential author of a violation that this violation is considered by public authorities as highly damaging. Moreover, it reduces the likelihood that the author can expect to benefit from the violation. In fact, the amount of sanctions imposed is considered in academic literature as an intermediate indicator for the level of enforcement in certain jurisdictions.[44] This would have a significant positive impact on consumers protection (e.g. increased compliance with conduct of business rules), on competition between financial institutions (e.g. removing the competitive advantages derived from violations of financial services legislation), and to safety and integrity of financial markets (e.g. fewer cases of market abuse/manipulation, increased compliance with prudential rules). At the same time it would not prevent Member States to go beyond the EU minimum criteria, and fine other violations, provide for higher levels of fines or for further types of sanctions.

Concerning the impact on Member States, this option would require changes in national legislations in certain Member States, while other Member States would make no changes or only minimal changes. Types and level of sanctions provided for in national legislations should be revised only to the extent this is necessary to comply with the minimum standards, which is possibly not even the case in all Member States. Therefore, compliance costs for Member States are expected to be limited. Moreover, the discretion that Member States would maintain in defining type and level of sanctions, would allow them to provide for sanctions which best fit their different legal systems and traditions.

- **Policy option 3: uniform type and level of administrative sanctions for key violations**

Option 3 would ensure that identical sanctions are provided for in all Member States at least for violations of the most important provisions of the EU Directives. This would assist the development of a level playing field in the European financial market by reducing the potential advantage that financial institutions may derive from differing national regimes. This option could also increase consumer confidence and mutual trust between supervisors, leading to more efficient cross-border supervision.

Similarly to option 2, this option could increase the deterrent effect of sanctions and consequently reduce risks of violations of EU law, which would have a significant positive impact on consumer protection, competition, safety and integrity of financial markets. However, the fact that Member States would not be able to provide for further types of sanctions or higher levels of fines than those provided for in the uniform EU framework could weaken the overall deterrence of some national regimes.

This option would probably require significant changes in all national legislations in order to make uniform types and levels of sanctions for key violations of EU rules and would eliminate any flexibility in dealing with such violations. Therefore, compliance costs could be higher than in Option 2 and the uniform regime might not suit all national legal systems and cultures. For instance, Member States would be obliged to change the levels of pecuniary sanctions applicable to those violations, even where they are only slightly different from the harmonised levels, and they would no longer be allowed to provide for types of sanctions different from the harmonised ones (e.g. for violations of additional requirements which are allowed - but not required for all Member States – under EU Directives). Some of them would also have to provide for the application of new types of sanctions.

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[44] See references quoted above (Footnote 22), in particular CRA International, p. 31; John C Coffee, p. 13 ssq.

- **Policy option 4: uniform type and level of administrative sanctions across EU**

Option 4 would eliminate any divergence as to the types and levels of sanctions applicable to all violations of EU rules, not just key ones, which would therefore have the effect of harmonising all sanctions in all Member States. As with Option 2, his would ensure a level playing field in the European financial market: financial institutions would not take any advantage from different national regimes. Again, this could also significantly increase consumer confidence and mutual trust between supervisors leading to more efficient cross-border supervision.

Similarly to options 2 and 3, this option would increase the deterrent effect of sanctions and consequently reduce risks of violations of EU law, which would have a significant positive impact on consumer protection, competition, safety and integrity of financial markets.

This option would have a huge impact on Member States, even greater than that of Option 3 as more infringements would be covered: it would probably require major changes in all national legislations in order to make uniform types and level of sanctions. Similarly to Option 3, levels of sanctions would have to be modified in almost all Member States, types of sanctions different from the common ones would not be allowed any more and some Member State would have to provide for the application of new types of sanctions. But under this Option such changes would have to be made for all violations of EU financial rules. This could require the overall legal system to be revised, new procedures to be put in place and institutional architecture to be adapted. Therefore, compliance costs could be significant and the uniform regime could not fit national legal system and culture in different Member States. Uniform types and levels of sanctions could also jeopardise the dissuasiveness of sanctions in some cases. For example, Member States would not be able to sanction certain violations that may not be provided for in the uniform EU framework, even if specific national circumstances (e.g. additional requirements which are allowed - but not required for all Member States – under EU Directives) would require such sanctions.

Comparison of options

The objectives outlined in section 4 cannot be achieved under option 1, which preserves the "status quo" and thus the problems identified in section 3.2. Although the ESAs could promote further convergence on the types and level of sanctions, this action would hardly be effective without an EU framework being in place. Option 4 would be the most effective in terms of ensuring level playing field and better cross-border supervision, as it eliminates any divergence in types and level of sanctions. The effectiveness of Option 3 would be slightly lower because divergences would persist for certain "non-key" violations. Option 2 would be less effective in this regard but it would permit to better adapt sanctions to the specificities of the different national legal systems. As to consumer confidence and protection, the difference in the effectiveness of options 2, 3 and 4 is minor: they can be considered equally effective as far as appropriate minimum standards are set, that will be perceived as being sufficient to ensure that violations are adequately punished on an equivalent basis.

Options 2, 3 and 4 are considered to be similarly effective in terms of ensuring deterrence: uniform types and level of sanctions are not necessarily more dissuasive than different sanctions complying with minimum standards which are sufficiently strict. Moreover, Option 2 (and Option 3 but only for less important violations) would allow for the provision of additional types of sanctions and higher level of fines, which can increase dissuasiveness in some Member States.

Regarding efficiency, Option 2 seems more efficient than option 3 and 4 as it leads to lower compliance costs for Member States.

	Effectiveness in achieving the objectives below			Efficiency in achieving all objectives
	Improve dissuasiveness of sanctions	Develop level playing field	Improve trust between supervisors	
1. Do nothing	0	0	0	0
2. minimum common criteria for key violations	√√	√	√	√ √
3. uniform type and level for key violations	√	√√	√√	√
3. uniform type and level for all violations	√	√ √	√ √	√

ISSUE 2: Addressees of administrative sanctions

This issue deals with the possibility to apply sanctions to natural persons (individuals) and/or to legal persons (financial institutions) responsible for a violation of EU financial services legislation. The following options do not envisage the possibility that all sanctions are applicable to natural persons only or to legal persons only, as there are no reasons justifying such a restriction of the personal scope of sanctions.

Options	**Description**
1: no EU action	In some Member States certain sanctions would remain applicable to natural persons or to legal persons only, even where individuals and financial institutions are jointly responsible for an infringement.
2: sanctions applicable to both natural and legal persons	EU action ensuring that in all Member States both legal and natural persons may be held liable for the violation of financial services legislation. Administrative sanctions would be applied to the individual who committed a violation and to the financial institution which benefited from this violation. Legal persons would be responsible for the violation committed on their behalf by any person who has a leading position within the legal person.

- **Policy option 1: no EU action**

In the absence of any action at EU level, Member States would probably not extend the personal scope of sanctions as currently provided in their legislations. The fact that, in some Member States, natural or legal persons responsible for a violation will evade sanctions for their illegal behaviour would probably not ensure optimal dissuasiveness. The problems relating to the divergences of sanctioning regimes (unlevel playing field, inefficient cross border supervision, etc) would remain unsolved.

- **Policy option 2: sanctions applicable to both natural and legal persons**

Under this option, when competent authorities establish that the responsibility for a violation is on a natural person or a legal person or both of them, they will apply sanctions to all those

persons. This would significantly increase dissuasiveness of sanctions:[45] knowing that they cannot escape the negative consequences of their illegal behaviours, for instance, the managers of financial institutions would be discouraged from reiterating such behaviours and the financial institutions would be encouraged to take the organisational measures to prevent violations committed by their staff. Increased dissuasiveness of sanctions would ensure better compliance with EU rules, with positive impacts on consumer protection, fair competition, safety and integrity of financial markets.

Harmonising the personal scope of sanctions across Member States would also have a positive impact on the level playing field in the European financial market, as the players would risk to be held liable for violations of EU rules wherever they operate in the European Union. This would also increase consumer confidence and mutual trust between supervisors.

This option would require legislative measures to be taken at national level only in Member States where the scope of sanctions do not cover both natural and legal persons responsible for the violation. On the basis of the information available from the Committees of Supervisors, this would concern three Member States in the banking sector, ten Member States in the insurance sector.[46] Those measures should not lead to major changes in national legal systems.

Comparison of options

Option 1 would not achieve any of the objectives outlined in section 4 while Option 2 would help in ensuring level playing field and better cross-border supervision and would increase dissuasiveness of sanctions.

	Effectiveness in achieving the objectives below			Efficiency in achieving all objectives
	Improve dissuasiveness of sanctions	Develop level playing field	Improve trust between supervisors	
1. Do nothing	0	0	0	0
2. sanctions applicable to both natural and legal persons	√	√	√	√

ISSUE 3: Factors taken into account when determining the sanctions

This issue concerns the elements to be taken into account by competent authorities when deciding the type of administrative sanctions and/or calculating the amount of the administrative pecuniary sanction to be applied to the author of a specific violation. This includes, for instance, the gravity of the violation, the benefits for the author of the infringement derived from the violation, the financial strength of the author of the infringement and his cooperative behaviour.

Options	**Description**
1: no EU action	Factors taken into account by the different national authorities continue to be partly different. Member States would not be encouraged to revise their national legislations in order to modify or integrate the factors to be taken into account in deciding types and amount of

45 See references quoted above (Footnote 22), in particular Granlund.

46 CEBS report, p. 58, and reply sheets from national authorities; CEIOPS report, p. 18-20, 41, 43, 102, 106-110, 149

	the sanctions imposed.
2: some key factors to be taken into account by all authorities	EU action to establish some common key factors to be taken into account by all competent national authorities when determining the level of a sanction. For instance, EU action to establish that competent authorities have to take into account the benefits derived from the violation (provided that they can be calculated), the financial strength of the author of the infringement (e.g. the annual income of an individual or the assets of a legal person), any cooperation by the authors of the infringement in the investigation, or any recurrence of violations. Member States could take into account, in addition to those common factors, any other factor they consider relevant.
3: list of exhaustive and identical factors to be taken into account by all national authorities	EU action to precisely define all factors to be taken into account by competent authorities in order to ensure sanctions imposed are effective, proportionate and dissuasive. Therefore, the same factors would be applied by competent authorities throughout the European Union, including the key factors mentioned in option 2. Competent authorities would not be allowed to consider other factors.

- **Policy option 1: no EU action**

Under this option, while almost all Member States take into account the gravity of the violation, other factors such as the impact of the violation (e.g. benefits gained or losses caused) and the personal conditions of the author of the infringement (e.g. his financial strength), would be taken into account only in some Member States or for certain violations.

The existing convergence in considering the gravity of the violation would probably be insufficient to ensure optimal dissuasiveness and the other factors would probably remain divergent.

- **Policy option 2: some key factors taken into account by all national authorities**

This option would allow competent authorities to better adapt the type and the level of sanctions imposed to the impact of the violation and the personal conditions of the offenders, which would help ensuring effectiveness, proportionality and dissuasiveness of the sanctions actually applied. Providing for similar types and level of sanctions in national legislations could be insufficient to ensure that the perpetrators of similar violations would incur similar sanctions in different Member States if the factors taken into account to determine the actual sanctions imposed were completely different. This option would lead to increased convergence in the way sanctions are applied by competent authorities across Europe while maintaining some flexibility. This would ease the cooperation between competent authorities which could count on a common understanding of how sanctions imposed for a particular violation should be adapted to the specifics of that violation. At the same time, Member States would have the possibility to consider additional factors that are particularly relevant in a specific national context.

This option would help in ensuring proportionality of sanctions: the sanctions imposed would always be linked to the benefits gained by the author of the violation and would therefore better reflect the negative consequences of the violation. Linking the level of a sanction to the financial strength of the author of the violation will ensure that sanctions are sufficiently dissuasive even for large financial institutions.

Dissuasiveness of sanctions will also be increased: when pecuniary sanctions are capable to disgorge the profits derived from the violation and to significantly affect the financial situation of the author of infringements, illegal behaviours will be further discouraged.[47] Similarly, more severe sanctions imposed in case of recurrent violations would discourage the repetition of illegal behaviours. Increased dissuasiveness would reduce risks of violations of EU law and therefore benefit consumer protection, competition, safety and integrity of financial markets.

Furthermore, taking into account the cooperative behaviour of the author of the violation would help in discovering other persons possibly responsible for the same violation, in assessing the consequences of that violation and also in detecting other violations. This would therefore contribute to better detection of violations, which would be beneficial for all players in financial markets: the users of financial services would be better protected; competition between financial institutions would less be distorted by unfair conducts, market integrity and safety would be better safeguarded.

This option would not require major changes in national legislation. Some Member States already provide for the key factors mentioned above and the others could add those factors without repealing the existing provisions. For example, on the basis of the information available from the Committees of Supervisors, in the market abuse sector, 8 Member States already take into account the benefit derived from a violation, while the remaining Member States could add that factor to existing provision. In the banking sector, 13 Member States already take into account the financial strength of the author of an infringement, while the remaining Member States would have to add that factor to existing provisions.[48] Therefore, compliance costs for Member States are expected to be limited.

- **Policy option 3: list of exhaustive and identical factors taken into account by all national authorities**

This option would eliminate any divergence on factors to be taken into account in deciding the type of sanctions and/or calculating the amount of the fine to be applied to the author of a specific violation. Uniformity in the way sanctions are applied would facilitate the cooperation between competent authorities and therefore ensure better cross border supervision.

As far as the uniform list of factors includes those mentioned in option 2, the impacts of providing for a uniform application of those factors would be the same than in option 2, in terms of proportionality and dissuasiveness of sanctions and better detection of infringements.

However, the list would in principle include only factors that can be applied in the same way in all national legal systems, which would preclude the possibility to take also into account those factors which can be part of the fundamental principles of some legal systems but not relevant in others.

Finally, this option would require changes in all national legislations, as it implies a revision of all provisions concerning the way sanctions are applied. Important investments in terms of resources and therefore significant compliance costs are therefore expected.

Comparison of options

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47 See references quoted above (Footnote 22)

48 CEBS report, p. 53, and responses by national authorities); CESR MAD report, excerpts from the replies of national authorities

Option 1 would preserve the "status quo" and therefore would not contribute to achieve the objectives of approximating and reinforcing sanctioning regimes.

Option 3 would be the most effective in terms of facilitating cooperation between competent authorities, as it would introduce a uniform list of factors to be taken into account by all of them. Option 2 would be less effective in this regard but it would allow the authorities to consider also other factors specifically linked to the national legal system where they operate. Options 3 and 2 are considered to be equally effective in terms of ensuring proportionality and dissuasiveness of sanctions and facilitating detection of violations, given that the key factors identified in Option 2 are also included in the list of factors established under Option 3.

However, Option 2 is clearly more efficient than option 3 as it requires less changes in national legislations and therefore lower compliance costs.

	Effectiveness in achieving the objectives below			Efficiency in achieving all objectives
	Improve dissuasiveness of sanctions	Develop level playing field	Improve trust between supervisors	
1. Do nothing	0	0	0	0
2: some key factors to be taken into account by all authorities	√	√	√	√ √
3: list of exhaustive and identical factors to be taken into account by all national authorities	√	√ √	√ √	√

ISSUE 4: criminal sanctions

This issue concerns the application of criminal sanctions to violations of EU financial services legislation. Such sanctions may include fines, custodial measures such as imprisonment, and complementary sanctions such as confiscation and disqualification. The options relating to this issue can be combined with all the policy options identified for the issues concerning administrative sanctions. The option of introducing uniform rules on criminal sanctions has not been considered as it would not be legally viable[49].

Options	**Description**
1: no EU action	Some Member States would continue to apply criminal fines and/or custodial penalties to certain violations of EU financial services legislations while other Member States would apply administrative sanctions only. While a large majority of Member States currently provide for criminal sanctions in case of market abuse or market manipulation, the range of the other violations for which such sanctions are envisaged would remain divergent across EU.
2: introduction of criminal sanctions for the most serious violations	EU action to identify, for each directive, conducts which are seriously detrimental to the interests that EU Directives in the financial sector aim to promote (financial market integrity, competition and consumer protection), for which the application of administrative sanctions does not prove sufficient. EU action would require Member States to ensure that these infringements are regarded as criminal offences when committed with intent or by serious negligence.

[49] Article 83 TFEU provides a legal basis provides a legal basis only for the establishment of minimum rules concerning the definition of criminal offences and sanctions under certain conditions, not for full harmonisation of criminal sanctions.

	Member States remain responsible for defining the constituent elements of various criminal offences and designing the penalty provisions. However, with regard to certain specific criminal offences, they could be required to ensure that the maximum level of the sanctions provided for by their laws would not be below a certain minimum provided for in an EU measure.

- **Policy option 1: no EU action**

In the absence of any action at EU level, it is unlikely that Member States would revise their criminal laws in order to achieve further convergence in that area. Certain Member States would continue to provide for criminal sanctions for certain violations of financial services legislation, while others would provide for administrative sanctions. Among the first group, the definition of the criminal offences would differ from one Member State to the other. Therefore there will continue to be divergences.

- **Policy option 2: introduction of criminal sanctions for the most serious violations**

Criminal sanctions consistently applicable to the most serious violation of EU financial services law would send out a strong message of disapproval that could increase dissuasiveness of sanctions and have a positive impact on the public perception of the appropriateness of sanctions: consumer confidence would increase if they would feel that the authors of violations incur criminal penalties (*stigmatisation effect*).

The information collected in the Member States shows that despite the lack of the obligation to provide for criminal offences in view of the transposition of certain directives in question the Member States opted for such a solution in several areas. For example, in case of market manipulation prohibited under the Market Abuse Directive, only three Member States do not provide for criminal fines, and three further Member States do not provide for any criminal sanctions.[50] 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 criminal fines in only eight Member States and by imprisonment in only seven Member States. [51]

Not all violations would be subject to criminal penalties but only the most serious ones indicated by the needs of the policy in question. Criminal sanctions would only be provided for in areas where they are the most efficient, effective, and dissuasive tool to achieve the proper enforcement of EU financial services rules. Other violations would continue to attract administrative sanctions.

The nature of criminal law, its sensitivity not only for fundamental rights, and its link to Member States' sovereignty require that criminal offences would be provided for only in areas where this is necessary as an *ultima ratio.* The necessity test would have to be carried out strictly.

Comparison of options

Option 1 would not contribute to resolve the problems identified in section 3.2., as it preserves the "status quo".

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[50] Source: CESR MAD report, excerpts from the replies of national authorities

[51] Source: CESR Mifid report, p. 186, 194.

Option 2 would be effective in terms of increasing dissuasiveness of sanctions and consumer confidence in terms of level and type of sanctions, especially in relation to imprisonment and so-called additional measures (pecuniary sanctions seem to give a comparable effect when concerned by both systems). Option 2 has the advantage of providing the stigmatisation effect.

The level of the resources/costs required for the modification of national criminal laws will probably be relatively high but those costs will be diminished by the fact that the Member States already consider some of the violations as criminal despite the lack of the general obligation stemming from the EU law. This aspect would be also taken into account when assessing the necessity of the introduction of the criminal law measures.

	Effectiveness in achieving the objectives below			Efficiency in achieving all objectives
	Improve dissuasiveness of sanctions	Develop level playing field	Improve trust between supervisors	
1. Do nothing	0	0	0	0
2. application of criminal sanctions to the most serious violations	√	√	√	√

ISSUE 5 EU action to support effective application of sanctions

This issue concerns the mechanisms that Member States may put in place to improve the application of sanctions, and particularly detection of violations of EU financial services legislation. 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 occur. Therefore, the policy options concerning this issue should ideally be combined with those concerning the other issues mentioned above.

The application of sanctions for violations of EU financial services legislation is the responsibility of national authorities. It has to be noted that insufficient detection of violations might be due to a number of reasons, such as lack of human and financial resources devoted to the activities of national supervisory authorities or lack of appropriate training of persons carrying out investigations. Moreover, insufficient application of sanctions might be the result of the difficulty to prove certain violations of financial services rules, the strict rules on burden of proof, and possibly the lack of specific expertise in the field of financial services of the national authorities responsible for the application of sanctions. However, these potential problems are mainly related to the organisation and functioning of national administration and data are lacking on their actual relevance. Therefore, EU action envisaged in this field will not address these potential problems, which could be better addressed at national level. Nevertheless, the EU can take action to ensure that (1) all national authorities have the necessary key powers and investigatory tools, and (2) national authorities 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 ("whistleblowing"), and at encouraging persons who are responsible of potential violations, to report those violations to the competent authorities.

Cooperation between competent authorities of different Member States and the cooperation between those authorities and the new European Supervisory authorities could be further strengthened for the purpose of detecting violations and imposing appropriate sanctions.

Options	Description
1: Coordination by ESAs - no additional EU action	No action in relation to consistent and predictable programs to protect whistleblowers and to exempt them from sanctions when they are involved in the infringement ("leniency programs"). National authorities cooperate on the basis of the provisions concerning the exchange of information and the mutual assistance in investigations in the EU Directives applicable in the financial sector. New European Supervisory Authorities can use their powers to carry out peer reviews and collect information on sanctions to promote exchange of information and best practices between Member States.
2: additional EU action to ensure all Member States provide for key investigatory powers and tools,	Consistent measures taken by all Member States to protect persons (e.g. employees of financial institutions) who denounce potential violations of financial services legislation committed by other persons, and providing for reduction of sanctions applicable to the persons who confess their involvement in a violation.

- **Policy option 1: no EU action**

Under this option, certain Member States would continue to provide for rules obliging financial institutions to put in place early warning systems for malfunctions in the internal control mechanisms and prohibiting retaliation against whistleblowers. However, the large majority of them would probably not put in place consistent and predictable programs to protect whistleblowers and to exempt them from sanctions when they are involved in the infringement ("leniency programs").

Competent authorities would continue to cooperate with each other making use of the existing mechanisms. They would render assistance to competent authorities of other Member States, particularly by exchanging information and cooperating in investigation activities. Under this option, it is expected that the role played by the new ESAs would further facilitate cooperation between competent authorities, which would help in ensuring more consistent application of sanctions and more efficient supervisory activities. In particular, mechanisms for ensuring agreement and co-ordination between national supervisors of the same cross-border institution or in colleges of supervisors will be introduced, and the ESAs will 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.

Better detection of infringements and more consistent application of sanctions would increase their dissuasiveness, to the benefit of the overall functioning of financial markets and the users of financial services.

- **Policy option 2: additional EU action to ensure all Member States provide for key investigatory powers and tools**

Under this option, Member States would count on additional instruments to detect violations of EU law, and particularly on the assistance of persons involved in illegal conducts or aware of wrongdoings from third parties. When violations are regularly detected and punished, dissuasiveness and effectiveness of sanctions would be increased. As explained in the analysis of the previous issues, this could reduce violations of EU rules and would therefore be beneficial to consumers' protection, competition, safety and integrity of financial markets. The perception that

the authors of infringements are usually discovered and effectively punished would also restore confidence in the financial sector.

Comparison of options

Under option 1, the objective of reinforcing national sanctioning regimes could be achieved to a certain extent through the coordination activity that the new ESAs are already entitled to carry out. Option 2, while including the activities of the new ESAs, would be nevertheless more effective in terms of better and more consistent enforcement of sanctions, as new forms of cooperation would be developed and new instruments would be available to detect violations.

As to their efficiency, Option 1 would probably require additional administrative activities to be carried out by the competent authorities (e.g. collecting information and providing them to ESAs), but they are unlikely to bring about important investments in terms of costs or resources, as Member States could use the existing administrative structures. Option 2 would require, in addition, actions to put in place whistleblowing mechanisms and leniency programs from those Member States which currently don't provide for them: national legal frameworks would have to be supplemented and adapted but should not require major changes. Whistleblowing mechanisms could also require some organisational measures to be taken by financial institutions (e.g. on internal reporting of misconducts and confidentiality of whistleblowers identity)

	Effectiveness in achieving the objectives below			Efficiency in achieving all objectives
	Improve dissuasiveness of sanctions	Develop level playing field	Improve trust between supervisors	
1. Coordination by ESAs - no additional EU action	√	√	√	√
2. additional EU action to reinforce mechanisms facilitating detection of violations/application of sanctions	√√	√√	√√	√ √

5.1.1. Preferred policy options

In the light of the comparative analysis carried out in section 5.1, the following options concerning the content of the measures have been selected for the five issues addressed:

- ISSUE 1: policy option 2 - **introducing minimum common criteria on type and level of administrative sanctions**
- ISSUE 2: policy option 2 - **sanctions applicable to both natural and legal persons**
- ISSUE 3: policy option 2 - **some key factors taken into account by all national authorities.**
- ISSUE 4: policy option 2 - **introduction of criminal sanctions for the most serious violations.**
- ISSUE 5: policy option 2 - **reinforcement of mechanisms facilitating detection of infringements/enforcement sanctions.**

5.1.2. Cumulative impacts of the preferred options

The impacts of the preferred options will be further reinforced by the cumulative nature of the action taken, as convergence on all of those issues together will ensure national authorities have

at their disposal a broad range of sanctioning powers that enable them to apply, in each specific case, the sanctions that are the most appropriate in terms of effectiveness, proportionality, and dissuasiveness. The cumulative action will therefore increase the positive effect on financial institutions, users of financial services, and on public authorities in charge of the application of sanctions.

As the expected consequence of the preferred policy options is to improve the application of EU rules, the specific impacts of those options on stakeholders are in fact the same as the impacts of those rules themselves, which have been identified and assessed in the impact assessments of the Commission proposals for those rules.

Impact on SMEs: the preferred policy options are not expected to have specific impacts on SMEs. More efficient sanctioning regimes ensuring better compliance with EU law would benefit to all players in financial markets, as well as all users of financial services, including in both cases SMEs.

Simplification and Administrative burden: the preferred policy options will not create an administrative burden on financial institutions, or non-financial companies, which are already today subject to sanctioning regimes in all Member States. More uniform sanctioning regimes throughout the EU may in fact lead to reduced compliance costs for market participants through the simplification of the legal framework for cross-border financial institutions.**Social impacts**: the preferred policy options will have a positive impact on overall consumer protection and confidence. They will also have a positive impact on employees and society at large, to the extent that they reduce the risk of financial instabilities caused by violations of EU law, which – as the financial crisis in 2007/2008 has shown – can have a strong negative impact on the economy at large and on employment.

Environmental impacts: none foreseen.

Third country impacts: The reinforced focus on effective, proportionate and dissuasive sanctioning regimes is compatible with the common objectives of major jurisdictions within the G20 Group to strengthen the regulation and supervision of the financial sector. It is in line with developments in other jurisdictions. For example, the US has recently adopted rules to reinforce the detection of violations in the framework of the Dodd-Frank-Bill of July 2010. Moreover, several sanctions applied by US regulators in the aftermath of the financial crisis express a level of concern to ensure sufficient deterrence that is without doubt equivalent to the suggestions made in this Communication.

Impact on EU competitiveness: the preferred policy options are expected to have a positive impact on the EU's competitiveness. A strong and credible enforcement of financial services rules contributes to the stability of the EU financial sector, with positive effects on it. Moreover, it contributes to strengthening the EU, in competition with other jurisdictions, as a centre for reliable and stable financial services industries, benefiting from a high level of confidence by investors and consumers.

5.1.3. Impact on EU budget:

The policy options selected in section 5.1.1 do not have any implication for the budget of the European Union. Revision of sanctioning regimes would be primarily managed by national authorities.

5.2. Options relating to the nature of the measures

This section assesses the policy instruments that may be used to implement the policy options selected in section 5.1.1. The following options therefore deal with the nature of the measures that may be taken to this end.

The options have been assessed against the baseline scenario (see section 3.2.2), and compared in terms of efficiency and effectiveness, to identify the most appropriate instrument for the implementation of the set of preferred measures concerning the issues to be addressed.

- **Policy option 1: non binding measures facilitating approximation of sanctioning regimes**

This non-regulatory option would consist of EU initiatives aimed at:

– raising Member States awareness on the problems relating to the inefficiency and divergence of national sanctioning regimes;

– promoting cooperation and exchange of good practices between Member States;

– providing guidance/issuing recommendations on key issues such as type and level of sanctions, addressees of sanctions, criteria to be taken into account in the application of sanctions, introduction of criminal sanctions for the most serious violations.

Within this option, the Commission would help Member States in identifying failures in their national legislation and suggest measures they may take on a voluntary basis on how to strengthen national sanctioning regimes in a consistent manner.

Member States would not be obliged to make any change in national legislations but they would revise the existing sanctioning regime only if, and to the extent, they consider it appropriate. As to its effectiveness, this option would provide Member States with a general common framework on how to deal with all issues. In particular, this would support the actions they would be willing to take in order to approximate the type and level of administrative sanctions, the personal scope of them and the factors to be taken in the application of sanctions, as well as to introduce criminal sanctions and to reinforce the mechanisms facilitating detection of infringements. However, in the absence of any obligation, it would not be ensured that all Member States take all measures required. Moreover, the relevant issues would be probably dealt with differently by each Member State.

- **Policy option 2: minimum approximation of sanctioning regimes - sectoral approach**

This option would involve legislative action at Community level to set common minimum standards in the directives concerned on some key issues of sanctioning regimes.

Such standards would concern primarily administrative sanctions and would be adapted to the specifics of the different EU Directives. The introduction of criminal sanctions for the most serious violations could be envisaged where this would prove necessary to ensure effective application of EU law.

This would imply that new provisions on the issues 1, 2, 3, 4 and 5, would be introduced in the sectoral directives to the extent that problems have been identified in relation to those directives.

This option appear to be very effective in addressing the above mentioned issues: targeted provisions in sectoral directives would permit to set common standards on types and level of sanctions, addressees of sanctions and factors to be taken into account in the application of sanctions, which are the most appropriate in the specific sector, and for the specific directive concerned. Under this option, an obligation to provide for criminal offences could be introduced if and when necessary, depending on the characteristics of the sector concerned.

As to the issue 5, this option would permit to introduce targeted common rules on whistleblowing and on the cooperation with ESAs (eg. in some areas ESAs could be entrusted with a role of mediator). Rules on the cooperation between competent authorities could also be reinforced where the ones already provided for in the directive concerned do not prove sufficient.

Under this option, Member States would still enjoy a significant discretion in the choice and application of sanctions. They would be obliged to ensure compliance with some minimum EU standards but would be allowed to provide for more stringent rules. Therefore, this option would not necessarily require important changes in national sanctioning regimes.

- **Policy option 3: minimum approximation of sanctioning regimes – cross-sectoral approach**

This option would require a general legal framework at EU level applicable across sectors (banking, insurance, securities).

The European legislator would specify the general principles to be taken into account in designing sanctioning regimes in the financial services sector. Existing general clauses such as those requiring that sanctions are effective, proportionate and dissuasive will be explained and detailed, in order to clarify their meaning.

This option would allow for the implementation of the policy options selected for the issues 1,2, 3 and 5, as Member States would be obliged to revise their sanctioning regimes in order to adapt them to the general principles set at EU level, which may cover the issues 1,2,3 and 5. A common framework would guarantee the overall coherence of the review of sanctioning regimes. This option would not address the issue 4, as a cross sectoral approach would not permit to identify the most serious violations for which criminal sanctions are necessary.

However, as EU legislation would have to be applicable to all sectors, it could cover very general issues only. Consequently, Member States would maintain considerable discretion in implementing the common rules set at EU level, which would significantly reduce the effectiveness of this option.

- **Policy option 4: full approximation of sanctioning regimes – sectoral approach**

In this option, which also requires EU level regulatory action, fully harmonised administrative sanctions would be established across the EU, in each of the sectors concerned. Full approximation is in any case excluded for criminal sanctions, given that the European legislature has not the power to fully harmonise them but only to establish minimum rules.

EU legislation would set out detailed rules on administrative sanctions applicable to different categories of infringements. This option would therefore imply a complete set of provisions regulating all elements of the sanctioning regime.

Full approximation of sanctioning regimes would therefore not be suitable for the implementation of the policy measures selected for the issues 1 and 3, which exclude the

introduction of uniform rules on the type and the level of administrative sanctions and the factors to be taken into account in the application of sanctions.

On the contrary this option would be effective in dealing with issue 2, as it would ensure that sanctions are always applicable to both natural and legal persons involved in the violation.

As to issue 5, while full approximation would achieve the objective of reinforcing mechanisms facilitating detection of the violations, it would probably require major changes in national legislations and therefore significant investments in terms of resources and compliance costs for Member States. Moreover, if whistleblowing mechanisms and leniency programs are regulated in detail at EU level, Member States will not be allowed to adapt them to the specificities of their legal systems, which could affect the effectiveness of such mechanisms.

5.2.1. Preferred policy instruments

Following the above assessment of the options relating to the nature of the measures, we consider that the most appropriate to address the issues analysed in section 5.1 is a legislative action aiming at minimum approximation of national sanctioning regimes, covering potentially all the issues concerned. Legislative action would ensure that Member States will implement consistently the measures identified in section 5.1.1.

The most effective approach is considered to be the sectoral approach under option 2, which would permit to introduce precise provisions covering all the issues to be addressed (type and level of sanctions, addressees of sanctions, factors to be taken into account for the application of sanctions and mechanisms facilitating detection of the violations, and possibly the introduction of criminal sanctions for the most important violations). This option could be combined with option 3 by establishing some basic principles common to all sectors, which would guarantee the overall coherence of any EU action in this field.

6. MONITORING AND EVALUATION

This Impact assessment provides evidence supporting the need for EU action based on minimum harmonization of sanctioning regimes ensuring compliance with certain common standards.

The policy options selected will be presented in the Commission communication in order to allow all the stakeholders concerned to comment on the approach proposed. The Commission will carefully evaluate the feedback received and take it into account when coming forward with firm proposals. The Commission will sum up the contributions received by the first half of 2011. The Commission, while drafting such proposals, will monitor and update its assessment of the various policy options selected. A comprehensive monitoring and evaluation programme, based on appropriate indicators, can only be developed once detailed proposals have been made.

ANNEX **1**

List of the main Directives concerned

- Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions ("Capital Requirements Directive") OJ L302 17.11.09;

- Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments ("MiFID Directive"), OJ L145 30.04.2004;

- Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation ("Market Abuse Directive" or "MAD"), OJ L096 12.04.2003;

- Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance ("Solvency II Directive) OJ L335 17.12.2009;

- Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading ("Prospectus Directive") OJ L345 31.12.2003;

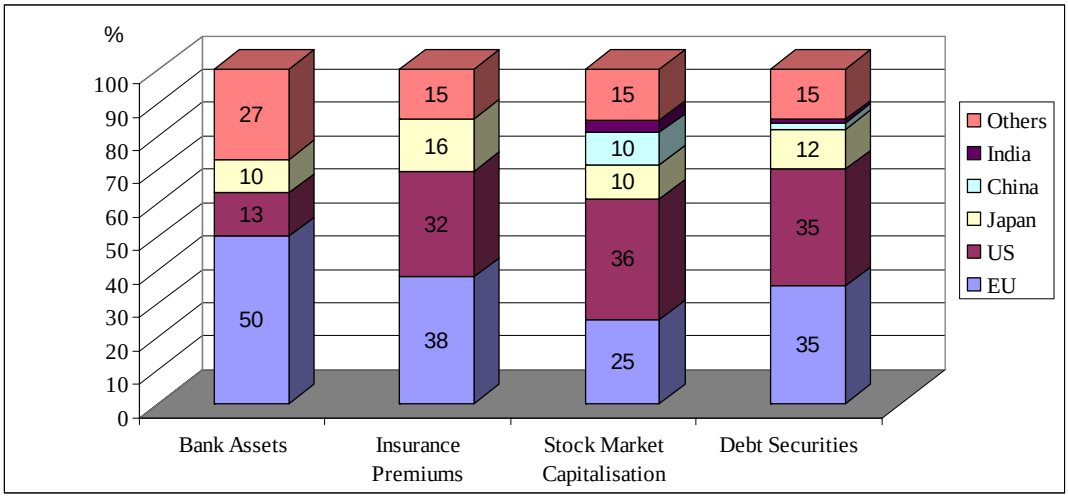
- Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on Insurance Mediation, OJ L009 15.01.2003;

- Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing ("Anti-Money Laundering Directive"),OJ L309 25.11.2005;

- Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities ("UCITS Directive"),OJ L302 17.11.2009.

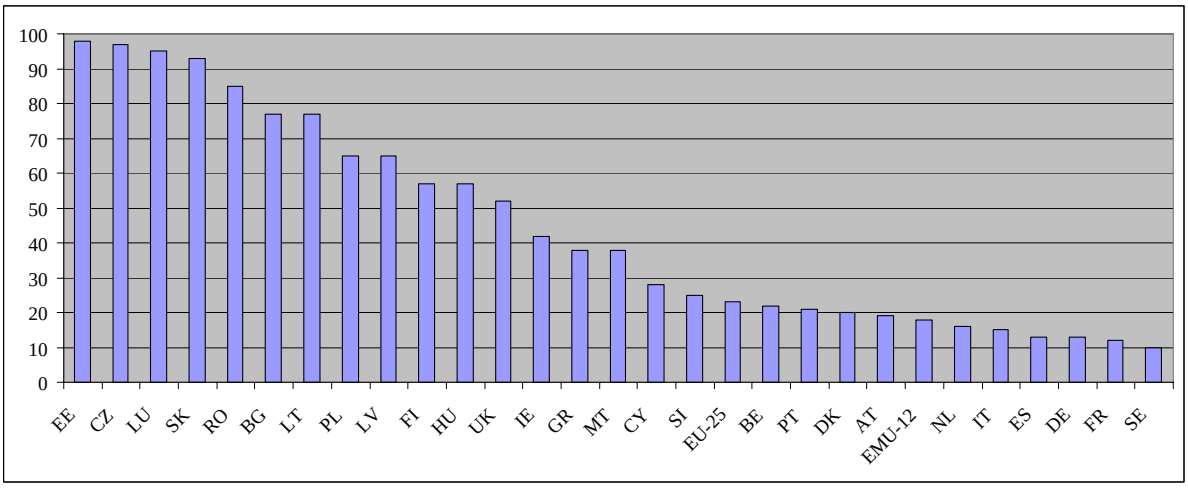
ANNEX II

Chart 1: EU contribution to world financial activity in % (2008/20009)



Source: European Commission, European Financial Integration Report 2008 (2009)

Chart 2 - Market share of foreign-owned banks (% of total assets)



Source: European Commission, European Financial Integration Report 2008 (2009)