Comments

of the
Zentraler Kreditausschuss

on the Communication of the European Commission

Reinforcing sanctioning regimes in the financial services sector

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Register of Interest Representatives
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1 The ZKA (www.zka-online.de) is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks financial group, and the Verband deutscher Pfandbriefbanken (VdP), for the mortgage banks. Collectively, they represent more than 2,300 banks.
The Zentraler Kreditauschuss wishes to comment as follows on the measures proposed by the European Commission in the aforementioned Communication:

1. Minimum approximation of national sanctioning regimes

The European Commission’s intention to establish a coherent system of sanctioning regimes in the financial services sector is in principle welcomed. Violations of key provisions of supervisory law should be punished appropriately. Different sanctioning regimes in this area may lead to regulatory arbitrage and distortions of competition.

The complex national scenarios in the area of sanctions law, particularly of criminal law and the law on administrative offences, impede any schematic, area-specific approach across the EU. For example, important terms such as “intent” and “participation” are understood very differently in some cases in Member States. Partial interference in Member States’ different national sanctioning regimes is therefore risky, as picking out individual aspects from an area of law and altering them by means of EU rules may seriously upset both the finely balanced national legislation on sanctions and the balance of rights and obligations of the parties involved and thus jeopardise the regulatory initiative.

Irrespective of whether action is called for at European level, any approximation of the definition of criminal offences should take into account that Article 83 of the Treaty on the Functioning of the European Union (TFEU), referred to in footnote 23, can only be used to a limited extent as a legal basis for EU measures. While Article 83(1) TFEU grants powers in the area of substantive criminal law, supervisory law is not mentioned in the list of potential targets of regulation in Article 83(1), sentence 2. Article 83(2) TFEU stipulates in particular that any action in the area of criminal law must be “essential to ensure the effective implementation of a Union policy in an area.” A single European criminal law regime in the area of banking supervision or for the financial services sector does not appear essential at present. Furthermore, Article 83(2) TFEU only allows the establishment of minimum rules; this therefore excludes rules on the type and level of sanctions. Moreover, any action would require strict compliance with the subsidiarity principle.

Should the Commission – as indicated in the Communication – nevertheless see a need for action in this area, it should therefore confine itself to merely setting a framework by means of a recommendation. This is the only way to avoid any system inconsistency in general criminal law and the law on administrative offences, and in administrative law.
2. Appropriate types of administrative sanctions for the violation of key provisions

The Zentraler Kreditausschuss also believes that infringements of key provisions of supervisory law should be punished appropriately. Particularly the sanctioning powers mentioned by way of example in section 3.1 – withdrawal of licences and disqualification/dismissal of managers – are important in our view. However, the Member States and not the EU are called upon here to implement appropriate national sanctions in accordance with the existing rules established by way of directives.

German law already fulfils the requirement that the competent supervisory authorities should be allowed to impose “in each specific case a sanction that is likely to be optimal in terms of effectiveness, proportionality, and dissuasiveness.” For example, BaFin, the German financial regulator, can take action against enterprises conducting banking business or providing financial services without the required licence (Section 37 German Banking Act [KWG]). It can also take action against enterprises which are involved in the preparation, conclusion and settlement of such transactions. BaFin may order enterprises and their governing bodies to immediately cease business operations and liquidate this business without delay, issue instructions for the liquidation and appoint a suitable person as the liquidator. The measures ordered are immediately enforceable by law, but not yet non-appealable.

BaFin informs and warns the general public about, among other things, action taken against enterprises unlawfully conducting banking business. When doing so, it names the enterprises concerned (see http://www.bafin.de/nn 722596/DE/Verbraucher/UnerlaubteGeschaefte/unerlaubtegeschaefte no de/html? nnn=true). It also gives general warnings about disreputable providers. No further measures are required here in our view.

3. Publication of sanctions

Whether a “name & shame” policy is a suitable, preventative or dissuasive measure against violations of key provisions of an EU act appears questionable. It should not be overlooked that such disclosure may cause heavily disproportionate damage to the guilty party or the capital market (see in this connection, for example, Fleischer, ZGR 2004, 437, 477). The need to weigh up economic considerations is taken into account in Section 40b of the German Securities Trading Act [WHG]) as follows: BaFin “may make publicly known measures that it has adopted due to contraventions of prohibitions or requirements of this Act on its website, provided that this is suitable and necessary to resolve or avoid irregularities in accordance
with section 4(1) sentence 2, unless such publication would place the financial markets in considerable danger or would cause disproportionate damage to the parties involved.”

Should the approach calling for mandatory publication be pursued further, the circumstances triggering this supervisory sanction should be defined restrictively. Publication of (not yet) non-appealable sanctions naming names may be tantamount to a prejudgement. Also, a requirement for supervisors to weigh up the consequences should be stipulated: given the sensitiveness of the financial markets, they should be allowed not to publish sanctions particularly to avoid endangering financial market stability.

4. A sufficiently high level of administrative fines

According to the Communication, the sanctions imposed in individual cases are often well below the maximum levels provided for under national law and the range of admissible sanctions is not always used to the full. The deficits in enforcement that are consequently seen to exist in practice in some Member States do not justify in our view the introduction of minimum levels for each category of administrative offences. Moreover, what “benefit” or unlawful gain a market participant may derive from an infringement depends on the specific individual case involved. A generally applicable minimum level would fail to do justice to this situation. Should the Commission see the need to take action in this area, the idea to set a minimum level should be dropped in favour of the possibility provided for under both German law on administrative offences and criminal law to skim off any unlawfully acquired capital gains.

5. Sanctions provided for both individuals and financial institutions

Depending on how the relevant rules are designed and to whom they are addressed, administrative sanctions can be imposed on both natural persons and financial institutions.

Any imposition of criminal sanctions on legal persons meets with fundamental reservations, on the other hand. German criminal law makes no provision for the imposition of sanctions on legal persons. The acting individual is responsible under criminal law. A fine can only be imposed on legal persons under the law on administrative offences subject to expanded conditions (Section 30 German Administrative Offences Act [OwiG] in conjunction with Section 59 German Banking Act [KWG]). A condition in particular is a violation of the legal person’s business-related duties or its enrichment. A mandatory requirement to impose sanctions on legal persons would require a broad, in-depth discussion confined not only to the
financial services sector and covering, among other things, the need for regulation and the principles governing the attribution of actions and blame to be applied in this area. It would also have to be closely examined whether such a requirement is not inadmissible interference in national sovereignty.

6. **Appropriate criteria to be taken into account when applying sanctions**

The European Commission is right to state that sanctions should be effective and proportionate. The additional criterion of dissuasiveness is not suitable for every measure, however. The possibility to impose fines provided for under German law is, for example, primarily an appeal to a sense of duty. It is not a (real) punishment. The minimum criteria proposed by the Commission (to be applied cumulatively?), which are geared to the application of criminal sanctions, therefore do not appear appropriate.

7. **Possible introduction of criminal sanctions for the most serious violations**

The complex national scenarios in the area of criminal law impede any schematic, area-specific approach across the EU. For example, important terms such as “intent” and “participation” are understood very differently in some cases in Member States. It is also questionable whether the EU has the power to legislate for this area (see in this connection also our detailed remarks in section 1 above). Should any action be taken in this area, it must be ensured that sanctions are fair and appropriate in relation to the seriousness of the offence and the fault on the part of the perpetrator.

8. **Appropriate mechanisms supporting effective application of sanctions**

Depending on the size and organisational structure of an institution, the establishment of an in-house information mechanism which ensures that employees remain anonymous on request (e.g. tip-off system or whistleblowing) may also be useful for detecting violations.