

# eucrim

2015 / 4

## THE EUROPEAN CRIMINAL LAW ASSOCIATIONS' FORUM



**Focus: Criminal/Punitive Law Protection of the Financial Sector**

**Dossier particulier: Protection pénale/punitive du secteur financier**

**Schwerpunktthema: Strafrechtlicher und strafrechtsähnlicher Schutz des Finanzmarktes**

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*Konstantina Panagiannaki*

The Associations for European Criminal Law and the Protection of Financial Interests of the EU is a network of academics and practitioners. The aim of this cooperation is to develop a European criminal law which both respects civil liberties and at the same time protects European citizens and the European institutions effectively. Joint seminars, joint research projects and annual meetings of the associations' presidents are organised to achieve this aim.

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### Imprint

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# Guest Editorial

Dear Readers,

The imposition of tight regulatory controls on banks and other financial intermediaries is a universal characteristic of modern economic systems. The frequency and intensity of legislative and administrative measures affecting financial activities demonstrate the state's incessant concern with the way in which the market operates in this field. The precise perimeter of the regulated sector varies, however, from one jurisdiction to another and changes over time. The same is true of the type and direction of regulatory intervention. This raises important questions about the existence or otherwise of common denominators – common objectives and overarching justifications – that hold together the edifice of financial regulation.

The discussion on regulatory objectives has both a positive and a normative aspect. The regulatory regime's actual objectives constitute an indispensable element of its description. What purposes does financial regulation serve? Are they the same for all sectors of the financial industry? Is the current regulatory regime a continuation of earlier state interventions in financial markets – in the sense that, despite any technical adaptations of the tools employed, the objectives have remained essentially stable – or is it something fundamentally different? The answers to these questions are important for an understanding of the nature and function of the regulatory regime. An identification of the regulatory objectives is also essential for a correct legal assessment of specific factual situations and ensuing administrative responses.

Of equal importance is the discussion of the means, or tools, used to achieve the set objectives. Traditionally, the policy debates have focused on substantive regulatory norms. Questions of optimal enforcement have received less attention. In terms of regulatory tools, the emphasis has predominantly been on administrative supervision, enforcement, and sanctions. Of course, the market sectors and issues vary. In the case of prudential regulation in the banking and insurance sectors, private actions and criminal sanctions are, as a general rule, of marginal, if any, importance. In contrast, in securities regulation, the possibility of (and conditions for) private enforcement is a continuously debated issue; in certain areas, especially those

involving market abuse and securities fraud, criminal sanctions have always played a central role.

In any event, in the wake of the global financial crisis, the time is opportune for a concerted reassessment of the situation. A host of new regulatory requirements are now in operation; their application and enforcement cause considerable dilemmas and difficulties, both from the perspective of regulatory effectiveness and from a rule-of-law viewpoint. In this context, the actual and potential contribution of criminal law to the smooth operation of banking and financial markets, the protection of their users, and the preservation of systemic stability requires explicit and detailed analysis.

Recent legislative developments at the EU level, in particular, may tend to increase the significance of criminal sanctions in this area. Even in the prudential field, the emerging “single rulebook” is not confined to imposing obligations on financial intermediaries as legal persons but lifts the corporate veil to place novel regulatory burdens on board members and directors – personally. The new provisions thus establish significant behavioral standards for individuals and, in an increasing number of instances, require the penalization of substandard conduct. This is bound to bring familiar concepts and considerations of criminal law to bear on a hitherto distant legal field – thus opening new vistas, both for regulatory lawyers and for criminal lawyers.

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Christos Hadjiemmanuil



## European Union\*

*Reported by Dr. Els De Busser (EDB) and Cornelia Riehle (CR)*

### Foundations

#### Schengen

##### Germany and Austria Reintroduce Temporary Controls at Internal Borders

According to the European Commission, the temporary reintroduction of controls at the international EU borders by Germany and Austria complies with the Schengen Borders Code. This was the subject of a Commission Opinion released on 23 October 2015.

Germany implemented the measure on 13 September 2015 to cope with the large influx of refugees. Austria followed on 16 September 2015. The Commission concluded that the necessity and proportionality of these measures were in accordance with the arrangements made under the Schengen Borders Code. The measures taken by the two Member States were justified by the sudden increase in the number of persons seeking international protection at the borders of these countries.

In the same opinion, the Commission expressed its appreciation of the decision taken by Slovenia to discontinue, as

of 16 October 2015, the temporary border controls it had introduced at its internal border with Hungary on 17 September 2015. A separate opinion will focus on the decision taken by the Hungarian authorities on 17 October 2015 to temporarily reintroduce border controls at the border with Slovenia. (EDB)

►eucrim ID=1504001

### Institutions

#### Council

##### Increased Information Sharing Activated in Response to Migratory Crisis

On 30 October 2015, the Luxembourg Presidency decided to activate the Integrated Political Crisis Response (IPCR) arrangements on an “information sharing mode.” The EU IPCR arrangements were originally approved on 25 June 2013 by the Council and enable the EU institutions to take rapid decisions when facing major crises requiring a tailored response at EU political level.

The decision taken by the Luxem-

bourg Presidency aims at monitoring the current migratory flows, supporting decision-making in this respect, and implementing the agreed measures. In concrete terms, the “information sharing mode” means that EU institutions, Member States, and agencies continuously share information on the situation via a common web platform. The Commission and the EAAS will provide support by means of information analysis. (EDB)

►eucrim ID=1504002

#### Court of Justice of the EU (CJEU)

##### EP Endorses Reform of the CJEU

After four years of negotiations, the EP voted in favour of the substantial reform of the CJEU statute on 28 October 2015. A key element of the compromise text is the doubling of the number of General Court judges in three steps by 2019 (see eucrim 2/2015, p. 35).

The reform is considered essential in the face of the substantial increase in the General Court’s workload and in order to decrease the duration of procedures. (EDB)

►eucrim ID=1504003

##### New President of the CJEU

On 7 October 2015, and following the partial replacement of the Members of the Court of Justice, Prof. Dr. Koen Lenaerts was elected as the new President of the CJEU. President Lenaerts’ term will run from 8 October 2015 to 6 October

\* If not stated otherwise, the news reported in the following sections cover the period September – November 2015.

2018. He has been a judge at the CJEU since 7 October 2003 and Vice President since 9 October 2012. He succeeds Mr. Vassilios Skouris following the end of the latter's term of office. (EDB)

➤eucrim ID=1504004

## Europol

### 2015 Internet Organised Crime Threat Assessment

On 30 September 2015, Europol released its most recent Internet Organised Crime Threat Assessment (IOCTA) report. Besides informing decision-makers on several levels about protection against cyber threats and the fight against cybercrime, the report aims to assist priority setting for the EMPACT Operational Action Plan for 2016. The report therefore includes recommendations with regard to the three main mandated areas: cyber attacks, sexual exploitation of children online, and payment fraud.

One of the key findings of the report is the trend towards growing aggression in conjunction with cyber attacks by means of, e.g., sexual extortion. Businesses and citizens are increasingly threatened by malware, including ransomware (the victim must pay a ransom in order to regain unrestricted access to files) that often applies encryption. A troubling trend in the commercial live streaming of child sexual abuse is fostered by growing Internet coverage in developing countries together with pay-as-you-go streaming solutions that provide the viewer with a high degree of anonymity. Anonymization and encryption technologies are often used by attackers and abusers use to protect their identities, communications, data, and payment methods.

Besides a list of key findings, the report includes concrete recommendations on the level of investigation, capacity building and training, prevention, partnerships, and legislation. (EDB)

➤eucrim ID=1504005

### Fake Online Travel Agency Dismantled

At the beginning of October, a joint operation led by the Romanian Police and the Italian State Police, supported by Europol's European Cybercrime Centre (EC3), saw the arrest of 50 members of an organised criminal group in Romania. The organised criminal group, active since 2013, obtained payment card information and other personal data from victims worldwide. This data was used to acquire high-value goods and services, including plane tickets, but also sports bets, electronic devices, jewellery, agricultural machinery, and real estate. The proceeds from the online fraud were also used to facilitate other crimes at the national and international levels. (CR)

➤eucrim ID=1504006

### Irregular Migration Network Dismantled

At the beginning of October, "Operation Bouquet" –an international investigation led by France and Portugal and supported by Europol –led to the arrest of 69 individuals involved in facilitating irregular migration within the EU.

The smugglers were investigated on the grounds of providing transport for irregular migrants between Lisbon, Paris, and the Belgian border, using their own vehicles and travelling along the main motorways to avoid detection. In Portugal, marriages of convenience between migrants and Portuguese women were also investigated. (CR)

➤eucrim ID=1504007

## Eurojust

### Letter of Understanding with EUNAVFOR MED Signed

On 1 October 2015, Eurojust signed a Letter of Understanding on Cooperation with EUNAVFOR MED, a EU military operation in the southern Central Mediterranean launched by the EU on 22 June 2015. EUNAVFOR MED shall undertake systematic efforts to identify,

capture, and dispose of vessels used by migrant smugglers or traffickers. Under the Letter of Understanding, both parties agree to exchange strategic information of a non-operational nature, best practices, as well as expertise and experience in the field of illegal immigrant smuggling. (CR)

➤eucrim ID=1504008

### Project to Improve Cross-Border Videoconferencing

On 5 November 2015, the project "Multi-Aspect Initiative to Improve Cross-border Videoconferencing" was started with a meeting organized and hosted by the Austrian Federal Ministry of Justice in Vienna.

The project, which is financially supported by the European Commission, aims at promoting the practical use of cross-border videoconferencing. It also endeavours to share best practice and expertise on organisational, technical, and legal aspects as well as to enhance technical interoperability. Eurojust supports the project with its experience, know-how, and technical infrastructure as well as real-time interpretation where required. (CR)

➤eucrim ID=1504009

### Operation against Users of DroidJack Malware

On 27 October 2015, an operation involving Germany, France, Britain, Belgium, Switzerland, and the United States took place against users of DroidJack, a malware giving its user complete control over other mobile telephones using the Android operating system. The operation led to house searches and arrests of suspected users of DroidJack.

The operation was supported by Eurojust organising a coordination meeting and Europol providing analytical support. (CR)

➤eucrim ID=1504010

### US "Cyber Prosecutor" at Eurojust

On 15 and 16 September 2015, the Attorney General of the US Department

of Justice announced the temporary secondment of a prosecutor from the Criminal Division of the US Department of Justice to sit in Eurojust and to work with Europol's European Cybercrime Centre (EC3). The secondment shall further enhance cooperation between the US, Eurojust, and the EC3 in the fight against cybercrime. After this first secondment, the three parties will assess whether a permanent arrangement should be established in the future. (CR)  
 ►eucrim ID=1504011

## Specific Areas of Crime / Substantive Criminal Law

### Protection of Financial Interests

#### Progress on the European Public Prosecutor's Office (EPPO)

In October and November 2015, several meetings were held on the proposed regulation on the establishment of the EPPO. Arts. 17-23, 28a and 36-37 of the draft regulation were the main focus of the discussions. Even though the Luxembourg Presidency reported a con-

structive debate, several issues remain open. One of these issues is the competence of the EPPO for offences covered by the PIF Directive and whether this should be static – i.e., reflect the content of the Directive on the day of adoption of the EPPO Regulation – or whether it will take into account future amendments of the Directive and of national implementation law.

Other points of discussion included the preponderance criterion, the conditions applying to the evoking of cases, and the conditions under which the EPPO can decide that there is no need to investigate or prosecute a case at the EU level.

A substantial question is also the judicial review of decisions taken by the EPPO. The Presidency believes that most Member States would like to foresee a limited role for the CJEU in the judicial review of decisions of the Office. The discussions on the exact scope of this judicial review are complex, but the Presidency thinks the wording of Art. 36 could be agreed upon.

On 24 November 2015, drafts of the debated set of provisions were presented in the context of preparing an agreement

at the Council meeting of 3 December 2015. (EDB)

►eucrim ID=1504012

### Organised Crime

#### Extraordinary JHA Council after Paris Attacks

On 20 November 2015, the Ministers of Justice and of Home Affairs met in Brussels for an extraordinary JHA Council in the aftermath of the terrorist attacks in Paris on 13 November 2015. The meeting was convened at the request of France and chaired by Etienne Schneider, Luxembourg's Deputy Prime Minister and Minister of Internal Security, and Félix Braz, Minister of Justice.

In the conclusions adopted during this meeting, the Council reiterated the urgency and priority of finalising an EU PNR system by the end of 2015. This system of exchange of PNR data should include internal flights in its scope, provide for a sufficiently long period during which PNR data can be retained in non-masked-out form, and should not be limited to crimes of a transnational nature.

Law enforcement cooperation will be enhanced *inter alia* by the following:

- Speeding up implementation of the Prüm agreement and decisions;
- Defining a common approach to the use of SIS II data relating to foreign fighters;
- Launching a European Counter Terrorist Centre (ECTC) with Europol on 1 January 2016.

Further conclusions include strengthening of the cooperation between FIUs in the context of investigating the financing of terrorism, a planned revision of the current Directive on firearms, and the strengthening of cooperation through Europol in this respect. Lastly, a specific set of conclusions was dedicated to the criminal justice response to radicalisation leading to terrorism and violent extremism. (EDB)

►eucrim ID=1504013

#### Common abbreviations

CEPOL	European Police College
CDPC	European Committee on Crime Problems
CFT	Combatting the Financing of Terrorism
CJEU	Court of Justice of the European Union
ECJ	European Court of Justice (one of the 3 courts of the CJEU)
ECtHR	European Court of Human Rights
EDPS	European Data Protection Supervisor
(M)EP	(Members of the) European Parliament
EPPO	European Public Prosecutor Office
FIU	Financial Intelligence Unit
GRECO	Group of States against Corruption
GRETA	Group of Experts on Action against Trafficking in Human Beings
JIT	Joint Investigation Team
LIBE Committee	Committee on Civil Liberties, Justice and Home Affairs
(A)ML	(Anti-)Money Laundering
MLA	Mutual Legal Assistance
MONEYVAL	Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism
PIF	Protection of Financial Interests
SIS	Schengen Information System
THB	Trafficking in Human Beings



## Counter-Terrorism Measures

During the JHA Council of 8-9 October 2015, the Council adopted conclusions on measures to fight trafficking in firearms. These include calling on the Member States to enter information on sought firearms into SIS II in accordance with Art. 38 of Decision 2007/533/JHA as well as into the Europol Information System (EIS) and Interpol's Illicit Arms Records and Tracking Management System (iARMS). The Commission is welcome to make proposals for strengthening the firearms legislative framework.

The Luxembourg presidency and the EU Counter-Terrorism Coordinator informed the Council of the implementation of measures planned following the attacks of 7 January 2015 (see eucrim 1/2015, pp. 7-8). The Council agreed that progress should be made on the following points by December 2015:

- Operationalise the common risk indicators by FRONTEX;
- Reinforce border checks through better use of SIS II and Interpol's Stolen and Lost Travel Documents database;
- Improve transmission of information to Europol;
- Prevent radicalisation on the Internet: continuing financial and other support to the Europol Internet referral unit (see p. ???) and to the EU Syria Strategic Communications Advisory Team;
- Improve the use of existing JHA tools in counter-terrorism assistance to third countries.

At the JHA Council on 3-4 December 2015, a progress report will be presented on these priority measures. (EDB)

►eucrim ID=1504014

## EU Signs CoE Convention and Additional Protocol on Prevention of Terrorism

On 22 October 2015, on behalf of the EU, the Luxembourg Presidency of the Council co-signed the CoE's Convention on the Prevention of Terrorism and the additional protocol thereto.

While the Convention was already

open for signature in 2005, the Additional Protocol was adopted on 19 May 2015 in order to address the issue of foreign terrorist fighters. It includes the criminalisation of travelling for terrorist purposes and the financing, facilitation, and organisation of such travel, thus implementing the UN Security Council Resolution on foreign terrorist fighters (2178(2014)).

Félix Braz, Luxembourg's Minister of Justice, who co-signed in the name of the EU, stated that "The European Union supports the Council of Europe in its work, which sets legal rules in order to make a number of acts punishable by law." (EDB)

►eucrim ID=1504015

## Criminal Justice Response to Radicalisation and Draft EP Report

On 19 October 2015, the Commission, in cooperation with the Luxembourg Council Presidency, organised a High-Level Conference on "The Criminal Justice Response to Radicalisation."

During the meeting, policymakers, professionals, and experts exchanged views on effective intervention and the management and practices of sentencing in order to avoid the spreading of radicalised ideas, both inside and outside the EU's prisons, that potentially lead to acts of terrorism. Further topics dealt with during this conference included the implementation of the European PNR, cooperation with third countries, the ex-

## Cybercrime Mock Trial

*Role play on how to conduct trials in cybercrime cases*

ERA, Trier, 25-26 April 2016

The Cybercrime Mock Trial intends to be a practice-oriented exercise of a legal procedure that is the actual enactment of a fictitious cybercrime case. Participation in the trial provides the participants with an insider's perspective from which to learn about the application of substantive and procedural cybercrime rules.

The course will help participants in gaining a basic understanding of the legal mechanism through which a hypothetical cybercrime dispute can be conducted in trial regardless of the concrete national procedural setting. Moreover, it helps them develop critical thinking skills, oral skills, understanding of substantive/procedural areas of law and international cooperation rules.

### Structure of the course

#### Day 1

##### Morning Session:

- Presentation of the case by the trainers, including necessary key references regarding some Internet fundamentals (IP addresses, encryption data, cloud computing, anonymity online, proxy servers, etc.);
- Split into 2 working groups.  
Investigation phase part I (1,5 hours).

##### Afternoon Session:

- Investigation phase part II (2 hours, of which 1.5 in Working Groups and 30 mins in plenary);
- Trial preparation phase (2 hours, of which 1.5 in Working Groups and 30 mins in plenary).

#### Day 2

##### Morning Session:

- Mock trial (2,5 hours).

##### Who should attend?

This course is primarily aimed at judges, prosecutors and defence lawyers.

The conference will be held in English.

*For further information, please contact Mr. Laviero Buono, Head of European Criminal Law Section, ERA. e-mail: lbuono@era.int*

change of information, the role of Eurojust and Europol in coordinating police and judicial work as well as training, especially through CEPOL.

On the same day, the EP's LIBE Committee voted on a non-binding resolution that illegal content spreading violent extremism via the Internet should be deleted promptly but also in line with fundamental rights and freedom of expression. The draft report lists recommendations for a joint, comprehensive EU strategy on preventing radicalisation and recruitment of EU citizens by terrorist organisations. Recommended measures include a common definition of "foreign fighters," freezing citizens' financial assets in order to prevent them from taking part in terrorist activities in third states' conflict areas, and close cooperation with third states in order to identify travelling foreign fighters. Pro-active de-radicalisation and inclusion is crucial. Ultimately, MEPs suggest introducing measures enabling users to flag illegal content circulating on the Internet and social media networks.

The draft report on preventing radicalisation is scheduled for a plenary vote on 23-26 November 2015. (EDB)

►eucrim ID=1504016

### Ninth EU Anti-Trafficking Day Includes High-Level Conference and Publication of Three Studies

On 20 October 2015, the Commission and the Luxembourg Presidency of the Council organised a high-level conference to mark the Ninth EU Anti-Trafficking Day. The conference entitled "Time for Concrete Action: Implementing the Legal and Policy Framework on Trafficking in Human Beings" brought together representatives of EU Member States, the EP, the EU network of National Rapporteurs and/or Equivalent Mechanisms, and representatives from civil society. Panel discussions were held on topics such as prevention by addressing the demand and following the money trail of traffickers. The need for full and effective implementation of the EU Anti-Trafficking Direc-

tive (2011/36/EU) was also highlighted during the event.

At the same time, the Commission launched three new studies on its website that are deliverables of the EU Strategy towards the Eradication of Trafficking in Human Beings 2012-2016.

All three studies – full reports and executive summaries – are available on the Commission's website. (EDB)

►eucrim ID=1504017

## Procedural Criminal Law

### Procedural Safeguards

#### Council and EP Reach Agreement on Presumption of Innocence

On 4 November 2015, the Council and the EP reached agreement on a compromise text for the proposed Directive on the strengthening of certain aspects of the presumption of innocence and the right to be present at trial in criminal proceedings.

The proposed directive imposes minimum rules on certain aspects of the presumption of innocence and the right to be present at trial. More precisely, Member States should ensure that suspects and accused persons are presumed innocent until proven guilty under the law. Two rights linked to this principle are provided for by the proposed text: the right to remain silent and the right against self-incrimination. Also, Member States are required to respect the following related obligations in accordance with the proposed directive: before the final judgment, suspects and accused persons may not be presented as guilty by using measures of physical restraint, and the burden of proof must be on the prosecution, while any reasonable doubts as to guilt should benefit the accused.

The directive will complement the legal framework provided by the ECHR and the EU Charter of Fundamental Rights. It is one of the measures following from the 2009 roadmap on procedural rights.

The next step in the procedure – after

legal-linguistic revision – is to submit the text to the EP for a vote at first reading. (EDB)

►eucrim ID=1504018

## Data Protection

### Reactions to Suspension of the Safe Harbour Framework

Following the CJEU ruling of 6 October 2015 in case C-362/14, in which the CJEU declared Commission Decision 2000/520/EC invalid (see eucrim 3/2015, p. 85), the impact of the case on the EU institutions became apparent.

The case – also known as the *Schrems* case (after the complainant's surname) – was the subject of a debate in the EP on 14 October 2015. Nicolas Schmitt, the minister responsible for relations with the EP during the Luxembourg Presidency, addressed the plenary, admitting that the EP had regularly drawn attention to the shortcomings of data flows under the Safe Harbour Agreement. Pointing out that it would first be for the Commission to express its intentions after seeing its decision invalidated, he called for careful analysis of the ruling's consequences.

The Commission had already given a statement shortly after the judgment during the JHA Council of 9 October 2015. Commissioner for Justice, Consumers and Gender Equality, Věra Jourová, set out three priorities:

- Guaranteeing the effective protection of citizens' data during transfer thereof to the USA;
- Guaranteeing the continuation of data transfers to the USA, in so far as these transfers constitute "the backbone of our economy;"
- Ensuring coherence and coordination with national supervisory authorities.

During the debate in the EP on 14 October 2015, Commissioner Jourová stressed that the Commission is working closely with the EDPS within the Article 29 Data Protection Working Party. It is also engaged in dialogues with businesses. The aim is to define clear guidelines to avoid



fragmentation of the internal market. With regard to relations with the USA, she emphasized the need for a commitment that protects EU citizens' data.

In a resolution voted on 29 October 2015, the EP expressed its concern that too little has been done to safeguard citizens' fundamental rights following revelations of electronic mass surveillance by Edward Snowden. In addition, by 285 votes to 281, MEPs decided to call on Member States to grant Edward Snowden protection and prevent extradition to third states. The EP welcomed the CJEU ruling in the *Schrems* case, which confirmed its long-standing position on these transatlantic data flows. It urged the Commission to immediately take action and look for alternatives to the Safe Harbour framework.

Lastly, the EP expressed its concerns in the resolution on recent laws on surveillance by intelligence agencies in Member States. On 6 November 2015, the Commission issued an explanatory communication aiming to offer guidance on transatlantic data transfers. The communication contains alternative transfer instruments, the conditions under which they can be used, and the restrictions that apply. (EDB)

➤eucrim ID=1504019

### Agreement on Draft Data Protection Directive

On 8-9 October 2015, the Council reached consensus on its negotiation position on the draft data protection directive. The proposed directive presented by the Commission in 2012 aims at protecting personal data processed for the prevention, investigation, detection, or prosecution of criminal offences, or the execution of criminal penalties, or the safeguarding against and the prevention of threats to public security.

In June 2015 (see eucrim 2/2015, p. 41), agreement was already reached on the draft data protection regulation covering the processing of personal data in commercial matters. Now, the Council has also agreed on the draft data pro-

tection directive; this also enables the Luxembourg presidency to start discussions with Parliament on the second part of the data protection reform package. The presidency aims at finalising the entire data protection package by the end of 2015. (EDB)

➤eucrim ID=1504020

### Asset Freezing and Recovery

#### Possible New Interpol Notice for Asset Recovery

The 84th Interpol General Assembly in Kigali, Rwanda on 3 November 2015 approved a proposal to launch a pilot project aiming to introduce a new tool for the recovery of illicit criminal assets.

Cross-border tracing and recovery of illegally gained assets is a significant instrument in the global fight against cor-

ruption and financial crime. Interpol's well known system of global police alerts or notices would see the addition of a special notice for tracing and recovering such assets. (EDB)

➤eucrim ID=1504021

## Cooperation

### Law Enforcement Cooperation

#### Operation against Pakistani Migrant Smuggling

On 24 and 25 October 2015, Europol coordinated the Spanish-Polish law enforcement operation "Shafat-Turkeba" against migrant smuggling and trafficking in human beings. The operation led to the arrest of 29 suspected migrant smugglers. The smugglers are suspected

## Electronic Evidence in Criminal Proceedings

### *Collection, analysis and presentation of e-evidence in court*

Lisbon, 29 February 2016 – 1 March 2016

Today, almost all criminal courts are confronted with the question of whether or not electronic evidence presented in criminal proceedings is admissible. Rules governing the admissibility of electronic evidence vary in the legal framework of different Member States and are continuously challenged by the evolution of technological devices such as computers, mobile phones, printers and digital cameras. All these devices create many opportunities for the commission of crimes, such as phishing, identity theft, online child pornography and internet fraud.

This conference aims at promoting advanced knowledge, exchange of experience and best practices between judges, prosecutors and lawyers in private practice from EU Member States who are dealing with criminal proceedings where e-evidence is involved. This will improve participants' knowledge of the strategies and techniques used in different European countries and will ultimately improve cross-border cooperation among Member States' authorities. Key topics are:

- Definition of 'electronic evidence': practical examples of analogue and digital evidence;
- Legal implications of electronic evidence (collection, evaluation and admissibility);
- Impact of electronic evidence on criminal proceedings;
- Insights into different national EU criminal justice systems regarding the handling of e-evidence in court.

Who should attend? Judges, prosecutors, lawyers in private practice and ministry officials active in the field of EU criminal law.

The conference will be held in English.

*This conference is organised by ERA in cooperation with the Centre of Judicial Studies. For further information, please contact Mr. Laviero Buono, Head of European Criminal Law Section, ERA. e-mail: lbuono@era.int*

to be part of an organised criminal network responsible for facilitating deadly journeys across the Mediterranean Sea for Pakistani migrants. Furthermore, they are suspected of labour exploitation used to make the migrants pay back the debts for the transport to Europe. “Packages” for the journey and forged or fake passports and ID cards amount to €14,000 charged to each migrant by the criminal network. Assistance to the operation was provided by Europol’s Joint Operational Team “Mare.” (CR)

►eucrim ID=1504022

### I-Checkit against Identity Fraud

On 4 November 2015, Interpol’s General Assembly endorsed I-Checkit, a service model intended to complement and enhance national border security systems by allowing trusted partners to conduct advanced passenger checks in real time against Interpol’s global databases, including its Stolen and Lost Travel Documents (SLTD) database. The resolution follows a 16-month pilot project with AirAsia. Another pilot project will be conducted throughout 2016 in the maritime transportation sector. Furthermore, current testing with a small number of companies in the hotel and banking sectors will be continued. (CR)

►eucrim ID=1504023

### Operational Forum on Countering Migrant Smuggling Networks

On 15-16 October 2015, an Operational Forum on Countering Migrant Smuggling Networks was held by Interpol and Europol in Lyon. The meeting was attended by more than 120 participants from approx. 50 source, transit, and destination countries affected by irregular migration flows as well as participants from international and regional organizations and the private sector. Results of the meeting include decisions to:

- Establish an Interpol Specialist Operational Network against Migrant Smuggling, aiming to increase the real-time exchange of police information worldwide. The network will comprise

experts from source, transit, and destination countries.

- Reinforce cooperation between Interpol and Europol to ensure optimal investigative support to the police across source, transit, and destination countries within their respective memberships.

- Launch Operation Hydra by means of Interpol aiming to promote global information exchange on the location of fugitives, to enhance networking between fugitive investigators and specialized units, and to increase the use of Interpol notices and diffusions.

- Carry out regional operations in Africa via Interpol’s regional bureaus in Abidjan and Nairobi.

A follow-up meeting will be held at Europol headquarters in The Hague on 22 and 23 February 2016. (CR)

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### Interpol – Europol Call for Action to Target People-Smuggling Networks

On 11 September 2015, Interpol and Europol agreed to issue a joint call for urgent action to target people-smuggling networks. As a first step, the two organisations have called on their respective services to urgently organize a summit involving senior police officers from source, transit, and destination countries. (CR)

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## Council of Europe\*

*Reported by Dr. András Csúri*

### Foundations

#### Reform of the European Court of Human Rights

#### Network for Case Law Exchange and Launch of Multilingual Twitter News Account

On 5 October 2015, the Court launched a network for the exchange of information on the case law of the European Convention on Human Rights between the Court and the national superior courts. The focal points for the exchange are the research departments of the superior courts and the Jurisconsult of the European Court of Human Rights. The French Court of Cassation and the French Conseil d’État were the first

courts to sign up for the network, and several European superior courts have already announced their intention to join the network over the coming months. President Spielmann emphasized that this new form of cooperation reflects that implementing the ECHR is a shared responsibility between the Court and the national superior courts.

Additionally, the Court has launched a multilingual Twitter account reserved for news on case law publications, translations, and the HUDOC case law database. The Court already has a Twitter account reserved for press releases, with tweets mainly in English and French.

\* If not stated otherwise, the news reported in the following sections cover the period September – November 2015.

Registrar Fribergh stated that the new account is designed to improve the understanding of the Court's case law, especially in states where neither English nor French is well understood. It should help legal professionals, public officials, and NGOs follow developments in this area.

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### Launch of COURTalks-disCOURs Video on Application Admissibility

On 4 November 2015, with the cooperation and support of the CoE's European Programme for Human Rights Education for Legal Professionals, the Court launched the first COURTalks-disCOURs video dealing with the admissibility of applications.

The video provides judges, lawyers, and legal professionals with an overview of the admissibility criteria, which all applications must meet in order to be examined by the Court (see eucrim1/2014 p. 15). It is subtitled in 14 different languages to improve accessibility to the ECHR. The video will serve as a training tool for the HELP programme and complements other relevant information material produced by the Court, e.g., the Practical Guide on Admissibility Criteria and the video on admissibility conditions (see eucrim 1/2015 pp.10-11).

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## Specific Areas of Crime

### Corruption

#### GRECO: Fourth Round Evaluation Report on Greece

On 22 October 2015, GRECO published its Fourth Round Evaluation Report on Greece. This latest evaluation round was launched in 2012 in order to assess how states address corruption prevention in respect of MPs, judges, and prosecutors (for further reports, see eucrim 3/2014, p. 83; 4/2014, pp. 104-106; 1/2015, p. 11; 2/2015, pp. 43-45; eucrim 3/2015 p.

87-88). The report generally states that corruption was one of the problems that contributed to Greece's financial crisis, for instance by exempting authors of illegal acts from liability, facilitated by an obscure legislative process. The recommendations urged securing integrity in parliament and in the judiciary.

As regards MPs, the report states that Greece is at an early stage of integrity policies, as such rules do not yet exist with regard to parliamentarians. The report therefore calls for the swift adoption of a code of conduct for MPs. It also calls for rules on the acceptance of gifts and on contacts with third parties and lobbyists who seek to influence the parliamentary process. In addition, rules need to be introduced for ad hoc disclosure when a conflict with a parliamentarian's private interests arises. GRECO is hopeful that an anti-corruption strategy and action plan – adopted in 2013-2014 – will bring about changes, including supervision of the declaration of assets and interests undertaken (as of 2015) by the independent Committee for the Investigation of Declarations of Assets (CIDA). The report calls for a review of the system of immunities and making parliamentarians aware of their obligations.

The report states that, although rules are in place to protect the integrity of judges and prosecutors, the system of their professional supervision needs consolidation, as too many bodies, mainly composed of peers and designated for a short period, are involved. GRECO further recommends adequate guarantees against both undue delays before the the decision stage and interventions of third parties seeking to speed up decisions. Channels for complaints against undue delays need to be clarified, streamlined, and properly communicated to the public as well. Moreover, the justice system needs to be assessed as to its overall functioning and made more accountable through periodic reporting. The report notes that an inter-connected IT system to support workload management and communication is still missing. GRECO

further recommends reviewing the selection process and the term of tenure of most senior positions of judges and prosecutors by involving their peers and in this way improving their independence from the executive.

With regard to prosecutors, the report specifically recommends the drafting of precise case management rules and their consistent application within the prosecution services, including criteria for the assignment and withdrawal of a case.

➤eucrim ID=1504028

### Money Laundering

#### MONEYVAL: Lifting the Public Statement on Bosnia and Herzegovina

In April 2011, MONEYVAL invited Bosnia and Herzegovina to develop a clear action plan in response to MONEYVAL's 2009 third round mutual evaluation report to remedy the major deficiencies identified in its anti-money laundering and counter-terror financing regime (AML/CFT). In 2014, a high-level mission took place in Bosnia and Herzegovina, as the country had failed to enact previously required legislative amendments to the AML/CFT Preventive Law and the Criminal Code in order to meet international standards. Due to further insufficient progress, MONEYVAL issued a Public Statement on 1 June 2014. Preventive legislation was passed thereafter, but the required amendments to the Criminal Code were still outstanding throughout 2014. Therefore, the Public Statement remained in place. (see eucrim 3/2015 p. 89)

On 18 September 2015, MONEYVAL decided to lift its Public Statement on Bosnia and Herzegovina, since a number of key amendments to the Criminal Code were adopted in May 2015 to address outstanding shortcomings in relation to the ML offence and the confiscation regime. Bosnia and Herzegovina was also removed from MONEYVAL's Compliance Enhancing Procedures.

➤eucrim ID=1504029

# A Heavily Regulated Industry

## The Varied Objectives of Financial Regulation

Prof. Dr. Christos Hadjiemmanuil

### I. The Evolving Nature of Financial Regulation

Until the early 1970s, the various national systems of banking regulation had largely monetary objectives. Controls on commercial banking activity (including administratively set interest rates, quantitative limits on credit expansion, and reserve requirements) were imposed for the purpose of preventing the over- or under-expansion of the money and bank credit supply. In addition, in many countries, including the UK and France, the state sought to direct the flow of available credit towards certain economic areas and activities, and away from others. Another policy concern related to the conditions of competition within the banking industry; the prevailing theories, however, had very little to do with the theories and policies of modern competition law. Thus, regulation used to be justified in terms of the avoidance of market concentration and monopolistic tendencies in the provision of banking services, either at the national or at the local level; today, however, we know that economies of scale in banking are not unlimited so as to raise the specter of a natural monopoly.

The cartelization of financial markets was tolerated, however, if not actively encouraged. The total effect of regulated interest rates, credit controls, and limits on branching was to severely curtail opportunities for robust competition. In any event, “excessive” competition was discouraged, since it could undermine the profitability of banks and eventually lead to failures. As for the protection of depositors against the consequences of bank failure, this was addressed primarily through the extension of a safety net in the form of formal deposit insurance and/or the provision of implicit state guarantees in support of bank liabilities.<sup>1</sup>

Since then, both the economic conditions and the conceptual assumptions under which financial institutions operate, have changed dramatically. The last decades of the 20th century were marked by a great global wave of financial liberalization. Direct regulatory controls with monetary objectives almost disappeared. Their perverse economic side effects reduced their attractiveness as a policy tool, especially since their effectiveness was rapidly diminishing, due to market innovations as well as the gradual dismantling of the old system of exchange controls and its substitution by the almost unlimited freedom

of movement of capital. By dispelling the notion that mandatory reserve requirements and other regulatory restrictions on the expansion of bank assets and liabilities are necessary (as distinct from helpful, or convenient) for the implementation of monetary policy and by insisting on the sufficiency of market-based approaches,<sup>2</sup> theoretical developments in the field of monetary economics have played a crucial role in this trend.

The new environment has, however, brought new priorities to the fore. In particular, from 1973 on, bank failures – a phenomenon unknown in the early post-War period – have become increasingly common, bringing to the center of regulatory attention the problem of excessive risk-taking by banks and its subsidization by the state through the provision of a safety net. The instability of the new financial environment eventually led to the global financial crisis in 2007-2009, turning financial regulation into a highly salient political issue.

At the same time, the growing financialization of the economy, also at the retail level, and the rising importance of capital markets – both as a conduit for the financing of the real economy and as a destination for household savings, either in the form of direct securities investments or indirectly through life assurance programs and collective investment schemes – have increased the economic significance and political salience of the non-banking segments of the financial industry. The protection of investors has thus emerged as an important policy priority, both *per se*, that is, as a form of protection for a large class of citizens, and as a means of promoting the growth of the relevant markets by building confidence in their integrity and by ensuring their smooth operation.

Under the pressure of these developments, over the past four decades, financial regulation has refocused on new objectives. Of course, the regulatory regime’s existing objectives are not *ipso facto* optimal or even justifiable. There is a close logical link between a public measure’s objectives and the underlying justifications or reasons for adopting it.<sup>3</sup> Are these reasons valid? The matter is always open for discussion. An additional question is whether the objectives, as reflected in binding legal norms or in authoritative policy statements, are sufficiently coherent and whether they can properly inform the use of the regime’s operational tools.



## II. The Objectives of Financial Regulation as Set Out in Global Standards

Authoritative but rather vague descriptions of the general regulatory objectives can be found in reports of the global standard-setting bodies with responsibility for the three main financial sectors (banking, securities and insurance). By the late 1990s, the Basel Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS), and the International Organization of Securities Commissions (IOSCO) had all produced high-level regulatory principles of world-wide applicability for their respective sectors.<sup>4</sup> The global sectoral standards may or may not embody a conceptually coherent view of the regulatory tasks but they certainly reflect, and at the same time unify and consolidate, the supervisory community's self-understanding of its function. Thus, they are a good starting point for an analysis of current official approaches to regulation. Each set of principles approaches the question of regulatory objectives in a distinct way.

With regard to banking regulation, the BCBS's core principles require countries to specify clearly the responsibilities and objectives of the authorities involved in supervision and to equip them with sufficient powers for bank licensing, ongoing supervision, enforcement of compliance with applicable legal norms, and the taking of timely corrective actions to address safety and soundness concerns.<sup>5</sup> The commentary specifies that the responsibilities and objectives of each of the authorities involved in banking supervision should be clearly defined in legislation and publicly disclosed. It also defines the primary objective of banking supervision, which is "to promote the safety and soundness of banks and the banking system."<sup>6</sup> This turns out to be not simply a core objective but the overriding one, as it is further stated that, "if the banking supervisor is assigned broader responsibilities, these [should be] subordinate to the primary objective and [should] not conflict with it."<sup>7</sup> From this viewpoint, banking supervision is first and foremost (though not exclusively) about prudential controls.<sup>8</sup>

The BCBS principles recognize that "banking supervision" – that is, the specialist banking regulatory agency and its machinery – is only part of the arrangements necessary to ensure stability in financial markets. Other governance elements ("preconditions") are identified as being indispensable for the effectiveness of banking regulation in the narrow sense, namely: sound and sustainable macroeconomic policies; a well-established framework for financial stability policy formulation; a well-developed public infrastructure; a clear framework for crisis management, recovery and resolution; an appropriate level of systemic protection (or public safety net); and effective market discipline.<sup>9</sup> This opens the road to a broader conception of regulation, which is not confined to what the regula-

tor is (tasked with) doing. Nonetheless, the BCBS's objectives are confined to the core (prudential and/or stability-related) tasks of banking regulators and do not include other bank-related objectives, such as competition, financial inclusion, the fight against financial crime, or the protection of bank clients in their capacity as consumers.

For the insurance sector, the overall objective, or task, of supervision is "to maintain fair, safe and stable insurance markets for the benefit and protection of policyholders."<sup>10</sup> In this case, it is the protection of direct stakeholders, specifically the policyholders, rather than any systemic consideration which holds center stage. For the remainder, it is recognized that the precise objectives may vary by jurisdiction, that the supervisor's mandate may include several objectives, and that these may change over time according to the evolution of financial markets and prevailing conditions.<sup>11</sup> It is essential, however, that the applicable objectives be clearly defined.<sup>12</sup>

One should note that the interests of policyholders are at risk from the potential inability of insurance firms to honor their financial obligations (often of a very long-term nature). The preservation of the insurance firm's assets and its prudent financial management are necessary in order for the contracts to fulfil their intended economic role, but it is beyond the capacity of individual stakeholders to monitor the situation, and private law's remedies are inappropriate for this purpose. Policyholders are at risk, however, from the terms and manner of promotion of insurance contracts, the content and implications of which many of them may find difficult to understand and evaluate. Information asymmetries between insurers and their clients abound, and the possibility of mis-selling and sharp practices is ubiquitous. Accordingly, for the implementation of insurance regulation's objective, it is necessary for the regulatory regime to rely on prudential and conduct-of-business requirements in equal parts.

Ultimately, with regard to securities regulation, IOSCO identifies three objectives: protecting investors; ensuring that markets are fair, efficient, and transparent; and reducing systemic risk.<sup>13</sup> The most recent version of the IOSCO standard does not include further commentary but identical detailed explanations can be found in all previous editions.<sup>14</sup> Thus, in IOSCO's view:

The three objectives are closely related and, in some respects, overlap. Many of the requirements that help to ensure fair, efficient and transparent markets also provide investor protection and help to reduce systemic risk. Similarly, many of the measures that reduce systemic risk provide protection for investors.<sup>15</sup>

Investor protection means protection from a variety of misleading, manipulative, or fraudulent practices, both by the intermediaries who provide professional services to investors and by issuers of financial instruments and by third-party

participants in trading activities. IOSCO's discussion of the objectives points to all these issues emphasizing the need for disclosure and accounting requirements and equitable treatment of investors, while also noting that the capacity of individual investors to privately enforce such requirements may be limited.<sup>16</sup> Notably, the IOSCO text further refers to the need for capital requirements, as a way of protecting investors and counterparties from the risk of direct financial default.<sup>17</sup>

Ensuring that markets are fair, efficient, and transparent – especially by preventing improper trading practices and ensuring equal access for market users, the fair treatment of trade orders, and reliable price formation process based on transparency – can be seen as both another aspect of the previous objective of investor protection and as a means towards achieving the wider economic purposes of market building.<sup>18</sup> The latter, however, are not discussed explicitly.

Significantly, IOSCO recognizes the reduction of systemic risk as a parallel objective of securities regulation. In particular, it considers that securities intermediaries should be subject to capital and other prudential requirements, not only in order to protect individual counterparties but also to prevent systemic damage. Efficient and accurate clearing and settlement processes also contribute to this objective, which is further served by effective and legally secure arrangements for default handling.<sup>19</sup>

### III. Regulatory Objectives in National Law: The Case of the UK

In contrast to the global standards, statements of the objectives of financial regulation in express and general terms are rarely found in national legislation. Instead, the objectives are often implied by the subject matter and structure of the regulatory scheme or, in cases where they are explicitly stated in the text, their significance is limited to the narrower set of issues covered by the particular enactment. This is not the case, however, in the UK, where the establishment in 2000 of a unified regulatory and supervisory system, operating on the basis of a single statute and a single regulatory agency for the entire financial industry, enabled the legislator to state authoritatively the overall regulatory objectives. Originally, four objectives were set out:

- (a) maintaining confidence in the UK's financial system ("market confidence objective");
- (b) promoting public understanding of the financial system, especially through the promotion of public awareness regarding the benefits and risks associated with different kinds of investment or other financial dealing and the provision of appropriate information and advice ("public awareness objective");

- (c) securing the appropriate degree of protection for consumers ("protection of consumers objective"); and
- (d) reducing the extent to which the financial sector may be used for purposes connected with financial crime ("reduction of financial crime objective").<sup>20</sup>

As a result of the UK's shift from a single financial regulator to a "twin peaks" model,<sup>21</sup> with separate prudential and conduct-of-business authorities (the Prudential Regulation Authority, or PRA, and the Financial Conduct Authority, or FCA), the objectives are currently set out separately for each authority. Accordingly, the PRA is entrusted with a general objective and a sectoral objective relating only to the insurance field, namely:

- (a) promoting the safety and soundness of the persons (primarily deposit-takers and insurance companies, but also certain investment firms) authorised by it ("general objective"); and
- (b) contributing to the securing of an appropriate degree of protection for those who are or may become policyholders ("insurance objective").<sup>22</sup>

Interestingly, the general objective has a clear systemic colouring, since it must be advanced primarily by "seeking to ensure that [regulated entities carry on their business] in a way which avoids any adverse effect on the stability of the UK financial system", as well as by "seeking to minimise the adverse effect that the failure of a [regulated entity] could be expected to have on the stability of the UK financial system".<sup>23</sup> For its part, the FCA is entrusted with one "strategic" and three "operational" objectives, which it must promote through its rule-making, guidance-giving, and policy-making actions.<sup>24</sup> The former is extremely broad and imprecise, since it consists in:

- (c) ensuring that the relevant markets function well ("strategic objective").

The operational objectives include:

- (d) securing an appropriate degree of protection for consumers ("consumer protection objective");
- (e) protecting and enhancing the integrity of the UK financial system ("integrity objective"); and
- (f) promoting effective competition in the interests of consumers in financial markets ("competition objective").

The FSMA provides more detailed guidance on the meaning of the operational objectives. In particular, it explicates that the appropriate degree of protection of consumers is contingent on differences in the risk characteristics of various investments, differences between consumers in terms of their experience, expertise and expectations, consumers' needs for information and advice, etc.<sup>25</sup> This opens the road for distinctions, depending on the particular financial markets and products, and, in particular, for a differentiated treatment of retail and wholesale users of financial services. It is also specified that the "integrity objective" relates to a variety of more specific objectives, some of which are of a prudential and/or systemic



nature, while others address issues of market organization and the fight against various types of criminal misconduct.<sup>26</sup> Thus, alongside the soundness, stability, and resilience of the UK financial system, its “integrity” is said to depend on the orderly operation of financial markets and the transparency of their price formation process as well as on the prevention of phenomena of market abuse or of the misuse of the financial system for purposes connected with “financial crime”. The latter is defined to include any offense involving fraud or dishonesty, misconduct in, or misuse of information relating to a financial market, handling the proceeds of crime, or the financing of terrorism.<sup>27</sup>

Lastly, the competition objective goes beyond typical questions of general competition law, to cover a much broader assessment of the efficiency and quality of the operation of the financial market. Relevant considerations, which can influence the FCA’s rule- and policy-making, include the extent to which the market responds to informational and other needs of different categories of consumers, the access of consumers to financial services (including access by those facing social exclusion or economic deprivation), the ease with which consumers can move from one financial service provider to another, the ease with which new providers can enter the market, and the extent to which competition is encouraging innovation.<sup>28</sup>

#### IV. General Objectives of European Financial Regulation

While regulatory objectives may be defined at the national level, as in the case of the UK, it remains true that, for all EU Member States, financial regulatory policy is increasingly determined at the supranational level.<sup>29</sup> It is at this level that the most important questions of regulatory policy are answered in the form of primary legislation (directives and regulations of the Parliament and the Council) and further elaborated by means of additional legal instruments. The latter include delegated and implementing measures of the Commission as well as “technical standards”, which are formally adopted by the Commission but are drafted by the three European Supervisory Agencies (ESAs), that is, the European Banking Authority (EBA),<sup>30</sup> the European Insurance and Occupational Pensions Authority (EIOPA),<sup>31</sup> and the European Securities and Markets Authority (ESMA).<sup>32</sup> The ESAs were established in the wake of the global financial crisis as sector-based pan-European regulatory authorities.<sup>33</sup>

One can gain a bird’s-eye perspective on the general objectives of the European regulatory approach by looking at the relevant provisions of the instruments establishing the ESAs. Interestingly, these define the objectives of all three authorities in almost identical terms.<sup>34</sup> This implies that, in the eyes of the European legislator, there are no categorical differences between the respective sectors, and that any distinctions are

either superficial or dependent on questions of degree. Thus, the ESAs’ common overarching objective is to promote the public interest by contributing to:

- the short, medium and long-term stability and effectiveness of the financial system.
- More specifically, leaving aside the integration objectives (which are inherent in the European dimension of the regime and particular to it), they must contribute to:
- the integrity, transparency, efficiency and orderly functioning of financial markets;
  - the establishment of equal conditions of competition;
  - the appropriate regulation and supervision of financial institutions’ risk-taking activities; and
  - the enhancement of customer protection.<sup>35</sup>

Again, in all cases, systemic risk is singled out as a special cause for concern. It is thus stressed that, in carrying on their tasks, the ESAs must “pay particular attention to any systemic risk posed by financial institutions, the failure of which may impair the operation of the financial system or the real economy”.<sup>36</sup>

The dominant role of systemic risk in post-crisis regulatory thinking is also evident in the emergence of a separate system of macro-prudential oversight of financial developments. It is now felt that prudential regulation and supervision as it applies to financial institutions individually can contribute to the preservation of systemic stability, but is not sufficient for this purpose.<sup>37</sup> The pre-crisis assumption was that the observance of prescribed standards of safety by individual financial institutions would ensure, in the aggregate, systemic stability. This was a fallacy of composition. In reality, the supervisory tools cannot guarantee the achievement of the macro-prudential objectives, because they can only detect idiosyncratic failures in particular institutions but are not suitable for identifying system-wide interactions and anticipating adverse macro-financial developments. For this reason, a special pan-European body, the European Systemic Risk Board (ESRB), has now been entrusted with the task of continuously monitoring and assessing systemic risks, taking into account both developments within the financial system and wider macroeconomic developments, and recommending measures for their containment.<sup>38</sup> The ESRB’s macro-prudential objectives<sup>39</sup> overlap with the macro-prudential objectives of financial regulation, but its tasks are complementary to those of financial supervisors. From another perspective, one might wonder whether certain tools employed by macro-prudential regulators in Europe and elsewhere (such as reserve requirements, caps on loan-to-value ratios, especially for mortgage lending, etc.<sup>40</sup>) do not mark a blurring of the distinction between monetary, macroeconomic, and financial regulation as well as an unremarked return to controls with mixed objectives, as was the case in the early post-WWII period.<sup>41</sup>

Significantly, European policy statements tend to draw the positive implications of financial regulation for the economy's wider growth dynamics more starkly than the global and national texts discussed above. From this perspective, regulation may be seen less as a system of protection than as an indispensable form of market-building and, accordingly, as serving general economic policy objectives rather than objectives related to the interests (whether individual or collective) of the financial markets' immediate stakeholders. The domination of public objectives over private ones is evident in a recent Commission policy paper, in which the identified objectives of the Union's financial regulatory agenda (financial stability, financial integration, market integrity and confidence, and efficiency) are, in the final analysis, meant to serve a single "overriding objective" of a general economic nature: "to create a financial system that serves the economy and facilitates sustainable economic growth".<sup>42</sup>

## V. Academic Classifications

Certain themes reappear with remarkable regularity in the official texts. For evident reasons, these are also highlighted in the academic literature. Thus, an influential study identifies systemic stability and consumer protection as the key objectives of financial regulation, with a third objective, namely competition, playing a much more limited role.<sup>43</sup> Consumer protection, however, has a dual aspect: it relates, on the one hand, to the avoidance of the financial losses that a financial institution's failure may inflict on its clients (prudential objective) and, on the other, to the protection of clients against objectionable behavior on the part of the intermediaries (conduct-of-business objective).<sup>44</sup>

Evidently, both the prudential side of consumer protection and systemic stability require the observance of adequate standards of safety and soundness at the level of individual institutions. For this reason, regulators are bound to pursue both objectives largely in unison and through identical tools, including financial controls (such as capital adequacy and liquidity requirements, limits on large exposures, or rules on asset investment), corporate governance requirements, and, possibly, structural controls (or limits on the activities that institutions of a specific description may undertake). The two objectives thus define jointly the terrain of prudential regulation. This leaves us with two generic types of regulation and supervision:

- *prudential regulation*, focusing on the economic viability of financial institutions and aiming at (a) the personal protection of their clients against the risk of default; and (b) the protection of the financial system in general against the risk of contagious failures and/or large-scale financial crises (a purely public objective); and

- *conduct-of-business regulation*, aiming at the compliance of financial institutions (especially securities and insurance firms) with acceptable standards of behavior in their bilateral relationships with their clients.<sup>45</sup>

The distinction between the two types of regulation is highly important for the architecture of the financial regulatory system. The best-known proposal in this regard is Michael Taylor's "twin peaks" model, according to which financial regulation must be organized in two pillars, based on the main objectives and tools: a prudential supervisory agency for banks and a single conduct-of-business agency.<sup>46</sup> At first, Australia (1996–2001)<sup>47</sup> and, more recently, the UK (2012) implemented variations of this model.<sup>48</sup> For Europe as a whole, the idea was voiced in the de Larosière Report,<sup>49</sup> but has not yet been followed.

In the prudential field, one could still distinguish between the prudential regulation of institutions whose potential failure is presumed to have systemic implications (in particular, banks), to which both objectives apply, and the prudential regulation of other institutions (such as most securities intermediaries and insurance companies) whose objective is limited to the protection of their immediate clients and counterparties. This distinction may have implications for the differentiation of the regulatory objectives and approaches across sectors. The traditional assumption is that banks, due to their specific financial structure and/or mutual links, raise particular systemic concerns.<sup>50</sup> In contrast, while insurance companies (especially life assurance companies) require strict prudential controls for the protection of policyholders, they are of little systemic importance. The same applies to securities firms, which may not even require substantial prudential controls at the individual level, because they do not issue liabilities to retail clients. However, the situation may have changed. Financial walls between the sectors have broken down as a result of the emergence of financial conglomerates. The increasingly strong interconnections between banks and other intermediaries, especially through complex securities financing transactions, suggest that the sectors can no longer be distinguished on this basis.

The distinction may, however, serve as a criterion for the allocation of supervisory tasks. Prudential responsibilities could, accordingly, be assigned to a different authority for each category.<sup>51</sup> Still, it is interesting to note that the recent emergence of macro-prudential oversight weakens this distinction. Macro-prudential oversight has solely public (systemic) objectives but, due to its focus on concentrations of exposures across financial institutions, interconnectedness, and vulnerabilities to common shocks, the scope of its assessments cannot be limited to the "systemically significant" institutions but must cover all segments of the financial industry. Moreover, some of its tools apply generally – even though banks are bound to be affected more immediately than other intermediaries.

As for conduct-of-business regulation, it might be useful to treat it separately from another broad category of regulatory interventions, namely the regulation of organized financial markets, including payment and settlement systems, and market-based transactions. The former focuses on the intermediary-client relationship. In contrast, *market regulation* relates to the organization of multilateral markets and exchanges, the specification of transactional procedures and traded products, their membership rules, the oversight of members' activities, and the policing of trading rules, etc.; and its objectives are more diverse and, in a certain sense, wider. The primary objective of conduct-of-business regulation is the individual protection of clients. One could interpret market regulation in related terms, as a form of collective consumer protection, but this would not tell the whole story. The existence of organized, standardized, and continuous financial markets has broader implications. In this sense, market regulation is primarily about market-building and economic efficiency.<sup>52</sup> These are public-interest objectives.<sup>53</sup> The vague terms typically used to define the objectives of market regulation (such as fairness, integrity, efficiency, or orderly operation) obfuscate its forward-looking, economic-policy-based elements and weak connection to the narrower private interests of investors.<sup>54</sup>

## VI. Beyond the Core Objectives

It should be noted that the official definitions of regulatory objectives discussed above, just like the associated academic debates, relate to the mandate, tasks, and organizational structure of the main financial supervisory agencies, namely those responsible for the licensing and continuous supervision of regulated enterprises and markets. The objectives of financial regulation may appear in a different light if one extends the discussion to cover the complete network of legal norms and regulatory interventions affecting the financial sector.

In a very broad sense, financial regulation would therefore include the "regulation" of contractual or transactional behavior, even when this relies on civil liabilities or criminal prohibitions rather than administrative enforcement.<sup>55</sup> Even within the confines of public law,<sup>56</sup> however, certain matters may fall outside the purview and administrative responsibility of the main agencies. And in many cases, relevant intervention will not be part of an overarching regime but will take the form of issue-specific enactments and enforcement regimes, with discrete, special objectives.

In particular, the financial sector is not exempt from the application of competition law, a horizontal policy.<sup>57</sup> In most market segments, competition is fierce but several supporting systems (for instance, payment and clearing systems, credit card

networks, etc.) are characterized by network economies and/or strong economies of scale, thus raising competition issues (prevention of abuse of a dominant position or anticompetitive agreements, provision of rights of access, system interoperability). Merger controls may also be relevant in connection with larger intermediaries. The most important concern, however, may be state aid, including that in the form of bailouts for failing banks.<sup>58</sup>

It is also common practice to establish special administrative enforcement tools in support of interests of a primarily private nature. This is true for a variety of cases, such as consumer credit and payment services in the banking field. Social regulation makes its appearance more rarely, for instance in the form of mandatory provision of basic transactional account services by banks as a means of combating financial exclusion.<sup>59</sup>

Finally, the regulatory regime may be put in the service of anti-crime policy. The example of the UK, where the fight against financial crime is included in the objectives of the main regulatory agencies, has already been mentioned. Yet regulatory requirements against money laundering bind financial institutions the world over.<sup>60</sup> In this case, the regulatory regime supports the enforcement of criminal law without, however, determining its content. Of course, more often than not, the relationship will take the opposite course, meaning that various duties created under the regulatory regime will be enforced by way of criminal penalties. A conspicuous example is the criminal enforcement of the European market abuse regime.<sup>61</sup>

When all these facets are taken into account, it becomes clear that the objectives of financial regulation are neither clear-cut nor static. The identification of core objectives has a certain usefulness. In particular, it is important for determining the regulatory system's general architecture. It can also support coherent policy-making and inform individual supervisory decisions in the core areas. But it cannot delimit the field of financial regulation or prevent the grafting of new purposes and directions onto its evolving framework.

1 On 1960s regulatory thinking, see A.H. Meltzer, 'Major Issues in the Regulation of Financial Institutions', *Journal of Political Economy*, vol. 75, 1967, pp. 482–501.

On UK banking policies in the early post-WWII period (1945–70), see C. Hadjiemanuil, *Banking Regulation and the Bank of England*, LLP, London, 1996, pp. 3:26.

2 See M. Goodfriend and R.G. King, 'Financial Deregulation, Monetary Policy, and Central Banking', *Federal Reserve Bank of Richmond Economic Review*, vol. 74:3 (May-June 1988), pp. 4–8.

3 For present purposes, it is unnecessary to delve into the distinction between public justification of regulatory measures (that is, their putative economic rationale and/or the rationalizations offered in their support) and the private reasons of their promoters and legislators (that is, their motives for working towards the enactment or implementation of such measures). See, e.g., G.J. Benston, *Regulating Financial Markets: A Critique and Some Proposals*, AEI Press, Washington, D.C., 1999, pp. 7–11. Public choice theory teaches that regulatory intervention frequently serves, not the general public interest in market efficiency, economic growth, minimiza-



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tion of risk and the like, but the narrower private interests of its promoters. Since the present discussion is merely intended to describe the stated objectives of the current system of financial regulation, it is sufficient to assume that the officially proclaimed objectives are true ones, and not a sham.

4 All are included in the Financial Stability Board's list of 14 'Key Standards for Sound Financial Systems', [http://www.financialstabilityboard.org/what-we-do/about-the-compendium-of-standards/key\\_standards/](http://www.financialstabilityboard.org/what-we-do/about-the-compendium-of-standards/key_standards/).

5 BCBS, 'Core Principles for Effective Banking Supervision', Sept. 2012, p. 10.

6 *ibid.*, p. 21.

7 *ibid.*

8 In the original version of BCBS principles, the same idea was expressed in more nuanced terms. The systemic dimension of prudential regulation was emphasized, but linked to certain complementary considerations, such as the preservation of confidence, the protection of depositors, and the promotion of market discipline: "the key objective of supervision is to maintain stability and confidence in the financial system, thereby reducing the risk of loss to depositors and other creditors; supervisors should encourage and pursue market discipline by encouraging good corporate governance ... and enhancing market transparency and surveillance." It was further stated that "[b]anking supervision should foster an efficient and competitive banking system that is responsive to the public's need for good quality financial services at a reasonable cost." In addition, the limits of prudential regulation were recognized, by noting that "there is a trade-off between the level of protection that supervision provides and the cost of financial intermediation. The lower the tolerance of risk to banks and the financial system, the more intrusive and costly supervision is likely to be, eventually having an adverse effect on innovation and resource allocation." BCBS, 'Core Principles for Effective Banking Supervision (Basel Core Principles)' (Sept. 1997), pp. 9-10.

9 BCBS, 'Core Principles ...', Sept. 2012, pp. 14-16. Specifically on the deposit insurance component of the safety net, see International Association of Deposit Insurers (IADI), 'IADI Core Principles for Effective Deposit Insurance Systems', Nov. 2014.

10 IAIS, 'Insurance Core Principles, Standards, Guidance and Assessment Methodology', 19 Oct. 2013, p. 16. Initially, efficiency was also mentioned; IAIS, 'Insurance Core Principles', Principles No. 1, Oct. 2000, p. 4.

11 IAIS, 'Insurance Core Principles, Standards, ...', 19 Oct. 2013, p. 16.

12 *ibid.*, p. 15.

13 IOSCO, 'Objectives and Principles of Securities Regulation', June 2010, p. 3. Originally, in IOSCO, 'Objectives and Principles of Securities Regulation', Sep. 1998, pp. 6-8.

15 *ibid.*, p. 6.

16 *ibid.*, pp. 6-7.

17 *ibid.*

18 *ibid.*, pp. 7-8.

19 *ibid.*, p. 8.

20 Financial Services and Markets Act 2000 (FSMA), as originally enacted, ss. 2-6.

21 FSMA, as amended by the Financial Services Act 2012, pt. 2. On the "twin peaks" model, see below, text and fn. 46-49.

22 FSMA, as amended, ss. 2B-2C.

23 FSMA, as amended, s. 2B(3).

24 FSMA, as amended, ss. 1B-1E.

25 FSMA, as amended, s. 1C(2).

26 FSMA, as amended, s. 1D(2).

27 FSMA, as amended, s. 1H(3). In the original version of the FSMA, s. 6(3), the definition of financial crime did not include the financing of terrorism.

28 FSMA, as amended, s. 1E(2).

29 In contrast, front-line supervision remains a competence of the several Member States. In particular, each Member State is required to entrust the administrative responsibility for the licensing and continuous supervision of each category of financial institutions to a supervisory agency ("national competent authority"). Tasks are divided horizontally between the various countries' authorities in accordance with the principle of "home-country control", so that the supervisory responsibility

for each financial institution belongs to the country the of which that institution happens to have its seat and center of operations. Of course, due to the creation of the Banking Union, since 4 November 2014, the supervision of all banks ("credit institutions") in the euro area has passed to a Single Supervisory Mechanism (SSM), within which the central role belongs to a European institution, the ECB; Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, O.J. L 287, 29.10.2013, pp. 63-89.

30 Regulation (EU) No. 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, O.J. L 331, 15.12.2010, pp. 12-47.

31 Regulation (EU) No. 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC, O.J. L 331, 15.12.2010, pp. 48-83.

32 Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, O.J. L 331, 15.12.2010, pp. 84-119.

33 The three agencies are called "supervisory" (ESAs), but this is a misnomer, since they have very limited supervisory responsibilities and their actual tasks are primarily of a regulatory nature.

34 Regulation 1093/2010, rec (11) and Art. 1(5); Regulation 1094/2010, rec (10) and Art. 1(6); and Regulation 1095/2010, rec (11) and Art. 1(5).

35 Regulation 1093/2010, Art. 1(5), first subpar.; Regulation 1094/2010, Art. 1(6), first subpar.; and Regulation 1095/2010, Art. 1(5), first subpar.

36 Regulation 1093/2010, Art. 1(5), third subpar.; Regulation 1094/2010, Art. 1(6), third subpar. (with reference to "financial market participants," instead of "financial institutions"); and Regulation 1095/2010, Art. 1(5), third subpar.

37 A. Crockett, 'Marrying the Micro- and Macro-Prudential Dimensions of Financial Stability', speech at the Eleventh International Conference of Banking Supervisors, Basel, 20-21 September 2000, <http://www.bis.org/speeches/sp000921.htm>; C. Borio, 'Towards a Macroprudential Framework for Financial Supervision and Regulation?', *BIS Working Paper* No 128, Feb. 2003.

38 Regulation (EU) No. 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, O.J. L 331, 15.12.2010, pp. 1-11, rec. (1). See L. Bini Smaghi, 'Going Forward – Regulation and Supervision after the Financial Turmoil', speech at the 4th International Conference of Financial Regulation and Supervision, 'After the Big Bang: Reshaping Central Banking, Regulation and Supervision', Bocconi University, Milan, 19 June 2009, <http://www.bis.org/review/r090623e.pdf>.

39 Regulation 1092/2010, rec. (10) and Art. 3(1).

40 Macro-prudential measures may take the form either of add-ons to normal prudential requirements, in an attempt to enhance the resilience of financial institutions, or of independent interventions, such as quantitative restrictions on credit expansion, reserve requirements, caps on loan-to-value ratios, levies on particular activities, etc., which seek to dampen the financial cycle. See S. Claessens, 'Overview of Macroprudential Policy Tools', *IMF Working Paper* No. WP/14/214, Dec. 2014.

41 Cf. IMF, 'The Interaction of Monetary and Macroprudential Policies', 29 Jan. 2013, <https://www.imf.org/external/np/pp/eng/2013/012913.pdf>.

42 Commission Staff Working Document, 'Economic Review of the Financial Regulation Agenda', SWD(2014) 158 final, 15 May 2014, p. 8, pp. 49-50.

43 C. Goodhart, P. Hartmann, D. Llewellyn, L. Rojas-Suarez and S. Weisbrod, *Financial Regulation: Why, How And Where Now?*, London: Routledge, 1998, pp. 2-9.

44 *ibid.* A variation of this classification appears in D. Llewellyn, 'The Economic Rationale for Financial Regulation', *FSA Occasional Paper* No. 1, Apr. 1999, 9-12, where the objectives are said to include systemic stability, the safety and soundness of financial institutions, and the protection of the consumer. This classification is not convincing, because Llewellyn explicitly considers the prudential objective of avoiding failure to be a subcategory of consumer protection. If so, the second objective is redundant: safety and soundness may form the prudential leg of consumer protection or, in relation to significant institutions, it may simultaneously serve the systemic and the consumer protection objectives, but it can never have a separate purpose. This leaves only two overarching objectives: fostering financial stability and protecting the customers of financial services. See, e.g., 'Report of the High-Level Group on Financial Supervision in the EU', 25 Feb. 2009 ('de Larosière Report'), p. 13.

45 See Llewellyn, *op. cit.* (fn. 44), pp. 9-10.

46 M. Taylor, "Twin Peaks": A Regulatory Structure for the New Century', *CSFI Paper* No. 20, Center for the Study of Financial Innovation, London, Dec. 1995. This division of supervisory work is also consistent with the partial collapse (due to deregulation, financial innovation, and the emergence of multifunctional financial



groups or “conglomerates”) of legal and market-based barriers, which, in the past, kept the three financial sectors and their respective supervisors segregated. See also C. Hadjiemmanuil, ‘Institutional Structure of Financial Regulation: A Trend towards “Megaregulators”?’, *Yearbook of International Financial & Economic Law*, vol. 2000-2001, pp. 127-190.

47 Australian Prudential Regulation Authority Act 1998; Australian Securities and Investments Commission 2001.

48 Financial Services Act 2012.

49 Op. cit. (fn. 44).

50 See E.A.J. George, ‘Are Banks Still Special?’, *Bank of England Quarterly Bulletin*, vol. 37 (1997), pp. 113-118.

51 See, e.g., Goodhart et al., op. cit. (fn. 43), pp. 159-168.

52 R. Baldwin, M. Cave and M. Lodge, *Understanding Regulation: Theory, Strategy, and Practice*, 2nd ed, Oxford University Press, Oxford, 2012, p. 3, note that, while regulation is often thought of as a means of preventing undesirable activities, it may well have an enabling or facilitating purpose, e.g., “where the airwaves are regulated so as to allow broadcasting operations to be conducted in an ordered fashion, rather than left to the potential chaos of an uncontrolled market.”

53 Specifically, with regard to market infrastructures, systemic risks are an evident policy priority. Such risks, however, are better addressed at the technical and contractual design level than by way of continuous supervision. See Committee on Payment and Settlement Systems and IOSCO Technical Committee, ‘Principles for Financial Market Infrastructures’, Apr. 2012.

54 Nonetheless, the instrumentalist objectives of market regulation are made clear in the Commission Staff Working Document, op. cit. (fn. 42), and, especially, in the Commission Green Paper, ‘Building a Capital Markets Union’, COM(2015) 63 final, 18 Feb. 2015.

55 For various definitions of regulation, ranging from the exceedingly wide to the rather narrow, see R. Baldwin, M. Cave and M. Lodge, *Understanding Regulation: Theory, Strategy, and Practice*, 2nd ed, Oxford University Press, Oxford, 2012,

pp. 2–3; and the following entries in N.J. Smelser and P.B. Baltes (eds.), *International Encyclopedia of the Social & Behavioral Sciences*, Elsevier Science, Oxford, 2001: D.E.M. Sappington, ‘Regulation, Economic Theory of’, p. 12951 (regulation as the act of controlling or directing by a rule, principle, or method, thus encompassing many forms of control by a variety of actors); S. Sterett, ‘Regulation and Administration’, p. 12945 (regulation as the effort to shape significant institutions to serve some social concerns that might not be taken into account in the ordinary process of doing business, or the imposition of legal orders on those engaged in economic activity); N.L. Rose, ‘Regulation, Political Economy of’, p. 12967 (regulation as use of the coercive power of the state to alter firms’ pricing, entry, production, investment, or product choice decisions).

56 That is, if regulation is defined in a narrower sense as the “sustained and focused control exercised by a public agency over activities that are valued by a community,” P. Selznick, ‘Focusing Organizational Research on Regulation’, in R.G. Noll (ed.), *Regulatory Policy and the Social Sciences*, Berkeley: University of California Press, Berkeley, 1985, p. 363.

57 The applicability of European competition law to banking institutions was recognized in Case 172/80, *Gerhard Züchner v. Bayerische Vereinsbank A.G.* [1981] ECR 2021.

58 For the European policy on the matter, see now ‘Communication from the Commission on the application from 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis (“Banking Communication”)’ (2013/C 216/01), OJ 2013 C216/1.

59 See C.V. Gortsos, ‘A Primer on Financial Inclusion’, contribution to a Festschrift in honor of Stelios Perakis, forthcoming (2016).

60 See Financial Action Task Force (FATF), ‘International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations’ (Feb 2012).

61 Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive), O.J. L 173, 12.06.2014, pp. 179–189.

# Criminal Liability of Heads of Business

## A Necessary Pillar in the Enforcement of the Protection of the Financial Interests of the EU

Prof. Dr. Katalin Ligeti

The 1995 Convention on the Protection of the Financial Interests of the European Communities (hereafter “PIF Convention”) already acknowledged “that businesses play an important role in the areas financed by the European Communities and that those with decision-making powers in business should not escape criminal responsibility in appropriate circumstances.”<sup>1</sup> The PIF Convention, therefore, stipulated in Art. 3 a provision on the criminal liability of heads of business.<sup>2</sup> Later, the Second Protocol to the PIF Convention extended criminal liability to legal persons.<sup>3</sup> From then on, in the EU’s criminal policy, individual criminal liability of senior corporate officials for severe failures of management duties and responsibilities for PIF offenses has been complemented with corporate criminal liability.<sup>4</sup>

The approach of the EU, requiring in particular, the imposition of criminal liability on heads of business for grave manage-

ment failures, was certainly innovative at that time. It signaled that, in the eyes of the EU legislature, individual criminal liability of low-level employees, corporate criminal liability, and compliance schemes were not a sufficient basis for a sustainable and effective legal program to deter PIF offenses.

This early commitment of the EU legislature of working towards a level playing field for the liability of heads of business within the Area of Freedom, Security and Justice seems, however, to have been discontinued. In 2012, the EU Commission tabled a Proposal for a Directive on the fight against fraud concerning the Union’s financial interests by means of criminal law (hereafter “PIF Directive”).<sup>5</sup> The PIF Directive aims at “lisbonising”<sup>6</sup> the PIF *acquis* and will, therefore, replace the PIF Convention and its Protocols. However, the envisaged new EU legal framework no longer contains any provision on the criminal liability of heads of business.

In contrast to the development in the PIF field, in the financial sector, the call for individual criminal liability of corporate officials is becoming increasingly louder in the Member States. In general, in the aftermath of the global financial crisis, only a few heads of business have been charged with financial crimes.<sup>7</sup> To shareholders of financial institutions, the impunity of senior managers gave the impression that they were the ones who ultimately suffered instead of the senior managers, whose actions caused the collapse of the financial institutions.<sup>8</sup> Because taxpayers' money was used to save the bankrupt financial institutions, regulators have been severely criticized for their inability to sanction the senior individuals responsible for the institutions' wrongdoing.<sup>9</sup> The discussion was not limited to criminal liability *stricto sensu* but has also included liability under punitive administrative law. In the following, the term *punitive liability* will stand for both criminal liability and liability under punitive administrative law.

These critiques led several countries to reconsider the punitive liability of heads of business in the financial industry. The 2015 reform of the UK regulatory regime for financial services is a recent example that characteristically reflects the trend towards increased individual liability on the part of heads of business for "bad management" by introducing the so-called senior managers' regime (hereafter "SMR").<sup>10</sup> Such developments echo the approach of the new European regulatory framework in the area of financial and banking services<sup>11</sup> that requires Member States to impose punitive administrative sanctions not only against legal persons, but also against natural persons.

This article argues that punitive liability of heads of business represents a pillar in the enforcement of the PIF *acquis*. The article begins with some conceptual clarification as to the notion and scope of punitive liability of heads of business and give a brief overview of the existing EU legislation. The rather modest approximation achieved so far in the PIF *acquis* will be compared with developments in the financial sector. The concluding remarks assert that the inconsistent allocation of responsibility and liability to the corporation, its senior officials, and other (lower-level) employees results in an enforcement gap in relation to crimes affecting the EU's financial interests and undermines the legal protection of the individual head of business in the Area of Freedom, Security and Justice.

## I. Notion and Scope of Liability of Heads of Business

The need for and added value of introducing criminal liability of heads of business has been long discussed both in Europe and the US.<sup>12</sup> From a criminal law viewpoint, the core idea of liability of heads of business is to punish managers and corporate officials for failing to prevent the wrongs committed by

others, especially lower-level employees. This failure can take different forms. For instance, a head of business may be aware of the criminal behavior of others, but willfully refuse to intervene, or he/she may suspect what is happening, or will most likely happen, but deliberately turn a blind eye to the behavior, even though the matter clearly requires further investigation. He/she may also negligently fail to exercise sufficient control over other persons, even though he/she is in a position to do so and is expected to supervise them.

Therefore, criminal liability of heads of business may take different legal forms. It can be autonomous or derived liability, based on intent, *dolus eventualis*/recklessness, or negligence. The main difficulty is determining which legal duties of the heads of business may qualify as a basis for criminal liability, as well as to assess whether these duties have been met in practice or not. A related question is whether the head of business's duty of control and supervision is based on a general legal duty of care or on specific legal duties of care. Furthermore, these duties are most likely also entrenched in corporate governance rules, which determine the allocation of decision-making powers and control within the corporation.<sup>13</sup>

In addition, a further relevant dimension when analyzing the liability of heads of business is that of administrative law. Legal systems usually create different, alternative, or complementary enforcement tools to tackle corporate crime. For instance, in European systems, criminal enforcement is often augmented by administrative enforcement. In fact, national approaches to the punitive liability of heads of business vary from extending the general principles of criminal participation, to providing for specific rules of liability in the general or the special parts of the criminal code or in administrative law. Some Member States, such as the Netherlands, pursue a double track approach by providing for the administrative liability of the "leading person" (*leidinggevend*) in administrative law<sup>14</sup> and for the "vicarious liability" of the supervisor for the offenses committed by the legal person according to the criminal code,<sup>15</sup> thus leading to the cumulative criminal liability of the head of business and the legal person.<sup>16</sup> Germany still excludes corporate criminal liability. It allows, however, for liability of heads of business in the general part of the criminal code<sup>17</sup> as well as within the regime on administrative regulatory offenses.<sup>18</sup> Finland provides for the criminal liability of both heads of businesses and heads of corporations but lacks punitive administrative liability.<sup>19</sup> Conversely, Poland has a well-developed regime of punitive administrative enforcement, while also providing for extensive rules on participation in the commission of the offense. Paradoxically, its legislation contains a regime of corporate liability, but it is not used in practice.<sup>20</sup> France provides for various criminal provisions specifically targeting senior managers of limited companies and other entities.<sup>21</sup>



These examples indicate that national criminal justice systems approach the punitive liability of heads of business in fundamentally different ways. Although the examples are of a general scope, i.e., not only limited to punitive liability in relation to PIF offenses, such variation in national approaches is surprising in light of the decade-long efforts of the EU Commission to approximate the criminal liability of heads of business for PIF offenses.

## II. Punitive Liability of Heads of Business for PIF Offenses

Against the backdrop of the important role that business and, in particular, its senior officials play in committing PIF offenses, and being mindful of the above-mentioned diversity of national approaches,<sup>22</sup> Art. 3 of the PIF Convention included a provision on the harmonization of the criminal liability of heads of business in order to better protect the EU's financial interests. Accordingly, "each Member State shall take the necessary measures to allow heads of business or any persons having power to take decisions or exercise control within a business to be declared criminally liable in accordance with the principles defined by its national law in cases of fraud affecting the European Community's financial interests, [...], by a person under their authority acting on behalf of the business."

The wording of Art. 3 was repeated *verbatim* in the provision of Art. 6 of the Convention on the Fight against Corruption involving Officials of the European Communities and Officials of Member States of the European Union.<sup>23</sup> Provisions on the criminal liability of heads of business were also included in the Protocols attached to the PIF Convention. Art. 7(1) of the 1996 Protocol to the Convention states that criminal liability of heads of business should also be provided in cases of corruption.<sup>24</sup> Art. 12 of the 1997 Protocol to the Convention refers directly to Art. 3 of the PIF Convention as also being applicable in cases of money laundering.<sup>25</sup>

Although Art. 3 of the PIF Convention was innovative in its approach to introducing criminal liability of heads of business, its harmonizing effect was, however, rather modest. This is mainly due to the reference in the provision to "the principles defined by [the] national law" of the implementing Member State. This was understood by the Member States as a possibility to shape freely the punitive liability of heads of business for PIF offenses. This was confirmed both by the 2004 and the 2008 Commission reports on the implementation of the PIF Convention,<sup>26</sup> which noted considerable gaps in the implementation of the cited provision in the Member States. The 2004 report stated that "the Member States have shown a certain reluctance to scrutinise their national systems with re-

gard to the concept of criminal liability of heads of businesses. [...] Member States are simply relying on what is already to be found in their national laws. The Commission is not convinced that the reference to existing domestic provisions is sufficient and believes that incompatibilities continue to exist by virtue of the fact that a decision-maker is liable under different circumstances depending on the country concerned."<sup>27</sup> This rather negative evaluation of the Commission was largely reiterated in the 2008 report,<sup>28</sup> indicating that Member States made little progress in implementing the criminal liability of heads of business for PIF offenses.

The reluctance of the Member States *vis-à-vis* this type of criminal liability cannot, however, be explained by traditional sovereignty concerns alone, which are even more apparent as regards the general part of substantive criminal law.<sup>29</sup> Implementing Art. 3 of the PIF Convention undeniably confronted national legislatures with a series of important conceptual questions: Precisely who should be considered heads of business?<sup>30</sup> What type of behavior should they be held responsible for (lack of control, aiding and/or abetting)? How are the actions or omissions of subordinates attributable to them? If *mens rea* is not required for the assumption of criminal liability, should it be based on vicarious or strict liability schemes? How does this relate to the general principles of criminal law, such as the principle of individual guilt? And, if *mens rea* is required, does this lead to evidentiary issues? What role is there for punitive administrative law?

The complexity of these questions coupled with the timid efforts of the Member States to implement Art. 3 of the PIF Convention led the authors of the *Corpus Juris* to propose a European model provision.<sup>31</sup> Art. 13 of the *Corpus Juris*<sup>32</sup> stipulated criminal liability in cases of offenses defined by the *Corpus Juris* when such offense had been committed for the benefit of the business by a person acting under the authority of another person who was the head of business, or who controlled or exercised the power to make decisions within it, provided that the head of business had "knowingly allowed the offence to be committed." Art. 13(3) extended the criminal liability of the head of business to situations where the head of business failed to exercise the necessary supervision over the person under his/her authority, if such failure facilitated the commission of the offense. The model of the *Corpus Juris* required intent for the criminal liability of the head of business<sup>33</sup> and thereby rejected vicarious or strict liability. Although the model of the *Corpus Juris* was rather restrictive due to the required *mens rea*, it seems not have had any practical impact on shaping the respective laws in the Member States.

This brief overview shows that the main weakness of the pre-Lisbon EU legal framework on the criminal liability of heads

of business was its large reliance on principles of national law. Member States have come up with divergent solutions, some even being reluctant to accept this form of liability.

The need for the criminal liability of heads of business with regard to the protection of the EU's financial interests was again put on the table in the context of the proposed PIF Directive. The impact assessment accompanying the Commission's proposal restated the considerations already expressed in the 2004 and 2008 Commission reports on the implementation of the PIF Convention.<sup>34</sup> In more detail, the impact assessment noted that some Member States apply restrictive definitions requiring that the persons within its scope hold a certain formal level of power in the organization, or only hold them criminally liable if they know and support the concrete criminal conduct of their subordinates. This unduly restricts liability to those holding official power with effect outside the organization. The intentional breach is often committed at a preparatory stage by employees who do not hold positions with effect outside the organization, e.g., members of committees, assistants to the board of directors, etc. In addition, problems in finding and admitting evidence often prevent the sanctioning of the actual perpetrator within the organization, resulting in impunity. This diversity of national approaches has been understood as an expression of the lack of consensus on the matter among the Member States. Confronted with the resistance of the Member States and the relatively small success of the harmonization of punitive liability of heads of business, the EU Commission decided to drop the provision on the criminal liability of heads of business as a political compromise when drafting the new PIF Directive. It is worth noting that not even the relevant discussions in the European Parliament<sup>35</sup> and the Council<sup>36</sup> make any reference to the issue.

### III. The competence of the EU to legislate on the Punitive Liability of Heads of Business for PIF Offenses

The fact that the PIF Directive is silent on the punitive liability of heads of businesses is certainly not liable to a lack of competence of the EU legislature to regulate on the matter, but it rather reflects a deliberate policy choice. Both Art. 325(4) TFEU and Art. 83(2) TFEU provide the EU legislature with the necessary competence to act. Originally, the European Commission grounded its Proposal for the PIF Directive on Art. 325(4) TFEU. It claimed that Art. 325(4) TFEU constitutes *lex specialis* compared to Art. 83(2) TFEU for adopting criminal law provisions in the specific field of the protection of EU's financial interests.

The Impact Assessment<sup>37</sup> and the Explanatory Memorandum<sup>38</sup> accompanying the Commission's Proposal claimed that the re-

ference in Art. 325(1) TFEU to "deterrent" confers the competence on the EU to adopt criminal law provisions based on this article. In the Commission's view, "deterrent" [...] comprises by nature, and historically (see the PIF Convention) a criminal law dimension, since criminal law is needed as a basis to create a risk for potential perpetrators to be caught under embarrassing circumstances, and thus disincentive to commit the illegal act in first place".<sup>39</sup> The Commission further argued that Art. 325 TFEU differently from its pre-Lisbon version (Art. 280 TEC), no longer excludes expressly the adoption of measures "impacting on national criminal law."<sup>40</sup> It, therefore, constitutes the legal basis for adopting criminal law measures for the protection of the financial interests of the EU and a *lex specialis* compared to the Treaty provisions of Title V. Finally, the Commission emphasized that Art. 325 TFEU provides for the protection of the EU's financial interests "against all angles of illegal attacks which can be envisaged"<sup>41</sup> and it is not limited only to the adoption of "minimum rules".

The reasoning of the Commission, in particular its claim on the comprehensive competence laid down in Art. 325 TFEU demonstrates that omitting the criminal liability of heads of businesses from the PIF Directive was not motivated by considerations linked to the competence to legislate. It is interesting to note, that the Commission's choice for the legal basis was contested by the Council. The Council's Legal Service (CLS) rejected the argument on the *lex specialis* character of Art. 325 TFEU and the teleological interpretation of the term "deterrent".<sup>42</sup> Instead it restated the horizontal application of Art. 83(2) TFEU for the adoption of criminal law provisions for the enforcement of all already harmonized Union policies including the protection of the EU's financial interests. The CLS recalled, in particular, the Final Report of Working Group X "Freedom, Security and Justice" of the European Convention that expressly referred to the protection of the EU's financial interests within the scope of the Title V provisions.<sup>43</sup> The Council's intervention resulted in changing the legal basis of the PIF Directive: Art. 325(4) TFEU was replaced by Art. 83(2) TFEU.<sup>44</sup> This new legal basis however is limited to adoption of "minimum rules with regard to the definition of criminal offences and sanctions". Art. 83 TFEU does not provide for adopting rules on the general part of substantive criminal law.

Irrespective of this limitation, the recent instruments enacted on the basis of Art. 83(1) TFEU<sup>45</sup> not only lay down the definition of constitutive elements of the offence and penalties, but they all require the criminalization of incitement, aiding and abetting and, more importantly, to provide for the liability of legal persons. One can, therefore, argue that even the new legal basis would allow the EU to legislate on the criminal liability of the head of business.

#### IV. Punitive Liability of Heads of Business in the Financial Sector

The financial crisis provoked a lively public debate over the individual liability of senior managers in the banking and financial industry who were commonly regarded as the real source of corporate wrongdoing. This led the EU legislature to start elaborating a framework for the punitive liability of natural persons in the area of financial and banking services.

In particular, the recently adopted legal framework on prudential supervision of credit institutions and investment firms applicable to all 28 Member States, the so called CRD IV package,<sup>46</sup> contains important provisions on punitive administrative sanctions against natural persons. Art. 9 (1) of the Capital Requirements Directive IV (CRD IV) prohibits persons or undertakings that are not credit institutions, from carrying out the business of taking deposits or other repayable funds from the public. According to Art. 66 (2) d CRD IV Member States have to ensure that in case of violation of this prohibition administrative penalties can be applied against natural persons. Administrative pecuniary penalties can go up to EUR 5 million. Subsection 5 of the EU Regulation on prudential requirements<sup>47</sup> stipulates uniform rules on corporate governance that specify the division of duties and decision-making powers concerning credit institutions and investment firms falling in the scope of the Regulation. It spells out the duties of senior managers, the breach of which may lead to the mentioned administrative sanctions. Since the CRD IV is a Directive, it has to be implemented into national law of the Member States. Therefore, the national laws of the Member States have to define and detail the conducts that represent a breach of the prohibition laid down in Art. 9 (1) CRD IV, as well as the scope of persons to whom the conduct rules apply. In addition, the national implementing legislation must define also the criteria for imposing punitive sanctions on natural persons in accordance with Art. 66 (2) d CRD IV. It has to stipulate, in particular, the *mens rea* requirements.

To sum up, the CRD IV package requires Member States to provide for punitive liability of individuals for violation of

rules of prudential supervision. National implementing legislation across the EU has to henceforth provide for the punitive liability of natural persons. The EU legislature, however, once again has refrained from setting uniform standards for the punitive liability of managers.

#### V. Concluding Remarks

To date, punitive liability of senior managers across Europe still appears largely unsatisfactory and, to a certain extent, at odds with the role that corporations and their representatives have assumed in present-day societies.

In general, and beyond the provisions related to the criminal law protection of the EU budget, the diversity of national legislation and practice enhances the risk of ineffective law enforcement and legal uncertainty. The divergent conceptual shape of punitive liability of heads of business impedes the well-functioning operation of the internal market and hampers cooperation between the criminal justice authorities of the Member States. The nationally oriented approaches and the current absence of a level playing field create opportunities for abuse by criminals and for avoiding liability. The fragmentation of laws is also problematic from the perspective of the legal protection of the head of business concerned. Due to the scattered national approaches, heads of business working for corporations that are active in several EU Member States are confronted with diverging national rules, for instance on due diligence. This leads to problems related to the principle of individual guilt (*nulla poena sine culpa*), the principle of legal certainty (*lex certa*), the principle of *ne bis in idem*, and the presumption of innocence.<sup>48</sup> There is a need to clarify and to critically rethink the punitive liability of heads of businesses from the perspective of the integrated legal order of the EU. The scope and the conditions of the liability of heads of businesses should be addressed in a coherent manner in the Area of Freedom, Security and Justice considering both criminal and punitive administrative law and taking into account at the same time the legal protection of the individual head of business concerned.

1 See the Preamble to the Convention on the protection of the European Communities' financial interests of 1995 ("PIF Convention") O.J. C 316, 27 November 1995.

2 Commission of the European Communities, Commission Staff Working Paper Annex to the Second Report from The Commission: Implementation by Member States of the Convention on the Protection of the European Communities' Financial Interests and its Protocols – Article 10 of the Convention, COM(2008) 188, 14 February 2008, p. 45 ff.

3 Second Protocol of the Convention on the protection of the European Communities' financial interests, O.J. C 221, 19 July 1997. The subject matter of the Protocol referred to money laundering, but Art. 3 obliged Member States to introduce the liability of legal persons with regard to money laundering, fraud

and active corruption. The fact that the PIF Convention originally did not contain provisions on the liability of legal persons is explicable by the attitude of the majority of the Member States that considered corporate criminal liability a red flag against approximation of criminal law. See details in J.A.E. Vervaele, *Fraud against the European Community: The need for European fraud legislation*, Kluwer, 1992, p. 313.

4 PIF offences" stands for fraud, corruption or money laundering affecting the EC's financial interests.

5 European Commission, Proposal for a Directive of the European Parliament and of the Council on the Fight against Fraud to the Union's Financial Interests by Means of Criminal Law, COM(2012) 363 final, 11 July 2012.



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- 6 "Lisbonisation" of an act refers to the legislative process by which acts of the former Third Pillar are repealed, annulled or amended. On the concept of "Lisbonisation" see T. Blanche, 'The genesis of Protocol 36', forthcoming in *New Journal of European Criminal Law*, 2015, Issue 4.
- 7 A. Keay, 'The Public Enforcement of Directors' Duties: A Normative Enquiry', in *Common Law World Review* 2014, p. 89 ff.
- 8 The discussion on the responsibility of heads of businesses for the bankruptcy of a company is long-standing – see, indicatively: R.K.S. Rao, D.S. Sokolow and D. White, 'Fiduciary Duty a la Lyonnais: An Economic Perspective on Corporate Governance in a Financially Distressed Firm', *Journal of Corporate Law*, 1997, p. 53 ff.; J.C. Lipson, 'The Expressive Function of Directors' Duties to Creditors', *Stanford Journal of Law, Business and Finance*, 2007, p. 224 ff.
- 9 A. Keay, 'The Public Enforcement of Directors' Duties', *op. cit.* [n. 7], p. 89 ff.
- 10 See the ongoing debate on the Bank of England and Financial Services Bill (HL Bill 75), available at <http://services.parliament.uk/bills/2015-16/bankofenglandandfinancialservices.html>
- 11 Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms ("Capital Requirements Directive IV" – CRD-IV), O.J. L 176, 27 June 2013 and the Regulation 575/2013/EU on prudential requirements for credit institutions and investment firms ("Capital Requirements Regulation" – CRR), O.J. L 176, 27 June 2013.
- 12 J.C. Coffee JR., 'No Soul to Damn, No Body to Kick: An Unscandalized Inquiry into the Problem of Corporate Punishment', *Michigan Law Review*, 1981, p. 407 ff.; T.L. Spiegelhoff, 'Limits of Individual Accountability for Corporate Crimes', *Marquette Law Review*, 1984, p. 604 ff.; E. Lederman, 'Criminal Law, Perpetrator and Corporation: Rethinking a Complex Triangle', *Journal of Criminal Law and Criminology*, 1985, p. 285 ff.; B. Fisse and J. Braithwaite, 'The Allocation of Responsibility for Corporate Crime: Individualism, Collectivism and Accountability', *Sidney Law Review*, 1988, p. 468 ff.; Dannecker G., 'Fahrlässigkeit in formalen Organisationen', in K. Amelung (ed.), *Individuelle Verantwortung und Beteiligungsverhältnisse bei Straftaten in bürokratischen Organisationen des Staates, der Wirtschaft und der Gesellschaft*, Pro Universitate, 2000, p. 209 ff.; K. F. Brickley, 'In Enron's Wake: Corporate Executives on Trial', *Journal of Criminal Law and Criminology*, 2006, p. 397 ff.
- 13 S. M. Kriesberg, 'Decisionmaking Models and the Control of Corporate Crime', *Yale Law Journal*, 1976, p. 1091 ff.; H. Hung, 'Directors' Roles in Corporate Social Responsibility: a Stakeholder Perspective', *Journal of Business Ethics*, 2011, p. 385 ff.; J. M. Dine, 'The Capture of Corruption: Complexity and Corporate Culture', *Global Business & Development Law Journal*, 2007, p. 263 ff.
- 14 Article 5 paragraph 1 of the General Administrative Act.
- 15 Article 51 paragraph 2 of the Criminal Code.
- 16 D.R. Doorenbos, 'Daderschap en aansprakelijkheid van leidinggevenden', in D.R. Doorenbos, M.J.C. Somsen (Eds.), *Onderneming en sanctierecht. Handhaving van financieel toezichtrecht, in het bijzonder onder de Wft en Pw*, Kluwer, 2013.
- 17 Section 14 of the German Criminal Code (StGB).
- 18 Section 9 of the Act on Regulatory Offences (OWiG).
- 19 Art. 7 of Chapter 48 of the Finnish Criminal Code. See R. Lahti, 'Über die Regelung der strafrechtlichen Verantwortung juristischen Personen in Finnland: Finlandiya Hukukunda Tüzel Kişilerin Ceza Sorumluluğu', in A. Nuhoğlu (Ed.), *Sanktionen gegen juristische Personen. Tüzel Kişiler Hakkında Uygulanan Yaptırımlar: International Colloquium in Honour of Prof. Dr. Dr. h.c. mult. Klaus Tiedemann*, Bahçeşehir Üniversitesi Yayınları, 2013, p. 115 ff.
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- 22 M. Delmas-Marty, 'Incompatibilities between Legal Systems and Harmonisation Measures: Final Report of the Working Party on a Comparative Study on the Protection of the Financial Interests of the Community', in Commission of the European Communities, *The Legal Protection of the Financial Interests of the Community: Progress and Prospects since the Brussels seminar of 1989*, 1993, p. 71.
- 23 Convention on the fight against corruption involving officials of the European

- Communities of officials of Member States of the European Union, O.J. C 195, 25 June 1997.
- 24 Protocol to the Convention on the protection of the European Communities' financial interests, O.J. C 313, 23 October 1996.
- 25 Second Protocol of the Convention, *op. cit.* [n. 3].
- 26 Commission of the European Communities, Report from the Commission: Implementation by Member States of the Convention on the Protection of the European Communities' Financial Interests and its Protocols – Article 10 of the Convention, COM (2004) 709 final, 25 October 2004, pp. 5-6; Commission of the European Communities, Second Report from The Commission: Implementation by Member States of the Convention on the Protection of the European Communities' Financial Interests and its Protocols – Article 10 of the Convention, COM (2008) 77 final, 14 February 2008, p. 3.
- 27 Report from the Commission: Implementation by Member States, *op. cit.* [n. 26], p. 5.
- 28 Second Report from the Commission, *op. cit.* [n. 26], 14 February 2008, p. 3.
- 29 Art. 83 TFEU does not contain a legal basis for EU competence to approximate the general part of criminal law. See H. G. Nilsson, 'How to combine minimum rules with maximum legal certainty?', *Europarättslig Tidskrift*, 2011, p. 669; A. Klip, *European Criminal Law. An Integrative Approach*, 2nd ed., Intersentia, 2012, p. 167-168, recognizes that the literal reading of the legal basis suggests a competence only for the "special part", but points out that "it will be inevitable to deal with the general part related issues if one deals with both definition and sanctions".
- 30 At the international level, the only definition of "person with a leading position" for the purpose of criminal law is provided in Art. 18 par. 1 of the 1999 Criminal Law Convention on Corruption of the Council of Europe, ETS 173.
- 31 The Explanatory Notes of the *Corpus Juris* stressed that criminal liability of heads of businesses was "necessary in economic and financial matters", but did not further detail their reasons. See M. Delmas-Marty, J.A.E. Vervaele (Eds.), *The Implementation of the Corpus Juris in the Member States*, Vol. I, Intersentia, 2000, p. 73 ff.
- 32 Art. 13 in the version of 1997; the provision, with an identical text, was later renumbered into Art. 12 of the 2000 version.
- 33 According to the Explanatory Notes of the *Corpus Juris* this liability required the "individual fault of the decision-maker who consciously allowed the offence to take place". See M. Delmas-Marty, J.A.E. Vervaele (Eds.), *op. cit.* [n. 31], p. 74.
- 34 European Commission, Commission Staff Working Paper – Impact Assessment accompanying the document Proposal for a Directive on the Fight against Fraud to the Union's Financial Interests by Means of Criminal Law, SWD (2012) 195 final, 11 July 2012, p. 16.
- 35 See the Interinstitutional File 2012/0193 (COD). The General Approach agreed in the Council is currently set out in Doc. 10729/13, 10 June 2013.
- 36 For the position and the debate in the European Parliament, see the European Parliament First Reading Report on the Proposal for a PIF Directive, A7-0251/2014, 25 March 2014.
- 37 Commission Staff Working Paper – Impact Assessment accompanying the document Proposal for a Directive, *op. cit.* [n. 34].
- 38 European Commission, Proposal for a Directive on the fight against fraud to the Union's financial interests by means of criminal law, *op. cit.* [n. 34].
- 39 Commission Staff Working Paper – Impact Assessment accompanying the document Proposal for a Directive, *op. cit.* [n. 34], p. 27.
- 40 *Ibid.*, p. 26 ff.
- 41 *Ibid.*, p. 27.
- 42 Council Legal Service, Opinion on the Legal basis for the PIF Directive, Doc. 15309/12, 22 October 2012.
- 43 See the Final Report of Working Group X "Freedom, Security and Justice" to the European Convention, CONV 426/02, 2 December 2002, p. 10. The CLS recalled the "protective mechanisms" of Art. 83(2) TFEU (emergency brake and the opt-out regime). Accordingly, "a change of the legal basis would be tantamount to circumventing this protective mechanism established by the Treaty".
- 44 Interesting to note that the European Parliament – notwithstanding the opinion of its Committee on Legal Affairs – supported the Commission's choice for Art. 325 TFEU. See the European Parliament First Reading Report, *op. cit.* [n. 36].
- 45 Directive 2011/36/EU on preventing and combating trafficking in human beings and protecting its victims, and replacing Council Framework Decision 2002/629/JHA, O.J. L 101, 15 April 2011; Directive 2013/40/EU on attacks against information systems and replacing Council Framework Decision 2005/222/JHA, O.J. L 218, 14 August 2013; Directive 2014/62/EU on the protection of the euro and other currencies against counterfeiting by criminal law, and replacing Council Framework Decision 2000/383/JHA, O.J. L 151, 21 May 2014.
- 46 Directive 2013/36/EU, *op. cit.* [n. 11].
- 47 Regulation 575/2013/EU, *op. cit.* [n. 11].
- 48 M.J.J.P. Luchtman, A.A.H. Van Hoek, 'Transnational Cooperation in Criminal Matters and the Safeguarding of Human Rights', *Utrecht Law Review*, 2005, p. 1 ff.



# Investigative and Sanctioning Powers of the ECB in the Framework of the Single Supervisory Mechanism

## Mapping the Complexity of a New Enforcement Model

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In most publications that deal with the Banking Union, the global financial crisis of 2008 is mentioned in the introductory paragraph. It is also the unavoidable starting point of this contribution, as it is the collapse of the banking sector that has shown the necessity to rethink the mechanism of banking supervision. Economic growth and financial stability have been seriously damaged by the global crisis that has plagued the world since 2007. The financial and banking crisis shed some light on the need for stronger and more efficient supervision but also on the need for a more effective system of sanctions and penalties to be applied. In particular, the Eurozone proved to be particularly exposed to the waves of the market because of the differences in supervision policies among the Member States which adopted the Euro as a single currency.

Whether more effective banking supervision could have prevented the crisis is not sure, but at least the crisis uncovered one of its most fundamental flaws, namely that banking supervision based on the Westphalian model of the nation-state, is not capable to grasp the risks inherent to the banking sector. The banking system has played a key role in the financial crisis: major bank groups suffered deficits and debt positions, leading a number of them to seek State aid. In Eurozone countries, the banking and sovereign debt crises highlighted the flaws of a common monetary and currency Union without consistency of banking supervision. Indeed, when the bankruptcy of Lehman Brothers dragged major European banks into the crisis, it became clear that if risk knows no borders, neither should supervision. National regulators were faced with their insufficiency to face global problems and Eurozone Member States were particularly subject to spill-over effects from each other's budgetary policies.

This insight nourished the desire to achieve deep supervisory integration, a desire which eventually gave birth to a centralised structure, baptised the “European Banking Union”<sup>1</sup>. Since 2010, the EU Commission has therefore taken an inclusive approach supporting the swift progress towards an integrated financial framework as a vital part of the policy measures to put Europe back on the path of financial stability, economic recovery and growth.<sup>2</sup> In September 2012 the Commission present-

ed a communication entitled “A Roadmap towards a Banking Union” in order “to break the link between sovereign debt and bank debt and the vicious circle which has led to over €4,5 trillion of taxpayers money being used to rescue banks in the EU”.<sup>3</sup>

“The European Banking Union places the European Central Bank (ECB) at the heart of banking supervision in Europe and in particular in the Eurozone. It represents a product of a recent tendency to transfer “decisive regulatory powers as well as powers concerning enforcement – investigations, measures and penalties – to the EU level”.<sup>4</sup>

This article offers an account on the Single Supervisory Mechanism, its functioning and its articulated sanctioning system, composed of administrative measures and penalties. Part I analyses the institutional design and the complex legal framework composed of both directly applicable European rules and national law implementing the Capital Requirements Regulation (CRR)<sup>5</sup> and the Capital Requirements Directive (CRD IV).<sup>6</sup> We will try to shed some light on the division of tasks between the ECB and the national competent authorities (NCAs) operating at national level. Part II explores the investigatory powers the measures and penalties applicable in the framework of banking supervision and the proceedings for their enforcement. It will also discuss their controversial nature: administrative, punitive or quasi-criminal? Part III examines judicial protection for the supervised entities. Specific attention will be given to judicial review. Part IV will outline some conclusions.

### I. The SSM: a *Mechanism* of Single Supervision

The Single Supervisory Mechanism is part of a broader architecture that aims to consolidate the banking sector of the European Union. This project is named the European Banking Union, and is built on three pillars: The Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM),<sup>7</sup> and a uniform deposit guarantee scheme.<sup>8</sup> This entire construction rests upon the foundations of the so-called Single Rulebook, which is composed of the CRR and the CRD IV. It contains a harmonised set of rules that aim to safeguard the

soundness, stability and integrity of the banking system, also referred to as “prudential regulation”. Such regulation consists in requirements such as capital buffers, liquidity ratios, or large exposure limits on banks. Far from being an example of “rule making by principles”, the CRR and CRD IV provide detailed and precise enforceable rules.<sup>9</sup> The two legal instruments represent the substantive law on prudential and capital requirements for credit institutions in the European Union based on the international agreement called ‘Basel III’<sup>10</sup> and they are applicable in both Eurozone and non-Eurozone Member States. It is relevant to highlight that the different pillars of the banking union do not have the same territorial scope. While the SSM is limited to the Eurozone, all other pillars are applicable in the whole European Union. Within the Banking Union, the role of the SSM is to ensure that Eurozone banks respect the prudential requirements that are imposed on them.

The SSM is shaped by Council Regulation (EU) n° 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (hereinafter the SSMR). As its title suggests, the SSMR entrusts the ECB with the enforcement of prudential regulation. To that aim, the SSMR provides the ECB with a supervisory toolbox composed of investigative measures, administrative measures as well as administrative penalties. Nevertheless, the SSM does not put the task of banking supervision exclusively on the shoulders of the ECB as the only supervisor. As revealed by its name, the SSM is a mechanism. It is a mechanism that, while relying on the assistance, cooperation and expertise of multiple national supervisory authorities, achieves single supervision of the Eurozone banking sector.

Within the SSM, the ECB has been given the exclusive competence to carry out specific supervisory tasks, based on a cooperative framework that involves the national competent authorities (hereinafter NCAs). In order to determine the allocation of enforcement powers between the ECB and the NCAs, the SSMR has adopted a distinction between significant and less significant credit institutions.<sup>11</sup> While the significant institutions are under direct supervision by the ECB, less significant institutions remain under direct NCA supervision. This implies that the ECB can only directly exercise the supervisory powers attributed to it by the SSMR over significant banks.

By no means does the distinction between significant and less significant banks aim at excluding less significant banks from the SSM or from ECB supervision. Several features of the SSM establish the contrary. While the NCAs retain their power to adopt the supervisory decisions concerning less significant banks, they must execute their mission in accordance with the regulations, guidelines or general instructions issued

by the ECB, and are subject to a duty of cooperation in good faith as well as an obligation to exchange information with the ECB. Moreover, the supervision of less significant institutions remains subject to oversight by a specific Directorate General of the ECB entrusted with the indirect supervision of less significant institutions. In addition, the ECB may decide at any time to take over direct supervision over one or more less significant banks when this is considered to be necessary for the consistent application of high supervisory standards. Furthermore, where the SSMR does not confer certain powers of the ECB, for instance in the case of supervision of less significant institutions, the ECB may require the NCAs by way of instructions to make use of their powers under and in accordance with the conditions set out in national law. The NCAs must follow such instructions,<sup>12</sup> even while the nature of their acts remains national.<sup>13</sup>

While the ECB stays involved in the supervision of less significant institutions, the NCAs are also involved in the supervision of significant institutions that are under direct ECB supervision. This involvement intervenes both during the investigations and during the execution of specific measures or penalties. This reflects again the fact that the SSM is conceived rather as a mechanism, than as a single supervisory entity.<sup>14</sup> The cooperation between the ECB and NCAs will play a crucial role in the effectiveness of the SSM.<sup>15</sup>

The supervision of significant institutions is organised through the establishment of Joint Supervisory Teams (hereinafter “JSTs”). For each significant institution, a JST has been created, composed of staff of the ECB as well as the NCAs. Every JST will be coordinated by a designated ECB staff member (the JST coordinator) and one or more NCA subcoordinators. The ECB is in charge of the establishment and composition of JSTs, but the appointment of staff members from the NCAs to JSTs is made by the respective NCAs. A JST is the main tool within which the NCA assist the ECB in the supervision of significant institutions and is a far-reaching example of a mixed administration. The JSTs are considered to be a cornerstone and a symbol of the SSM,<sup>16</sup> since the strength of this organisational structure lies in the fact that it relies on the NCAs’ experience and expertise to execute a policy that is decided on the European level. The JSTs should perform the supervisory review and evaluation, participate in the preparation of a supervisory examination programme to be proposed to the Supervisory Board, including an on-site inspection plan, implement the supervisory examination programme approved by the ECB and any ECB supervisory decisions, ensure coordination with the on-site inspection team referred and liaise with NCAs where relevant. The main supervisory task of the ECB is to “ensure compliance with” the prudential requirements of CRD IV and CRR by Eurozone banks. To perform this task,



the ECB can apply not only directly applicable Union law, such as CRR, but also national law exercising options granted by directly applicable Union law, or national law implementing Directives,<sup>17</sup> such as the national legislation adopted to transpose the prudential requirements of CRD IV. The fact that an EU institution can apply national substantive rules has been described as “a model of enforcement that is unseen in European law”.<sup>18</sup> For the first time, indeed, a European institution will rely on the national implementation of European law to carry out its tasks.

In order to ensure compliance with the above-mentioned prudential requirements, the ECB utilizes a set of supervisory powers, ranging from investigatory powers to preventive administrative measures and administrative (pecuniary) penalties. Unfortunately, these powers are not foreseen by one single legal basis. The supervisory toolbox of the ECB is composed of different layers, including directly applicable Union law (for instance, the SSMR, the SSM Framework Regulation – hereinafter SSMFR –, or Regulation 2532/98), as well as national legislation implementing Directives (for instance, CRD IV).

The following section will discuss the different supervisory powers of the ECB on the basis of the distinction adopted by the SSMR itself, namely investigatory powers, the power to impose administrative penalties, and the power to take administrative measures that are not considered to be administrative penalties. Attention will also be given to the procedural regime attached to the exercise of each of these powers. To remind, these are the powers that the ECB can exercise for the direct supervision of significant credit institutions. As pointed out above, when less significant credit institutions are concerned, the ECB’s powers are limited to issuing regulations, guidelines or general instructions to the NCAs, which need to adopt their supervisory decisions accordingly. The present analysis will be limited to the allocation of enforcement powers in case of breaches of CRD or CRR requirements by significant banks.

## II. The Different Layers of the ECB’s Supervisory Toolbox

To ensure compliance with the CRD/CRR requirements, the ECB has supervisory powers coming from different legal bases. According to the SSMR, the ECB not only has all the powers set out in the SSMR itself, but also has all powers that NCAs have under Union law, *unless otherwise provided for by the SSMR*.<sup>19</sup> When it comes to investigatory powers and administrative measures that are not considered to constitute administrative penalties, the ECB possesses all of the powers that NCAs have under Union law, while the Regulation *provides otherwise* in the case of administrative penalties.

### 1. Investigatory powers

In order to fulfil its tasks, the ECB can rely on direct investigatory powers provided by the Chapter III of the SSMR. These powers are not limited to significant banks but they also apply to investigations involving less significant banks when the ECB decides, pursuant to Art. 6(5)(d) SSMR, to make use of these investigatory powers with respect to a less significant supervised entity.<sup>20</sup> In this case, the supervision is shared between the European level and the national level, because the decision of the ECB to carry on direct investigation cannot exclude or limit the power of NCAs to supervise less significant banks. As a result, the investigatory powers of the ECB are not exclusive but they should be carried out in strict cooperation with the national authorities.

In order to carry out its tasks, the ECB has “appropriate supervisory powers”. These powers include all the powers that Union law requires to be conferred on competent authorities designated by the Member States for those purposes. “To the extent that those powers fall within the scope of the supervisory tasks conferred on the ECB, for participating Member States the ECB should be considered the competent authority and should have the powers conferred on competent authorities by Union law”. The broad investigatory powers of the ECB include the right to request information from a wide range of entities and individuals, to carry out general investigations and to conduct on-site inspections. In order to open an investigation, the ECB shall adopt a specific decision specifying its legal basis and purpose together with the intention to exercise the investigatory powers laid down in Art. 11(1) SSMR and the fact that any obstruction of the investigation by the person being investigated constitutes a breach of an ECB decision, susceptible to entail sanctions according to Art. 18(7) SSMR and in accordance with Regulation 2532/98.<sup>21</sup>

The power to conduct general investigations is provided by Art. 11 SSMR according to which the ECB may conduct all necessary investigations of any legal or natural person “established or located in a participating Member State”. This limitation is relevant because it excludes any direct investigatory power outside the SSM-zone. The general investigations include the right to:

- (a) require the submission of documents;
- (b) examine the books and records and take copies or extracts from such books and records;
- (c) obtain written or oral explanations from any legal or natural person or their representatives or staff;
- (d) interview any other person who consents to be interviewed for the purpose of collecting information relating to the subject matter of an investigation.

In the first three cases, the ECB has the power to oblige the natural or legal persons under investigation to execute its or-

ders. However, it lacks strict enforcement powers when a person obstructs the conduct of the investigation. In the latter case, the ECB should rely on the support of the NCAs where the relevant premises are located. In compliance with national law, the NCAs shall offer necessary assistance, including granting the ECB access to the business premises of the supervised legal persons. No specific power is provided when it comes to private premises or vehicles of the managers or related staff.

While Art. 11 provides for the interview of any person on a voluntary basis, Art. 10 SSMR provides that the ECB may require from both legal and natural persons (including managers or members of staff) all information that is necessary for supervisory and related statistical purposes. Upon such a request by the ECB, the legal or natural persons cannot refuse, and have to supply the information requested. This investigatory power conferred to the ECB interferes with the professional and banking secrecy existing in several Member States. Art. 10(2) SSMR makes clear that “professional secrecy provisions do not exempt those persons from the duty to supply that information. Supplying that information shall not be deemed to be in breach of professional secrecy”, including banking secrecy rules. Both the SSMR and the SSMFR are silent on the status of legal profession privilege. Recital 48 of the SSMR refers to it as a “fundamental principle of Union law, protecting the confidentiality of communications between natural or legal persons and their advisors, in accordance with the conditions laid down in the case-law of the Court of Justice of the European Union”. This recital seems to recall the case law of the ECJ as developed in the field of competition law and in particular in the leading case of *Akzo Nobel Chemicals and Ackros Chemicals v. European Commission*.<sup>22</sup> In that case the ECJ confirmed its restrictive interpretation refusing to modify or overturn prior precedent (dated back to 1982<sup>23</sup>) according to which communications with in-house lawyers are not accorded legal professional privilege under European law. The SSMR is confirming this restrictive approach, which seems to be problematic if we consider the strong protection offered by the ECHR.

The investigatory powers include the right to carry out all necessary on-site inspections at the business premises of the supervised legal persons.<sup>24</sup> This power represents the most intrusive investigatory measure of the ECB and it is subject to prior notification to the NCA of the place where the premises are located. When the ECB is not suspecting any infringement of banking regulation, it notifies the supervised entity of its intention to carry out an inspection, specifying when it will take place. In exigent cases, “where the proper conduct and efficiency of the inspection so require, the ECB may carry out the on-site inspection without prior announcement”.<sup>25</sup> In order to carry out these on-site inspections, the ECB appoints on-

site inspections teams composed by both ECB and NCAs officials.<sup>26</sup> In case of obstruction, the NCA of the relevant Member State provides for assistance including “the sealing of any business premises and books or records. Where that power is not available to the national competent authority concerned, it uses its powers to request the necessary assistance of other national authorities”.<sup>27</sup> It means that the NCAs must assist, if necessary by force and by sealing any business premises and books or records.

Due to their coercive nature, on-site inspections and forced sealing may require judicial authorization in several Member States. When that is the case, the prior authorization should be obtained before the investigatory measure takes place. This “dependence on national law leaves room for differences between the Member States”<sup>28</sup> composing a variable geometry puzzle. The lack of a specific and common provision on judicial authorization risks hampering the homogeneous application of the SSM in the EU. It would have been preferable to establish common rules implying the need for a judicial authorization when a coercive measure needs to be carried out. This solution would also have been more in line with the case law of the ECHR on access to business premises and sealing of books and records.

Furthermore, Art. 13 of the SSMR limits the effectiveness of judicial review by the national courts, by stipulating that national courts “shall control that the decision of the ECB is authentic and that the coercive measures envisaged are neither arbitrary nor excessive having regard to the subject matter of the inspection”.<sup>29</sup> In principle national courts are entitled to check the proportionality of the measures; to this aim, they may ask the ECB for detailed explanations on the grounds for suspicion that an infringement has occurred, its seriousness and to what extent the supervised entity is involved.<sup>30</sup> However, the national courts “shall not review the necessity for the inspection” and they cannot have direct access to the ECB’s file.

This information should be available to the national competent authorities concerned. It means that before making such a request, the ECB should verify the existing information already at disposal of the NCAs.<sup>31</sup> The ECB and the national competent authorities should indeed have access to the same information “without credit institutions being subject to double reporting requirements”.<sup>32</sup>

## 2. Administrative measures and penalties

The ECB legal framework distinguishes between administrative measures and penalties, although this distinction is not always clear.

#### a) Administrative measures that are not considered to constitute administrative penalties

Next to its sanctioning powers, analysed in the following paragraph, the ECB can also adopt administrative measures that are not considered to constitute administrative penalties, as they are not foreseen under Art. 18, which is devoted to pecuniary and non-pecuniary penalties. This power of the ECB stems once again from different legal bases. To remind, in conformity with Art. 9(1), 2<sup>nd</sup> indent SSMR, the ECB not only can exercise the powers directly granted to it by the SSMR, but also the powers that the NCAs have under relevant Union law.

Art. 16(1) SSMR foresees that when a bank fails to honour the prudential requirements imposed by CRR, by the national legislation exercising options granted by CRR, or by the national legislation implementing CRD IV, the ECB can take certain specific measures to require any entity under its supervision to take the necessary steps at an early stage. Likewise, the ECB can take the same measures when it has evidence that a bank is likely to breach those requirements within the next 12 months, or when its arrangements, strategies, processes and mechanisms and the own funds and liquidity held by it do not ensure a sound management and coverage of risks. The wording of Art. 16(1) SSMR already suggests that these measures are not of a punitive, but rather of a preventive nature, since the purpose is to intervene at an early stage, to avoid that there will be a breach in the near future, or to ensure a sound management and risk coverage.

Art. 16(2) SSMR sums up the measures announced by Art. 16(1). The ECB can require banks to hold own funds in excess of the capital requirements imposed on them, to reinforce the arrangements, processes, mechanisms and strategies, to present a plan to restore compliance with supervisory requirements, to apply a specific provisioning policy or treatment of assets in terms of own funds requirements, to reduce the risk inherent in certain activities, products and systems of institutions, to limit variable remuneration as a percentage of net revenues where it is consistent with the maintenance of a sound capital base, or to use net profits to strengthen own funds. In addition, the ECB can restrict or limit the business, operations or network of institutions that pose excessive risks to the soundness of a bank, or request the divestment of activities that would pose such risks. Furthermore, the ECB can also restrict or prohibit distributions by the institution to shareholders, members or holders of Additional Tier 1 instruments where the prohibition does not constitute an event of default of the institution. Moreover, the ECB can impose additional or more frequent reporting requirements, and specific liquidity requirements. It can also require additional disclosures and decide at any time on the removal of members from a bank's

management body who do not fulfil the requirements set out in CRR or in the national law implementing CRD IV.

#### b) Administrative penalties

When imposing administrative penalties, the ECB has to take into account different rules in order to determine the level of the penalty to be imposed and the procedure to be respected. The applicable rules differ according to the source of the requirement being breached, as well as the person to be sanctioned. On the basis of these criteria, the SSMR itself makes a distinction between three types of penalty,<sup>33</sup> which is subject to a formal classification by the SSM Framework Regulation.<sup>34</sup> On the basis of this formal classification, three types of penalties will be discussed below in the following order: fines and periodic penalty payments, administrative pecuniary penalties, and penalties for "other breaches". This order presents the sanctioning power of the ECB in a decreasing way, from direct sanctioning powers to indirect sanctioning powers. This order has been preferred for the present contribution, because the cases where the ECB only has an indirect sanctioning power, are negatively defined, starting from a definition of the cases where the ECB does have a direct sanctioning power. A special mention should also be made of the publicity of the aforementioned penalties, which in some cases could be considered as presenting a supplementary punitive character.

##### i) Fines and periodic penalty payments

Pursuant to Art. 18(7) SSMR, in cases of a breach of regulations or decisions of the ECB itself, by natural or legal persons,<sup>35</sup> the ECB may impose sanctions in accordance with Council Regulation (EC) No 2532/98 of 23 November 1998 concerning the powers of the European Central Bank to impose sanctions (hereinafter "Regulation 2532/98"). When breaches of ECB regulations or decisions are concerned, the SSMR falls back on the previous legal framework applicable to the sanctioning powers of the ECB. However, this does not mean that there are no novelties to be discovered. In fact, Regulation 2532/98 has recently been modified by Council Regulation (EU) 2015/159 of 27 January 2015,<sup>36</sup> in order to adapt the ECB's sanctioning power to its new competences in the field of banking supervision.

According to Regulation 2532/98, both fines and periodic penalty payments fall under the notion of "sanctions".<sup>37</sup> While fines are defined as "a single amount of money which an undertaking is obliged to pay as a sanction",<sup>38</sup> periodic penalty payments are "amounts of money which, in case of a continued infringement, an undertaking is obliged to pay either as a punishment, or with a view to forcing the persons concerned to comply with the ECB supervisory regulations and deci-

sions”.<sup>39</sup> It is worth stressing that this second part of the provision seems to allow the ECB to apply periodic penalty payments as a mere measure, excluding the regime that is usually applicable to penalties.<sup>40</sup>

Regulation 2532/98 also foresees procedural rules to be respected when the ECB imposes fines or periodic penalty payments. These rules reflect the right of a supervised entity to be informed in writing about the findings of the investigation,<sup>41</sup> the right to make submissions in writing within a reasonable time limit,<sup>42</sup> the right to be represented by lawyers or other qualified persons at closed oral hearings,<sup>43</sup> the right to have access to the file,<sup>44</sup> and the right of internal<sup>45</sup> as well as judicial review.<sup>46</sup>

The SSM Framework Regulation classifies the ECB’s fines and periodic penalty payments imposed under Regulation 2532/98 as administrative penalties.<sup>47</sup> It provides also that the aforementioned procedural rules contained in Regulation 2532/98 are further complemented by the procedural rules for the imposition of administrative penalties laid down by the SSM Framework Regulation itself.<sup>48</sup> When it comes to fines, these rules are embedded in Arts. 123 to 127 of the SSM Framework Regulation, which are briefly presented below, as they are also applicable to administrative pecuniary penalties that are not fines and periodic penalty payments. For periodic penalty payments, Art. 129 of the SSM Framework Regulation provides for separate rules to complement those of Regulation 2532/98. These rules reflect the right to be heard,<sup>49</sup> the right of access to the file,<sup>50</sup> and the right to be represented.<sup>51</sup>

## ii) Administrative pecuniary penalties

Art. 18(1) SSMR provides the ECB with a direct sanctioning power. Indeed, the ECB has the power to impose specific pecuniary penalties if a legal person under its supervision, intentionally or negligently, breaches a directly applicable act of Union law, in relation to which relevant Union law makes administrative pecuniary penalties available to NCAs. The material scope of this direct sanctioning power is represented by Art. 67(1) CRD IV, which requires the Member States to make administrative penalties available to NCAs in case of violations of specific CRR requirements.

Furthermore, Art. 18(1) SSMR does not limit the direct sanctioning power of the ECB to the “significant” banks. As a consequence, the allocation of powers between the European and the national level seems unclear. Scholars are divided: on one hand they consider Art. 18(1) fully applicable toward any credit institution, regardless of their significance.<sup>52</sup> On the other hand, the application of the significance criterion would be more consistent with the rules governing supervision. Furthermore, despite the silence of Art. 18(1) SSMR, Art. 124(1)(a)

SSM Framework Regulation, dealing with the duty to referral of alleged breaches to the investigating unit, mentions only breaches “committed by a significant supervised authority”. It must be highlighted that the direct sanctioning power of the ECB is limited to “credit institutions, financial holding companies or mixed financial holding companies”. When individuals are concerned, the ECB has no direct power to impose sanctions but it has to request the NCAs to impose sanctions on natural persons.<sup>53</sup> Furthermore, it is worth stressing that Art. 18(1) does not only limit the direct sanctioning power of the ECB to breaches by legal persons, but also to a specific structure of their conduct: the infringement should be intentional or, at least, negligent.<sup>54</sup>

The SSM Framework Regulation classifies the sanctions pronounced by the ECB under Art. 18(1) SSMR as administrative penalties, and gives them the specific title of “administrative pecuniary penalties”, in order to distinguish them from the “fines and periodic penalty payments” that the ECB can impose in case of breaches of ECB regulations and decisions.

Mirroring the sanctioning regime of Regulation 2532/98, the pecuniary penalties that the ECB can impose under Art. 18(1) SSMR amount to twice the amount of the profits gained or losses avoided because of the breach where these can be determined, or to 10% of the total annual turnover of a legal person in the preceding business year, or such other pecuniary penalties as may be provided for in relevant Union law.

Art. 18(3) further guides the sanctioning power of the ECB, by stipulating that all the penalties have to be “effective, proportionate and dissuasive”. In line with the previous approach, it is to be expected that the ECB will consider a range of factors, among them the level of cooperation shown by the supervised entity, the seriousness, the repetition, the frequency and the duration of the offence, any potential profits obtained through it, the size of the supervised entity and – potentially – prior sanctions imposed by other authorities based on similar facts.<sup>55</sup>

Furthermore, in order to determine whether to impose a penalty and in determining the appropriate penalty, the ECB must cooperate closely with the NCAs.<sup>56</sup> The latter requirement will be facilitated by the fact that direct ECB supervision of significant entities will be conducted through close cooperation within JSTs, as explained above.

Arts. 123 to 127 of the SSM Framework Regulation provide for procedural rules that are applicable to the imposition of administrative penalties.<sup>57</sup> They foresee that alleged breaches that are subject to administrative penalties – be they fines, periodic penalty payments, or administrative pecuniary penalties – must be referred to an internal investigation unit (hereinafter IIU) that



is independent from the ECB Supervisory Board and Governing Council.<sup>58</sup> The establishment of the IIU, foreseen by Art. 123 of the SSM Framework Regulation, reflects the requirement of a separation between the investigating and decision taking phase for imposing administrative sanctions,<sup>59</sup> as required by the *Dubus* jurisprudence of the ECtHR.<sup>60</sup> Prior to the adoption of the SSM Framework Regulation, the Executive Board of the ECB cumulated the investigative and decision making functions under Council Regulation 2532/98, as this Regulation came into existence before the *Dubus* judgment.<sup>61</sup> This problem has been overcome, since Arts. 123 to 127 of the SSM Framework Regulation apply not only to the imposition of administrative pecuniary penalties, but also to fines and periodic penalty payments imposed under the 2532/98 Regulation.

While Art. 125 Framework Regulation further describes the powers of the independent investigation unit, Art. 126 Framework Regulation is devoted to the procedural rights of the supervised entity under investigation. These rights include the right to be informed of the findings of the investigation unit,<sup>62</sup> the right to make written submissions within a reasonable time limit set by the investigating unit,<sup>63</sup> the right to be assisted and represented by lawyers or other qualified persons at closed oral hearings organised at the initiative of the investigating unit,<sup>64</sup> and the right of access to the file.<sup>65</sup> Others are lacking, as it is the case for the right not to incriminate oneself. As stated in the *Orkem* case,<sup>66</sup> the “Commission may not compel an undertaking to provide it with answers which might involve an admission on its part of the existence of an infringement which it is incumbent upon the Commission to prove”. The case referred to fines applicable in competition law but the principle should apply also in the banking sector when it comes to ‘punitive’ penalties. As scholars already observed, “it would have been wise if the ECB obligation to ensure compliance with the right not to incriminate oneself would have been codified in the SSM Regulation or SSM Framework Regulation. For reasons of legal certainty of individuals, but also to prevent possible non-compliance with the right by the investigation unit”.<sup>67</sup>

### iii) Penalties for other breaches: Art. 18(5)

The ECB has not been left without powers where natural persons or banks under its supervision breach other requirements than those that fall under the scope of Art. 18(1) SSMR. In cases not covered by Art. 18(1) SSMR, the ECB maintains an indirect sanctioning power. Art. 18(5) SSMR entrusts the ECB with the power to “require the NCAs to open proceedings with a view to taking action in order to ensure that appropriate penalties are imposed”.

Art. 134(1) of the SSM Framework Regulation frames this power, starting from a list of those cases that are not covered

by Art. 18(1). To summarise, this list comprises all cases in which a breach is attributed to a natural person, in which a non pecuniary penalty is to be imposed, or in which the breach does not concern CRR requirements. In addition, Art. 134(1) SSM Framework Regulation also foresees the scenario where pecuniary or non-pecuniary penalties are to be imposed in accordance with relevant national legislation which confers specific powers to the NCAs in Eurozone Member States which are currently not required by the relevant Union law.

In all these cases, as pointed out above, the ECB can request the NCAs to open proceedings. Art. 134(1) SSM Framework Regulation further clarifies that in respect of significant supervised entities, an NCA shall open proceedings only at the request of the ECB where necessary for the purpose of carrying out its task under the SSMR. This implies that the ECB can decide on the possibility of a sanction itself, even in case of a breach of national prudential requirements. This provision of the SSMR confirms that when it comes to significant entities, it is the ECB which has the power of direct supervision within the SSM, and for that purpose it can apply directly applicable Union law as well as national law implementing Union law. Even though NCAs can only open penalty proceedings upon request of the ECB, the mechanic nature of the SSM stays reflected through the fact that NCAs may ask the ECB to request it to open proceedings.<sup>68</sup>

While the ECB can require the NCAs to open proceedings, the NCAs are not obliged to sanction. This can be deducted from their obligation to inform the ECB, upon completion of a penalty procedure initiated at the request of the ECB, of the penalties that have been imposed, “if any”.<sup>69</sup> Consequently, only if the ECB decides not to request the NCAs to sanction, this decision can be considered to be final and binding, as the NCAs will be without power to open proceedings. On the contrary, if the ECB decides to request the NCAs to open penalty proceedings, the NCAs maintain their discretion to decide on the existence and, *a fortiori*, the type and level of the sanction.<sup>70</sup> Since it is up to the NCAs to decide on the type and the level of the sanction, these questions will be appreciated at the national level and depends on the powers that NCAs enjoy under European as well as national legislation.<sup>71</sup> If upon completion of a penalty procedure, an NCA decides to sanction, the Art. 18(5) SSMR requires the penalty to be effective, proportionate and dissuasive. As the penalty proceedings are conducted by the NCAs, they fall within the sphere of national procedure.

### iv) Publicity as an additional form of punishment?

According to Art. 18(6) SSMR, the ECB shall publish any administrative pecuniary penalty directly applicable according to Art. 18(1) SSMR “whether it has been appealed or not, in the

cases and in accordance with the conditions set out in relevant Union law”, including information on the type and nature of the breach and the identity of the supervised entity concerned. This practice, called “naming and shaming” amplifies the effects of the sanctions making it public and affecting the reputation of the financial entity or credit institution.

As highlighted by the Commission, the aim of publishing financial and banking sanctions is twofold: on one hand, it has a strong deterrent effect on credit institutions, mainly because they will incur reputational damage. On the other hand, it helps the consumers and investors to be better informed and it would ‘punish’ any wrongdoers by avoiding the use of their services. To these aims, the publication of banking administrative sanctions is a duty also for the Member States. Art. 68 CRD IV introduced new rules on the publication of administrative sanctions, according to which “Member States shall ensure that the competent authorities publish on their official website at least any administrative penalties against which there is no appeal and which are imposed for breach of the national provisions transposing this Directive or of Regulation (EU) No. 575/2013, including information on the type and nature of the breach and the identity of the natural or legal person on whom the penalty is imposed, without undue delay after that person is informed of those penalties”. Publication of penalties against which there is an appeal is not excluded, but in this case competent authorities “shall, without undue delay, also publish on their official website information on the appeal status and outcome thereof”. A few exceptions to the duty to publish the name of the entity submitted to the administrative penalties, authorising anonymised data, are (a) the risk to jeopardise the stability of the financial markets or an on-going criminal investigation; or (b) to cause a disproportionate damage to the supervised entity concerned.

Neither the CRD IV nor the SSMR address the question of “what form this publication should take in relation to the presumption of innocence”.<sup>72</sup> In other words, does the publication of a sanction which is made when the case is under appeal scrutiny constitute a violation of the presumption of innocence? A possible answer to this question can be found in the draft directive of the Commission on the presumption of innocence. This Proposal requires that Member States must ensure that, before a final conviction, public statements and official decisions from public authorities do not refer to suspects or accused persons as if they have already been convicted. According to the Commission, the presumption of innocence should be without prejudice to the possibility of the publication, according to national law, of decisions imposing sanctions following administrative proceedings. This raises the question of what the role of the presumption of innocence is in case of naming and shaming in administrative proceedings. The European legal framework is

uncertain because until now, neither the ECJ, nor the ECtHR has given any ruling on the question of whether naming and shaming in the national financial market regulations of the EU Member States violates the presumption of innocence. However, the ECHR clearly states that, even though anticipate enforcement in administrative proceedings cannot be radically excluded, “the Member States are required to confine such enforcement within reasonable limits that strike a fair balance between the mutual interests involved”.<sup>73</sup>

### III. Judicial Review of Measures and Penalties

Previous paragraphs have listed coercive measures and administrative sanctions that the ECB may use in carrying out its centralised supervisory tasks, autonomously or in cooperation with the national authorities. The system of administering EU banking supervisory law based on the interplay of two legal systems leads to intriguing questions with regard to judicial review and the legal protection of the supervised entity.

Nevertheless, effective judicial protection is a fundamental right of the EU legal order. Judicial review is the means by which courts exercise their supervisory control over the administrative measures or penalties applied by a State enforcement agency.<sup>74</sup> It represents a structural component of any system pretending to be respectful of the rule of law. It is protected by Arts. 6 and 13 of the ECHR and now fully codified in Art. 41, 47(2) and 48 of the EU Charter. This right covers:

- The right for the individuals to enforce their rights before a court.
- The fact that the court should comply with several structural requirements such as impartiality and independence, fair trial, reasonable time, etc.

In an interconnected multi-layered system like the SSM the issue needs to be analysed in a multilevel dimension, including the EU and the national level. The first question to be addressed concerns the ‘formal’ statute of judicial review as to whether acts and decisions in the supervisory process of credit institutions can be challenged before a court and, if so, which court, European or national. The second question concerns the “substantial” statute of judicial review: what is the content of such control? Which requirements are subject to judicial control?

Legal protection against banking supervision measures and sanctions may thus become quite complex. A supervised entity can be affected by decisions taken by the ECB or by the NCAs and for each decision it should rely on a different judicial review mechanism, being it at the European or at the national level.



At the European level, Art. 24 SSMR confers the internal control over the legality of the ECB decisions to an Administrative Board of Review, a board with the task to carry out an internal administrative review of the decisions taken by the ECB in the exercise of its powers. The internal review can be introduced by a natural or legal person concerned within one month from the notification of the decision. The request has no suspensory effect and it “shall pertain to the procedural and substantive conformity with this Regulation of such decisions”,<sup>75</sup> while the nature of such a board is uncertain: Art. 12(4) states that it “should act independently and in the public interest” but its direct connection with the ECB, being a part of it, justifies some scepticism on its capacity to fulfil the requirements of impartiality and independence set up by the ECHR case law.

Furthermore, the board cannot overrule the ECB decision under scrutiny; it can only express a reasoned opinion that the Supervisory Board should “take into account” when adopting a new decision.<sup>76</sup> In this light, its decisional powers are so limited as to exclude that it might satisfy the requirements of “judicial review”. Nevertheless, when it comes to administrative penalties, it is sufficient for the ECHR that the person concerned should have had at least one chance to have the final decision to be reviewed by a Court. This possibility is given by Art. 24(11) providing that the existence of the internal board “is without prejudice to the right to bring proceedings before the CJEU in accordance with the Treaties”. Nevertheless, one should consider that the ECJ case law has held that when the application of an act of Union law by a Union institution requires complex assessments, the authority enjoys a wide measure of discretion, the exercise of which is subject to limited judicial review. “The judiciary will only scrutinize the authority’s decision for a manifest error or misuse of powers and whether it clearly did not exceed the bounds of its discretion”.<sup>77</sup> In this light, the possibility to challenge the ECB decision before the Court of Justice may not always prove sufficient.

Furthermore, as previously analysed, the ECB is applying also national law in its supervisory tasks. How can the judicial review of ECB decisions based on national law be organised? Indeed, in order to respect the fundamental right of effective judicial protection, ECB decisions must be subject to judicial review. It should be stressed that the Court of Justice of the EU (CJEU) has exclusive jurisdiction to decide on the validity of ECB decisions. This implies that in case of an ECB decision based on national law, the CJEU would have to adjudicate on the basis of national law. In terms of European law, this result is striking. According to today’s legal framework, the ECJ can only adjudicate on the basis of applicable EU law, while the application and interpretation of national law is exclusively reserved to national judges.

Issues also arise when it comes to the national level, especially when penalties are applied by NCAs under request of the ECB. In these cases, the natural or legal persons affected by the decision are entitled to lodge an appeal before the competent national court. But which are the powers of national courts in these cases? To what extent they may assess the legality or the appropriateness of the measure? These questions remain for the time being unanswered.

#### IV. Conclusions

The purpose of this contribution has been to give an overview on how supervision of the largest banks in the Eurozone has been designed, to unpack the toolbox, to shed light on the ECB’s enforcement powers, to raise concerns and to identify challenges. The framework suggests scholars must address basically three issues.

- First, how to grant an effective enforcement of such a complex legal and institutional design? The complexity of the supervisory system and the partly unclear division of tasks between the European and the national level justifies a certain scepticism about its effectiveness. How the ECB and the NCAs will manage their forced cooperation in order to enforce such a complex machine is to be seen in the coming years?
- Second, the SSM relies more and more on administrative penalties as regulatory measures. The reform packages in the banking sector increased enormously the number of administrative sanctions and their severity. The nature of these sanctions seems to be questionable. Boundaries between administrative and criminal penalties are becoming hazy because are taking on the elements of each other creating a third kind of phenomenon, a greyzone of “criministrative law”.<sup>78</sup> If analysed in the light of the case law of the ECHR, banking sanctions seem to be criminal in their essence.<sup>79</sup>
- And, thirdly, if this is the case, what kind of procedural safeguards should apply? Are the procedural safeguards provided by the banking regulations adequate to the standards set up by the European court of human rights? Judicial protection seems highly problematic and several fundamental rights are not sufficiently protected.

The SSM entered into force only one year ago and for the time being concrete case law is lacking. It might prove that the incorporation in regulatory law on banking supervision of principles and safeguards belonging to criminal law is recommended and maybe overdue.

1 For further details see notably D. Busch, G. Ferrarini (eds.), *European Banking Union*, Oxford: Oxford University Press, 2015; E. Ferran, N. Moloney, J. G. Hill, J. C. Coffee JR., *The Regulatory Aftermath of the Global Financial Crisis*, Cambridge: Cambridge University Press, 2012.

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2 See European Parliament resolution of 7 July 2010 with recommendations to the Commission on Cross-Border Crisis Management in the Banking Sector 2010/2006(INI) and its Report on the proposal for a Regulation establishing a European Banking Authority, July 2010.

3 Communication from the Commission to the European Parliament and the Council: “A roadmap towards a Banking Union”, COM (2012) 510, 12.9.2012. Besides, the urgency was stressed by several official documents: see *inter alia* “Towards a genuine economic and monetary union”, EUCO 120/12, 26.06.2012 and “A Blueprint for a Deep and Genuine Economic and Monetary Union Launching a European Debate”, COM(2012) 777 f/2, 30.11.2012.

4 L. Wissink, T. Duijkersloot, R. Widdershoven, *Shifts in Competences between Member States and the EU in the New Supervisory System, for Credit Institutions and their Consequences for Judicial Protection*, in Utrecht Law Review, vol. 10, Issue 5 (December 2014), p. 92.

5 Regulation (EU) no 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) no 648/2012, O.J. L 176, 27.6.2013, p. 1 (CRR).

6 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing directives 2006/48/EC and 2006/49/EC, O.J. L 176, 27.6.2013, p. 338 (CRD).

7 See Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a single Resolution Fund and amending Regulation (EU) No 1093/2010, O.J. L 225, 30.7.2014 p. 1.

8 The uniform deposit insurance scheme has not been specified yet. Since the 2010 the debate concerns a more secure legal regime for deposits. Proposal for a directive on Deposit Guarantee Schemes COM (2010) 368 final. It would require that all banks and financial institutions, without exception, join a deposit guarantee scheme. Depositors below €100 000 are in any case excluded from suffering losses, their claims being protected by national DGS.

9 E. J. Pan, *Understanding Financial Regulation in Utah Law Review*, 2012, 4,1919-1920.

10 CRR and CRD IV are the result of the Basel III accord, which introduced revised standards on financial regulation at an international level in response to the financial crisis.

11 Criteria to define a credit institution as ‘significant’ are provided by Art. 6(4) SSMR according to which “The significance shall be assessed based on the following criteria: (i) size; (ii) importance for the economy of the Union or any participating Member State; (iii) significance of cross-border activities”. With respect to the ‘size’, an entity shall not be considered less significant, unless justified by particular circumstances to be specified in the methodology, if any of the following conditions is met: (i) the total value of its assets exceeds EUR 30 billion; (ii) the ratio of its total assets over the GDP of the participating Member State of establishment exceeds 20 %, unless the total value of its assets is below EUR 5 billion; (iii) it is one of the three most significant credit institutions in a participating Member State.

12 Art. 6(3) SSMR.

13 For more detailed explanations, see C. Gortsos, *The Single Supervisory Mechanism (SSM): Legal aspects of the first pillar of the European Banking Union*, Athens: Nomiki Bibliothiki, 2015, p. 230.

14 See also B. Wolfers, T. Voland, *Level the playing field: the new supervision of credit institutions by the European Central Bank*, in Common Market Law Review, 51, 2014, pp. 1463-1496; N. Moloney, *European Banking Union: Assessing its Risks and Resilience*, in Common Market Law Review, 51, 2014, pp. 1609-1670; E. Ferran, V. Babis, *The European Single Supervisory Mechanism*, Legal Studies Research Paper Series, University of Cambridge, Faculty of Law, 2013.

15 See also T. Tröger, *The Single Supervisory Mechanism – Panacea or Quack Banking Regulation?* SAFE Working Paper Series No. 27, 19.10.2013

16 Speech of Mrs. Danièle Nouy at *ECB Forum on Banking Supervision*, 4 November 2015, Frankfurt am Main.

17 SSMR, Art. 4(3).

18 A. Witte, *The Application of National Banking Supervision Law by the ECB: Three Parallel Modes of Executing EU Law?* in Maastricht Journal, Vol. 21, No. 12014, pp. 89-109.

19 Art. 9(1) SSMR.

20 Art. 138SSMFR.

21 See Art. 142 SSMFR.

22 C-550/07 P.

23 Case 155/79, *AM & S Europe v. Commission*, 18.5.1982.

24 Art. 12 SSMR.

25 Art. 12(1) SSMR.

26 Detailed rules on the execution of on-site inspections is provided by Art. 143-146 SSMFR.

27 Art. 12(5) SSMR.

28 L. Wissink, T. Duijkersloot, R. Widdershoven, *op. cit.* p. 101.

29 Art. 13(2) SSMR

30 Art. 13(2) SSMR. On this issue, see also B. Wolfers, T. Voland, *op. cit.*

31 G. Schuster, K. Lackhoff, E. Windthorst, *The SSM Framework Regulation Part 4 : Investigatory Measures and Sanctioning Powers*, Freshfields Bruckhaus Deringer LLP, June 2014.

32 SSMR recital 47.

33 Art. 18 SSMR.

34 Art. 120 SSMFR.

35 Regulation 2532/98, as amended by Council Regulation (EU) 2015/159 of 27 January 2015, Art. 1(3).

36 Council Regulation (EU) 2015/159 of 17 January 2015, O.J. L 27, 3.2.2015, p. 1.

37 Regulation 2532/98, as amended by Council Regulation (EU) 2015/159 of 27 January 2015, Art. 1(7).

38 Regulation 2532/98, Art. 1(5).

39 Regulation 2532/98, Art. 1(6).

40 See Recommendation for a Council Regulation amending Regulation (EC) No 2532/98 concerning the powers of the European Central Bank to impose sanctions (ECB/2014/19), J.O. C 144, 14.5.2014, p. 2, according to which “the definition of ‘sanctions’ should also be amended so that the reference to periodic penalty payments being imposed ‘as a consequence of an infringement’ is deleted”.

41 Regulation 2532/98, Art. 4b(3).

42 *Ibid.*, second indent.

43 *Ibid.*, third indent.

44 *Ibid.*, fourth indent.

45 *Ibid.*, Art. 4b(5).

46 *Ibid.*, Art. 5.

47 Art. 120 SSMFR.

48 Art. 129 SSMFR.

49 Art. 22(1) SSMR.

50 Art. 22(2) SSMR ; Art. 32 SSMFR.

51 Art. 27 SSMFR.

52 S. Loosveld, *The ECB’s Investigatory and Sanctioning Powers under the Future Single Supervisory Mechanism in Journal of International Banking Law and Regulation*, 2013, p. 423.

53 Art. 134(1) SSMFR.

54 G. Schuster, K. Lackhoff, E. Windthorst, *op. cit.*, p. 3.

55 *Ibid.*

56 Art. 18(3) and 9(2) SSMR.

57 For further details, see C. Gortsos, *op. cit.* p. 297.

58 Art. 123 and 124 SSMFR.

59 G. Schuster, K. Lackhoff, E. Windthorst, *op. cit.*, p. 4 ; R. d’Ambrosio, *op. cit.*, p. 74.

60 ECHR, *Dubus v. France*, 11 June 2009, n° 5242/04.

61 R. d’Ambrosio, *op. cit.*, pp. 76-77.

62 Art. 126(1) SSMR.

- 63 Art. 126(2) SSMR.  
 64 Art. 126(3) SSMR.  
 65 Art. 126(4) SSMR; L. Wissink, T. Duijkersloot, R. Widdershoven, *op. cit.*, p. 111.  
 66 Case 374/87, *Orkem v Commission*, § 26.  
 67 L. Wissink, T. Duijkersloot, R. Widdershoven, *op. cit.*, p. 114.  
 68 SSMFR, Art. 134(2).  
 69 SSMFR, Art. 134(3).  
 70 R. D'Ambrosio, *Due Process and Safeguards of the Persons Subject to SSM Supervisory and Sanctioning Proceedings*, in Quaderni di Ricerca Giuridica della Consulenza Legale, December 2013, n° 74, pp. 48-49; Freshfields Bruckhaus Deringer, *op. cit.*, p. 3.  
 71 Art. 18(5) SSMR.  
 72 J. Pfaeltzer, *Naming and Shaming in Financial Market Regulations: Violation of the Presumption of Innocence?* in *Utrecht Law Review*, Vol. 10, No. 1, 2014, pp. 134 s.  
 73 ECtHR, *Janosevic v Sweden*, [2004] 38 EHRR 22.

- 74 Defining judicial review at a European dimension is a hard exercise; inputs in R. Wilson QC, *Judicial review. An Introduction to the Key Principles*, in Piers von Berg (ed.), *Criminal Judicial Review*, Hart, Oxford-Portland, 2014, 6 f.  
 75 Art. 24(1) SSMR; for the composition of the Administrative Board of Review, see Art. 24(2) SSMR.  
 76 Art. 24(7) SSMR.  
 77 A. Witte, *op. cit.*, referring to Case T-187/06 *Ralf Schröder v. CPVO* [20 08] ECR II-3151, para. 59 and the case law cited.  
 78 A. Bailleux, *The Fiftieth Shade of Grey Competition Law, 'Criministrative Law' and 'Fair Trial Rights'*, in F. Galli – A. Weyembergh, *Do Labels Still Matter?* IEE, 2014, p. 139.  
 79 For a general overview on how to classify banking measures, penalties and sanctions according to the Engel criteria, see R. D'Ambrosio, *op. cit.*, p. 9 f.; A. de Moor-van Vugt, *Administrative Sanctions in EU Law in Review of European Administrative Law*, vol. 5, n. 1, 2012, p. 5.

# The “Europeanization” of Financial Supervision in the Aftermath of the Crisis

Konstantina Panagiannaki

In the aftermath of the economic crisis, that began in 2007 in the U.S.A. and spread to the European economy, weakening the EU, every discussion about its causes and how to address them was linked to the absence of a suitable supervisory<sup>1</sup> framework. The EU has been accused of lacking sufficient legal tools both at a precautionary level as well as for crisis management.<sup>2</sup> Even though the internal market of financial services had been making progress, up until 2007 there were no truly centralized<sup>3</sup> mechanisms and tools to supervise financial activities, identify their complexity, their risks and the interconnections between the financial institutes, as indicated by the De Larosi re Report.<sup>4</sup> Adam Smith’s “invisible hand” and de-regulation<sup>5</sup> as a dominant approach had been proven insufficient to address the fragmentation of financial institutes, which were acting on a European level, but were supervised nationally.<sup>6</sup> The EU responded with a reform and established a new supervisory system consisting of the ESFS<sup>7</sup> (European System of Financial Supervision) and the SSM<sup>8</sup> (Single Supervisor Mechanism). ESFS is a network of European agencies and national authorities that applies to the whole financial sector. The SSM constitutes the first pillar of the banking union, applies only to credit institutes, and is a composite administration of the ECB and the national competent authorities.

This article seeks to explore this new infrastructure by examining its tasks and the sanctions it can address. For the purpose of this contribution, I use the term “Europeanization” in quo-

tation marks in order to describe this reform, because ESFS and SSM do not possess the same level of centralization. As far as the ESFS is concerned, the supervision remains mainly on a national level, but the EU agencies play a significant role in unifying its application. On the contrary, SSM constitutes a fully centralized supervisor.

## I. European Supervisory System

### 1. Macroeconomic<sup>9</sup> Level

To undo the mistakes of the past,<sup>10</sup> the EU set up the ESRB (European Systemic Risk Board) with the mandate to oversee risks in the financial system as a whole. The outburst of the crisis made it apparent, that macroprudential supervision had been neglected. Therefore, the establishment of the ESRB seeks to remedy this deficiency and defines in Art. 2 lit. (c) Reg. 1092/2010 the notion of systemic risk. The ESRB was established by Regulation (EU) No 1092/2010 and entered into force on 26 December 2010. It is founded upon Art. 114 TFEU, the title of which is “Approximation of laws”. The question that arises is whether the set-up of a committee can be regarded as an approximation measure. This question will be addressed in relation to the other parts of the ESFS, as they share the same legal basis. Because its Secretariat is supported and located within the European Central Bank (ECB), the legal framework of ESRB is complemented by the Council

Regulation (EU) No 1096/2010, which confers specific tasks upon the ECB concerning the functioning of the ESRB. This regulation is based on Art. 127 § 6 TFEU. The ESRB is part of the ESFS pursuant to Art. 1 § 2 Reg. 1092/2010 and constitutes an advisory committee without legal personality, which selects and analyzes information about systemic risks for the first time. Its powers and legal acts will be examined in Section II. of this paper.

## 2. Microeconomic<sup>11</sup> Level

Both ESFS and SSM operate at the microeconomic level. The ESFS will celebrate its fifth anniversary on 1 January 2016, whereas the SSM was established one year ago, on 4 November 2014. However, as already mentioned, the ESFS applies to the entire financial sector, whereas SSM is limited to credit institutes, defined by Art. 4 of the Capital Requirements Regulation.<sup>12</sup>

### a) ESFS

The ESFS comprises of the EBA<sup>13</sup> (European Banking Authority), EIOPA<sup>14</sup> (European Insurance and Occupational Pensions Authority), ESMA<sup>15</sup> (European Securities and Markets Authority), their joint committee, the ESRB and the national competent authorities. EBA, ESMA and EIOPA are mentioned in their regulations as European Supervisory Authorities (ESAs). Because ESAs are founded following the same concept, their regulations have similarities in wording and numbering. In this article the Regulation of EBA (Regulation) will be used as an example, and where differences occur, the relevant regulation will be referred to. The legal status of ESAs is declared in Art. 5 of the Regulation, which defines ESAs as a "... Union body with legal personality", implying that they fulfil the characteristics of an agency. The term "agency" is a term originating from jurisprudence, that is not legally binding and that describes a body that has a legal personality, is endowed with autonomy, and has a specific scope of tasks, as in the case of ESAs. Indeed, they function as regulatory agencies, as opposed to executive agencies.

ESAs, like the ESRB, are based on Art. 114 TFEU according to the 17th recital of the Regulation, and as already noted, the question arises, as to whether the establishment of a European body can be regarded as an approximation measure. This is not the first time that the EU has set up agencies using Art. 114 TFEU, and this procedure has already been challenged in the case<sup>16</sup> of the ENISA agency, where the CJEU stated, that Art. 114 TFEU is not addressed to Member States only, but can also refer to the EU level. In that case, the establishment of an EU body is in compliance with Art. 114 TFEU, if it contributes

to a harmonisation process and has a close link to the objectives of the internal market. In the 17th recital, the Regulation itself cites the ENISA case, in an attempt to prove the ESAs' conformity and to dismiss any criticism about the choice of Art. 114 TFEU.

### b) SSM

The SSM constitutes one of the four pillars of the European Banking Union, together with the Single Resolution Mechanism (SRM),<sup>17</sup> the Deposit Guarantee Scheme and the Single Rulebook. It functions as a composite administration of the ECB and the national competent authorities according to Art. 2 § 9 and Art. 6 of the SSM Regulation. It was founded by Council Regulation (EU) 1024/2013 (cited as SSM Regulation) pursuant to Art. 127 § 6<sup>18</sup> TFEU, while the cooperation of ECB and national authorities within the SSM is regulated in Regulation (EU) 468/2014 of the ECB (cited as SSM Framework Regulation) pursuant to Art. 132 § 1 TFEU.

The SSM is originally designed for the Member States that belong to the Euro area (Art. 2 § 1 SSM Regulation), but it remains open to the other Member States, if they are willing to participate in its regime and form a close cooperation, (Art. 7 SSM Regulation). In the course of the SSM, the supervision of the credit institutes can be classified into two categories: direct and indirect supervision. The decisive criterion that distinguishes these categories is the systemic significance of the institute according to Art. 6 § 4 SSM Regulation. Their classification is determined by the ECB according to Art. 43 SSM Framework Regulation. Crucial factors for the assessment of systemic significance are the size of the institutes, their importance for the economy and their cross-border activities. The three biggest credit institutes of a Member State always fall into the category of direct supervision, which also applies to those institutes that are financially supported by the ESFS<sup>19</sup> or the ESM<sup>20</sup>.

For the systemically significant institutes, the SSM becomes the centralized supervisor in place of the national authorities (Art. 9 SSM Regulation) and the ECB forms joint supervisory teams with the national authorities pursuant to Art. 3 SSM Framework Regulation. In contrast, the less significant ones fall within the national competence under the instructions of the SSM, and therefore under the indirect supervision of the SSM. However, the SSM always retains the possibility to take over direct supervision, even of the less significant institutes, (Art. 6 § 5 lit. b SSM Regulation). Currently, about 120 banking groups, this amounts to 1.200 entities that possess 85% of the banking assets in the EU, fall within the direct supervision of the SSM, in comparison to about 3.500 banking entities that remain under national supervision.



## II. Powers and Sanctions

### 1. Macroeconomic Level

The ESRB is not vested with binding powers, yet its foundation is a novelty, as it is the first committee at the EU level mandated with macroprudential oversight. In order to fulfil this mandate according to Art. 2 Regulation 1092/2010, it collects and analyses the relevant information and prioritizes the risks. It provides the ESAs with the necessary information and fosters the exchange of information between the competent supervisory authorities pursuant to Art. 15 of the relevant regulation. Furthermore and more importantly, it can provide warnings and issue recommendations, that can be addressed to the EU as a whole, to one or more Member States, to the ESAs, or to national competent authorities, (Art. 16 of the regulation). Although warnings and recommendations lack legal binding effect, the addressee is obliged to comply or explain according to Art. 17, and according to Art. 18, the ESRB has the possibility to publish its warnings and recommendations. Both the "comply or explain" principle and the publication exert pressure on the addressee. Therefore, in order to avoid this process, the addressee can choose to comply, and in this way, the powers of the ESRB produce a de-facto binding effect.<sup>21</sup> This explains why these "tools" are perceived as compensation for the lack of legal binding powers.<sup>22</sup>

### 2. Microeconomic Level

#### a) ESFS

With the creation of ESAs, financial supervision, as already stated, remains national and thus decentralized,<sup>23</sup> but the ESAs foster the convergence, coordination, and unified application of law, especially with the Single Rulebook, which aims at the creation of a unified substantive law. To fulfil these tasks, the ESAs are equipped with non-binding powers. In specific situations and under specific conditions, however, they possess binding powers, which is a striking feature for agencies. As far as non-binding powers are concerned, the ESAs draft technical regulatory (Art. 10 of the Regulation and Art. 290 TFEU) and implementing (Art. 15 of the Regulation and Art. 291 TFEU) standards, which become binding when endorsed by the Commission either in form of a regulation or a decision and they form the Single Rulebook. They also issue guidelines and recommendations requiring the national authorities to "comply or explain" (Art. 16 of the Regulation) and issue opinions (Art. 34 of the Regulation).

Although ESAs are agencies, they are equipped with binding powers and can address decisions under specific conditions both against national authorities and against financial institutions circumventing the national authorities. This can only

happen, however, when EU law is breached (Art. 17 of the Regulation), in emergency situations (Art. 18 of the Regulation) and when a settlement agreement between national authorities has been reached (Art. 19 of the Regulation). Because of the legal nature of decisions and this power being bestowed on an agency, it is conceived as *ultima ratio* after following a three-step mechanism. Firstly, the relevant agency addresses a recommendation to the competent authority. If the national authority does not comply, then the Commission issues an opinion. If, again, the national authority does not comply, then ESAs can circumvent the national authority and address a decision to financial institutions in the case of Arts. 17 and 18, or, as in the case of Art. 19, the decision is addressed to the national authorities. These decisions can be appealed to the CJEU, but also within the ESAs to the Board of Appeal according to Arts. 58 and 60 of the Regulation. The conferral of binding powers constitutes an unprecedented phenomenon, adding centralization elements to the role of the ESAs.<sup>24</sup>

#### b) SSM

In general, the powers of the SSM and, subsequently, the sanctions it can address depend on its acting as a direct or indirect supervisor. However, there is an important exception: the SSM decides upon the authorisation, the withdrawal of the authorisation and the acquisition or disposal of qualifying holdings for all credit institutes, regardless of their systemic relevance according to Art. 6 § 4 of the SSM Regulation.

Beyond this exception, the SSM has the typical investigatory and supervisory powers that a competent national authority has, when acting as the direct supervisor (Art. 9 SSM Regulation). In the course of its investigatory powers (Arts. 10-13 SSM Regulation), the SSM can request information from the credit institutes, examine books, require the submission of documents, interview people and carry out on-site inspections. As far as the supervisory powers are concerned, they are regulated in Arts. 14-18 of the SSM Regulation. They include the authorisation, the withdrawal of the authorisation and the acquisition or disposal of qualifying holdings, which applies to all, systemic and non-systemic, credit institutes. Furthermore, the SSM can require the supervised entities to take measures at an early stage to comply with the supervisory requirements (capital adequacy, liquidity, etc.), to hold own funds, to minimise risks, to limit remuneration, to restrict or prohibit distributions to shareholders, to report more often, or to remove members from the management board. If the supervised entities breach the requirements of directly applicable Union law, which entails administrative penalties, the SSM can impose them. If the breach of the requirements does not involve directly applicable Union law, the SSM can then require the national competent authorities to take action and impose administrative penalties.

### III. Conclusion

The new European supervisory system attempts to counteract the weaknesses of the former, nationally driven system of financial supervision. The set-up of the ESRB as a committee at the macroeconomic level, the role of the agencies as part of the ESFS at the microeconomic level, and especially the foundation of the SSM as a direct supervisor have totally changed the previous supervisory system. This is an important step towards Europeanization. It remains to be seen, whether this new system will actually be more efficient.



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1 For a definition, see e.g. banking supervision "It covers the regulatory and monitoring apparatus that is directed towards helping to preserve the financial health and safety of banks... Supervision has a wider interest in the prudential health of banking at a market and generalized level.", P. Newman, M. Milgate, J. Eatwell, *The New Palgrave Dictionary of Money and Finance*, Volume 1, 1992, p. 156.

2 "Die Krise hat ... deutliche Schwachstellen des Aufsichtsrahmens offenbart." Lehmann, Manger-Nestler: Die Vorschläge zur neuen Architektur der europäischen Finanzaufsicht, *EuZW* 2010, p. 87.

3 The European forum of coordination of national supervisors mainly consisted of the level-3 committees of the Lamfalussy-process. The Lamfalussy-process is a legislative and supervisory process for the financial sector based on comitology since 2001, named after Alexandre Lamfalussy, who chaired the group of wise men, and who proposed this process to enhance and accelerate legislation in the financial sector. Lembke Martin, *Eine Aufsichtsbehörde für den europäischen Kapitalmarkt*, Peter Lang, Frankfurt am Main, 2010, p. 62.

4 The High-Level Group of Financial Supervision in the EU, chaired by Jacques de Larosière, Report, Brussels, 25 February 2009. In the aftermath of the crisis, a group of wise men chaired by Jacques de Larosière was assigned by the Commission to point out the weaknesses and propose reforms. See J. de Haan, S. Oosterloo, D. Schoenmaker, *Financial Markets and Institutions, a European perspective*, Cambridge, 2012, pp. 383-384.

5 About the different approaches of supervisory de-regulation and re-regulation, see in this respect P. Newman, M. Milgate, J. Eatwell, *The New Palgrave Dictionary of Money and Finance*, op. cit. [n. 1], p. 157.

6 See J. de Haan, S. Oosterloo, D. Schoenmaker, *Financial Markets and Institutions, a European perspective*, Cambridge, 2012, p. 382.

7 ESFS comprises of EBA, EIOPA, ESMA, their joint committee, ESRB and national authorities.

8 Council Regulation (EU) No 1024/2013.

9 "Macroprudential supervision focuses on the soundness of the financial system as a whole. Macroprudential analysis must ... pay ... attention to common or correlated shocks ... contagious knock-on effects ... interactions between financial institutions and their environment ... as well as the dynamics ... over time." J. de Haan, S. Oosterloo, D. Schoenmaker, *Financial Markets and Institutions*, op. cit. [n. 6], p. 393.

10 "... the financial crisis of 2007 - 2009 highlighted the important distinction between both concepts (microprudential and macroprudential supervision)", J. de Haan, S. Oosterloo, D. Schoenmaker, *Financial Markets and Institutions*, op. cit. [n. 6], p. 393.

11 "The intermediate objective of microprudential supervision is to supervise and limit the distress of individual financial institutions ... The fact that the financial system as a whole may be exposed to common risks is not (fully) taken into account.", J. de Haan, S. Oosterloo, D. Schoenmaker, *Financial Markets and Institutions*, op. cit. [n. 6], p. 393 and pp. 385-386.

12 Regulation (EU) No 575/2013. Art. 4 §1 (1) of the Reg.: "... undertaking ... take deposits or other repayable funds ... and grant credits".

13 Regulation (EU) No 1093/2010.

14 Regulation (EU) No 1094/2010.

15 Regulation (EU) No 1095/2010.

16 CJEU C-217/04, *United Kingdom v European Parliament and Council of the European Union*, 02.05.2006.

17 Regulation (EU) No 806/2014.

18 Its legal basis is strongly criticised, because Art. 127 § 6 TFEU speaks for the conferral of specific tasks upon the ECB. Turning the ECB into a direct supervisor seems to exceed the mere conferral of specific tasks. See K. Peters, "Die geplante europäische Bankenunion – eine kritische Würdigung", in *WM*, Issue 9, p. 399.

19 European Financial Stability Facility, Agreement of 27 Member States of EU on 9 May 2010

20 European Stability Mechanism, Treaty Establishing the European Stability Mechanism of 2 February 2012

21 "Wenngleich derartige Instrumente keinen verbindlichen Rechtscharakter aufweisen, so kommt ihnen doch eine faktische Bindungswirkung zu, da sie als abstrakt-generelle Normen konzipiert sind und ihre Vorgaben von den Adressaten letztlich doch umgesetzt werden müssen." S. Nicolas, Rechtsschutz gegen Maßnahmen der neuen europäischen Finanzaufsichtsagenturen, in *BKR* 2012, p. 9.

22 See Rötting, Lang, "Das Lamfalussy-Verfahren im Umfeld der Neuordnung der europäischen Finanzaufsichtsstrukturen", *EuZW* 2012, p. 10.

23 J. de Haan, S. Oosterloo, D. Schoenmaker, *Financial Markets and Institutions*, op. cit. [n. 6], p. 385.

24 See, in this respect, "National supervisors will want to avoid being overruled by the ESA. If this happens too often, their reputation will be hurt.", J. de Haan, S. Oosterloo, D. Schoenmaker, *Financial Markets and Institutions*, op. cit. [n. 6], p. 387. Comparing the three ESAs, ESMA seems to act more as a centralized supervisor, because of its exclusive supervisory powers over rating agencies registered in the EU. See J. de Haan, S. Oosterloo, D. Schoenmaker, "Financial Markets and Institutions, a European perspective", Cambridge, 2012, p. 386. This also concerns ESMA's power to temporarily prohibit or restrict certain financial activities, Art. 9 § 5 Regulation (EU) 1095/2010. See CJEU C-270/12, *UK v. Parliament and Council*, 22.01.2014 about ESMA's power to prohibit short selling, article 28 Regulation (EU) 236/2012 and "The legal limits to agencification in the EU? CJEU C-270/12 UK v. Parliament and Council" in <http://europeanlawblog.eu/?p=2176>.

# Imprint

## Impressum

Published by:

**Max Planck Society for the Advancement of Science  
c/o Max Planck Institute for Foreign and International  
Criminal Law**

represented by Director Prof. Dr. Dr. h.c. mult. Ulrich Sieber  
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Internet: <http://www.mpicc.de>

Official Registration Number:  
VR 13378 Nz (Amtsgericht  
Berlin Charlottenburg)  
VAT Number: DE 129517720  
ISSN: 1862-6947



MAX-PLANCK-GESELLSCHAFT

**The publication is co-financed by the  
European Commission, European  
Anti-Fraud Office (OLAF), Brussels**



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**Language Consultant:** Indira Tie, Certified Translator, Max Planck Institute for Foreign and International Criminal Law, Freiburg  
**Typeset:** Ines Hofmann, Max Planck Institute for Foreign and International Criminal Law, Freiburg  
**Produced in Cooperation with:** Vereinigung für Europäisches Strafrecht e.V. (represented by Prof. Dr. Dr. h.c. mult. Ulrich Sieber)  
**Layout:** JUSTMEDIA DESIGN, Cologne  
**Printed by:** Stückerle Druck und Verlag, Ettenheim/Germany

### Subscription:

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