



Keynote speech - Ronald Gerritse

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Good morning ladies and gentlemen.

I am privileged to have the opportunity to address this gathering of international criminal law experts on the role of financial supervision legislation in the prevention of financial fraud. The perspective of my speech may be different from the one you were expecting. I see it as a challenge to establish the link with the domain of criminal law.

The AFM promotes the careful provision of financial services to consumers. It also supervises the fair and efficient operation of the capital markets. An essential aspect of this is the confidence of companies and consumers in the financial markets. This confidence is being sorely tested by the continuously expanding debt crisis, which is steadily taking on the nature of a political crisis. As such, the situation requires political solutions, a matter to which government leaders are currently applying themselves. Given today's theme, this is not a subject I will be addressing. My intention is to approach the issue of confidence from the standpoint of the supervision of market integrity, by considering the following areas:

1. The implications of financial fraud for the operation of the financial markets
2. The role of integrity supervision by the AFM in tackling fraud
3. The relationship between the enforcement of administrative law and the enforcement of criminal law
4. The implications of integrity supervision for the financial markets

Implications of fraud

It will come as no surprise that fraud erodes confidence in the financial markets.

- it damages the confidence of consumers and investors, so that they no longer know who to trust with their money, and the reputations of honest parties suffer enormously due to the actions of dishonest ones;
- it damages the confidence in auditors for example, who are supposed to formally inspect a company' s financial position and business procedures;
- it damages the trust in the government and supervisors because of their apparent inability to prevent or detect fraud.

The international examples will be familiar to you. Bernard Madoff, who set up a Ponzi scheme of unprecedented size. Or Jerome Kerviel, whose rogue trading saddled his employer, Société Generale with a loss of 4.9 billion euro.

The Netherlands has also repeatedly received rude awakenings from large-scale investment frauds in recent years. Investors were seduced by glossy folders and guaranteed double-digit returns. The investments turned out to be dubious, however. They involved holiday resorts to be constructed in exotic locations, resold US life insurance policies, or teak plantations. If the money paid into a scheme wasn't immediately paid out to new investors, then it almost certainly vanished into the pockets of the scheme's founders.

As a supervisory body, we see other practices as well:

Insider trading. Illegal providers of financial products who evade supervision. Boiler rooms, from where worthless shares are sold aggressively over the phone.

We see intermediaries committing mortgage fraud. In a few major cases, we encountered opaque international corporate structures, clearly designed to hide ownership, control or assets.

Corruption is also a threat to the sector's integrity. The Dutch Public Prosecutor is currently dealing with a case of large-scale fraud in the property market. It is suspected that a pension fund and a property developer have been cheated out of hundreds of millions of euros by corrupt management. The project developer was part of a large Dutch bank.

A striking paradox exists here: fraud spells disaster for confidence in the financial markets, but is encouraged by an excess of confidence, specifically, the belief of unsuspecting consumers in offers that are too good to be true. Moreover, these offers needn't be fraudulent to seriously damage confidence. Just as harmful are overpriced, complex financial products for consumers, based on questionable business models. Unfortunately, the focus of such products is not the client's interest, but the commission the provider or intermediary receives. Consumers who buy such products, often following advice they never requested, will feel they have been duped.

These examples can create the lasting impression that deception and cheating are permanent features of financial markets. For a financial supervisor, this is a fairly serious conclusion, and one that brings me to the role of the AFM in preventing and combating financial fraud and corruption.

Role of the AFM in preventing and combating financial fraud and corruption

Financial supervisors in particular perform a key task in this respect. In contrast to the criminal courts and related bodies, the supervisor clearly maintains a permanent relationship with the markets and does not focus solely on punishing fraud after the event. This supervisory relationship opens up possibilities for influencing the conduct of financial institutions.

Supervisory framework

As business-conduct supervisor, the AFM's goal is to promote integrity in the financial sector. By means of supervision, our aim is to create effective barriers against fraud and corruption. We have made the tackling of dishonest parties and serious breaches of integrity a core theme of our work. In this context, we take preventive as well as repressive action in the six following ways:

1. We monitor compliance with the licence regulations and prospectus obligations.
2. We assess the integrity of the executive directors of financial institutions that register with us.
3. We check the integrity of the business operations.

4. We supervise the provision of essential information to consumers of financial products, so that they are not misled.
5. We are alert to signs of market abuse and thoroughly investigate them.
6. We issue warnings to investors and consumers, if necessary in cooperation with foreign supervisory authorities.

The AFM makes the utmost use of its powers. In the case of companies that manage to evade supervision, we try to catch them with other methods. Regarding collective investment companies that are not subject to supervision, we have forced them to disclose information to investors, uncovering dishonest practices as a result. The AFM has also been successful in advocating an increase in the threshold above which investments are exempt from supervision. It is being raised from its present level of € 50,000 to € 100,000. Next year, we also intend to intensify the supervision based on the Prevention of Money Laundering and Financing of Terrorism Act (Wwft).

Enforcement and the relationship between administrative law and criminal law

In the case of a serious violation of financial laws, we conduct a thorough investigation and aim to take visible enforcement measures. If necessary, we report the case to the Public Prosecution Service. We also collaborate in a structured way with the Tax Administration, the investigation and intelligence services and the Dutch Central bank. This collaboration is essential for tackling fraud effectively.

Key aspect in tackling fraud is also the right balance between the enforcement of administrative law and the enforcement of criminal law. Let me explain this.

Market parties are becoming increasingly aware of the effect of administrative law enforcement. The AFM has the power to impose substantial fines not only on a company, but also on the responsible executive director. We can also publish the fines. An administrative fine is usually higher than a criminal fine, and administrative enforcement considerably swifter than criminal enforcement.

This does not mean, however, that criminal enforcement is superfluous. We have to correctly employ criminal law for violation of financial law where criminal offences are

involved. That is, for example fraud, money laundering, and forgery. The use of criminal investigative powers is also necessary for acts that violate financial law, where extensive detection methods are needed to produce sufficient evidence, such as in cases of insider trading.

A criminal prosecution and conviction has serious consequences for an organisation and its board of directors. In the case of an executive director convicted of fraud, the AFM can bar him from pursuing his profession for eight years because he is no longer trustworthy. We can also order the organisation to bring its integrity in order or revoke its licence if the damage is irreparable.

Administrative law enforcement and criminal law enforcement strengthen and complement each other, the sharing of information by supervisory authorities and investigation services being essential to this. Collaboration and the exchange of information are also important between countries. Two examples are investigations into insider trading and international investment fraud. Through IOSCO, the international network of supervisory agencies, we are able to access supervisory information from other countries. In some cases, the fellow agency can also provide criminal-law information. As this does not require an official request for assistance, the exchange of data proceeds fairly smoothly.

Implications of integrity supervision for the financial markets

The supervision of market integrity by the AFM has become visible and is here to stay. But what else does this mean for the financial markets? They are becoming more and more aware of our role. We see this from an increasing alertness on the part of organisations we investigate and from the involvement of major law firms in our cases. Although it occasionally makes the organisation concerned more resistant, the effect is also faster compliance with legal standards. There is no getting around the fact that market integrity supervision has a major impact on an organisation that is the subject of an investigation. At stake are the reputation of the company, and the position of its directors. The demand for information and the obligation to cooperate are a serious intrusion on day-to-day operations, which compels a careful and balanced approach as prescribed by the General Administrative Law Act.

The issue is whether the desired effect can also be achieved with a less heavy-handed approach. Considerations concern not only the choice of investigation methods and enforcement measures, but also the way to influence the compliance by market parties in an effective way. For example, if it is more effective that we supervise illegal parties which are willing to reform as opposed to using our enforcement powers then the soft alternative is preferable. Such an approach demands a pragmatic attitude.

The principle is that institutions are responsible themselves for complying with laws and regulations, as well as for conducting their business operations with integrity, in order to prevent fraud. This brings us to today's key question: *How can we assist commercial enterprises in complying with and implementing anti-fraud legislation?* As supervisor, do we have an obligation to assist them? The answer is "Yes".

Regulations and Guidelines

Financial institutions have to contend with a variety of integrity regulations, often stemming from international directives:

- regulations for customer due diligence in order to prevent money laundering;
- regulations for dealing with incidents;
- reporting regulations;
- insider regulations;
- regulations for structuring business procedures in order to prevent criminal acts;
- integrity requirements applying to executive directors.

Most integrity regulations are simply common sense. They represent a translation of obvious standards that are generally accepted under the heading of good governance. Nevertheless, these regulations also entail uncertainty because the vast majority are principle based. By contrast, market parties need guidelines for complying with open standards, such as integrating integrity into business operations. The AFM meets them halfway to satisfy this need. Using the media of policy regulations and legal interpretations, we provide explanations of specific standards. For example, we expressed our opinion on the competence of executive boards,

reporting regulations and separation of assets. DNB, the Netherlands' central bank, recently drew up guidelines for managing the integrity risks of real-estate activities.

We have to guard against defining supervisory standards in detail, however, to avoid creating a rule-based system unintentionally. Questions of legitimacy arise if the AFM acts as both regulator and enforcer. Fundamentally, we operate within a system that includes the separation of powers and democratic control. An added danger is that organisations will engage in box checking if integrity requirements are too specific. Our objective is not functional compliance with a minimum set of standards simply because the supervisory authority wants it that way. The point is for market parties to aim naturally for adherence to the integrity standards. Only in this way can they regain the lost confidence of consumers and investors. The burden of supervision and compliance with integrity regulations is certainly not excessive for companies, and pales by comparison with the damage to society that financial fraud can bring about.

Self-regulation

Markets can assist in reducing the supervisory burden by implementing effective self-regulation, however, which also helps promote integrity. Examples include establishing codes of conduct, screening market parties, and setting up integrity desks. We see this, for instance, at Dutch portfolio managers and to an increasing degree in the real-estate sector. The AFM supports self-regulation. A well-organised market simplifies the task of supervision by making information on risks and the level of compliance in the industry concerned more accessible. Industry associations are a powerful force for introducing legal standards. In some market segments, our supervision depends heavily on the organisation of the market. For example, without proper collaboration with the operators of trading platforms, it is impossible for the AFM to supervise complex phenomena like high-frequency trading and market manipulation.

Self-regulation alone, however, provides insufficient guarantee for sustained supervision of integrity. In the absence of a disciplinary system, a statutory supervisory regime is definitely essential for correcting abuses.

Obligation to notify

The corrective capacity for detecting and preventing fraud is best embedded in the economic chain. Market parties are not just the subject of supervision; they are also its eyes and ears. Accountants and civil-law notaries have to be alert to non-standard valuations, cash flows and transactions. Financial institutions have a duty to report unusual transactions and events, as well as suspicions of market abuse. All aspects of compliance with reporting obligations need improvement. If this is done, the burden of repressive supervision can be lightened. Within this context, we do have to be able to remove the fear that action will be taken against reporters of incidents because of their involvement in them.

Clemency regulation

This brings me finally to the importance of a whistleblower- or clemency regulation to financial supervision. If we want market parties to report serious abuses voluntarily, without them being fined or prosecuted, a clemency regulation is indispensable. It encourages a race to the government by persons who want to provide incriminating evidence in exchange for immunity. This will enable us to detect and close large cases more rapidly, as well as limit the damage to investors. Within the supervision of competition, a clemency regulation is a proven method for identifying cartel agreements. It is an instrument that is clearly missing. This is why I am glad that the European Commission recently embraced the importance of whistleblower regulations. In its proposal for a new market abuse regulation, the Commission promotes the introduction of adequate arrangements that provide appropriate protection for whistleblowers that report suspected market abuse.

However, the Dutch system of criminal and administrative law enforcement complicates the introduction of a clemency regulation. The task is to develop a system that enables the AFM to grant limited immunity, without eroding the exclusive right of the Public Prosecution Service to institute criminal proceedings. Concealed within this task is an interesting supervisory innovation.

Conclusions: challenges for the markets and for the supervisor

This brings me to the end of my speech in which I touched upon the use of administrative law in tackling financial fraud, its relationship to criminal law, and the implications for the financial markets. Alongside a repressive approach, the responsibility of market parties for combating fraud and promoting integrity is a key factor. As supervisor, we provide support for this responsibility. Our challenge in this context is to convince market parties that transparent and honest conduct represents a competitive edge in today's uncertain climate. It enables them to win back the lost confidence of consumers and secure their access to sources of capital. The challenge facing the markets is for them to show supervisors and investors alike that they take compliance with integrity regulations seriously.