



Report on credible deterrence of misconduct in securities market regulation. July 2015.

IOSCO has recently approved a report on actions that regulators can adopt to deter securities market participants from engaging in misconduct or infringements that later might have a negative impact on their integrity and efficiency, thus undermining investor confidence and protection.

This highly practical document is based on the collective experience of its members, including the CNMV. It contains a detailed description of 7 factors identified for credible deterrence, illustrated with innovative examples adopted by some members of IOSCO. These models may allow other authorities to improve their supervision, investigation and sanction strategies and provide guidance in case of any legislation changes that may strengthen regulators' or supervisors' competences.

Measures to achieve deterrence are credible when would-be wrongdoers perceive that the risks of engaging in infringement or misconduct outweigh the rewards. The risk that misconduct may be detected, investigated and later sanctioned make them opt for compliance. This improves the implementation of securities market regulations.

This report complements IOSCO Objectives and Principles of Securities Regulation (IOSCO Principles) and their methodology, and it provides a wider strategic thinking about how to achieve and maintain credible deterrence.

The aim of the report is deterrence at the time of implementation of legislation, that is, at the time of compliance. Other mechanisms, such as previous authorisations to enter the financial services industry, continuous supervision or financial education programmes, can also serve as effective prevention measures, but they do not refer to the moment of compliance *stricto sensu*.

The 7 factors of credible deterrence identified in the report are the following:

1. Legal certainty. The consequences of misconduct must be precise and predictable. Misconduct can be deterred by regulations when it is concrete and foreseeable and allows persons and entities to anticipate and be responsible for the consequences of their actions.

Deterrence occurs when laws and regulations are clear and unambiguous and foster legal certainty, are aligned to the jurisdiction and are transparent, so that people and entities know and understand the obligations that apply to them. Also when they create the expectation that laws will be enforced and that misconduct will be detected, investigated and sanctioned and, simultaneously, there are appropriate avenues for the prosecution and remediation of misconduct, and administrative and judicial decision makers are informed, impartial, independent and competent.

2. Detecting misconduct. Regulators use mechanisms to detect misconduct in a timely manner and create the expectation that non-compliance will be investigated, prosecuted and punished. Regulators who are well

connected and have access to information sources in real time will be able to detect misconduct before it affects investors or markets.

Detection will be more effective if regulators establish mechanisms for information exchange, both at the national and international levels, technologically advanced surveillance programmes, including cross-border transactions, systems to receive complaints and tips from the public and internal information channels between the supervision and investigation departments.

Some legislations establish compulsory reporting requirements for suspicious transactions by certain participants (gate keepers) and regulate the function of whistleblowers, such as the Market Abuse Regulation (MAR) regulating the framework for whistleblowers in the European Union (UE).

3. Co-operation and collaboration to eliminate safe havens through collaboration with criminal authorities and other national and international agencies to share information (both public and non-public).

This will need co-operation agreements (such as IOSCO Multilateral Memorandum of Understanding [MMoU]) that facilitate the removal of legal obstacles for the sharing of information and co-operation, and that each regulator has a centralised process for the timely prioritisation and execution of information requests from other authorities. In ESMA's Market Integrity Standing Committee, European authorities regularly exchange information on the application of market abuse laws in the EU.

4. Investigation and prosecution through early, bold, resolute supervision, investigation and sanctions. Misconduct should be sanctioned and published in a timely manner.

For this purpose, regulators should have sufficient supervision powers including powers to request assistance, to freeze assets and to adopt other measures to prevent the destruction of evidence.

5. Sanctions. The sanction system must be effective, proportionate and dissuasive.

Sanctions for non-compliance should be such that they outweigh the potential benefits. Deterrence will be greater if natural persons are considered personally responsible for their actions. Regulators should be empowered to directly impose sanctions and/or refer cases to administrative, civil and/or criminal courts. Sanctions should be effective, proportionate and dissuasive: they should cover the cost of investigations and, when possible, should be practical and innovative, serving the public interest and investors.

6. Public disclosure: By means of transparent and prudent messages to the public regarding supervision and investigation measures.

Transparency promotes potential offenders' understanding and deterrence. Compliance is facilitated when authorities communicate their objectives, mandates and outcomes in a timely manner. Regulators should alert the public about non-compliance and misconduct, as well as about high risk products and services, which might be used by the industry to set out good practice standards.

7. Regulatory governance. Regulators should regularly evaluate their supervision, investigation and sanction strategies, priorities and tools. At the same time, they should identify innovating solutions and practices in response to the increasing complexity of national and international regulations and to emerging risks.

The performance analysis of market participants and its constraints is an innovating tool that can be used by regulators to understand which aspects influence the decisions of adopting good or bad practices. The Financial Conduct Authority (FCA) in the United Kingdom and the Autoriteit (AMF) in The Netherlands use tools (investigations) to understand the change in behaviour and be able to intervene in markets with greater effectiveness.

Relevant links:

