AEDBF ATHENS WORKSHOP October 17th 2008

SANCTIONS AND MEASURES PROVIDED IN EUROPEAN JURISDICTIONS TO COMPLY WITH EU DERIVING BANKING AND CAPITAL MARKETS NATIONAL LAW

Monaco Banking and Financial rules

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This text has been prepared with the M. François Poher' bright help.

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Before to screen the keys topics of the Monaco banking and finance legislation, it is necessary to give to a brief moment to describe what is the legal situation in the Principality.

First of all, Monaco is not a member, neither the European Union, nor the European Economic Area.

Consequently, the European Union Directives, rules and legislations are not directly applicable in Monaco.

Monaco is a member of the European Council and the Human Rights European Court is competent for Monaco.

Moreover, there is a main difference for Monaco between banking law and financial services law.

Concerning banking law, and particularly the rules regarding the organization and control of the banks and credit institutions, the French legislation is mainly applicable, subject to its validation by the Monegasque Government, since 1945, and, consequently, important parts of French Monetary and Finance Code are applicable in the Principality, but limited, in fact, to the French former banking law of 1984 January 24th articles, which are included in the previous code.

Concerning the security portfolio management companies and financial services rules, and even in the case these are one of the bank activities in the Principality, they are submitted to Monegasque legislation.

I - Monaco as a financial place

The first banks, mostly French, appeared in the Principality in the late 19th century. At this time, the legislation was very soft and light. Having grown relatively slowly, banking expanded rapidly in the 1970's after the Monacan government introduced a policy of encouraging high-quality projects that would help the Principality's economic development.

In the 1990's the government, concerned to diversify the

activities of Monaco's financial services, regulated a range of financial services in addition to banking and insurance, starting with mutual fund management in 1990, followed by portfolio management, the transmission of orders and advisory services in 1997.

The aim of these regulations was first to regulate a non regulated sector of the local economy, and to protect customers and preserve market security. With this respect, it is reminded that only credit institutions and portfolio management companies authorized by the Minister of State are allowed to sell financial products on the Monacan territory.

As the Principality of Monaco does not have a stock market, its banks and financial professionals specialize in asset management.

The Monetary Agreement concluded with France which represented the European Union, on December 2001 24th allowed Monaco to adopt the euro as its currency, thus ensuring monetary continuity (Monaco's currency had previously been the French Franc). The agreement confirmed that the Monacan banking system has full access to Eurozone payment systems and is therefore also subject to the monetary policy of the European Central Bank, and that credit institutions have partially access to securities settlement systems. It also confirmed that Monaco has

appropriate regulations for preventing systemic risk in payment and securities settlement systems.

At the Principality's request, the International Monetary Fund conducted a comprehensive review of the financial sector which was concluded in May 2003. The IMF report finds that the regulation and supervision of the financial sector are consistent with international standards.

Furthermore, the Monegasque authorities also provide the International Monetary Fund (IMF) with the main indicators relating to the Principality's banking and financial activities on a regular basis, thereby contributing to the exercise entitled "Offshore Financial Centers Information Framework".

Since a first anti-drug law dating from 1970, the Principality has enhanced its legislation to counter money laundering and the financing of terrorism, introducing laws and regulations and creating SICCFIN (*Service d'Information et de Contrôle des Circuits Financiers* - Financial Circuits Information and Control Department), a specialist anti-money laundering unit responsible for processing and disseminating information about the financial circuits used for money-laundering.

Monaco's anti-money laundering arrangements have been reviewed by the FATF, which deemed Monacan legislation

to be consistent with international standards for legal measures to counter money-laundering.

II – The Financial system

1 – Banks and Credit institutions.

Following the agreement of 14 April 1945, between France and Monaco on exchange controls and exchanges of letters in 1963, 1987 and 2001 setting the terms and conditions for implementing French banking legislation in the Principality, credit institutions are partly governed by prevailing banking regulations in France. The exchange of letters between France and Monaco of 27 November 1987 provides that the provisions of French banking law 2004 January 24th apply in Monaco when they strictly concern the regulation and organization of credit institutions. Certain provisions relating to criminal matters or exercise of the duties of company director, liquidator or auditor cannot be applied without taking Monaco's own laws into account.

The secrecy rules which are providing in the French legislation (Article L 511.33 Monetary and Financial Code) apply in Monaco.

Credit institutions established in the Principality are thus supervised by the French Banking Commission

(*Commission Bancaire*) and, as far as their organization is concerned, they must comply with the rules laid down by the French Minister of the Economy, Finance and Industry after consulting the French Advisory Committee on Legislation and Regulation (*Comité Consultatif de la Législation et de la Réglementation Français* - CCLRF). Any credit institution wishing to establish itself in the Principality must obtain prior authorization from the Minister of State (the same applies to any creation of a business in Monaco) and a licence from the French Credit Institutions and Investment Firms Committee (*Comité des Etablissements de Crédit et des Enterprises d'Investissement* - CECEI).

Banks and financial companies are represented by a professional body, the Monacan Association of Financial Activities (*Association Monegasque des Activités Financières*). They also belong to a French professional body, either the French Banking Association (*Fédération Bancaire Française*) or the French Association of Financial companies (*Association Française des Sociétés Financières*) as the case may be:

2 – Security Portfolio Management companies

Collective and/or individual management companies fall within the Monegasque legislative and regulatory process constituted by Laws n° 1 338 and 1 339 of 2007

September 7th and Sovereign Orders 1 284 and 1 285 of 2007 September 10th.

The accreditation and control of such companies are within the remit of the Financial Activities Audit Committee. They can practice, after obtaining accreditation, all or some of the following activities:

- the management, on behalf of a third party, of portfolios of fixed-term securities or financial instruments
- the management of unit trusts or other collective investment undertakings incorporated in Monaco or abroad
- the receipt and relay of orders on financial markets, concerning fixed term securities or financial instruments, on behalf of a third party
- consultancy and advisory services within the areas mentioned above

3 – Insurance companies

Insurance companies are governed by the Convention between France and Monaco of 1963 May 18th. Prior authorization must be obtained from the Minister of State in order to create a subsidiary of an insurance company in the Principality and will be given after the French authorities have agreed to establishment of the subsidiary.

No insurance company has a direct presence in the Principality at the present time. Insurance services are offered by some fifty or so agents and brokers, representing over 150 insurance companies.

Insurance agents and brokers are governed by Act 1.144 of 1991 July 26th and Act 1.162 of 1993 July 7th on money-laundering and the financing of terrorism and supervised by the French Insurance Supervisory Commission (*Commission de Contrôle des Assurances*).

4 - Company Service Providers

There are 37 companies authorized to manage and administer foreign entities. Like all companies in the Principality, their incorporation is subject to government authorization.

The companies are regularly controlled by the Economic Investigations Department (*Service des Enquêtes Economiques*) of the Economic Expansion Directorate (*Direction de l'Expansion Economique*) under the terms of Act 1.144 of 1991 July 26th.

As financial organizations, they also fall within the scope of Act 1.162 of 1993 July 7th as amended on money-laundering and the financing of terrorism and are

therefore subject to controls by SICCFIN.

The sector was examined as part of the IMF review in 2002-03, which concluded that the authorities had a good knowledge of the sector.

5 – Trusts (Act 214 of 1936 February 27th as amended by Act 1.216 of 1999 July 7th).

Act 214 was designed for the use of Monacan residents of British or American origin, wishing to settle the arrangements for only their succession according to the law of their country of origin. This continues to be the main reason for using the facilities accorded by Act 214 as amended.

The constitution of a trust is subject to the formal rules of Monacan law relating to testaments and donations and must therefore take place before a notary. The trustees are legal entities or individuals authorized as such by the judicial authorities of the Principality.

6 – Sanctions and measures provided in the banking and capital markets laws of Monaco.

For the banks, and concerning control and organization, the French legislation is applicable, even

if the bank is not a French one, and the French Banking Committee is competent.

61 - The power to sanction and rights to defense:

The CCAF (the Financial Activities Audit Committee) provided by the previous 2007 Laws, which have not legal body and not have a specific budget, has relatively extensive powers to issue injunctions and sanctions, which were previously exercised directly by the Minister of State. Some deeds or procedures implemented by the CCAF are incumbent upon or the judicial judge and others upon the administrative judge (cf. below).

These two ways, depending on the nature of the deed, does not facilitate the understanding of the system. The power to issue injunctions is laid down in article 19 of the law. It includes, in the event of the refusal of the company concerned by the injunction to comply with the formal notification, a referral of the case to the President of the Court of First Instance, so that the latter may order by an official ruling that the formal notification is respected.

Judicial competence also takes precedence when the CCAF, in compliance with article 42, pronounces for protective purposes the suspension of the authorization (for a maximum period of three months) of the individual responsible for the alleged opacity concerning “one or

several obligations prescribed by the law". This emergency measure, which may be taken independently of administrative sanctions, can only be cancelled by the President of the Court of First Instance.

No provision is made for stay of execution: the decision to lift the sanctions taken by the President is only effective on the day when it is pronounced.

The possibility of combining the two procedures exists as the provisional suspension is implemented upon refusal of an authorized establishment to comply with the injunction.

Each stage of the procedure consists of an administrative deed, and appeal against excessive power may be filed before the administrative judge.

Rights to defense, in contrast to the procedure for administrative sanctions lay down in articles 34 and following, are not guaranteed during the preliminary phase which is subject to the sole discretion of the CCAF. The company under investigation is not invited to provide explanations. It may admittedly be conceded that it had all the time necessary to do so under article 19, if, as suggested hereinafter, both systems are compatible. In the description of reasons and according to article 42, it is held that, as this protective measure is not a sanction, there are no grounds for respecting the principle governing all court hearings and giving to parties the right to a fair hearing including the right to defense and the right to be confronted in an open court with all evidence and

witnesses used by the other party. However, there is little doubt with respect to ECHR (European Court of Human Rights) case law and its interpretation of articles 6-1 and 6-2 of the Convention, that the suspension of the authorization, due to the extremely detrimental or even irreversible consequences that it may produce, may be assimilated to a sanction. It is the responsibility of the judicial judge, or more probably the administrative judge, to give a decision on this matter when called to rule on compensation proceedings against the State. The comparison between injunctions and emergency measures that may be ordered by the AMF (the Financial Markets Association) (articles 621-13 and 14) also reveals a characteristic specific to Monaco as although the objective of these procedures may be relatively similar to that of the Monaco system, they differ in that they are strictly regulated by the judicial authority which has the sole power to enforce them. As a result, the AMF may for protective purposes only suspend authorization as this is the exclusive prerogative of the judicial judge and, as such, this measure is not mentioned in the arsenal described in article 621 – 14 of the Monetary and Financial Code.

This highly discretionary option, which is not open to a stay of execution, is totally excessive with respect to common law. It is a fearsome weapon which, if used, can prove detrimental both to the company concerned and to the State which is inevitably exposed to an appeal before

the Supreme Court in the event of error by the CCAF in the decision making process.

Powers to issue sanctions stricto sensu are determined by a prudent administrative methodology. Rights to defense are guaranteed (article 36). Equal footing and the principle governing all court hearings and giving to parties the right to a fair hearing including the right to defense and the right to be confronted in an open court with all evidence and witnesses used by the other party are also expressed in the description of the functioning of the procedure (article 37). The individual charged with making the report may not contribute to the decision in order to prevent accusations of partiality that have often been made against decisions taken by the COB (the former French market regulator) and the AMF.

Sanctions take the following form: warning, accusation, temporary suspension or withdrawal of authorization. It may be noted that temporary suspension can be implemented either for protective purposes in accordance with article 42 (described earlier) or as an administrative sanction in accordance with article 34. The joint application of these two systems of suspension, complying with completely different conditions, is detrimental to the judicious management of sanctions and raises question marks for lawyers. The procedure prescribed by article 34 has to be notified publicly and can be appealed against,

according to case law, before the Supreme Court. The procedure prescribed by article 42 would not appear to require public notification and cannot be cancelled before a ruling by the president of the Court of First Instance.

62 - The issue of sanctions issued against credit institutions

The other issue that merits attention concerns sanctions issued against fully operational credit institutions. The above-mentioned observations apply only to service providers which, in the case of Monaco, means portfolio management companies.

It would appear evident that the CCAF has full regulatory control over authorized companies and portfolio management companies. This is not the case with respect to credit institutions which are authorized by the CECEI (French banking regulator) due to laws common to both countries since 1945.

The wording of article 41, which requires the break-up of a company following the withdrawal of authorization, does not apply to credit institutions due to article 32. Does this imply that a credit institution cannot be subject to a suspension measure or a withdrawal of authorization? In this respect, the law offers no answers and has failed to resolve an issue that was already a subject of debate before the adoption of the new regulations.

Under former regulations, it was the Minister of State who issued sanctions and, however, despite the fact that this was not expressly stipulated by law 1194, he could only do so subject to the disciplinary powers of the Banking Commission as defined in article 613-21 of the French banking and financial Code and in compliance with letters exchanged defined in article and in compliance with the exchange of letters in 1963. It can obviously be argued that there is no doubt that the jurisdiction of the Banking Committee , in terms of disciplinary action, is restricted to banking services and is not applicable to services governed by the CCAF. Although in organic and practical terms, it would appear that possibility of co-ordination of the two systems is feasible, on a judicial level, there problem nonetheless remains entire due to the shortcomings of the legal text. Could there be sanctions founded on the same prejudices in contradiction with the principle of *non bis in idem*, as the Banking Committee has extensive prerogatives in terms of the appreciation of the internal control systems of lending establishments, a domain also included in the scope of the CCAF?

Which of the authorizations will take priority and how will sanctions be determined if two systems were to be implemented simultaneously and/or consecutively? Could the CCAF suspend the authorization of a credit institution, at least insofar as concerns its financial activities, under the provisions of article 42? Could this *de facto*, if not legal, situation undermine the principle of equality of treatment

between the companies concerned (credit institutions versus authorized companies)?

The new regulations provide no answers to these questions. However, the provisions of article 32 maintaining that credit institutions are not subject to the break-up procedure set forth in article 41 in compliance with articles 5 and 7 of law 767 of 8th July 1964 attest to the difference of treatment between the two categories.

The reasons for this situation can be briefly explained as follows:

"Whilst credit institutions *are subject to the general regime of this Bill in terms of approval and functioning, their specific characteristics justify the fact that some obligations and prohibitions should not be applied to them. In particular, Article 29 restates the provisions currently in force and exempts* credit institutions *from certain obligations.*

More generally, it appears henceforth that banking and financial law in the Principality must evolve towards a greater autonomy with respect to French law. Conflicts and erroneous interpretations are becoming widespread, putting approved establishments into positions that are difficult to clarify.

The interpenetration in Monacan laws, of French laws that have evolved considerably since their origins, and treaties or exchanges and bilateral agreements give rise to

questions with regard to the applicability of some whole sections of French law in Monaco, but that is another story.

63 - Grading of sanctions and the absence of the faculty to order pecuniary fines

Finally, contrary to the majority of European regulators, the CCAF cannot order pecuniary sanctions. This deprives this authority of a considerable part of the efficiency that was expected through its independence. The arsenal of disciplinary sanctions such has been described, without the ability to impose fines, renders the measure too rigid, insufficiently graded and a weak deterrent, except when use is made of the tactical or strategic atomic bomb – the suspension or removal of approval. One cannot avoid thinking that the large number of penal offences which form Section V of the Bill would have been more efficiently sanctioned in the form of administrative measures, punishable by pecuniary fines. Incidentally, it is not expressly ruled out that accumulation may take place, but the fact remains that only the penal judge may order fines. Article 45, that will be dealt with later, is symptomatic of this penalization of behaviour or acts that are considered to be non-compliant, which could advantageously have been discouraged by administrative means alone, as is the case in many States of the European Union.

64 - Ordering sanctions and the exception of unconstitutionality

The presentation of reasons, as in the Reporter's Bill, shows the probable unconstitutionality of the Act. One of the national Councilors, during the session of 2007 September 4th , actually justified his refusal to vote the new law, due to the manifest unconstitutionality that affects it, with regard to Articles 3, 43, 44, 45, 47, 50 and possibly 14.

Without going into the detail of the questions that could arise concerning the unconstitutionality of the Bill, we will limit ourselves to indicating that one of the main problems concerns the incompatibility of the independence of the Commission, with the delegation of executive power, including the power of administrative sanctions, with which only the Minister of State is legally empowered.

Whilst a person sanctioned by the CCAF can defer the decision taken against them by this authority at the Supreme Court due to a grievance concerning an excess of power, they can also invoke the exception of unconstitutionality of the law before the same court. This exception is considered as perpetual. If the exception of unconstitutionality should be admitted and thrive upon an occasion of individual recourse, the whole measure will be in question. Indeed the extended jurisdiction of the Supreme Court leads it to monitor the constitutionality of

the Bill upon which the contested administrative decision was based. An examination of the jurisprudence of the Supreme Court shows that, in this case, the jurisdiction is extended to all the provisions of the Constitution and not only to Chapter III of the latter, as stated in Article 90 Number 2 of the Constitution.

This constitutional invalidity risk, which has been taken intentionally, shall threaten the effectiveness of sanctions the Commission could be liable to deliver. We can lawfully doubt that reference to article 1 of the Constitution and to international commitments the Principality would have taken towards France could likely convince further the constitutional judge. In this case, by way of international commitments, they at the very most negotiations with France, within the framework of the French/Monaco working group on financial legislation formed in 2003. A literal reading of article 1 of the Constitution, which only refers to agreements entered into with France, and not mere discussions, leaves the question of the constitutional validity of the text unresolved.

65 - The other prerogatives of the Commission

The Commission is vested with the authority to enter into cooperation agreements with foreign authorities. This prerogative is not new as such, since the former "Commission of Control of management and similar trading activities" already had this authority. Article 17, which the former Bill did not provide, however sets forth

that the exchange of information may only take place provided there is reciprocity and provided the foreign authority is subject to professional secrecy.

The rules of specialties related to communicate information are also instituted to prevent them from being used for other purposes than such provided in the cooperation agreements. Restrictions thereby imposed rely are based upon such established in this regard by the Swiss Federal Banking Commission.

66 - On the Markets in Financial Instruments Directive (MIFID) subdued transposition

The other great innovation of this act of law and its implementation order is the somewhat subdued transposition of one of the guiding principles of the MIFID.

Even if the preamble does not refer to it, we can only be struck by the use of terms which largely drew their inspiration in the famous Directive. The purpose sought is the same, namely to ensure a better protection of the investors.

Provisions enshrining this reinforced protection are designated in the Act under the expression “rules of good conduct”.

The Act of law contents itself with referring to it (article 23) and leaves it to the Ordinance to provide for it while specifying that authorized companies must comply with

them, after the fashion of prudent man rules, which shall be commented hereafter. Article 26 - Last paragraph, which deals with portfolio management agreements, recalls that (authorized companies) “must not use such agreement for other purposes than such for which they were entered into”. This generally formulated obligation, which is used a legal basis for the rules of good conduct, and the breach of which entail criminal prosecution under the provisions of article 45 (3) of the Act (see hereunder). It is not an innovation as such. The provision must already on article 5 of the former law amended in 2001.

67 - Looking for the client’s exclusive interest

The terms of the Ordinance, due to their precise nature, explain what is meant with looking for the “client’s exclusive interest”, a principle, which, under the former law, had remained quite hazy. Further, this search for the client’s exclusive interest is henceforth extended to all services authorized companies are liable to provide.

These standards have never appeared before in the legal landscape of Monaco.

The clients’ classification excepted, one of the cornerstones of the Directive, we have to admit that the Ordinance makes a transposition of a large number of obligations arising out of the Directive.

68 - The prevention and management of conflicts of interest

The new text sets the standards for the identification, prevention and management of conflicts. The service provider should strive to avoid conflicts of interest and settle any potential conflict by giving priority to the interests of the client. Article 9 which refers to the autonomy of the decision of the service provider is, in all probability, aimed at asset management companies which are subsidiaries of a banking group which, despite the capital, operational and organic links existing between them, must have real independence with respect to its shareholder and key partner in order that it can give priority to the interests of its clients in all instances. The autonomy requirement will be even stronger when the shareholder entrusts the subsidiary with the management of own-account positions or when the company itself manages its own assets. Conflicts likely to arise from such situations are numerous, particularly when it is possible that the taking and execution of orders is carried out by the shareholder bank, which is an additional source of conflicts of interest. Although the new text fails to provide any clear indications on this issue, it is evident that the service providers will be obliged, in compliance with the MIF directive, to adopt a management of conflicts of interest policy, which implies the implementation of organizational measures implicitly, alluded to in article 6 of the text. However, the difference between the directive

and French law is that the text gives no details on the method of identification of conflicts which will obviously fall into two categories: (i) between the service provider and the client; (ii) between two clients. The wording of the articles of the new text can be interpreted as meaning that the first reason is the only that carries any weight: i.e. between the service provider and the client, but this would ignore the fact that any institutional client, be it the parent company of the service provider, would be deemed in any case whatsoever as a client.

69 - The prevention of conflicts of interest and the issue of retrocessions

In the case of Monaco, where a large number of asset management companies belong to international banking groups, this issue is of particular importance. The problem of conflicts of interest inevitably leads to the assessment of the related problem of remuneration of services, notably under the aegis of retrocessions paid by banks to asset management companies and commission received by the same deposit banks in return for the distribution/investments of funds or financial instruments. It can be forthwith be assumed by the wording of the text that service providers, banks and asset management companies shall be held to declare the amount and nature of such remuneration. A contrario, it would not appear, as stipulated by the Directive and now required by French

law that it is required to specify the amount and the method of calculation. The fact nonetheless remains that there are sound grounds for insisting that it is the responsibility of the service provider to prove, on request of the client, during legal proceedings, or by the regulator that the amount of the remuneration was not detrimental to the obligation of respecting the best interests of the client. The problem of retrocessions is an issue that is be dealt with as a priority in the document concerning the management of conflicts of interest.

The consequences of this new obligation are not insignificant, particularly as concerns the declaration of remunerations, which ought to be included in account agreements and management mandates; and be subject to clauses applicable to asset management companies and depositaries and also bind the latter to asset managers and salespersons of funds and other financial instruments. A code of good conduct could be a useful instrument to standardize practice and information on this front.

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