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# **Typology of stock market offenses in France: An analysis of sanctions by the AMF since 2006**

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**October 2012**

# **Typology of stock market offenses in France: An analysis of sanctions by the AMF since 2006**

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## **Abstract**

This paper presents a study intended to demonstrate how the Financial Market Authority (AMF) in France uses its regulatory and sanctioning powers with regard to brokers, listed companies and other actors (individuals) in the financial industry during the period 2006-2011. The AMF actions are evaluated over time, by examining the evolution of the number and severity of sanctions, as well as in space, through international comparisons. Overall the imposed sanctions according to both their category and the status of those sanctioned strongly indicate that few firms and brokers are sanctioned by the AMF. In addition, the AMF imposes very few administrative sanctions (reprimand or warning). Despite the increase in the maximum fines that may be imposed by the AMF, the set fines by the Enforcement Committee are very weak relative to the volume of the Paris market, to the total assets under management and to the volume of transactions on the Paris stock exchange. A comparison of the AMF statistics with those of its British and American counterparts shows a wide gap between the amounts of fines paid by fraudsters in 2006.

**Keywords:** Insider Trading, Fraud, AMF, Accounting Manipulations

**JEL Classification:** G38, K23

## ***I. Introduction***

The question of stock market-related offenses has long been identified as an important subject in finance research (Sutherland 1940). The earliest theoretical approach to the phenomenon is known as the “Triangle of Fraud” (Cressey 1953). According to this approach, cases of fraud in general have three characteristics in common: the pressure felt by the individual who will commit a fraud, the opportunity to commit it and the rationalization of the fraud by its perpetrator, who persuades himself that the act is coherent with his personal ethics. Each of the three sides of the Triangle of Fraud has subsequently been the subject of theoretical insights, giving birth to a veritable theory of fraud (Fleming et al. 2012).

To address the risk of fraud, anti-fraud efforts take three approaches: prevention, deterrence and detection of crime. Prevention depends primarily on internal controls, sensitizing the actors and developing an ethical culture. Deterrence tries to implement environments that discourage individuals from fraud. Finally, fraud detection is performed by “watchdogs,” such as auditors, market regulatory authorities and tax auditors.

Market regulatory authorities, such as the Financial Market Authority<sup>1</sup> (AMF) in France, play an essential role in deterring fraud by implementing appropriate control mechanisms and contributing to the creation of a deterrent environment for the listed companies.

In the same spirit, analysis of the sanctions imposed by a market authority contributes to a better understanding of the importance of the level of fraud deterrence in a given country. The present study intends to demonstrate how the AMF uses its regulatory and sanctioning powers with regard to brokers, listed companies and other actors (both companies and individuals) in the financial industry. The goal of this study is to evaluate the active role of the AMF in the financial industry over the last five years by analyzing sanctions according to both their category and the status of those sanctioned (companies vs. individuals). The actions of the AMF are evaluated both over time (evolution of the number and severity of sanctions) and in space (through international comparisons). To the extent that the role of a market authority is central in the struggle against financial fraud, our study questions whether the actions of the AMF have a sufficient level of deterrence in this area. If not, what could be the reasons that explain the relatively weak level of sanctions imposed?

This article is structured in the following manner: We first present a review of the literature on financial fraud, including fraud in financial reports, fraud carried out by investment services providers

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<sup>1</sup>The AMF exercises four different types of responsibility: regulation, authorization, oversight and sanctions.

(ISPs) and price manipulations and/or insider trading. Second, the AMF's regulations regarding sanctions are presented. Third, the methodology of the study is presented. Next, the results of our analysis are presented, distinguishing exceptional sanctions and other sanctions, classified by category. Finally, these results are discussed, particularly in comparison with results from American and British market authorities.

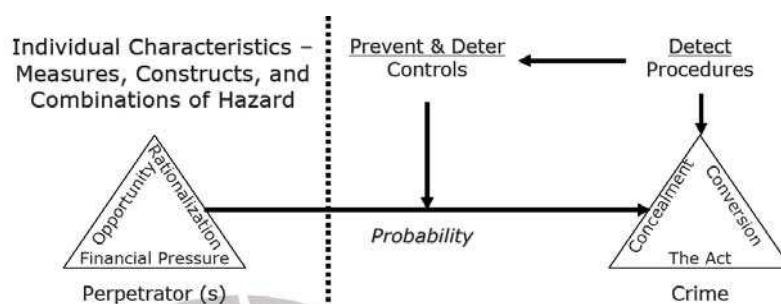
## ***II. Review of the academic literature regarding stock market-related offenses***

### **II.1. From Fraud Triangle to financial fraud theory: The role of deterrence**

Sutherland (1940) first highlighted the crimes of people involved in economics and business activity and is credited with coining the term "white-collar crime." Sutherland's PhD student, D.R. Cressey (1953), shaped a theory of fraud and came to the conclusion that all frauds generally had three characteristics in common. First, the person committing the fraud perceived a financial need (pressure) that could not be shared. The second commonality was opportunity. The perceived opportunity was a perception of both control and detection weaknesses. Additionally, the ability to commit the act (the crime) and lack of detection were required to concretize the perceived opportunity. Third, the person responsible for the fraud rationalized his action, persuading himself that it was consistent with his personal code of ethics. The rationalization of the fraud depends on each individual's culture and character; it also depends on the power of the pressure and of the legal and cultural environment. The Fraud Triangle remains a relevant reference that helps in understanding and fighting fraud. Each side of the Fraud Triangle model has been enriched by various contributions that have built a living financial fraud theory (Fleming et al. 2012).

The Fraud Triangle is mainly focused on the perpetrator(s) of the crime and answers to the question, "Why is fraud committed?" Albrecht et al. (2006) and Kranacher et al. (2010) refer to the Elements of Fraud, focusing on the crime itself and answering the question, "How is fraud committed?" The Elements of Fraud consist of the act (execution and methodology of the fraud), concealment (hiding the fraud act) and conversion (legitimization of the gains). Fleming et al. (2012) propose a fully conceived meta-model of white-collar crime (Figure 1) that links the perpetrator(s) to the crime by the probability of committing the crime.

**Figure 1: Fully Ascribed Meta-Model of White-Collar Crime**



(Fleming et al. 2012)

Thus, anti-fraud efforts try to reduce the probability of the fraud path by employing prevention, deterrence and detection (of the crime). Prevention, according to the authors, mainly involves (1) implementing internal controls and (2) becoming sensitive to fraud and establishing an ethical culture. Detection of crime is mainly devoted to “watchdogs,” such as auditors, market regulators and tax auditors. Fraud deterrence “refers to creating environments in which people are discouraged from committing fraud... Fraud deterrence is enhanced when (1) the perception of detection is present and (2) potential perpetrators recognize that they will be punished when caught” (Fleming et al. 2012).

To that end, market regulators, such as the AMF, deter fraud by creating an appropriate control and punishment environment for listed firms. The analysis of AMF sanctions contributes to an understanding of the level to which these sanctions actually deter fraud.

## **II.2. Financial statement infractions: definition, motivations and deterrence**

The literature frequently distinguishes between manipulations that conform to legal rules and standards and those that do not (fraud). From a legal view, accounting manipulations become fraudulent when an intentional material misstatement of the financial statements occurs. “*Fraud, particularly financial statement fraud, is deliberate deception with the intent to cause harm, injury, or damage*” (Rezaee and Riley 2010). Regulators make a distinction between an error, which is not intentional, and fraud, which is intentional. This distinction is introduced in SAS No. 99, in the International Standards on Auditing (ISA No. 240) and in the French standards on auditing (NEP No. 240)(AICPA 2002; CNCC 2010; IFAC 2009). In practice, the intent is very difficult to find out and is typically determined by an administrative, civil or criminal proceeding (Mulford and Comiskey 2002).

The motivations to perpetrate financial statement fraud are numerous. We propose below a synthetic review of literature using the fraud triangle approach.

<b>Incentive / Pressure</b>	
<b>Managers' greed</b>	Financial statement fraud may considerably increase performance-linked bonuses and thus remuneration (Ross L. Watts and Zimmerman 1978; Healy 1985, 1999; Lambert 1984; McNichols and Wilson 1988; Moses 1987; Gaver et al. 1995; Balsam 1998; Holthausen et al. 1995; Guidry et al. 1999).
<b>Managers' fear</b>	Increasing performance through fraud may make it possible to avoid negative outcomes, such as job loss (Fudenberg and Tirole 1995).
<b>The need to respect financial conditions</b>	To procure funding under the most favorable conditions, managers may be tempted to manipulate accounts to present a more favorable financial situation (R.L. Watts and Zimmerman 1986; Sweeney 1994; DeFond and Jiambalvo 1994). Initial public offerings (IPOs) put intense pressure on managers that can lead to financial manipulations (Friedlan 1994; Teoh et al. 1998).
<b>Taxes reduction</b>	Reducing taxes is another major motivation for manipulating accounts (Scholes et al. 1992; Jennings et al. 1996; Collins et al. 1998).
<b>The need to minimize the cost of capital</b>	Minimizing financial costs and the cost of capital is another key motivational factor in financial manipulations (Stolowy and Breton 2003; Dechow et al. 1996; Hribar and Jenkins 2004).
<b>Opportunity</b>	
<b>Governance</b>	Weaknesses in the governance of a company present an opportunity to commit financial statement fraud. Smaili et al. (2009) provide a summary of the determinants of errors (leading to restatements) and frauds (leading to enforcement procedures). Two major groups of determinants are thus defined according to the firm's financial situation (incentive/pressure) and its system of governance (opportunity). Dechow et al. (1996) demonstrate that there are more frauds in firms with a poor standard of governance, those in which insiders dominate the Board of Directors and those in which the role of the audit committee is relatively unimportant.
<b>Rationalization</b>	
<b>Managers' integrity</b>	Hogan et al. (2008) present an interesting review of the literature available on the Fraud Triangle and, more specifically, about the rationalization of fraud. They quote previous studies that noted the importance of managers' integrity (Gillett and Uddin 2005; Hernandez and Groot 2007).
<b>Low risk of detection</b>	The probability of a financial statement fraud being detected is very low (Wuerges and Borba 2010), which represents a strong rationalization for most fraud-perpetrating managers.

Beasley et al. (2010) provide a comprehensive analysis of fraudulent financial reporting occurrences investigated by the US SEC and provide insights to deterring fraudulent financial reporting. The authors note the severe consequences for the company and individuals involved (cease and desist, officer/director bar, SEC bar, fines and disgorgements).

### **II.3. Reasons for fraud for Investment Services Providers (ISPs)**

ISPs include brokers and asset management firms. Brokers are defined by the French Monetary and Financial Code as investment companies and credit establishments that have received accreditation to provide investment services<sup>2</sup>. Carrying out each of these investment services requires accreditation, which is issued by the Prudential Supervisory Authority (PSA) after approval of the broker's program of activity by the AMF, except when the service provider's principal activity is portfolio management.

According to the French Monetary and Financial Code, asset management firms are investment companies whose main activity is asset management on behalf of third parties or that manage one or more collective investment bodies. The AMF accredits asset management firms at the time of their creation. To grant the accreditation for an asset management firm, the AMF verifies whether the firm has its head office and management personnel in France, whether it has sufficient initial capital available as well as necessary and sufficient financial means and whether it provides the identities of its stockholders (whether direct or indirect, individuals or corporations) who have qualifying participation, as well as the amount of their participation. The AMF evaluates the quality of these stockholders with regard to the need to guarantee healthy and prudent management. It also evaluates whether the firm is actually managed by at least two persons who possess the necessary integrity and experience appropriate to their function to guarantee healthy and prudent management and whether the firm has a program of activity for each of the services that it intends to provide. This program should be adapted to cover all foreseen activity, be updated regularly and adhere to a securities guarantee mechanism managed by the Deposit Guarantee Fund.

The AMF determines the rules of good conduct and the obligations of professionals authorized to provide investment services. When violations of the promulgated texts occur, the ISPs are responsible. The deontological principles<sup>3</sup> of ISPs are listed in the French Monetary and Financial Code and serve the interests of clients, their information and the orderly functioning of the financial markets.

We have been able to identify very few academic studies on brokers and asset management firms in the area of management sciences, but there are various juridical articles on this subject. Brokers and

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<sup>2</sup>Including the reception, the transmission and the execution of orders on behalf of third parties, proprietary negotiation, portfolio management for third parties, investment counseling, underwriting, guaranteed investment, unsecured investment and the exploitation of a multilateral system of negotiation.

<sup>3</sup>The deontological principles oblige ISPs to behave with loyalty and act with equity to the betterment of the interests of their clients and the integrity of the market; to conduct their activity with due skill, care and diligence in the best interests of their clients and the integrity of the market; to possess the resources and procedures necessary to satisfactorily carry out their activity; to implement these resources and procedures efficiently; to inquire as to the financial position of their clients, their investment experience and their goals with respect to the services requested; to appropriately communicate useful information during negotiations with their clients; to try to avoid conflicts of interest and, when these conflicts cannot be avoided, ensure that clients are treated equitably; and to conform to all applicable regulations with respect to the exercise of their activity to best promote the interests of their clients and the integrity of the market.



asset management firms are sometimes addressed in articles concerning the SEC and the Financial Services Authority (FSA). To our knowledge, no article in management sciences has examined French ISPs.

In one of the first studies on brokers, Yerkes (1974) identified the role of brokers as guardians of the accuracy of information published by listed firms.

Various academic articles have been published on the role of the SEC in the United States. Some authors have highlighted the links between the directors of the SEC and the financial industry (Coates, 2001), while others have focused on the actions of the financial lobby in relation to the SEC and reforms on insider trading and merchant banking (Macey and Haddock, 1985; Macey, 1988). More recently, Pritchard (2005) expressed concern about the vulnerability of the SEC as an independent agency, while Prentice (2006) justified strict regulations by the SEC using an analysis of the psychological behaviors of investors (2006).

According to Files et al. (2008), Feroz et al. (1991) and Karpoff et al. (2008a,b), sanctions by the SEC are costly for companies (monetary penalties), the management of these companies (loss of employment), auditors (sanctions and loss of reputation) and investors (decline in stock price).

There is significant debate among economists regarding the choice between the role and power of a public regulator and the efficiency of laws and civil suits by investors. Studies by La Porta et al. (2006) and Barth et al. (2004) showed that the role of a public regulator is modest with respect to laws on investment and banking establishment supervision.

In contrast, more precise studies on the utilization by investors and regulators of the powers conferred on them by the law, such as those conducted by Jackson and Roe (2009), have concluded that countries that invest more in regulation and sanctions have better outlooks for the future.

According to Gadinis (2008), the SEC brings between 120 and 150 prosecutions against members of the financial industry annually, including brokers, investment banks and their partners. Although the crimes seem numerous, no academic study has addressed this essential subject to restore investor confidence.

Gadinis presented the first academic study on sanctions by the SEC for brokers and their partners, based on a database covering the years 2005 to 2007. The study by Gadinis shows that sanctions against larger brokers (measured by size) most often concerned the brokerage as a company, rather than its partners or managers. In 40% of the cases, sanctions only concerned the company, while for smaller brokers; this number fell to 10%. In addition, larger brokers often tried to avoid trial by negotiating with the SEC.

Studying 545 sanctions against brokers, Gadinis further shows that the SEC sanctioned larger brokers and their partners less frequently than smaller brokers. Although fines were higher for the larger brokers (\$11.9 million as opposed to \$2.3 million), smaller brokers were much more often prohibited from continuing to operate than were larger ones (25% vs. 4%). Finally, Gadinis shows that larger brokers and their partners were less affected by blame and prohibitions from continuing to operate than were smaller brokers.

#### **II.4. Reasons for insider trading (and manipulations)**

Insider trading is a crime committed by a person who has privileged information regarding a listed company. In French law, the French Commercial Code explicitly defines insider trading as follows:

*“Insider trading is defined, for directors of companies whose shares are listed in a regulated market and for persons who, through the exercise of their profession or professional functions, have access to privileged information regarding the outlook or condition of an issuer whose shares are traded on a regulated market, as carrying out or knowingly allowing to carry out, either directly or through a third party, one or more operations before the public is aware of this privileged information.”*

Insider trading is far from being a recent phenomenon. Banerjee and Eckard (2001) note that with the increase in industrial activity in the United States at the end of the 19<sup>th</sup> century, the absence of regulation to guide the conduct of company directors gave rise to a multitude of cases in which insiders engaged in sharing information with the public and in transactions.

The United States was the first nation to directly address the problem of insider trading. In 1934, in the midst of an economic crisis, the Securities Exchange Act (SEA) was promulgated, providing for the strict overseeing of the markets to prevent the inequalities produced by insider trading. In the same year, the SEC was created to enforce the stringent laws that had been enacted. Thus, the United States addressed the problem of insider trading very early, which led to the creation of a system of laws and rigorous enforcement. Bhattacharya and Daouk (2002) examine the laws of 103 countries that have their own stock markets. The authors conduct an international survey of various governmental authorities to determine the original date of the first regulation concerning insider trading and the first judicial prosecution. Bhattacharya and Daouk (2002) state that only 55% of developed countries had laws concerning insider transactions prior to 1990, and this number was 39% for developing countries. By 2002, these statistics evolved to 100% and 80%, respectively, indicating a clear progression. The authors also conduct a study of events showing that the adoption of regulations had no significant impact on insider transactions. Furthermore, Beny (2005) attempts to isolate various factors influencing the impact of laws on insider transactions. His study demonstrates that the extent of laws

is slightly greater within countries that operate under civil law, while sanctions are more severe in countries that follow common law.

According to the literature, insider trading poses a real ethical problem that manifests itself in two distinct ways: the ethics of financial markets and the ethics of companies. At the market level, the equity and transparency of the stock exchange and financial centers are biased by such practices. The confidential information revealed by some economic actors is harmful to the orderly functioning of markets and the fluidity of exchanges between investors. At the company level, the interests of stockholders are ignored in favor of the interests of insiders. In principle, the insiders, generally the directors and managers of a company, are committed to act in the interest of their stockholders, which essentially translates into an increase in the value of the shares and amount of dividends paid annually. This principle of commitment is not respected when a manager, who is profiting from his position as an insider, acts in his own interest to the detriment of the stockholders. In this context, Bebchuk and Jolls (1998) examine the impact of insider trading on the wealth of stockholders. They question the generally accepted notion that these diversions can constitute an effective means of compensation for directors when such diversions are accompanied by a loss of wealth for stockholders.

The debate between academic researchers and market participants about the real impact of insider trading on markets has never been settled definitively. Moreover, various studies on insider trading have shown a positive correlation between insider operations and changes in the purchase price of shares (Eckbo and Smith 1998). These studies focused on either abnormal returns from insider transactions (Seyhun 1992) or the speed with which private information is reflected in the price of shares (Rozeff and Zaman, 1998).

Several studies have measured the activity of insider operations to determine whether insiders have the ability to generate abnormal profits. As a general rule, the results indicate that insiders outperformed the market. For example, the studies by Lorie and Niederhoffer (1968), Pratt and De Vere (1968), Jaffe (1974) and Finnerty (1976) show that insiders were able to generate abnormal excess returns after the date of the commercial transaction. Other studies, such as those by Rozeff and Zaman (1998) and Linn and Rozeff (1995), examine the rapidity with which the market integrates the announcement of insider trading and show that more than 85% of privileged information is absorbed in one day.

Studies examining real cases of insider trading show that these infractions involve both abnormal returns and abnormal volumes of transactions (Cornell and Sirri, 1992; Meulbroek, 1992). As a general rule, insiders commit their crimes well before the announcement, thus avoiding the period during which regulatory organizations are maximally vigilant.

### ***III. Role and function of the AMF and the Enforcement Commission***

#### **III.1. The role of the AMF**

The AMF<sup>4</sup> is an independent, incorporated public body with financial autonomy whose mission is overseeing the protection of savings invested in financial instruments, the information of investors and the orderly functioning of the financial markets. The AMF exercises four types of responsibilities: regulation, authorization, oversight and sanctions.

The AMF regulates the financial operations of listed companies. The AMF supervises and controls the mandatory information disclosed by those firms, making sure that it is precise, sincere, exact and distributed to the entire financial community.

The AMF authorizes the creation of open-ended collective investment scheme (SICAV) funds and common investment funds (FCPs). In particular, the AMF verifies the information included in the simplified prospectus of each product.

The AMF defines the principles of organization and operation that should be respected by market companies (such as Euronext Paris), the systems of regulation-settlement and the central depositories (such as Euroclear France). The AMF also approves rules for clearinghouses (such as Clearnet).

The AMF establishes and enforces the rules for good conduct and the obligations that should be respected by professionals authorized to provide investment services.

#### **III.2. Sanctioning powers of the AMF**

The AMF exercises control in two ways. First, it issues accreditations (administrative authorizations to carry out regulated activities) and visas (authorizations to issue financial securities) and decides on the admissibility of public offers. Second, it exercises control over the reference documents issued by companies conducting public investment offerings and on the permanent information distributed by issuers. This control extends to professionals who are obligated to follow professional standards. The AMF thus oversees the regulation of operations for stocks that are the object of public investment offerings.

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<sup>4</sup>AMF was created in 2003 (Law on financial security) and succeeded to the COB (Commission des Opérations de Bourse).

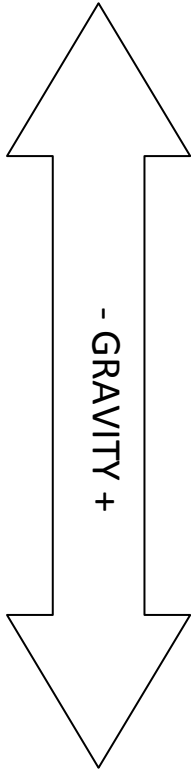
The AMF is endowed with powers of investigation to complement its mission of control. Following the justified request of the secretary general of the AMF and after authorization of the president of the superior court, the AMF can obtain documents and conduct on-site inspections to investigate infractions regarding insider trading, communication or the dissemination of misleading or false information and price manipulation.

Additionally, after a contradictory procedure, the AMF can sanction persons placed under its authority. Administrative sanctions range from warning to reprimand to suspension from practice on a temporary or permanent basis. Pecuniary sanctions by the AMF could be as high as €1.5 million (before 2008), €15 million (between 2008 and 2010) and €100 million (after 2010) or ten times the amount of the profits realized in connection with the infraction.

**III.3. Reinforcement of sanctions over time**

The Enforcement Committee may impose one or more of the following disciplinary sanctions, depending on the gravity of the violation (Table 1).

**Table 1: Disciplinary Sanctions of the Enforcement Committee**



1. Warning
2. Reprimand
3. Suspension from carrying out certain operations and other limitations on activities
4. Temporary suspension of one or more directors or, in the case of a payment institution exercising hybrid activities, of persons declared responsible for the management of payment services activities with or without naming a provisional administrator
5. Dismissal from office of one or more directors or, in the case of a payment institution exercising hybrid activities, of persons declared responsible for the management of payment services activities with or without naming a provisional administrator
6. Partial withdrawal of accreditation
7. Total withdrawal of accreditation or removal from a “list of accredited persons” with or without naming a liquidator

In place of or in addition to these sanctions, the Enforcement Committee can impose a pecuniary sanction of up to €100 million (Table 2).

**Table 2: Pecuniary Sanctions of the Enforcement Committee**

	Violation of professional obligations as specified by law, the general regulations of the AMF or approved professional rules	Attempted or actual commission of an insider trading violation, price manipulation or dissemination of false information or any other infraction of such a nature as to negatively affect investor protection
<b>Professionals</b>		
LSF 2003 <sup>5</sup>	€1.5 million or ten times the amount of any profit realized and/or disciplinary sanction	€1.5 million or ten times the amount of any profit realized and/or disciplinary sanction
LME 2008 <sup>6</sup>	€10 million or ten times the amount of any profit realized and/or disciplinary sanction	€10 million or ten times the amount of any profit realized
LRBF 2010 <sup>7</sup>	€100 million or ten times the amount of any profit realized and/or disciplinary sanction	€100 million or ten times the amount of any profit realized
<b>Individuals placed under the Enforcement Committee's authority</b>		
LSF 2003	€300,000 or five times the amount of any profit realized and/or disciplinary sanction	€1.5 million or ten times the amount of any profit realized and/or disciplinary sanction
LME 2008	€300,000 or five times the amount of any profit realized and/or disciplinary sanction	€1.5 euros or ten times the amount of any profit realized and/or disciplinary sanction
LRBF 2010	€300,000 or five times the amount of any profit realized and/or disciplinary sanction	€15 million or ten times the amount of any profit realized and/or disciplinary sanction
<b>Other persons: issuers, directors of the issuer, auditors, all persons</b>		
LSF 2003		€1.5 million or ten times the amount of any profit realized and/or disciplinary sanction
LME 2008		€10 million or ten times the amount of any profit realized
LRBF 2010		€100 million or ten times the amount of any profit realized

Sources: laws, data collected by the authors

## ***IV. Analysis of sanctions by the AMF from 2006 to 2010***

### **IV.1. Methodology**

To conduct our study, we downloaded from the AMF's website ([www.amf-france.org](http://www.amf-france.org)) the sanction reports issued between January 2006 and December 2010. Within the sanction reports, we manually collected different data concerning the perpetrators, the offenses, the procedure and the legal references.

<sup>5</sup>Law on financial security of Aug. 2, 2003: Limits applicable for violations committed before August 6, 2008

<sup>6</sup>Law on modernization of the economy of Aug. 4, 2008: Limits applicable for violations committed between August 6, 2008, and October 24, 2010

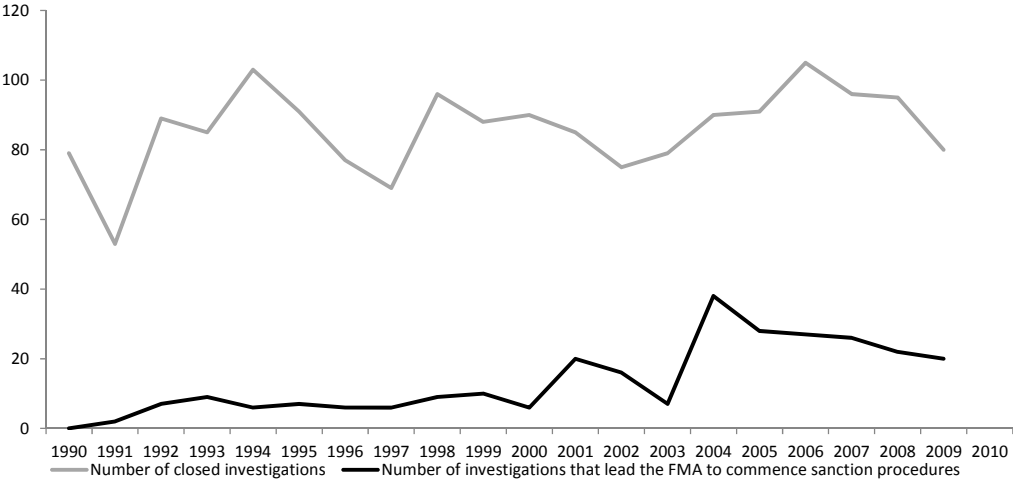
<sup>7</sup>Law on banking and financial regulation of 2010: Limits applicable for violations committed beginning October 24, 2010

In this study, which investigates a recent period, we intentionally do not consider the judicial outcomes of the cases in which the AMF issued sanctions. It is necessary to wait until all of the cases have been judged by French jurisdictions to be able to study complementary sanctions and the evolution of fines. Addressing this facet, which is under way, will be the subject of a subsequent paper by the authors.

It appears that almost all of the sanctions studied fall within the scope of the financial security law of August 2003. The maximum amount for sanctions ranged from €300,000 to €1.5 million for each offense (and sometimes an amount as much as ten times the amount of profits realized).

The following diagram (Figure 2) shows that the number of investigations closed by the AMF (or the COB and FMC prior to 2003) has remained steady since 1995 at approximately 80 to 100 annually. No further changes to this number can be seen even though markets have become more complex with the introduction of new management techniques, such as electronic trading and hedge funds. Moreover, the financial industry has developed considerably in terms of both technique and volume during this period.

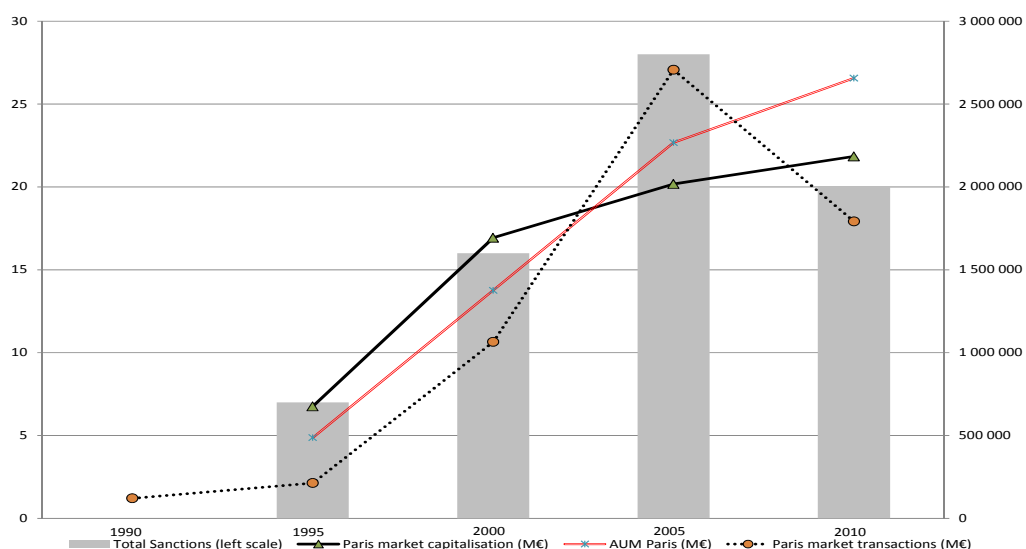
**Figure 2: Investigations and sanctions by the AMF since 1990**



Source: annual reports of the AMF

In contrast, the number of sanctions appears to be increasing. The diagram below (Figure 3) indicates that the number of sanctions issued by the AMF is correlated with the value of assets under management, the volume of transactions and the market capitalization of the Paris stock exchange.

**Figure 3: Evolution of the number of sanctions and the volume of the Paris stock exchange**



Sources: AMF, French Asset Management Association (Association Française de la Gestion Financière - AFG), World Stock Exchange, Euronext, data collected by the authors

## **IV.2. Discussion and table: Analysis of sanctions by the AMF**

From 2006 to 2010, the AMF imposed the four exceptional sanctions described below, each totaling more than €1.5 million.

### **IV.2. a. Study of the exceptional sanctions by the AMF between 2006 and 2010**

Bearing in mind their exceptional nature, we present a summary of four substantial fines imposed by the AMF, and we subsequently exclude them from our analysis of sanctions by the AMF. From 2006 to 2010, the AMF reported four pecuniary sanctions whose amounts were greater than the fixed part of the fines authorized by the General Regulation of the AMF: a fine of € 9.6 million in the AI Investment case in 2006, a fine of € 6.25 million in the Vivendi case in 2008, a fine of € 5.5 million in the Marionnaud case in 2008 and of a fine of € 4 million in the Semper Gestion case in 2009. Beasley et al. (2010) note that, between 1998 and 2007, maximum fine imposed by the SEC was \$750 million for fraudulent financial reporting.

The fines for these four important sanctions totaled more than € 25 million, compared with the total sanctions for the same period, which were €74.5 million. The amounts of these exceptional sanctions



were very heterogeneous compared with all the other sanctions; thus, we have conducted two parallel analyses: one that includes the exceptional sanctions and one that does not.

**IV.2.b. Distribution of sanctions by category**

From 2006 to 2010, the AMF considered 530 cases of fraud for infractions committed either by companies or individuals. The number of cases examined varies significantly from year to year but rarely is higher than 100 cases per year.

**Table 3: Number of sanctions by type**

Types of sanctions	ISPs infractions	Fraudulent financial reporting	Stock Price manipulation	Insider trading	Total cases at the Enforcement Committee
Number of sanctions	134	168	57	171	530
% of Total	25%	32%	11%	32%	100%

Sources: AMF, data collected by the authors

Classifying the cases of the Enforcement Committee by the categories of fraud prosecuted, we note that insider trading and manipulation of accounting and financial information are the infractions most often dealt with by the AMF. They each represent 32% of the cases examined, as opposed to 25% for ISPs and only 11% for stock price manipulations. The number of cases increased considerably in 2008, reaching a peak of 177 cases. In the years that followed, the number of cases dropped and then stabilized at approximately 80 cases per year.

**Table 4: Number of sanctions and exonerations**

Total cases at the Enforcement Committee	Number of "company" sanctions	Number of "individual" sanctions	Percent of "company" exonerations	Percent of "individual" exonerations
530	103	143	29%	38%

Sources: AMF, data collected by the authors

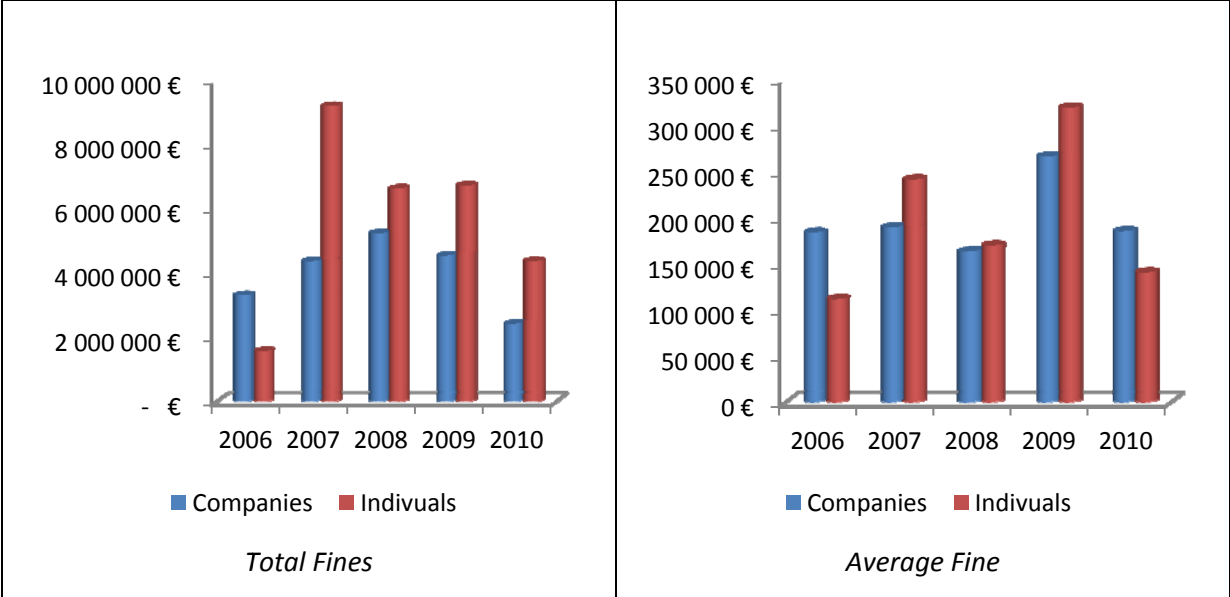
The Enforcement Committee of the AMF has the power to impose administrative and pecuniary sanctions on individuals or corporations accused of fraud; it can also clear innocent parties. Of the 530 cases examined by this committee from 2006 to 2010; only 103 companies were sanctioned; in contrast to 143 individuals over the entire period studied. Each year, the number of professionals sanctioned clearly surpassed the number of firms sanctioned, but on average, the Enforcement Committee only imposed 50 condemnations per year, with a maximum of 71 sanctions in 2008. In 38% of the cases, individuals were cleared, whereas only 29% of the corporations were exonerated.

Despite a declining trend for the number of firms cleared during this period, the number of sanctions remained very low in relation to the number of cases considered.

**IV.2.b. Amount of pecuniary sanctions by category**

The combined changes in fines imposed by the AMF on companies and professionals show a clear decline for the amount of fines between 2007 and 2010 for professionals and a weaker decline for companies between 2008 and 2010.

**Figure 4: Fines (excluding exceptional fines)**



Sources: AMF, data collected by the authors

The first figure shows that for the study period, the total fines collected following sanction of individuals clearly exceeded the total fines paid by firms, except for the year 2006. After a peak of €9,240,000 in 2007, the total sanctions paid by professionals stabilized in 2008 and 2009 at approximately €6,700,000 and then declined in 2010 to €4,360,000. For firms, we note a downward trend in total sanctions imposed, decreasing from €5,235,000 in 2008 to €2,411,000 in 2010. These results indicate that the Enforcement Committee is generally more severe with individuals despite a similar rate of fraud for both companies and professionals.

On average (figure 2), the pecuniary sanctions imposed by the AMF on corporations, not taking exceptions into account, were rather stable for the study period at approximately €190,000, except for 2009, when the average slightly surpassed €265,000. With respect to individuals, we note a certain disparity in the average sanctions for the entire period. The average amount of pecuniary sanctions for individuals rose from €170,000 in 2008 to approximately €320,000 in 2009 and then fell to €140,000 the following year.

The progression for the total amount of fines imposed by the AMF, as well as the allocation of the average pecuniary sanctions from 2006 to 2010, shows that individuals are more severely punished for their transgressions than are corporations (Table 5). Furthermore, the downward trend for sanctions suggests that the AMF has softened with respect to fraud and tends to have a lighter hand with pecuniary sanctions over time.

**Table 5: Total fines and average fines for the period from 2006 to 2010**

	Exceptional sanctions included		Without exceptional sanctions	
	Companies	Individuals	Companies	Individuals
<i>Pecuniary sanctions</i>				
Total fines	33 215 688 €	37 732 980 €	19 851 000 €	28 462 500 €
Average fines	331 227 €	263 867 €	197 827 €	199 038 €

Sources: AMF data collected by the authors

**Table 6: All pecuniary sanctions**

Sanction by category	ISPs Infractions	Fraudulent financial reporting	Stock Price manipulation	Insider trading
Total « Companies » (all sanctions)	20 160 688 €	7 830 000 €	11 664 688 €	12 150 000 €
Total « Individuals » (all sanctions)	7 116 480 €	15 989 500 €	3 868 480 €	23 301 000 €
Average « Companies » (all sanctions)	469 594 €	210 827 €	479 740 €	480 900 €
Average « Individuals » (all sanctions)	163 546 €	234 990 €	419 737 €	284 753 €
Average « Companies » (excluding exceptional sanctions)	113 267 €	206 053 €	284 375 €	256 522 €
Average « Individuals » (excluding exceptional sanctions)	116 217 €	245 992 €	123 412 €	222 549 €

Sources: AMF, data collected by the authors

Table 6 shows that companies received the heaviest sanctions for matters having to do with ISPs but that ISPs represented only 25% of the cases handled by the committee. In contrast, individuals paid the largest part of their fines for insider trading infractions.

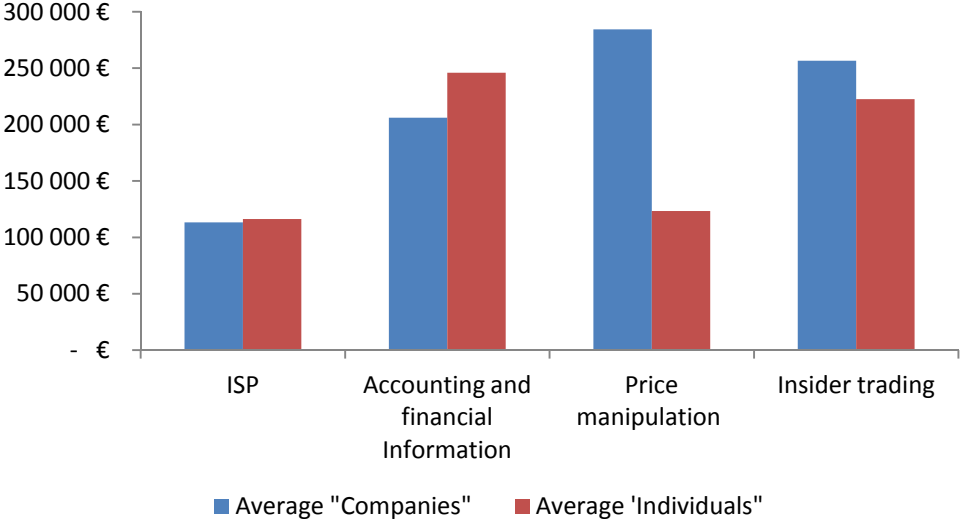
The statistics show that sanctions against brokers more often concerned the investment company and less often its partners or directors; in fact, out of the 134 ISPs cases during the study period, only 26% of the fines were paid by the partners, at a rate of only approximately €2 million per year, with a clear drop between 2009 and 2010. Fines for investment companies were much higher, reaching more than €20 million during the period from 2006 to 2010. Further, we note that since 2006, the total fines for companies have dropped considerably. The penalties in 2010 only represent 2% of the total fines imposed on brokers and asset management companies (€456,000 out of a total of €20,160,688).

While companies received heavier fines than did individuals in ISPs cases, the opposite trend was noted for irregularities in fraudulent financial reporting, with the total fines imposed on professionals representing slightly more than double those imposed on sanctioned companies.

Price manipulation only represents 11% of the cases examined by the AMF Enforcement Committee. Companies are sanctioned the most for this type of fraud; they paid approximately €11.7 million during the period from 2006 to 2010 compared with €3.8 million paid by professionals.

As noted above, individuals are subject to the heaviest sanctions in cases of insider trading. For a period of five years, they paid more than €26 million for insider trading infractions compared with only €11.6 million paid by companies.

**Figure 5: Comparison of company and individual fines (excluding exceptional fines)**



Sources: AMF, data collected by the authors

Examining the averages for fines imposed by the AMF classified by fraud category (Figure 5), we note that when the exceptionally high fines are removed from the data, the financial punishments for companies and individuals were quite similar for ISP cases, averaging less than €120,000. For securities infractions and price manipulation, the average pecuniary sanction for corporations (€284,375) was slightly more than double that for individuals (€123,412). The sanctions imposed on individuals or corporations who participated in accounting and financial information fraud or insider trading averaged between €200,000 and €250,000 per case. Thus, with the exception of the four sanctions considered to be exceptionally high during the period studied, we note that the average fines imposed by the AMF remain quite close regardless of the fraud committed but also very weak in relation to the maximum amount that the Enforcement Committee is authorized to impose.

#### IV.2.d. Analysis of administrative sanctions by category

The Enforcement Committee very rarely exercises its administrative discipline powers. Administrative sanctions only represent 16% of all sanctions imposed by the AMF. Over a period of five years, only nine warnings were addressed to companies, compared with 15 for professionals. Reprimands were even rarer, with only seven reprimands issued to companies between 2006 and 2008. Similarly, individuals who were punished only received seven reprimands, four of which were issued in 2010. The most serious administrative sanctions are almost never used. There was not a single decision calling for temporary suspension or withdrawal of accreditation for firms guilty of infractions. Moreover, we only counted two temporary suspensions for professionals in 2007 (one for one year and one for three years) in cases involving asset management for third parties.

**Table 7: Sanctions on companies and on individuals by administrative category**

Number of administrative sanctions	Warning	Reprimand	Temporary suspension	Removal of accreditation	Total
Total « Companies »	9	7	0	0	16
%	16%				
Total « Individuals »	14	7	2	0	23
%	16%				

Sources: AMF, data collected by the authors

#### IV.2.e. Cross-analysis of administrative and pecuniary sanctions

The Enforcement Committee rarely imposed both administrative and pecuniary sanctions on defrauders. We have attempted to examine the level of the pecuniary sanctions in such cases. We see clearly that for companies, the average fine accompanied by a warning or reprimand did not exceed €100,000, while when a firm received only a pecuniary sanction for fraud, the average fine was approximately €331,227.

**Table 8: Sanctions by administrative category for companies and individuals**

Average sanctions by category	Warning or Reprimand & Fines
Companies	94 000 €
Individuals	113 393 €

Sources: AMF, data collected by the authors

The pattern is similar for dual-sanctioned individuals. On average, a fine accompanied by a warning or reprimand represented slightly less than half the average general sanction imposed on professionals. These results show that the AMF Enforcement Committee tends to lessen the fines imposed on individuals or corporations guilty of fraud when it has already issued a reprimand or warning.

#### IV.2.f. Analysis of the volume of sanctions by AMF in relation to ISP and company activity

An analysis of the proportion of pecuniary sanctions for fraud in accounting and finance information relative to the market capitalization of the Paris exchanges (Eurolist and Alternext) from 2006 to 2010 shows that on average, a fine represents only 0.00021% of market capitalization, or the equivalent of €2,090 per billion euros in value of stocks traded on the market. Moreover, the average fine for this type of fraud reaches only 0.00016% of the turnover for companies listed on the exchange, which represents €1,615 per billion euros of turnover. If we divide the average amount for pecuniary sanctions in AFI cases by the number of companies listed during this period, we note that individual fines amounted to only €4,694 per issuer.

**Table 9: Analysis of the amounts of AFI sanctions by year vs. the market capitalization of the Paris stock exchange**

	Paris market capitalisation (Eurolist&Alternext)	Total turnover of listed companies
Average 2006 to 2010 (M€)	2 279 295	2 950 272
Total Fines to Listed companies (M€)	4.8	
Fines(%)	0,00021%	0,00016%
Fines(€)	2 090 € <i>(per billion € of market capitalization)</i>	1 615 € <i>(per billion € of total turnover)</i>

Sources: AMF, Euronext, data collected by the authors

**Table 10: Analysis of the amount of sanctions (OI and PM) per year vs. market transactions of the Paris stock exchange**

	Market transactions
Average 2006 to 2010 (M€)	2 562 009
Total Fines "Insider trading & price manipulations" (M€)	10
Fines(%)	0.00040%
Fines (€)	3 980 € <i>(per billion € of market transactions)</i>

Sources: AMF, Euronext, data collected by the authors

Similarly, an analysis of the proportionality of the sanctions imposed in cases of insider trading and price manipulation relative to the volume of transactions reveals a very weak percentage of 0.0004%. In other words, the combined fines in cases of stock exchange offenses and insider trading operations represent, on average, only €3,980 per billion euros of transactions. In conclusion, fraudulent investment service providers and asset management companies have been condemned to pay, on average, a fine that represents only 0.022% of their turnover or the equivalent of €216 per million euros of turnover.

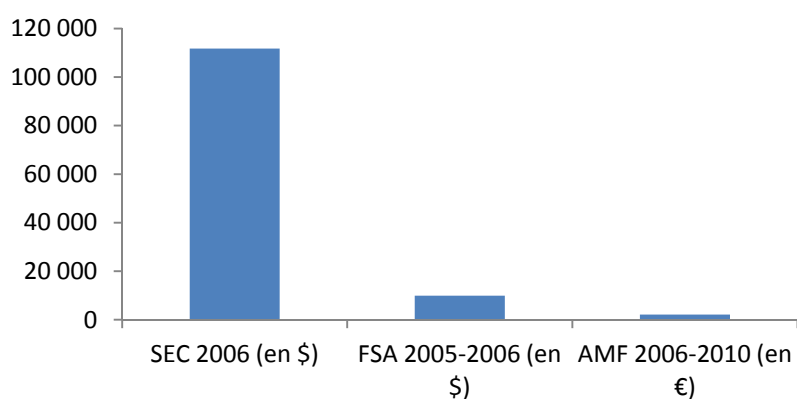
Based on these results, we note that if one considers either the volume of transactions or the amount of turnover, the Enforcement Committee timidly imposes very weak sanctions relative to the volume of the French market.

**Table 11: Analysis of the amount of sanctions (ISP) per year vs. funds managed on the Paris stock exchange**

	Market transactions	Assets under management
Average 2006 to 2010 (M€)	2 562 009	2 458 400
Total Fines to ISP	5.5	
Fines(%)	0,00011%	0,022%
Fines (€)	1 086,65 € <i>(per billions € of market transactions)</i>	216 € <i>(per M€ of Asset under management)</i>

Sources: AMF, French Asset Management Association (Association Française de la Gestion Financière - AFG), Euronext, data collected by the authors

**Figure 6: Fines for listed companies in billions of market capitalization**



*FSA: Financial Services Authority (The FSA is an independent, non-governmental British body created by the Financial Services and Markets Act in 2000 whose goal is to regulate the functioning of financial markets.*

*SEC: Securities and Exchange Commission (SEC). This is the only body regulating financial markets in the United States. It has the role of watchdog for the markets, as does the AMF in France, particularly in terms of transparency and deontology of management practices.*

A comparison of AMF statistics with those of its British and American counterparts shows a wide gap between the amount of fines paid by American companies in 2006 and the amount imposed on sanctioned companies in some European countries (Figure 6). The sums collected by the AMF from fraudulent companies represented 21% of the sanctions imposed by the FSA and amounted to barely 2% of the fines received by the SEC. This finding raises the following questions: How can we explain the difference between the sums received by the AMF and those received by other bodies? Is divergence in the regulations used by the stock exchange watchdogs the source of this difference, or is it instead a problem of the inability to detect abuse? With the growth in volume of financial transactions and the rapidity with which large-scale transactions are executed, the role of market oversight is likely to become increasingly difficult. In August 2011, the British regulator implemented a new system, named Zen, to improve its ability to detect suspicious movements. For its part, the SEC estimates the cost of its project to implement a system that allows it to follow the stock markets and derivative markets in real time at \$1 billion. Further, the issue of the current economic crisis still remains. The AMF Enforcement Committee could intentionally reduce fines for defrauders in the French market to avoid the risk of their collapse.

## ***V. Conclusion***

In conclusion, the results of our study show that relatively few firms and brokers are sanctioned by the AMF, which is consistent with earlier research on the subject (Burns and Kedia 2006; Kedia and Rajgopal 2011; Gordon et al. 2009; Peterson 2008).



Our study of AMF sanctions allows us to make several important statements. Certainly, the number of sanctions by the AMF has increased in correlation with the size of the financial market in Paris. However, the AMF makes little use of its power to strongly sanction those committing fraud, as demonstrated by the fact that only four sanctions surpassed the threshold of €1.500.000 during the period from 2006 to 2010. The AMF imposes average fines that are weak, with the exception of those four exceptional fines. The average amount of a fine for a company (ISP or issuer), is €198 K, and the average amount of a fine for an individual is €199 K. The AMF imposes fines that are very weak relative to the volume of the Paris market. Fines to issuers represent only 0.00021 % of market capitalization, and fines to ISPs (brokers and asset management firms) represent only 0.00011% of the total for transactions and assets under management. Finally, fines for price manipulation and insider trading represent only 0.0004% of the volume of transactions on the Paris stock exchange.

In addition, the AMF imposes very few administrative sanctions. Approximately 10% of companies or individuals sanctioned received a reprimand or warning. Furthermore, when an administrative sanction is imposed, it appears that the pecuniary sanction is reduced. Finally, the AMF never imposes definitive suspensions from the markets on professionals, ISPs or individuals, and there has been recidivism among the recipients of AMF sanctions.

A comparison of the AMF statistics with those of other watchdog bodies, particularly the SEC, shows a very significant gap between the amount of fines paid by American companies in 2006 and the amount demanded from sanctioned companies in France during the same year. The sums collected by the AMF from fraudulent companies equated to only 2% of the fines received by the SEC. These findings raise the following questions: How can we explain the difference between the amount of sanctions imposed by the AMF and those imposed by its foreign counterparts? Is this difference linked to divergence in the regulations used by the various market authorities? Is it a matter of the lack of resources for the detection of abuses in the face of the growth in the volume of financial transactions and the rapidity with which large-scale transactions are executed? Another interpretation could be linked to the context of the current economic crisis. The AMF Enforcement Committee could be intentionally lowering fines on those prosecuted for fraud in the French market to avoid the risk of their collapse.

Nevertheless, considering the weakness of the fines and the fact that no professional sanctioned for fraud has ever been prevented from continuing his activity, there is the concern that if the AMF does not modify its behavior, there is no reason why fraud should not increase in the next few years.

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